Vostok Energy Plc

Annual Report and Financial Statements
31 December 2010

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Annual Report and Financial Statements 2010

Contents

Vostok Energy Plc

Company information

Registered No 05806076

Directors
Charles Jamieson *(Executive Chairman)*
Robert Cathery *(Executive Director)*
Blaine Karst *(Finance Director)*
Roger Cagle
Ronald Harris
John Orange
Mark Sadykhov
Jacob Ulrich

Secretary
Tony Hunter

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Executive Chairman's statement

SARATOV REGION AND BORTOVOY LICENCE LOCATION

Vostok Energy Public Limited Company ("the Company") and its subsidiaries ("the Group" or "Vostok") remain focused on adding shareholder value through increasing reserves and production The Group's work programme has been based on three principal objectives continued exploration of the hydrocarbon potential of the Bortovoy licence (the "licence") via additional seismic and exploratory drilling, appraisal of the Group's known reserves through appraisal/development drilling and re-evaluation of existing seismic and other technical data, and commercialising the gas reserves through construction of a gas processing facility while increasing available production capacity through development drilling and acid matrix and fracturing programmes on selected wells

Exploration Activities

In December 2010 the Group completed drilling its first Devonian well in the eastern area of the licence Testing of the well began in January 2011 Subsequent to year-end the deeper horizons in the Devonian were successfully tested resulting in a significant increase in reserves for the eastern licence area

The Devonian prospect was identified by our geological team based on the 3D seismic acquired during the previous year as part of our on-going seismic acquisition At year-end, a 300 square kilometre 3D seismic acquisition programme was underway to further delineate prospects in the eastern area of the licence

Appraisal/Development Activities

During the year an extensive acid matrix programme was completed in the western area of the licence providing production capabilities for the western gas plant that now exceed production capacity by over 50%

Commercialisation

With the start-up of the gas processing facility in November 2010, the Group achieved a key milestone in its strategy with the commercialisation of the reserves in the western area of the licence

The Company expects now to be able to fund its current operations and a basic capital programme from cash flow The goal is to obtain funds for the construction of a second gas processing plant in the eastern area of the licence through an Initial Public Offering of shares or other fundraising to be completed in the latter part of 2011

Business Review
Review of Operations

Drilling and re-entries

Exploration drilling
West Area
No exploratory drilling was undertaken in the west area of the licence during 2010

East Area
Lower Permian
In the eastern area of the licence the Group completed drilling the Timoninskoye 44 exploration well which was begun during Q4 of 2009 in fulfilment of licence commitment obligations The well was drilled to a total depth of 1,800m to test a lower Permian Timoninskoye bank margin reef prospect Geophysical logs and core data over the prospective lower Permian intervals indicated that the reservoir section was of lower than anticipated porosity and permeability albeit hydrocarbon (oil) saturated Initial completion and testing of this interval failed to recover hydrocarbons in commercial quantities and at year end the well was suspended pending proposed further evaluation and possible acid fracturing Two additional lower Permian exploration wells, Muravlinskaya-1 and East Lipovskaya-1 were drilled during Q1 and Q2 2010, however, both wells encountered similar hydrocarbon, oil and gas saturated, low porosity and permeability reservoir sections in the prospective lower Permian reservoir intervals Completion and testing undertaken on the Muravlinskaya-1 well recovered both oil and gas in non-commercial quantities whilst the anticipated reservoir interval in the East Lipovskoye-1 well failed to recover significant quantities of hydrocarbons

The drilling location of both wells had been selected based upon structural interpretation of the initial processing of 2008-2009 3D seismic data undertaken by the acquisition company During 2010 Vostok's technical staff subsequently commissioned the reprocessing of this data to be undertaken by Paradigm Geophysical Ltd , the contractor which had previously processed all of the 2D seismic data acquired by Vostok during 2007-2009 The interpretation of the Paradigm processing of the 3D data available during Q3 2010 indicates that both the Muravlinskaya-1 and East Lipovskoye-1 were likely not optimally located on the lower Permian bank margin reef structure At year end both wells were suspended pending further evaluation and possible further completion and testing using acid fracturing techniques

Devonian
The Nepryakhinskaya-1 Devonian exploration well commenced drilling in April 2010 and completed drilling at a total depth of 4,650 metres in the lower Devonian in late November The well was logged using both Russian and western geophysical logging services and based upon both preliminary log analysis and high background gas shows whilst drilling the well was being cased to total depth at year end

Development drilling
As a result of a successful development drilling in the Karpenskoye Field during 2009 no additional development wells were required to be drilled for gas deliverability in the west area of the Licence in 2010

Well re-entries and recompletions
During 2010 the Company acquired all rights to three additional wells within the Karpenskoye field area, wells No 7, No 19, and No 52 These wells are located within the hydrocarbon-bearing area of the field and are scheduled for re-completion and testing during 2011

Business review
Review of Operations

BORTOVOY LICENCE

Acid fracturing and stimulation
Two wells, Karpenskoye-13 and Karpenskoye 17 of Vostok's 7 well acid fracturing and stimulation programme began in the Karpenskoye Field during Q4 2009 were successfully treated and tested early in 2010 The additional gas production from these 2 wells resulted in production capability of the field exceeding the 1 47 million m³ per day maximum capacity requirement of the gas plant

Seismic activity

Conventional 2D seismic
During 2010 further seismic interpretation work and selected custom reprocessing was ongoing on the Group's extensive 2D seismic data base which was acquired in 2007 and 2008 and upon older existing 2D seismic data

Where possible this data was integrated with data from existing wells to increase the inventory of exploration prospects and leads on the licence

3D Seismic
Interpretation of the deeper Devonian and Carboniferous intervals in the easternmost licence area revealed a number of prospective exploration plays based upon which the Group commenced drilling the Nepryakhinskaya-1 Devonian exploration well during April 2010 In addition, the structural detail provided by 3D data for the Devonian interval has assisted in developing play concepts elsewhere on the licence A 150 square kilometers 3D seismic acquisition programme covering the West Lipovskoye field and Timoninskoye prospect areas located immediately to the west of the 2008-09 3D programme was begun during Q4 2009 and continued during Q1 2010 Acquisition of this survey was, however only partially completed due to surface access problems caused by an early spring thaw A third 180 km2 3D seismic acquisition campaign was begun late in 2010 and was ongoing at year end This survey will complete the acquisition of data outstanding in the 2009-10 programme area and will extend the Company's area of 3D coverage to the west to include the Kochkurovskoye area

Geological and geophysical evaluations

West Area
In the western area of the licence geophysical and geological work undertaken since 2007 has provided for the identification of prospect leads on the continuation of the lower Permian bank margin between the Karpenskoye and Mokrousovskoye fields and for refinement of potential future lower Permian exploration drilling prospects in the Krasnokutskoye area In the area to the north and west of the Mokrousovskoye field this work has also allowed for refinement of prospect leads relating to the upper Carboniferous bank margin which was identified in 2008 and possible deeper middle and upper Devonian structural prospects No further geophysical or geological work was undertaken in the west area during 2010

Business review

Review of Operations

Central Area

Interpretation of the conventional 2D seismic acquired in 2008 across the central area of the licence demonstrated that the central area, of the licence lying between the Mokrousovskoye and Pavlovskoye fields, is occupied by a basement uplift which has structurally elevated older, Devonian and Carboniferous sediments by about 1000m relative to the east and west areas and displaced the basin margin southwards beyond the boundary of the licence The central licence area is currently indicated to be less prospective than the remaining areas of the licence and no additional geological or geophysical work was conducted on the area during 2010

East Area

The east area of the licence has been the Company's main area of focus for geophysical and geological work during 2010 in support of proposed future development and exploitation of both gas and liquids

Devonian and Carboniferous

Due to their potential magnitude and significance the emphasis of geological and geophysical work conducted during 2010 has been primarily upon the potential prospective resources of the Devonian interval This work was undertaken in an effort to further identify the depositional, structural and tectonic controls that have been in play to develop seismically identified prospects, and to understand the influences that these factors have exerted upon defining the prospectivity of overlying sedimentary intervals, particularly the Carboniferous

Based upon positive indications that were encountered whilst drilling the Nepriyakhinskaya-1 Devonian exploration well during Q3 and Q4 of 2010, the company developed a contingent schedule and strategy for drilling additional Devonian wells in combination with superimposed Carboniferous prospects during 2011

Lower Permian

Additional work on lower Permian prospects drilled during 2010 as well as prospects proposed for future drilling was also initiated during 2010 This involved attempting to rationalize the results of recently drilled lower Permian wells based upon interpretation of customized reprocessing of 3D seismic data by Paradigm Geophysical Ltd in Moscow in combination with seismic character analysis It is hoped that these studies will aid in defining those areas of lower Permian carbonate reef build ups with higher primary (depositional) porosity that can serve as hydrocarbon reservoirs

Reserves evaluation

In October 2010 Vostok's independent engineers, Miller and Lents, prepared a revised reserves evaluation report as of 1 September 2010 in support of the Company's initiative to secure a UK public listing Miller and Lents revised their 31 May 2010 estimate of economic recoverable 3P reserves of the Group from 728 5 Bcf of natural gas and 21 7 MMBbl of oil and condensate to 714 Bcf and 20 0 MMBbl of oil and condensate and their estimate of Proven P1 Reserves from 526 to 519 Bcf of gas and from 15 6 to 13 3 MMBbl of oil Proven natural gas reserves of the Group increased overall from 390 Bcf to 545 Bcf

Future developments

Other than for two infill oil development wells in the Karpenskoye field no further drilling is proposed for the west area during 2011 Instead the Group will continue to focus its drilling and completion activities together with its geological and geophysical activity upon evaluating and increasing reserves and resources in the eastern area of the licence This will involve an exploration drilling programme comprising at least one Devonian exploration well to be drilled on the Muravlinskaya prospect, a possible second Devonian exploration well to be drilled based upon the interpretation results of 3D seismic currently being acquired and one lower Permian exploration well

Business review

Financial review

Review of 2010 results

The Annual Report and Financial Statements are prepared under International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") The Group uses US dollars as its presentation currency The Group revenue for 2010 was 276 thousand USD (2009 – 46 thousand USD) and the loss after taxation was 22 490 million USD (2009 – 11 860 million USD) Detailed Group financial information is set out in the audited financial statements for 2010 on pages 13-45 of this report

The Group is predominantly in an exploration and development phase and standard key performance indicators such as growth in sales, returns on invested capital and employee retention figures are not true indicators of group performance The key performance indicators at 31 December were

	2010	2009
Proven gas reserves in billion cubic feet [1]	519 0	544 8
Proven oil reserves in millions of barrels [1]	13 3	14 6
Available production capacity of gas in million cubic feet per day	72 2	59 5
Revenue for the year (in millions of USD) [2]	0 3	0 0
Loss for the year (in millions of USD)	22 5	11 1

[1] The gas and oil reserves are based on the most recent independent engineer's reports The decrease in reserves resulted from re-evaluating the field structures on the licence based on recent drilling and re-entry results and the interpretation of recently acquired 3D seismic

[2] The increase in revenue resulted from the gas plant which was under commissioning and had some limited production from November 2010 to the end of the year

On 26 November 2010 the Company achieved a major milestone with first gas production from the Karpenskoye gas plant At year-end, the gas plant was still going through commissioning and had only intermittent production

Corporate events

On 20 July 2010 the Company issued an additional 1,840,000 shares to the Employee Benefit Trust (the "EBT") bringing the total number shares issued to the EBT for employees to 3,800,000

On 13 October 2010 the Company finalised a convertible debt financing of 50 million USD with Deutsch Bank, the proceeds of which were to be used to complete the development of the gas plant and cover corporate administrative expenses The debt is convertible at a price of an Initial Public Offering ("IPO") which is being planned by the Company for 2011

Charitable donations and social responsibility

The primary Group operations are in the Saratov region in Russia and it is one of the goals of the Group to provide support to the local community to ensure the region benefits from the Group's presence on an enduring basis During the year, the Group spent 121 thousand USD (2009 – 201 thousand USD) on sponsorships and charitable donations for local government and non-governmental agencies that support local development and industry and for agencies focusing on maintaining and improving local environmental standards

Events since the end of the year

There have been no significant events since the end of the year

Business review

Risk Management

Financial

The Finance Director is responsible for the Company's financial risk management function and the Audit Committee provides oversight of this while ultimate approval on financial decisions remains with the Board of Directors

Operations and commercial

The main activity of the Group is the exploration, development and production of gas The Group currently sells all gas produced to a subsidiary of OJSC Gazprom, the Saratov Gas Company LLC The selling price as set out in the agreement is calculated at a 20% discount to the weighted average selling price for commercial and domestic gas consumers in the Saratov region as determined by the Russian Tariff Service For 2010, this price was 61 72 USD (1,927 roubles) per thousand cubic meters of gas The contract sets out volumes to be delivered however the volumes can be amended based on mutual agreement and Gazprom is only required to pay for the gas actually delivered

There is oil and condensate associated with the production of gas reserves The Group sells the oil and condensate at "spot" rates based on contracts with selected customers who pay for the oil at or prior to delivery Given the limited oil production to date, the Group does not maintain any fixed price or long term marketing contracts Although gas and oil market prices may fluctuate, as a general policy, the Group does not and does not intend to hedge gas and oil sales Under appropriate circumstances such as taking advantage of attractive prices, the Group may engage in longer term sales contracts and price hedging

The Group maintains insurance over operations as required by local regulations In addition, the Group maintains internationally placed insurance coverage for their field assets, drilling and operating activities in Russia in recognition of the risks associated with expanded operations While the Group recognises the inherent political and economic risks of working in Russia, the Group has made the decision not to carry any political risk or associated business interruption coverage The Group reviews overall insurance requirements regularly to ensure a proper balance between exposure and coverage

Operating environment

Ongoing operations and those of similar companies in Russia are subject to the prevailing economic, political and regulatory uncertainties

The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition These characteristics have in the past included higher than normal inflation, lack of liquidity in the capital markets and the existence of currency controls which cause the national currency to be illiquid outside Russia The continued success and stability of the Russian economy will be significantly impacted by the government's continued actions with regard to supervisory, legal and economic reforms

Business review

Risk Management

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently Management's interpretation of such legislation as applied to the transactions and activity of the Group in Russia may be challenged by the relevant regional and federal authorities Based on reviews and audits performed to date by the relevant authorities, there have been no significant tax fines or penalties incurred and management believes that as of 31 December 2010, its interpretation of the relevant legislation is appropriate and the Group's tax and currency positions will be sustained

Strategic and reputational

The Company is committed to promoting and developing high standards of corporate responsibility Responsibility for ensuring that these are followed lies with the Board of Directors and senior executive officers and staff The Company believes that by incorporating high standards into its corporate culture, the Company's risk profile is reduced

A comprehensive set of procedures and policies is maintained at both head office and the operational level to ensure effective operations The Company reviews the Group's policies and procedures on an ongoing basis including environmental policies to ensure compliance with local and international standards The Group has developed a comprehensive environmental monitoring and reporting system and when required, the Company employs independent advisors to ensure good practise is achieved

Financial Risks

A review of financial risks is included in note 26 to the Financial Statements

Directors' report

The directors of the Company present their report and financial statements for the year ended 31 December 2010

Principal activity and review of the business
The principal activities of the Group during the year were exploration, development and production of natural gas and hydrocarbon liquids The Group's operating activities during 2010 were in Russia where the Group holds a sub-soil licence for geological exploration and production of hydrocarbons

Business Review
A review of the Group's business during the year and its future prospects is included in the Executive Chairman's Statement and Business Review on pages 3-9 which should be read in conjunction with this report of which they form part and in which they are incorporated by reference

Board of Directors
The directors at 31 December 2010 and 2009 are as given below except where noted otherwise

Charles Jamieson
Robert Cathery
Blaine Karst
Roger Cagle
Ronald Harris
John Orange *(appointed 9 September 2010)*
Mark Sadykhov
Jacob Ulrich
Aric Cunningham *(resigned 17 February 2011)*
Kevin Bortz *(resigned 14 March 2011)*
Alexander Capelson *(resigned 21 April 2011)*

Dividends
The directors do not recommend a dividend for the year (2009 – $nil)

Audit and Risk Committee and Remuneration Committee
The Board currently has an Audit and Risk Committee and a Remuneration Committee

The role of the Audit and Risk Committee is to review and monitor the integrity of the financial reporting by the Company, to review the Group's internal control and risk management systems and oversee the relationship with the external auditors The Audit and Risk Committee meets and discusses issues throughout the year and approves the audit plan and audited financial report for submission to the Board for approval

The Remuneration Committee is primarily responsible for determining and recommending to the Board the framework for executive remuneration It is also responsible for the design of share incentive plans and allocation and issue of shares to employees under such plans The Remuneration Committee meets as required to discuss and determine remuneration issues and formally reports their activities and makes recommendations to the Board for approval

Subsidiaries
The Company had the following subsidiaries at 31 December 2010 (all are owned directly by the Company unless otherwise noted)

	Country of incorporation	Effective ownership percentage 2010	2009
Active subsidiaries			
Royal Atlantic Energy (Cyprus) Limited ("RAECL")	Cyprus	100	100
Diall Alliance LLC – 100% subsidiary of RAECL ("DIALL")	Russia	100	100
Vostok Energy Ltd	United States	100	100
Vostok Energy Resources Limited ("VERL")	United Kingdom	100	100
Vostok (Cyprus) Limited ("VCL")	Cyprus	100	100
Inactive subsidiaries			
Zhaikinvest LTD LLP ("Zhaikinvest") – inactive since 2007	Kazakhstan	75	75
Vostok Energy Company, CJSC ("VEC") – inactive since 2009	Russia	100	100

Directors' report

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 Group and Company financial statements for each financial year The directors have elected under company law to prepare Group and Company financial statements in accordance with IFRS as adopted by the EU

The financial statements are required by law and IFRS adopted by the EU to present fairly the financial position of the Group and the Company and the financial performance of the Group The Companies Act 2006 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and the company and of the profit or loss of the group for that period

In preparing the group and company financial statements, the directors are required to

a select suitable accounting policies and then apply them consistently,

b make judgements and accounting estimates that are reasonable and prudent,

c state whether they have been prepared in accordance with IFRSs adopted by the EU,

d prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and 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 Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Statement as to disclosure of information to the auditor
The directors who were in office on the date of approval of these financial statements have each confirmed that as far as they are aware, there is no relevant audit information of which the auditor is unaware Each of the directors has also confirmed that they have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that it has been communicated to the auditor

Auditor
A resolution to re-appoint Ernst and Young as auditors will be proposed at the Company's forthcoming Annual General Meeting

By order of the Board

Tony Hunter
Secretary

20 May 2011

Independent auditor's report

to the members of Vostok Energy Plc

We have audited the financial statements of Vostok Energy Plc for the year ended 31 December 2010 which comprise the Group and Parent Company Statements of Financial Position, the Group Statements of Comprehensive Income, the Group and Parent Company Statements of Cash Flow, the Group and Parent Company Statements of Changes in Equity and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2010 and of the group's and the parent company's loss for the year then ended,
- the financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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

Mirco Bardella, *(Senior Statutory Auditor)*
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

20 May 2011

Vostok Energy Plc

Consolidated statement of comprehensive income

for the year ended 31 December 2010

	Notes	2010 USD'000	2009 USD'000
Revenue		267	46
Operating expenses	4	(4,364)	(3,410)
Administrative expenses	5	(13,252)	(10,291)
Other gains/(losses)	7	(540)	1,921
Total expenses		(18,156)	(11,780)
Operating Loss		(17,889)	(11,734)
Finance income	8	19	250
Finance costs	9	(4,620)	(376)
Loss before taxation		(22,490)	(11,860)
Income tax benefit/(expense)	13	2,981	(1,341)
Loss for the year		(19,509)	(13,201)
Other comprehensive income			
Foreign exchange movements on			
Translation of foreign entities		(2,060)	3,369
Total comprehensive income		(21,569)	(9,832)

	2010 USD	2009 USD
Loss per share during the year (Note 13)		
– basic	0 10	0 07
– diluted	0 10	0 07

Vostok Energy Plc

Consolidated balance sheet

at 31 December 2010

	Notes	2010 USD'000	2009 USD'000
Non-current assets			
Intangible assets	15	58,140	36,233
Property, plant and equipment	16	210,433	160,651
Trade and other receivables	17	8,993	13,430
Deferred tax	13	6,828	5,389
		284,394	215,703
Current assets			
Inventories	18	60	33
Trade and other receivables	19	24,522	15,570
Cash and cash equivalents	20	18,147	18,361
		42,729	33,964
Total assets		327,123	249,667
Current liabilities			
Trade and other payables	21	10,754	6,087
Non-current liabilities			
Borrowings	22	99,801	8,018
Provisions	23	7,922	9,900
		107,723	17,918
Total liabilities		118,477	24,005
Net assets		208,646	225,662
Equity			
Share capital	24	1,870	1,851
Share premium	24	50,569	295,674
Own shares held	24	(11,600)	(5,983)
Equity component of convertible debt	24	6,048	1,964
Currency translation reserve	24	(11,759)	(9,699)
Share option reserve	24	2,598	1,426
Accumulated reserves/(deficit)	24	170,920	(59,571)
Total equity attributable to owners of the parent		208,646	225,662

These financial statements were approved and authorised for issue by the Board of Directors

Signed on behalf of the Board of Directors

Blaine Karst

Blaine Karst,
Director

20 May 2011

Vostok Energy Plc

Consolidated statement of changes in equity

for the year ended 31 December 2010

	Share capital USD'000	Share premium USD'000	Own shares held USD'000	Equity component of convertible debt USD'000	Currency translation reserve USD'000	Share option reserve USD'000	Accumulated reserves/ (deficit) USD'000	Total equity USD'000
Balance at 1 January 2009	1,701	252,195	–	–	(13,068)	594	(46,370)	195,052
Total comprehensive income for the period	–	–	–	–	3,369	–	(13,201)	(9,832)
Transactions with owners								
Share issues	150	45,833	–	–	–	–	–	45,983
Own shares issued to the employee benefit trust	–	–	(5,983)	–	–	–	–	(5,983)
Equity element of convertible debt	–	–	–	1,964	–	–	–	1,964
Share issue costs	–	(2,354)	–	–	–	–	–	(2,354)
Share option charge	–	–	–	–	–	832	–	832
Total of transactions with owners	150	43,479	(5,983)	1,964	–	832	–	40,442
Balance at 31 December 2009	1,851	295,674	(5,983)	1,964	(9,699)	1,426	(59,571)	225,662
Total comprehensive income for the year	–	–	–	–	(2,060)	–	(19,509)	(21,569)
Transactions with owners								
Share issues	19	(244,402)	–	–	–	–	250,000	5,617
Own shares issued to the employee benefit trust	–	–	(5,617)	–	–	–	–	(5,617)
Equity element of convertible debt	–	–	–	4,084	–	–	–	4,084
Share issue costs	–	(703)	–	–	–	–	–	(703)
Share option charge	–	–	–	–	–	1,172	–	1,172
Total of transactions with owners	19	(245,105)	(5,617)	4,084	–	1,172	250,000	4,553
Balance at 31 December 2010	1,870	50,569	(11,600)	6,048	(11,759)	2,598	170,920	208,646

Vostok Energy Plc

Consolidated statement of cash flows

for the year ended 31 December 2010

	Notes	2010 USD'000	2009 USD'000
Operating activities			
Loss for the year		(19,509)	(13,201)
Adjustments to reconcile loss for the year to net cash flow used from operating activities			
Tax for the year	13	(2,981)	1,341
Net finance costs	8, 9	4,601	126
Foreign exchange losses/(gains)	7	178	(638)
Depreciation, depletion and amortisation	15, 16	1,073	596
Share based payments	12	1,172	832
Movement in provisions		122	(1,504)
Working capital adjustments			
Decrease/(Increase) in trade and other receivables		4,787	87
Decrease/(Increase) in inventories		(27)	22
(Decrease)/Increase in trade and other payables		4,816	3,077
Net cash flow used in operating activities		(5,768)	(9,262)
Investing activities			
Interest received	8	19	250
Payments to acquire intangible assets		(21,957)	(8,068)
Purchase of property, plant and equipment		(58,360)	(93,891)
Net cash flow used in investing activities		(80,298)	(101,709)
Financing activities			
Proceeds on issue of share capital		–	36,943
Costs on share capital transactions		(4,355)	–
Interest paid		(2,278)	(113)
Proceeds from new borrowings		93,364	6,693
Repayment of long-term borrowings		–	(2,168)
Net cash flow from financing activities		86,731	41,355
Increase/(decrease) in cash and cash equivalents		665	(69,616)
Net foreign exchange difference		(879)	2,507
Cash and cash equivalents at beginning of the year	20	18,361	85,470
Cash and cash equivalents at the end of the year	20	18,147	18,361

Notes to the consolidated financial statements

for the year ended 31 December 2010

1 Corporate Information

a) Organisation and principal activities

The Company is a public limited company incorporated in Great Britain The principal activities of the Company and its subsidiaries are the exploration, development, and production of hydrocarbons The Group's operating activities are in Russia, where the Group holds a sub-soil license for geological exploration and production of hydrocarbons The registered office of the Company is Masters House, 107 Hammersmith Road, London, England, W14 0QH

The Group comprises the Company and its significant subsidiaries as set out below

Operating Entity	Principal Activity	Country of Incorporation
Vostok Energy Plc	Management and holding company	United Kingdom
Vostok Energy Resources Limited	Financing subsidiary	United Kingdom
Royal Atlantic Energy (Cyprus) Limited	Holding company	Cyprus
Vostok (Cyprus) Limited	Holding company	Cyprus
Diall Alliance LLC	Oil and gas exploration	Russia
Vostok Energy Ltd	Administrative centre	United States

b) Russian business environment and country risk

The Group's operations are subject to country risk being the economic, political and social risks inherent in doing business in Russia These risks include matters arising out of the policies of the Government, economic conditions, imposition of, or changes to, taxes and regulations and foreign exchange rate fluctuations Refer to Note 26 for more information on key risks

c) Financial risk management

The Group's long term success is exposed to the effect of fluctuations of oil and gas prices in the local markets which are influenced by international prices Refer to Note 26 for a description of other risks

2 Significant Accounting Policies

a) Authorisation of financial statements and statement of compliance with IFRSs

The financial statements for the Group for the year ended 31 December 2010 were authorised for issue by the board of directors and the balance sheet was signed on the board's behalf by Blaine Karst

The financial statements have been prepared in accordance with IFRS as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2010

The financial statements have been prepared on the historical cost basis The principal accounting policies adopted are set out below

b) Basis of preparation

The Group's financial statements are presented in US dollars and all values are rounded to the nearest thousand dollars (USD) except when otherwise indicated

c) Changes in accounting policies

The accounting policies adopted by the Group at 31 December 2010 have been consistently applied in all periods presented During the period, the following standards have been adopted in these financial statements

IFRS 2 Share based payment (Revised)

The IASB issued an amendment to IFRS 2 that clarified the scope and the accounting for cash-settled share-based payment transactions The Group adopted this amendment as of 1 January 2010 It did not have an impact on the financial position or performance of the Group in any of the periods presented

IFRS 3 Business Combinations (Revised) and IAS 27 Consolidated and Separate Financial Statements (Amended)

As there were no business combinations or changes in the ownership interest of a subsidiary without loss of control, the change in accounting policy as a result of the changes in the standards has had no impact on the financial position or performance of the Group in any of the periods presented

IAS 39 Financial Instruments Recognition and Measurement – Eligible Hedged Items

The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item As the Group has not entered into any such hedges in any period presented, the Group has concluded that the amendment will have no impact on the financial position or performance of the Group

IFRIC 17 Distribution of Non-cash Assets to Owners

The interpretation provides guidance on accounting for arrangements whereby and entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends The adoption of the interpretation did not have any impact on the Group

2 Significant Accounting Policies (continued)

IFRIC 18 Transfers of Assets from Customers
The interpretation applies to entities that receive from customers items of property, plant and equipment or cash for the acquisition of construction of such items These assets are then used to connect customers to a network or to provide ongoing access to a supply of goods or services As the group does not enter into such transactions this interpretation has no impact on the Group

Improvements to IFRSs 2009
In May 2009 the IASB issued an omnibus of amendments to its standards, primarily with a view to remove inconsistencies and clarify wording The adoption of the amendments did not have any impact on the financial position or performance of the Group in any period presented

IAS 24	Related Party Disclosures (Amendment)
IAS 32	Financial Instruments Presentation – Classification of Rights Issues
IFRS 9	Financial Instruments Classification and Measurement
IFRIC 14	Prepayments of a minimum funding requirement (Amendment)
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments (Endorsed)

Improvements to IFRSs 2010
In May 2010 the IASB issued Improvements to IFRSs, an omnibus of amendments to its IFRS standards The amendments have not been adopted as they become effective for annual periods on or after 1 July 2010 or 1 January 2011 The amendments listed below are considered to have a reasonably possible impact on the Group

IFRS 3	Business Combinations
IFRS 7	Financial Instruments Disclosures
IAS 1	Presentation of Financial Statements
IAS 27	Consolidated and Separate Financial Statements

The Directors anticipate that the adoption of these Standards and Interpretations as appropriate in future periods will have no material impact on the financial statements of the Group

At the date of authorisation of these financial statements, there were no Standards and Interpretations relevant to the Group operations in issue but not yet effective or endorsed (unless otherwise stated)

d) Basis of consolidation
The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December each year

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases Control comprises the power to govern the financial and operating policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights, currently exercisable or convertible potential voting rights, or by way of contractual agreement The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting year-end as the parent company and are based on consistent accounting policies All intergroup balances and transactions, including unrealised profits arising from them, are eliminated

e) Comparative figures
Where a change in presentational format of the consolidated financial statements has been made during the year, comparative figures have been restated accordingly

f) Business combinations
Business combinations are accounted for using the purchase method of accounting The assets and liabilities of the acquiree are measured at fair value on the date of acquisition The results of acquired operations are included in the consolidated statement of comprehensive income from the date on which control was obtained Combinations of businesses under common control have been accounted for using the pooling of interests method

g) Foreign currency translation
Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date All differences are taken to profit or loss

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined

2 Significant Accounting Policies (continued)

The assets and liabilities of foreign operations are translated into USD at the rate of exchange ruling at the balance sheet date Income and expenses are translated at weighted average exchange rates for the year The resulting exchange differences are recognised in other comprehensive income On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in profit or loss

The functional currency of the Company is the US dollar while the functional currency of its Russian subsidiaries is the Russian ruble ("RUB")

h) Revenue recognition
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes The following criteria must also be met before revenue is recognised

Sale of goods
Revenue associated with the sale of oil and gas is recognized when the title passes to the customer

Finance income
Revenue is recognised as interest accrues using the effective interest method The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to its net carrying amount

i) Borrowing costs
Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation Capitalisation of borrowing costs is suspended during extended periods in which active development is interrupted All other borrowing costs are recognised in profit or loss in the period in which they are incurred

j) Taxation
Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss,
- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future, and
- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Income tax is charged or credited to other comprehensive income if it relates to items that are credited or charged to other comprehensive income Otherwise income tax is recognised in profit or loss

k) Share-based payments
The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award Fair value is determined by an appropriate pricing model with the assistance of an external valuer if required In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions)

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions and of the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, treated as vesting as described above The movement in cumulative expense since the previous balance sheet date is recognised in profit or loss, with a corresponding entry in equity

Notes to the consolidated financial statements

for the year ended 31 December 2010

2 Significant Accounting Policies (continued)

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification No reduction is recognised if this difference is negative

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in profit or loss for the award is expensed immediately Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value treated as an expense in profit or loss

l) Intangible assets – exploration and evaluation expenditures

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

Drilling, seismic and other costs

All costs incurred in technical services, seismic data, and for exploration and appraisal activities are initially capitalised as intangible assets on a well by well basis until the results of the drilling have been determined If commercial reserves have been discovered and development has been approved, the carrying values of the related intangible assets are reclassified as development and production assets If commercial reserves have not been discovered, the costs are charged to profit or loss after appraisal activities are completed

Exploration and evaluation assets are assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount and in any event prior to the transfer of the carrying value to development and production assets When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, the impairment will be measured, presented and disclosed in accordance with IAS 36 'Impairment of assets'

Sub-soil licences

Costs incurred prior to the award of oil and gas licences, concessions and other exploration rights are expensed in profit or loss Costs incurred on the acquisition of a licence interest are initially capitalised on a licence by licence basis and are capitalised within intangible fixed assets and held un-depleted until the exploration phase on the licence is complete or commercial reserves have been discovered at which time the costs are reclassified as development and production assets

For amortization purposes, useful lives are estimated as follows

Sub-soil licences	–	25 years
Other licenses	–	5 years

m) Property, plant and equipment

Oil and gas assets

Oil and gas assets are stated at cost less accumulated depletion or accumulated depreciation and impairment costs Costs incurred to develop commercial reserves and bring them into production together with their related exploration and evaluation expenditures are capitalised within property, plant and equipment on a field by field basis Major facilities may be capitalised separately if they relate to more than one field or to the licence area as a whole Subsequent expenditure is capitalised only if it either enhances the economic benefits of the development/production asset or replaces part of the existing development/production asset Any costs remaining associated with the part replaced are expensed Directly attributed overheads and finance costs are capitalised where they relate to specific exploration and development activities

Motor vehicles, office equipment and furniture

Motor vehicles, office equipment and furniture are stated at cost less accumulated depreciation and impairment losses

Depletion

Depletion is provided on oil and gas properties in production, including related pipeline costs, using the unit of production method, based on proven reserves, applied to the sum of the total capitalised exploration, evaluation and development costs, together with estimated future development and decommissioning costs at current prices Depletion is provided based on the expected production profile on a field by field basis which may exceed the existing licence period It is standard industry practice in Russia to receive licence extensions providing production plans demonstrate that additional time is required to economically produce the field

Depreciation

Major oil and gas facilities that have a shorter useful life than the related production expected from the fields are depreciated on a straight-line basis over the expected useful life of the facility Depreciation is provided on motor vehicles, office equipment and furniture at rates calculated to write off the cost, less estimated residual value, evenly over its expected useful life

For depreciation purposes, useful lives are estimated as follows

Buildings, facilities	–	15-30 years
Office equipment and furniture	–	5 years
Furniture and fixtures	–	5 years
Motor vehicles and machinery	–	5 years

2 Significant Accounting Policies (continued)

Decommissioning and environmental restoration provision
The decommissioning and environmental restoration provision is calculated at the net present value of the total costs expected to be incurred at the end of the producing life of each field in the removal and decommissioning of the production, storage and transportation facilities currently in place The cost of recognizing the provision is included as part of the cost of the relevant assets within exploration and development costs or property, plant and equipment and is charged to profit or loss on a unit of production basis

n) Impairment of intangible assets and property, plant and equipment
The carrying amounts for non-current assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable If there are indicators of impairment, an exercise is undertaken to determine whether the carrying values are in excess of their recoverable amount Such review is undertaken on an asset by asset basis, except where such assets do not generate cash flows independent of other assets, in which case the review is undertaken at the cash generating unit level

If the carrying amount of an asset or its cash generating unit exceeds the recoverable amount, a provision is recorded to reflect the asset at the lower amount Impairment losses are recognised in profit or loss

Calculation of recoverable amount
The recoverable amount of assets is the greater of their value in use and fair value less costs to sell In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash generating unit to which the asset belongs The Group's cash generating units are the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets

Reversals of impairment
An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised

o) Inventories
Inventories represent unsold natural gas and hydrocarbon liquids in storage recorded at the lower of cost or net realizable value on a first-in first-out basis Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses

p) Financial assets
Financial assets are recognised when the Group becomes party to the contracts that give rise to them and are classified as financial assets at fair value through profit or loss, loans and receivables, held-to maturity investments, or as available-for-sale financial assets, as appropriate The Group determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end When financial assets are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs The Group considers whether a contract contains an embedded derivative when the entity first becomes a party to it The embedded derivatives are separated from the host contract if it is not measured at fair value through profit or loss and when the economic characteristics and risks are not closely related to those of the host contract Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required

All purchases and sales of financial assets are recognised on the trade date, being the date that the Group commits to purchase or sell the asset Transactions require delivery of assets within the timeframe generally established by regulation or convention in the market place The subsequent measurement of financial assets depends on their classification, as follows

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available-for-sale Such assets are carried at amortised cost using the effective interest method if the time value of money is significant Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process

Trade and other receivables
Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount Where the time value of money is material, receivables are carried at amortised cost Provision is made when there is objective evidence that the Group will not be able to recover balances in full Balances are written off when the probability of recovery is assessed as being remote

Cash and cash equivalents
Cash and cash equivalents include balances with banks and short-term investments with maturities of three months or less at the date acquired

2 Significant Accounting Policies (continued)

q) Impairment of financial assets
The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired

Assets carried at amortised cost
If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i e the effective interest rate computed at initial recognition) The carrying amount of the asset is reduced, through the use of an allowance account The amount of the loss is recognised in profit or loss

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed Any subsequent reversal of an impairment loss is recognised in profit or loss, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the company owing the obligation) that the Group will not be able to collect all of the amounts due under the original terms of the invoice The carrying amount of the receivable is reduced through use of an allowance account Impaired debts are derecognised when they are assessed as irrecoverable

r) Interest bearing loans and borrowings
Obligations for loans and borrowings are recognised when the Group becomes party to the related contracts and are measured initially at the fair value of consideration received less directly attributable transaction costs

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method

Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance income and finance cost

s) Financial liabilities and equity
Financial liabilities and equity instruments are classified according to substance of the contractual arrangements entered into An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities

t) Equity Instruments
Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs

Convertible debt
Instruments where the holder has the option to redeem for cash or convert into a pre-determined quantity of equity instruments are classified as compound instruments in the balance sheet and presented partly as a liability and partly within equity

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument The difference between the proceeds of issue and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity

Transaction costs are apportioned between the liability and equity components of the convertible debt based on their relative carrying amounts at the date of issue The portion relating to the equity component is charged directly against equity

The interest expense on the liability component is calculated by applying the prevailing market interest rates for similar non-convertible debt to the instrument The difference between this amount and the interest paid is added to the carrying value of the convertible debt

u) Derecognition of financial assets and liabilities
A financial asset or liability is generally derecognised when the contract that gives rise to it is settled, sold, cancelled or expires Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in profit or loss

v) Employee benefit trust
The Group operates an employee benefit trust ("EBT") which holds shares in the Company The Group and Company record the assets and liabilities of the EBT as their own The shares in the Company owned by the EBT are presented as a reduction in equity shareholders' funds in the consolidated and parent company balance sheet and included in a separate negative reserve described as "Own shares held"

2 Significant Accounting Policies (continued)

w) Judgements and key sources of estimation uncertainty

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities as well as the disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period Actual outcomes could differ from those estimates

In the process of applying the Group's accounting policies, management has made judgements that have a significant effect on the amounts recognised in the financial statements

Taxation

The Company's subsidiaries in Russia are subject to routine tax audits and also a process whereby tax computations are discussed and agreed with the appropriate authorities Whilst the ultimate outcome of such tax audits and discussions cannot be determined with certainty, management estimates the level of provisions required for both current and deferred tax on the basis of professional advice and the nature of current discussions with the tax authority concerned

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below

Fair value of acquisition

Upon acquisition, assets and liabilities, including exploration and evaluation assets, are included in the financial statements at their fair market value The actual value that will be realised from exploration and evaluation assets is inherently uncertain and reflects a wide range of factors including but not limited to geographical and geophysical factors, future costs and commodity prices, the duration of the licence and its term and the availability of financial and other resources required to progress exploration and development activities

Impairment review of intangible assets and oil and gas plant and equipment (Notes 15 and 16)

Management is required to assess the level of the Group's commercial reserves, which are utilised in determining the depletion charge for the period and assessing whether any impairment charge is required The Group utilizes independent experts and their own internal expertise to assess the commercial viability of reserves and any future capital expenditures, on a field by field basis

Sub-soil licences (Note 15)

The Group is subject to periodic reviews of its activities by governmental authorities in Russia with respect to the requirements of its sub-soil licences and seeks amendments to the licences when supported by the results of ongoing exploration and development activities The requirements under the licences are subject to interpretation and enforcement policies of the relevant authorities In management's opinion, as of 31 December 2010, there are no serious non-compliance issues that will have an adverse effect on the financial position or the operating results of the Group

Decommissioning and environmental restoration (Note 23)

The Group operates in the upstream oil industry in the Russian Federation and its activities may have an impact on the environment The enforcement of environmental regulations in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered The Group periodically evaluates its obligations related thereto The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter interpretation and enforcement of existing legislation, cannot reasonably be estimated at present, but could be material

Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group

Share-based payments (Note 12)

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted Judgement is required in determining the most appropriate valuation model for a grant of equity instruments, depending on the terms and conditions of the grant Management is also required to use judgement in determining the most appropriate inputs to the valuation model including expected life of the option, volatility and dividend yield The assumptions and models used are disclosed in Note 12

3 Segment information

The Group's operations comprise one class of business being oil and gas exploration, development and production The primary Group operation is in one geographical region which is Russia Companies incorporated outside of Russia are mainly administrative centers which primarily support the operations in Russia

4 Operating expenses

	2010 USD'000	2009 USD'000
Repair and maintenance	195	870
Depreciation, depletion and amortisation	891	425
Rental, heating and other operating costs	443	369
Environmental and conservation	206	294
Material and transport services	1,150	292
Operations and property insurance	204	273
Property, transport, environmental and water utilization taxes	521	243
Expensed exploration and development costs	145	238
Salaries and benefits	333	223
Subsoil usage royalties	38	55
Mineral extraction tax	14	46
Other costs	154	43
Land rental	70	39
	4,364	3,410

5 Administrative expenses

	2010 USD'000	2009 USD'000
Salaries and benefits	6,986	4,869
Professional fees	3,348	2,930
Office	1,615	1,280
Travel and training	890	976
Depreciation	182	171
Insurance	231	65
	13,252	10,291

6 Auditor's remuneration

	2010 USD'000	2009 USD'000
Auditor's remuneration for services included in professional fees		
Statutory audit – Company	152	150
Subsidiary audits	40	138
Taxation and advisory services	61	157

7 Other gains and losses

	2010 USD'000	2009 USD'000
Exceptional operating items		
Reversal of impairment of intangible assets	–	(41)
Reversal of impairment of property, plant and equipment	–	(1,602)
Provision against prepayments	122	139
Exchange (gain)/loss	178	(638)
Sponsorships and charitable donations	121	201
Other losses	119	20
	540	(1,921)

7 Other gains and losses (continued)

The reversal of the impairment charges for 2009 is a reversal of a provision set up in 2007 The reversal is primarily for gas plant costs of 873 thousand USD that are now believed to have future value and for well drilling and re-entry costs of 770 thousand USD that the Group had not expected to be recovered based on production tests in 2007 During 2009 the decision was made to re-enter the wells and apply further acid fracturing stimulation of old and new target zones and it has now been determined that the well costs will be recoverable through future production revenues

The provision against prepayments of 122 thousand USD (2009 – 139 thousand USD) is for advance payments on contracts where the services were not provided and costs are not recoverable (Note 19)

The exchange (gain)/loss is the result of changes in exchange rates from the time a transaction is recorded until it is settled The majority of the loss of 178 thousand USD (2009 - 638 thousand USD gain) was incurred by subsidiary operations in Russia

8 Finance income

	2010 USD'000	2009 USD'000
Interest on short-term deposits	19	250

9 Finance costs

	2010 USD'000	2009 USD'000
Interest on non-current liabilities	–	113
Unwinding of discount on provisions	1,089	101
Other finance costs	3,531	162
	4,620	376

For 2009 the interest on non-current liabilities relates to non-current borrowings (Note 22) The unwinding of the discount on provisions relates to the decommissioning provision (Note 23) For 2010 other finance costs relate to costs incurred in contemplation of a planned public listing of the Company shares In 2009 the other finance costs relate to a commitment charge on the loan facility (Note 22)

10 Directors' emoluments

Included in staff costs are directors' emoluments of 2 381 million USD (2009 – 2 192 million USD) and fees payable to non-executive directors of 66 thousand USD (2009 – 23 thousand USD)

The highest paid director's emoluments was 1 246 million USD (2009 – 1 084 million USD) which includes an accrual for share based payments of 796 thousand USD (2009 - 455 thousand USD)

During 2009 the Company advanced funds to the Chief Operating Officer to cover employment taxes in Russia At 31 December 2009 the Company had advances receivable of 133 thousand USD as a result of the actual Russian employment tax liability being less than originally estimated All advances were recovered in 2010 and there were no advances receivable at 31 December 2010

11 Staff costs

	2010 USD'000	2009 USD'000
Wages and salaries	5,816	3,424
Share-based payment benefits	1,172	832
Social security costs	795	657
Rental benefits	383	354
	8,166	5,267

11 Staff costs (continued)

Total salaries and benefits for the Group includes 333 thousand USD (2009 - 223 thousand USD) recorded as operating expenses, 6 986 million USD (2009 - 4 869 million) included in administrative expenses and 847 thousand (2009 - 175 thousand USD) recorded as seismic, development and drilling included in intangible assets and construction costs included in property, plant and equipment

The average monthly number of employees (including executive directors) for the year for the Group was as follows

	2010 No	2009 No
Operations	89	38
Head office and administration	76	65
	165	103

The Group does not have any employee retirement or pension benefit plan, however, funds are paid into the required government pension funds or social benefit programmes for all its employees as they arise

12 Share-based payments

The Company grants awards of shares to staff as reward for past service and incentive to continue to work for the Group The shares are normally held jointly with the employee and the Employee Benefit Trust awarded at fair market value to senior management and key employees of the Company at nil cost The share awards vest at specified time intervals and vesting is dependent on staff remaining in full employment with the Company for a three year period The awards are equity settled

The fair value of the share awards was estimated at the grant date using a Black Scholes simulation model, taking into account the terms and conditions upon which the awards were granted

The following table shows details of share awards outstanding during the year

	2010 Shares	2009 Shares
As at 1 January	2,460,000	1,960,000
Granted during the year	1,340,000	500,000
As at 31 December	3,800,000	2,460,000
Vested at 31 December	2,820,000	896,667

The following table lists the inputs to the model ($ amounts are USD)

	2010	2009
Award grant date	20 July	1 October
Number of awards	1,340,000	500,000
Fair value at grant date	$1 52	$1 52
Share price at grant date	$1 53	$1 53
Amount payable by executive	$3 05	$nil
Risk free rate	6%	6%
Dividend yield	nil	nil
Expected volatility	29 7%	32 7%
Expected life of awards	1 5 years	2 years
Weighted average remaining contractual life of share options at the end of the year	0 96 years	1 1 years

Expected volatility is based on historic share price movements The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome Maximum term for the awards is three years For key employees the probability that not all the awards will vest due to the resignation was set at 0% (2009 - 20%) No other features of options' terms were incorporated into the measurement of fair value

12 Share-based payments (continued)

The following table lists liabilities arising from share-based payment transactions (amounts are in thousand US$)

	2010	2009
Carrying value of liability on share-based awards	2,598	1,426
Number of awards	1,959	852

The expense recognized for share-based payments in respect of employee services received during the year is 1 172 million USD (2009 – 832 thousand USD)

Share options

In 2010, 1,340,000 shares (2009 – 500,000 shares) were approved as compensation to key employees and the senior management of the Group subject to vesting conditions being met, such shares vesting over a three year period from the date set in the joint operating agreements between employees and the EBT The actual shares issued to the EBT for the year were 1,840,000 (2009 – 1,960,000 shares)

13 Tax

The tax charge for the year comprises

	2010 USD'000	2009 USD'000
Current tax – UK tax	(1,495)	1,495
Current tax – foreign tax	–	36
Deferred tax	(1,486)	(190)
	(2,981)	1,341

The income tax benefit in the statement of comprehensive income is lower than the standard rate of corporation tax in the UK of 28% (2009 - 28%) The differences are reconciled below

	2010 USD'000	2009 USD'000
Loss before taxation	(22,490)	(11,860)
Tax at applicable rate of tax of 28% (2009 – 28%)	(6,297)	(3,321)
Tax effect of		
– unrecognized tax losses	3,492	1,341
– effect of different foreign tax rates	606	202
– items not deductible for tax	661	985
– non-taxable expense	–	(180)
– derecognition of items from prior year	52	308
– foreign exchange loss	–	458
– other	(1,495)	1,548
Total tax (benefit)/expense reported in profit or loss	(2,981)	1,341

The effect of different foreign tax rates is the result of losses incurred in subsidiaries located in countries where lower levels of tax rates are applied

As at 31 December 2010 the Group has unrecognised deferred tax asset on tax losses which arose in the UK of 16 386 million USD (2009 – 11 949 million USD), in the US of 1 623 million USD (2009 – 727 thousand USD) and in Russia of 1 994 million USD (2009 – 1 882 million USD)

Deferred tax has not been provided for these losses on the basis that it is not sufficiently certain there will be adequate taxable profits arising in the future to offset against the tax losses The losses incurred in the UK are available to carry forward indefinitely for offset against future taxable profits The losses arising in the US will expire 20 years from the year incurred, the losses in Russia will expire 10 years from the year incurred

There was no tax charge/(credit) to equity during the year (2009 – nil)

13 Tax (continued)

Deferred tax

The deferred tax included in the balance sheet is as follows

	2010 USD'000	2009 USD'000
Deferred tax assets		
– tax losses carried forward	8,926	6,180
– current assets	518	1,072
– property, plant and equipment	334	–
Deferred tax liabilities		
– intangible assets	(2,950)	(1,633)
– property, plant and equipment	–	(230)
	6,828	5,389

The movement in the net deferred tax asset in the consolidated financial statements is as follows

	2010 USD'000	2009 USD'000
As at 1 January	5,389	5,344
Credited to profit or loss	1,486	190
Net exchange adjustment	(47)	(145)
As at 31 December	6,828	5,389

A net deferred tax asset has been recognised on the basis that there will be sufficient taxable profits, based on the group's profit forecast, against which these temporary differences can be utilised

The deferred tax included in profit or loss is as follows

	2010 USD'000	2009 USD'000
Deferred tax assets		
– tax losses carried forward	(2,804)	(1,755)
– property, plant and equipment	(562)	–
– current assets	–	(1,375)
Deferred tax liabilities		
– intangible assets	1,326	1,633
– property, plant and equipment	–	1,078
– other allowances	–	229
– current assets	554	–
	(1,486)	(190)

14 Loss per share

The calculation of basic loss per ordinary share is based on the loss for the period and the weighted average number of shares in issue ($ amounts in USD'000)

	2010	2009
Loss for the purposes of basic loss per share	19,509	13,201
Weighted average number of ordinary shares for the purposes of basic loss per share	186,143,458	175,280,273
Loss per share (amounts in USD)		
Basic	0 10	0 07
Diluted	0 10	0 07

As the Group has made a loss in the period, basic and diluted loss per share are equal

Notes to the consolidated financial statements

for the year ended 31 December 2010

15 Intangible assets

		Exploration and evaluation expenditures		
	Sub-soil licence rights USD'000	Drilling, seismic & other costs USD'000	Sub-soil licences USD'000	Total USD'000
Cost				
Balance at 1 January 2009	1,000	16,942	17,604	35,546
Translation difference	–	(16)	(2)	(18)
Additions (write-offs)	(1,000)	6,831	–	5,831
At 31 December 2009	–	23,757	17,602	41,359
Translation difference	–	(201)	(21)	(222)
Additions and reclassifications	–	22,397	–	22,397
At 31 December 2010	–	45,953	17,581	63,534
Amortisation and impairment				
Accumulated balance at 1 January 2009	(1,000)	(5,150)	(7)	(6,157)
Amortisation for the year	–	–	(10)	(10)
Reversal of impairment charge	–	41	–	41
Write-offs	1,000	–	–	1,000
At 31 December 2009	–	(5,109)	(17)	(5,126)
Amortisation for the year	–	(260)	(8)	(268)
At 31 December 2010	–	(5,369)	(25)	(5,394)
Net book value				
At 31 December 2009	–	18,648	17,585	36,233
At 31 December 2010	–	40,584	17,556	58,140

The subsoil licence rights related to Zhaikinvest, a subsidiary of the Group, for a licence to operate in Kazakhstan The decision was made not to proceed with this project and the asset was fully provided for in 2007 and written off in 2009

Amortisation is recognized in profit or loss as part of operating expenses (Note 4) Impairment and reversal of impairment provisions are recognized in profit or loss as part of other gains and losses (Note 7)

Included in sub-soil licences is the Bortovoy license, which is the license area that the Group operates, located in the Saratov region of Russia The sale of the licence and the sale of major assets belonging to the Group are restricted pursuant to the convertible loan agreement and the conditional convertible bond agreement (Note 22)

In management's opinion, as at 31 December 2010 there is no serious non-compliance issues in respect of the licences that would have an adverse effect on the financial position or the operating results of the Group

16 Property, plant and equipment

	Oil and gas assets USD'000	Motor vehicles USD'000	Other equipment and furniture USD 000	Total USD'000
Cost				
Balance at 1 January 2009	60,869	400	450	61,719
Translation differences	1,678	(11)	142	1,809
Additions	98,700	33	12	98,745
Disposals	(158)	(10)	(7)	(175)
At 31 December 2009	161,089	412	597	162,098
Translation differences	(985)	(1)	(1)	(987)
Additions	55,478	65	55	55,598
Disposals	(3,747)	–	(2)	(3,749)
At 31 December 2010	211,835	476	649	212,960
Depreciation				
Accumulated balance at 1 January 2009	(2,119)	(113)	(166)	(2,398)
Translation differences	(9)	–	(12)	(21)
Depreciation and depletion	(451)	(78)	(119)	(648)
Disposals	8	7	3	18
Reversal of impairment charge	1,602	–	–	1,602
At 31 December 2009	(969)	(184)	(294)	(1,447)
Depreciation and depletion	(870)	(87)	(126)	(1,083)
Disposals	1	–	2	3
At 31 December 2010	(1,838)	(271)	(418)	(2,527)
Net book value				
At 31 December 2009	160,120	228	303	160,651
At 31 December 2010	209,997	205	231	210,433

Depletion is charged to profit or loss through operating expenses (Note 4) Depreciation is charged to the profit or loss through operating expenses (Note 4) and administrative expenses (Note 5) During the year 278 thousand USD (2009 –62 thousand USD) of depreciation was capitalized and included as additions to property plant and equipment

The sale of all or a substantial part of the assets belonging to the Group is restricted pursuant to the convertible loan agreement and the conditional convertible bond agreement (Note 22)

The amount of interest capitalized into property, plant and equipment was 3 509 million USD (2009 – 68 thousand USD)

17 Trade and other receivables – non current

	2010 USD'000	2009 USD'000
Other receivables	3,043	8,659
Prepayments	5,950	4,771
	8,993	13,430

Prepayments are advance payments on contracts for capital projects relating to exploration, development and production and therefore classified as non-current assets Other receivables are for value added taxes which are to be used as an offset against future value added tax liabilities but are not expected to be recovered within the next twelve months

18 Inventories

	2010 USD 000	2009 USD'000
Natural gas and hydrocarbon liquids	60	33
	60	33

Inventory represents amounts of natural gas and hydrocarbon liquids held in storage pending sales to customers The major component of inventory costs expensed during the period as a part of operating expenses was 52 thousand USD (2009 – 101 thousand USD) for mineral extraction and sub-soil usage royalty taxes (Note 4)

19 Trade receivables and other receivables – current

	2010 USD'000	2009 USD'000
Tax receivables	20,017	10,164
Prepayments	2,222	4,629
Other	2,168	775
Trade receivables	115	2
	24,522	15,570

Prepayments are advance payments for services to be rendered within the next twelve months Tax receivables relate primarily to value added tax payments that are expected to be recovered within the next twelve months

Other receivables includes 1 767 million USD (2009 – 430 thousand USD) relating to the current portion of amortized costs for non-current borrowings (Note 22) For 2009 other receivables also includes 3 516 million USD of prepaid costs for the non drawn-down portion of the convertible loan

The amounts shown in prepayments are net of provisions as the Group does not expect to recover advance payments on the related contracts Movements in the provision were as follows

	2010 USD'000	2009 USD'000
At 1 January	1,004	1,068
Charge for the year	122	139
Amounts written off	(232)	(203)
At 31 December	894	1,004

No trade receivables have been pledged as security for any credit facilities

20 Cash and cash equivalents

Cash is kept on deposit with banks and earns interest at the daily deposit rates or placed in short-term deposits such as money market funds which can be redeemed upon demand At 31 December 2010 the cash and cash equivalents totaled 18 147 million USD (2009 - 18 361 million USD)

21 Current liabilities

	2010 USD'000	2009 USD'000
Trade and other payables	8,351	3,421
Accruals	2,403	1,171
Current tax payable	–	1,495
	10,754	6,087

22 Non-current borrowings

	Effective interest rate	2010 USD'000	2009 USD'000
Amounts due in less than 5 years			
Convertible loan issued 18 September 2009	LIBOR + 4%	51,923	3,183
Convertible bond issued 13 October 2010	10%	46,111	–
		98,034	3,183
Net amounts due in more than 5 years			
Convertible loan	LIBOR + 4%	–	4,405
		98,034	7,588
Current borrowings (assets) (Note 19)		(1,767)	(430)
Non-current borrowings (liabilities)		99,801	8,018
Net convertible debt		98,034	7,588
Convertible loan comprises			
Drawdown of the loan		60,000	10,000
Equity element		(6,048)	(1,964)
		53,952	8,036
Cost of borrowing		(5,538)	(516)
Capitalized interest		3,509	68
Net convertible loan		51,923	7,588
Convertible bond comprises			
Drawdown of the bond		50,000	–
Cost of borrowing		(3,889)	–
Net convertible bond		46,111	–

On 18 September 2009, the Company entered into a convertible loan agreement to borrow up to 60 million USD The convertible loan was drawn down in full at 31 December 2010

The loan is convertible into ordinary shares of the Company at any time up to 18 March 2012 at the loan holder's option Conversions done prior to 19 March 2011 are to be converted at a price of 3 0531 USD per share From 19 March 2011 to 18 March 2012, the loan is convertible at 3 0531 USD per share plus a pro-rated amount of margin payments at 4% interest made up to the time of the conversion For any unconverted amounts, the loan is to be repaid in six equal semi-annual installments beginning 15 June 2013 and ending on 15 December 2015

On 13 October 2010 the Company entered into a convertible bond agreement (the "bond") to borrow up to 50 million USD The bond was drawn down in full at 31 December 2010

The bond is convertible into ordinary shares of the Company at any time up to 6 April 2013 at the bond holder's option To determine the number of ordinary shares received upon conversion, the amount of the bond to be converted is divided by the share price paid by investors for ordinary shares of the Company at the time of a Qualifying Initial Public Offering (the "QIPO") as defined in the convertible bond agreement At the Company's option, the conversion of the bond can be forced if the ordinary shares of the Company trade at a value of 50% above the QIPO price for at least 20 dealing days in any period of 30 consecutive dealing days any time prior to 6 April 2013 For any unconverted amounts, the bond is to be repaid in full in one installment on 13 April 2013

The net proceeds received from the issue of the convertible loan are split between a debt component and an embedded equity element The fair value of the convertible loan component for the drawdowns taken in 2010 have been calculated as the present value of the contracted future cash flows using an assumed market interest rate of LIBOR plus 7% (2009 – 9%) The equity element is calculated as the difference between the principal amount and the fair value of the convertible loan The fair value of the convertible bond drawdown has been calculated at the present value of the contracted future cash flows using an assumed market interest rate of 12%

The interest charged for the year for the convertible loan and bond is calculated by applying the effective market interest rate of the assumed market interest rate to the liability component for the period since the convertible loan or bond was drawn-down The short term part of the convertible loan calculated at amortized cost using the effective interest rate is negative

Notes to the consolidated financial statements

for the year ended 31 December 2010

23 Decommissioning Provision

	2010 USD'000	2009 USD'000
Beginning of period	9,900	675
Change in provision	588	5,917
Unwinding of discount	1,089	101
Reserve adjustment due to estimates change	(3,599)	2,931
Translation of differences	(56)	276
	7,922	9,900

The provision is for decommissioning and environmental restoration costs relating to the Bortovoy licence The decrease in the provision recorded in 2010 of 1 978 million USD was due to the revision of inflation and discount rates used in the calculation of the present value of future decommissioning and environment restoration costs

Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group

The liability becomes payable at the end of the useful life of each well and the gas plant which ranges from 20 to 30 years

24 Equity

Authorised and issued share capital

Authorised	2010 USD'000	2009 USD'000
250,000,000 ordinary shares of USD 0 01 each	2,500	2,500

Allotted, called up and fully paid	Ordinary shares No	Amount USD'000	Share capital USD'000	Share premium USD'000	Own shares held USD'000
At 1 January 2009	170,068,760	260,023	1,701	252,195	–
Share issue 20 January 2009	1,460,000	4,457	14	4,443	(4,457)
Share issue 15 June 2009	500,000	1,526	5	1,521	(1,526)
Share issue 24 September 2009	13,101,438	40,000	131	39,869	–
Share issue costs	–	–	–	(2,354)	–
At 31 December 2009	185,130,198	306,006	1,851	295,674	(5,983)
Share premium reduction 30 June 2010	–	–	–	(250,000)	–
Share issue 20 July 2010	1,840,000	5,607	19	5,598	(5,617)
Share issue costs	–	–	–	(703)	–
At 31 December 2010	186,970,198	311,613	1,870	50,569	(11,600)

Redeemable shares

At 31 December 2010 there were 50,000 redeemable shares at 1 pound sterling in issue The shares were issued during the year in connection with the conversion of the Company to a public limited company

Own shares held

The Company has approval to transfer up to 4,460,000 shares to the EBT for allocation to officers and employees of the Group The formal establishment of the EBT was completed on 20 January 2009 In 2010 1,840,000 shares equal to one percent of called up share capital were issued pursuant to the EBT (2009 – 1,960,000 shares) For presentation purposes, the shares held in the EBT are included as own shares held

On 30 June 2010 the Company reduced share premium by 250 million USD as part of the process of converting to a public limited company

Currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of subsidiaries whose functional currency are not in US dollars into the group's presentation currency

24 Equity (continued)

Share option reserve

The share option reserve relates to the fair value of the equity settled share based payments that have been expensed through profit or loss

Equity element of convertible debt

The equity element of convertible debt is the difference between the principal amount and the fair value of the loan and bond convertible debts reflecting values of the convertible option of the debt instruments

25 Operating lease obligations

Operating lease payments are mainly rentals by the Group for land, office space and equipment required for use on a temporary basis Leases are normally signed on a short term basis of one to two years with options to extend

Lease payments under operating leases recognized in the statement of comprehensive income for the year were 1 021 million USD (2009 – 918 thousand USD)

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

	2010 USD'000	2009 USD'000
Within one year	781	510
In two to five years	243	35
More than five years	191	201

26 Financial instruments

Financial instruments recognised in the balance sheet

	Loans and receivables USD'000	Other financial liabilities at amortised cost USD'000	Total USD'000
Year ended 31 December 2010			
Financial assets			
Trade and other receivables	299	–	299
Current borrowings	–	1,767	1,767
Cash and cash equivalents	18,147	–	18,147
	18,446	1,767	20,213
Financial liabilities			
Trade and other payables	–	8,351	8,351
Non-current borrowings	–	99,801	99,801
	–	108,152	108,152
As at 31 December 2009			
Financial assets			
Trade and other receivables	205	–	205
Current borrowings	–	430	430
Cash and cash equivalents	18,361	–	18,361
	18,566	430	18,996
Financial liabilities			
Trade and other payables	–	3,421	3,421
Non-current borrowings	–	8,018	8,018
	–	11,439	11,439

26 Financial instruments (continued)

The Group had no financial instruments held at fair value through profit and loss, held to maturity or available for sale and no derivatives used for hedging

The main financial risks faced by the Group through its normal business activities are credit risk, foreign currency risk, liquidity risk and interest rate risk

Interest rate risk

The Group has financial assets and liabilities which are exposed to interest rate risk Changes in interest rates impacting borrowings change either their fair value (fixed rate borrowings) or their future cash flows (floating rate borrowings)

Whilst fixed rate interest bearing borrowings are not exposed to cash flow interest rate risk, there is no opportunity for the Group to enjoy a reduction in borrowing costs in markets where rates are falling In addition, the fair value risk inherent in fixed rate borrowing means that the Group is exposed to unplanned costs should borrowings be restructured or repaid early as part of the liquidity management process In contrast, whilst floating rate borrowings are not exposed to changes in fair value, the Group is exposed to cash flow risk as costs increase if market rates rise

Interest on financial instruments classified as floating rate is re-priced at intervals of less than one year Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument The other financial instruments of the Group that are not included in the tables below are non-interest bearing and are therefore not subject to interest rate risk

The following tables set out the carrying amount, by maturity of the Group's financial instruments that are exposed to interest rate risk

	Within 1 year USD'000	1-2 years USD'000	3+ years USD'000	Total USD'000
Year ended 31 December 2010				
Floating rate				
Cash and cash equivalents	18,147	–	–	18,147
Borrowings	1,767	2,152	(101,953)	(98,034)
Year ended 31 December 2009				
Floating rate				
Cash and cash equivalents	18,361	–	–	18,361
Borrowings	430	440	(8,458)	(7,588)

A one per cent increase/decrease in interest rates on floating rate assets and liabilities would have decreased/increased property, plant and equipment by 449 thousand USD In 2009 a one percent increase/decrease in interest rates on floating rate assets and liabilities would have decreased/increased loss before taxation by 4 thousand USD and would impact the Group's equity by the same value

Credit Risk

Credit risk is the potential exposure of the Group to loss in the event of non-performance by a counter-party The amount that best represents the maximum credit exposure of the Group's financial assets is the carrying value of the financial assets at the balance sheet date

This risk arises principally from cash and cash equivalents Management's policy is to hold cash and cash equivalents in reputable financial institutions of which 91 9% (2009 – 66 4%) of cash and cash equivalents are held in reputable financial institutions in the UK To limit exposure to credit risk on trade receivables, management's policy is to sell only to financially solid customers and use prepayments or payment upon delivery for product sales whenever possible The average credit period taken on sale of goods is less than seven days There is no allowance for estimated irrecoverable amounts from sale of goods for the year (2009 – nil)

Maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date

Foreign currency risk

Fluctuations in exchange rates can have significant effects on the Group's reported profit or loss The Group's financial assets and liabilities give rise to transactional currency exposures Such exposures arise from transactions in a currency other than the Group's functional currency

The Group's primary operations are within Russia where the functional currency of the Group's subsidiaries is the Russian ruble ("RUB") The currencies giving rise to this foreign currency risk are US dollar based intra-group borrowings and payables The recent instability of the RUB to US dollar has increased the risks of significant unrealized gains and losses associated with the intra-group borrowings To mitigate this risk the Group has restructured the majority of intra-group borrowings to ruble based loans using Group companies with ruble functional currencies

26 Financial instruments (continued)

Cash balances in the Group are usually held in US dollars, but smaller amounts may be held in pounds sterling or local currencies to meet operating and administrative expenses or to comply with local legislation The Group does not have formal arrangements to mitigate foreign exchange risks at this time however as circumstances dictate, the Group considers hedging positions to protect the value of any cash balances it holds in non-US dollar currency or to protect against exchange fluctuations on future non-USD denominated commitments or obligations

The following table demonstrates the Group's exposure to foreign currency risk based on gross amounts

	US dollar USD'000	Sterling USD'000	Euro USD'000	Russian ruble USD'000	Total USD'000
Year ended 31 December 2010					
Cash and cash equivalents	16,536	188	1	1,422	18,147
Trade and other receivables	30	72	–	197	299
Trade and other payables	(2,577)	(1,041)	(13)	(4,720)	(8,351)
Borrowings	(98,034)	–	–	–	(98,034)
	(84,045)	(781)	(12)	(3,101)	(87,939)
Year ended December 2009					
Cash and cash equivalents	12,601	174	–	5,586	18,361
Trade and other receivables	30	172	–	3	205
Trade and other payables	(828)	(86)	(9)	(2,498)	(3,421)
Borrowings	(7,588)	–	–	–	(7,588)
	4,215	260	(9)	3,091	7,557

A ten per cent strengthening of US dollar against the following currencies would have decreased loss before tax and impact the Group's equity by the amounts shown below For a ten per cent strengthening of the US dollar against the euro there is no significant impact on loss before tax or on the Group's equity This analysis assumes that all other variables remain constant and the analysis is performed on the same basis for 2009

	Effect on loss before tax/equity USD'000
Year ended 31 December 2010	
Pounds sterling	78
Russian ruble	310
Year ended 31 December 2009	
Pounds sterling	(26)
Russian ruble	(309)

A ten percent weakening of the US dollar against the above currencies would have had an equal but opposite effect on the basis that all other variables remain constant

Liquidity risk
Liquidity risk is the risk that sources of funding for the Group's business activities may not be available

Management is continually monitoring cash requirements for the Group and evaluating potential sources to fund its operating and capital expenditures All Group entity operations are controlled through annual and monthly budget reviews to mitigate liquidity risk It is the goal of management to ensure adequate funding is available through an appropriate mix of debt and equity instruments In 2010 the Group arranged a convertible debt financing facility (Note 22) of 50 0 million USD (2009 – 60 0 million USD) to complete the construction of its gas processing facility and cover other development and exploration costs

26 Financial instruments (continued)

The table below summarizes the maturity profile of the Group's financial liabilities based on contractual undiscounted payments

	On demand USD'000	Less than 3 months USD 000	3 to 12 months USD'000	1 to 5 years USD'000	>5 years USD'000	Total USD'000
Year ended 31 December 2010						
Trade and other payables	–	8,351	–	–	–	8,351
Non-current borrowings	–	1,925	5,775	126,956	–	134,656
Year ended 31 December 2009						
Trade and other payables	–	3,421	–	–	–	3,421
Non-current borrowings	–	113	351	8,531	3,496	12,491

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements Fair value has been determined as at the balance sheet date by discounting the estimated future cash flows at prevailing interest rates

	Book value		Fair value	
	2010 USD 000	2009 USD 000	2010 USD'000	2009 USD'000
Cash and cash equivalents	18,147	18,361	18,147	18,361
Trade and other receivables	299	205	299	205
Trade and other payables	(8,351)	(3,421)	(8,351)	(3,421)
Borrowings	(98,034)	(7,588)	(98,034)	(7,588)

Capital management

The primary objective of the Group's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximize shareholder value The Group has no externally imposed capital requirements The Group's aim is to finance its operations through equity and debt financing

The Group's objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt No changes were made in the objectives, policies or processes during the years ended 31 December 2010 and 2009

The Group monitors capital using a gearing ratio, which is non-current borrowings divided by capital The Group's strategy is to reduce its gearing when the opportunity arises Capital comprises equity attributable to the equity holders of the parent

	2010 USD'000	2009 USD'000
Borrowings	98,034	7,588
Capital	208,646	225,662
Gearing ratio	47%	3%

27 Related party transactions

Transactions with related parties

	Charges to related parties USD'000	Purchases from related parties USD'000	Amounts owed by related parties USD'000	Amounts owed to related parties USD'000
Entities with key management personnel of the Group				
2010	226	11,358	127	665
2009	92	375	172	236

27 Related party transactions (continued)

Transactions primarily relate to the provision of goods and services from companies whose Boards have common directors with the Company's Board

Sales and purchases between related parties are made at normal market prices Outstanding balances with entities other than subsidiaries are unsecured, interest free and cash settlement is expected within thirty days of invoice Terms and conditions for transactions with subsidiaries are the same, with the exception that balances are placed on intercompany accounts with no specified credit period The Group has not provided or benefited from any guarantees for any related party receivables or payables During the year ended 31 December 2010, the Group has not made any provision for doubtful debts relating to amounts owed by related parties (2009 – nil)

Key management compensation

Key management is considered to comprise all senior executives and directors of the Company including the CEO, COO, Executive Vice President, Vice President Exploration and Development and the Finance Director

	2010 USD'000	2009 USD'000
Salaries and other short-term employee benefits	2,523	2,052
Share-based payments	1,172	832
	3,695	2,884

The share-based payments represent the IFRS 2 charge for the period

28 Capital commitments

The Group has commitments pursuant to its sub-soil licence agreements to continue to explore and develop the licence area Management estimates that at 31 December 2010 no such non-accrued licence commitments exist (2009 – 2 8 million USD)

Prior to 31 December 2010 the Group entered into contracts relating to work on the new gas plant, drilling, work-over and seismic services as part of the normal business activity Pursuant to these contracts, there were outstanding work commitments still to be delivered of 8 4 million USD (2009 – 14 8 million USD)

29 Contingencies

Russian business operating environment

During the year ended 31 December 2010 all of the Group's business was conducted in Russia through its investment in subsidiaries operating in the oil and gas industry These operations and those of similar companies in Russia are subject to the economic, political and regulatory uncertainties prevailing in Russia

The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition These characteristics have in the past included higher than normal historic inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside Russia Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product, Russia continues to develop economic reforms and improve its legal, tax and regulatory frameworks to bring it more in line with a stable market economy The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged As such, significant additional taxes, penalties and interest may be assessed It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review Under certain circumstances reviews may cover longer periods

Management believes that the Group has complied with all regulations, and paid and accrued all taxes that are applicable However, it is possible that the relevant local or national governmental authorities may attempt to revise their previous approach to such transactions and assess additional income and other taxes and duties against the Group

Notes to the consolidated financial statements

for the year ended 31 December 2010

29 Contingencies (continued)

Restoration, rehabilitation, and environmental costs

The Group operates in the upstream gas industry in the Russian Federation and its activities may have an impact on the environment The enforcement of environmental regulations in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered The Group periodically evaluates its obligation related thereto The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter interpretation and enforcement of existing legislation, cannot reasonably be estimated at present, but could be material Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group

Sub-soil licenses

The Group is subject to periodic reviews of its activities by Russian governmental authorities with respect to the requirements of its oilfield licences Management of the Group corresponds with governmental authorities to agree on remedial actions, if necessary, to resolve any findings resulting from these reviews Failure to comply with the terms of a licence could result in fines, penalties, licence limitation, suspension or revocation The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Group Management believes that in practice the relevant authorities rarely suspend or restrict the licences, especially at the exploration stage, and tend to terminate licences only in the event of continuous non-compliance and the failure of the licence holder to remedy breaches The Group is attempting to comply with its licence requirements and has not received any official warnings or notifications about continuous non-compliance or any risk of suspension, restriction or termination

30 Post balance sheet events

There were no significant post balance sheet events

31 Foreign exchange rates

The exchange rate at the year-end was 30 4769 RUB to 1 USD (2009 – 30 3135) and the average exchange rate for the year was 30 3692 RUB to 1 USD (2009 – 31 7409) For UK operations, the exchange rate at the period end was 0 6464 £ to 1 USD (2009 – 0 6193) and the average exchange rate for the period was 0 6329 £ per 1 USD (2009 – 0 6408)

Vostok Energy Plc

Parent company balance sheet

at 31 December 2010

	Notes	2010 USD'000	2009 USD'000
Non-current assets			
Property, plant and equipment	5	233	298
Investments in subsidiaries	6	348,229	264,465
		348,462	264,763
Current assets			
Trade and other receivables	7	3,952	4,567
Cash and cash equivalents		16,752	12,287
		20,704	16,854
Total assets		369,166	281,617
Current liabilities			
Trade and other payables	8	4,889	2,784
Non-current borrowings	9	99,801	8,018
Total liabilities		104,690	10,802
Net assets		264,476	270,815
Equity			
Share capital	10	1,870	1,851
Share premium	10	50,569	295,674
Own shares held	10	(11,600)	(5,983)
Currency translation reserve	10	45	27
Share option reserve	10	2,598	1,426
Equity component of convertible debt	9	6,048	1,964
Accumulated reserves/(deficit)		214,946	(24,144)
Total equity attributable to owners of the parent		264,476	270,815

These financial statements were approved and authorised for issue by the Board of Directors

Signed on behalf of the Board of Directors

Blaine Karst

Blaine Karst,
Director

20 May 2011

Vostok Energy Plc

Parent company statement of changes in equity

for the year ended 31 December 2010

	Share capital USD'000	Own shares held USD'000	Equity element of convertible debt USD'000	Share premium USD'000	Currency translation reserve USD'000	Share option reserve USD'000	Accumulated deficit USD'000	Total equity USD'000
Balance at 1 January 2009	1,701	–	–	252,195	29	594	(15,645)	238,874
Total comprehensive income for the year	–	–	–	–	(2)	–	(8,499)	(8,501)
Transactions with owners								
Share issues	150	–	–	45,833	–	–	–	45,983
Own shares issued to the employee benefit trust	–	(5,983)	–	–	–	–	–	(5,983)
Equity element of convertible debt	–	–	1,964	–	–	–	–	1,964
Share issue costs	–	–	–	(2,354)	–	–	–	(2,354)
Share option charge	–	–	–	–	–	832	–	832
Total of transactions with owners	150	(5,983)	1,964	43,479	–	832	–	40,442
Balance at 31 December 2009	1,851	(5,983)	1,964	295,674	27	1,426	(24,144)	270,815
Total comprehensive income for the year	–	–	–	–	18	–	(10,910)	(10,892)
Transactions with owners								
Share issues	19	–	–	(244,402)	–	–	250,000	5,617
Own shares issued to the employee benefit trust	–	(5,617)	–	–	–	–	–	(5,617)
Equity element of convertible debt	–	–	4,084	–	–	–	–	4,084
Share issue costs	–	–	–	(703)	–	–	–	(703)
Share option charge	–	–	–	–	–	1,172	–	1,172
Total of transactions with owners	19	(5,617)	4,084	(245,105)	–	1,172	250,000	4,553
Balance at 31 December 2010	1,870	(11,600)	6,048	50,569	45	2,598	214,946	264,476

Vostok Energy Plc

Parent company statement of cash flows

for the year ended 31 December 2010

	Notes	2010 USD'000	2009 USD'000
Operating activities			
Net cash flow used in operating activities	11	(5,518)	(8,314)
Net cash used in operating activities		(5,518)	(8,314)
Investing activities			
Investments in subsidiaries		(76,617)	(103,516)
Interest income on cash investments		5	210
Purchase of property, plant and equipment	5	(58)	(126)
Net cash used in investing activities		(76,670)	(103,432)
Financing activities			
Proceeds on issue of share capital		(4,335)	36,943
Interest payments on long term liabilities		(2,278)	(112)
Proceeds from convertible debt		93,364	6,693
Repayment of non-current borrowings		–	(2,168)
Net cash provided by financing activities		86,751	41,356
Net (decrease)/increase in cash and cash equivalents		4,563	(70,390)
Cash and cash equivalents at beginning of year		12,287	82,695
Effect of exchange rate changes on cash and cash equivalents		(98)	(18)
Cash and cash equivalents at end of year		16,752	12,287

Notes to the parent company financial statements

for the year ended 31 December 2010

1 Corporate information

Organisation and principal activities

The Company is a public limited company incorporated in Great Britain The principal activity of the Company is the management of investments in subsidiaries engaged in the exploration, development, and production of hydrocarbons The Company's main operating subsidiary is in Russia where the subsidiary holds a sub-soil licence for geological exploration and production of hydrocarbons To assist in management operations, the Company has a registered branch office in Moscow, Russia The registered UK office of the Company is Masters House, 107 Hammersmith Road, London, England, W14 0QH

2 Significant accounting policies

The Company's accounting policies, key accounting estimates and judgements follow those of the Group as set out in Note 2 to the consolidated financial statements The following accounting policies also apply to the Company

Basis of preparation

The financial statements are presented in US dollars No income statement is presented by the Company as permitted by section 408(3) of the Companies Act 2006

Investments in subsidiaries

Non-current investments in subsidiaries are included in the financial statements at cost The Company assesses investments for impairment whenever events or changes in circumstances indicate that the carrying value of an investment may not be recoverable If any such indication of impairment exists, the Company makes an estimate of its recoverable amount Where the carrying amount of an investment exceeds its recoverable amount, the investment is considered impaired and is written down to its recoverable amount

3 Taxation

As at 31 December 2010 the Company has unrecognised deferred tax assets which arose in the UK of 16 386 million USD (2009 - 11 949 million USD) Deferred tax has not been provided for these losses on the basis that it is not sufficiently certain there will be adequate taxable profits arising in the future to offset against the tax losses The losses incurred in the UK are available to carry forward indefinitely for offset against future taxable profits

4 Loss attributable to members of the parent company

The loss dealt with in the financial statements of the parent company is 10 910 million USD (2009 – 8 499 million USD)

Notes to the parent company financial statements

for the year ended 31 December 2010

5 Property, plant and equipment

	Office equipment and furniture USD'000	Motor vehicles USD'000	Total USD'000
Cost			
At 1 January 2009	346	–	346
Additions	114	61	175
Disposals	(6)	–	(6)
Translation differences	12	3	15
At 31 December 2009	466	64	530
Additions	26	32	58
Disposals	(2)	–	(2)
Translation differences	–	(1)	(1)
At 31 December 2010	490	95	585
Depreciation			
Accumulated depreciation at 1 January 2009	115	–	115
Charge for the year	96	10	106
Disposals	(2)	–	(2)
Translation differences	13	–	13
At 31 December 2009	222	10	232
Charge for the year	104	18	122
Disposals	(2)	–	(2)
At 31 December 2010	324	28	352
Net book value			
At 31 December 2009	244	54	298
At 31 December 2010	166	67	233

6 Investments in subsidiaries

	Investment in subsidiary undertakings USD'000	Loans to subsidiary undertakings USD'000	Total USD'000
Balance at 1 January 2009	30,593	128,070	158,663
Additions	11,213	94,589	105,802
Balance at 31 December 2009	41,806	222,659	264,465
Additions	253,819	–	253,819
Disposals	–	(170,055)	(170,055)
Balance at 31 December 2010	295,625	52,604	348,229

Information on investments in subsidiaries can be found in the Directors' Report in the consolidated financial statements The investment costs relate to the acquisition and funding of exploration and development operations in Russia

All loans to subsidiaries are demand loans but are classified as long term as the Company does not expect to demand repayment of the advances in 2011

No interest was charged on loans to subsidiaries in the year (2009 – $nil)

Notes to the parent company financial statements

for the year ended 31 December 2010

7 Trade and other receivables

	2010 USD'000	2009 USD'000
Prepayments and deposits	325	372
Tax receivables	614	46
Other receivables	3,013	4,149
	3,952	4,567

Prepayments and deposits are advance payments for services to be rendered within the next twelve months Tax receivables relate primarily to value added tax payments that are expected to be recovered within the next twelve months

Other receivables includes 1 767 million USD (2009 – 430 thousand USD) relating to the current portion of amortized costs for non-current borrowings (Note 9) For 2009 other receivables also includes 3 516 million USD of prepaid costs for the non drawn-down portion of the convertible loan

8 Trade and other payables

	2010 USD'000	2009 USD 000
Trade payables	3,641	804
Accruals and other payables	1,248	1,940
Short-term borrowings	–	40
	4,889	2,784

9 Non-current borrowings

	Effective interest rate	2010 USD'000	2009 USD'000
Net amounts due in less than 5 years			
Convertible loan issued 18 September 2009	LIBOR + 4%	51,923	3,183
Convertible bond issued 13 October 2010	10%	46,111	–
		98,034	3,183
Amounts due in more than 5 years			
Convertible loan	LIBOR + 4%	–	4,405
		98,034	7,588
Current borrowings (assets) (Note 7)		(1,767)	(430)
Non-current borrowings (liabilities)		99,801	8,018
Net convertible bond		98,034	7,588
Convertible debt comprises			
Drawdown of the loan		60,000	10,000
Equity element		(6,048)	(1,964)
		53,952	8,036
Cost of borrowing		(5,538)	(516)
Capitalized interest		3,509	68
Net convertible loan		51,923	7,588
Convertible bond comprises			
Drawdown of the bond		50,000	–
Cost of borrowing		(3,889)	–
Net convertible bond		46,111	–

Notes to the parent company financial statements

for the year ended 31 December 2010

9 Non-current borrowings (continued)

On 18 September 2009 the Company entered into a convertible loan agreement to borrow up to 60 million US$ The convertible loan was drawn down in full at 31 December 2010

The loan is convertible into ordinary shares of the Company at any time up to 18 March 2012 at the loan holder's option Conversions done prior to 19 March 2011 are to be converted at a price of 3 0531 US$ per share From 19 March 2011 to 18 March 2012, the loan is convertible at 3 0531 US$ per share plus a pro-rated amount of margin payments at 4% interest made up to the time of the conversion For any unconverted amounts, the loan is to be repaid in six equal semi-annual installments beginning 15 June 2013 and ending on 15 December 2015

On 13 October 2010 the Company entered into a convertible bond agreement (the "bond") to borrow up to 50 million US$ The bond was drawn down in full at 31 December 2010

The bond is convertible into ordinary shares of the Company at any time up to 6 April 2013 at the bondholder's option To determine the number of ordinary shares received upon conversion, the amount of the bond to be converted is divided by the share price paid by investors for ordinary shares of the Company at the time of a Qualifying Initial Public Offering (the "QIPO") as defined in the convertible bond agreement At the Company's option, the conversion of the bond can be forced if the ordinary shares of the Company trade at a value of 50% above the QIPO price for at least 20 dealing days in any period of 30 consecutive dealing days any time prior to 6 April 2013 For any unconverted amounts, the bond is to be repaid in full in one installment on 13 April 2013

The net proceeds received from the issue of the convertible loan are split between a debt component and an embedded equity element The fair value of the convertible loan for the drawdowns taken in 2010 has been calculated as the present value of the contracted future cash flows using an assumed market interest rate of LIBOR plus 7% (2009 – 9%) The equity element is calculated as the difference between the principal amount and the fair value of the convertible loan The fair value of the convertible bond drawdown has been calculated at the present value of the contracted future cash flows using an assumed market interest rate of 12%

The interest charged for the year for the convertible loan and bond is calculated by applying the effective market interest rate of the assumed market interest rate to the liability component for the period since the convertible loan or bond was drawn-down The short term part of the convertible loan calculated at amortized cost using the effective interest rate is negative

10 Equity

Authorised and issued share capital

Authorised	2010 USD'000	2009 USD 000
250,000,000 ordinary shares of USD 0 01 each	2,500	2,500

In 2009, the shareholders approved an increase in the authorized share capital of the Company from 200,000,000 to 250,000,000 shares

Allotted, called up and fully paid	Shares No	Ordinary shares Amount USD'000	Share capital USD'000	Share premium USD'000	Own shares held USD'000
At 1 January 2009	170,068,760	260,023	1,701	252,195	–
Share issue 20 January 2009	1,460,000	4,457	14	4,443	(4,457)
Share issue 15 June 2009	500,000	1,526	5	1,521	(1,526)
Share issue 24 September 2009	13,101,438	40,000	131	39,869	–
Share issue costs	–	–	–	(2,354)	–
At 31 December 2009	185,130,198	306,006	1,851	295,674	(5,983)
Share premium reduction 30 June 2010	–	–	–	(250,000)	–
Share issue 20 July 2010	1,840,000	5,607	19	5,598	(5,617)
Share issue costs	–	–	–	(703)	–
At 31 December 2010	186,970,198	311,613	1,870	50,569	(11,600)

Redeemable shares

At 31 December 2010 there were 50,000 redeemable shares at 1 pound sterling in issue The shares were issued during the year in connection with the conversion of the Company to a public limited company

Notes to the parent company financial statements

for the year ended 31 December 2010

10 Equity (continued)

Own shares held

The Company has approval to transfer up to 4,460,000 shares to the EBT for allocation to officers and employees of the Group The formal establishment of the EBT was completed on 20 January 2009 In the current year 1,840,000 shares were issued pursuant to the EBT (2009 – 1,960,000) For presentation purposes, the shares held in the EBT are included as own shares held

On 30 June 2010 the Company reduced the share premium account by 250 million US$ as part of the process of converting to a public liability company

Currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of subsidiaries whose functional currency are not in US Dollars into the Group's presentation currency

Share option reserve

The share option reserve relates to the fair value of the equity-settled share based payments that have been expensed through profit or loss

Equity element of convertible debt

The equity element of convertible debt is the difference between the principal amount and the fair value of the loan and bond convertible debts reflecting values of the convertible option of the debt instruments

11 Reconciliation of loss from operations to net cash used in operating activities

	2010 USD'000	2009 USD'000
Loss before taxation	(10,910)	(8,499)
Adjustments for		
Foreign exchange losses	52	17
Tax for the year	(705)	1,495
Depreciation, depletion and amortization	122	106
Net finance costs	3,531	275
Interest income on cash invested	(5)	(210)
Accrued share based payments	1,172	832
Increase in trade and other receivables	615	(4,217)
Increase in trade and other payables	610	1,887
Net cash flow used in operating activities	(5,518)	(8,314)

12 Share-based payments

The Company grants awards of shares to staff as reward for past service and incentive to continue to work for the Group The shares are normally held jointly with the employee and the Employee Benefit Trust awarded at fair market value Senior management and key employees of the Company at nil cost The share awards vest at specified time intervals and vesting is dependent on staff remaining in full employment with the Company for a three year period The awards are equity settled

The fair value of the share awards was estimated at the grant date using a Black Scholes simulation model, taking into account the terms and conditions upon which the awards were granted

The following table shows details of share awards outstanding during the year

	2010 Shares	2009 Shares
As at 1 January	2,460,000	1,960,000
Granted during the year	1,340,000	500,000
As at 31 December	3,800,000	2,460,000
Vested at 31 December	2,820,000	898,667

Notes to the parent company financial statements

for the year ended 31 December 2010

12 Share-based payments

The following table lists the inputs to the model

	2010	2009
Award grant date	20 July	1 October
Number of awards	1,340,000	500,000
Fair value at grant date	$1 52	$1 52
Share price at grant date	$1 53	$1 53
Amount payable by executive	$3 05	$nil
Risk free rate	6%	6%
Dividend yield	nil	nil
Expected volatility	29 7%	32 7%
Expected life of awards	1 5 years	2 years
Weighted average remaining contractual life of share options at the end of the year	0 96 years	1 1 years

Expected volatility is based on historic share price movements The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome Maximum term for the awards is three years For key employees the probability that not all the awards will vest due to the resignation was set at 0% (2009 – 20%) No other features of options' terms were incorporated into the measurement of fair value

The following table lists liabilities arising from share-based payment transactions (amounts are in thousand USD)

	2010	2009
Carrying value of liability on share-based awards	2,598	1,426
Intrinsic value of vested awards	1,959	852

The expense recognised for share-based payments in respect of employee services received during the year is 1,172 thousand USD (2009 – 832 thousand USD)

Share options

In 2010, 1,340,000 shares (2009 – 500,000 shares) were approved as compensation to key employees and the senior management of the Group subject to vesting conditions being met, such shares vesting over a three year period from the date set in the joint operating agreements between employees and the EBT The actual shares issued to the EBT for the year were 1,840,000 (2009 – 1,960,000 shares)

Notes to the parent company financial statements

for the year ended 31 December 2010

13 Financial instruments

Financial instruments recognised in the balance sheet

	Loans and receivables USD'000	Other financial liabilities at amortised cost USD'000	Total USD 000
Year ended 31 December 2010			
Financial assets			
Non-current investments	52,604	–	52,604
Trade and other receivables	157	–	157
Current borrowings	–	1,767	1,767
Cash and cash equivalents	16,752	–	16,752
	69,513	1,767	71,280
Financial liabilities			
Trade and other payables	–	3,641	3,641
Non-current borrowings	–	99,801	99,801
	–	103,442	103,442
Year ended 31 December 2009			
Financial assets			
Non-current investments	222,659	–	222,659
Trade and other receivables	203	–	203
Current borrowings	–	430	430
Cash and cash equivalents	12,287	–	12,287
	235,149	430	235,579
Financial liabilities			
Trade and other payables	–	804	804
Short-term borrowings	–	40	40
Non-current borrowings	–	8,018	8,018
	–	8,862	8,862

The Company had no financial instruments held at fair value through profit and loss, held to maturity and no derivatives used for hedging

The main financial risks faced by the Company through its normal business activities are interest rate risk, credit risk, foreign currency risk and liquidity risk

Interest rate risk

The Company has financial assets and liabilities which are exposed to interest rate risk Changes in interest rates impacting borrowings change either their fair value (fixed rate borrowings) or their future cash flows (floating rate borrowings)

Whilst fixed rate interest bearing borrowings are not exposed to cash flow interest rate risk, there is no opportunity for the Company to enjoy a reduction in borrowing costs in markets where rates are falling In addition, the fair value risk inherent in fixed rate borrowing means that the Company is exposed to unplanned costs should borrowings be restructured or repaid early as part of the liquidity management process In contrast, whilst floating rate borrowings are not exposed to changes in fair value, the Company is exposed to cash flow risk as costs increase if market rates rise

Interest on financial instruments classified as floating rate is re-priced at intervals of less than one year Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument The other financial instruments of the Company that are not included in the tables below are non-interest bearing and are therefore not subject to interest rate risk

Notes to the parent company financial statements

for the year ended 31 December 2010

13 Financial instruments (continued)

The following tables set out the carrying amount, by maturity of the Company's financial instruments that are exposed to interest rate risk

	Within 1 year USD'000	1-2 years USD'000	3-5 years USD'000	> 5 years USD'000	Total USD'000
Year ended 31 December 2010					
Floating rate					
Cash and cash equivalents	16,752	–	–	–	16,752
Borrowings	1,767	2,152	(101,953)	–	(98,034)
Year ended 31 December 2009					
Floating rate					
Cash and cash equivalents	12,287	–	–	–	12,287
Borrowings	430	440	(8,458)	–	(7,588)

A one per cent increase/decrease in interest rates on floating rate assets and liabilities would have decreased/increased investments in subsidiaries by 449 thousand USD (2009 – 4 thousand USD)

Credit risk

Credit risk is the potential exposure of the Company to loss in the event of non-performance by a counter- party The amount that best represents the maximum credit exposure of the Company's financial assets is the carrying value of the financial assets at the balance sheet date

This risk arises principally from cash and cash equivalents Management's policy is to hold cash and cash equivalents in reputable financial institutions of which 99 4% (2009 – 99 2%) of cash and cash equivalents are held in reputable financial institutions in the UK

Maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date

Foreign currency risk

Fluctuations in exchange rates can have significant effects on the Company's reported profit or loss The Company's financial assets and liabilities give rise to transactional currency exposures Such exposures arise from transactions in currencies other than the Company's functional currency

Cash balances in the Company are usually held in US dollars, but smaller amounts may be held in pounds sterling or local currencies to meet operating and administrative expenses or to comply with local legislation

The Company does not have formal arrangements to mitigate foreign exchange risks at this time however as circumstances dictate, the Group considers hedging positions to protect the value of any cash balances it holds in non-US dollar currency or to protect against exchange fluctuations on future non-USD denominated commitments or obligations

Notes to the parent company financial statements

for the year ended 31 December 2010

13 Financial instruments (continued)

The following table demonstrates the Company's exposure to foreign currency risk based on gross amounts

	US dollar USD'000	Sterling USD'000	Euro USD 000	Russian ruble USD'000	Total USD'000
Year ended 31 December 2010					
Intercompany advances	52,604	–	–	–	52,604
Cash and cash equivalents	16,467	188	–	97	16,752
Trade and other receivables	101	–	–	56	157
Trade payables	(2,540)	(1,041)	(13)	(45)	(3,639)
Borrowings	(98,034)	–	–	–	(98,034)
Year ended 31 December 2009					
Intercompany advances	222,659	–	–	–	222,659
Cash and cash equivalents	12,015	173	–	99	12,287
Trade and other receivables	30	173	–	–	203
Trade payables	(636)	(86)	(9)	(73)	(804)
Borrowings	(7,588)	–	–	–	(7,588)

A ten per cent strengthening of US dollar against the following currencies would have decreased loss before tax and impact the Company's equity by the amounts shown below For a ten per cent strengthening of the US dollar against the euro there is no significant impact on loss before tax or on the Company's equity This analysis assumes that all other variables remain constant and the analysis is performed on the same basis for 2009

	Effect on loss before tax/equity USD'000
Year ended 31 December 2010	
Pounds sterling	85
Russian ruble	(11)
Year ended 31 December 2009	
Pounds sterling	(26)
Russian ruble	(3)

A ten percent weakening of the US dollar against the above currencies would have had an equal but opposite effect on the basis that all other variables remain constant

Liquidity risk

Liquidity risk is the risk that sources of funding for the Company's business activities may not be available

Management is continually monitoring cash requirements for the Company and evaluating potential sources to fund its operating and capital expenditures All Company entity operations are controlled through annual and monthly budget reviews to mitigate liquidity risk It is the goal of management to ensure adequate funding is available through an appropriate mix of debt and equity instruments In 2010 the Group arranged a convertible debt financing facility (Note 9) of 50 0 million USD (2009 – 60 0 million USD) to complete the construction of its gas processing facility and cover other development and exploration costs

The table below summarises the maturity profile of the Company's financial liabilities at 31 December 2010 and 2009 based on contractual undiscounted payments

	On demand USD'000	Less than 3 months USD'000	3 to 12 months USD'000	1 to 5years USD'000	>5 years USD'000	Total USD'000
Year ended 31 December 2010						
Trade payables	–	(3,641)	–	–	–	(3,641)
Non-current borrowings	–	1,925	5,775	126,956	–	134,656
Year ended 31 December 2009						
Trade payables	–	(804)	–	–	–	(804)
Non-current borrowings	–	113	351	8,531	3,496	12,491

Notes to the parent company financial statements

for the year ended 31 December 2010

13 Financial instruments (continued)

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements Fair value has been determined as at the balance sheet date by discounting the estimated future cash flows at prevailing interest rates

	Book value		Fair value	
	2010 USD'000	2009 USD'000	2010 USD'000	2009 USD'000
Intercompany advances	52,604	222,659	52,604	222,659
Cash and cash equivalents	16,752	12,287	16,752	12,287
Trade and other receivables	157	203	157	203
Trade payables	(3,641)	(804)	(3,641)	(804)
Current borrowings	–	(40)	–	(40)
Borrowings	(98,034)	(7,588)	(98,034)	(7,588)

Capital management

The primary objective of the Company's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximize shareholder value The Company has no externally imposed capital requirements The Company's aim is to finance its operations through equity and debt financing

The Company's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt No changes were made in the capital management objectives, policies or processes during the years ended 31 December 2010 and 2009

The Company monitors capital using a gearing ratio, which is non-current borowings divided by capital The Company's strategy is to reduce its gearing when the opportunity arises Capital comprises equity

	2010 USD'000	2009 USD'000
Borrowings	98,034	7,588
Capital	264,476	270,815
Gearing ratio	37%	3%

14 Related party transactions

Obligations to related parties

As at 31 December 2010 the Company had no non-current obligations to related parties as all obligations were paid out during the year

Transactions with related parties

	Charges to related parties USD'000	Purchases from related parties USD'000	Amounts owed by related parties USD'000	Amounts owed to related parties USD'000
Entities with key management of the Company				
2010	223	100	1	–
2009	92	204	172	245

The Company advances funds to its subsidiaries There was no interest accrued on the advances in 2010 (2009 – $nil) See Note 6 that details movements and year-end balances in respect of subsidiary undertakings

Notes to the parent company financial statements

for the year ended 31 December 2010

14 Related party transactions (continued)

Key management compensation

Key management is considered to comprise senior executives and directors of the Company including the COO, Executive Vice President, Vice President Exploration and Development and the Finance Director

	2010 USD'000	2009 USD'000
Salary and other short term employee benefits	1,362	1,469
Share-based payments	1,172	832
	2,534	2,301

The share-based payments represent the IFRS 2 charge for the period

During 2009 the Company advanced funds to the Chief Operating Officer to cover employment taxes in Russia At 31 December 2009 the Company had advances receivable of 133 thousand US$ as a result of the actual Russian employment tax liability being less than originally estimated All advances were recovered in 2010 and there were no advances receivable at 31 December 2010

15 Operating lease obligations

Operating lease payments primarily represent rentals payable by the Company for office space and equipment required for use on a temporary basis Longer term office leases will be entered into if terms are favourable but would include break clauses providing for a one to two year notice period

Lease payments under operating leases recognised in profit or loss for the year were 342 thousand USD (2009 – 561 thousand USD)

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

	2010 USD'000	2009 USD'000
Within one year	358	127
2 – 5 years	208	109

16 Post balance sheet events

There have been no post balance sheet events requiring disclosure

Annual General Meeting

The Company's Annual General Meeting ("AGM") will be held at the Company's offices at 4/5 Park Place, London SW1A 1LP on 29 June 2011 at 12 30 pm The Notice of Meeting follows, and sets out the business to be transacted An explanation of each of the resolutions follows below

Resolution 1 To Receive and Adopt the Annual Report and Accounts
The directors of the Company are required to lay the Annual Report and Accounts before the shareholders each year at the Annual General Meeting Resolution 1 is an ordinary resolution to receive and adopt the Company's Annual Report and Accounts for the financial year ended 31 December 2010

Resolutions 2, 3, 4, 5, 6, 7, 8 & 9 Re-appointment of Directors
The Company's Articles of Association require that every year any Director who shall have been a Director at each of the preceding two AGMs, retire from office and, if appropriate, seek re-appointment This year, Charles Jamieson, Robert Cathery, Blaine Karst, Roger Cagle, Ronald Harris, Mark Sadykhov and Jacob Ulrich retire in this way and ordinary resolutions 2, 3, 4, 5, 6, 7 & 8 are for their re-appointment

The Company's Articles of Association also require that any Director who has been appointed as such by the Board since the last AGM, retire from office and, if appropriate, seek re-appointment This year, John Orange retires in this way and ordinary resolution 9 is for his re-appointment

Resolution 10 Re-appointment of Auditors
The Company's Auditors are required to be re-appointed at every AGM Resolution 10 is an ordinary resolution to approve the re-appointment of Ernst & Young LLP as auditors

Resolution 11 Auditors Remuneration
This resolution is to authorise the Directors, as is customary, to negotiate and agree the remuneration of the auditors In practice, the Audit Committee will consider and approve the audit fees on behalf of the Directors

Vostok Energy Plc (the "Company)

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the Company will be held at the Company's offices at 4/5 Park Place, London SW1A 1LP on 29 June 2011 at 12 30 pm

AGENDA

To consider and, if thought fit, approve the following ordinary resolutions numbered 1 to 11

1. To receive and adopt the Directors' Report and Accounts for the period ended 31 December 2010,
2. To re-appoint Charles Jamieson as a director of the Company,
3. To re-appoint Robert Cathery as a director of the Company,
4. To re-appoint Blaine Karst as a director of the Company,
5. To re-appoint Roger Cagle as a director of the Company,
6. To re-appoint Ronald Harris as a director of the Company,
7. To re-appoint Mark Sadykhov as a director of the Company,
8. To re-appoint Jacob Ulrich as a director of the Company,
9. To re-appoint John Orange as a director of the Company,
10. To re-appoint Ernst & Young LLP as auditors,
11. To authorise the directors to fix the remuneration of the auditors,

By order of the board

Tony Hunter
Secretary

20 May 2011

Registered Office Masters House, 107 Hammersmith Road, London W14 0QH
Registered in England and Wales No 5806076

Notes

1. A member entitled to vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote instead of him A proxy need not be a member of the Company
2. A Form of Proxy is enclosed with this notice
3. To be valid, the Form of Proxy and any power of attorney, or notarially certified copy thereof, under which it is executed, must be lodged with the Company Secretary, Vostok Energy Plc, Masters House, 107 Hammersmith Road, London, W14 0QH not later than 12 30pm on Monday 27 June 2011, or, if the meeting is adjourned, not later than 48 hours before the time set for such adjournment
4. The completion and return of the Form of Proxy does not preclude a member from attending the meeting and voting in person