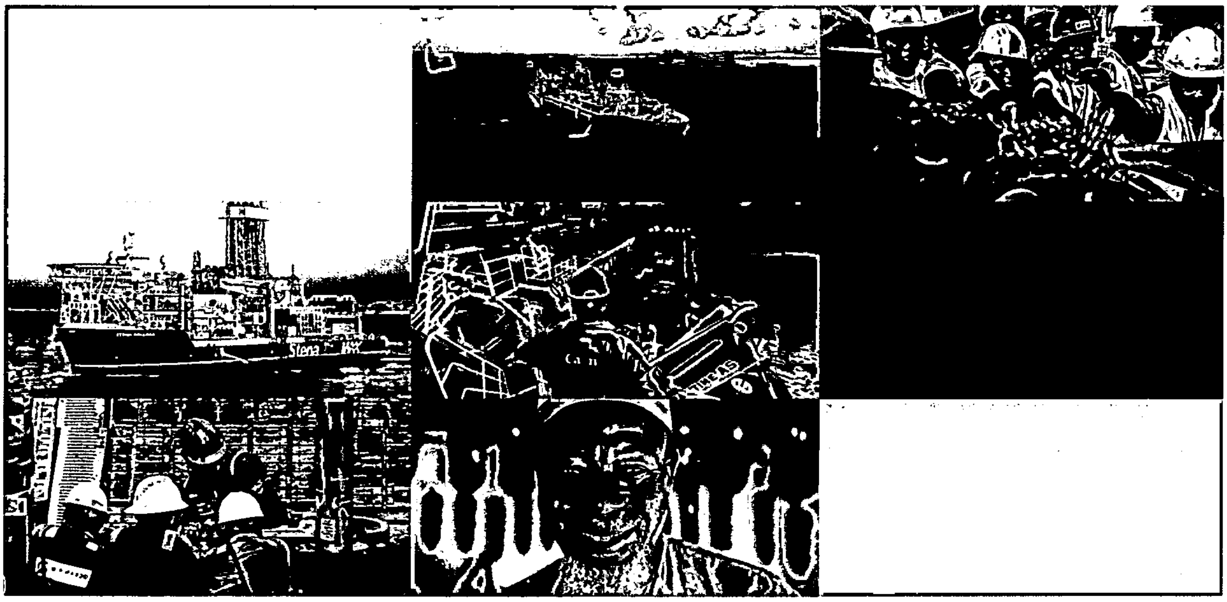
Nautical Petroleum Limited
Registered No: 04362104

Nautical Petroleum Limited

Directors' Report and Financial Statements

31 December 2018



Cairn

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COMPANY INFORMATION

Directors

Simon J Thomson

James D Smith

Paul Joseph Mayland

Brita Holstad

Secretary

Duncan A. Wood

Independent auditors

PricewaterhouseCoopers LLP

144 Morrison Street

Edinburgh, EH3 8EX

Solicitors

Shepherd and Wedderburn LLP

1 Exchange Crescent

Conference Square

Edinburgh EH3 3UL

Registered Office

4th Floor

Wellington House

125 Strand

London WC2R 0AP

Registered number

SC04362104

DIRECORS' REPORT

The Directors present their report and audited financial statements for the year ended 31 December 2018. The financial statements have been prepared in US Dollars and all values are rounded to the nearest thousand US Dollars ($'000) except when otherwise indicated. Following the commencement of production on Kraken (June) and Catcher (December) in 2017, the Company changed its functional and presentational currency from GB£ to US$ from 1 January 2018.

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.

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 Dividend

The Company's loss for the year ended 31 December 2018 was US$111.0m (2017: loss of US$10.4m). The Company has not paid or declared a dividend in respect of the current or prior year.

Production

2018 marked the first full year of production from the Company's two UK North Sea producing assets. Production on Kraken commenced in June 2017 and Catcher came on stream late December 2017. During 2018, daily gross production volumes on both assets have increased significantly, with Kraken averaging 30,300 boepd and Catcher 43,000 boepd across the year. Combined production for 2019 is expected to average 19,000 – 22,000 beopd net to Nautical, before adjusting for the FlowStream entitlement.

Revenue

Revenue from the sale of oil and gas was US$387.9m (2017: US$19.5m) for the year ending 31 December 2018, after adjusting for hedging transactions. Release of deferred revenue of US$21.2m, gives total revenue of US$409.1m (2017: US$22.4m)

At 31 December, the Company had hedged ~2.7 mmbbls of forecast production through 2019 using collar structures with a weighted average floor of US$67.1 per bbl and an average ceiling of US$83.1 per bbl and a further ~0.5 mmbbls of 2020 forecast production with a floor and ceiling of US$67.5 and US$87.5 per bbl respectively. With a year-end oil price of US$50.7 per bbl, the fair value of the hedge options held by Nautical has increased significantly at the year-end giving rise to financial assets of US$44.4m at the Balance Sheet date with unrealised gains of US$43.9m recorded through other comprehensive income, offset by losses on settled options.

Cost of sales

Total production costs of US$131.4m (2017: US$5.9m) include US$59.5m of operating and variable lease payments on the Catcher and Kraken FPSOs respectively. All Catcher lease payments are charged direct to production costs as operating lease charges. Following acceptance of the Kraken FPSO in H2 2018, lease payments are separated into variable and fixed components, with the latter being calculated based on minimum charges in the lease agreement and being deducted against the lease liability on the Balance Sheet. If all lease payments are included as operating costs, production costs were US$20.49/boe. Effective 1 January 2019, the Company will adopt IFRS 16 resulting in recognition of Catcher minimum lease commitments as an asset and liability on the Balance Sheet, aligning the accounting with that of the Kraken FPSO.

Movements in oil inventory and underlift positions, measured at market value, of US$7.7m (2017: US$15.8m), were charged against cost of sales in the period. The Company's accounting for revenue and the classification and measurement of underlift is unaffected by the implementation of IFRS 15.

Unsuccessful exploration costs of US$15.5m (2017: US$2.2m), primarily relating to the operated Ekland unsuccessful well.

At year end, the Company has reviewed its exploration and appraisal and its development and producing assets for indicators of impairment and performed impairment tests where indicators were identified. With up to 18 months of performance history now available, the remaining oil and gas reserves and production profiles have been reassessed, resulting in an impairment charge of US$147.5m arising on the Kraken asset. No impairment charge has been recognised in relation to the Catcher asset.

Finance income includes exchange gains in the current year of US$16.3m. Finance costs in the period include loan interest and facility fees on the group Reserve Based Lending facility ("RBL") of US$18.6m and finance lease interest of US$7.7m.

Net cash inflow from operating activities for the year of US$174.1m (2017: US$52.8m) reflects net cash generated from oil and gas sales after deducting administrative costs and pre-award costs. Adding back these expenses leads to a net cash inflow from oil and gas production of US$177.5m in the year (2017: US$54.4m)

Cash outflows on exploration expenditure was US$29.3m in the year (2017: US$4.0m) mainly relating to the Agar-Plantain and Ekland wells.

Development and producing asset cash outflows in the year was US$98.3.m (2017: US$145.4m) related to costs on Kraken and Catcher.

The Company had net debt of US$474.9m at 31 December 2018, representing a net cash outflow of US$96.9m over the year, after taking into account the waived intercompany loans on US$420.5m. Borrowings under the RBL facility at 31 December 2018 were US$85m, all drawn in the year, before adjusting for unamortised facility fees and accrued interest for disclosure in the Financial Statements.

Strategic Report

Included in the Strategic Report are the Company's Business Review and principal risks and uncertainties

Directors

The Directors of the Company during the year ended 31 December 2018 and up to the date of signing the financial statements were:

Simon J Thomson

James D Smith

Paul Joseph Mayland

Brita Holstad

The Company maintains qualifying 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.

Going concern

Following the Board's review of the Company's financial position and forward cash forecasts, the Directors have secured appropriate assurances from ultimate parent Company, to ensure the Company meet its liabilities as and when they fall due for the foreseeable future and for a period of at least twelve months from the date of authorisation of these financial statements. Hence, these financial statements have been prepared on a going concern basis.

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
3 April 2019

STRATEGIC REPORT

Results and Dividend

The Company's loss for the year ended 31 December 2018 was US$111.0m (2017: loss of US$10.4m). The Company has not paid or declared a dividend in respect of the current or prior year.

Business Review

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 licence round applications.

The Company's strategy and business model are linked to those of the Cairn Energy PLC group ("the Group") during the year and the information that fulfils the requirements of the Strategic Report can be found in the Strategic Report section of the Group's annual report on pages 1 to 65, which does not form part of this report.

Principal Risks and Uncertainties

From the perspective of the Company, the principal risks and uncertainties are integrated with the principal risks of the group and are not managed separately. Accordingly, the principal risks and uncertainties of the group which include those of the Company, are discussed in pages 32 to 40 of the Group's annual report which does not form part of this report.

Key Performance Indicators

The key performance indicators of the Company are the same as that of the Group. These are discussed on pages 6 to 9 of the Group's annual report which does not form part of this report.

On behalf of the Board

Brita Holstad

Brita Holstad

Director
Nautical Petroleum Limited
3 April 2019

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 2018 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (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 2018; the income statement, the statement of comprehensive income/(expense), the statement of cash flows, and 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

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.

We have nothing to report in respect of the above matters.

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. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

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 Strategic Report and 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.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 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 Strategic Report and 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.

Lindsay Gardiner (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
03 April 2019

INCOME STATEMENT

For the year ended 31 December 2018

	Note(s) 19	2018 $'000	2017 $'000 (restated)
Revenue	15	409 106	22 369
Cost of sales	15	(131 409)	(5 934)
Depletion and amortisation	7	(169 089)	(19 817)
Gross Operating Profit/(Loss)		**108 608**	**(3 382)**
Pre-award costs		(2 904)	(1 711)
Unsuccessful exploration costs	6	(15 473)	(2 202)
Impairment/liquidation of investment in subsidiary	17	(148)	(768)
Impairment of capitalised development assets	7	(147 508)	-
Gain on sales of assets		-	42
Administrative expenses	2, 3	(518)	34
Operating loss		**(57 943)**	**(7 987)**
Finance income	5	16 264	6 429
Finance costs	5	(69 335)	(12 032)
Loss before taxation		**(111 014)**	**(13 590)**
Taxation	4	-	3 221
Loss for the year		**(111 014)**	**(10 369)**

STATEMENT OF COMPREHENSIVE INCOME/EXPENSE

For the year ended 31 December 2018

		2018 $'000	2017 $'000 (restated)
Loss for the year		(111 014)	(10 369)
Other Comprehensive Income - items that may be recycled to the Income Statement			
Fair value on hedge options	11	36 086	(2 907)
Hedging loss recycled to the Income Statement	15	7 806	-
Other Comprehensive Income/(expense) for the year		43 892	(2 907)
Total Comprehensive expense for the year		(67 122)	(13 276)

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note(s)	2018 $'000	2017 $'000 (restated)	2016 $'000 (restated)
ASSETS				
Non-current assets				
Intangible exploration /appraisal assets	6	41 241	22 384	18 789
Property, plant & equipment - development/producing assets	7	901 848	1 186 272	728 791
Derivative financial instruments	11	7 700	-	-
Investments	17	15 642	15 767	15 127
Total non-current assets		966 431	1 224 423	762 707
Current assets				
Inventory and spare parts	16	8 235	11 149	-
Trade and other receivables	8	62 280	22 330	21 741
Derivative financial instruments	11	36 655	-	-
Bank deposits		-	-	96
Cash and cash equivalents	11	161 509	55 029	930
Total current assets		268 679	88 508	22 767
TOTAL ASSETS		1 235 110	1 312 931	785 474
Non-current liabilities				
Loans and borrowings	9	(85 000)	-	-
Finance lease liabilities	9, 14	(146 888)	(168 236)	-
Deferred revenue	9	(30 826)	(49 590)	-
Provisions - decommissioning	9, 13	(117 828)	(116 928)	(74 323)
Total non-current liabilities		(380 542)	(334 754)	(74 323)
Current liabilities				
Loans and borrowings from group companies	9	(326 589)	(770 660)	(565 878)
Trade and other payables	9, 10, 14	(77 906)	(84 261)	(55 527)
Deferred revenue	9	(21 964)	(24 385)	-
Provisions- unused rig days	7, 9, 13	-	(24 174)	(8 840)
Total current liabilities		(426 459)	(903 480)	(630 245)
Total liabilities		(807 001)	(1 238 234)	(704 568)
NET ASSETS		428 109	74 697	80 906
Capital and reserves				
Called-up share capital	12	24 873	24 873	22 708
Share premium		93 070	93 070	84 971
Hedge reserve		40 985	(2 907)	-
Retained Earnings (accumulated losses)		269 181	(40 339)	(26 773)
TOTAL EQUITY		428 109	74 697	80 906

The financial statements on pages 11 to 51 were approved by the Board of Directors on 3 April 2019 and signed on its behalf by

Brita Holstad

Brita Holstad
Director

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

Amounts in $ '000	Called up Share capital	Share premium	Hedge reserves (restated)	Retained Earnings / Accumulated losses	Total equity
At 1 January 2016	22 708	84 971	-	(51 275)	56 404
Profit for the year and total comprehensive income	-	-	-	26 889	26 889
Change in presentation currency*	-	-	-	(2 387)	(2 387)
At 31 December 2016 (restated)	22 708	84 971	-	(26 773)	80 906
Change in presentation currency*	2 165	8 099	-	(3 197)	7 067
Fair value on hedge options**	-	-	(2 907)	-	(2 907)
Loss for the year	-	-	-	(10 369)	(10 369)
At 31 December 2017 (restated)	24 873	93 070	(2 907)	(40 339)	74 697
Loss for the year	-	-	-	(111 014)	(111 014)
Fair value on hedge options	-	-	36 086	-	36 086
Hedging loss recycled to Income Statement	-	-	7 806	-	7 806
Waived intercompany loan	-	-	-	420 534	420 534
At 31 December 2018	24 873	93 070	40 985	269 181	428 109

*Change in presentation currency, see note 1o), for details of change in functional and presentation currency.

** Change in accounting policy, see note 1b), for details of changes in accounting policy as a result of the adoption of IFRS 9

STATEMENT OF CASH FLOW

For the year ended 31 December 2018

	2018 $'000	2017 $'000
OPERATING ACTIVITIES		
Loss before taxation	(111 014)	(13 590)
Unsuccessful exploration costs	15 473	2 202
Depletion and Amortisation	169 089	19 817
Impairment of capitalised development assets	147 508	-
Impairment of investment subsidiary	124	801
Movement of inventory and spare parts	2 914	(11 148)
Discounted financial activities	9 875	4 442
Finance cost	(6 698)	(2 907)
Trade and other receivables movements	(34 967)	(6 280)
Trade and other payables movements	3 001	(14 560)
Net deferred revenue (released/received)	(21 185)	73 975
Net cash generated from operating activities	174 120	52 752
INVESTING ACTIVITIES		
Additions to property, plant and equipment - development / producing assets	(98 349)	(145 446)
Disposals of property, plant and equipment - development / producing assets	-	92
Additions to exploration expenditure capitalised	(29 349)	(4 007)
Net Cash used in investing activities	(127 698)	(149 361)
FINANCING ACTIVITIES		
Loans and borrowings from group companies	(22 298)	148 842
Loans from financial institutions	85 000	-
Financial lease reimbursement	4 762	1 402
Financial lease payments	(7 406)	-
Net Cash generated from financing activities	60 058	150 244
Net increase in cash and cash equivalents	106 480	53 635
Cash and cash equivalents at the beginning of the year	55 029	930
Translation difference	-	464
Cash and cash equivalents at the end of the year	161 509	55 029

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 2018 were authorised for issue in accordance with a resolution of the Directors on 3 April 2019. The Company is incorporated in England and domiciled in the UK. The registered office is located at Wellington House, 125 Strand, London, England.

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 International Financial Reporting Standards ("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 IFRS, issued by the International Accounting Standards Board ("IASB") as adopted by the EU, and interpretation issued by the International Financial Reporting Interpretations Committee ("IFRIC"). The Company's financial statements are also consistent with IFRS as issued by the IASB as they apply to accounting periods ended 31 December 2018.

Effective 1 January 2018, the Company has adopted the following amendments to standards:

- Amendments to IAS 28 Investments in Associates and Joint Ventures
- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers

Note 1: Significant accounting policies (continued)

In addition, the Company has adopted the following interpretation issued by IFRIC:

- IFRIC 23 Uncertainty over Income Tax Treatments

The following standard, issued by the IASB and endorsed by the EU has yet to be adopted by the Company:

- IFRS 16 Leases (effective 1 January 2019)

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 statements disclosures.

IFRS 9 Financial instruments

Adoption of IFRS 9 Financial Instruments on 1 January 2018 has resulted in re-classification of the Company's change in fair value relating to the time value of an option, designated for hedged accounting. IFRS 9 requires the change in fair value relating to the time value of an option, designated for hedge accounting, to be recorded in other comprehensive income, whereas previously the Company had recorded such movements through the Income Statement. The changes have been applied fully retrospectively and result in the restatement of comparative information details of which can be found in note 19. The adoption of IFRS 9 has also resulted in a change in policy for receivable loss allowance recognition, further detail is given in note 1f). The change in policy has not had a material impact on the financial statements for 2018.

Other standards and amendments effective 1 January 2018

The other changes to IFRS effective 1 January 2018, including the adoption of IFRS 15 "Revenue from Contracts with Customers", have no significant impact on the Company's financial statements. Relevant accounting policies have been reviewed and updated to reflect adoption of IFRS 15 but given that the Company's customers are clearly identified, the performance obligations easily identifiable and the price readily determinable, the changes to policies have no impact on the resulting accounting.

IFRIC 23 Uncertainty over income tax treatments

The Company have chosen to adopt IFRIC 23 in advance of its effective date of 1 January 2019. This interpretation provides guidance on how uncertain tax treatments should be addressed and requires an entity to assess the probability of an uncertain tax position being accepted by the relevant taxation authority. The interpretation has been applied in calculating unused tax losses disclosed in the notes to the financial statements. The prior year impact of adoption is not material and comparative disclosure has not been amended.

Note 1: Significant accounting policies (continued)

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.

In assessing the impact of IFRS 16, the Company have identified one asset where accounting treatment will change:

- Accounting for the FPSO on the Catcher producing asset

All other leases are either for periods of less than one-year or have less than one year remaining on the date of adoption, such as drilling rigs to be used in the Company's exploration and development activities or are for low-value items which have no material impact on the Company's financial statements. Additional disclosure will be provided in the 2019 financial statements relating to these leases where material.

The Catcher FPSO is classified as an operating lease under the current accounting standard. Under IFRS 16 the Company will recognise a right-of-use asset and lease liability for the vessel based on the minimum lease commitment over the expected charter period. On initial adoption of IFRS 16, the Company will recognise a lease liability of US$147.5m and a corresponding right-of-use asset. Forecast minimum lease payments of US$33.9m in 2019 will reduce the lease liability rather than be charged against profit as a lease charge. Forecast finance lease interest charges on the Catcher FPSO for 2019 are US$7.2m. Variable lease charges in excess of the minimum commitment will continue to be charged against profit. The right-of-use asset will be amortised on a unit-of-production basis consistent with the Company's other development/producing assets. In the cash flow statement, minimum lease payments relating to the Catcher FPSO will be classified as financing cash flows; currently they are included in operating cash flows. Variable lease payments shall remain in operating cash flows.

There is no change in accounting for the Kraken FPSO which is currently accounted for as a finance lease.

Nautical Petroleum Limited 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. Assessing whether such contracts will be treated as a lease by Nautical Petroleum Limited is likely to be highly judgemental with assumptions and other considerations based on the right of substitution by the operator and the reasonable certainty of leases being extended beyond an initial period.

Note 1: Significant accounting policies (continued)

Details of current finance leases can be found in note 14, while current operating lease commitments are disclosed in note 13 as they relate to operating costs, and property, plant & equipment - development/producing assets.

c) Intangible exploration/appraisal assets

Costs

The Company follows a successful effort-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. Costs are recognised following a cost accumulation model where any contingent future costs on recognition of an asset are recognised only when incurred. This includes where the Company have entered into a "farm-in" agreement to either acquire or part-dispose of an exploration interest.

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.

Note 1: Significant accounting policies (continued)

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 & 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.

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.

Note 1: Significant accounting policies (continued)

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

Note 1: Significant accounting policies (continued)

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.

A farm-in is an agreement in which a party agrees to acquire from one or more of the existing licensees, an interest in an exploration licence, for a consideration which may consist of the performance of a specified work obligation on behalf of the existing licensees. This obligation may be subject to a monetary cap. Refund of full or partial costs incurred to date may also be included in a farm-in agreement. Where the Company have part-disposed of an exploration licence interest through a farm-in arrangement, a "farm-down", the contingent consideration payable by the third party on the Company's behalf is not recognised in the financial statements. The future economic benefit which the Company will receive as a result of the farm-down will be dependent upon future success of any exploration drilling.

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, financial assets at fair value through other comprehensive income or financial assets subsequently measured at amortised cost. The Company holds financial assets which are classified as financial assets held at fair value through profit or loss and financial assets at amortised cost.

Financial liabilities generally substantiate claims for repayment in cash or another financial asset. Financial liabilities are categorised as held at amortised cost. All of the Company's financial liabilities are held at amortised cost.

Note 1: Significant accounting policies (continued)

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

Trade and other receivables

Trade receivables represent sums due from the sale of oil and gas from the producing assets. Other receivables primarily represent recharges to joint operations. Financial assets are fair value gains arising from the hedging activities. Joint operation receivables are receivables that relate to the Company's interest in its oil and gas joint arrangements, including the Company's participating interest share of the other receivables of the joint arrangements themselves.

Trade receivables, other receivables and joint operation receivables, which are financial assets, are measured initially at fair value and subsequently recorded at amortised cost.

A loss allowance is recognised, where material, for expected credit losses on all financial assets held at the Balance Sheet date. Expected credit losses are the difference between the discounted contractual cash flows due to the Company, and the discounted actual cash flows that are expected to be received. Where there has been no significant increase in credit risk since initial recognition, the loss allowance is equal to 12-month expected credit losses. Where the increase in credit risk is considered significant, lifetime credit losses are provided. For trade receivables a lifetime credit loss is recognised on initial recognition where material.

Prepayments, which are not financial assets, are measured at historic cost.

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.

Note 1: Significant accounting policies (continued)

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 as a hedge for hedge accounting, changes in the intrinsic value of the hedged item and the time value of the option are recognised within other comprehensive income (where the hedge is effective) based on fair value and are reclassified to the Income Statement when the hedged production itself affects profit or loss. Hedge effectiveness is assessed on a prospective basis at commencement and throughout the life of the option. Any hedge ineffectiveness identified is immediately charged to the Income Statement.

Changes in the fair value of the time value of an 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.

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.

Note 1: Significant accounting policies (continued)

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 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 ownership have been passed to the buyer. This occurs when the customer takes delivery of a cargo of oil from the FPSO as this is the point in time that the consideration due is unconditional as only the passage of time is required before payment is due. Revenue is measured using the Brent (or estimated Brent) price plus or minus the applicable discount based on the quality of the oil.

Revenue from the sale of gas is recorded based on the volume of gas accepted each day by the customers at the delivery point.

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 is entitled.

m) Licence interests

The Company's principal licence 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)	20.0
UK (Offshore)	P1763	(Block 9/9d & 9/14a)	25.0**
UK (Offshore)	P2070	(Block 28/4a)	36.0
UK (Offshore)	P2312	(Blocks 3/16a & 3/17a)	60.0*
UK (Offshore)	P2379	(Blocks 22/11b, 22/12b, 22/16b & 22/17c)	40.0**
UK (Offshore)	P2381	(Blocks 22/13c & 22/18d)	40.0**
UK (Offshore)	P2393	(Block 28/10a)	60.0**
UK (Offshore)	P2453	(Block 28/9c)	20.0**
UK (Offshore)	P2454	(Block 28/9d)	36.0**

* Subject to regulatory approval following farm-down

** Awarded in 2018

Note 1: Significant accounting policies (continued)

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.

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 (2017: US$70 per boe) escalated at 2.0% (2017: 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 including assumptions on performance of assets;
- Cost profiles for the development of the field and subsequent operating costs supplied by the operator and escalated at 2.0% (2017: 2.0%) per annum; and
- Post-tax discount rates of 10% (2017: 10%).

Note 1: Significant accounting policies (continued)

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.

o) Foreign currencies

Effective, 1 January 2018, the functional and presentational currency of the Company, changed from GB£ to US$. This change reflects the significant revenue streams now being generated by the entity which are receivable in US$. Changes in functional currency are accounted for prospectively, therefore there is no adjustment to comparative information. The change in presentational currency, results in re-presentation of comparative information using the following exchange rates:

Rates of exchange to GB£1 were as follow:	US$
Closing 2016	1.2339
Closing 2017	1.3514
YTD Average 2017	1.2890

Note 2. Auditors' remuneration

The Company's auditors' remuneration of US$25,519 (2017: US$23,846) 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 (2017: US$ nil).

Note 3. Administrative expenses

	2018 $ '000	2017 $ '000
Wages and salaries	(20)	150
Social security costs	16	18
Pension costs	60	10
Professional Fees	17	68
Other administrative expenses	445	(279)
Total administrative expenses	518	(33)

The Company's monthly average number of employees was nil (2017: 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 US$3.7m (2017: US$3.5m) and pension contributions of US$0.3m (2017: US$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	2018 $ '000	2017 $ '000
Analysis of tax charge / (credit) in year:		
Other UK deferred tax credit	-	(3 221)
Total tax credit for the year	-	(3 221)

Expenditure incurred on Cairn's behalf by Dyas BV under the carry agreement, capitalised in property, plant & equipment - development assets, creates a deferred tax liability. UK deferred tax credits of US$ nil (2017: US$2.9m) were realised to offset this deferred tax liability and US$ nil (2017:US$0.3m) was released due to a change in tax rate.

Note 4: Taxation (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:

	2018 $ '000	2017 $ '000
Loss before tax	(111 014)	(13 590)
Loss before taxation multiplied by the average UK statutory rate of corporation tax of 19% (2017: 19.25%)	(21 093)	(2 616)
Effects of:		
Non-deductible expenses and non-taxable income	(628)	369
Special tax rates and reliefs applying to oil and gas activities	(33 738)	(30 325)
Tax losses surrendered to other group companies	1 510	656
Impact on deferred tax of adjustments in respect of prior years	2	(1 787)
Release of provision on carried interests due to change in tax rate	-	(321)
Temporary differences not recognised	53 947	30 803
Total tax credit for the year	-	(3 221)

The UK main rate of corporation tax is currently 19% (2017: 19.25%).

The applicable UK statutory tax rate applying to North Sea oil and gas activities is currently 40% (2017: 40%).

Deferred Tax Assets and Liabilities	Assets $'000	Liabilities $'000	Total $'000
Reconciliation of movement in deferred tax (assets)/liabilities:			
At 1 January 2017	-	-	-
Deferred tax movement on additions to development assets in respect of carried interests	3 221	-	3 221
Other deferred tax charge to income statement for the period	(3 221)	-	(3 221)
At 31 December 2017	-	-	-
Deferred tax movement on additions to development assets in respect of carried interests	-	-	-
Other deferred tax charge to income statement for the period	-	-	-
At 31 December 2018	-	-	-

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 US$116.4m (2017: US$164.7m); non-Ring Fence trading losses of US$3.7m(2017: US$3.7m); management expenses of US$0.6m (2017: US$1.9m); non trade loan relationship deficits of US$ nil (2017: US$0.8m); or on other ring fence temporary differences of US$117.8m (2017: US$116.9m) relating to decommissioning liabilities, as it is not deemed probable that sufficient 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

	2018 $ '000	2017 $ '000
Foreign exchange gain realised	-	3 333
Foreign exchange gain unrealised	16 264	2 836
Other financial income	-	260
Finance income	16 264	6 429
Foreign exchange loss realised	(6 000)	-
Interest payable to group companies	(32 518)	(7 424)
Unwind of discount on decommissioning provision	(2 107)	(1 904)
Finance lease interest	(7 769)	(2 510)
Loss on mark-to-market financial instrument	-	(290)
Facility fee amortisation	(15 123)	-
Loan interest	(3 461)	-
Other financial expenses	(2 357)	96
Finance costs	(69 335)	(12 032)
Net financial items	(53 071)	(5 603)

Finance income of US$16.3m is related to foreign exchange gain due to group loan in other currency than US$, Great British Pounds (GB£) (see note 17).

Out of the finance costs of US$69.3m, US$32.5m is interest payable on the amounts due to group undertakings (see note 9), US$2.1m (US$1.9m in 2017) is related to the unwind of discount on the decommissioning provision (see note 13), US$7.8m (US$2.5m in 2017) related to finance lease (see note 14), and US$18.6m (2017; US$ nil) related to the RBL facility (see note 9).

Note 6. Intangible exploration/appraisal assets

Amounts in $ '000	Capitalised exploration expenditure
Cost	
At 1 January 2017	21 539
Translation difference	2 054
Additions	4 007
Unsuccessful exploration costs	(2 202)
At 31 December 2017	25 397
Additions	34 330
Unsuccessful exploration costs	(15 473)
At 31 December 2018	44 254
Impairment	
At 1 January 2017	2 750
Translation difference	263
At 31 December 2017	3 013
At 31 December 2018	3 013
Net book value	
At 31 December 2016	18 789
At 31 December 2017	22 384
At 31 December 2018	41 241

Out of the total additions of US$34.3m, US$18.2m relates to the newly acquired P1763 Agar-Plantain licence, and US$13.2m is related to drilling of the Ekland well (licence P2184). In 2017 the addition of US$4.0m, mainly related to P2312 Chimera licence (US$3.0m).

Portfolio turnover during the year has resulted in the addition of six new licences, with two relinquished. The Company has also entered into a farm-out agreement for a 40 % non-operated interest in licence P2312 containing the Chimera prospect. This is conditional upon regulatory consent.

The Ekland well (licence P2184) was unsuccessful and related costs of US$14.6m where charged to the Income Statement in 2018. In 2017 unsuccessful exploration costs of US$2.2m was mainly related to the relinquished licence P2149 Scylla.

The net book value of exploration/appraisal assets remaining capitalised at year end of US$41.2m, includes cost of US$35.7m relating to discovered resource across two fields: the current year Agar-Plantain (P1763 licence) discovery (US$18.2m) and the Laverda (P2070 licence) discovery (US$17.5m). At 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 2017	732 568
Translation difference	69 819
Additions	201 802
Capitalised leased assets	177 505
Decommissioning asset additions	29 587
Disposals	(168)
At 31 December 2017	1 211 113
Additions	62 768
Capitalised leased assets remeasurement	(11 460)
Decommissioning asset additions	5 266
Dereocognition unused rig days	(24 401)
At 31 December 2018	1 243 286
Depletion, amortisation and impairment	
At 1 January 2017	(3 777)
Translation difference	(1 321)
Depletion and amortisation	(19 817)
Disposals	74
At 31 December 2017	(24 841)
Depletion and amortisation	(169 089)
Impairment	(147 508)
At 31 December 2018	(341 438)
Net book value	
At 31 December 2016	728 791
At 31 December 2017	1 186 272
At 31 December 2018	901 848

Kraken and Catcher fields ramped up production during 2018 with gross production of 30,300 and 43,000 boepd respectively. Combined depletion charges for the year were US$169.1m (2017: US$19.8m).

Kraken additions represent development activity spend of US$31.8m (2017: US$100.0m), all funded through cash and cash equivalents, which was offset by a US$23.0m reversal of accruals following the successful renegotiation of the development drilling rig contract. During 2017, there was a further US$9.6m of non-cash decommissioning asset increases. The asset remains unchanged in 2018.

On Catcher, cash additions during the year were US$28.8m (2017: US$83.9m) with further non-cash additions of US$5.3m (2017: $19.0m) relating to the increase in the Catcher decommissioning asset.

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

Leased assets

During 2017, US$200.8m, the net present value of future minimum lease payments was recorded on the Balance Sheet for the Kraken FPSO, as a right-of-use producing asset. Subsequent to initial recognition, the lease agreement was amended which reduced the finance lease liability by US$36.4m and a corresponding reduction to the leased production asset.

In the second half of 2018, the Kraken FPSO lease agreement was further amended resulting in a reduction of the lease liability and right-of-use asset by US$11.5m (see note 14)

Amortisation of US$18.2m (2017: US$3.4m) was charged against the FPSO right-of-use asset in the year.

Impairment Testing Sensitivity Analysis

At 31 December 2018, impairment tests were conducted on the Company's development/producing assets and on certain exploration/appraisal assets where indicators of impairment were identified.

The recoverable amount for all assets is based on fair value less costs of disposal estimated using discounted cash flow modelling. The key assumption used in determining the fair value are often subjective, such as the future long-term oil price assumption, or the operational performance of the assets. With the Company's two North Sea producing assets completing their first full year of production, reserve estimates have been updated to reflect the performance of fields to the Balance Sheet date, which have either been in line or exceeded pre-drill estimates for the Catcher asset but have been below expectations for the Kraken asset where performance issues with the FPSO have led to lower than expected daily production volumes. Following a downgrade of recoverable reserves in place at the year end, an impairment charge has been recorded on the Kraken asset of US$147.5m (2017: US$ nil). No impairment was identified on the Catcher asset.

The Company have run sensitivities on its long-term oil price assumption of US$70/boe, using alternate long-term price assumptions of US$65/boe and US$60/boe and a long-term assumption equal to the forward curve price at the end of the Company's three-year short-term assumption period (US$66.3/boe). These are considered to be reasonably possible changes for the purposes of sensitivity analysis.

There was no impairment of the Company's exploration/appraisal assets under any of the sensitivities run. The impact of these changes on the impairment recorded on the Company's development/producing assets is summarised below:

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

Reduction in long-term oil price assumption to:	Forward Curve $ '000	US$65 $ '000	US$60 $ '000
Impairment of development/producing assets	(187 117)	(199 817)	(253 917)
Total impairment	(187 117)	(199 817)	(253 917)

All impairment arising on development/producing asset sensitivities relates to the Kraken asset and the numbers above would replace the current impairment charge of US$147.5m

The Company's proved and probable and contingent reserve estimates are based on P50 probabilities. P10 and P90 estimates are also produced but would not provide a reasonable estimate to be used in calculating the fair value of the Company's assets. The reserve estimates are incorporated into production profiles which include assumptions on the performance of the asset. The Company's current assumptions imply a maximum uptime for producing assets of 85%-90%.

Further sensitivity analysis was performed on the Kraken asset reducing forecast production volumes and associated operating costs by 5% and 10%, as an approximation of a reduction in the uptime of the asset, which are seen as reasonably possible alternatives. With this reduced production, the following impairment charges would arise on development/producing assets:

Reduction in production volumes	5% reduction in production US$ '000	10% reduction in production US$ '000
Impairment of development/producing assets	(201 117)	(252 517)

Note 8. Trade and other receivables

	2018 $ '000	2017 $ '000
Amounts receivable from group companies	2 401	2 151
Trade receivables	42 660	2 044
Accrued income underlift	52	5 532
Share of joint operations prepayments	17 167	11 975
Other prepayments	-	628
Total trade and other receivables	62 280	22 330

The expected credit losses was not material for both 2018 and 2017. 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 share of joint operations prepayments, US$14.8m relates to overcalled funds, where US$6.1m relates to Kraken and US$7.1m relates to Catcher. In 2017, the share of joint operations prepayments, consisted of prepayment amount of US$5.9m related to Kraken and overcalled funds of US$6.3m related to Catcher.

At 31 December 2018, no amount within the Company's trade and other receivables, was past due or impaired (2017: US$ nil).

Note 9. Current and non-current liabilities

	2018 $ '000	2017 $ '000
Trade and other payables		
Trade payables	8 393	5 310
Share of joint operations payables	42 444	73 275
Other taxation and social security	(5)	176
Accruals and other payables	8 544	2 652
Finance lease liability	18 530	1 458
Financial liability on derivative contracts	-	1 390
Total trade and other payables	77 906	84 261
Loans and borrowings - Amounts payable to group companies	326 589	770 660
Deferred revenue	21 964	24 385
Provision - unused rig days	-	24 174
Total current liabilities	426 459	903 480

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

Non- current liabilities

	2018 $ '000	2017 $ '000
Debt to financial institution	85 000	-
Finance lease liability	146 888	168 236
Deferred revenue	30 826	49 590
Provisions - decommissioning	117 828	116 928
Total non-current liabilities	380 542	334 754

Reserve-based lending facility

The Company's is a part of the Cairn Energy PLC Group's RBL facility. Under the facility the Company can borrow against the producing assets Kraken and Catcher. At 31 December 2018 the Company had cash drawings of US$85.0m, all advanced in the year.

The Group have signed an extension to its existing RBL facility with a syndicate of international banks. The extension became effective 20 December 2018. Interest on outstanding debt is charged at the appropriate LIBOR for the currency drawn plus an applicable margin. The facility remains subject to bi-annual redeterminations, has a market standard suite of covenants and is cross-guaranteed by all Group companies' party to the facility. Debt is repayable in line with the amortisation of bank commitments over the period from 1 July 2022 to the extended final maturity date of 30 December 2025.

Under IFRS 9, the extension of the facility to December 2025 constitutes substantially different terms from the original and as such the financial liability relating to the original facility was extinguished on the date of the extension and replaced with a new liability based on the revised terms. This resulted in the acceleration of the amortisation of borrowing costs relating to the previous facility, resulting in a charge of US$15.1m to the Income Statement in the year. (2017: nil). The Company is recharged, from Group, borrowing cost allocated based on annual cash drawing under the facility.

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

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

	$ '000	$ '000
Opening liability	770 660	565 878
Loans advanced recoginsed in cash flow statement	85 000	148 842
Loans repaid recognised in cash flow statement	(22 298)	-
Loan waived	(420 534)	-
Decrease (increase) in intercompany payables	(1 239)	2 009
Facility fee, arrangement fees and bank charges	18 584	-
Less: Fess and charges charged direct to the income statment	18 584	-
Borrowing cost and interest payable	-	-
Translation difference	-	53 931
Closing liability	411 589	770 660
Amounts due less than one year:	326 589	770 660
Amounts due greater than one year:	85 000	-
Closing liability	411 589	770 660

FlowStream deferred revenue

	2018 $ '000	2017 $ '000
Opening deferred revenue	73 975	-
Fair value of proceeds received	-	74 600
Released during the year	(21 185)	(3 011)
Foreign exchange differences	-	2 386
Closing deferred revenue	52 790	73 975
Amounts expected to be released within one year	21 964	24 385
Amounts expected to be released after one year	30 826	49 590

Deferred revenue of US$52.8m relates to the stream agreement with FlowStream. Under the initial stream agreement, the Company received 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. 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.

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

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 2018 financial statements.

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.

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

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 2018.

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

	2018 $ '000	2017 $ '000
Financial instruments		
Loans and borrowings	411 589	770 660
Trade and other payables	77 906	84 261
Provisions - unused rig days	-	24 174
Long term lease liabilities	146 888	168 235
Less cash and cash equivalents	(161 509)	(55 029)
Net debt	474 874	992 301
Equity	428 109	74 697
Capital and net debt	902 983	1 066 998
Gearing ratio	53 %	93 %

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	
	2018	2017	2018	2017
	$ '000	$ '000	$ '000	$ '000
Financial assets				
Financial assets at amortised cost				
Cash and cash equivalents	161 509	55 029	161 509	55 029
Receivable from group companies	2 401	2 151	2 401	2 151
Other receivables	42 711	8 204	42 711	8 204
Derivative financial instruments				
Financial assets - hedge options	44 355	-	44 355	-
	250 976	65 384	250 976	65 384

	2018	2017	2018	2017
	$ '000	$ '000	$ '000	$ '000
Financial liabilities				
Fair value through other Comprehensive Income				
Financial liabilities on derivative contracts	-	1 390	-	1 390
Amortised cost				
Financial lease liabilities	165 418	169 694	165 418	169 694
Loans and borrowings	85 000	-	85 000	-
Loans and borrowing from Group companies	326 589	770 660	326 589	770 660
Trade and other payables	13 375	5 310	13 375	5 310
Share of joint operations payables	5 284	5 245	5 284	5 245
	595 666	952 299	595 666	952 299

Loans and borrowing from Group companies, trade and other payables and share of joint operations payables, 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

The expected financial maturity of the Company's financial liabilities at 31 December 2018 is as follows:

	< 1 year	1-2 years	2-5 years	>5 years
	$ '000	$ '000	$ '000	$ '000
Financial liabilities at amortised cost				
Loans and borrowing from Group companies	326 589	-	-	-
Financial lease liabilities	18 530	18 628	58 253	70 007
Trade and other payables	13 375	-	-	-
Share of joint operations payables	5 284	-	-	-
Loans and borrowings	-	-	-	85 000
	363 778	18 628	58 253	155 007

Note 11: Financial instruments (continued)

As at 31 December 2017, all the Company's financial liabilities were expected to mature within one year.

The Company's derivative financial instruments are classified as Level 2 in the fair value hierarchy.

Commodity price hedging

	2018	2017
	$ '000	$ '000
Non-current assets		
Financial assets – hedge options maturing after one year	7 700	-
Current assets		
Financial assets – hedge options maturing within one year	36 655	-
Current liabilities		
Financial liabilities – hedge options maturing within one year	-	(1 458)
	44 355	(1 458)

The Company currently have an active commodity price hedging programme in place to protect debt capacity and support committed capital programmes. A mark-to-market gain on oil price hedge options has created a financial asset as at 31 December 2018.

At 31 December 2018 the Company had hedged ~2.7m barrels of 2019 Kraken and Catcher oil production, using collar structures. The weighted average floor and ceiling prices are US$67.07/bbl and US$83.08/bbl respectively (all prices quoted relate to dated Brent). Also, at 31 December 2018, the Company had hedged ~500,000 barrels of 2020 oil production using a collar with floor and ceiling prices of US$67.50 and US$87.50 respectively.

The collar structures have been designated as hedges for hedge accounting. Hedge effectiveness is assessed at commencement of the option and prospectively thereafter. At the year end, the closing oil price was approximately US$50.7/bbl, below the floor price of all collars entered into. Fair value movements on the cost of the option are recorded in other comprehensive income in the period, with fair value gains of US$43.9m being recorded in the year (2017 restated: fair value loss of US$2.9m) offset by a loss of US$7.8m (2017: nil) on options that have matured. This loss is recycled to the Income Statement.

Note 11: Financial instruments (continued)

Effects of hedge accounting on financial position and loss for the year

	31 December 2018	31 December 2017
Volume of oil production hedged	3.2 mmbbls	1.4 mmbbls
Weighted average floor price of options	US$67.14	US$57.30
Weighted average ceiling price of options	US$83.81	US$67.50
Maturity dates	January 2019 – March 2020	January 2018 – December 2018
	2018 $ '000	2017 $ '000
Financial asset	44 355	-
Financial liability	-	(1 458)
Hedging gains/(loss) reported in other comprehensive income	36 086	(2 907)
Hedging loss recycled to Income Statement	7 806	-
Hedging loss recorded in income statement against revenue (note 15)	(7 806)	-

Sensitivity analysis has been performed on equity movements that would arise from changes in the year end oil price forward curve and the resulting impact on the fair value of open hedge options at the year end. The sensitivity analysis considers only the impact on line items directly relating to hedge accounts (being financial assets and fair gains through other comprehensive income) and not the impact of the change of other Balance Sheet items where valuation is based on the year-end oil price, such as inventory.

Change in year end oil price forward curve	Increase/ (decrease) in equity $ '000
Decrease of 10%	15 300
Decrease of 20%	31 500
Increase of 10%	(13 500)
Increase of 20%	(25 400)

Note 12. Called-up Share Capital

	No. of shares '000	$ '000
At 1 January 2018	92 022	24 873
At 31 December 2018	92 022	24 873

The total authorised number of ordinary shares at 31 December 2018 and 31 December 2017 was 92,022 of which all shares were in issue. The share capital consists of 92,022 ordinary shares of £0.20.

Note 13. Commitments and provisions

Expected contractual obligation/licence commitments

	2018 $ '000	2017 $ '000
Oil and gas expenditures		
Intangible exploration/appraisal assets – drilling rig commitments	10 121	21 447
Property, plant & equipment – development and producing assets	18 871	272 333
Contracted for:	28 992	293 780

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:

	2018 $ '000	2017 $ '000
Production cost - operating lease charges		
Not later than one year	33 884	33 931
After one year but no moer than five years	114 721	124 012
After five years	23 002	47 368
	171 607	205 311

Following adoption of IFRS 16 on 1 January 2019, accounting for the Catcher FPSO will change with a lease liability and right-of-use asset being recorded on the Balance Sheet. See note 1b for further detail.

Legal disputes

At 31 December 2018 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.

Note 13: Commitments and provisions (continued)

Decommissioning provisions

	2018 $ '000	2017 $ '000
Kraken	61 270	63 624
Catcher	56 558	53 304
Total decommissioning provisions	117 828	116 928

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 2040.

The costs are escalated at 2.0% per annum (2017: 2.0%) and discounted at a risk-free rate of 2.0% (2017: 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 US$200.8m 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 US$56.6m;
- 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 commencement rather than a rate determined in the lease agreement which could not be readily determined.

Note 14: Financial lease liabilities (continued)

Post initial recognition, adjustments of US$36.4m in 2017 and US$11.5m in 2018 have reduced the lease liability and right-of-use asset. The revised liability is computed based on updated minimum lease commitments using an interest rate calculated at the date of the modification.

	Minimum lease payments		**Present value of minimum lease payments**	
	31 December 2018 $ '000	31 December 2017 $ '000	31 December 2018 $ '000	31 December 2017 $ '000
Not later than one year	18 930	1 600	18 530	1 458
After one year but no more than five years	88 688	88 504	76 888	77 200
After five years	100 600	130 504	70 000	91 036
Total future minimum rentals payable	208 218	220 608	165 418	169 694
Less future finance charges	(42 800)	(50 914)		
Present value of minimum lease payments	165 418	169 694		
Long-term lease liability	146 888	168 236		
Short-term lease liability	18 530	1 458		

Reconciliation of opening and closing liability to cash flow movements

	2018 $ '000	2017 $ '000
Opening liability	169 694	-
Financial lease recognised on commencement	-	200 780
Revision to finance lease	(11 460)	(36 400)
Leases commenced and revisions to leases in the year	(11 460)	164 380
Lease payments net of reimbursements received	(30 106)	(6 000)
Variable lease payments through cost of sales	22 700	6 000
Finance lease reimbursements(payments) in cash flow statement	(7 406)	-
Reimbursement received from lessor	4 762	1 402
Reimbursement due transferred to other receivables	2 059	1 402
Finance lease interest	7 769	2 510
Other non-cash finance lease movements	9 828	3 912
Closing liability	165 418	169 694

Subsequent to initial recognition, the lease agreement was amended to incorporate an interim production period, commencing in November 2017 and which concluded on commencement of a second amendment agreement in September 2018. During this interim period, minimum lease payments were reduced to nil, with all lease payments dependent upon the availability and performance of the FPSO.

Note 14: Financial Lease Liabilities (continued)

The second amendment agreement provided additional compensation to the joint venture partners for ongoing performance issues with the FPSO and also introduced a zero-hire rate effective after 72 hours of a period of shutdown.

Amounts due to the Company from the lessor of US$3.0m (2017: US$1.4m) have been offset by the lessor against outstanding invoices disputed by the operator. The Company fully expects to recover this amount, and the receivable is recognised within other receivables.

Note 15. Revenues and cost of sales

	2018 $ '000	2017 $ '000
Oil Sales	393 160	19 498
Gas Sales	2 567	-
Loss on hedge options	(7 806)	-
Release of deferred revenue (see note 9)	21 185	3 011
Translation difference, release of deferred revenue	-	(140)
Revenue	409 106	22 369
Procuction and other costs	(64 180)	(14 952)
Oil inventory and underlift adjustment	(7 689)	15 820
Variable and operating lease charges	(59 540)	(6 802)
Cost of sales	(131 409)	(5 934)
Depletion and amortisation (see note 7)	(169 089)	(19 817)
Gross profit (loss)	108 608	(3 382)

Revenue

The Company receives revenue from its producing assets, Kraken and Catcher. Both assets commenced production during 2017. On Kraken, where oil is sold, the Company take a full lifting of crude on a scheduled basis to reflect the Company's working interest. On Catcher, the Company receive a percentage share of each lifting of crude and the Company's working interest share of gas sales. Payment terms are within 30 days.

Sales volume during the year average just under 16,000 boepd for the two assets combined, realising an average sales price of US$67.99/bbl.

Finance income received is disclosed in note 5.

Note 15: Revenue and cost of sales (continued)

Commodity price hedging

During 2018, the Company realised losses on hedge options of US$8.0m through the first ten months of the year as the oil price exceeded the ceiling on several hedge contracts. This was offset by gains of US$0.2m as the oil price fell back in November/December below the US$60/bbl floor on one hedging contract. Hedging losses are recycled to the Income Statement from other comprehensive income when the option matures.

Details of the Company's hedging position at 31 December can be found in note 11.

Cost of sales

Inventory of oil held at the year-end is recorded at a market value of US$8.2m (2017: US$10.4m). Underlift adjustments on Kraken production volumes were US$0.1m (2017: US$5.6m) at 31 December 2018. Variable finance lease costs on the Kraken FPSO of US$22.7m (2017: US$6.0m) are charged to the Income Statement US$36.8m (2017: US$1.0m) of operating lease charges on the Catcher FPSO.

Note 16. Inventory and spare parts

	2018 $ '000	2017 $ '000
Inventory of crude oil	8 235	10 443
Spare parts	-	706
Inventory and spare parts	8 235	11 149

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$50.7 (2017: 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, including a six % mark-up on the relevant hourly rate. Other charges, such as bank facility payments are recharged without mark-up.

	2018 $ '000	2017 $ '000
Net invoiced from group companies	(16 579)	(9 235)
Net invoiced to group companies	-	526

Balances which are outstanding with group companies at the Balance Sheet date:	2018 $ '000	2017 $ '000
Amounts receivable from group companies	2 401	2 151
Amounts payable to group companies	(326 589)	(770 660)

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

Note 17: Related party transactions and investments (continued)

Investments in related parties

Cost - Amounts in $ '000	Investments in group companies
At 1 January 2017	20 583
Liquidations	(768)
Translation difference	1 929
At 31 December 2017 and 1 January 2018	21 744
Additions	23
At 31 December 2018	21 767

Impairment - Amounts in $ '000	
At 1 January 2017	5 456
Translation difference	521
At 31 December 2017 and 1 January 2018	5 977
Impairment	148
At 31 December 2018	6 125

Net book value at 31 December 2018	15 642
Net book value at 31 December 2017	15 767

The Company's subsidiaries as at the Balance Sheet date are set out below.

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	Production	Switzerland	UK	Baarerstrasse 8, 6300 Zug, Switzerland
Alba Resources Limited	Exploration	Scotland	UK	50 Lothian Road, Edinburgh, EH3 9BY
Nautical Holdings Limited	Holding company	England	UK	Wellington House 4th Floor, 125 The Strand, London, WC2R 0AP
Nautical Italia SRL	Non-trading	Italy	Italy	Piazza Pietro Merolli n. 2, 00151 Roma, Italy
Transunion Petroleum Italia SRL	Non-trading	Italy	Italy	Piazza Pietro Merolli n. 2, 00151 Roma, Italy
UAH Limited	Holding company	England	UK	Wellington House 4th Floor, 125 The Strand, London, WC2R 0AP

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 address mentioned above.

Note 19. Restatement of Comparative Financial Statements on adoption of IFRS 9

Year ended 31 December 2017	Converted Financial Statements* $ '000	IFRS 9 restatement – hedge option $ '000	Restated December 2017 $ '000
Income Statement			
Operating loss	(7 987)	-	(7 987)
Finance income	6 429	-	6 429
Finance costs	(14 939)	2 907	(12 032)
Loss before taxation from continuing operations	(16 497)	2 907	(13 590)
Taxation	3 221	-	3 221
Loss for the year attributable to equity holders of the parent	(13 276)	2 907	(10 369)
Statement of Comprehensive Income			
Profit for the year	(13 276)	2 907	(10 369)
Fair value on hedge options	-	(2 907)	(2 907)
Other comprehensive (expense)/income for the year	-	(2 907)	(2 907)
Total comprehensive expense for the year	(13 276)	-	(13 276)
Balance Sheet			
Hedge reserve	-	(2 907)	(2 907)
Retained earnings (accumulateed losses)	(43 246)	2 907	(40 339)
Total equity	74 697	-	74 697

The adoption of IFRS 9 has no other impact on the assets or liabilities recorded and presented in the Group's 2016 year-end Balance Sheet.

*Last year Financial Statement have been converted from GB£ to US$, see note 1o) for details of change in presentational currency.