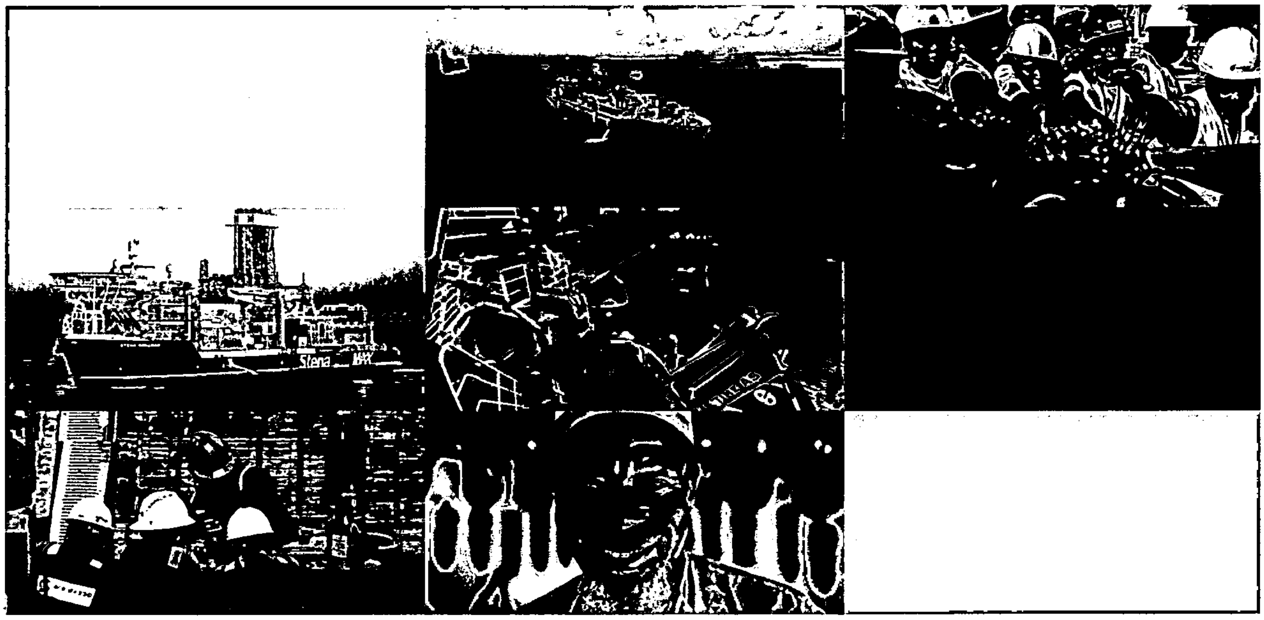
Nautical Petroleum Limited

Directors' Report and Financial Statements

31 December 2017



Cairn

Table of Contents

Company information

Directors

Simon J Thomson
James D Smith
Paul Joseph Mayland
Brita Holstad

Secretary

Duncan A. Wood

Independent auditors

PricewaterhouseCoopers LLP
141 Bothwell Street
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Solicitors

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Conference Square
Edinburgh EH3 3UL

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London W1J 6EQ

Registered number

SC04362104

Directors' report

The Directors present their report and audited financial statements for the year ended 31 December 2017. The financial statements have been prepared in pounds sterling and all values are rounded to the nearest thousand pounds (£'000) except when otherwise indicated.

This report has been prepared in accordance with the special provisions relating to small companies within Part 15 of the Companies Act 2006 and therefore does not include a Strategic Report.

Consolidated financial statements are not produced for the Company and its wholly owned subsidiaries as provided under the exemption in section 400(1) of the Companies Act 2006.

Principal activities

The activities of Nautical Petroleum Limited (the Company / Nautical) focus on oil and gas exploration, development and production in the UK sector of the North Sea (UKCS).

The Company's core competence is within the subsurface, hydrocarbon development and commercial arena of the Exploration & Production (E&P) business. The Company has built an asset portfolio which will continue to be expanded through 'farming in' to and acquisitions of assets from existing oil and gas companies on the UKCS and with focused license round applications.

The Company is incorporated and domiciled in the UK. The Company's registered office is in London. The Company's immediate parent is Capricorn Energy Limited. Capricorn Energy Limited is a wholly owned subsidiary of Cairn Energy PLC (Cairn). Cairn is based in Edinburgh and is an oil and gas exploration and production company listed on the London Stock Exchange. Cairn has explored, developed and produced hydrocarbons in a variety of locations around the world. For further information on the company please see: www.cairnenergy.com.

Results and dividends

The Company's loss for the year ended 31 December 2017 was £10,300k (2016: profit of £19,856k). The Company has not paid or declared a dividend in respect of the current or prior year.

Business review

The Company is well positioned for further growth, with a strong parent company and access to equity and debt.

Significant progress was made on the Company's two non-operated development projects in the UKCS. The Catcher (Nautical Petroleum Limited 20% working interest (WI)) and Kraken (Nautical Petroleum Limited 29.5% WI) developments in the UK North Sea achieved first oil production in 2017, with total project capex expenditure estimated by the Operators to be ~30% and ~25% below original project sanction respectively. 2018 full year production, net to the Company, is forecast to be 17,000-20,000 bopd, with ongoing project commissioning on both fields expected to be completed in H1 2018. Full capacity production is expected to be achieved by mid-year, with peak net production to the Company of 25,000 bopd, delivering significant cash flow for reinvestment.

Following the commencement of production on Kraken and Catcher, the Company expects to receive significant cashflows denominated in USD. Consequently, the functional currency of the Company will change from GBP to USD from January 2018.

In September 2014, Nautical entered into an agreement to farm-down 10% of the Company's working interest on the Catcher development, satellite fields and surrounding exploration acreage to Dyas. Under the terms of the deal, Dyas funded exploration and development costs of Nautical and its subsidiaries in respect of the licenses up to a cap of $182.0m. The remaining carry was recognised as a receivable at its discounted, post tax fair value. The carry was fully utilised in January 2017.

The Company is funded by its ultimate parent. On 18 July 2014, Cairn Energy PLC signed a seven year reserve based lending facility with a syndicate of six international banks (BNP Paribas, Commonwealth Bank of Australia, DNB Bank ASA, HSBC Bank PLC, Société Générale and Standard Chartered Bank) which was effective 1 August

Directors' report (continued)

2014. Until completion of the Catcher and Kraken developments, the facility could be utilised to fund development costs on those projects and facility finance costs. At the year end, no amounts had been drawn under the facility, with maximum available currently forecast to be $386.4m during the course of the development projects. The facility may also be utilised to issue letters of credit and performance guarantees for the Cairn Group of up to USD 175.0m. Following completion, the facility can be used for general corporate purposes.

The company has commenced a hedging programme and to date, the Company has hedged ~2m barrels of 2018 oil production using put and call options and collar structures with a weighted average floor and ceiling price of US$58.4/bbl and US$70.2/bbl respectively.

Principal risks and uncertainties

The Company is subject to a variety of risks which derive from the nature of the oil and gas exploration business.

Future exploration success
The Company's future depends significantly upon its success in finding or acquiring and developing oil and gas reserves. If the Company is unsuccessful, it would adversely affect the results of its operations and financial condition.

The cost of drilling, completing and operating wells is often uncertain. As a result, the Company may incur cost overruns or may be required to curtail, delay or cancel drilling operations because of many factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, the need for compliance with environmental regulations, governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

Volatile Oil and Gas Prices
Although oil prices have improved during the year, oil price outlook remains volatile. Exposure to commodity prices is fundamental to the Company's activities; however the Company manages its investment programme to ensure that a threshold economic return is delivered and the business model is funded even in sustained downside price scenarios.

Lower oil and gas prices would results in a reduction of future cash flow to the company and could lead to an impairment of development/producing assets. In addition, they may also result in JV partner capital constraints which could delay or cancel future exploration and development projects.

Kraken and Catcher operational and project performance
Whilst there were some operational challenges in Kraken commissioning, both Kraken and Catcher successfully achieved first oil in 2017. Delivering operational excellence in all the Company's activities is a strategic objective for the Company and the Company works closely with all JV partners to mitigate the risk and impact of any operational delay or underperformance. Therefore, the Company has a low appetite for risks which may impact on operating cash flow.

Kraken and Catcher operational and project performance issues would result in a reduction of future cash flows and could lead to increased operational costs. In addition, they may also result in HSE incidents.

Reliance on JV operators for asset performance
The Company accepts that there are risks associated with a non-operator role and will seek to mitigate against these risks by working with partners of high integrity and experience and maintaining close working relationships with all JV partners.

Reliance on JV operators for asset performance could lead to poor performance of assets, cost/schedule overruns and HSE performance issues. Further, it can lead to delay in first oil from development projects.

Directors' report (continued)

Financial instruments

For details of the Company's financial risk management policy see note 10.

Going concern

Following the Board's review of the Company's financial position and forward cash forecasts, the directors are of the view that the Company has adequate financial resources to continue its operational activities and meet its liabilities as and when they fall due for a period of at least 12 months from the date of authorisation of these financial statements. The Company's net current liabilities are £585.1m as at 31 December 2017 (2016: £485.2m).

Directors

The directors of the Company during the year ended 31 December 2017 were:
Simon J Thomson
James D Smith
Paul Joseph Mayland
Brita Holstad

The Company maintains third party indemnity insurance on behalf of its directors.

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' 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 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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and ensure that these have been applied consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (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 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 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 hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' report (continued)

Disclosure of information to auditors

The directors of the Company who held office as at the date of this report confirm that, as far as they are aware, there is no relevant audit information of which the Company's auditors are unaware. In making this confirmation, the directors have taken appropriate steps to make themselves aware of the relevant audit information and that the Company's auditors are aware of this information.

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office, and a resolution that they be re-appointed will be prepared at the annual general meeting.

On behalf of the Board

Brita Holstad

Brita Holstad

Director
Nautical Petroleum Limited
23 April 2018

Independent auditors' report to the members of Nautical Petroleum Limited

Report on the audit of the financial statements

Opinion

In our opinion, Nautical Petroleum Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Directors' Report and Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2017; the income statement and statement of comprehensive income, the statement of cash flow, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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.

Other required reporting

Companies Act 2006 exception reporting

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
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Entitlement to exemptions

Under the Companies Act 2006 we are required to report to you if, in our opinion, the directors were not entitled to take advantage of the small companies exemption from preparing a strategic report. We have no exceptions to report arising from this responsibility.

Michael Timar (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
23rd April 2018

INCOME STATEMENT

For the year ended 31 December 2017

	Note(s)	2017 £'000	2016 £'000
Revenue	15	17,355	-
Cost of sales	15	(4,604)	-
Depletion and amortisation	7	(15,375)	(55)
Gross loss		**(2,624)**	**(55)**
Pre-award costs		(1,406)	(44)
Unsuccessful exploration costs	6	(1,630)	(10,905)
Loss on disposal of subsidiary	17	(593)	-
Impairment of capitalised development assets	7	-	(2,238)
Gain on sales of assets		32	-
Administrative expenses	2, 3	24	(378)
Operating loss		**(6,197)**	**(13,620)**
Finance income	5	4,988	6,882
Finance costs	5	(11,590)	(1,040)
Loss before taxation		**(12,799)**	**(7,778)**
Taxation	4	2,499	27,634
(Loss)/ Profit for the year		**(10,300)**	**19,856**

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

	2017 £'000	2016 £'000
Total Comprehensive (Loss)/Profit	(10,300)	19,856
Other comprehensive income for the year/period – items that may be recycled to profit or loss	-	-
Total Comprehensive (expense) / income	(10,300)	19,856

STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

	Note(s)	2017 £'000	2016 £'000
ASSETS			
Non-current assets			
Intangible exploration /appraisal assets	6	16,563	15,228
Property, plant & equipment - development/producing assets	7	877,782	590,664
Investments	17	11,667	12,260
Total non-current assets		906,012	618,152
Current assets			
Inventory and spare parts	16	8,249	-
Trade and other receivables	8, 11	16,523	17,621
Bank deposits		-	78
Cash and cash equivalents	11	40,719	754
Total current assets		65,491	18,453
TOTAL ASSETS		971,503	636,605
Non-current liabilities			
Finance lease liabilities	9, 14	(124,486)	-
Deferred revenue	9	(36,694)	-
Provisions - decommissioning	13	(86,521)	(60,237)
Total non-current liabilities		(247,701)	(60,237)
Current liabilities			
Loans and borrowings	9	(570,250)	(458,628)
Trade and other payables	9, 10, 14	(62,349)	(45,004)
Deferred revenue	9	(18,044)	-
Provisions- unused rig days	7, 9, 13	(17,887)	(7,164)
Total current liabilities		(668,530)	(510,796)
Total liabilities		(916,231)	(571,033)
NET ASSETS		55,272	65,572
Capital and reserves			
Called-up share capital	12	18,405	18,405
Share premium		68,867	68,867
Accumulated losses		(32,000)	(21,700)
TOTAL EQUITY		55,272	65,572

The financial statements on pages 10 to 35 were approved by the Board of Directors on 23 April 2018 and signed on its behalf by

Brita Holstad

Brita Holstad
Director

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

Amounts in £ '000	Called up Share capital	Share premium	Accumulated losses	Total equity
At 1 January 2016	18,405	68,867	(41,556)	45,716
Profit for the year and total comprehensive income	-	-	19,856	19,856
At 31 December 2016	18,405	68,867	(21,700)	65,572
Loss for the year and total comprehensive expense	-	-	(10,300)	(10,300)
At 31 December 2017	18,405	68,867	(32,000)	55,272

STATEMENT OF CASH FLOW

For the year ended 31 December 2017

	2017 £ '000	2016 £ '000
OPERATING ACTIVITIES		
Loss before tax	(12,799)	(7,778)
Unsuccessful exploration costs	1,630	10,905
Depreciation	15,375	55
Write-down of capitalised development assets	-	2,238
Loss on disposals of subsidiary	593	3
Movement of inventory and spare parts	(8,249)	-
Discounted financial activities	3,446	(894)
Trade and other receivables movements	1,098	(21)
Trade and other payables movements	15,003	1,026
Deferred revenue received	54,738	-
Net cash generated from operating activities	70,835	5,534
INVESTING ACTIVITIES		
Additions to property, plant and equipment - development / producing assets	(139,145)	(101,718)
Disposals of property, plant and equipment - development / producing assets	68	-
Additions to exploration expenditure capitalised	(2,965)	(8,256)
Net Cash used in investing activities	(142,042)	(109,974)
FINANCING ACTIVITIES		
Loans and borrowings from group companies	110,135	105,134
Financial lease reimbursement	1,037	-
Net Cash generated from financing activities	111,172	105,134
Net increase in cash and cash equivalents	39,965	694
Cash and cash equivalents at the beginning of the year	754	60
Cash and cash equivalents at the end of the year	40,719	754

Notes to the financial statements

Note 1. Significant accounting policies

a) Basis of preparation

The financial statements of Nautical Petroleum Limited ("the Company") for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors on 20 April 2018. The Company is incorporated and domiciled in the United Kingdom. The registered head office is located at 50 Lothian Road, Edinburgh, Scotland.

The Company is a wholly-owned subsidiary of Capricorn Energy Limited and of its ultimate parent, Cairn Energy PLC. It is included in the consolidated financial statements of Cairn Energy PLC which are publically available. Therefore the company is exempt by virtue of section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements.

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review on pages 4 and 5. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are presented in the financial statements and supporting notes. In addition, note 10 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and its exposures to credit risk and liquidity risk.

The Company prepares its financial statements on a historical cost basis. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy. The Company's financial statements comply with the Companies Act 2006 as applicable to companies using IFRS. The accounting policies adopted during the period are consistent with those adopted by the ultimate parent company, Cairn Energy PLC.

b) Accounting standards

The Company prepares its financial statements in accordance with applicable International Financial Reporting Standards ("IFRS"), issued by the International Accounting Standards Board ("IASB") as adopted by the EU. The Company's financial statements are also consistent with IFRS as issued by the International Accounting Standards Board ("IASB") as they apply to accounting periods ended 31 December 2017.

Effective 1 January 2017, the Company has adopted the following amendments to standards:

- Amendments to IAS 7 Statement of Cash Flows
- Amendments to IAS 12 Income Taxes
- Amendments to IFRS 12 Disclosure of Interests in Other Entities

The adoption of the amendment of IAS 7 results in further disclosure in the financial statements reconciling opening and closing loans and borrowings and finance lease liabilities to respective movements in the cash flow statement. The adoption of the other two amendments has had no material impact on the Company's results or financial statement disclosures.

The following new standards issued by the IASB and endorsed by the EU have yet to be adopted by the Company:

- Amendments to IAS 28 Investments in Associates and Joint Ventures (effective 1 January 2018)
- Amendments to IFRS 2 Share Based Payments (effective 1 January 2018)
- IFRS 9 Financial Instruments (effective 1 January 2018)
- IFRS 15 Revenue from Contracts with Customers (effective 1 January 2018)
- IFRS 16 Leases (effective 1 January 2019)

Note 1: Significant accounting policies (continued)

No early adoption of the above new standards is intended. The amendments to IAS 28 and IFRS 2 are not expected to have any material impact on the Company's results or financial statement disclosures.

IFRS 9 Financial Instruments
The fair value of gains and losses on the time value of an option not designated within the hedge currently recognised in the income statement, will now be allocated to Other Comprehensive Income.

IFRS 9 also requires entities to adopt an "expected loss" approach to measuring impairment when considering trade and other receivables. The Company's exposure to credit risk at the year end is low and a provision for expected losses is not expected to be material. This reflects both the low volume of receivables due from third parties at the year end and historic rate of recovery of amounts due from partners in joint operations.

IFRS 15 Revenue from Contracts with Customers
The Company recognised revenue in 2017 on sale of oil from the Kraken field in the UK. The adoption of IFRS 15 is not expected to have any impact on revenue recorded, given customers and the performance obligations are easily identified and price is readily determinable.

On commencement of Kraken production in 2017 and in accordance with industry practice the Company elected to classify underlift adjustments within cost of sales rather than as additional revenue. Under IFRS 15, the Company believe this is the only permissible treatment for such an adjustment.

IFRS 16 Leases
IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

During the year, the Company recognised a right-of-use asset and a finance liability in respect of the Kraken FPSO. All joint operators were party to the lease agreement, therefore the Company recognised only it's 29.5% working interest share in the asset and liability. There will be no change in the accounting on adoption of IFRS 16. The Catcher FPSO is classified as an operating lease under the current accounting standard. Under IFRS 16 Cairn will recognise a right-of-use asset and lease liability for the vessel based on the expected charter period. Had IFRS 16 been applicable in the current period, the impact on the Income Statement for the year would not have been material.

Other operating leases that are currently capitalised in property, plant and equipment, including drilling rigs, are not considered likely to result in separate right-of-use assets as the lease agreements are less than one year (or will have less than one year remaining on adoption of IFRS 16) though the Company will reassess on adoption on the effective date.

The Company are continuing to assess accounting for leases held through joint operations, particularly where the operator enters into a lease agreement on behalf of the joint operation but where the joint operators are not direct parties to the lease agreement. Discussions are ongoing with industry peers to reach conclusion on this issue.

Operating leases for offices in London, will be recorded as right-of-use assets and lease liabilities on adoption of IFRS 16 but amounts are not expected to be material. The Company has no other significant lease agreements.

The Company has not early adopted any other standard, amendment or interpretation that was issued but is not yet effective.

Note 1: Significant accounting policies (continued)

c) Intangible exploration/appraisal assets

Costs

The Company follows a successful efforts based accounting policy for oil and gas assets.

Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the income statement.

Expenditure incurred on the acquisition of a licence interest is initially capitalised on a licence-by-licence basis. Costs are held, un-depleted, within intangible exploration/appraisal assets until such time as the exploration phase on the licence area is complete or commercial reserves have been discovered. Exploration expenditure incurred in the process of determining oil and gas exploration targets is capitalised initially within intangible exploration/appraisal assets and subsequently allocated to drilling activities. Exploration/appraisal drilling costs are initially capitalised on a well-by-well basis until the success or otherwise of the well has been established. The success or failure of each exploration/appraisal effort is judged on a well-by-well basis. Drilling costs are written off on completion of a well unless the results indicate that hydrocarbon reserves exist and there is a reasonable prospect that these reserves are commercial. Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are written off to the Income Statement.

Following appraisal of successful exploration wells, if commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalised intangible exploration/appraisal costs are transferred into a single field cost centre within property, plant & equipment - development/producing assets, after testing for impairment (see below).

Proceeds from the disposal or farm down of part or all of an exploration asset are credited initially to that interest with any excess being credited to the Income Statement.

Impairment

Intangible exploration/appraisal assets are reviewed regularly for indicators of impairment and tested for impairment where such indicators exist. An indicator that one of the Company's assets may be impaired is most likely to be one of the following:

- There are no further plans to conduct exploration activities in the area;
- Exploration drilling in the area has failed to discover commercial reserve volumes;
- Changes in the oil price or other market conditions indicate that discoveries may no longer be commercial; or
- Development proposals for appraisal assets in the pre-development stage indicate that it is unlikely that the carrying value of the exploration/appraisal asset will be recovered in full.

In such circumstances the intangible exploration/appraisal asset is allocated to any property, plant & equipment - development/producing assets within the same cash-generating unit (CGU) and tested for impairment. Any impairment arising is recognised in the Income Statement for the year. Where there are no development/producing assets within the CGU, the excess of the carrying amount of the exploration/appraisal asset over its recoverable amount is charged immediately to the Income Statement.

d) Property plant and equipment – development/producing assets

Costs

All costs incurred after the technical feasibility and commercial viability of producing hydrocarbons has been demonstrated are capitalised within development/producing assets on a field-by-field basis. 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. Any remaining costs associated with the part replaced are expensed.

Note 1: Significant accounting policies (continued)

Costs of borrowings relating to the ongoing construction of development assets and facilities are capitalised during the development phase of the project. Capitalisation ceases once the asset is ready to commence production.

Net proceeds from any disposal, part disposal or farm down of development/producing assets are credited against the appropriate portion of previously capitalised cost. A gain or loss on disposal of a development/producing asset is recognised in the income statement to the extent that the net proceeds, measured at fair value, exceed or are less than the appropriate portion of the net capitalised costs.

Impairment
Development/producing assets are reviewed for indicators of impairment at the balance sheet date. Indicators of impairment for the Company's development/producing assets include:

- Downward revisions of reserve estimates;
- Increases in cost estimates for development projects; or
- A decrease in the oil price or other negative changes in market conditions.

Impairment tests are carried out on each development/producing asset at the balance sheet date where an indicator of impairment is identified. The test compares the carrying value of an asset to its recoverable amount based on the higher of its fair value less costs of disposal or value in use. Where the fair value less costs of disposal supports the carrying value of the asset, no value-in-use calculation is performed.

If it is not possible to calculate the fair value less costs of disposal of an individual asset, the fair value less costs of disposal is calculated for the CGU containing the asset and tested against the carrying value of the assets and liabilities in the CGU for impairment. Where an asset can be tested independently for impairment, this test is performed prior to the inclusion of the asset into a CGU for further impairment tests.

If the carrying amount of the asset or CGU exceeds its recoverable amount, an impairment charge is made.

Where there has been a charge for impairment in an earlier period that charge will be reversed in a later period where there has been a change in circumstances to the extent that the recoverable amount is higher than the net book value at the time. In reversing impairment losses, the carrying amount of the asset will be increased to the lower of its original carrying value or the carrying value that would have been determined (net of depletion) had no impairment loss been recognised in prior years.

If the carrying amount of the asset or cash-generating unit exceeds its recoverable amount, an impairment charge is made.

Decommissioning
At the end of the producing life of a field, costs are incurred in plugging and abandoning wells, removing subsea installations and decommissioning production facilities. The Company recognises the full discounted cost of decommissioning as an asset and liability when the obligation to rectify environmental damage arises. The decommissioning asset is included within property, plant & equipment – development/producing assets with the cost of the related installation. The liability is included within provisions.

Revisions to the estimated costs of decommissioning which alter the level of the provisions required are also reflected in adjustments to the decommissioning asset. The amortisation of the asset is calculated on a unit of production basis based on proved and probable reserves. The amortisation of the asset is included in the depletion and amortisation charge in the income statement and the unwinding of discount of the provision is included within finance costs.

e) **Farm in / farm outs**
Proceeds receivable on disposal of development and producing assets, including through farm out transactions and carry arrangements, are recognised at fair value.

Note 1: Significant accounting policies (continued)

f) **Financial instruments**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets are categorised as financial assets held at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Company holds financial assets which are classified as loans and receivables.

Financial liabilities generally substantiate claims for repayment in cash or another financial asset. Financial liabilities are categorised as either fair value through profit or loss or held at amortised cost. The Company's financial liabilities are held at amortised cost or fair value through profit or loss.

Financial instruments are generally recognised as soon as the Company becomes party to the contractual regulations of the financial instrument.

Trade and other receivables

Other receivables (classified as loans and receivables under IAS 39) that have fixed or determinable payments that are not quoted on an active market are initially measured at fair value and then subsequently at amortised cost using the effective interest method less any impairment. Other receivables are recognised when invoiced.

The carrying amounts of trade and other receivables are tested at each reporting date to determine whether there is objective material evidence of impairment, for example overdue trade debt. Any impairment losses are recognised through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the Income Statement or Balance Sheet in accordance with where the original receivable was recognised.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and short-term deposits with an original maturity of three months or less.

Trade payables and other non- derivative financial liabilities

Trade payables and other payables are non-interest bearing and are measured initially at fair value and subsequently amortised cost.

Commodity price hedging

The Company may hedge oil production for the Company's assets in line with hedging policies approved by the Cairn Energy PLC Board. Where a hedging instrument has been formally designated a hedge for hedge accounting, changes in the intrinsic value of the hedged item are recognised within other comprehensive income (where the hedge is effective) and are reclassified to the Income Statement when the hedged production itself affects profit or loss. Hedge effectiveness is assessed on both a prospective and retrospective basis. Any hedge ineffectiveness identified is immediately charged to the Income Statement.

Changes in the fair value of the time option not designated within the hedged item are recognised in the Income Statement.

g) **Equity**

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs, allocated between share capital and share premium.

Note 1: Significant accounting policies (continued)

h) Taxation

The total tax charge or credit represents the sum of current tax and deferred tax.

The current tax credit is based on the taxable loss for the year. Taxable profit or loss differs from net profit or loss as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

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 or loss.

Deferred tax assets are recognised for deductible temporary differences that exist only where it is probable that taxable profits will be generated against which the carrying value of the deferred tax asset can be recovered.

Deferred tax liabilities are recognised for all taxable temporary differences except in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint operations where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

A deferred tax asset or liability is not recognised if a temporary difference arises on initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss. However, where the recognition of an asset is associated with an interest in a joint operation, which applies to all the Company's intangible exploration/appraisal asset and property, plant & equipment – development/producing asset additions, and the Company is not able to control the timing of the reversal of the temporary difference or the temporary difference is expected to reverse in the foreseeable future, a deferred tax asset or liability shall be recognised.

Current and deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

i) Financial Lease Liabilities

Finance lease liabilities are measured at inception and recorded on commencement of the asset being brought in to use. Measurement is based on the lower of fair value of the asset or the net present value of minimum lease commitments. Lease payments made in excess of the minimum commitment are charged direct to the income statement as variable lease costs.

Lease payments are allocated between capital and interest based on the rate implicit in the lease agreement. Where this is not practical to determine, the Cairn Energy PLC Group's incremental borrowing rate is used.

Where there are changes subsequent to initial recognition, adjustments are made to both the lease liability and the capitalised asset. The interest rate used where the rate implicit in the lease are not determinable is updated at the date of the remeasurement.

j) Revenue

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Company and revenue can be reliably measured.

Revenue from oil sales represents the Company's share of sales, on a liftings basis, from its producing interests in the UK North Sea, at the point in time where the significant risks and rewards of ownership have been passed to the buyer. Revenue is measured using the Brent (or estimated Brent) price plus or minus the applicable discount based on the quality of the oil.

Note 1: Significant accounting policies (continued)

k) Cost of Sales

Production costs include the Company's share of costs of the joint operation in extracting oil. Also included are marketing and transportation costs, measured on a cost per barrel basis and loss-of-production insurance costs payable over the period.

Adjustments for overlift (where liftings taken by the Company exceed the Company's working interest share), underlift (where liftings taken by the Company are less than the Company's working interest share) and movements in inventory are included in cost of sales. Oil inventory is measured at market value in accordance with established industry practice.

Variable lease charges represent lease payments made on finance leases over and above the minimum lease commitment. Operating lease costs are charged directly to the Income Statement.

l) Deferred Revenue

Deferred revenue, arising from a streaming agreement, is treated as cash received in advance of future oil sales. Revenue is recorded at the fair value of the consideration received and is amortised to the income statement on a unit-of-production basis, based on expected future volumes to which the stream provider are entitled.

m) License interests

The Company's principal license interest at the Balance Sheet date is the following:

Country	**Block/ License**	**Working Interest (%)**
UK (Offshore)	P1077 (Block 9/2b)	29.5
UK (Offshore)	P1430 (Blocks 28/9a and 28/10c)	20.0
UK (Offshore)	P2070 (Block 28/4a)	36.0
UK (Offshore)	P2077 (Block 28/8)	36.0
UK (Offshore)	P2184 (Block 22/18c)	45.0
UK (Offshore)	P2312 (blocks 3/16a & 3/17a)	100.0

n) Significant accounting judgments, estimates and assumptions

Key estimations and assumptions

The Company has used estimates and assumptions in arriving at certain figures within the financial statements. The resulting accounting estimates may not equate with the actual results which will only be known in time. Those areas believed to be key areas of estimation are noted below, with further details of the assumptions contained in the relevant note.

Impairment testing on oil and gas assets

Where an indicator of impairment is identified on an intangible exploration/appraisal asset or a development/producing asset, an impairment test is conducted in accordance with the Company's accounting policies. The test compares either the carrying value of the asset or the carrying value of the CGU containing the asset, to the recoverable amount of that asset or CGU.

Note 1: Significant accounting policies (continued)

The recoverable amount of an asset represents its fair value less costs of disposal. This is based on either a verifiable third-party arm's-length transaction from which a fair value can be obtained or where there is no such transaction, the fair value less costs of disposal of an asset is calculated using discounted post-tax cash flow models over the field life of the asset.

The key assumptions used in the Company's discounted cash flow models reflect past experience and take account of external factors. These assumptions include:

- Short/medium-term oil price based on a three-month average forward curve for three years from the Balance Sheet date;
- Long-term oil price of US$70 per boe (2016: US$70 per boe) escalated at 2.0% (2016: 2.0%) per annum;
- Reserve estimates of discovered resource (2P and 2C) based on P50 reserve estimates;
- Production profiles based on the Company's internal estimates which are not materially different from those of the operators;
- Cost profiles for the development of the field and subsequent operating costs supplied by the operator and escalated at 2.0% (2016: 2.0%) per annum; and
- Post-tax discount rates of 10% (2016: 10%).

Lease classification of Kraken and Catcher FPSO lease agreements
The Company is party to lease agreements on its North Sea producing assets for the charter of an FPSO on each licence. In determining whether each lease should be classified as either a finance lease or an operating lease, the Company has considered the substance of both transactions individually, including the term of each lease in relation to the expected life of the asset and whether options to purchase the FPSO at the end of the lease term are reasonably certain to be exercised.

The Company concluded that the lease agreement for the Kraken FPSO, where it is considered reasonably certain that the FPSO will be purchased by the joint operation toward the end of the initial term, should be classified as a finance lease. By contrast, the Catcher FPSO, with a shorter initial lease term and with no current expectation that the joint operation shall purchase the FPSO at the end of that lease term, was determined to be an operating lease, with substantially all risks and rewards of ownership remaining with the lessor.

The new accounting standard, IFRS 16 Leases, is effective for the Company's financial year beginning 1 January 2019 and will require the Catcher FPSO operating leased asset to be recognised on the balance sheet as a right-of-use asset. Further details are provided in section b.

Accounting for the FlowStream transaction
The Company entered into a stream agreement with FlowStream during the year, receiving ~US$75m for a share of future Kraken production. Under the agreement, the Company delivers oil to FlowStream at the point of production (the Company has agreed to market FlowStream's oil on their behalf), with FlowStream's percentage share of the production from the field agreed at the outset. The price FlowStream receive for the oil is based on market prices.

The transaction does not give rise to a contractual obligation for the Company to deliver cash or another financial asset to FlowStream; FlowStream's return is entirely dependent on future production from Kraken. As such, the Company has concluded that this transaction does not give rise to a financial liability; rather, the agreement is considered as a future sale of oil and the proceeds treated as deferred revenue.

Note 2. Auditors' remuneration

The Company's auditors' remuneration of £18,500 (2016: £10,118) has been borne by the intermediate holding company Capricorn Energy Limited. Auditors' remuneration for other services is disclosed in the financial statements of Cairn Energy PLC, the ultimate parent undertaking.

The Company has a policy in place for the award of non-audit work to the auditors which requires approval by the Audit Committee of Cairn Energy PLC, the ultimate parent undertaking. No such costs were incurred by the Company during the year (2016: £nil).

Note 3. Administrative expenses

	2017 £ '000	2016 £ '000
Wages and salaries	116	301
Social security costs	14	4
Pension costs	8	6
Professional Fees	53	1
Other administrative expenses	(214)	66
Total administrative expenses	(24)	378

The Company's monthly average number of employees was zero (2016: nil). Wages and salaries costs are related to Cairn Energy employees that are recharged to Nautical Petroleum Limited.

The directors of the Company are also directors of other companies in the Cairn Energy PLC group. The directors received remuneration for the year of £2.7m (2016: £2.5m) and pension contributions of £0.2m (2016: £0.2m), all of which was paid by other companies in the group. The directors do not believe that it is practicable to apportion this amount between their services as directors of the Company and their services as directors of Cairn Energy PLC and fellow subsidiary companies. There are no agreements between the Company and the Board of Directors. No loans or guarantees have been granted on behalf of the Management, shareholders or the Board of Directors.

Note 4. Taxation

Tax on loss on ordinary activities	2017 £ '000	2016 £ '000
Analysis of tax credit in year:		
Other UK deferred tax credit	(2,499)	(27,634)
Total tax credit for the year	(2,499)	(27,634)

Expenditure incurred on Cairn's behalf by Dyas BV under the carry agreement, capitalised in Property, plant and equipment - development assets, creates a deferred tax liability. UK deferred tax credits of £2.2m (2016: £26.2m) were realised to offset this deferred tax liability and £0.3m (2016: £1.4m) was released due to a change in tax rate.

Note 4: Income taxes (continued)

Factors affecting tax credit for the year
A reconciliation of income tax credit applicable to profit or loss before taxation at the UK statutory rate, to income tax credit at the Company's effective tax rate, is as follows:

	2017 £ '000	2016 £ '000
Loss before taxation	(12,798)	(7,778)
Loss before taxation multiplied by the average UK statutory rate of corporation tax of 19.25% (2016: 20%)	(2,464)	(1,556)
Effects of:		
Non-deductible expenses and non-taxable income	286	(215)
Impact of investment allowance on deferred tax	-	(14,400)
Special tax rates and reliefs applying to oil and gas activities	(23,527)	(9,936)
Tax losses surrendered to other group companies	509	-
Impact on deferred tax of adjustments in respect of prior years	(952)	(2,197)
Release of provision on carried interests due to change in tax rate	(249)	(1,738)
Temporary differences not recognised	23,898	2,408
Total tax credit for the year	(2,499)	(27,634)

The UK main rate of corporation tax is currently 19.25% (20% prior to 1 April 2017). The change in the UK tax rate had no impact either on the Company's net deferred tax position at 31 December 2017 nor on the tax credit for the year.

The applicable UK statutory tax rate applying to North Sea oil and gas activities is currently 40%. The applicable rate applying in the prior year was 40%.

Deferred Tax Assets and Liabilities	Assets £ '000	Liabilities £ '000	Total £ '000
Reconciliation of movement in deferred tax (assets)/liabilities:			
At 1 January 2016	-	-	-
Deferred tax movement on additions to development assets in respect of carried interests	27,634	-	27,634
Other deferred tax charge to income statement for the period	(27,634)	-	(27,634)
At 31 December 2016	-	-	-
Deferred tax movement on additions to development assets in respect of	2,499	-	2,499
Other deferred tax charge to income statement for the period	(2,499)	-	(2,499)
At 31 December 2017	-	-	-

Unrecognised deferred tax assets
No deferred tax asset has been recognised at the Balance Sheet date on Ring Fence trading losses in excess of the temporary differences arising in respect of non-current assets of £121.9m (2016: £147.8m); non-Ring Fence trading losses of £2.8m (2016: 2.7m); management expenses of £1.4m (2016: £1.7m); non trade loan relationship deficits of £0.6m (2016: £0.6m); or on other ring fence temporary differences of £86.5m (2016: £nil) relating to decommissioning liabilities, as it is not deemed probable that future profits will be available to recover the value of the asset given the detrimental change in market conditions continuing to impact the oil and gas industry.

Note 5. Net financial items

	2017 £ '000	2016 £ '000
Foreign exchange gains realised	2,586	2,334
Foreign exchange gain unrealised	2,200	2,697
Other financial income	202	1,851
Finance income	4,988	6,882
Interest receivable from group companies	(5,760)	(344)
Unwind of discount on decommissioning provision	(1,477)	(696)
Finance lease interest	(1,969)	-
Market-to-market loss on financial instrument	(395)	-
Other financial expenses	(1,989)	-
Financial expenses	(11,590)	(1,040)
Net financial items	(6,602)	5,842

Out of the other financial expenses of £11,590k, £5,760k is interest payable on the amounts due to group undertakings, (see note 9), £3,446k (£696k in 2016) is related to the unwind of discount on the abandonment provision (see note 13), and amount of £2,384k is related to mark-to-market loss on financial instrument (see note 11).

Note 6. Intangible exploration / appraisal assets

Amounts in £ '000	Capitalised exploration expenditure
Cost	
At 1 January 2016	20,106
Additions	8,256
Unsuccessful exploration costs	(10,905)
At 31 December 2016	17,457
Additions	2,965
Unsuccessful exploration costs	(1,630)
At 31 December 2017	18,792
Impairment	
At 1 January 2016	2,229
Impairment charge	-
At 31 December 2016	2,229
Impairment charge	-
At 31 December 2017	2,229
Net book value	
At 31 December 2015	17,877
At 31 December 2016	15,228
At 31 December 2017	16,563

Out of the total additions of £4,371k, £2,246k is mainly related to the newly acquired P2312 Chimera license. In 2016 the additions of £8,256k, mainly related to the drilling of the Laverda well (£3,337k). The well was partly carried by Dyas under the farm-down agreement specified in Note 7.

Note 6: Intangible exploration /appraisal assets (continued)

The unsuccessful exploration costs of £1,630k was mainly related to the relinquished license P2149 Scylla. In 2016 the unsuccessful exploration costs of £10,905k include the P1077 Kraken West discovery (£6,760k), the P1976 West of Kraken costs incurred (£1,357k) and additional amounts spent on UK licenses.

At the year end, the company reviewed its intangible exploration/appraisal assets for indicators of impairment, and no impairment was identified.

Note 7. Property, plant & equipment – development/producing assets

Amounts in £ '000	Capitalised development / producing expenditure
Cost	
At 1 January 2016	384,535
Additions	170,607
Decommissioning asset additions	38,583
At 31 December 2016	593,725
Additions	149,323
Capitalised leased assets	131,345
Decommissioning asset additions	21,893
Disposals	(123)
At 31 December 2017	896,163
Depletion, amortisation and impariment	
At 1 January 2016	(768)
Depletion and amortisation	(55)
Impairment	(2,238)
At 31 December 2016	(3,061)
Depletion and amortisation	(15,375)
Disposals	55
At 31 December 2017	(18,381)
Net book value	
At 31 December 2015	383,767
At 31 December 2016	590,664
At 31 December 2017	877,782

Both the Kraken and the Catcher developments achieved first oil in 2017. Kraken came on stream in June 2017 and gross production volumes of 2,465,000 barrels were achieved during the period as performance issues connected with FPSO were addressed. Catcher commenced production late December 2017. Total additions to development assets in the year of £302.6m, and of this amount £219.1m (2016: £138.3) and £83.5m (2016: £70.9) relate to the Kraken and Catcher developments respectively.

On the commencement of production the Kraken FPSO was recorded on the balance sheet as a right-of-use producing asset addition of £154.9m. This amount was equal to the net present value of future minimum lease payments of the finance lease liability as at that date – see note 9 Current and non-current liabilities. Subsequent to initial recognition, the lease agreement was amended to include an interim production period to allow the lessor to address operational issues with the FPSO. During this interim production period, minimum lease commitments are reduced to nil, resulting in a reduction to the finance lease liability of £26.8m and a corresponding reduction to the leased production asset. Further additions of £3.8m represents the recognition of a decommissioning asset associated with the FPSO (see note 9), increasing the net book value of the capitalised leased asset to £131.9m at 31 December 2017.

Note 7: Property, plant & equipment – development/producing assets (continued)

The decommissioning asset is management's best estimate of future cost of removal of the drilled wells and installed subsea equipment at Catcher and Kraken (see note 13).

Depletion of £15.4m was charged based on production on both assets during the period.

In September 2014, Nautical entered into an agreement to farm-down 10% of the Company's working interest on the Catcher development, satellite fields and surrounding exploration acreage to Dyas. Under the terms of the deal, Dyas have funded exploration and development costs of Nautical of the licenses up to a cap of $182.0m. The carry was fully utilised in January 2017.

In February 2016 the Company increased its working interest in Kraken by 4.5% to 29.5%. The additional interest was acquired from First Oil plc for nominal consideration with the Company liable for working capital liabilities that existed at the date of the agreement. £11.2m is therefore included within 2016 additions relating to this transaction.

At the year end, the Company reviewed its development assets for indicators of impairment. Subsequent impairment tests did not identify any required impairment on the Kraken asset (2016: nil) nor the Catcher asset (2016: £2.2m).

Note 8. Trade and other receivables

	2017 £ '000	2016 £ '000
Amounts receivable from group companies	1,591	400
Trade receivables	1,507	109
Accrued income underlift	4,094	-
Share of joint operations prepayments	8,861	15,103
Other prepayments	470	2,009
Total trade and other receivables	16,523	17,621

There was no allowance for doubtful debts made in 2017 (2016: £nil). In determining the recoverability of other receivables, the Company carries out a risk analysis based on the type and age of the outstanding receivable.

Out of the Joint operations prepayments an amount of £4.6m (£15.1m in 2016) relates to Kraken and £4.7m (£0m in 2016) relates to Catcher joint operator receivables for overcalled funds.

At 31 December 2017, no amount within the Company's trade and other receivables, was past due or impaired (2016: £nil).

Note 9. Current and non-current liabilities

Current liabilities

	2017 £ '000	2016 £ '000
Deferred revenue	18,044	-
Loans and borrowings- Amounts payable to group companies	570,250	458,628
Trade payables	3,928	1,209
Financial liability on derivative contracts	1,029	-
Finance lease liability	1,079	-
Provision - unused rig days	17,887	7,164
Other taxation and social security	130	(20)
Share of joint operations payables	54,220	30,202
Accruals	1,963	13,613
Total current liabilities	668,530	510,796

Non-current liabilities

	2017 £ '000	2016 £ '000
Finance lease liability	124,486	-
Deferred revenue	36,694	-
Provisions - decommissioning	86,521	60,237
Total non-current liabilities	247,701	60,237

Reconciliation of the opening and closing loans and borrowings to cash flow movements:

	2017 £ '000	2016 £ '000
Opening liability	458,628	356,194
Loan and borrowings advanced recognised in cash flow statement	110,135	105,134
Increase (decrease) in intercompany payables	1,487	(2,700)
Closing Loans and Borrowings	570,250	458,628

	2017 £ '000
FlowStream deferred revenue	
Opening deferred revenue	-
Fair value of proceeds received	56,966
Released during the year	(2,228)
Closing deferred revenue	54,738
Amounts expected to be released within one year	18,044
Amounts expected to be released after one year	36,694

Deferred revenue of £54.7m (US$74.0m) relates to the stream agreement with FlowStream. Under the initial stream agreement, the Company received £57.3m (US$74.6m) in June 2017 with FlowStream receiving 4.5% of future Kraken production. FlowStream's entitlement to Kraken production reduces to 1.35% after FlowStream achieves a 10% return and would further reduce to 0.675% if FlowStream achieves a 15% return.

For financial liability, see note 11 Financial Instruments.

Note 9: Current and non-current liabilities (continued)

Transocean Leader
The Company has accrued for increased costs of Kraken development wells drilled under the Transocean Leader contract, due to potential unused rig days at the end of the contract. Due to renegotiations in the first quarter of 2018, the contract will now be terminated at the completion of the planned drilling, hence the provision for unused rig-days has been reversed in 2018.

Decommissioning provisions are described in note 13 Commitments and provisions.

Note 10. Financial risk management: objectives and policies

The main risks arising from the Company's financial instruments are commodity price risk, liquidity risk, credit risk and foreign currency risk. The Board of Cairn Energy PLC, through the Treasury Sub-Committee, reviews and agrees policies for managing each of these risks and these are summarised below.

Cairn Energy PLC's treasury function and Executive Team as appropriate are responsible for managing these risks, in accordance with the policies set by the Board. Management of these risks is carried out by monitoring of cash flows, investment and funding requirements using a variety of techniques. These potential exposures are managed whilst ensuring that the Company has adequate liquidity at all times in order to meet their immediate cash requirements. There are no significant concentrations of risks unless otherwise stated. The Company does not enter into or trade financial instruments, including derivatives, for speculative purposes.

The primary financial assets and liabilities comprise cash, short and medium-term deposits, intra-group loans and other receivables and financial liabilities held at amortised cost. The Company's strategy has been to finance its operations through a mixture of retained profits and bank borrowings. Other alternatives such as equity issues and other forms of non-investment-grade debt finance are reviewed by the Board, when appropriate.

Commodity price risk
Commodity price risk arises from the Company's production revenues, which could be adversely affected due to changes in commodity prices. There is also a risk such change could also impact debt availability under the reserve based lending facility.

The Company measures commodity price risk by projecting all material committed and anticipated cash flows associated with petroleum production. The Company reviews and considers hedging of actual and forecast exposures for the current and subsequent five years.

The Company may choose to hedge commodity price risk where there is a risk to debt capacity and the impact on cash flow and headroom would be material. Where the impact is not material the Company may still choose to hedge to maintain headroom. Details of current hedging arrangements, can be found in note 11 Financial Instruments.

Transacted derivatives are designated, where possible, in cash flow hedge relationships to minimise accounting income statement volatility. The Company is required to assess the likely effectiveness of any proposed cash flow hedging relationship and demonstrate that the hedging relationship is expected to be highly effective prior to entering into a hedging instrument and at subsequent reporting dates.

Liquidity risk
The Company closely monitors and manages its liquidity risk using both short and long-term cash flow projections, supplemented by debt and equity financing plans and active portfolio management. Cash forecasts are regularly produced and sensitivities run for different scenarios including, but not limited to, changes in and delays of development projects. The Company's forecasts show that the Company has financial headroom for the 12 months from the date of approval of the 2017 financial statements.

Note 10: Financial risk management: objectives and policies (continued)

The Company currently has surplus cash that is invested with a number of international and UK financial institutions, ensuring sufficient liquidity to enable the Company to meet its short and medium-term expenditure requirements

Foreign currency risk
The Company manages exposures that arise from non-functional currency receipts and payments by matching receipts and payments in the same currency and actively managing the residual net position.

Where residual net exposures do exist and they are considered significant the Company may from time to time opt to use derivative financial instruments to minimise exposure to fluctuations in foreign exchange and interest rates.

Credit risk
Credit risk arises from cash and cash equivalents, investments with banks and financial institutions and joint operations.

Customers and joint operation partners are subject to a risk assessment using publicly available information and credit reference agencies, with follow-up due diligence and monitoring if required.

Investment credit risk for investments with banks and other financial institutions is managed by the Group Treasury function in accordance with the Board-approved policies of Cairn Energy PLC. These policies limit counterparty exposure, maturity, collateral and take account of published ratings, market measures and other market information. The limits are set to minimise the concentration of risks and therefore mitigate the risk of financial loss through counterparty failure.

Where investments are made in repos, collateral is fixed income debt securities with a minimum rating of BBB- which is managed by Euroclear. No adjustment is made to the counterparty credit rating to reflect the collateral held when assessing investment options.

It is the Company's policy to invest with banks or other financial institutions that firstly offer the greatest degree of security and secondly the most competitive interest rates. Repayment of principal is the overriding priority and this is achieved by diversification and shorter maturities to provide flexibility. The Board continually re-assesses the Company's policy and updates as required.

At the year end the Company does not have any significant concentrations of bad debt risk. The maximum credit risk exposure relating to financial assets is represented by the carrying value as at the balance sheet date.

Capital Management
The objective of the Company's capital management structure is to ensure that there remains sufficient liquidity within the Company to carry out committed work programme requirements. Cairn Energy PLC's treasury function monitors the long-term cash flow requirements of the business in order to assess the requirement for changes to the capital structure to meet that objective and to maintain flexibility.

The Company manages the capital structure and makes adjustments to it in light of changes to economic conditions. To maintain or adjust the capital structure, the Company may buy-back shares, make a special dividend payment to shareholders, return capital, issue new shares for cash, repay debt, put in place new debt facilities or other such restructuring activities as appropriate. No significant changes were made in the objectives, policies or processes during the year ended 31 December 2017.

Note 10: Financial Risk Management: Objectives and Policies (continued)

The Company's capital and net debt were made up as follows:

	2017 £ '000	2016 £ '000
Financial instruments		
Loans and borrowings	570,250	458,628
Trade and other payables	62,349	45,004
Accrual for contract loss	17,887	7,164
Long term lease liabilities	124,486	60,236
Less cash and cash equivalents and bank deposits	(40,719)	(832)
Net debt	734,253	570,200
Equity	55,272	65,572
Capital and net debt	789,525	635,772
Gearing ratio	93 %	90 %

Note 11. Financial instruments

The Company calculates the fair value of assets and liabilities by reference to amounts considered to be receivable or payable on the balance sheet date. The Company's financial assets and liabilities, together with their fair values are as follows:

	Carrying amount		Fair Value	
	2017 £ '000	2016 £ '000	2017 £ '000	2016 £ '000
Financial assets				
Cash and cash equivalents	40,719	754	40,719	754
Amounts receivable from group companies	1,591	400	1,591	400
Other debtors	6,071	17,221	6,071	17,221
Financial liabilities				
Fair value through profit and loss				
Financial liabilities on derivative contracts	1,029	-	1,029	-
Amortised cost				
Trade and other payables	5,137	1,189	5,137	1,189
Amounts payable to Group companies	570,250	458,628	570,250	458,628
Share of joint operations payables	54,220	30,202	54,220	30,202
Accruals	1,963	13,613	1,963	13,613

All of the above loans and receivables are current and unimpaired. The fair value of financial assets and liabilities has been calculated by discounting the expected future cash flows at prevailing interest rates.

Maturity analysis

All of the financial liabilities have a maturity of less than one year.

Note 11: Financial instruments (continued)

Commodity price hedging

Having moved into production on its North Sea assets, the Company commenced a hedging programme in 2017 in order to protect debt capacity and support committed capital programmes. At 31 December 2017 the Company had hedged ~1.4m barrels of 2018 Kraken oil production, using a combination of put and call options (to effectively form a collar) and a collar structures, with a weighted average floor price of US$57.3/bbl and average weighted ceiling price of US$68.3/bbl (all prices quoted relate to dated Brent).

The put option and collar structure have been designated hedges for hedge accounting. The call option does not qualify for hedge accounting under IAS 39 (nor would it under IFRS 9) as it is not specifically combined with a put option to form a collar. At the year-end, the closing oil price was approximately US$66.5/bbl, above the floor price of both the put option and collar and below the ceiling price of both the call option and the collar. The premium payable on the put option and collar was not designated within the hedged item. Fair value movements on the cost of the option are recorded in the Income Statement in the period.

Sensitivity analysis has been performed on hedges in place at the year end. The sensitivity analysis considers only the impact on line items directly relating to hedge accounting and does not include the impact of a change in the oil price on other income statement line items, such as inventory valuations. A 10% fall in the oil price would have had no impact on either the income statement or other comprehensive income. A 10% increase in the oil price would result in a charge to the income statement of £2.4m and a charge through other comprehensive income of £3.4m. These are considered to be reasonably possible changes for the purposes of sensitivity analysis.

Subsequent to the year end the Company entered into further hedging agreements on ~650,000 barrels of 2018 Catcher production. Combined with the Kraken hedges this increases the weighted average floor price to US$58.4/bbl and the weighted average ceiling price to US$70.2/bbl.

In 2017 the market-to-market losses on the option premium were recorded as part of the financing cost of £2,364k. See note 5 Financial Items. The Company has recorded a financial liability for market-to-market losses of £1,336k (see note 9) and £1,029k as the amounts payable to financial institutions relating to the commodity price hedging. See note 9 Current and non- current financial liabilities.

Note 12. Called-up Share Capital

	No. of shares '000	£ '000
At 1 January 2017	92,022	18,405
At 31 December 2017	92,022	18,405

The total authorised number of ordinary shares at 31 December 2017 and 31 December 2016 was 92,022 of which all shares were in issue. The share capital consists of 92,022,000 ordinary shares of £ 0.20.

Note 13. Commitments and provisions

Expected contractual obligation / licence commitments

	2017 £ '000	2016 £ '000
Oil and gas expenditures		
Intangible exploration/appraisal assets – drilling rig commitments	15,870	18,490
Property, plant & equipment - development and producing assets	201,512	502,400
Contracted for:	217,382	520,890

Note 13: Commitments and provisions (continued)

Capital commitments represent the Company's share of obligations in relation to its interests in joint operations. As all the Company's joint operations are jointly controlled assets, these commitments represent the relevant share of the capital commitments of the joint operations themselves.

The capital commitments for property, plant & equipment – development/producing assets, which relate entirely to the Company's UK North Sea producing assets, exclude costs of the Kraken FPSO finance lease obligations, which are disclosed in note 9 Current and Non-Current Debt.

Operating lease commitments
At the year end, the Company had the following operating lease relating to the Catcher FPSO:

	2017 £ '000	2016 £ '000
Production costs - operating lease charges		
Not later than one year	25,107	-
After one year but no more than five years	91,763	106,053
After five years	35,050	60,354
	151,920	166,407

Legal disputes
At 31 December 2017 Nautical Petroleum Limited is not subject to any legal disputes.

Liability for damages / insurance
The company has an extensive insurance program in place that covers wells (well out of control), third party liability and pollution.

Decommissioning provisions

	2017 £ '000	2016 £ '000
Kraken	47,079	35,712
Catcher	39,442	24,505
Keddington	-	20
Total Decommissioning provisions	86,521	60,237

Provisions for decommissioning are based on the latest estimates provided by operators, subject to internal review and adjustment where deemed necessary. Costs provided to date are an estimate of the cost that would be incurred to remove and decommission facilities that existed at the year end and to plug and abandon development wells drilled to that date, using assumptions based on existing technology and the current economic environment.

The decommissioning provisions represent management's best estimate of the obligation arising based on work undertaken at the balance sheet date. Actual decommissioning costs will depend upon the prevailing market conditions for the work required at the relevant time. The expected date the abandonment of Catcher is 2026 and for Kraken is 2034.

The costs are escalated at 2.0% per annum (2016: 2.0%) and discounted at a risk-free rate of 2.0% (2016: 2.0%).

Note 14. Financial Lease Liabilities

On 20 December 2013, the Company entered into a bareboat charter agreement with Armada Kraken PTE Limited (a subsidiary of Bumi Armada) for the lease of an FPSO vessel for the Kraken field. The lease agreement became effective on commencement. This agreement is considered to be a finance lease and commenced on the date of first oil production on 23 June 2017.

The measurement of the Kraken FPSO lease liability of £154.9m on initial recognition was:

- Calculated from the date the lease agreement became effective which was on commencement of the lease in June 2017;
- Based on minimum lease commitments of 50% from end of the "ramp-up period" (the period from first oil production to the FPSO operating at contracted performance levels) in the original lease term, with no adjustment for a contingent Interim Production Period agreement;
- Inclusive of final optional purchase price of £41.9m;
- Inclusive of refunds due after commencement of the lease resulting from delays in delivering the FPSO; and
- Calculated using an interest rate based on the Cairn Energy PLC's incremental borrowing rate at not be readily determined.

Post initial recognition, adjustments of £26.8m, reducing the lease liability and right-of-use asset, have been made to reflect reductions of minimum lease commitments to nil for the maximum duration an Interim Production Period which was agreed between the joint operators and the lessor to allow operational issues with the FPSO to be rectified. The revised liability is computed using an interest rate calculated at the date of the modification.

	Minimum lease payments		Present value of minimum lease payments	
	31 December 2017 £ '000	31 December 2016 £ '000	31 December 2017 £ '000	31 December 2016 £ '000
Not later than one year	1,184	-	1,079	-
After one year but no more than five years	83,321	-	71,111	-
After five years	78,734	-	53,375	-
Total future minimum rentals payable	163,239	-	125,565	-
Less future finance charges	(37,674)	-		
Present value of minimum lease payments	125,565	-		
Long-term lease liability	124,486			
Short-term lease liability	1,079			

Reconciliation of opening and closing liability to cash flow movements

	2017 £ '000	2016 £ '000
Opening liability		-
Finance lease recognised on commencement	154,899	-
Revision to finance lease	(26,777)	-
	128,122	-
Lease payments net of reimbursements received	(4,240)	-
Variable lease payments through cost of sales	5,277	-
Finance lease reimbursements in cash flow statement	1,037	-
Reimbursement due transferred to other receivables	1,037	-
Foreign exchange difference	(6,600)	-
Finance lease interest	1,969	-
Closing liability	125,565	-

Note 14: Financial Lease Liabilities (continued)

Subsequent to initial recognition, the lease agreement was amended to incorporate an interim production period while the Kraken FPSO achieves the targeted throughput of oil. During this interim period, minimum lease payments are reduced to nil, with all lease payments dependent upon the availability and performance of the FPSO.
Amounts due to the Company from the lessor of £1.0m have been offset by the lessor against outstanding invoices disputed by the operator. The Company fully expect to recover this amount and the receivable is recognised within other receivables.

Note 15. Revenues and Cost of Sales

During the period, the Company lifted one cargo of Kraken crude, realising £15.1m. No Catcher crude was sold during the period.

	2017 £ '000	2016 £ '000
Oil Sales	15,127	-
Release of deferred revenue (see note 9)	2,228	-
Revenue	17,355	-
Production and other costs	(11,600)	-
Oil inventory and underlift adjustment	12,273	-
Variable and operating lease charges	(5,277)	-
Cost of sales	(4,604)	-
Depletion and amortisation (see note 7)	(15,375)	-
Gross loss	**(2,624)**	-

Finance income received is disclosed in note 5.

Cost of Sales
Inventory of oil held at the year-end is recorded at a market value of £7.7m. Underlift adjustments on Kraken production volumes were £4.1m at 31 December 2017. Variable finance lease costs on the Kraken FPSO of £4.6m are charged to the Income Statement with £0.7m of operating lease charges on the Catcher FPSO.

Note 16. Inventory and spare parts

	2017 £ '000	2016 £ '000
Inventory of crude oil	7,727	-
Spare parts	522	-
Inventory and spare parts	8,249	-

The inventory of crude oil is an adjustment for closing volume of production on the Kraken FPSO based on the Company's working interest share less the Flowstream entitlement. The inventory is valued at market value, based on closing Brent price of US$66.6 less a forecast discount, marketing and transport fees and Flowstream price differential adjustment.

Note 17. Related party transactions and investments

Key management personnel
See to note 3 for remuneration to key management personnel (including directors).

Other related parties
During the course of the year the Company entered into transactions, in the ordinary course of business, with other related parties. Cost related to technical or other work performed by employees of a related party is allocated based on time writing, includes a five per cent mark up on the relevant hourly rate.

	2017 £ '000	2016 £ '000
Net invoiced from group companies	(6,833)	(5,741)
Net invoiced to group companies	389	325

Balances which are outstanding with group companies at the Balance Sheet date:	2017 £ '000	2016 £ '000
Amounts receivable from group companies	1,591	400
Amounts payable to group companies	(570,250)	(458,628)

The amounts outstanding are unsecured, repayable on demand and will be settled in cash.

Investments in related parties
Investments are held in related party companies.

Cost - Amounts in £ '000	Investments in group companies
At 1 January 2016	12,325
Additions	4,357
At 31 December 2016 and 1 January 2017	16,682
Liquidations	(593)
At 31 December 2017	16,089

Impairment - Amounts in £ '000	
At 1 January 2016	63
Liquidations	4,359
At 31 December 2016 and 1 January 2017	4,422
Impairment	-
At 31 December 2017	4,422

Net book value at 31 December 2017	11,667
Net book value at 31 December 2016	12,260

The Company's subsidiaries as at the balance sheet date are set out below.

Note 17: Related party transactions and investments (continued)

Direct holdings	Business	Country of incorporation	Country of operation	Registered office address
Agora Oil and Gas (UK) Limited	Exploration	Scotland	UK	50 Lothian Road, Edinburgh, EH3 9BY
Nautical Petroleum AG	Exploration	Switzerland	UK	Chollerstrasse 35, 6300 Zug
Alba Resources Limited	Exploration	Scotland	UK	50 Lothian Road, Edinburgh, EH3 9BY
Nautical Holdings Limited	Holding company	England	UK	6th Floor, 20 Berkeley Square, London, W1J 6EQ
Nautical Italia SRL	Exploration	Italy	Italy	Piazza Pietro Merolli n. 2, 00151 Roma, Italy
Transunion Petroleum Italia SRL	Exploration	Italy	Italy	Piazza Pietro Merolli n. 2, 00151 Roma, Italy
UAH Limited+	Holding company	England	UK	6th Floor, 20 Berkeley Square, London, W1J 6EQ

The companies Nautical Italia SRL and Transunion Petroleum Italia SRL are in the process of liquidation.

Note 18. Ultimate parent company

Nautical Petroleum Limited is a wholly owned subsidiary of Capricorn Energy Limited. The results of the company are consolidated into those of the ultimate parent company, Cairn Energy PLC, registered in Scotland, whose principal place of business is at 50 Lothian Road, Edinburgh, EH3 9BY.

Copies of the Cairn Energy PLC's financial statements are available to the public and may be obtained from the above mentioned address.