Placing and Admission to AIM

URALS ENERGY

Morgan Stanley


General
Location Map
7 Urals Energy Fields
Russia
March 2005
URALS NORD LICENSES
PESCHANOOZERSKOYE FIELD
ZAO ARCTICNEFT
YUZHNO-TYEBUKSKOYE FIELD
ZAO CNPSEI
SOSNOVSKOYE FIELD
ZAO CNPSEI
NEFEDOVSKOYE FIELD
ZAO CHEPETSKOYE NGDU
POTAPOVSKOYE FIELD
ZAO CHEPETSKOYE NGDU
ZOTOVSKOYE FIELD
ZAO CHEPETSKOYE NGDU
OKRUZHNOYE FIELD
ZAO PETROSAKH
Kolguyev Island
Sakhalin Island
RUSSIAN FEDERATION
ARCTIC OCEAN
BARENTS SEA
KARA SEA
LAPTEV SEA
EAST SIBERIAN SEA
BERING SEA
SEA OF OKHOTSK
SEA OF JAPAN
BALTIC SEA
BLACK SEA
CASPIAN SEA
ARAL SEA
NORWAY
SWEDEN
FINLAND
DENMARK
GERMANY
POLAND
CZECH REP.
SLOVAKIA
HUNGARY
ROMANIA
MOLDOVA
UKRAINE
BELARUS
LITHUANIA
LATVIA
ESTONIA
TURKEY
GEORGIA
ARMENIA
AZERBAIJAN
IRAN
AFGHANISTAN
TURKMENISTAN
UZBEKISTAN
TAJIKISTAN
KYRGYZSTAN
KAZAKHSTAN
MONGOLIA
CHINA
JAPAN
Moscow
Samara
Perm
Tyumen
Surgut
Urengoy
Tomsk
Novosibirsk
Chita
Vakutsk
Magadan
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URALS ENERGY

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the contents of this document or the action that you should take, you should consult a person authorised under the Financial Services and Markets Act 2000 ("FSMA") who specialises in advising on the acquisition of shares and other securities.

The Directors of the Company, whose names appear on page 8, accept responsibility, individually and collectively, for the information contained in this document and compliance with the AIM Rules. To the best of the knowledge and belief of the Directors, who have taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and there is no omission likely to affect the import of such information.

This document is an admission document which has been drawn up in accordance with the AIM Rules. This document has been issued in connection with the application for admission to trading of the shares on the AIM Market operated by London Stock Exchange plc ("AIM") (the "Admission"). This document does not comprise a prospectus for the purposes of the Prospectus Rules published by the Financial Services Authority of the United Kingdom (the "FSA"), as amended (the "Prospectus Rules") and a copy of it has not been, and will not be, approved by the FSA.

Application has been made for all of the shares of the Company in issue and to be issued, pursuant to the placing of shares on behalf of the Company (the "Placing"), to be admitted to trading on AIM. AIM is a market designed primarily for emerging or smaller companies to which a higher investment risk tends to be attached than to larger or more established companies. AIM securities are not admitted to the Official List of the United Kingdom Listing Authority. A prospective investor should be aware of the risks of investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with an independent financial adviser. Neither London Stock Exchange plc nor the United Kingdom Listing Authority has examined or approved the contents of this document.

The whole of this document should be read. An investment in the Company involves a significant degree of risk, may result in the loss of the entire investment and may not be suitable for all recipients of this document. Investors should consider carefully the risk factors which are set out in Part IV of this document.

Urals Energy Public Company Limited

(Incorporated and Registered in Cyprus Under the Companies Law, Cap 113 (1951) of Cyprus)

Placing of 26,667,000 shares at a price of 240 pence per share to raise £64,000,800 and Admission to trading on AIM

Nominated Adviser

Morgan Stanley & Co. International Limited

Share capital immediately following the Placing

Authorised			Issued and fully paid	
Number	Amount	Shares of par value of .25 Cyprus pence each	Number	Amount
100,000,000	CY£250,000		82,681,136	CY£206,703

The numbers for the authorised and issued share capital immediately following the Placing assume that no shares are issued pursuant to the Over-allotment Arrangements entered into by the Company.

All the shares will, on Admission, rank pari passu in all respects and will rank in full for all the dividends and other distributions declared, paid or made in respect of shares after Admission.

This document does not constitute an offer to sell or the solicitation of an offer to buy shares, in any jurisdiction in which such offer is unlawful. In particular, this document is not for distribution in or into Cyprus or the United States or to any resident or citizen of the United States, Canada, Cyprus, Russia, Australia or Japan. In addition, the shares have not been, and will not be, registered under the US Securities Act of 1933, as amended or under any state securities laws and may not be offered or sold in the United States and the shares have not been and will not be registered under the laws of the Russian Federation and may therefore not be offered or sold in the Russian Federation or to Russian persons. Purchasers of the shares may not offer to sell, pledge or otherwise transfer the Placing Shares in the United States or to, or for the benefit of, US persons (other than distributors) unless such offer, sale, pledge or transfer is registered under the US Securities Act or an exemption from registration is available. The Company does not currently plan to register the shares under the US Securities Act of 1933, as amended, or the shares under the US Securities Exchange Act of 1934, as amended.

The shares have not been and will not be registered under the securities legislation of Cyprus. Accordingly, the shares may not, subject to certain exceptions, be offered or sold, directly or indirectly, in or into Cyprus or to any national, citizen or resident of Cyprus.

MORGAN STANLEY

Morgan Stanley & Co. International Limited ("MSIL") and Morgan Stanley Securities Limited ("MSSL") are acting for the Company, and no one else, in connection with the Admission and the Placing, and will not be responsible to any person other than the Company for providing the protections afforded to their respective clients or for providing any advice in relation to the Admission or the Placing. MSIL's responsibilities as the Company's nominated adviser under the AIM Rules are owed solely to London Stock Exchange plc and are not owed to the Company or to any Director or to any other person whether in respect of his decision to acquire shares in reliance on any part of this document or otherwise. No representation or warranty, express or implied, is made by MSIL or MSSL as to any of the contents of this document for which the Company and the Directors are solely responsible. Neither MSIL nor MSSL has authorised the contents of, or any part of, this document and, without limiting the statutory rights of any person to whom this document is issued, no liability whatsoever is accepted by MSIL or MSSL for the accuracy of any information or opinions contained in this document or for any omissions of any information, for which the Company and the Directors are solely responsible. In particular, the information contained in this document has been prepared solely for the purposes of the Placing and the Admission and is not intended to inform or be relied upon by any subsequent purchasers of shares (whether on or off exchange) and accordingly no duty of care is accepted in relation to them.

The Company, MSIL and MSSL have only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of FSMA) in connection with the issue or sale of the shares in circumstances in which Section 21(1) of FSMA does not apply.

The distribution of this document and the offer of the shares in certain jurisdictions may be restricted by law. No action has been or will be taken by the Company, MSIL or MSSL to permit a public offering of the shares. Other than in the United Kingdom, no action has been or will be taken to permit the possession or distribution of this document (or any other offering or publicity materials or application form(s) relating to the shares) in any jurisdiction where action for that purpose may be required, or doing so is restricted or prohibited by law.

The placing of shares to persons who are resident in, or citizens of, or which are corporations, partnerships or other entities created or organised under the laws of countries other than the United Kingdom may be affected by the laws and regulations of the relevant jurisdiction. No person receiving a copy of this document in any territory other than the United Kingdom may treat the same as constituting an offer or an invitation to him to subscribe, apply for or purchase shares unless, in the relevant territory, such offer or invitation could lawfully be made without compliance with any registration or other legal requirements other than any such requirements which have been fulfilled. Accordingly, persons (including, without limitation, nominees and trustees) receiving this document should not, in connection with the Placing, distribute or send the same into any jurisdiction where to do so would or might contravene securities laws or regulations. It is the responsibility of any person outside the United Kingdom to satisfy himself as to the full observance of the laws and any regulatory requirements of the relevant territory in connection therewith, including obtaining any governmental or other consent which may be required, and compliance with other necessary formalities including the payment of any issue, transfer or other taxes due in such territory.

This document has been prepared solely for the benefit of the limited number of prospective investors to whom it has been addressed and delivered and may not, in any circumstances, be used for any other purpose or be viewed as a document for the benefit of the public. The reproduction, distribution or transmission of this document (either in whole or in part) without the prior written consent of the Company is prohibited.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive, each of MSSL and MSIL has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Member State it has not made and will not make an offer of shares to the public in that Member State, except that it may, with effect from and including such date, make an offer of shares to the public in that Member State:

(a) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;

(b) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or

(c) at any time in any other circumstances which do not require the publication by us of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of the above, the expression an "offer of shares to the public" in relation to any shares in any Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the shares to be offered so as to enable an investor to decide to purchase or subscribe the shares, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in that Member State.

In addition, until 40 days after the commencement of the Placing an offer or sale of shares within the United States by any dealer (whether or not participating in the Placing) may violate the registration requirements of the U.S. Securities Act of 1933, as amended.

MSSL, as agent for the Company, has agreed to procure subscribers for the Placing Shares or, failing which, to subscribe itself as principal for such shares at the Placing Price, on and subject to the terms of the Underwriting Agreement. The Placing Shares will represent 32.3% of the Enlarged Issued Share Capital. The Placing Shares are being placed by MSSL with institutional and other sophisticated investors and the Placing is conditional, inter alia, on Admission.

In connection with the Placing, MSSL, as stabilising manager, may (but will be under no obligation to) over-allot or effect other stabilisation transactions with a view to supporting the market price of the shares or any options, warrants or rights with respect to, or interests in, the shares or other securities of the Company, in each case at a higher level than that which might otherwise prevail in the open market. Such transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the period commencing on the date of announcement of the Placing Price and ending on the thirtieth day after the date of announcement of the Placing Price. However, there is no obligation on MSSL to effect stabilising transactions and no assurance that stabilising transactions will be undertaken. Such stabilisation, if commenced, may be discontinued at any time without prior notice. Save as required by law or regulation, MSSL does not intend to disclose the extent of any over allotments and/or stabilisation transactions conducted in relation to the Placing.

In connection with the Placing, MSSL, as stabilising manager, has entered into Over-allotment Arrangements with the Company, pursuant to which MSSL, or any person acting for it, may subscribe, or procure subscribers for, up to 4,000,050 Over-allotment Shares at the Placing Price, for the purposes of allowing MSSL, or its agent, to meet over-allocations in connection with the Placing and to cover short positions resulting from stabilisation transactions. Any decision to subscribe, or procure subscribers for, any Over-allotment Shares is expected to be taken by no later than 2 September 2005. The Over-allotment Shares made available pursuant to the Over-allotment Arrangements will rank *pari passu* with all other shares, including for all dividends and other distributions declared, made or paid on the shares after Admission and will form a single class for all purposes with the shares. See paragraph 8.2.2 of Part VII of this document for further details of these arrangements.

In connection with the Placing, MSIL and MSSL, and any of their respective affiliates acting as an investor for its or their own account(s) may subscribe for or acquire shares and, in that capacity, may retain, purchase, sell, offer to sell or otherwise deal for its or their own account(s) in such securities, any other securities of the Company or other related investments in connection with the Placing of otherwise. Accordingly, references in this document to the shares being issued, offered, subscribed for or otherwise dealt with should be read as including any issue or offer to, or subscription, acquisition or dealing by MSIL and MSSL or any of them and any of their affiliates acting as an investor for its or their own account(s). MSIL and MSSL do no intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

No person has been authorised to give any information or make any representation other than those contained in this document and, if given or made, such information or representations must not be relied on as having been authorised by the Company, MSIL or MSSL. Neither the delivery of this document nor any subscription or acquisition made under it shall, in any circumstances, create any implication that there has been no change in the affairs of the Company and its subsidiaries since the date of this document or that the information in it is correct as of any subsequent date.

This document contains forward-looking statements. Words such as "anticipate", "believe", "plan", "expect", "intend", "estimate", "project", "will", "should", "could", "may", "predict" and similar expressions are typically used to identify forward-looking statements. You are cautioned that actual results could differ materially from those anticipated in forward-looking statements. Also, where the Company makes estimates, these estimates may differ from comparable estimates in the D&M Report. The differences are due, *inter alia*, to timing and expenditure levels planned by the Company varying from those assumed in the D&M Report. Also, the forward-looking statements contained in this document are largely based on the Company's expectations, which reflect estimates and assumptions made by management and by D&M in the D&M Report. These estimates and assumptions by management reflect the Company's best judgment based on currently known market conditions and other factors, some of which are discussed below. Although the Company believes such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond the Company's control. In addition, management's assumptions about future events may prove to be inaccurate. The Company cautions all readers that the forward-looking statements contained in this document are not guarantees of future performance, and the Company cannot assure any reader that such statements will be realised or the forward-looking events and circumstances will occur.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, many of which are beyond the Company's control and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. These risks, uncertainties and other factors include, among other things, those listed under "Risk Factors," as well as those included elsewhere in this document. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates (including production targets) and intentions expressed in such forward-looking statements.

When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which the Company operates. Such forward-looking statements speak only as of the date on which they are made. Accordingly, the Company does not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. The Company does not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario. These cautionary statements qualify all forward-looking statements attributable to the Company or persons acting on the Company's behalf.

The D&M Report is contained in Part III herein. Your attention is directed, in particular, to the basis on which the reports were prepared, the representations made by the Company to D&M in the preparation of the report and the definitions, assumptions, explanations and qualifications relating to D&M's estimates set out therein. D&M also relied, without independent verification, upon information furnished by the Company with respect to the Company's ownership, subsurface data as it pertains to the target objectives and various other information that was accepted as provided and represented by the Company.

Illustrations and charts contained herein are principally derived from the Company's internal information and have not been independently verified unless specifically indicated.

A copy of this document is available to the public, free of charge, during normal business hours at the offices of Akin Gump Strauss Hauer & Feld, No. 1 Ropemaker Street, CityPoint, Level 32, London EC2Y 9AW for one month from the date of Admission.

CONTENTS

PLACING STATISTICS

Placing Price	£2.40
Number of Placing Shares	26,667,000
Number of shares subject to the Over-allotment Arrangements	4,000,050
Number of shares outstanding following the Placing(1)(2)	82,681,136
Percentage of the Enlarged Issued Share Capital subject to the Placing(1)(2)	32%
Estimated cash proceeds of the Placing (gross)(1)	£64,000,800
Estimated cash proceeds of the Placing receivable by the Company(1)	£58,375,870
Market capitalisation of the Company at the Placing Price(1)(2)	£198,434,726

EXPECTED TIMETABLE OF PRINCIPAL EVENTS(3)

Conditional dealings to commence on AIM	4 August 2005
Latest time for payment of the Placing Price in full	9 August 2005
Admission to trading effective and dealings in shares commence on AIM	9 August 2005

(1) Assuming that no Over-allotment Shares are acquired pursuant to the Over-allotment Arrangements.

(2) Assuming the conversion of the RP Explorer Notes into shares on the date of Admission.

(3) All dates in the table are subject to change.

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PART I

KEY INFORMATION

Urals Energy Public Company Limited is an independent exploration and production ("E&P") company with its principal assets and operations in Sakhalin Island, Timan Pechora (including areas in the Nenets Autonomous Okrug and Komi Republic) and the Republic of Udmurtia, Russia. The Company is focused on the integration of its five recently acquired subsidiaries and the exploitation of their assets. In addition, it is actively seeking to continue to grow and diversify its reserve and production portfolio through exploration activities and the acquisition of additional E&P companies or assets by taking advantage of the ongoing rationalisation of E&P assets in Russia.

The Company's five E&P subsidiaries have Proved and Probable reserves of 89.7 MMBOE and produced approximately 5,600 BOPD during the first six months of 2005. The Company's two largest subsidiaries by reserves and production, Petrosakh and Arcticneft, own and operate refining assets with a total refining capacity of 5,300 BOPD which provide the Company with the ability to maximise the value of the oil produced by choosing between the sale of oil or of refined products depending on market conditions, tax considerations and other factors.

The Company has the following key characteristics:

Russian E&P assets with a combination of current oil production with development and exploration potential

- Proved reserves of approximately 56 MMBOE, Probable reserves of approximately 34 MMBOE and Possible reserves of approximately 28 MMBOE, as well as maximum risked prospective resources of 226 MMBOE, all as described in the reports (collectively the "D&M Report") prepared by DeGolyer and MacNaughton ("D&M"), a leading independent petroleum consulting and reserve engineering firm with extensive experience in Russia. Investors should read the whole of the D&M Report provided in Part III of this document.
- Average daily production of approximately 4,200 BOPD for the first six months of 2005 and 5,600 BOPD if Arcticneft had been included over the same period.
- The only independent oil company offering E&P exposure to onshore and offshore Sakhalin Island, a Russian oil and gas region that has recently been a source for high profile exploration successes among international oil and gas companies, as well as to other oil-rich regions such as Timan Pechora and Udmurtia which have a well established infrastructure.

Favourable economic fundamentals through direct access to export markets for high quality oil combined with integrated refining operations

- Direct access by the Company's largest producing subsidiaries, Petrosakh and Arcticneft, to export markets resulting in the ability to export more than 70% of the oil production of all Company subsidiaries, which is more than twice the typical Transneft pipeline export allocation of 30–35%. Export oil sales prices have been traditionally much higher than prices for domestic oil sales in Russia. As a result of the proximity to export outlets of the Company's largest producing subsidiaries, the average selling price (net of applicable transportation, excise tax, export taxes, customs charges, VAT and refining costs) of oil from the total production of the Company's subsidiaries on a pro forma basis, including Arcticneft, was $28.75 per barrel in the first six months of 2005.
- High quality oil produced by Petrosakh with a gravity of approximately 36° API and by Arcticneft with an average gravity of approximately 47-50° API are typically sold at a price which is a premium to the international benchmarks of Oman and Brent, respectively.
- Integrated oil production and refining operations on Sakhalin Island and Kolguev Island (refining capacity of approximately 4,100 BOPD and 1,200 BOPD, respectively) providing greater marketing flexibility and resulting in improved netbacks.

Focus on organic growth and further acquisitions

- D&M estimates production increases to deliver approximately 8,300 BOPD by the end of 2006 and approximately 10,500 BOPD by the end of 2007 through in-fill drilling and well workovers, in each case from existing Proved and Probable reserves.
- Plans for exploration drilling on some or all of 16 identified prospects, including drilling of offshore blocks in Sakhalin and potential appraisal and exploration drilling in the oil rich Timan Pechora Basin.
- Identification and execution of further acquisition opportunities based on disciplined investment criteria and the application of Western evaluation techniques and parameters. The Company has completed three acquisitions of producing properties in the last 12 months, and believes that there is scope for further acquisitions.
- Consideration of opportunities to participate in future subsoil license auctions where it believes that they may offer access to economically attractive and prospective exploration and development opportunities with acceptable risk profiles.

Experienced Russian and Western management with a substantial investment in the Company

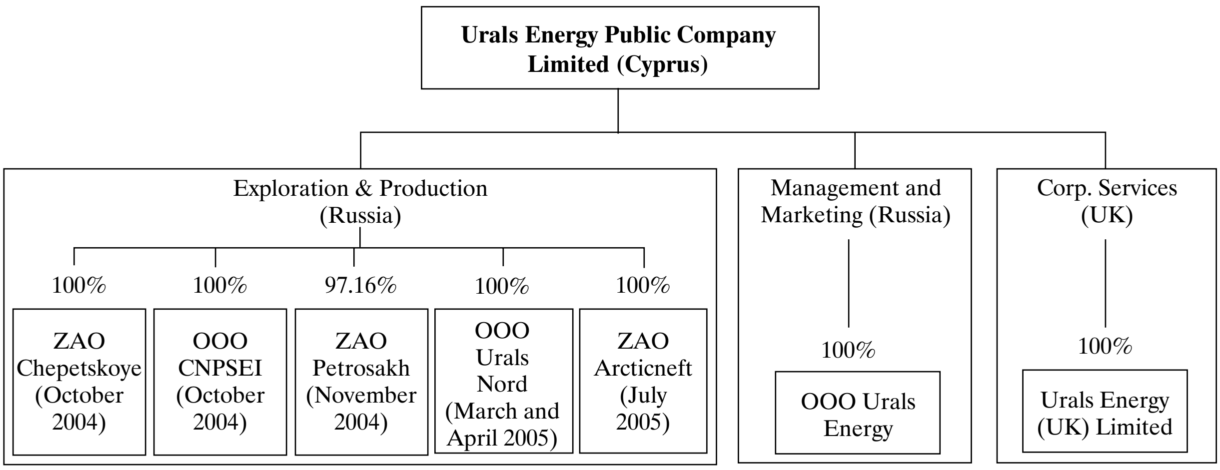
- The management of the Company are also principal investors in the Company. They are experienced Russian and Western businessmen who have invested and operated in the Russian oil industry since the early 1990s. The management team has extensive experience in acquiring and operating E&P assets in both Russia and Kazakhstan as well as in applying Western standards of operating efficiency, technical capabilities, controls and best practices.
- The management have built extensive relationships in the upstream oil sector with the major Russian oil companies and with key regulators and local and federal government bodies involved in production and transportation of oil in Russia.
- The Company's Chairman, Mr. Rovneiko, has been involved as an investor and manager of companies involved in trading oil from and producing oil in Russia since the early 1990s. The Company's CEO, Mr. Thomas, has recently served as CEO of Urals Energy NV, and as President of Nations Energy Group Ltd., a company with a substantial presence in the E&P sector in Kazakhstan. The President of the Russian operations, Mr. Dyachenko, has been involved in the Russian oil business for over ten years. All three have worked successfully together for the last five years.
- The Company's principal investors together formed Urals Energy NV in 2001 and assembled a portfolio of Russian oil assets that were producing approximately 30,000 BOPD (gross) when sold to LUKOIL in 2003 at a multiple of the initial investment.
- The Company's principal investors have directly and indirectly invested in excess of $80 million through equity contributions and loans in forming and growing the Company to date.

PART II

THE COMPANY

Urals Energy Public Company Limited was incorporated in Cyprus under the name Urals Energy Holdings Limited as a company with limited liability on 10 November 2003. The Company is beneficially owned by a small group of individuals through direct share ownership and private companies. Three of the individual investors comprise the executive committee of the Company's Board of Directors. Since its incorporation the Company has acquired and controls five Russian companies with exploration, development production and refining assets. The Company directs the management of the operations of its subsidiaries through its Moscow subsidiary, OOO Urals Energy.

The organisational structure of the Company and its subsidiaries (with acquisition dates for the subsidiaries) can be depicted as follows:



The Company is the holding company for all of its subsidiaries, including its Russian subsidiaries. It controls the overall planning, financing, oil marketing and acquisition strategy and oversees all exploration and development activity of its subsidiaries. The Moscow based subsidiary of the Company, OOO Urals Energy, directs all day to day operations. In the future, OOO Urals Energy plans to assume the function of the Russian subsidiaries' chief executive body, allowing the management of the Company to exercise effective direct control of all of their activities. The Company is putting in place additional systems and procedures that are intended to improve management access to current information on the results of operations of the Russian subsidiaries.

Except as otherwise provided in the Company's Articles of Association, the Company's Board of Directors and its committees are responsible for establishing all budgets adopted by its subsidiaries and controlling all major decisions on financing, capital expenditures and acquisitions. The Managing Director and the Chief Executive Officer each has authority to approve any single expenditure up to $5 million, whether for an acquisition, a financing or any other expenditure. The Executive Committee has authority to approve any single expenditure involving amounts greater than $5 million but less than $20 million. The Board of Directors makes decisions on overall strategic matters, including any decisions involving amounts equal to or greater than $20 million.

Each Russian subsidiary has its own General Director, Chief Accountant and local technical staff to carry out decisions communicated by the Company. The management of each subsidiary reports to the operational, accounting and other members of the senior management of OOO Urals Energy in Moscow. Each subsidiary signs its own contracts and is legally responsible for its own day to day activities, including the payment of all taxes and other governmental charges and employs its own local personnel to carry out such activities in accordance with the overall coordination and advice of the Company.

The Russian subsidiaries currently conduct their operations under numerous geological study licenses and production licenses. These licenses expire between 2006 and 2067, but may be extended. For a more detailed description of the licenses of the Company's subsidiaries, please read paragraph 8.1 of Part VII of this document.

Oil and refined product marketing decisions for all subsidiaries are coordinated through the Moscow headquarters of OOO Urals Energy. Depending upon prices that can be achieved for domestic and export oil sales and the sale of oil products, the Company's marketing department determines where the best net back prices can be achieved and directs the subsidiaries accordingly. For export oil, each subsidiary uses OOO Urals Energy as its export commissionaire in Russia, which entity acts as the selling agent and arranges for oil export and sales to the Company. The Company then sells such oil volumes at the export point to offshore third party purchasers. This enables the Company to aggregate supply, obtain competitive prices for the oil exported and optimise financing alternatives through coordinated export trade finance. Both OOO Urals Energy and the Company seek to recover a portion of the costs involved in their marketing activities with the principal proceeds paid directly to the Russian producing subsidiaries. In addition, Petrosakh and Arcticneft have direct access to export markets which allows the Company's subsidiaries to receive premium prices for the oil produced as compared with prices that are typically paid for the Urals blend sold via the Transneft pipeline system.

For domestic sales of oil and refined products, the Company and OOO Urals Energy co-ordinate sales made directly by the subsidiaries to third party purchasers. The refining capacity at the Company's main production subsidiaries, Petrosakh and Arcticneft, provides flexibility to sell oil and refined products domestically so as to achieve the best netback prices obtainable for the mix of export oil, domestic oil and refined products.

Finally, the quality of oil produced by Petrosakh and Arcticneft is higher than that of Urals blend. This enables the production of a higher value mix of refined products following primary distillation of the oil at Petrosakh's and Arcticneft's refining facilities than would be produced from the lower quality Urals blend.

Brief Summary of D&M Report

A brief summary of the Company's oil reserves and prospective oil resources appraised by D&M is provided below.

The D&M Report is contained in Part III of this document. Attention is directed in particular to the basis on which the reports were prepared, the representations made by the Company to D&M in the preparation of the report and the definitions, assumptions, explanations and qualifications relating to D&M's estimates set out therein. D&M also relied, without independent verification, upon information furnished by the Company with respect to the Company's ownership, subsurface data as it pertains to the target objectives and various other information that was accepted as provided and represented by the Company.

Reserves and Resources ('000 bbl)	**Proved Reserves**	**Probable Reserves**	**Possible Reserves**	**Probabalistic Resources[1]**
Petrosakh[2]	20,099	2,739	10,287	211,240
Arcticneft[3]	26,193	10,232	11,079	0
CNPSEI[2]	4,161	3,295	1,014	0
Chepetskoye NGDU[2]	5,380	17,581	5,484	0
Urals Nord[2]	0	0	0	14,979
Total	**55,833**	**33,847**	**27,864**	**226,219**

(1) Probabilistic risked high estimate according to D&M definition provided in Table 2 the Gross Prospective Resources report.

(2) As of 31 March 2005.

(3) As of 15 July 2005.

In addition to the reserve and prospective resource estimates, D&M has provided estimates of the net present value ("NPV") of the Proven and Probable reserves of the Company's subsidiaries. For a detailed explanation of the assumptions used in the NPV analysis and the pricing scenarios underlying the calculations, please refer to Part III which contains the D&M Report.

The NPV estimates for the base case pricing scenario as of 31 March 2005 are provided in the table below.

Net Present Value, $'000 (D&M Pricing Scenario B)[(2)]	Before Profits Tax		After Profits Tax[(1)]	
	Proved	Proved+ Probable	Proved	Proved+ Probable
Net Present Value at 8%	479,085	641,779	358,897	477,313
Net Present Value at 10%	417,870	543,960	311,740	402,357
Net Present Value at 12%	367,450	465,774	272,996	342,651

(1) Assuming Russian statutory profit tax rate of 24%.

(2) Pricing scenarios as defined in the D&M Report. The D&M Report contains three different pricing scenarios. Pricing scenario B is defined as the "base case" by D&M.

The table below provides historical daily oil production rates provided by the Company and the Company's estimate of future daily average oil production rates, in each case from Proved and Probable reserves as set out in the D&M Report:

Subsidiaries	Actual Historical Average Daily Production BOPD[(1)]				Estimated Future Net Proved + Probable Average Daily Production BOPD				
	2003	2004	January–March 2005	January–June 2005	April–December 2005[(1)]	2006	2007	2008	2009
Petrosakh	3,200	2,640	2,499	2,388	2,804	4,222	5,616	5,625	5,033
Arcticneft	1,798	1,595	1,395	1,334	1,527[(2)]	1,953	2,504	3,033	3,534
CNPSEI	791	1,054	1,045	1,014	982	1,255	1,729	1,923	1,948
CNGDU	766	739	803	846	916	885	666	674	1,340
Total	**6,555**	**6,028**	**5,742**	**5,582**	**6,228**	**8,315**	**10,515**	**11,255**	**11,855**

(1) Estimates from 1 April 2005–31 December 2005, with the exception of Arcticneft for which the average production is based on estimates of production for the period between 16 July 2005 and 31 December 2005.

(2) Average production for the period between 16 July 2005 and 31 December 2005.

Strategy for Growth and Value Creation

The Company's primary objective is to create value for its investors through the exploitation of its existing assets, with a strong focus on profitability and cash flow and through further acquisitions:

Growth through exploitation of existing assets

- The Company intends to develop its existing reserve base by in-fill drilling, well workovers and recompletions and other exploitation methods. The Company plans to spend approximately $38 million on development of its reserves before the end of 2007.
- The Company plans further exploratory activities, including 3D seismic activity and exploratory drilling, particularly on the offshore Pogranichny block licensed to Petrosakh and on the exploration licenses owned by Urals Nord in Timan Pechora. The D&M Report estimates a maximum risked prospective resource potential in the assets of Petrosakh and Urals Nord of approximately 226 MMBOE and a maximum unrisked resource potential of 943 MMBOE. The Company plans to spend approximately $25 million on exploration activities before the end of 2006.
- The Company applies Western technologies and efficiencies in the Company's subsidiaries and believes that it can achieve further gains in both operating and financial results by implementing a set of operating and management initiatives. These initiatives include:
  - — enhancement of production through well pump optimisation, use of dual completions and co-mingling, improved drilling and completion practices;
  - — use of 3D seismic and data integration and reservoir modeling;
  - — use of Western oilfield service providers such as Schlumberger where appropriate to optimise production;
  - — reduction of operating costs through streamlining the organisation and eliminating inefficiencies; and
  - — improved business processes through centralised decision-making and rigorous analysis of operational and technical data.

Value Creation Through Focus on Cash Flow and Profitability

The Company believes that there are opportunities to maximise the value of its existing reserves by exploiting the geographic location and refining capacity of the assets of its subsidiaries as follows:

- Maximising netbacks by adjusting the Company's marketing strategy and product output mix in response to fluctuations in prices. The Company intends to optimise its use of the existing refining facilities to benefit from the current high oil product pricing and refining margin environment. The Company has the ability to expand its refining capacity if oil production levels and the refined product market environment make it economically attractive.
- Exporting a higher than normal percentage of its oil production due to the location of its Petrosakh and Arcticneft subsidiaries that access export markets directly through wholly owned marine facilities.

Growth through further acquisitions

The experience, knowledge and relationships of the Company's management has enabled the Company to complete five acquisitions since the Company's formation in November 2003. The Company intends to continue to search for acquisition opportunities, focusing on properties with proven producing reserves that also have development and exploration potential. This acquisition strategy places particular emphasis on assets with the following characteristics:

— Proved and Probable reserves and current production;

— potential to increase production, either through the application of Western technologies or further development or both;

— control through either a sole ownership or majority position;

— percentage of exports greater than the amounts typically available through the Transneft pipeline system;

— potential to leverage the Company's existing physical and human resources, for example, by acquiring assets near existing operations of the Company's subsidiaries;

— location in areas that are not dominated by or under the control of one of the Russian vertically integrated companies; and

— appropriate risk-adjusted returns.

Although the Russian oil industry has experienced a marked consolidation since the mid-1990s, the Company believes that the industry will undergo further restructuring and rationalisation. In particular, the Company believes that the Russian upstream oil sector is following a similar cycle of consolidation and rationalisation similar to that seen in the U.S., Canadian and North Sea sectors over the past 25 years, with larger companies rationalising their portfolios through asset sales and smaller companies that lack the required technical and financial resources exiting the market. The Company has observed that Russian oil and gas majors portfolio rationalisation programmes, including the sale of smaller non-core activities, to enable them to focus on larger strategic opportunities. The industry is also characterised by a large number of smaller E&P companies that lack the required technical and financial resources to fully exploit their reserves. These factors combine to provide an opportunity for the Company to grow through the implementation of its acquisition strategy.

Each acquisition opportunity is identified, evaluated and executed under the direction of the Company's management. Acquisitions are also typically supported where advisable by outside legal, financial and technical experts for evaluation, due diligence and documentation. In considering acquisition opportunities, the Company uses Western evaluation techniques, sources of financing, standards of due diligence and transactional structures as determined by the Company's management. In evaluating acquisition opportunities, the Company seeks to ensure that the required returns adequately reflect the risks associated with each potential acquisition.

Overview of the Russian Oil Industry

Following the rapid privatisation drive in the mid-1990s, the Russian oil industry has evolved into a reasonably well defined sector, led by the Russian majors (LUKOIL, Surgutneftegaz, TNK-BP, Rosneft, Sibneft and others). These majors generally concentrate their operations in certain regions, owing to the fact that they were created from the remains of the Soviet controlled production associations that had asset concentration for efficiency reasons. A number of other smaller Russian and Western oil companies also conduct operations in Russia. The industry is highly competitive. Please see "Competition" in this Part II.

Constraints on pipeline exports is a factor that has kept domestic oil prices lower than comparable international prices and hindered a significant real increase in the domestic price of oil. Russian vertically-integrated oil companies are now typically seeking to increase the utilisation of their refining capacities but, given the increased profitability of export sales, many of them have until recently found it more profitable to export crude oil at higher world prices than to expend resources on refining. This has been changing recently as Russian domestic prices for oil have risen and the Russian government has raised the export tariffs on crude oil to a point where domestic sales of refined products now present an economic alternative to oil exports.

Russia has significantly increased its crude oil exports since 1991. Contributing factors include the fall in domestic demand, the continuing differential between domestic and foreign prices, the expansion of transportation capacity, especially pipelines, and the elimination of export quotas and licensing requirements in 1995. However, although export quantities have increased, they have been and will continue to be, restricted in the medium term by limited domestic and international pipeline transportation and port capacity.

The trunk pipelines for the transport of crude oil and refined products in Russia are controlled by Transneft and Transnefteproduct, both of which are State-controlled monopoly companies. The Russian government is expected to retain control over these entities for the foreseeable future. Most producers who do not have direct access to export markets are able to export only between 30–35% of their oil production through the Transneft system due to the capacity constraints and the allocation system of the Transneft system.

At present, the portion of the Transneft system dedicated to the export of crude oil is operating at or near capacity. Further, there are important capacity constraints in Russian oil-shipment terminals. Although there are Russian Government-sponsored and private programmes to improve pipeline and port capacity, it does not appear likely that the situation will improve significantly in the medium term.

Although refinery utilisation has increased in recent years due to some increase in domestic demand and, more importantly, to increased netbacks from the export of light petroleum products, refinery utilisation rates remain relatively low by international measures. This situation is gradually changing as demand and prices for refined products rise and as vertically integrated companies become more prepared to expend resources on refining.

The oil service sector has been substantially upgraded in recent years and many international service companies have expanded their operations in Russia to a point where the availability of Western services and supplies is comparable to the situation in more developed economies.

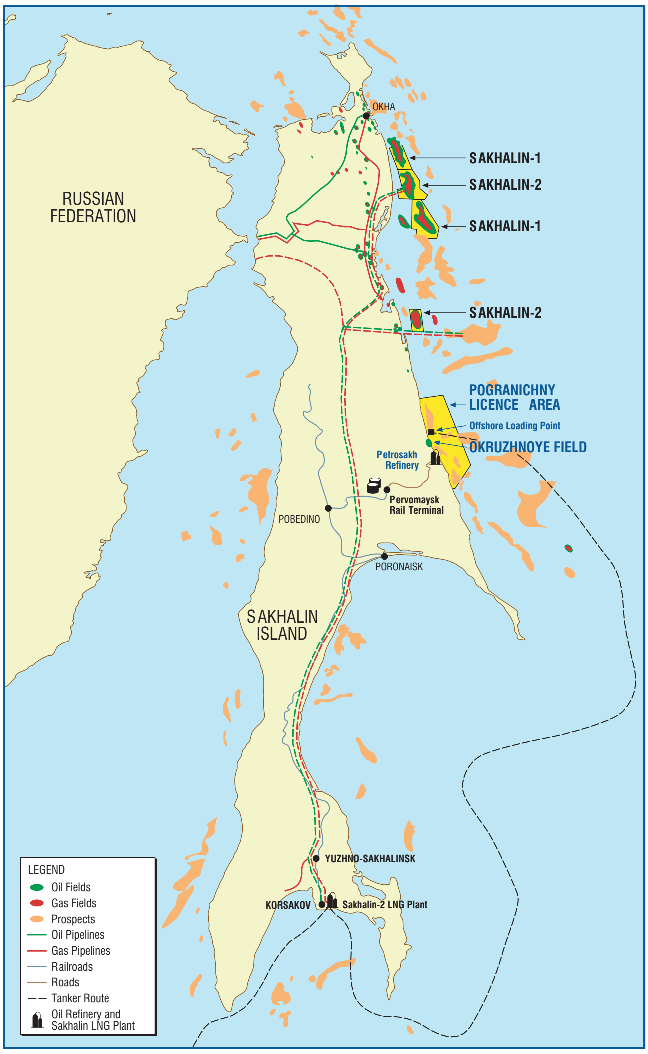
Description of the Company's Russian Subsidiaries

ZAO Petrosakh

History

ZAO Petrosakh ("Petrosakh") is a Russian closed stock private company headquartered in Yuzhno-Sakhalinsk, Sakhalin Oblast.

Petrosakh Area of Operation



Petrosakh was founded in 1991 as a Russian-U.S. joint venture to develop the Okruzhnoye field on the Eastern coast of Sakhalin Island. In 1993, Petrosakh was granted License No. YUSKH 00030 NE, subsequently reissued in May 1997 as the currently effective License No. YUSKH 00249 NE, to produce oil from the Okruzhnoye field for a period of 20 years.

In 1993, a 50% interest in Petrosakh was acquired by Nimir Petroleum Petrosakh Limited ("Nimir"), a subsidiary of Nimir Petroleum Group. Nimir accelerated the development of the field by drilling four new producing wells and recompleting 12 wells as producers. Nimir also constructed a 4,100 BOPD refinery, oil processing facilities, a marine export terminal and a 240-man work camp. By 1999, Nimir had invested approximately $150 million in the development of the Okruzhnoye field and production peaked at a rate of approximately 4,900 BOPD. Since that time, production gradually declined due to the lack of any substantial additional capital investment.

In or about 2000, Nimir Petroleum Group sold its ownership interest in Nimir to an affiliate of the Alfa Group, Moscow. From 2001 to 2002, Petrosakh drilled an additional three producing wells. In 2001, Petrosakh was granted License No. SHOM 10974 for the geological study of the Pogranichnoye Block which lies directly offshore and parallel to the existing Okruzhnoye field. In the summer of 2002, Petrosakh acquired a 480 square kilometre 3D seismic programme covering the central portion of the Pogranichnoye Block. In 2004, Petrosakh acquired an additional 65 square kilometres of 3D seismic in two programmes covering the Northern and Southern areas of the near-coastline transition zone. The Administration of Sakhalin Oblast currently controls a 2.84% minority ownership interest in Petrosakh which is held by its wholly-owned subsidiary, Sakhalin Oil Company.

The Company acquired full control of Nimir's 97.16% ownership interest in Petrosakh on 19 November 2004. As part of the agreement to acquire Petrosakh, the Company agreed to pay to the seller, Nimir, a perpetual royalty payment for any commercial quantities of oil produced and landed from the currently non-producing offshore areas covered by the license for the Pogranichnoye Block equal to $0.25 per tonne ($0.03 per barrel).

Management and Employees

Petrosakh is governed by a board of directors the majority of whom are representatives of the Company except for the nominee of Sakhalin Oil Company. Petrosakh's General Director is Mr. Yuri V. Motovilov who has served in that or similar capacities since 1991. Petrosakh has its headquarters office in the capital of Sakhalin Oblast, Yuzhno-Sakhalinsk, where it employs 36 administrative staff. Petrosakh has 294 field workers who work in 15 day rotational shifts and has 330 employees altogether.

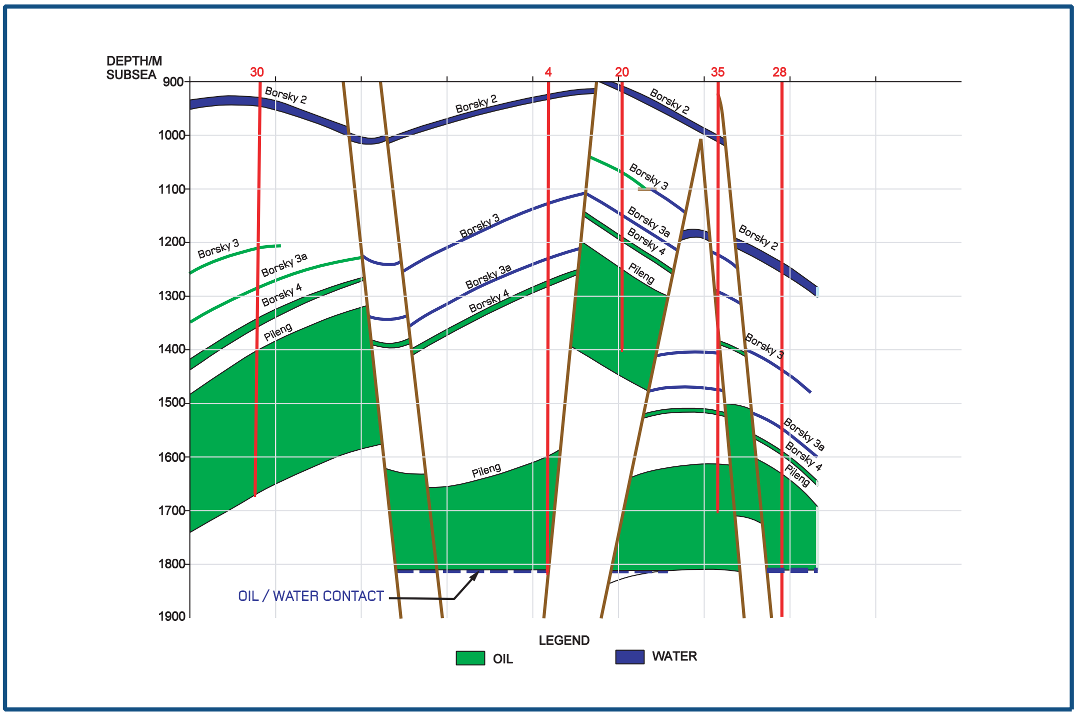
The Okruzhnoye Field

The Okruzhnoye oilfield is located in the North Sakhalin Basin approximately 500 kilometres Northeast of Yuzhno-Sakhalinsk and runs directly parallel to the Pacific Ocean coastline.

The field's areal extent is approximately 5.5 kilometres long by one kilometre wide. The primary producing reservoirs are the Borsky (Miocene age) and the Pileng (Paleogene age) and a total of five reservoir units hold reserves. Total cumulative production since commencement of production in 1992 from the field through 31 March 2005 is approximately 15.6 million barrels of oil. Both the Borsky and Pileng reservoirs are characterised by chertified sandstones and siltstones. The Borsky reservoir produces from four separate horizons (1,174–1,810 metres) with approximately 63.5 metres of net pay. The Pileng reservoir produces from two faulted accumulations with approximately 150 metres of net pay in the thickest section of the formation. The gross oil column for the field is approximately 560 metres.

The Okruzhnoye field is defined by a series of upthrown and downthrown fault blocks that are part of a Horst-Graben system with active tectonics. Heavy faulting is observed and micro-fractures created through compression enhance permeability as shown in the cross-section map below.

Okruzhnoye Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

The field currently produces oil from 14 wells, five of which are leased from Sakhalin Oil Company on long term leases on arms-length terms and has two injection wells, one water and one gas injection. Five wells are flowing producers and nine are produced with gas-lift. For the six months ended June 2005, the field's average daily oil production was 2,388 BOPD. Oil quality is light, sweet crude with a gravity of approximately 36° API (0.84 g/cm3), sulphur content of 0.28% and produced water of 3%.

The Company intends to continue the development of the Okruzhnoye field by drilling a minimum of 12 development wells and three water injection wells. In addition, up-hole completions in the Borsky reservoir are planned for five existing wells. The Company's plan is to drill three new development wells during 2005 and then temporarily halt drilling activities while a 20 square kilometre 3D seismic programme is acquired over the Okruzhnoye field. This 3D programme is contracted to begin in late November 2005 and will aid in selecting the location of future development wells. Following the interpretation of the onshore 3D programme, development drilling is planned to resume in 2006. The remaining nine wells are planned to be drilled and completed by the end of 2008. Drilling costs for each development well are estimated to be $2 million per well. This cost and timing estimate is based on the results of Well No. 43 (see below) and may be reduced depending on the type of rig employed for the second phase of the development drilling programme.

The first two development wells of the remaining nine well programme are planned for an area in the Eastern flank of the field that extends approximately 400 metres offshore. This area was covered by the 3D transition zone seismic programme acquired in 2004 and indicates an undeveloped package of Pileng reservoir. The first such development well, Well No. 43, spudded in March 2005 and reached a total depth of 1,900 metres on 24 June 2005. The well encountered a gross oil column of approximately 140 metres and is expected to be perforated and completed in late July 2005.

Assuming the successful completion of this development plan, the Company expects production will increase to approximately 7,000 BOPD in 2008.

Facilities and Infrastructure

Petrosakh's operations comprise integrated oil producing, processing, refining and transportation facilities. Most production facilities and equipment were imported from the United States and Canada. Petrosakh also has a rail terminal facility at Pervomaisk and its operational centre is located at the Okruzhnoye field site. Oil is transported by infield pipelines to a central processing plant with a capacity of 8,200 BOPD. Following processing, oil is either sent to export oil storage tanks or to Petrosakh's refinery directly adjacent to the processing plant. Total oil storage capacity for export is approximately 300,000 barrels. The amount of oil refined versus export storage is decided by the Company's management based on annual budgets, operating plans and prevailing market conditions.

Crude oil is exported by means of a pipeline which runs from the export tank farm to the sea bed and under the ocean floor to a pipeline end manifold located approximately half a kilometre offshore. There, a flange connects the undersea pipeline to a temporary rubber coated, steel-reinforced loading hose that is then attached to a tanker for loading. During loading, tankers are moored to buoys attached to seabed anchors by cable. A containment boom surrounds the tanker during loading operations to collect any spillage. Marine exports from Okruznhoye field site are seasonal depending on the presence of pack-ice which accumulates during the winter months. The typical navigation season is June through November.

The refinery has a capacity of up to approximately 4,100 BOPD of diesel, gasoline, kerosene and fuel oil (mazut). It was originally designed and built by Russell Industries Inc. of Tulsa, Oklahoma and then re-constructed at the Okruzhnoye field site with Hudson Engineering of Houston, Texas as primary contractor. The refinery began operations at Okruzhnoye field site in May 1994. The Company believes the capacity of the refinery can be increased from 4,100 BOPD to approximately 8,200 BOPD by installing an additional distillation tower, product cooler and re-boiler furnace. In the event increased oil production and market conditions justify this capital project, the Company intends to expand the refinery's capacity accordingly.

To transport refined products for sale to local markets, Petrosakh owns a fleet of 12 tanker trucks and a gravel-surfaced road that connects Okruzhnoye to the Pervomaisk rail terminal. At Pervomaisk, Petrosakh has a tank farm with product storage of 5,000 barrels, and rail loading racks to transfer products onto railcars for shipment to its customers, primarily located in Yuzhno-Sakhalinsk.

Oil Marketing

The ability of Petrosakh to sell oil on the local or export markets or to refine oil into products provides Petrosakh the flexibility to design its refining and export strategy designed to achieve price realisations for its oil production that is greater than it would otherwise be able to achieve. First and foremost, its off-shore island location means that it is not restricted to the Transneft 30-35% allocation for exports, and it can export all of its oil production for prices that historically have been higher than the prices achievable in the Russian domestic market. In addition, its high quality oil attracts a premium price when sold, which is also unavailable via the Transneft system that mixes high quality oil into a lower quality Urals blend, and produces a higher quality mix of refined products from primary distillation than the lower quality Urals blend. The refining capacity means that Petrosakh can take advantage of domestic prices for refined products that have recently been higher on a per barrel basis than comparable oil sales.

For 2005, the Company expects Petrosakh to produce approximately 982,500 barrels oil, of which approximately 187,500 barrels are planned to be refined into products, 37,500 barrels to be sold into local markets, and 757,500 barrels to be exported. For the six months ended June 2005, Petrosakh's refined product sales have resulted in a net selling price to the Company (net of VAT, excise taxes and refining and transportation costs) of $34.95 per barrel. This compares to a net oil export selling price (net of export taxes, customs charges and transportation costs) of approximately $33.57 per barrel.

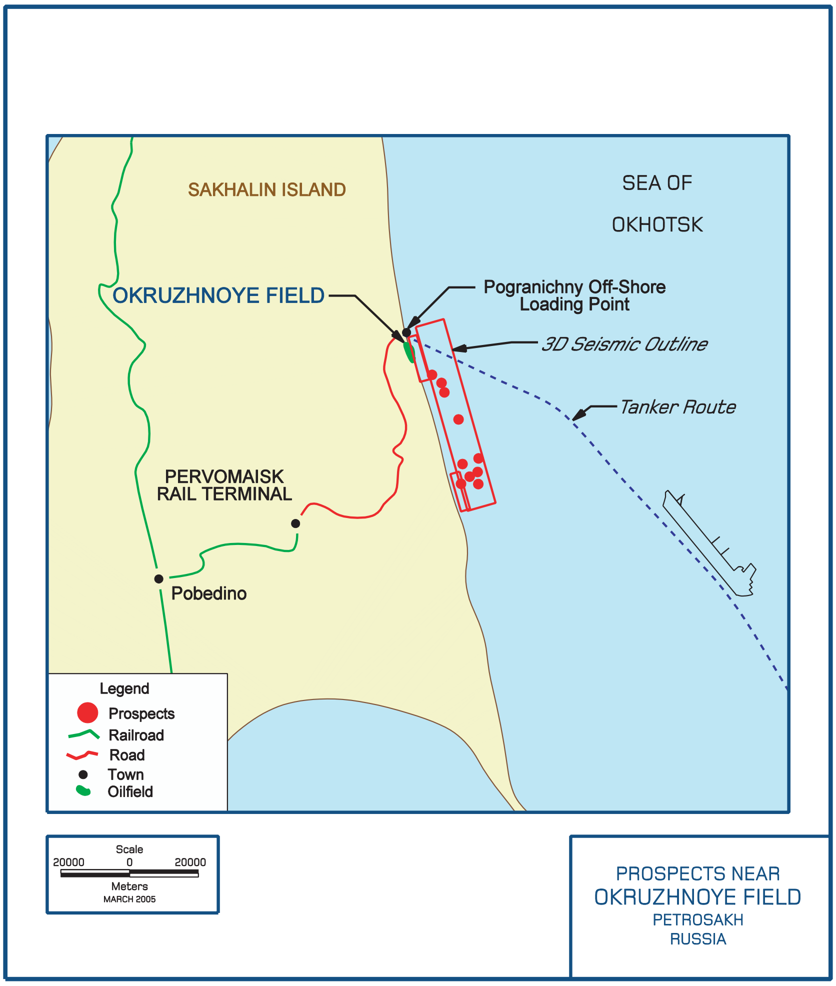
Petrosakh East Asian Export Markets

The Pogranichnoye Block

The exploration of the Pogranichnoye Block began in 2002 when a 3D seismic programme for 2002 was acquired by a joint venture of Dalmorneftegeophysika ("DMNG") and PetroGeophysical Services. The primary contractor for seismic processing and interpretation was DMNG, a Sakhalin-based seismic company that has provided seismic processing and interpretation for both the Sakhalin I project, led by ExxonMobil, and the Sakhalin II project, led by Shell. The 2004 transition zone seismic programme was acquired by Grant Geophysical and processed and interpreted by DMNG. The two 3D programmes cover a total of 545 square kilometres and evaluate much of the license area, except for the middle section of the coastal transition zone and certain deep water areas.

The results of DMNG's interpretation have been reviewed by both the Company and several outside geophysical consulting firms, including D&M. A total of 11 exploration prospects have been confirmed and mapped at the Pileng horizon. Gross unrisked prospective resources for the 11 prospects are estimated by D&M to be approximately 852 million barrels. This compares to a probabilistic and risked high estimate by D&M of approximately 200 million barrels.

Petrosakh Offshore Prospects



The Pogranichnoye license requires that Petrosakh commence one exploration well no later than the third quarter of 2005 and complete two exploration wells by November 2006 for which purpose Petrosakh will have to apply for the extension of the term of the license expiring in February 2006, which extension may only be granted to Petrosakh if it meets the requirements of the license including, *inter alia,* the above said minimum work requirements. Management is confident that it will meet the license requirements and be granted an extension. For this reason, and in order to secure the potential offered by this license area, the Company is moving quickly to comply with its license requirements.

The Company plans to drill a minimum of three exploration wells to test the prospectivity of the Pogranichnoye license area. If a discovery is made, Petrosakh intends to apply for a production license covering the areas that are deemed to contain oil. Petrosakh, with the assistance of the Company, is currently working with the licencing authorities to determine the areas that would be considered to be included in a production license should the planned wells be commercially successful with a view to maximizing the acreage to be included in any production license awarded to Petrosakh.

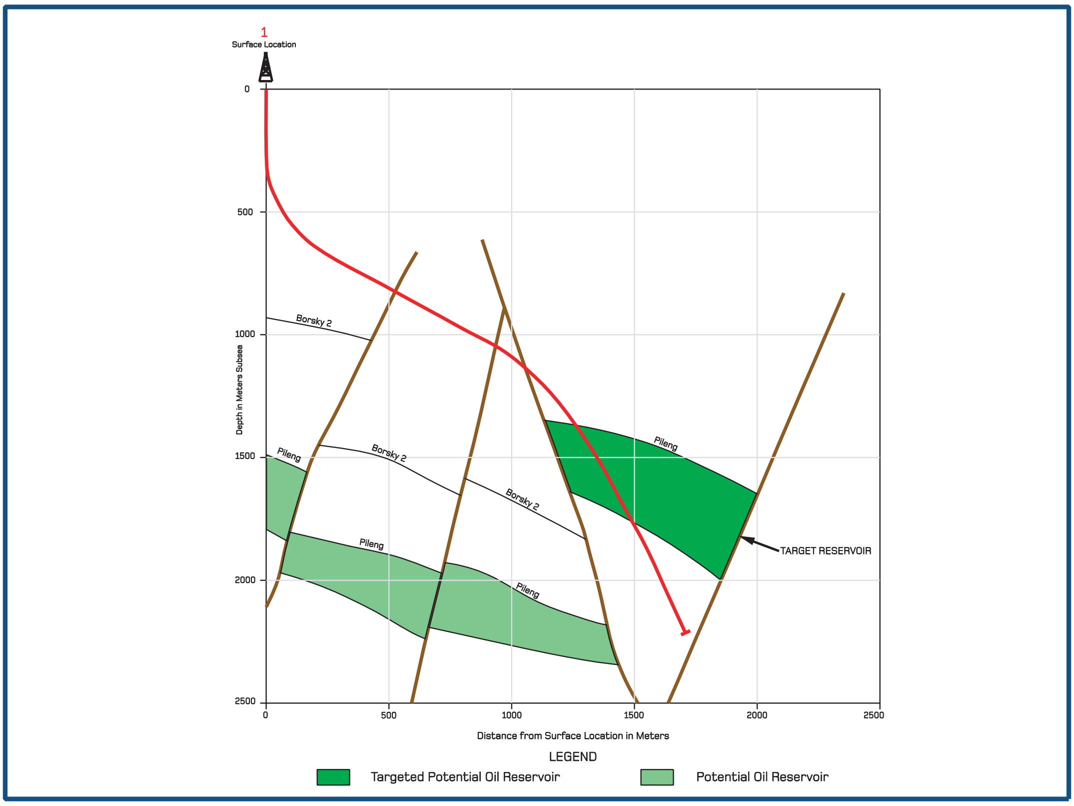
The Company has signed a reservation agreement with KCA Deutag Drilling GmbH for the T-2000 drilling rig, an arctic-class rig with the capability to drill extended reach wells. At a depth of 1,800-2,200 metres, the T-2000 is rated to drill approximately four kilometres offshore from the coastline at Okruzhnoye. To help manage the exploration drilling project, the Company has contracted Schlumberger Logelco Inc. (“Schlumberger”) to provide integrated project management services. As such, Schlumberger will act as the Company’s out-sourced drilling department during exploration drilling operations under the supervision of the Company’s Senior Vice President of Exploration and Production.

The T-2000 rig is currently located at Noyabrsk, Western Siberia and is being mobilised by rail and barge to the Okruzhnoye site. The Company has contracted with Lynden International and SEACOR Marine to manage the transportation of the T-2000 to Sakhalin Island. Once the barge reaches Okruzhnoye, it will offload the rig at Petrosakh's marine pier which has recently been strengthened for this offloading exercise. From the pier, the rig will be transported in pieces by truck to the drill site.

The first prospect to be evaluated is the East Okruzhnoye prospect located due east and offshore the existing Okruzhnoye field. The East Okruzhnoye structure is comprised of two main fault blocks: the Eastern and Western blocks. The prospect is a structurally-faulted anticline with two primary targets, the Borsky (875 metres subsea) and the Pileng (1,375 metres subsea) horizons.

The first exploratory well will test the Western fault block located approximately 1.3 kilometres offshore. Total measured depth is estimated to be 2,840 metres. Drilling is scheduled to begin by November 2005 and expected to require 40 days to reach target depth. The well has a planned trajectory estimated by Schlumberger that can be depicted as follows.

Planned Well Trajectory



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

Dry hole cost for this well is estimated at $5.75 million. D&M estimates that the gross unrisked resource potential for the Western fault block is approximately 24 million barrels.

The second well of the exploration programme will test the Eastern fault block of the East Okruzhnoye prospect located approximately 1.6 kilometres offshore and directly adjacent to the Western fault block. This prospect is similarly a structurally-faulted anticline with the same two primary targets, the Borsky and Pileng horizons. Total measured depth is estimated at 2,840 metres. Drilling is scheduled to begin in early January 2006 and completion estimated to be late February 2006. Dry hole cost for this well is estimated at approximately $5.8 million. D&M estimates that the gross unrisked resource potential for the Western fault block to be approximately 25 million barrels.

The third well, which is planned to be commenced by the end of the first calendar quarter of 2006, will test the Vitniskaya prospect located approximately 40 kilometres south of Okruzhnoye and 3.5 kilometres from the coastline. The prospect is a three-way dip closure bounded to the east by a closing fault. The primary targets are the Daginsky, Borsky and Pileng horizons. Although the Daginsky is not present in the Okruzhnoye field, the 3D seismic interpretation indicates the possible presence of Daginsky sandstones in the Vitniskaya prospect. The Daginsky formation is the primary producing reservoir for both Sakhalin I and Sakhalin II projects located further north along the coastline of Sakhalin Island (see the map on page 16).

To drill the Vitniskaya prospect, following completion of drilling in the East Okruzhnoye prospect, the T-2000 rig will be rigged-down and moved by truck on a winter road to the drilling site immediately adjacent to the coastline. This road is now being improved and temporary bridge-crossings strengthened to support the anticipated increased loads from moving the rig. Drilling is expected to commence in late March 2006 with completion estimated by May 2006. Dry hole cost for this well is estimated at approximately $9.0 million including mobilisation from Okruzhnoye to the drillsite. D&M estimates the gross unrisked resource potential for the Vitnitsky prospect to be approximately 51 million barrels.

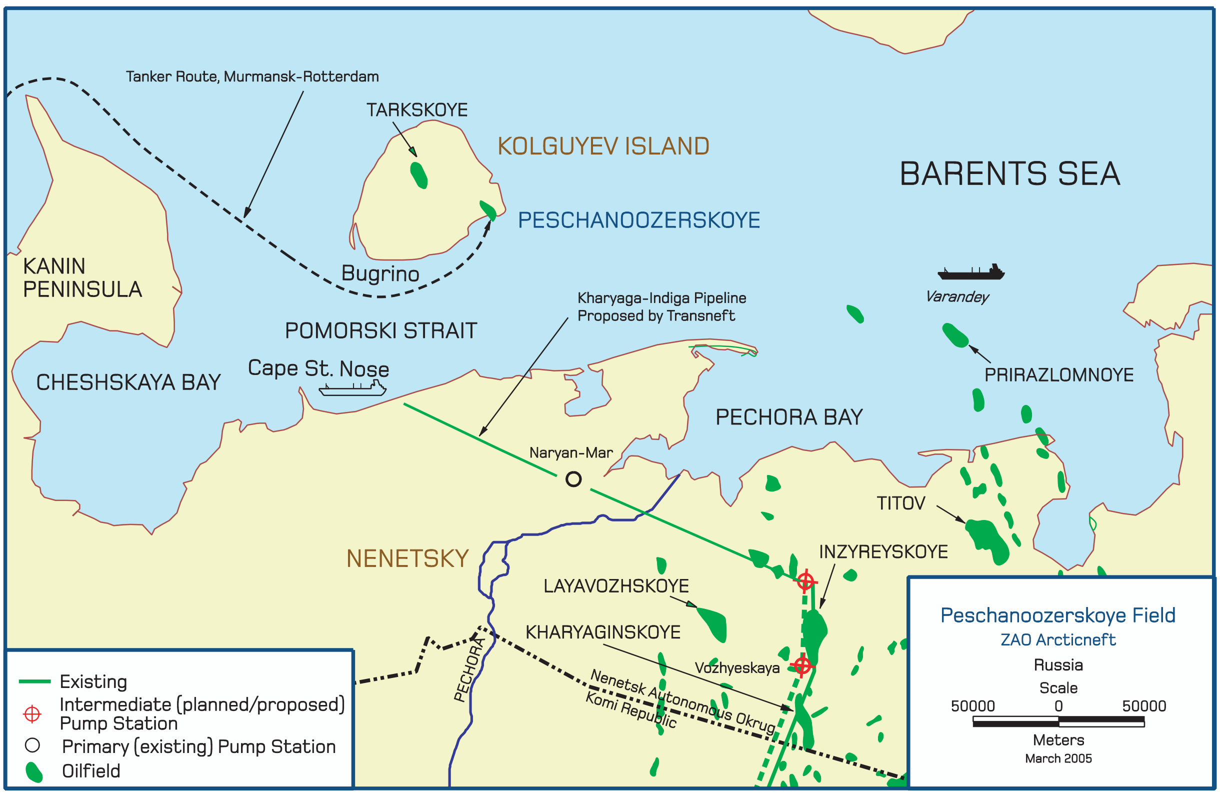
The Company estimates that the total cost of Petrosakh's three well exploratory programme to evaluate the Pogranichnoye license area will be approximately $25 million for integrated project management services, rig mobilisation services, exploration, drilling and testing.

ZAO Arcticneft

History

ZAO Arcticneft ("Arcticneft") is a Russian closed stock private company founded in 1998 by OAO Arkhangelskgeoldobycha (51%) and OAO LUKOIL-Arktik-Tanker (49%) for the purpose of developing and operating the Peschanoozerskoye field on Kolguyev Island in the Barents Sea.

Arcticneft Area of Operation



The field was originally discovered in the early 1980s by Arkhangeloskoye Production Geological Amalgamation, a predecessor of OAO Arkhangelskgeoldobycha, and production began in 1985. Following a re-organisation of LUKOIL-controlled subsidiaries in 1999, the Company was awarded a new production license No. NRM 00451 NE for the production of hydrocarbons from the field. The term of the license is until the later of the depletion of the field or 2067. In December 2004 the ownership interest of OAO LUKOIL-Arktik-Tanker was transferred to OOO LUKOIL-Kaliningradmorneft.

On 11 July 2005 the Company acquired 100% of the stock of Arctineft from OAO Arkhangelskgeoldobycha and OOO LUKOIL-Kaliningradmorneft.

Management and Employees

Arcticneft is governed by a board of directors, most of whom are senior executives of the Company. Its General Director is Viatcheslav A. Ivanov, who is also the Company's Vice President of Business Development. Following its acquisition by the Company, certain senior managers of Arcticneft were replaced and Company personnel were assigned key responsibilities for operations, accounting and oil marketing.

Arcticneft's headquarters are in the Northern Russian city of Murmansk, and the company is registered for tax purposes in the Nenets Autonomous Okrug. It maintains an operations centre in Murmansk including an office and a warehouse. Arcticneft owns a modern four story office building in Murmansk which is the company's administrative centre. There are presently approximately 385 employees. Arcticneft's operations personnel work in rotational shifts and are paid a hardship bonus for working in the arctic environment. Workers are rotated to the field site by plane from Murmansk to Kolguyev Island.

The Peschanoozerskoye Field

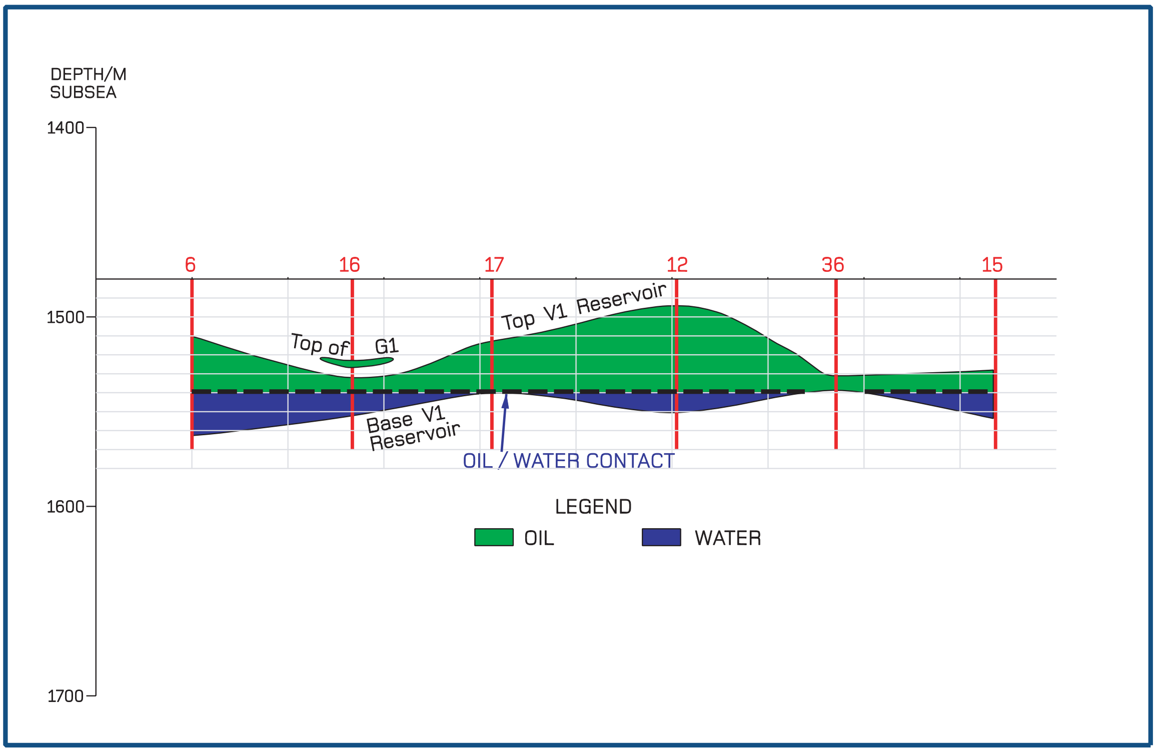
The Peschanoozerskoye field is located on Kolguyev Island in the Barents Sea approximately 150 kilometres from the Northern coastline of Russia. It lies in the Northern Timan Pechora Basin, one of Russia's most oil rich provinces.

The field is comprised of three blocks, West, Central and East. The Central block is subject to a separate mineral license owned by a state oil company. The West and East blocks comprise Arcticneft's license area.

An area within the license/block identified in technical documentation as the South block is mostly gas-bearing with possible reserves of 49.1 billion cubic feet of gas. Because there is no local sales market for this gas, D&M have classified these reserves as possible. Such gas as is currently produced from the South block is used by Arcticneft to generate electricity for oil-production operations.

The West and East blocks are the primary oil-bearing areas of Arcticneft's license. The areal extent of these blocks is approximately 13 kilometres by eight kilometres. The field is a four-way anticlinal closure with stratigraphic deposits present. The primary producing reservoir is the Charkaborzh, a Triassic-age sandstone. A total of nine different reservoirs are present, all of which are producing. The producing horizons range in depth from approximately 1,475 to 1,698 metres. A cross-section map of the field is presented below.

Peschanoozerskoye Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

For the six months ended June 2005, the field's average daily oil production was 1,334 BOPD from 33 wells. Most producing wells are on artificial lift. Water is injected for pressure maintenance through three injection wells. Arcticneft's crude is a light, sweet oil with a gravity of approximately 47° API (0.79g/cm3) that typically sells at a premium to Brent in international markets. The average sulphur content of the oil is 0.03% and produced water averages are approximately 7%.

Facilities and Infrastructure

The Peschanoozerskoye field was developed with traditional Russian drilling pads from which deviated wells were drilled. The oil is produced and transported by infield pipeline to the field processing facilities located in the centre of the field approximately three to five kilometres from the producing well pads. Following processing, the crude is either stored in the export tank farm or sent to one of two Crude Oil Topping Units ("COTU") and refined into oil products. The export storage tank farm has a capacity of approximately 470,000 barrels. The COTUs and the tank farm are located approximately 12 kilometres North of the centre of the field.

Arcticneft's COTUs have a combined maximum capacity of approximately 1,200 BOPD and produces gasoline, diesel and fuel oil. Diesel is generally used for electrical generation and other refined products are transported by tanker to local markets on the mainland. During 2004, Arcticneft refined approximately 80,000 barrels of oil, of which approximately 42,000 barrels were used for the generation of heat and electricity. The Company is reviewing the possibility of installing additional gas-fired electrical generating capacity to reduce diesel consumption and increase crude oil and refined product sales volumes.

Other Arcticneft infrastructure includes a 200-man work camp, operations office with satellite communications, warehouses, fire station, repair shop and garage, heating units, and one diesel-fired power station and two gas-fired turbine electrical generating units.

Oil Marketing

Crude exports are facilitated by Arcticneft's marine loading terminal located directly off the coast and adjacent to the field's tank farm and COTUs. Tankers are moored to buoys and a rubber loading pipeline is used to pump crude from the shore. Following loading, tankers transit to the port of Murmansk to clear customs prior to onward transportation to Rotterdam. Crude oil exports are limited by a navigation season from approximately June to November each year due to pack-ice that typically surrounds Kolguyev Island. Ice conditions are highly variable and may lengthen or shorten the navigation season by one or two months.

For the six months ended 30 June 2005, Arcticneft's export oil sales resulted in a net selling price (net of export taxes, customs charges and transportation) of $39.66 per barrel.

Future Development Plans

The Company believes that Arcticneft has significant potential to increase production, reduce costs and improve reserve recovery factors. To increase the rate of production, a well optimisation programme is planned, which includes the installation of downhole pumps in wells producing without the aid of artificial lift, and lowering the depth and increasing the stroke rate of existing downhole pumps where possible. The Company will search for a suitable drilling rig to drill approximately 68 planned infill development wells. This development programme is intended to reduce well spacing from its current distance of up to 2.5 kilometres between wells to a maximum of approximately 500 metres. If successful, this drilling programme is forecast to increase Arcticneft's daily production to approximately 3,000 BOPD by 2008.

The Company also believes that there is potential for additional well productivity through reservoir stimulation. In addition, the Company believes there may exist certain non-completed oil-bearing horizons that have never been fully evaluated or tested.

The Company intends to consolidate management of Arcticneft as soon as possible and to address certain perceived deficiencies in the internal control and information systems discovered in the acquisition due diligence process. New management is being installed on the island, the Murmansk administrative offices are being moved to an existing location owned by the Company, control of bank accounts and accounting functions are being assumed by the Moscow office of OOO Urals Energy and the control and management reporting functions will be linked to the same management reporting software system to be installed at all of the Company's subsidiaries.

Description of the Acquisition

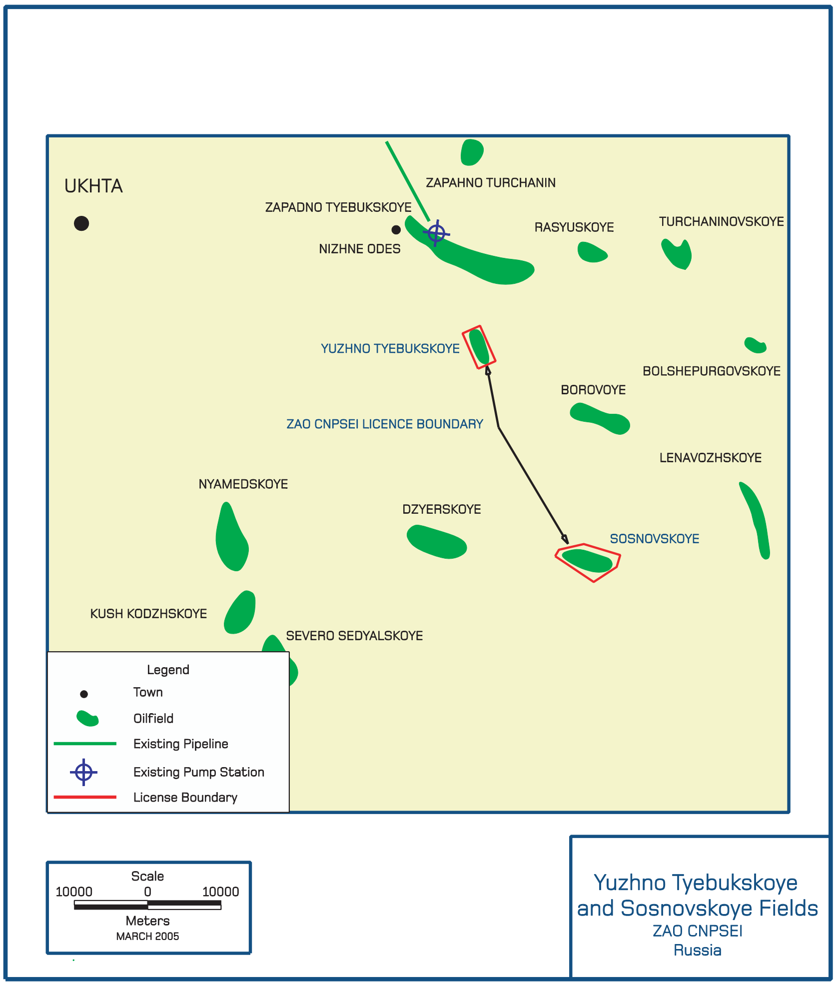
Arcticneft was acquired by the Company from two companies in the LUKOIL group on 11 July 2005. Details of the contract relating to the acquisition are set out in paragraph 8.1.2 of Part VII. The Company also entered into an arrangement to settle a dispute between Arcticneft and OOO Start concerning the ownership of 37 wells operated by Arcticneft. The implementation and completion of this settlement arrangement is subject to various conditions and actions of the parties involved. Further details of the settlement arrangements are set out on in paragraph 9 of Part VII of this document. During its acquisition due diligence, the Company identified various risks relating to Arcticneft, including missing financial, commercial and operational information, significant weaknesses in financial control and accounting procedures for the preparation of financial statements, tax reporting and budgeting and a failure to comply with various legal and corporate requirements. As part of the acquisition, the Company obtained limited warranties from affiliates of LUKOIL under the sale and purchase agreement to acquire Arcticneft. Management and the Directors believe that the consideration paid takes account of the risks presented. There is a risk that liabilities or obligations of Arcticneft exist which have not been taken into account by the Company and will not be covered by the warranties from the sellers. Further details of the risks arising as a result of the acquisition of Arcticneft are set out in Risk Factors on pages 98-99.

OOO CNPSEI

Background

OOO CNPSEI ("CNPSEI") was formed in 1990. Its two subsoil licenses were re-issued in 2002: License No. SYK 11310 NE for the Yuzhno-Tebukskoye field and License No. SYK 11311 NE for the Sosnovskoye field. CNPSEI is headquartered in Ukhta, Komi Republic located approximately 750 kilometres Northeast of Moscow. CNPSEI has approximately 136 employees.

CNPSEI Area of Operation



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

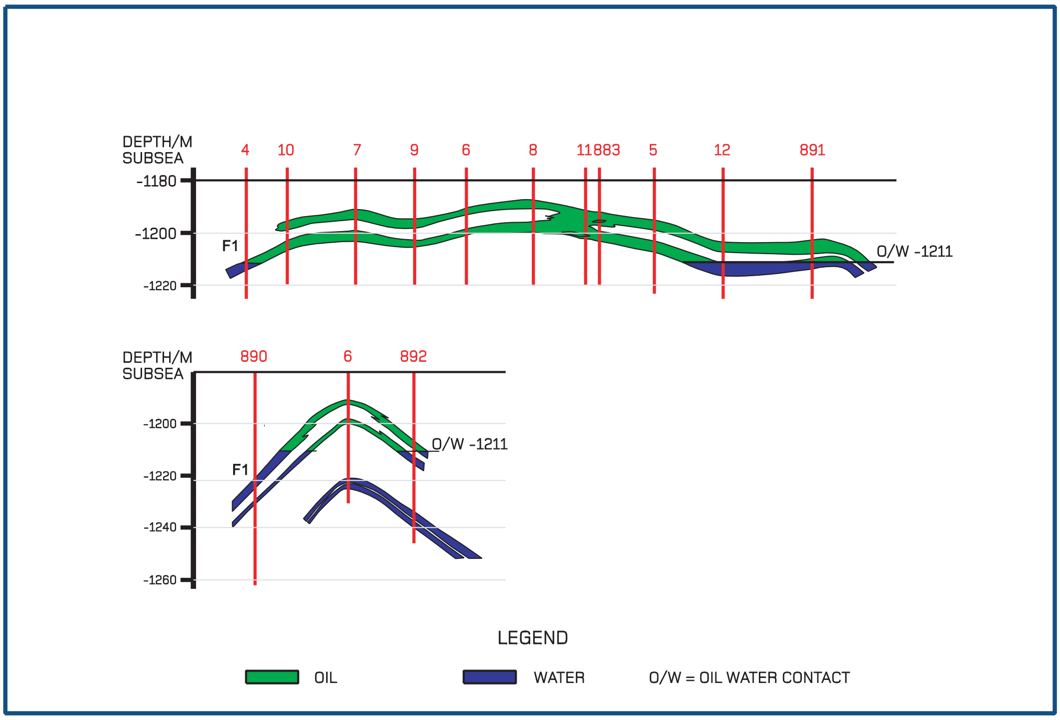
The Company acquired control over 100% of the stock of CNPSEI in October 2004. Management of the Company has substantial operational experience in the Komi Republic and is confident that further opportunities to expand in the region will become available to compliment its operations at CNPSEI.

The Company expects to reduce its operating expenses from prior levels as part of its overall cost reduction strategy. For example, since acquisition, the Company has replaced certain senior managers with its own personnel, reduced headcount by approximately 20%, installed a new custody transfer oil metering system, and focused on maximizing production from the existing wells.

The Yuzhno-Tebukskoye Field

Yuzhno-Tebukskoye field is located approximately 100 kilometres east of the city of Ukhta, and lies in the Southern part of the Timan Pechora Basin. The field is a four way anticlinal closure that produces from three carbonate reservoirs. The reservoirs are Devonian-age and produce from a depth of 984 metres to 1,211 metres. The cross-section diagram for the Yuzhno-Tebukskoye Field is shown below.

Yuzhno-Tebukskoye Field Cross Section



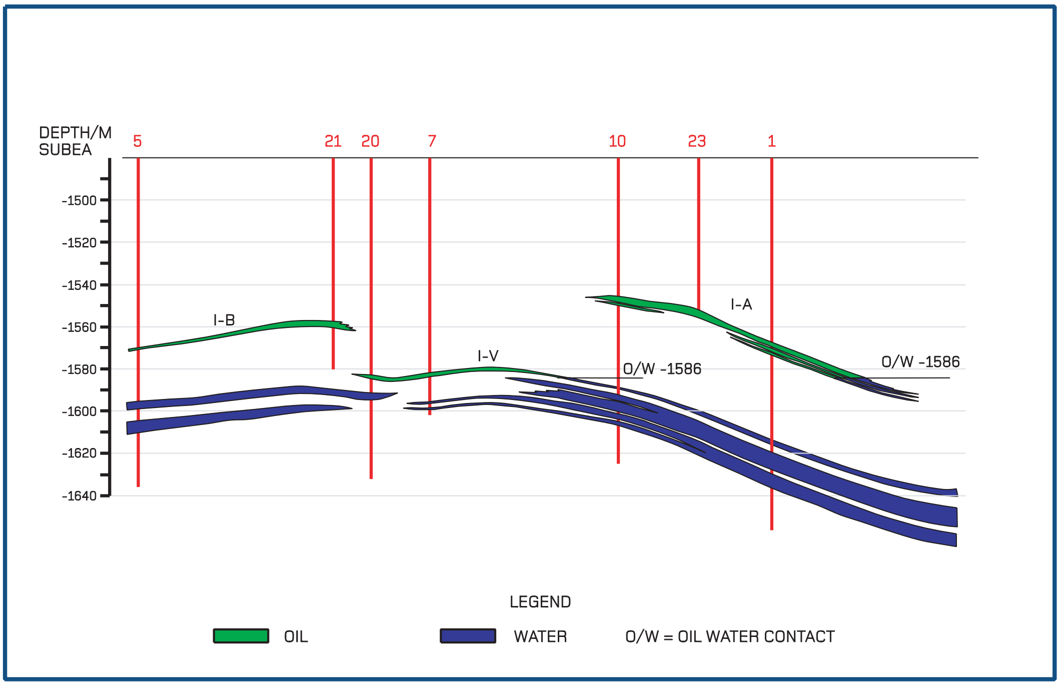
The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, but such illustration has not been subject to any independent verification.

The field was discovered in 1977 and has a total of nine producing wells. All wells are on artificial lift. The Company believes the field to be fully developed and is working to improve production and recovery factors by optimising the placement and stroke rate of downhole pumping units and maximizing water injection rates. For the six months ended 30 June 2005, the field produced an average rate of approximately 600 BOPD.

The Sosnovsky Field

The Sosnovsky field is located approximately 20 kilometres east of the Yuznho-Tebukskoye field, and lies in the Southern part of the Timan Pechora Basin. The field is a stratigraphic deposit that produces from three Devonian-age sandstone reservoirs. The three producing intervals range in depth from 1,547 metres to 1,600 metres.

Sosnovsky Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, but such illustration has not been subject to any independent verification.

The field was discovered in 1982 and has a total of nine producing wells. All wells are on artificial lift. Five of the wells are owned by OAO Tebukneft, a subsidiary of LUKOIL, and are leased to CNPSEI. The Company enjoys a good relationship with the management of Tebukneft and believes that the leases will remain in force for the life of the production from such wells. For the six months ended 30 June 2005, the field produced at an average rate of approximately 415 BOPD.

The Company believes the field to be developed fully and is working to improve production and recovery factors by optimising the placement and stroke rate of downhole pumping units, and maximizing water injection rates. The Company's goal through such methods is to maximise current oil production rates and to increase the overall recovery factor, thereby increasing the value of the field.

Oil Operations and Marketing

Production from each well is gathered in field tanks and trucked approximately 30 kilometres to a processing facility operated by Tebukneft. A processing fee of approximately $1.36 per barrel is negotiated on an arms length basis and paid to Tebukneft for oil processing and preparation. The pipeline-quality oil is then transferred to the Transneft pipeline system for shipment to domestic and export markets. For the six months ended June 2005, CNPSEI's average daily oil production was 1,015 BOPD. Oil produced is a sweet crude with a gravity of approximately 35° API. Because CNPSEI sells its oil into the Transneft system, all sales volumes are effectively considered as Urals Blend or approximately 32.8° API.

CNPSEI sells its oil into three primary markets: domestic Russian refineries (Moscow and Ryazan refineries), near-abroad countries (Belarus and Ukraine) and export destinations (far-abroad) such as Germany and the Black Sea. For 2004, approximately 55% was sold domestically, approximately 10% to near-abroad destinations, and approximately 35% to export markets. The Company controls the marketing of oil from CNPSEI as part of its overall oil marketing programme from the central office in Moscow in order to achieve the highest available price.

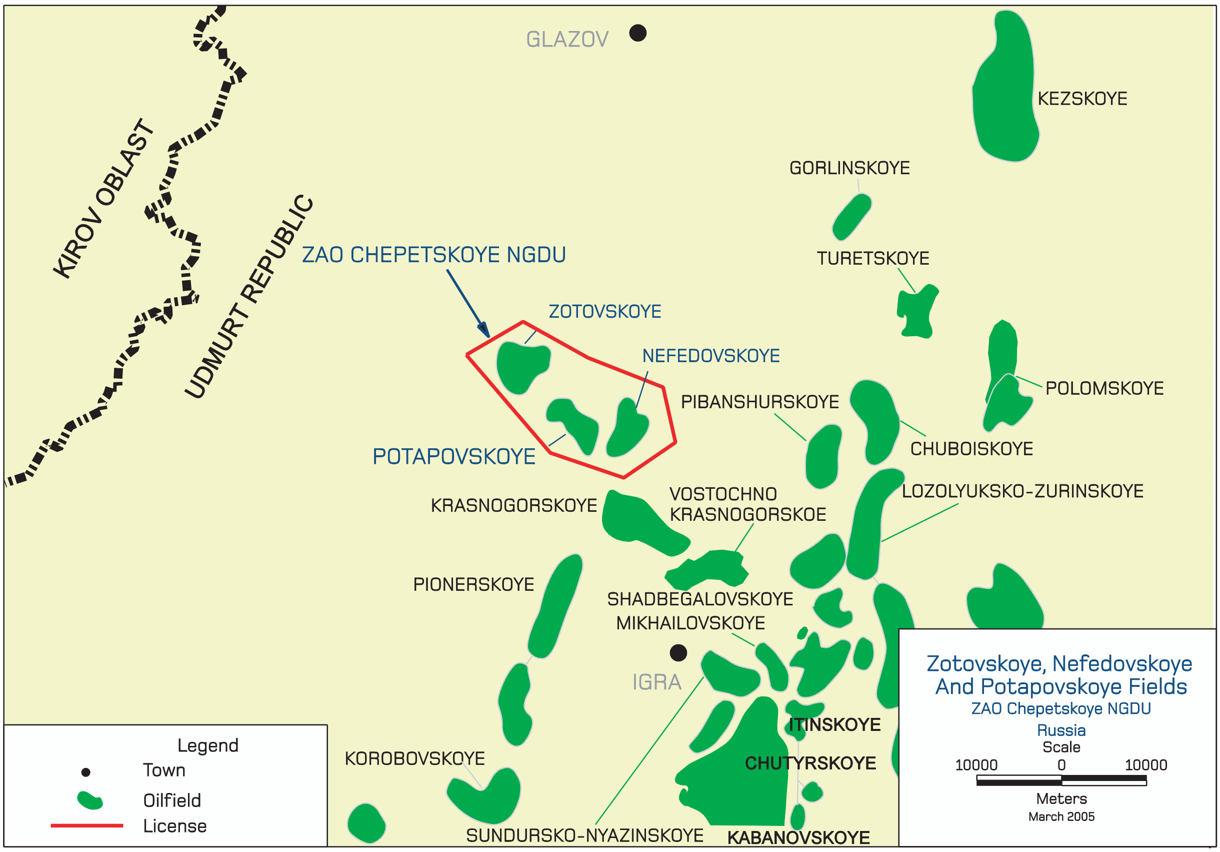
For the six months ended June 2005, CNPSEI's domestic oil sales have resulted in a net selling price (net of VAT and transportation costs) of approximately $16.70 per barrel. This compares to a net export selling price (net of export taxes, customs charges and transportation costs) of approximately $27.26 per barrel.

ZAO Chepetskoye NGDU

Background

ZAO Chepetskoye NGDU ("Chepetskoye") was created in 1993 as a stand-alone production company for the purpose of developing several discovered fields in the Northwestern area of the Urdmurtia Republic.

Chepetskoye Area of Operation



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

In 1999, it was awarded a geological study, exploration and production license, License No. IZHV 00387, for three fields: the Nefedovskoye field, the Potapovskoye field, and the Zotovskoye field. Development activities began for these three fields in 2000.

On 4 October 2004, the Company acquired a 100% interest in Chepetskoye from one of its principal shareholders as part of the Shareholder Agreement dated 28 July 2004, whereby shareholders of the Company contributed cash or assets for their equity interests in the Company.

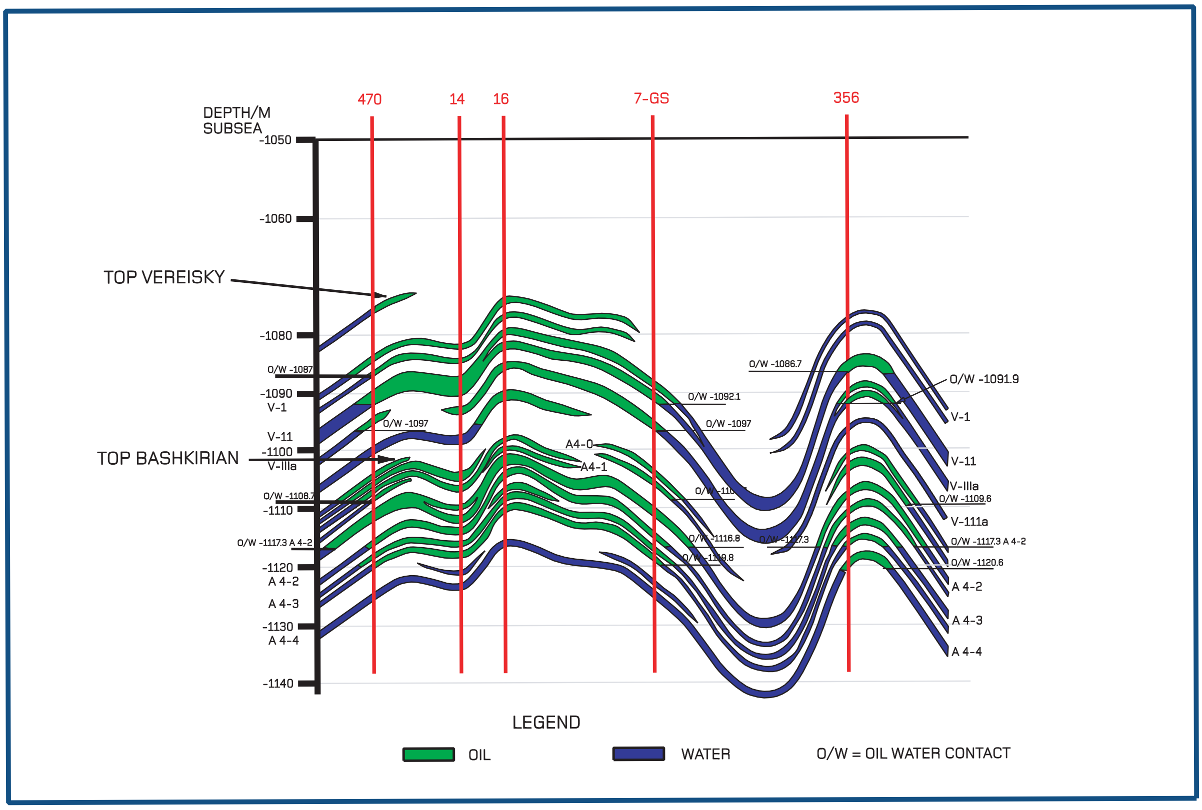
Chepetskoye's registered headquarters is in the town of Agrikol, Udmurtia and it has a representative office in Izhvesk, Udmurtia. As of 14 June 2005, it had 98 employees.

Chepetskoye's three fields are located adjacent to each other approximately 100 kilometres northwest of the city of Izhvesk and are part of the Volga-Kama Basin.

The Nefedovskoye Field

The Nefedovskoye field consists of two unfaulted structural and stratigraphic closures. The reservoirs range in age from the Middle Carboniferous (V-1) reservoir down through the Baskhkirian Stage (A4) reservoir. There are eight separate reservoirs that produce from 1,080 to 1,121 metres subsea. All reservoirs are carbonates.

Nefedovskoye Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, but such illustration has not been subject to any independent verification.

The areal extent of the field is approximately five square kilometres.

The field was discovered in 1970 and a total of seven exploration wells were drilled. Early production began in 1999 from existing exploration wells and the drilling of eight new development wells began in 2000. For the six months ended 30 June 2005, the field produced at an average rate of 292 BOPD from 11 producing wells.

In 2003, a 3D seismic programme was acquired over the field. Based on the interpretation of this seismic, Chepetskoye initiated a workover and drilling programme to increase production. Since January 2005, three wells have been re-perforated and three new development wells drilled. The three new wells are producing at a sustained rate of between 100 to 150 BOPD and cost an average of approximately $400,000. The field's daily production has increased to approximately 550 BOPD as of 30 June 2005. Based on the results of these new wells, the Company plans to continue development drilling of the field with the potential of an additional five development wells during 2005-2006. If successful, field production is expected by the Company to increase to a rate of 900 BOPD in 2006.

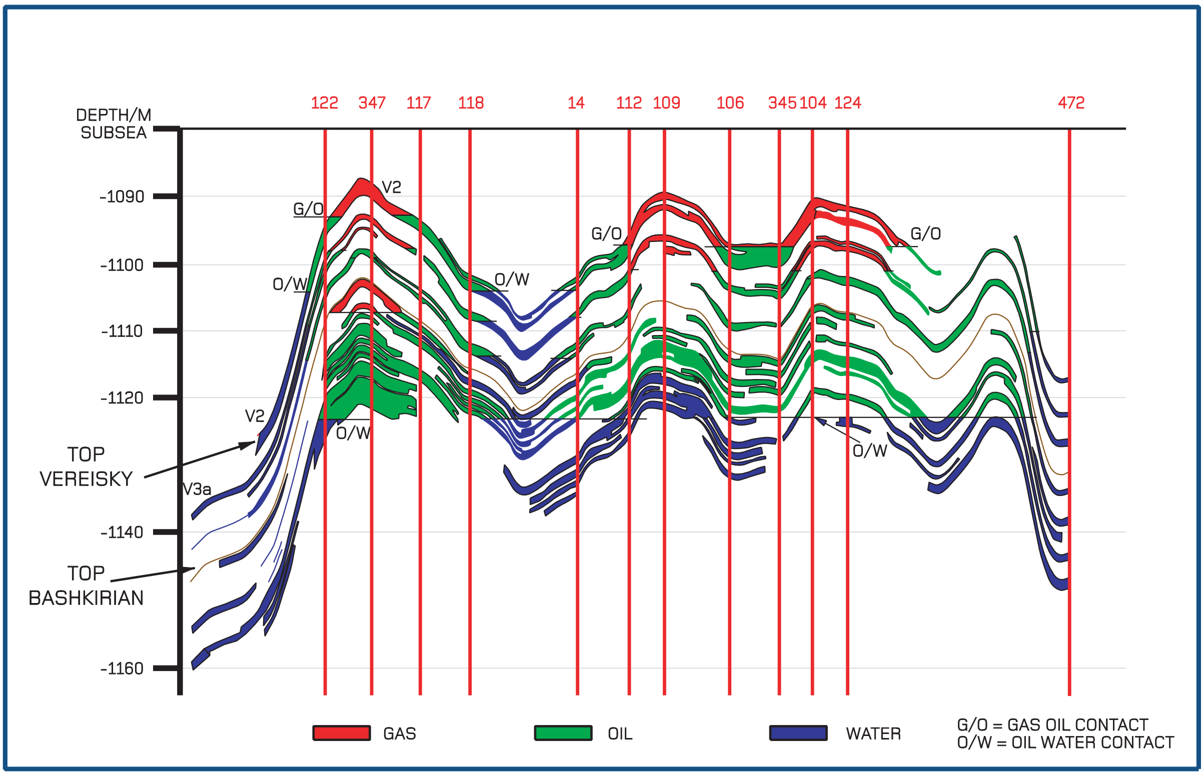
Chepetskoye has also recently conducted a Vertical Seismic Profile ("VSP") survey for three selected Nefedovskoye wells. This survey will help tie the 3D seismic to the actual downhole producing formation and allow improved well selection for the on-going development drilling programme.

The Zotovskoye Field

The Zotovskoye field is located approximately seven kilometres west-northwest of the Nefedovskoye field and 12 kilometres west of the Potapovskoye field. The field is an unfaulted, V-shaped structure that has an areal extent of approximately nine square kilometres. The field was discovered in 1971 and production began in 1999. Since 2001, 14 new development wells have been drilled.

The field produces from two primary reservoirs, both of which are carbonates—the Veristky and Bashkirian (Middle Carboniferous).

Zotovskoye Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

For the six months ended 30 June 2005, the field produced at an average rate of 520 BOPD from 13 producing wells. The Company does not have any plans for further development drilling at this time.

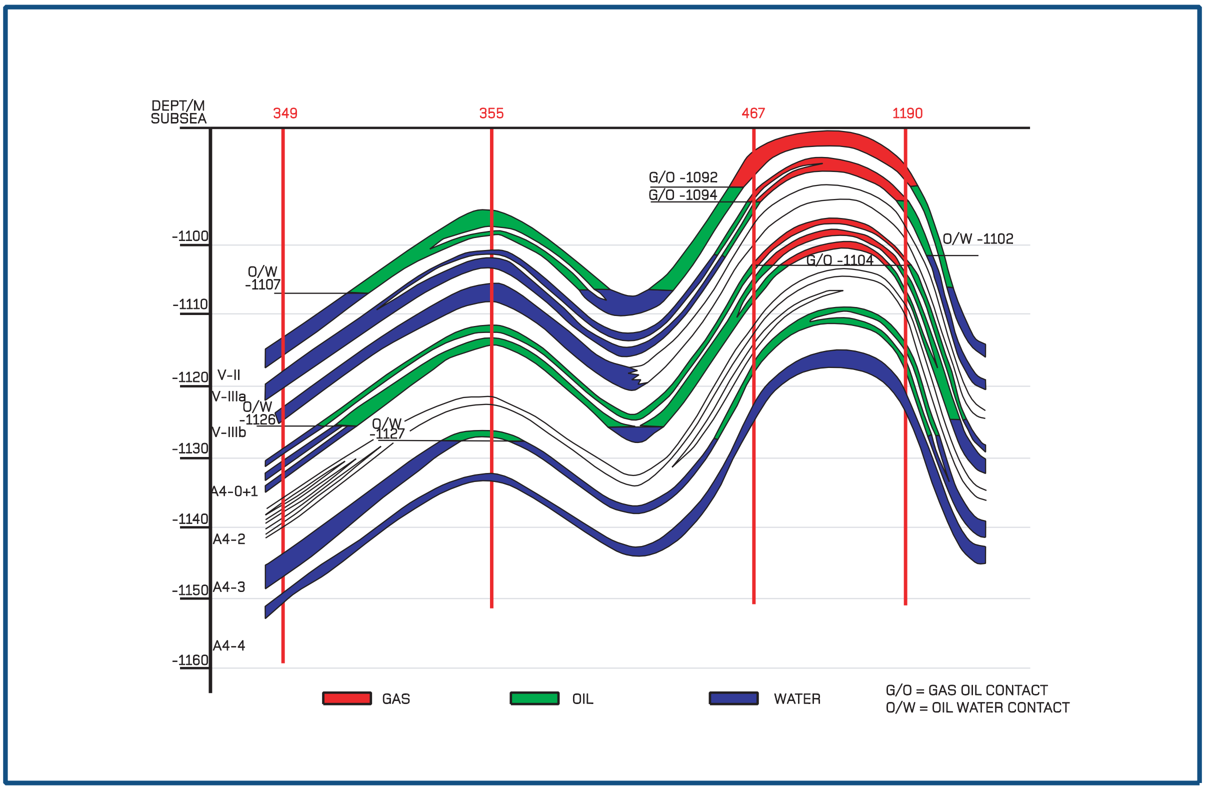
The Potapovskoye Field

The Potapovskoye field is approximately 7 kilometres east of the Nefedovskoye field.

The field is an unfaulted four way closure that is almost entirely undeveloped with an areal extent of approximately 19 square kilometres. The field was discovered in 1972 and is defined by seven exploration wells. Only one well is currently producing, and for the six months ended 30 June 2005, produced at an average rate of 33 BOPD. The oil-bearing reservoirs include the Middle Carboniferous (V-2 and V-3a) and

Bashkirian (A4 to A4-3) and are mapped from 1,085 to 1,128 metres subsea. The Potapovskoye field cross-section graph is shown below.

Potapovskoye Field Cross Section



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

The Potapovskoye field has significant undeveloped potential based on D&M Proved plus Probable reserves of 15.1 million barrels. Chepetskoye has initiated a 3D seismic programme for the field that is currently planned for acquisition in late 2005. Following processing and interpretation of this seismic programme, development drilling of the field is expected to commence in the second quarter of 2006. Depending on the results of the 3D seismic programme, the Company currently plans to drill 42 development wells to fully produce the field. Drilling costs are estimated at approximately $350,000 per well. If successful, this development drilling programme is estimated by the Company to increase Potapovskoye field production to a peak rate of approximately 3,000 BOPD by 2010.

Oil Operations and Marketing

The surface conditions for Chepetskoye's three fields allow for year-round drilling and production operations. Because the region has a heavy industrial base, good support infrastructure is available including year-round roads, electricity and water.

Production from each well is gathered in field tanks and trucked approximately 20 kilometres to a processing facility operated by Udmurtneft, a subsidiary of TNK-BP. A processing fee of $5.00 per tonne ($.68 per barrel) is paid to Udmurtneft for oil processing and preparation. The pipeline-quality oil is then transferred to the Transneft pipeline system for shipment to domestic and export markets. For the six months ended June 2005, Chepetskoye's average daily oil production was 846 BOPD. Oil quality produced is a sweet crude with a gravity of approximately 29° API. Because Chepetskoye sells its oil into the Transneft system, all sales volumes are effectively considered as Urals Blend or approximately 32.8° API.

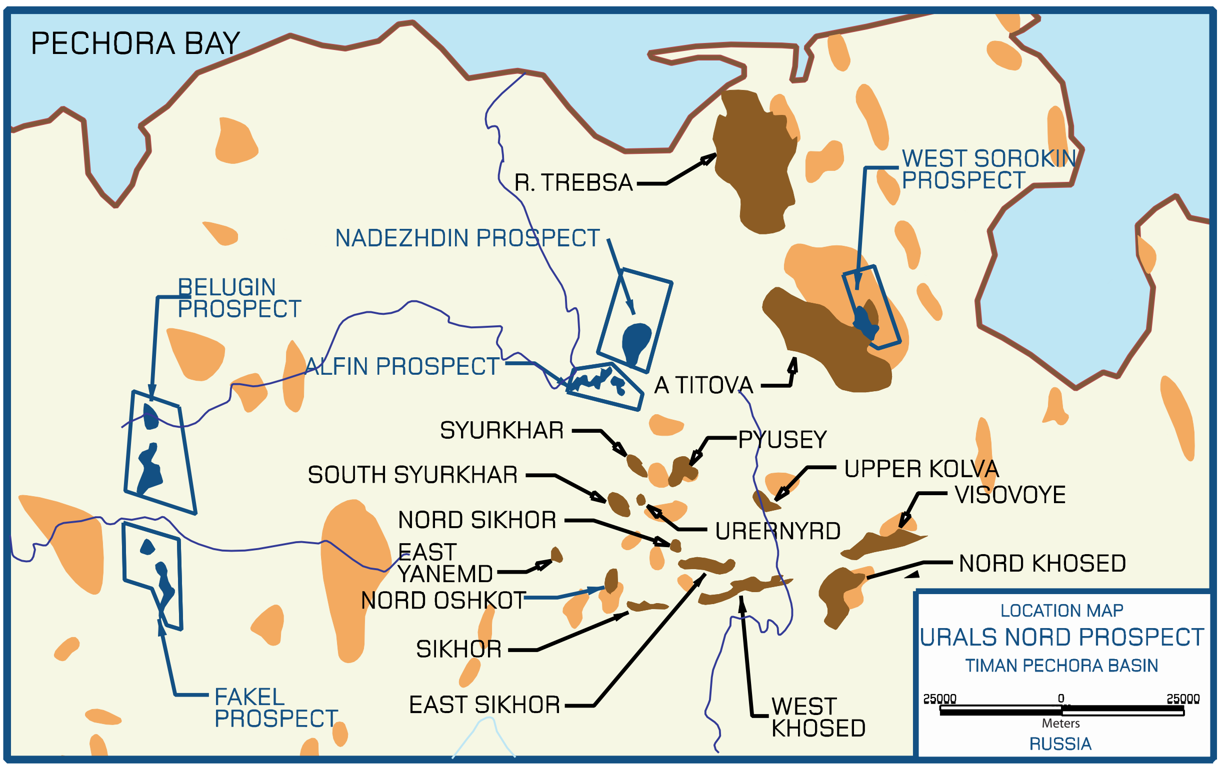
Chepetskoye sells its oil into three primary markets as directed by the Company's marketing coordinator in Moscow: domestic Russian refineries (Moscow and Ryazan refineries), near-abroad countries (Belarus and Ukraine) and export destinations (far-abroad) such as Germany and the Black Sea. For 2004, approximately 55% was sold domestically, 10% to near-abroad destinations, and 35% to export markets.

For the six months ended June 2005, Chepetskoye's domestic oil sales have resulted in a net selling price (net of VAT and transportation costs) of approximately $17.33 per barrel. This compares to a net export selling price (net of export taxes, customs charges and transportation costs) of approximately $27.51 per barrel.

OOO Urals Nord

The Company acquired 100% of OOO Urals Nord ("Urals Nord") via two separate acquisitions of 50% in March and April 2005. Urals Nord is a Russian limited liability company that holds geological study licenses to five blocks in the Northern part of the Timan Pechora Basin. The block names are Alfinsky, Nadezhdinsy, West Sorokin, Fakel and Belugin.

Urals Nord License Area



The above illustration is derived from the Company's internal information and represents the Company's interpretation of such information, and such illustration has not been subject to any independent verification.

All of Urals Nord's licenses are in the oil rich Timan Pechora Basin. One of the licenses, West Sorokin, is located directly adjacent to the A. Titova field with ABC1 reserves of over 400 million barrels of oil according to the Russian Ministry of Natural Resources. The Company is currently processing and evaluating seismic surveys to determine its future exploration programme. The licenses have drilling obligations which, if not complied with in a timely fashion, will result in Urals Nord's having to relinquish them. The obligations under one of the licenses have not been met, but the Company is currently evaluating whether to negotiate an extension or to relinquish the license without conducting activities thereon. There is currently no production from the licenses owned by Urals Nord. Two of Urals Nord's licenses are in the area of the route of the proposed Indiga pipeline from Kharyaga to the port of Indiga or the Russian coast of the Barents Sea.

The prospective formations in all blocks are Devonian-aged carbonate reef structures. Depths of targeted horizons range from 2,100 metres to 4,800 metres. A significant amount of 2D seismic data is available over all blocks. Only the West Sorokin block contains any previously drilled wells. However, two of these wells did not penetrate the Devonian-aged carbonates and the third is a Soviet era stratigraphic well that was not logged.

In 2004, the Company re-processed and re-interpretated a total of 490 kilometres of existing 2D seismic over the Alfinsky block. Based upon the re-mapping of the structure a quantitative risk analysis and resource potential calculation is being conducted. The Company currently plans to secure and mobilise a drilling rig to commence a well during the 2005/2006 winter drilling season. The Company conducted the necessary field work during the 2005 winter access season in order to be positioned to apply for the proper permits during the summer.

During February 2005, 198 kilometres of new 2D seismic was acquired over the Nadezhdinsky block. Structure maps are expected to be completed in early summer which will be used to carry out a risk assessment with the view to drilling an exploration well in 2006.

OOO Urals Energy

OOO Urals Energy is a Russian limited liability company located in Moscow that serves as the vehicle for employing central office staff, leasing office space and providing management, marketing and other related services to the Company's Russian subsidiaries. It also acts as the concessionaire for all export oil sales from the Russian subsidiaries whereby it sells oil on an agency basis to the Company on behalf of the Russian production companies. It has received Russian governmental approvals to become the formal contractual manager and act as the corporate General Director of all of the Russian subsidiaries except Arcticneft and Urals Nord and the Company intends to formalise these contractual relationships to achieve direct management and operating control over such subsidiaries by the end of 2005. OOO Urals Energy has no oil or gas production assets itself. OOO Urals Energy was contributed to the Company by certain of the Company's shareholders in lieu of payment for shares in the Company.

Urals Energy (UK) Limited

Urals Energy (UK) Limited is a company incorporated in England with its registered office in London. It employs certain UK based office support staff and provides a representative office and performs back office functions for the Company and its Russian subsidiaries. It maintains leased office space in London that houses records and acts as a liaison office when meetings occur in the UK. It also acts as the agent for service under various financing arrangements for the Company and the Russian subsidiaries. Urals Energy (UK) Limited was contributed to the Company by certain of the Company's shareholders in lieu of payment for shares in the Company.

Discussion of recent developments

Since the date of the most recent audited financial statements, a number of developments have occurred in the Company's business.

Trading activity

Oil production for the six months ended 30 June 2005 was approximately 5,600 BOPD, including Arcticneft. Development activities intended to stabilise or increase production included completing three well workovers and three new development wells owned and operated by Chepetskoye. These actions resulted in a net addition of approximately 370 BOPD. Petrosakh drilled one new development well (well No. 43) which is now being completed, and the results of which are being evaluated. A second Petrosakh development well (well No. 44) was recently commenced and is expected to be completed in September 2005.

To support Petrosakh's exploration drilling plans, an agreement has been signed with KCA Deutag for the mobilisation of the T-2000 rig, an arctic-class heavy-duty land drilling rig. Separate agreements for the transportation of the T-2000 rig have been completed with Lynden International, SEACOR and RZhD (the Russian Railways Company) for the barge and rail transportation of the rig and related components to the drill-site on Sakhalin Island. The Company intends to finalise a contract with KCA Deutag to drill a minimum of three wells in 2005-2006, at a cost of $31,500 per day for the rig.

Petrosakh began its 2005 summer oil export schedule with the first cargo loading of approximately 97,500 barrels in mid-June 2005. The second cargo of 113,000 barrels was loaded in late June 2005. Both cargoes were delivered to third party buyers in China and resulted in revenue, after export taxes and transportation costs, to Petrosakh of approximately $7 million.

Acquisition activity

In April 2005, the Company acquired the remaining 50% interest in Urals Nord it did not own for $14 million in cash, with $12.5 million to be paid in October 2005.

In July 2005, the Company acquired Arcticneft from affiliates of LUKOIL for an aggregate consideration of $32.5 million, plus an adjustment to reflect estimated working capital of $6 million. Of the $32.5 million payable to LUKOIL, $19.5 million has been paid in cash and the remaining $13 million is payable on or before 1 September 2005. In connection with the acquisition, the Company has arranged for Arcticneft to enter into arrangements with OOO START in order to settle the outstanding litigation involving OOO START and Arcticneft pursuant to which OOO START will transfer to Arcticneft clear title to certain wells that were the subject of the litigation. The Company and Arcticneft will pay to OOO START an amount of $3 million. See discussion at paragraph 9 of Part VII of this document.

Financing activity

Since 31 December 2004, the Company and its subsidiaries have raised external finance in a total amount of approximately $78 million through a combination of equity and debt. Certain of these financing obligations are collateralised, including through the assignment of specific oil export contracts.

The following table sets forth the Company's unaudited estimate of financial obligations for the Company and its subsidiaries as at 15 July 2005.

	15 July 2005
	(Unaudited)
	$ 000's
Shareholder loans	9,600[(1)]
Related party loans	6,000[(2)]
Bank Zenit debt	12,000
BNP Paribas export facility	18,500[(3)]
Petraco export pre-payment	10,000
LUKOIL Deferred Payment	13,000
Urals Nord Deferred Payment	12,500
OOO START Settlement	3,000
RP Explorer Convertible Note	10,000[(4)]
Total obligations	94,600
Cash and Equivalents	15,000
NET OBLIGATIONS	79,600

(1) These loans were converted into 3,650,480 shares on 4 August 2005.

(2) Includes a $3 million short-term loan to be repaid to a related party using proceeds of the Placing.

(3) The Company will repay $1.5 million of this amount prior to completion of the offering.

(4) Will convert into 2,929,651 shares upon closing of the offering calculated at the agreed GBP/USD exchange rate of 1.7778.

See also "Use of Proceeds" in this Part II.

Pro Forma Financial Information

The Unaudited Pro Forma Consolidated Financial Information for 2004 contained in Part VI of this document has been produced and provided herein for illustrative purposes only. Such information should not be relied upon as an indication of the results that the Company would have achieved if its acquisitions had occurred on 1 January 2004, nor should it be used as an indication of the results that the Company would have achieved during any period following the acquisitions. Specifically, the Company has adopted the following procedures and policies which will be reflected in its financial statements.

- All sales of oil and refined products by the Company and its subsidiaries will take place on arms length market terms.
- SG&A and operating expenses will be allocated on a basis consistent with IFRS and industry best practice.

- The historic results include significant one-time expenditures on formation of the Company and costs incurred in acquiring its principal subsidiaries. These one-off costs will not be incurred in the future. Further, with its improved sales processes and credit management, the Company expects that the bad debt expense in the future will be reduced.
- Under the previous owners of the Company's subsidiaries, the subsidiaries incurred significant discretionary general and administrative expenditures. The Company has adopted cost control policies to prevent such costs from being incurred in the future.
- The Russian subsidiaries will pay profits tax at the statutory rate of 24%. However in the short term the Company expects its cash tax rate to be lower than the statutory rate due among other things to: (i) the deductibility of exploration expenses; and (ii) the deductibility of interest.
- Exploration expenses will be accounted for using the successful efforts method as discussed in note 3(d) of the Urals Energy Public Company Limited Accountant's Report set out in Part V of this document.

No other material changes

Except as described above, there have been no known material changes in the financial or trading position of the Company since 31 December 2004, the date to which consolidated IFRS financial statements have been drawn up.

Regulation of the Russian Oil Industry

General

Regulation of the oil industry in Russia is still evolving with federal, regional and local authorities each promulgating rules.

At the federal level, mainly the Ministry of Natural Resources, Ministry of Industry and Energy, the Federal Tariffs Service and the Federal Anti-Monopoly Service set governmental policy for the oil and gas industry and regulate the activities of oil and gas companies, pipeline access and tariffs.

While, in principle, Russian federal law prevails over contradictory regional or local laws, regional and local authorities may enforce their taxation regimes, administer land-use regulations and oversee compliance with environmental and worker-safety codes. Local and regional authorities may also exercise some control over the use of the national and local pipeline grid through their jurisdiction to regulate land-use and environmental matters.

Licensing

Pursuant to Russian law, there are three major types of subsoil licenses: (i) geological study licenses, which are non-exclusive licenses granting the right to search for and evaluate mineral reserves, (ii) exploration and production licenses, which grant the licensee an exclusive right to produce minerals from the licensing area and (iii) combined licenses, which combine into one the first and second types of license.

The licensing regime for geological study, exploration and production is established primarily by the Subsoil Law and the regulations issued pursuant to it (the "Subsoil Regulations"). Until January 2000, when substantial amendments to the Subsoil Law were passed, geological study licenses were typically granted for up to five years, while production licenses were granted for up to twenty years and combined licenses were granted for up to twenty five years. Pursuant to the Subsoil Law as currently in effect, the maximum geological study term is still five years, and a production term is as long as required (as shown in the feasibility study) for rational full exploitation of the deposit. However, in practice the exploration and production licenses and combined licenses are still granted for a period of time which is originally determined by the licensing authorities. The Subsoil Law permits extension of the original term of such licenses if the feasibility study demonstrates that development of the deposit will exceed the term of the current license and the licensee complies with the license's terms and conditions. The Subsoil Law also permits extension of the term of a geological study license in order to complete geological study works, where fulfillment of the license's conditions is still also the major factor.

Subsoil licenses in Russia are generally issued by the Federal Subsoil Use Agency. Licenses relating to off-shore areas are granted for geological study works without an auction/tender procedure, but on the basis of the Federal Subsoil Use Agency's decision. The off-shore exploration and production licenses and the combined licenses are issued by the Federal Subsoil Use Agency on the basis of a government decision taken on an auction/tender. The on-shore exploration and production licenses and combined licenses are issued on the basis of the decision of an auction/tender commission, while the on-shore geological study licenses are issued without an auction/tender procedure, on the basis of the decision of a joint commission which is formed by the Federal Subsoil Use Agency with the participation of the regional authorities.

When the Subsoil Law provides for an auction or tender procedure in determining the award of a subsoil license, the licensing authorities in most cases prefer to organise an auction as it is seen as being fairer in determining the winning applicant according only to whichever party is prepared to pay the most for the license. In contrast, so far as the tender procedure is concerned, a number of criteria are relevant and the winner tends to be the participant which submits the most technically competent, financially attractive and environmentally sound proposal that meets the published tender terms and conditions.

The Subsoil Law guarantees the holder of a geological study license the opportunity to obtain a production license if it discovers a deposit in which the reserves of oil and gas are acknowledged by the Federal Subsoil Use Agency as being sufficient for commercial operations and if the holder complies with the license's term and conditions. Licenses may be transferred to another company only under certain limited circumstances. A licensee is also generally granted surface rights to use land covering the licensed area.

The licensee is ordinarily required to undertake certain commitments, including to maintain production at a certain level each year (applicable only to production and combined license holders), to keep environmental pollutants within specified limits and to remedy environmental contamination. The licensee may also be obliged to fulfill certain social obligations in the area to which the license relates, such as to pay certain compensation to local ethnic groups that populate the licensing area and provide them with other support. Failure to comply with the terms of the license or with the provisions of the Subsoil Law or Subsoil Regulations can lead to fees and penalties, stoppages of production and revocation of the license.

If a subsoil license is revoked, all oil and gas facilities in the relevant licensing area, including underground facilities, must be liquidated or undergo conservation. In accordance with both liquidation and conservation regulations, all mining facilities and oil and gas wells must be maintained at a level that is safe for the population, environment, buildings and other facilities.

Crude Oil and Refined Product Transportation Regime

From 1995, as part of a scheme to deregulate prices and liberalise export controls, the Russian government established equal pipeline and sea terminal access procedures for all oil companies in proportion to the actual production volume of each company. This system allowed Russian oil companies to export, on average, 30-35% of the produced oil.

Currently the allocation of pipeline sea terminal access rights is overseen by the Ministry of Industry and Energy. This Ministry approves quarterly schedules which, inter alia, detail the precise volumes of oil that each oil producer can pump through the Transneft system. Such quarterly schedules provide certain stability in the export regime for Russian oil companies.

Since September 2001, pipeline and sea terminal access rights are distributed among oil producers and their parent companies in proportion to the volumes of oil produced and delivered to the Transneft pipeline system (and not in proportion to total oil production volumes). Previously, the plan of reform envisaged that pipeline and sea terminal access rights would be sold at a tender (starting with 25% of pipeline capacity at the first stage).

Transneft has a very limited ability to transport individual batches of crude oil with the result that crude oil of differing qualities, delivered in the pipeline system, is blended. Transneft does not currently operate a system whereby companies shipping heavy and sour crude would compensate the shippers of higher-quality crude oil for the deterioration in the crude quality arising from blending. Although the introduction of such a compensatory system is currently under discussion between Transneft and the Russian government, these proposals have met with considerable resistance from regions whose reserves are low-grade.

Imports and Exports

In the past, the Russian government imposed seasonal limitations on the export of certain refined products (diesel, fuel oil, gasoline and kerosene). No such restrictions are applied by it at present. However, the Ministry of Industry and Energy is considering applying flexible seasonal regulation of the export duties on refined products and imposition of the State non-tariff measures on the domestic refined products market.

To protect national economic interests, the Russian government implements tariff regulations from time to time via the export duty. The amount of the export duty varies depending on the country's demand for oil products and the oil price. See paragraph 11.3 of Part VII of this document for a full description of Russian export taxes on oil.

Environmental

Russian industry has tended to cause excessive levels of pollution compared to Western standards. As a result of the damage inflicted on the environment under the Soviet regime, environmental issues and pollution control have won widespread support.

Two main sets of regulations govern environmental protection. The first set includes the Federal Law "On Environmental Protection" of 10 January 2002 and the Federal Law "On Ecological Expert Review" of 23 November 1995. These laws require that an environmental impact assessment be made prior to implementation of a project related to the use of natural resources. Companies are also required to obtain operational licenses and permits authorizing the discharge of pollutants into the air, water and soil.

While protection of the environment is apparently not an issue of immediate priority to the current Russian government, it is widely expected that, as the economic situation improves, enforcement of existing legislation and environmental standards and rules will become more stringent, and that more comprehensive legislation will be adopted.

Competition

The oil and gas industry is characterised by intense competition for production licenses, operatorships, capital, experienced human resources and customers. The Company has faced, and is likely to continue to face, intense competition both domestically and internationally. The Company's competitors include virtually all Russian oil companies as well as those non-Russian oil companies that are seeking to enter or grow their presence in the Russian E&P sector. The Russian oil industry tends to be dominated by the major Russian oil companies, including LUKOIL, Surgutneftegaz, Rosneft, TNK-BP, Tatneft, Sibneft and Russneft as well as some of the major international oil and gas companies. The Company competes with these and other oil companies, both within Russia and internationally, with respect to the exploration for and production and sale of crude oil and with respect to the wholesale and retail sale of refined oil products. The Company also competes with other oil companies with respect to asset, corporate and license acquisition opportunities.

The integrated oil and gas industry is currently subject to several important influences that impact the industry's competitive landscape. These include the following:

- *Consolidation.* In the past few years, the strategic and competitive landscape of the oil and gas industry has been transformed by mergers and acquisitions, driven mainly by the need to enhance shareholder returns, to respond to the growing competitiveness of national oil companies, and to achieve greater operational scale to capture new, attractive business opportunities.
- *Deregulation*. The establishment of free, competitive and integrated markets has become an important governmental objective in many countries, including Russia. Within Russia, privatisation of the oil and gas industry has allowed Russian as well as foreign oil companies to bid for licenses and to offer services, providing for new and increased competitive forces.
- *Technological Advances*. Technological innovations in the oil and gas industry have improved the industry's performance with respect to finding and developing hydrocarbon resources. Exploration success rates have improved, field life and recovery rates from existing and marginal fields have been increased, and full project cycle costs have generally been reduced. These have been achieved by applying advanced technology more effectively. In general, there is equal access to technology across the industry and, to achieve the Company's strategic and financial goals, the Company will need to compete by applying available technology to complex projects in the most skilful manner.
- *Environmental and Social Concerns.* In the face of intense competition, oil and gas companies are also facing increasing demands to conduct their operations in the context of and consistent with environmental and social goals. Investors, customers and governments are more actively following companies' performance on environmental responsibility and human rights including performance with respect to the development of alternative and renewable fuel resources.

As a result of the above influences and other factors, the Company expects competition to intensify. A number of other Russian oil companies, as well as foreign oil companies, are permitted to compete for licenses and to offer services in Russia, increasing the competition that the Company faces domestically. Additionally, internationally, the Company competes with the largest and most sophisticated oil and gas companies outside of Russia. In some cases, the Company may be at a disadvantage because foreign-domiciled companies may have access to greater financial and other resources, giving them a competitive advantage, both within Russia and internationally. Full implementation of Russia's Production Sharing Law could substantially increase the interest of foreign and domestic companies in oil production in Russia and further increase the level of competition the Company faces. Domestic competitors may also be strengthened if they acquire additional assets through the privatisation processes, or through mergers, joint ventures or other forms of business combinations.

For a discussion of tax rules relating to oil companies operating in Russia, see "Russian Taxation and Charges" in paragraph 11.3 of Part VII of this document.

Directors and Senior Management

The Directors and senior management of the Company have successfully managed businesses in one Russian oil sector and have over 50 years of combined experience. The management team of the Company has extensive experience operating large producing properties in both Russia and Kazakhstan, and is familiar with the technical and operational characteristics of Russian-CIS oilfields.

Viatcheslav V. Rovneiko—Director and Chairman of the Board

Mr. Rovneiko is a successful entrepreneur and businessman who has developed a number of enterprises in Russia and his participation has been key to the various acquisition transactions of the Company. In 1981, Mr. Rovneiko began his career in the oil sales accounting department of Soyuznefteexport in Moscow and in 1988 was assigned to Antwerp, Belgium as Commercial Manager for its subsidiary Nafta (B) NV Mr. Rovneiko co-founded the Company with the other principal investors and has led its strategy and planning since inception. Today his interests include ownership of Nafta (B) NV, Sarova Water Company, and OOO "Rosegarden". Mr. Rovneiko graduated from MGIMO in Moscow. Mr. Rovneiko holds both Russian and Belgian citizenship and is 46 years old.

William R. Thomas—Director and Chief Executive Officer

Mr. Thomas has more than 25 years experience in the energy industry as both an executive and investment banker. He is responsible for managing the Company's activities. Mr. Thomas was an International Negotiator at Pennzoil Company, and later an energy investment banker with Bankers Trust Company and Chemical Bank. For the past 12 years, he has specialised in new production ventures in Russia and the CIS. Since 1993, he has been President & CEO of Siberian American Oil Company, Vice President-Commercial Development of Amoco Eurasia Petroleum Company, President & CEO of Nations Energy Company Ltd., and Chief Executive of the Company. He graduated from the University of Texas at Austin with a BA in Economics. Mr. Thomas is a US citizen and is 49 years old.

Leonid Y. Dyachenko—Director of the Company and President, OOO Urals Energy

Mr. Dyachenko is a successful entrepreneur and businessman who has a diverse range of interests including trucking and transportation, pharmaceuticals, and oil trading. He manages the Moscow office of OOO Urals Energy and is responsible for day-to-day administration and government relations for the Company's Russian subsidiaries. Mr. Dyachenko began his career as a technological engineer with construction bureau SALUT (applied rocketry). In 1992, he was seconded to Dresdner Bank, Frankfurt, where he completed a management training programme in corporate finance. Since then, he has participated in a number of new businesses, primarily related to commercial trading and export finance. He graduated from Moscow Aviation Technology Institute with a degree in Technological Engineering. Mr. Dyachenko is a Russian citizen and is 41 years old.

Gueorgui N. Ramzaitsev—Director

Mr. Ramzaitsev has been in the oil trading and exploration and production business in Russia for over 15 years. He is the Managing Director of Nafta (B) NV, a Belgian oil trading and terminalling company and is Managing Director of Urals ARA NV, a Belgian oil trading company. In addition, he is a board member of Ukhtaneft Belgium NV and was on the board of Urals Energy NV Mr. Ramzaitsev is also one of the founders of the Company and provides advice and counsel on oil marketing strategies. He graduated from MGIMO in Moscow. Mr. Ramzaitsev holds both Russian and Belgian citizenship and is 53 years old.

Stephen M. Buscher—Chief Financial Officer

Mr. Buscher has extensive financial experience, particularly in Russia. He has lived and worked in the financial sector in Russia for over ten years. He acted as the co-head of the Moscow office for Lazard Freres and Merrill Lynch where he also was the overall relationship manager for CIS oil business. Most recently he was Managing Director of Rosbank responsible for the corporate finance group. He graduated from Connecticut College in 1983. He also received a diploma from the London School of Economics in 1987 and a Masters in Business Administration from Yale University in 1991. Mr. Buscher is a US citizen and is 44 years old.

Henry A. Wolski—Senior Vice President, Exploration and Production

Mr. Wolski is a senior oil engineer with substantial experience in the Russia/CIS oil sector. From 1982, he held various positions with Amoco in Canada, followed by employment in Russia for Samotlor Services, Magma Oil and Khanty Mansiysk Oil Company where he was technical director for all oilfield operations for KMOC in Russia from 2001 to 2004. Most recently, he was Senior Director for Production Operations for Petrokazakhstan Kumkol Resources. He graduated from the University of Toronto with degrees in Civil Engineering and Biochemistry in 1982. He is a member of various engineering societies. Mr. Wolski is a Canadian citizen and is 49 years old.

Alexei Y. Antipov—Senior Vice President, Corporate Services, OOO Urals Energy

Mr. Antipov is a specialist in accounting, corporate finance and IT systems and has been responsible for all financial and systems aspects of the Moscow office of OOO Urals Energy since its formation in 2003. He coordinates and manages the accounting, fiscal, administrative and human resources functions of the Company's subsidiaries. He began his career in 1984 at the State Bank of the USSR as a credit and systems officer followed by other positions with Russian and western enterprises in Moscow. Since 1994, he has served as chief financial officer for Russian oil company KomiTEK and then for companies that were subsidiaries of Urals Energy NV. He graduated from the foreign relations department of the Moscow Institute of Finance in 1983. Mr. Antipov is a Russian citizen and is 44 years old.

Viatcheslav A. Ivanov—Vice President, Business Development, OOO Urals Energy

Mr. Ivanov has worked in several capacities in the Russian oil and financial sectors. He worked at Uralsib (formerly, NIKoil Investment Banking Group) as a director of the corporate finance department where he led several M&A transactions. He also worked in the finance and investments department of Lukoil. Most recently, he worked at Troika Dialog as a director of the oil & gas practice. In this role he was responsible for all key accounts of the firm with Russian and international oil & gas majors and independents. He joined the Company in 2005. He is an MBA graduate of the William E. Simon Graduate School of Business Administration, University of Rochester, NY, USA (2000), and a BA graduate of the University of Toronto, ON, Canada (1998), and the Moscow Institute of Radioelectronics (1991). Mr. Ivanov is a Russian citizen and is 35 years old.

Corporate Governance

The Company is not subject to the requirements of any national corporate governance rules including the Cypriot Code on Corporate Governance, as it is not listed in Cyprus. The Company does not currently comply with the Cypriot Code on Corporate Governance. The primary reason for non-compliance is the absence of a sufficient number of independent non-executive directors on the Board of Directors and/or the various sub-committees it has established. The Directors will actively seek to involve one or more experienced independent non-executives to join the Board of Directors following admission to AIM. The Company intends to comply with the requirements of the Cypriot Code on Corporate Governance in the future.

The Directors are responsible for formulating, reviewing and approving the Company and its subsidaries' strategy, budget, certain items of capital expenditure and senior personnel appointments. The Directors have established audit, remuneration, nomination and executive committees, as described below, and will utilise other committees as necessary in order to ensure effective governance.

The initial members of the audit committee are comprised of three Directors. If the Board of Directors has designated any independent non-executive directors, then at least one member of the audit committee will be an independent non-executive director. The audit committee's responsibilities include, among other things, reviewing the Company's financial statements, accounting policies, internal controls and overseeing its relationship with its external auditors.

The initial members of the remuneration committee are comprised of three Directors. If the Board of Directors has designated any independent non-executive directors, then at least one member of the remuneration committee will be an independent non-executive director. The remuneration committee's responsibilities include, among other things, determining the Company's policy on remuneration; however, no director or manager shall be directly involved in any decisions as to their own remuneration.

The initial members of the nomination committee are comprised of three Directors. If the Board of Directors has designated any independent non-executive directors, then at least one member of the audit committee will be an independent non-executive director. The nomination committee's responsibilities include, among other things, reviewing the composition of the Company's board and making recommendations to the board with regard to any changes.

The initial members of the executive committee are comprised of three Directors. The executive committee responsibilities include the approval of any single sale, acquisition, borrowing, expenditure, settlement or other transaction greater than $5 million and less than $20 million subject to the Company's Articles of Association.

Related Party Transactions

The Company has agreements with certain entities that are owned by some of its principal investors for office space in Moscow and for engineering and transportation services in the Company's activities. None of these related party dealings is material and all of such dealings are on terms that the Company believes are competitive and arms-length terms. Specifically:

- The Company's head office in Moscow is leased from two companies that own the building at 6 Octyabrskaya. The two companies are owned by two of the principal investors. The rent paid is $366,000 per year plus a communications charge. The Company believes that the rent paid is at the market rate.
- The Company utilises an engineering centre for certain engineering and consulting services that is owned by two of the principal investors. The total amount paid to such engineering centre by the Company and its subsidiaries in 2004 was approximately $17,000.
- Formerly, the Company utilised companies owned by certain of the principal investors for oil marketing activities. One of such companies also provided credits in connection with the acquisition by the Company of CNPSEI. Such credits are being repaid. The Company no longer utilises the services of these companies for oil trading or sales and marketing activities.
- On 24 May 2005, the Company entered into a Loan Agreement with Nafta (B) NV, a company owned in part and controlled by two of the principal investors of the Company, whereby Nafta (B) NV loaned $4.5 million to the Company. The Company signed a pledge agreement to pledge its shares of Chepetskoye. To date, the outstanding principal of this loan is $3 million, and the Company plans to pay this loan in full out of the proceeds of the Placing. Further details are set out in paragraph 8.1.5 of Part VII of this document.
- On 20 May 2005, the Company issued 23,585 shares to Nafta (B) NV for a total consideration of $25 million. The share issuance was settled with a cash contribution of $18.38 million and conversion of $6.62 million in existing debt of the Company to Nafta (B) NV.
- The Company received loans from parties affiliated with its shareholders who collectively have provided a total of $12.3 million, pursuant to unsecured notes from the Company. On 4 August 2005, a portion of these notes in the aggregate principal amount of $9.3 million were converted into shares of the Company. This is described more fully in paragraph 8.1.4 of Part VII of this document. The loan in the principal amount of $3 million between the company and Penrith Trading Ltd will be paid in full out of the proceeds of the Placing. The Penrith loan is more fully described in paragraphs 6.2 and 8.1.4 of Part VII of this document.

Dividend Policy

The Company does not expect to declare a dividend in the short to medium term. The Directors believe the Company should seek to generate capital growth through the reinvestment of cash flows for its investors and may recommend distributions of dividends at some future date, depending upon the generation of sustainable profits, when it becomes commercially prudent to do so.

Use of Proceeds

The net proceeds of the Placing are expected to be approximately $104 million (£58 million), after commissions and expenses payable by the Company of approximately $10 million.

The Company intends to use approximately $12 million of the proceeds to repay bank debt, approximately $3 million to repay a related party loan, approximately $28 million in deferred acquisition payments in relation to the acquisitions of OOO Urals-Nord and ZAO Arcticneft, and approximately $41 million for capital expenditures to fund the Company's development and exploration programme. The remainder of the proceeds will be used for working capital and for general corporate purposes.

Details of the Placing

MSSL, as agent for the Company, has agreed to procure subscribers for the Placing Shares or, failing which, to subscribe itself as principal for such shares at the Placing Price, on and subject to the terms of the Underwriting Agreement. The Placing Shares will represent 32.3 per cent of the Enlarged Issued Share Capital. The Placing Shares are being placed by MSSL with institutional and other sophisticated investors and the Placing is conditional, inter alia, on Admission.

Commission is payable to MSSL by the Company in respect of the Placing Shares. Further details of the Underwriting Agreement are set out in paragraph 8.2.1 of Part VII of this document.

The Company resolved to issue the Placing Shares on 4 August 2005. The Placing Shares will be issued credited as fully paid and will, when issued, rank *pari passu* with the existing shares, including the right to receive all dividends and other distributions thereafter declared, made or paid. It is expected that the proceeds of the Placing will be received by the Company on 9 August 2005.

Following the Placing, the Directors either individually or through holding companies, together with connected parties, will hold 46,907,099 shares, representing approximately 56.7 per cent of the Enlarged Issued Share Capital. Certain other investors, as referred to in paragraph 3.1 of Part VII of this document, will together hold 2,610,756 shares, representing approximately 3.2 per cent of the Enlarged Issued Share Capital.

Over-allotment Arrangements

In connection with the Placing, MSSL, as stabilising manager, may (but will be under no obligation to) over-allot or effect other transactions with a view to supporting the market price of the shares or any options, warrants or rights with respect to, or interests in, the shares or other securities of the Company, in each case at a level higher than that which might otherwise prevail in the open market, for a limited time after the Placing Price is announced. Such transactions, if commenced, may be discontinued at any time and may only be undertaken during the period commencing on the date of announcement of the Placing Price (being the date of this document) and ending on the thirtieth day after the date of announcement of the Placing Price. Save as required by law or regulation, MSSL does not intend to disclose the extent of any over-allotments and/or stabilisation transactions conducted in relation to the Placing.

MSSL, as stabilising manager, has entered into Over-allotment Arrangements pursuant to the Underwriting Agreement with the Company pursuant to which MSSL may subscribe or procure subscribers for up to 4,000,050 Over-allotment Shares to be issued by the Company, at the Placing Price, for the purposes of allowing MSSL to meet over-allocations in connection with the Placing and to cover short positions resulting from stabilisation transactions. Any decision to subscribe or procure subscribers for any Over-allotment Shares is expected to be taken by no later than 2 September 2005.

Any Over-allotment Shares made available pursuant to the Over-allotment Arrangements will rank *pari passu* with the shares in all respects and shall be identical to all other shares. MSSL and UEN Cyprus Limited (a shareholder in the Company) have also entered into a stock lending agreement (the "Stock Lending Agreement") in connection with the Over-allotment Arrangements. Further details of this agreement are set out in paragraph 8.2.2 of Part VII of this document.

Lock-up and orderly trading arrangements

At Admission, related parties and applicable employees (all as defined in the AIM Rules) being UEN Cyprus Ltd, Belding Enterprise Limited, Abacus (Cyprus) Limited, Texas Oceanic Petroleum Company LLC, Nafta (B) NV, Viatcheslav V. Rovneiko, Gueorgui N. Ramzaitsev and Fantin Finance Limited will own 51,890,462 shares representing 97.75% of the Pre-Admission Share Capital. Each of these parties has undertaken pursuant to lock-up agreements entered into between each of them and the Company and MSIL on or before 4 August 2005, that, save in certain limited circumstances, it will not sell or dispose of any of its respective interests in shares at any time for a period of 365 days immediately following the Admission.

In addition, these parties have agreed that after the 365 day lock-up period referred to above they will agree to restrict their sales in a manner determined by MSIL as the Nominated Advisor for a further period of 365 days in order to maintain an orderly market.

At Admission, Hillsilk Limited will own 880,000 shares representing 1.66% of the Pre-Admission Share Capital. Hillsilk Limited has undertaken pursuant to a lock-up agreement entered into with the Company and MSIL on 4 August 2005, that save in limited circumstances, it will not sell or dispose of any of its interests in shares at any time for a period of 180 days immediately following Admission.

RP Explorer, after conversion of its notes described in paragraph 3.4 and 8.1.6 of Part VII of this document, will become the holder of shares in the Company and in connection therewith has agreed, pursuant to a lock-up agreement entered with the Company and MSIL on 4 August 2005, that for a period of 180 days following Admission it will restrict its sale of shares in a manner determined by MSIL as the Nominated Advisor for the Company so as to maintain an orderly market. Following the Admission, RP Explorer will hold 2,929,651 shares.

For further details on these arrangements, see paragraph 8.2.4 of Part VII of this document.

Admission to AIM and Dealings

The ISIN number for the Company's shares is CY0000111027. Application has been made for the shares to be admitted to trading on AIM. On 9 August 2005, the opening of the subscription lists shall take place and dealings in shares, as represented by Depositary Interests, are expected to commence.

Dealing Arrangements and CREST

CREST is a computerised paperless settlements system, which allows securities to be transferred via electronic means, without the need for a written instrument of transfer.

The Company's shares cannot be held or traded in the CREST system. To enable investors to settle their dealings in securities through CREST, a Depositary has been appointed to hold the relevant foreign securities and issue dematerialised depositary interests representing the underlying securities ("Depositary Interest"). The Company has appointed Computershare Investor Services PLC to act as the "Depositary". The Depositary will hold the shares for the Depositary Interest holders and this relationship is documented in a deed poll executed by the Depositary. This deed poll provides that the Depositary will pass on all rights and entitlements it receives, including the right to attend and vote at general meetings of the Company, to the relevant holder of Depositary Interests. The Depositary may not charge Depositary Interest holders for its services without first consulting the Depositary Interest holders.

The deed poll contains certain indemnities by a holder of Depositary Interests in favour of the Depositary and certain limitations of liability in favour of the Depositary.

The Depositary Interests will be independent securities under English law and will be held on a register maintained by the Depositary. The Depositary Interests will have the same security code as the underlying shares which they represent and will not require a separate admission to AIM.

Investors wishing to settle their dealings in securities through CREST can have their shares issued to the Depositary, which will then issue Depositary Interests to those investors, representing the transferred shares. The investors will not hold a share certificate evidencing the underlying shares. Each Depositary Interest will be treated as one share for the purposes of, for example, determining eligibility for dividend payments. Any payments received by the Depositary, as holder of the shares, will, pursuant to the deed poll, be passed on to each Depositary Interest holder noted on the Depositary Interest register as the beneficial owner of the relevant shares.

Participation in CREST is voluntary and investors who wish to hold share certificates may do so. They will not, however, then be able to settle their dealings in shares through CREST and will have their holding recorded on the Company's share register in the United Kingdom.

Application has been made by the Depositary for Depositary Interests, which represent the underlying shares, to be admitted to CREST on Admission.

The holder of Depositary Interests is entitled to a copy of the Deed on payment to the Depositary of a fee of approximately £88.

PART III

PETROLEUM CONSULTANTS' REPORT

DeGolyer and MacNaughton
4925 Greenville Avenue, Suite 400
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July 13, 2005

Urals Energy Holdings Limited
31 Evagorou Avenue
Nicosia CY-1066
Cyprus

Morgan Stanley & Co. International Limited
25 Cabot Square
Canary Wharf
London, E14 4QA
United Kingdom

At the request of Urals Energy Holdings Limited (UEHL), we have prepared estimates, as of March 31, 2005, of the extent of the proven, probable, and possible petroleum reserves and the value of the proven and probable petroleum reserves owned by UEHL. The interests evaluated consist of seven oil and gas fields located in Russia. The proven and probable reserves presented in this report have been prepared in accordance with reserves definitions presented in chapter 19 of *The Listing Rules* of the United Kingdom Listing Authority (UKLA). Such reserves definitions are included under the Classification of Reserves heading of this report. The possible reserves presented in this report have been prepared in accordance with the reserves definitions adopted by the Society of Petroleum Engineers (SPE) and the World Petroleum Congresses (WPC). The UKLA reserves evaluated herein are consistent with reserves evaluated on an SPE/WPC basis.

UEHL's holdings evaluated in this report include interests in seven oil fields in Russia. Interests in these seven fields are held in four separate subsidiary companies. The subsidiary companies, and the fields associated with each subsidiary, are ZAO Petrosakh (Okruzhnoye field), ZAO Chepetskoye NGDU (Nefedovskoye, Potapovskoye, and Zotovskoye fields), OOO CNPSEI (Sosnovskoye and Yuzhno-Tyebukskoye fields), and ZAO Arcticneft (Peschanoozerskoye field).

UEHL was in the process of acquiring Arcticneft's Peschanoozerskoye field as of March 31, 2005 and has represented that the acquisition was completed in July 2005. For this report the working interest in the reserves evaluation of this field was zero percent from March 31, 2005, through July 15, 2005. After July 15, 2005, the net working interest in the Peschanoozerskoye field was increased to the 100 percent ownership acquired by UEHL. Consequently, the production for the Peschanoozerskoye field from April 1, 2005, through July 15, 2005, was not included in the estimates of reserves and net present values presented in this report.

Reserves estimated in this report are expressed as working-interest reserves. Gross reserves are defined as the total estimated petroleum to be produced from the properties evaluated after March 31, 2005. Working-interest reserves are defined as that portion of the gross reserves to be produced from the properties attributable to the interests owned, as of March 31, 2005. UEHL has represented that it owns a 100-percent working interest in all properties evaluated herein with the exception of the Okruzhnoye field. UEHL has represented that it holds a 97.16-percent working interest in the Okruzhnoye field.

This report presents values for proven and proven-plus-probable reserves that were estimated using initial and escalated prices specified by UEHL. A detailed explanation of the future price and cost assumptions is included under the Valuation of Reserves heading of this report. Operating expenses and capital costs estimated herein are based on current costs as provided by UEHL. Future costs were adjusted as necessary to reflect changes in production rates or operating conditions. UEHL has represented that it has commissioned a firm other than DeGolyer and MacNaughton to evaluate plants and equipment.

UEHL has represented that the Russian Law on Subsoil provides for the extension of production licenses at the request of the license holder if there exists economic reserves upon the expiration of the primary term, provided the license holder is in material compliance with the terms of the existing license. Furthermore, we have been advised that the Law on Subsoil was amended in 2000 to provide that new production or combined production and exploration licenses for new fields or upon the expiration of the term of existing licenses will no longer be limited to a specified number of years and may now be issued for the full useful life of the fields associated with such license. We understand that the principal requirements are that the license holder complies with the material terms of the license and that mineral extraction has not been completed. As in the past, the license holder is required to submit to the appropriate government agency for approval, prior to production, individual field development plans based on the economic life of the field and not based on the term of the associated license. UEHL has represented that upon completion of the primary terms of the subject licenses associated with the fields evaluated herein, the license holder intends to extend these licenses to the end of the economic life of the fields, and that the license holder intends to proceed accordingly with development and operations of the fields. Based on these representations, we have included as proven, probable, and possible reserves those volumes that are estimated to economically producible from the fields evaluated after the expiration of the primary term of the licenses.

In this report, key information has been provided on the commercial fields in Russia evaluated herein. As far as we are aware, there are no special factors that would affect the production business of UEHL that would require additional information for the proper appraisal of these fields.

Values shown in this report for proven and proven-plus-probable reserves are expressed in terms of future gross revenue, future net revenue, and net present value. Future gross revenue is defined as that revenue derived from the sale of the gross reserves. Future net revenue is defined as the revenue attributable to the interests evaluated herein after deducting from the future gross revenue direct operating expenses, capital costs, taxes, and all interests, including royalties, attributable to others. Direct operating expenses include items such as operating expenses, gas-processing costs, compression costs, and estimated expenses of supervision. Capital costs include such items as pipelines, wells, compressors, and abandonment costs. Future profits tax expenses were taken into account by determining the appropriate taxes to be paid by UEHL. Net present value is defined as the future net revenue derived from proven and proven-plus-probable (non-risk-adjusted) reserves, discounted at a specified arbitrary discount rate over the expected period of realisation. In our opinion, net present value should not be construed to represent what a willing buyer and a willing seller would agree is the value of the property. Net present values using discount rates of 8, 10, and 12 percent are presented in this report. At the conclusion of this report, are summary tables of projected oil production, expenses, and future net revenue, in total and by subsidiary.

Estimates of petroleum reserves and future net revenue should be regarded only as estimates that may change as further production history and additional information become available. Not only are such reserves and revenue estimates based on that information which is currently available, but such estimates are also subject to the uncertainties inherent in the application of judgmental factors in interpreting such information.

Information used in the preparation of this report was obtained from UEHL. In the preparation of this report we have relied upon information furnished by UEHL with respect to the property interests to be evaluated, production from such properties, current costs of operation and development, current prices for production, agreements relating to current and future operations and sales of production, concession expiration dates, and various other information and data that were accepted as represented. Although we have not had independent verification, the information used in this report appears reasonable. The technical staff of UEHL involved with the assessment and implementation of development of UEHL's petroleum assets have demonstrated that they adhere to the generally accepted practices of the petroleum industry. The staff members appear to be experienced and technically competent in their fields of expertise. Site visits to the producing fields evaluated herein were not made by DeGolyer and MacNaughton employees. Existing production data, reports from third parties, and photographic evidence of the fields were considered adequate.

Executive Summary

Estimates of proven, probable, and possible oil and sales gas reserves, as of March 31, 2005, attributable to working interests owned by UEHL in Russia evaluated herein are listed below, expressed in thousands of barrels (10^3bbl) and millions of cubic feet (10^6ft^3):

	Working-Interest Reserves Summary		
	Proven	**Probable***	**Possible***
Oil, 10^3bbl	55,833	33,847	27,864
Sales Gas, 10^6ft^3	0	0	107,441

* Probable and possible reserves have not been adjusted for risk.

UEHL has represented that it has acquired Arcticneft's Peschanoozerskoye field in July 2005. For this report the working interest in the reserves evaluation of this field was zero percent from March 31, 2005, through July 15, 2005. After July 15, 2005, the working interest in the Peschanoozerskoye field was increased to the 100 percent ownership acquired by UEHL. Consequently, the production for the Peschanoozerskoye field from April 1, 2005, through July 15, 2005, was not included in the estimates of reserves and net present values presented in this report.

Estimates of the future net revenue and the net present value, using discount rates of 8, 10, and 12 percent, of the future net revenue to be derived from the proven and proven-plus-probable reserves, as of March 31, 2005, of the properties evaluated herein are presented as follows for three price scenarios, designated herein as Scenario A, Scenario B (also referred to as the Base Case), and Scenario C. A detailed explanation of the future price and cost assumptions is included under the Valuation of Reserves heading of this report. Values are expressed in millions of U.S. dollars (10^6 U.S.$):

Valuation of Reserves Summary—Scenario B (Base Case)

	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	909.425	1,396.850	692.608	1,060.793
Net Present Value at 8 Percent	479.085	641.779	358.897	477.313
Net Present Value at 10 Percent	417.870	543.960	311.740	402.357
Net Present Value at 12 Percent	367.450	465.774	272.996	342.651
Profits Tax Applied	0	0	219.204	338.678

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

Valuation of Reserves Summary—Scenario A

	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	845.403	1,305.214	643.827	991.007
Net Present Value at 8 Percent	439.065	591.534	328.447	439.094
Net Present Value at 10 Percent	381.327	499.234	283.939	368.340
Net Present Value at 12 Percent	333.814	425.536	247.411	312.045
Profits Tax Applied	0	0	203.879	316.737

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

Valuation of Reserves Summary—Scenario C

	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	1,208.265	1,843.922	919.888	1,400.888
Net Present Value at 8 Percent	636.238	854.779	478.374	639.252
Net Present Value at 10 Percent	555.233	726.182	416.166	540.888
Net Present Value at 12 Percent	488.535	623.215	365.046	462.338
Profits Tax Applied	0	0	291.633	446.645

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

Field Discussion

Detailed information regarding the seven fields evaluated in this report follows. These seven fields account for all of the total proven-plus-probable oil reserves of the properties evaluated herein. Also presented as follows is a map (Figure 1) of Russia showing the appropriate location of the seven fields evaluated herein.

FIGURE 1
GENERAL LOCATION MAP
7 URALS ENERGY FIELDS
RUSSIA
DeGolyer and MacNaughton Dallas, Texas

Okruzhnoye Field

The license number for the Okruzhnoye field is YuSKH 00249 NE. The Okruzhnoye field is located in the Sakhalin Oblast area of eastern Russia. It is 50 kilometers south of the city of Okha. The field lies within the North Sakhalin Basin. The producing reservoirs range in age from the Miocene, Borsky 2 reservoir down through the Paleogene, Pileng reservoir. A total of five different reservoirs have estimated reserves.

The Borsky 2 reservoir has a stratigraphic limit on the south flank. The dimensions of this reservoir are 2.0 by 1.5 kilometers. The top of reservoir is 1,174 meters true vertical depth subsea (TVDSS). An oil/water contact (OWC) is estimated at 1,275 meters TVDSS. Three wells penetrated this reservoir. The net oil reservoir map for the Borsky 2 reservoir has an average net thickness of 24.4 meters of oil. The average reservoir parameters for this reservoir are as follows: porosity equals 17 percent, water saturation equals 60 percent, permeability equals .010 darcy, average crude gravity equals 37 degrees API (°API), the gas-oil ratio (GOR) equals 134 cubic meters per metric ton (m^3/ton), and the initial reservoir pressure equals 13.7 mega pascals (MPa).

The Borsky 3 reservoir has three accumulations. The northern accumulation has a stratigraphic limit on the south flank, and the east flank is cut by a fault. The central accumulation is a stratigraphic feature except for a fault cutting the east flank. The southern accumulation is a structure closure cut by a fault on the east flank. The dimensions of the northern structure are 2.0 by 1.5 kilometers. The southern structure has dimensions of 1.5 by 1.0 kilometer. The dimensions of the southern structure are 0.5 by 0.25 kilometer. Eight wells penetrate the three reservoirs. The net oil reservoir map for the Borsky 3 reservoir has an average net thickness of 11.3 meters for all three accumulations. The average reservoir parameters are as follows: porosity equals 13 percent, average water saturation equals 67 percent, permeability equals 0.11 darcy, average crude gravity equals 37 °API, the GOR equals 133 m^3/ton, and the initial reservoir pressure equals 15.9 MPa.

The Borsky 3a reservoir has one faulted accumulation. This reservoir has dimensions of 4.0 by 1.5 kilometers. The top of reservoir is 1,222 meters TVDSS. An OWC is estimated at 1,670 meters TVDSS. Ten wells penetrate the reservoir. The net oil reservoir map for the Borsky 3a reservoir has an average net thickness of 9.0 meters of oil. The average reservoir parameters are as follows: porosity equals 12 percent, water saturation equals 68 percent, permeability equals .010 darcy, average crude gravity equals 37 °API, the GOR equals 131 m^3/ton, and the initial reservoir pressure equals 17.5 MPa.

The Borsky 4 reservoir has one faulted, structural accumulation. This reservoir has dimensions of 8.0 by 2.0 kilometers. The top of reservoir is 1,189 meters TVDSS. An OWC is estimated at 1,810 meters TVDSS. Fifteen wells penetrate this reservoir. The net oil reservoir map for the Borsky 4 reservoir has an average of 18.8 meters of oil. The average reservoir parameters are as follows: porosity equals 12 percent, water saturation equals 70 percent, permeability equals .048 darcy, average crude gravity equals 37 °API, the GOR equals 134 m^3/ton, and the initial reservoir pressure equals 18.7 MPa.

The Pileng reservoir has two faulted accumulations. Figure 2 displays a top of reservoir structure map for the Pileng reservoir. The larger feature is upthrown on the western side of a north/south-trending fault. This structure consists of 10 small-to medium-sized fault blocks. Another fault block is estimated on the eastern, downthrown side of the same fault. The total dimensions of the upthrown blocks are 6.5 by 1.25 kilometers. The top of reservoir in the upthrown block is 1,308 meters TVDSS. An OWC is estimated at 1,810 meters TVDSS in all of the upthrown fault blocks. The downthrown fault block has dimensions of 1.25 by 0.7 kilometers. The top of reservoir is 1,600 meters TVDSS. A probable OWC is estimated at 1,810 meters TVDSS. One well penetrates the downthrown fault block and is not producing. Most of the upthrown fault blocks are drilled and producing. The northern fault block in the upthrown structure is the only fault block getting pressure support through water injection. At least seven upthrown, individual fault blocks with net oil reservoir can be mapped. A total of 16 wells penetrate the upthrown blocks. Six of these wells are currently producing. Based on the production characteristics of the upthrown producing wells and the offset across the bounding faults, it would appear that most of the upthrown fault blocks are fully to partially sealing. The net oil reservoir map has an average thickness of 66.2 meters of oil. The average reservoir parameters are as follows: porosity equals 18 percent, water saturation equals 55 percent, permeability equals .0845 darcy, average crude gravity equals 37 °API, the GOR equals 135 m^3/ton, and the initial reservoir pressure equals 19.0 MPa.

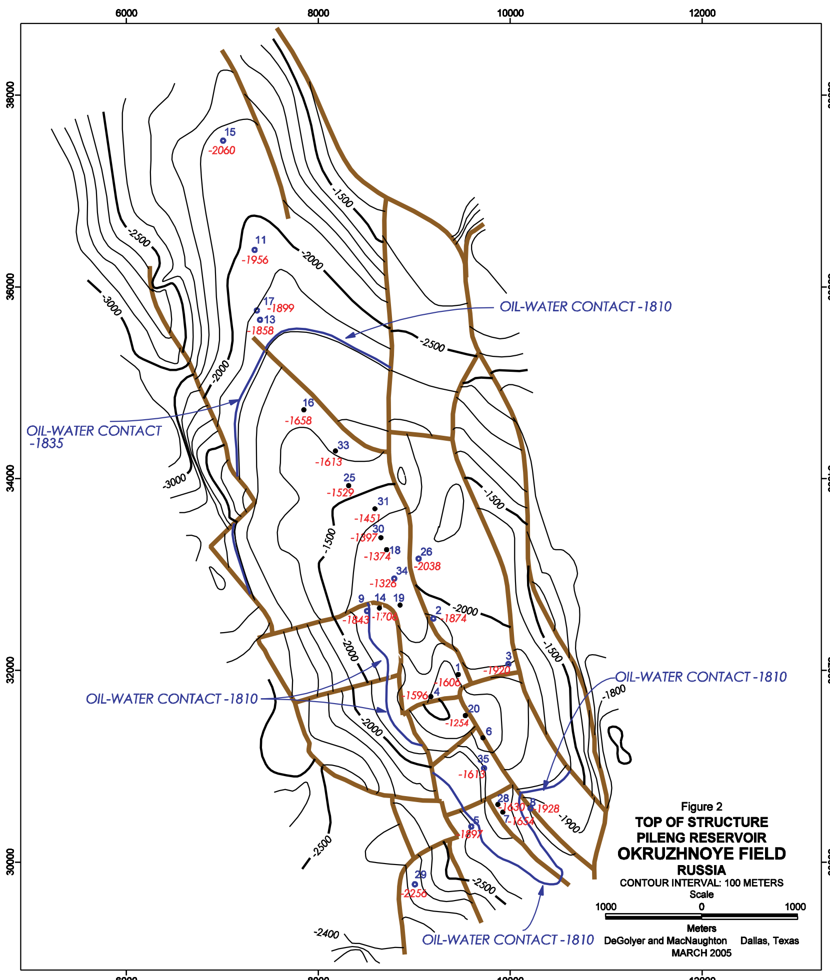


Figure 2
TOP OF STRUCTURE
PILENG RESERVOIR
OKRUZHNOYE FIELD
RUSSIA
CONTOUR INTERVAL: 100 METERS

Reserves for the Okruzhnoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine original oil in place (OOIP). The total OOIP associated with proven reserves for the Okruzhnoye field was estimated to be 184.47 million barrels and the proven-plus-probable OOIP was estimated to be 198.88 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.445. The field is partially developed with 10 producing wells. The volumetric estimation of reserves utilises a depletion-drive mechanism with limited water drive. Field production began in August 1992 from the Pileng reservoir at a rate of 4,950 barrels per month. The Okruzhnoye field produced an average of 1,817 barrels of oil per day (BOPD) in March 2005. The other reservoir in the field, the Borsky, began production in August 1998 at a rate of 4,150 barrels per month. Both reservoirs together have a cumulative oil production, as of March 31, 2005, of approximately 15,610,000 barrels. The estimated proven reserves recovery factor is 21.9 percent for the Pileng and 12.1 percent for the Borsky. A lower recovery factor for the Borsky is estimated due to less production history, relatively poorer reservoir quality than the Pileng reservoir, and a lack of water injection in the Borsky. The estimated proven-plus-probable reserves recovery factor is 23.0 percent for the Pileng and 14.0 percent for the Borsky. Fifteen additional wells are required to produce the proven reserves in the Pileng. The Borsky proven reserves, apart from those reserves associated with the two existing Borsky producers, have been treated as future uphole recompletions from the Pileng to the Borsky in 23 existing and future wells. The Borsky proven undeveloped reserves that could not be accommodated by Pileng recompletions were classified as probable. These Borsky probable reserves require 10 future wells. The Pileng is currently under water injection in the largest northern block only. The projected production life of the Okruzhnoye field is until 2035.

Peschanoozerskoye Field

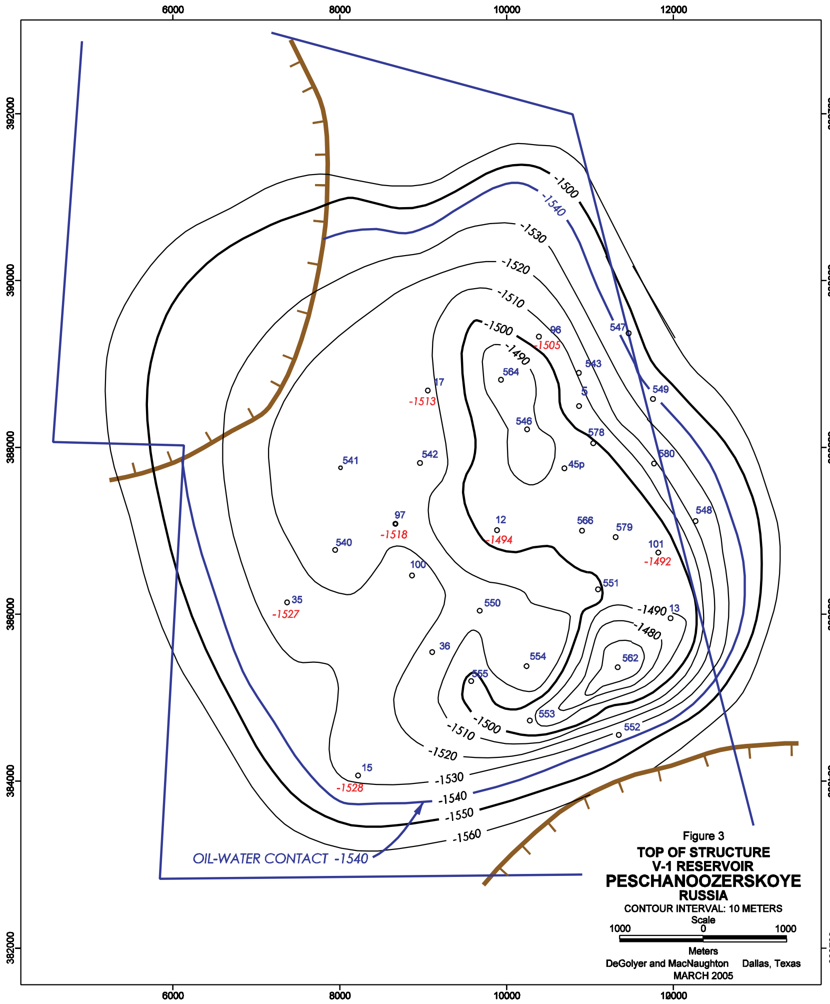
The license number for the Peschanoozerskoye field is NRM 00451 NE. This field is located on Kolguyev Island, offshore from the Kanin Peninsula in the Barents Sea. The field lies within the northern portion of the Timan Pechora Basin. The reservoir section includes Lower Triassic sandstones of the Charkaborzh Formation. Nine different reservoirs have mapped volumes within the Charkaborzh Formation.

The "G" reservoirs are the shallowest of the Triassic reservoirs in this field. Accumulations associated with G reservoirs are in two separate areas. One area is the southern block, and the other is the eastern block. The central block reserves have been excluded, as they fall within the license boundary of another operator.

The G-1 reservoir is mostly located in the eastern block. The dimensions of this reservoir are 5.9 by 4.6 kilometers. The top of reservoir is 1,510 meters TVDSS. A GWC is estimated at 1,527 meters. Three wells penetrate this reservoir but none are producing. The average reservoir thickness is 3.01 meters of gas. The average reservoir parameters are as follows: porosity equals 27 percent, water saturation equals 39 percent, permeability equals .0186 darcy, the condensate yield is 22.7 barrels/million standard cubic feet (bbl/MMscf), and the initial reservoir pressure equals 14.7 MPa.

The G-2 reservoir is associated with the southern block. The dimensions of this reservoir are 5.3 by 1.2 kilometers. The top of reservoir is 1,475 meters TVDSS. A variable OWC is estimated between 1,473 meters TVDSS and 1,483 meters TVDSS. Three wells penetrate this reservoir and none are producing. The net oil reservoir map has an average thickness of 4.41 meters of oil. The reservoir parameters are as follows: porosity equals 20.4 percent, water saturation equals 56 percent, permeability equals .0132 darcy, average crude gravity equals 48 °API, the GOR equals 210 m^3/ton, and the initial reservoir pressure was not available.

The "V" reservoirs in Peschanoozerskoye field are deeper than the reservoirs labeled "G." The V-1 reservoir is the shallowest of the "V" reservoirs. This reservoir is associated with the eastern block. The structure is a four-way closure. The dimensions of this reservoir are 8.5 by 6.3 kilometers. Figure 3 displays a top of reservoir structure map for the V-1 reservoir. The top of reservoir is at 1,520 meters TVDSS. An OWC is estimated at 1,540 meters TVDSS. Fifteen wells have penetrated this reservoir. There are four producers and one injector. The net oil reservoir map has an average thickness of 6.7 meters of oil. The average reservoir parameters are as follows: porosity equals 23.4 percent, water saturation equals 46 percent, permeability equals .0167 darcy, average crude gravity equals 49 °API, the GOR equals 152 m^3/ton, and the initial reservoir pressure was not available.



The V-1 + 2 reservoir is associated with the central block and has two accumulations. The western structure has a stratigraphic limit on its eastern flank. The eastern accumulation is totally stratigraphic in nature. The western structure has dimensions of 4.45 by 2.5 kilometers. The eastern structure has dimensions of 2.5 by 2.6 kilometers. The top of reservoir is 1,610 meters TVDSS. An OWC is mapped in the western structure at 1,623 meters TVDSS. A total of 13 wells penetrate the two structures, but none are producing. The net pay map has an average thickness of 4.92 meters of oil in the western structure and 2.47 meters of oil in the eastern structure. The average reservoir parameters are as follows: porosity equals 23 percent, water saturation equals 47 percent, average permeability equals .0521 darcy, average crude gravity equals 49 °API, the GOR equals 206 m^3/ton, and the initial reservoir pressure was not available.

The V-3 reservoir is associated with the western block. This reservoir is an elongate structure with a stratigraphic limit on its eastern flank. The dimensions of this structure are 12.5 by 4.2 kilometers. The top of reservoir is at 1,640 meters TVDSS. The OWC is highly variable, ranging from 1,631 meters TVDSS down to 1,698 meters TVDSS. Variable contacts suggest that the reservoir may be compartmentalised. It is likely that individual sands within the V-3 reservoir are stratigraphic in nature and not in vertical or horizontal communication. A total of 13 wells penetrate the reservoir but none are producing. The net pay map has an average thickness of 7.78 meters of oil. The average reservoir parameters are as follows: porosity equals 22 percent, water saturation equals 42 percent, permeability was not available, average crude gravity equals 49 °API, the GOR equals 230 m^3/ton, and the initial reservoir pressure was not available.

The V-4 reservoir is associated with the western block. This reservoir has an elongate structure with a stratigraphic limit on its northern and eastern side. The dimensions of this structure are 13.0 by 5.5 kilometers. The top of reservoir is at 1,650 meters TVDSS. The OWC is mapped at 1,690 meters TVDSS. Thirteen wells have penetrated this reservoir and 4 are producing. The net pay map has an average thickness of 4.35 meters of oil. The average reservoir parameters are as follows: porosity equals 23 percent, water saturation equals 41 percent, permeability equals .0171 darcy, average crude gravity equals 49 °API, the GOR equals 230 m^3/ton, and the initial reservoir pressure was not available.

The V-5 reservoir is associated with the western block. This reservoir has an elongate structure with a stratigraphic limit on the north and east flank. The dimensions of the reservoir are 9.8 by 2.7 kilometers. The top of reservoir is at 1,590 meters TVDSS. A GWC is mapped at 1,630 meters TVDSS. Eight wells penetrate this reservoir, but none are producing. The net pay map has an average thickness of 3.14 meters of gas. The average reservoir parameters are as follows: porosity equals 23 percent, water saturation equals 39 percent, permeability equals .0227 darcy, and the initial reservoir pressure equals 15.7 MPa.

The V-5a reservoir is associated with the western block. This reservoir has three separate stratigraphic accumulations. These accumulations are associated with the Peschanoozerskoye-23, -27, and -34 wells. The dimensions of the western structure are 2.8 by 1.0 kilometer. The dimensions of the central structure are 3.5 by 1.0 kilometer. The dimensions of the eastern structure are 3.1 by 1.0 kilometer. The average top of reservoir for all three structures is 1,600 meters TVDSS. No OWCs are identified. All wells appear to have lowest known oil. The net pay map has an average thickness of 1.4 meters of oil for the western accumulation, 1.2 meters for the central accumulation, and 1.2 meters for the eastern accumulation. The average reservoir parameters are as follows: porosity equals 23 percent, water saturation equals 42 percent, permeability was not available, average crude gravity equals 49 °API, the GOR equals 230 m^3/ton, and the initial reservoir pressure was not available.

The V-6 + 7 is associated with the western block. This reservoir has a stratigraphic limit on the northern and eastern side of the structure. The dimensions of this structure are 4.5 by 2.8 kilometers. The top of reservoir is 1,625 meters TVDSS. An OWC is mapped at 1,654 meters TVDSS. Two wells penetrate this structure and neither well is producing. The net pay map has an average thickness of 2.44 meters of oil. The average reservoir parameters are as follows: porosity equals 27 percent, water saturation equals 36 percent, permeability equals .0524 darcy, average crude gravity equals 50 °API, the GOR equals 233 m^3/ton, and the initial reservoir pressure was not available.

Reserves for the Peschanoozerskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total proven OOIP for the Peschanoozerskoye field was estimated to be 224.57 million barrels and the proven-plus-probable OOIP was estimated to be 241.13 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.326. The field is partially developed with 33 producing wells. Current production is from the V-1 and V-4 reservoirs. The volumetric estimation of reserves is based upon a depletion-drive mechanism with limited water drive. The field contains two water injection wells in the V-1 reservoir and one water-injection well in the V-4 reservoir.

Field production began in 1985 from Peschanoozerskoye-13, in the V-1 reservoir, at a rate of 2,920 barrels per month. The other currently producing reservoir in the field, V-4, began production in 1993. Both reservoirs together have a cumulative oil production as of July 31, 2005, of approximately 6,780,000 barrels. The Peschanoozerskoye field produced an average of 1,372 BOPD in March 2005. The estimated proven reserves recovery factor is 14.9 percent for the field. The estimated proven-plus-probable reserves recovery factor is 22.0 percent. Sixty-eight additional wells are required to produce the proven reserves in the field. The large number of wells to be drilled are required to decrease the current well spacing to approximately 500 meters between wells. An additional 34 wells are required to produce the probable reserves evaluated herein and the projected field production life is until 2095.

Nefedovskoye Field

The license number for the Nefedovskoye field is IZHV 00387 NE. This field is located approximately 100 kilometers northwest of the city of Izhevsk, Udmurt Republic, western Siberia. The field lies within the Volga-Kama basin. The reservoirs range in age from the Middle Carboniferous, Moscovian Stage, Verey 1 (V-1) reservoir down through the Bashkirian Stage, A4-4 reservoir. All reservoirs are carbonate.

The field can be described as a group of unfaulted structural and stratigraphic closures. These closures are associated with seven reservoirs that have net oil reservoir. A three-dimensional (3-D) seismic database was acquired over the field area. The main structure dips to the west and has a stratigraphic limit on the east flank. The uppermost reservoir, the V-1, has dimensions of 3.2 by 1.9 kilometers. The structure has a top of reservoir at 1,080 meters TVDSS. An OWC is estimated at 1,087 meters TVDSS.

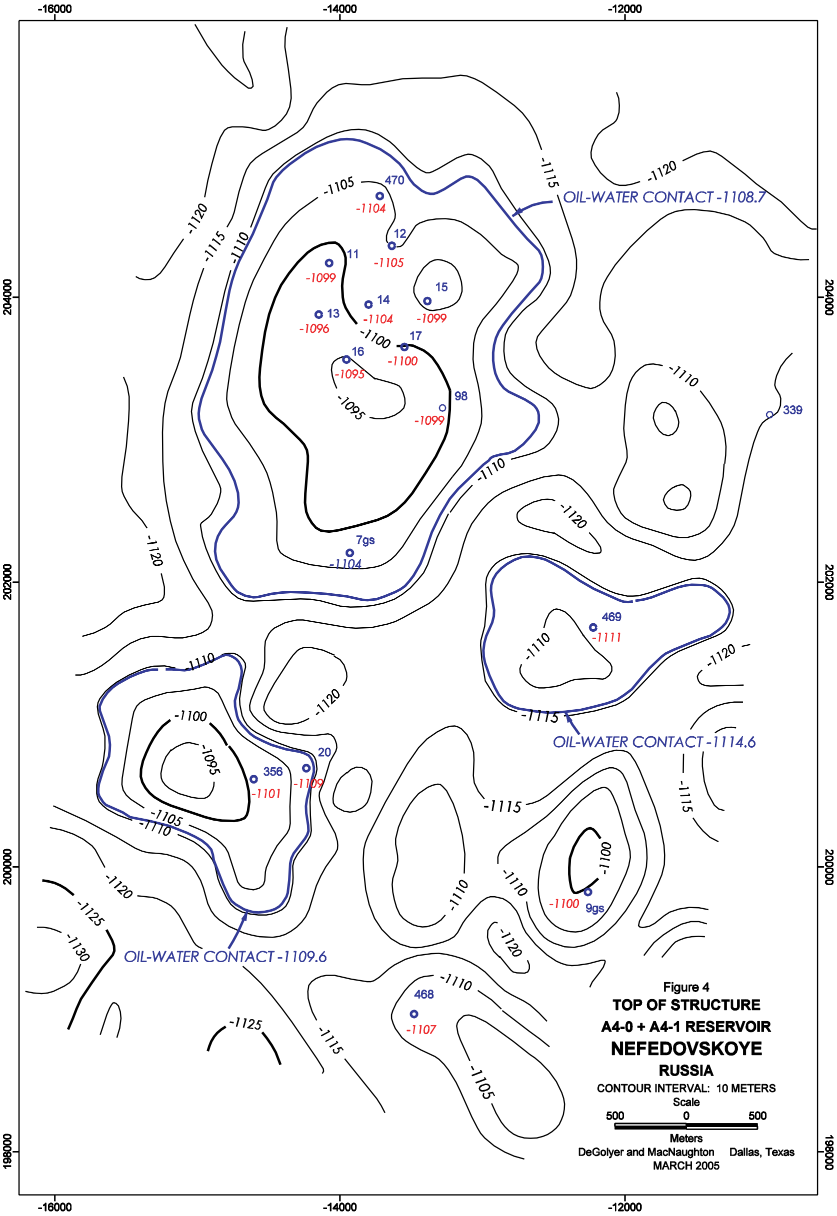
The Nefedovskoye-98 well is located in a small, stratigraphic accumulation, east of the main accumulation. This structure has dimensions of 0.75 by 0.5 kilometer. No OWC is estimated in Nefedovskoye-98, but there is known oil down to approximately 1,086 meters TVDSS. Seven wells penetrate the main accumulation. One well penetrates the small, eastern accumulation. None of the wells associated with this reservoir is currently producing.

The net oil reservoir map has an average thickness of 1.3 meters of oil in the main accumulation. The eastern accumulation has an average thickness of 1.0 meter of oil. The average reservoir parameters are as follows; porosity equals 16 percent, water saturation equals 33 percent, permeability equals .23 darcy, average crude gravity equals 29 °API, the GOR equals 12.09 m^3/ton, and the initial reservoir pressure equals 13.0 MPa.

The V-2 reservoir has three four-way closures with net oil reservoir. The main structure has dimensions of 3.0 by 2.0 kilometers. The structure has a top of reservoir at 1,085 meters TVDSS and an OWC at 1,092 meters TVDSS. Ten wells penetrate this reservoir. Four of the wells are producers. The southwestern structure has dimensions of 3.0 by 2.0 kilometers. The top of reservoir is at 1,080 meters TVDSS. An OWC is estimated at 1,086.7 meters TVDSS. The southeastern structure has dimensions of 0.75 by 0.75 kilometer. The structure has a top of reservoir at 1,094 meters TVDSS. An OWC is estimated at 1,095.3 meters TVDSS. Neither of the wells associated with these two structures is a producer. The net oil reservoir map has an average thickness of 1.6 meters of net oil reservoir for the main accumulation. The southwestern accumulation has an average net thickness of 1.7 meters of oil. The southeastern accumulation has an average net thickness of 1.0 meter of oil. The average reservoir parameters for the V-2 reservoir are as follows: porosity equals 17 percent, water saturation equals 22 percent, permeability equals .016 darcy, average crude gravity equals 29 °API, the GOR equals 12.09 m^3/ton, and the initial reservoir pressure equals 12.6 MPa.

The V-3a reservoir has two four-way closures with net oil reservoir. The main structure has dimensions of 2.8 by 1.9 kilometers. The structure has a top of reservoir at 1,090 meters TVDSS. An OWC is estimated at 1,097 meters TVDSS. The Nefedovskoye-12 well in the northern portion of the main accumulation has no reservoir rock. The area around the Nefedovskoye-12 well was interpreted to be slightly high structurally at the time of deposition with no carbonate deposited locally. A total of nine other wells in the V-3a main accumulation penetrated net oil reservoir. Three wells in this accumulation are currently producing. The southwestern structure has dimensions of 1.1 by 0.75 kilometer. The top of reservoir is 1,085 meters TVDSS. An OWC is estimated at 1,091.9 meters TVDSS. The one well in this accumulation is not producing. The net oil reservoir map for the main accumulation has an average net thickness of 1.0 meter of oil. The southwestern accumulation has an average net thickness of 1.1 meter of oil. The average reservoir parameters for the V-3a reservoir are as follows: porosity equals 16 percent, water saturation equals 27 percent, permeability equals .23 darcy, average crude gravity equals 29 °API, the GOR equals 12.09 m^3/ton, and the initial reservoir pressure equals 13.0 MPa.

The A4-0 + A4-1 reservoir is associated with the Bashkirian Stage in the Middle Carboniferous. Figure 4 displays a top of reservoir structure map for the A4-0 + A4-1 reservoir. This reservoir has three closures. The main structure has dimensions of 3.2 by 2.3 kilometers. The top of reservoir is 1,095 meters TVDSS. An OWC is estimated at 1,108.7 meters TVDSS. Ten wells penetrate the main accumulation. Six of the wells are producing. The southwestern structure has dimensions of 1.9 by 1.6 kilometers. The top of reservoir is 1,095 meters TVDSS. An OWC is estimated at 1,109.6 meters TVDSS. Two wells penetrate this reservoir and neither is producing. The southeastern structure has dimensions of 1.7 by 1.1 kilometers. The top of reservoir is 1,110 meters TVDSS. An OWC is estimated at 1,114.6 meters TVDSS. One well penetrates this reservoir and is not producing. The net oil reservoir map for the main accumulation has an average net thickness of 1.35 meters of oil. The southwestern structure has an average net thickness of 1.2 meters of oil. The southeastern structure has one well with an average net thickness of 1.0 meters of oil. The average reservoir parameters for the A4-0 + A4-1 reservoir are as follows: porosity equals 16 percent, water saturation equals 19 percent, permeability equals .011 darcy, average crude gravity equals 31 °API, the GOR equals 11.95 m^3/ton, and the initial reservoir pressure equals 13.3 MPa.



The A4-2 reservoir has two closures. The main structure has dimensions of 3.2 by 2.5 kilometers. The top of the reservoir is 1,110 meters TVDSS. An OWC is estimated at 1,116.8 meters TVDSS. Ten wells penetrate the main accumulation. Two of these wells are currently producing. The southwestern structure has dimensions of 1.9 by 1.6 kilometers. The top of reservoir is 1,105 meters TVDSS. An OWC is estimated at 1,117.3 meters TVDSS. The one well in this structure is not producing. The net pay map has an average net thickness of 1.3 meters of net oil reservoir. The southwestern structure has an average net thickness of 1.3 meters of net oil reservoir. The average reservoir parameters for the A4-2 reservoir are as follows: porosity equals 12 percent, water saturation equals 24 percent, permeability equals .016 darcy, average crude gravity equals 31 °API, the GOR equals 11.95 m^3/ton, and the initial reservoir pressure equals 13.1 MPa.

The A4-3 reservoir has two closures. The main structure has dimensions of 2.9 by 1.85 kilometers. The top of reservoir is 1,115 meters TVDSS. An OWC is estimated at 1,119.9 meters TVDSS. Eight wells penetrate the main accumulation. Three of the wells are currently producing. The southwestern accumulation has dimensions of 1.5 by 1.3 kilometers. The top of reservoir is 1,110 meters TVDSS. An OWC is estimated at 1,116.8 meters TVDSS. The one well in this structure is not producing. The net oil reservoir map has an average net thickness of 1.5 meters of oil. The southwestern structure has an average net thickness of 1.0 meters of oil. The average reservoir parameters for the A4-3 reservoir are as follows: porosity equals 14 percent, water saturation equals 20 percent, permeability equals .008 darcy, average crude gravity equals 31 °API, the GOR equals 11.95 m^3/ton, and the initial reservoir pressure equals 13.1 MPa.

The A4-4 reservoir has one small closure. This accumulation is in the southwestern part of the field. The structure has dimensions of 1.0 by 0.75 kilometer. The top of reservoir is 1,115 meters TVDSS. There is an OWC estimated at 1,120.6 meters TVDSS. The one well in this structure is not producing. The net oil reservoir map has an average net thickness of 0.85 meter of net oil reservoir. The reservoir parameters are as follows: porosity equals 12 percent, water saturation equals 35 percent, permeability equals .019 darcy, average crude gravity equals 31 °API, the GOR equals 12.0 m^3/ton, and the initial reservoir pressure equals 13 MPa.

Reserves for the Nefedovskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and rock volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total OOIP associated with proven reserves for the Nefedovskoye field was estimated to be 9.95 million barrels and the OOIP associated with proven-plus-probable reserves was estimated to be 30.25 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.027. Eight producing wells commingle production from four of the seven mapped reservoirs for this field. The volumetric estimation of reserves is based upon a depletion-drive mechanism. Field production began in December 1999 at a rate of 2,079 barrels per month, resulting in a cumulative oil production, as of March 31, 2005, of approximately 484,000 barrels. The Nefedovskoye field produced an average of 242 BOPD in March 2005. The estimated proven reserves recovery factor is 15.9 percent. Five additional wells are required to produce the proven reserves and 26 additional wells are required to produce the probable reserves. The proven-plus-probable reserves recovery factor is 17 percent of the OOIP. This increased recovery factor is slightly higher than the proven reserves recovery factor to account for the possibility of improved performance. The field is not currently under water injection and the projected field production life is until 2023.

Potapovskoye Field

The license number for the Potapovskoye field is IZHV 00387 NE. The Potapovskoye field is located approximately 100 kilometers northwest of the city of Izhevsk, in the Volga-Kama Basin. The field is about 7 kilometers east of Nefedovskoye field. The Potapovskoye field ranges from the Middle Carboniferous, Moscovian Stage, Verey Formation through the Bashkirian Stage. The productive reservoirs are carbonate. This field has one unfaulted, four-way closure.

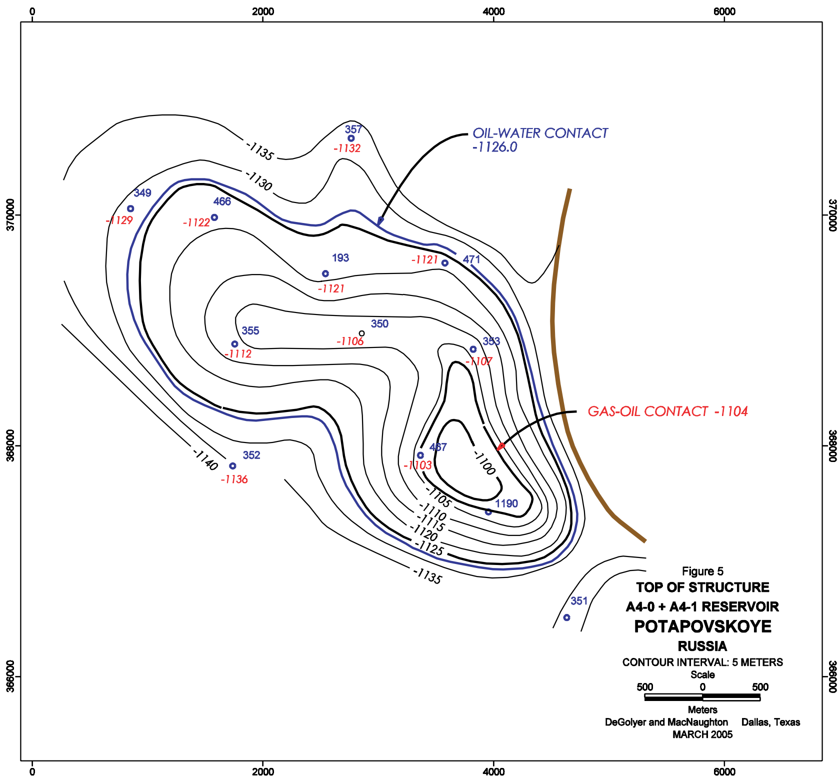
The shallowest reservoir, V-2, is part of the Moscovian Stage, Verey Formation. The dimensions of this reservoir are 8.5 by 3.7 kilometers. The top of reservoir is 1,085 meters TVDSS. A gas/oil contact (GOC) is estimated at 1,092 meters TVDSS and an OWC is estimated at 1,107 meters TVDSS. Eight wells are drilled though this reservoir but none are currently producing. The net oil reservoir map has an average thickness of 1.5 meters of net gas and 1.6 meters of net oil. The average reservoir parameters are as follows: porosity equals 17 percent, water saturation equals 33.2 percent, permeability equals .02 darcy, average crude gravity equals 28 °API, the GOR equals 9.1 m^3/ton, and the initial reservoir pressure equals 12.8 MPa.

The V-3a reservoir has dimensions of 6.8 by 2.8 kilometers. The top of reservoir is 1,090 meters with a GOC at 1,094.5 meters TVDSS and an OWC at 1,102 meters TVDSS. Five wells are drilled through this reservoir but none are currently producing. The net oil reservoir map has an average net thickness of 1.2 meters gas and 1.12 meters oil. The average reservoir parameters are as follows: porosity equals 17 percent, water saturation equals 33.2 percent, permeability equals .045 darcy, average crude gravity equals 31 °API, the GOR equals 12.3 m^3/ton, and the initial reservoir pressure equals 12.8 MPa.

The A4-0 + A4-1 reservoir is part of the Bashkirian Stage and has dimensions of 9.2 by 3.7 kilometers. Figure 5 displays a top of reservoir structure map for the A4-0 + A4-1 reservoir. The top of reservoir is 1,100 meters TVDSS. A GOC is estimated at 1,104 meters TVDSS and an OWC is estimated at 1,126 meters TVDSS. Eight wells are drilled through this reservoir and one of the wells, Potapovskoye-355, is producing. The net oil reservoir map has an average net thickness of 0.5 meters of gas and 1.8 meters of oil. The average reservoir parameters are as follows: porosity equals 14 percent, water saturation equals 27.1 percent, permeability equals .045 darcy, average crude gravity equals 31 °API, the GOR equals 12.3 m^3/ton, and the initial reservoir pressure equals 13.3 MPa.

The A4-3 reservoir has dimensions of 7.0 by 2.8 kilometers. The top of reservoir is 1,120 meters TVDSS. An OWC is estimated at 1,128 meters TVDSS. Five wells are drilled through this reservoir and one, Potapovskoye-355, is producing. The net oil reservoir map has an average net thickness of 0.77 meter of oil. The average reservoir parameters are as follows: porosity equals 15 percent, water saturation equals

28.8 percent, permeability equals .49 darcy, average crude gravity equals 31 °API, the GOR equals 12.3 m^3/ton, and the initial reservoir pressure equals 13.3 MPa.



Reserves for the Potapovskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total OOIP associated with proven reserves for the Potapovskoye field was estimated to be 16.05 million barrels and the OOIP associated with proven-plus-probable reserves was estimated to be 67.21 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.02. The field is mostly undeveloped with one producing well. The volumetric estimation of reserves is based upon a depletion with gas-cap expansion drive mechanism. Field production began in June 2000 from the A4-0 + 4-1 at a rate of 1,385 barrels of oil per month, resulting in a cumulative oil production as of March 31, 2005, of approximately 72,000 barrels. The Potapovskoye field produced an average of 32 BOPD in March 2005. The estimated proven reserves recovery factor ranges from 12 to 25.8 percent. A 12-percent recovery factor was used for unproduced reservoirs with no production history and a performance-based 25.8-percent recovery factor was used for proven reserves in the A4-0 + 4-1 reservoir. The overall field recovery factor for proven reserves equates to 15 percent of the OOIP. The overall field recovery factor for proven-plus-probable reserves was 23 percent of the OOIP. Eight additional wells are required to produce the proven reserves and 47 additional wells are required to produce the probable reserves. The field is not currently under water injection and the projected field production life is until 2052.

Zotovskoye Field

The license number for the Zotovskoye field is IZHV 00387 NE. This field is located approximately 100 kilometers northwest of the city of Izhevsk, in the Volga-Kama Basin. The field is about 7 kilometers west northwest of the Nefedovskoye field and 12 kilometers west of the Potapovskoye field. The Zotovskoye field has one reservoir in the Moscovian Stage, Verey Formation, and one in the Baskirian Stage of the Middle Carboniferous. The productive reservoirs are carbonate. The field has one unfaulted, V-shaped structure. The structure has minor closures within the main structure. These structures isolate different gas caps that share the same oil leg. In addition, the Verey Formation has two reservoirs, the V-2 and the V-3a. The closure associated with the V-2 reservoir has dimensions of 4.3 by 3.6 kilometers. The top of reservoir is 1,090 meters TVDSS.

The V-2 reservoir has GOCs of 1,097.6 meters TVDSS in the north and 1,092.7 meters TVDSS in the south. A minor gas cap is estimated on the west side of the structure at 1,094 meters TVDSS, based on the seismic data only. There is no well control to support this small gas accumulation. An OWC is estimated at 1,092.7 meters TVDSS. The V-3a top of reservoir is 1,095 meters TVDSS. GOCs are estimated at 1,101.3 meters TVDSS in the north and 1,097.7 meters TVDSS in the south. A small gas cap is estimated on the west side of the structure at 1,098 meters TVDSS, based on seismic data only. There is no well control to support this small gas accumulation. An OWC is estimated at 1,108.3 meters TVDSS.

The net oil reservoir intervals for these two reservoirs are estimated as one reservoir. Both V-2 and V-3a reservoirs are relatively thin and the producing wells are being commingled. Seventeen wells are drilled through the combined reservoir and three wells are producing the two reservoirs. The producing wells are Zotovskoye-117, -118, and -124. The net oil reservoir map for these reservoirs has an average net thickness of 2.15 meters oil. The combined reservoir V-2 + V-3a has average reservoir parameters as follows: porosity equals 14 percent, water saturation equals 33 percent, permeability equals .012 darcy, average crude gravity equals 35 °API, the GOR equals 25 m^3/ton, initial reservoir pressure equals 13.0 MPa.

The A4-0 + A4-3 reservoir, part of the Baskirian Stage, has a top of reservoir at 1,110 meters TVDSS. Figure 6 displays a top of reservoir structure map for the A4-0 + A4-3 reservoir. The dimensions of this reservoir are 3.9 by 3.9 kilometers. An OWC is estimated at 1,124 meters TVDSS. Seventeen wells are drilled through the reservoir and 12 wells are producing. The net oil reservoir map for the A4-0 + A4-3 reservoir has an average thickness of 5.0 meters of oil. The reservoir has average reservoir parameters as follows: porosity equals 19.1 percent, water saturation equals 15.9 percent, permeability equals .120 darcy, average crude gravity equals 35 °API, the GOR equals 29.4 m^3/ton, and the initial reservoir pressure equals 13.1 MPa.

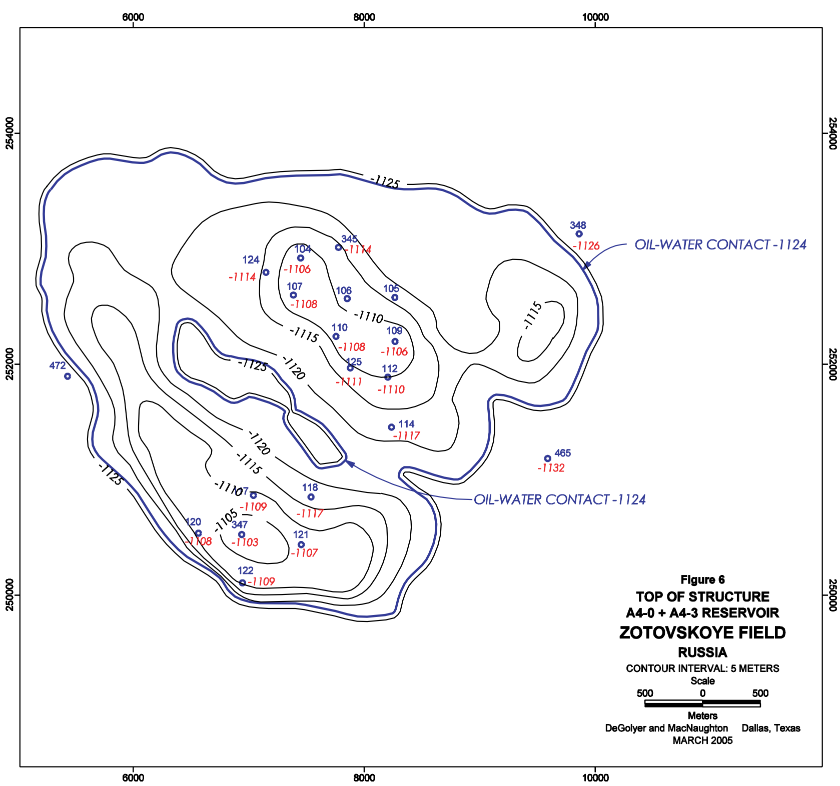


Figure 6
TOP OF STRUCTURE
A4-0 + A4-3 RESERVOIR
ZOTOVSKOYE FIELD
RUSSIA

Reserves for the Zotovskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total OOIP associated with proven reserves for the Zotovskoye field was estimated to be 15.09 million barrels and the OOIP associated with proven-plus-probable reserves was estimated to be 26.19 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.333. Twelve producing wells commingle production from both of the reservoirs evaluated for this field. The volumetric estimation of reserves is based upon a depletion-drive mechanism. Field production began in November 1999 at a rate of 2,450 barrels of oil per month, resulting in a cumulative oil production, as of March 31, 2005, of approximately 724,000 barrels. The Zotovskoye field produced an average of 528 BOPD in March 2005. The estimated proven reserves recovery factor is 13.3 percent. Six additional wells are required to produce the proven reserves and 20 additional wells are required to produce the probable reserves. The proven-plus-probable reserves recovery factor is 13.3 percent of the OOIP. The field is not currently under water injection and the projected field production life is until 2029.

Yuzhno-Tyebukskoye Field

The license number for the Yuzhno-Tyebukskoye field is SYK 11310 NE. This field is located in the Komi Republic, 100 kilometers east of the city of Ukhta. The field lies within the Timan Pechora Basin. The reservoirs range in age from the Devonian, Fammenian Formations, including the F3fm-F5 Upper reservoir through the F3fm-F1 reservoir. A total of three different reservoirs have been mapped. All reservoirs are carbonate.

The F3fm-F5 Upper reservoir is the shallowest reservoir and is associated with a four-way closure. The dimensions of this reservoir are 3.6 by 1.0 kilometers. The top of reservoir is 984 meters TVDSS. An OWC is estimated at 1,004 meters TVDSS. A total of 11 wells penetrated this reservoir. The net oil reservoir map for the F3fm-F5 Upper reservoir has an average net thickness of 2.2 meters of oil. The average reservoir parameters are as follows: porosity equals 18 percent, water saturation equals 28 percent, permeability equals .029 darcy, average crude gravity equals 26 °API, the GOR equals 11 m^3/ton, and the initial reservoir pressure equals 11.7 MPa.

The F3fm-F5 Middle reservoir is a four-way closure. The dimensions of this reservoir are 2.6 by 0.6 kilometers. The top of reservoir is 997 meters TVDSS. The OWC is thought to be the same at 1,004 meters TVDSS, as the overlying F3fm-F5 Upper reservoir. A total of 11 wells penetrate this reservoir. The net oil reservoir map for the F3fm-F5 Middle reservoir has an average thickness of 2.6 meters of oil. The average net reservoir parameters are as follows: porosity equals 18 percent, water saturation equals 28 percent, permeability equals 0.029 darcy, average crude gravity equals 26 °API, the GOR equals 11 m^3/ton, and the initial reservoir pressure equals 12.3 MPa.

The F3fm-F1 reservoir is a four-way closure. Figure 7 displays a top of reservoir structure map for the F3fm-F1 reservoir. The dimensions of this reservoir are 5.0 by 1.0 kilometer. The top of reservoir is 1,188 meters TVDSS. An OWC is estimated at 1,211 meters TVDSS. Thirteen wells penetrate this reservoir and 9 are producing. The net oil reservoir map for the F3fm-F1 reservoir has an average net thickness of 4.6 meters of oil. The average reservoir parameters are as follows: porosity equals 16 percent, water saturation equals 28 percent, permeability equals .076 darcy, average crude gravity equals 32 °API, the GOR equals 11 m^3/ton, and the initial reservoir pressure equals 13.6 MPa.

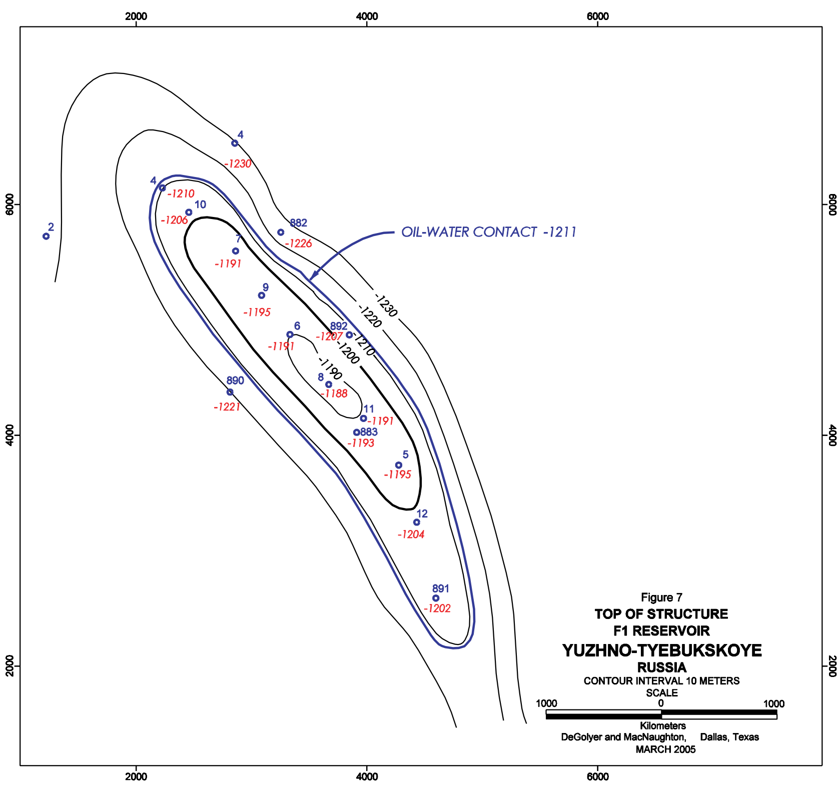


Figure 7
TOP OF STRUCTURE
F1 RESERVOIR
YUZHNO-TYEBUKSKOYE
RUSSIA
CONTOUR INTERVAL 10 METERS
SCALE
1000 0 1000
Kilometers
DeGolyer and MacNaughton, Dallas, Texas
MARCH 2005

Reserves for the Yuzhno-Tyebukskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total OOIP associated with proven reserves for the Yuzhno-Tyebukskoye field was estimated to be 19.27 million barrels and the OOIP associated with proven-plus-probable reserves was also estimated to be 19.27 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.031. The field is almost fully developed with eight producing wells. The volumetric estimation of reserves is based upon a depletion-drive mechanism. Field production began in May 2000 from the F-1 reservoir at a rate of 4,410 barrels of oil per month, resulting in a cumulative oil production, as of March 31, 2005, of approximately 1,510,000 barrels. The projected life of the Yuzhno-Tyebukskoye field produced an average of 610 BOPD in March 2005. The estimated proven reserves recovery factor for the field is 26.8 percent. Current production is from the F-1 reservoir and proven developed nonproducing reserves are estimated in the shallower F-5 reservoir. Existing wells in the F-1 penetrate the F-5 reservoir at shallower depths. Future development plans for the field include drilling one additional well for probable reserves and recompleting four of the existing F-1 wells to the F-5 when the current F-1 production ceases. The estimated proven-plus-probable reserves recovery factor for the field is 26.1 percent. This proven-plus-probable reserves recovery factor for the field is slightly lower than the proven reserves recovery factor because a lower recovery factor of 19 percent was utilised for the yet unproduced F-5 reservoir. The projected producing life of the Yuzhno-Tyebukskoye field is until 2040.

Sosnovskoye Field

The license number for the Sosnovskoye field is SYK 11311 NE. The Sosnovskoye field is located in the Komi Republic, 120 kilometers southeast of the city of Ukhta. The field lies within the Timan Pechora Basin. The reservoirs are Devonian Frasnian Formations, including D3dzr 1-A through D3jr reservoirs. A total of three reservoirs have been mapped.

The D3dzr 1-A reservoir is a stratigraphic deposit, possibly a slump, on the east flank of a four-way closure. Figure 8 displays a top of reservoir structure map for the D3dzr 1-A reservoir. The dimensions of this reservoir are 4.5 by 2.0 kilometers. The top of reservoir is 1,547 meters TVDSS. An OWC is estimated at 1,586 meters TVDSS. Seven wells penetrate this reservoir. The net oil reservoir map for the D3dzr 1-A reservoir has an average net thickness of 2.9 meters of oil. The average reservoir parameters are as follows: porosity equals 18 percent, water saturation equals 15 percent, permeability equals 0.154 darcy, average crude gravity equals 33 °API, the GOR equals 96.2 m^3/ton, and the initial reservoir pressure equals 15.2 MPa.

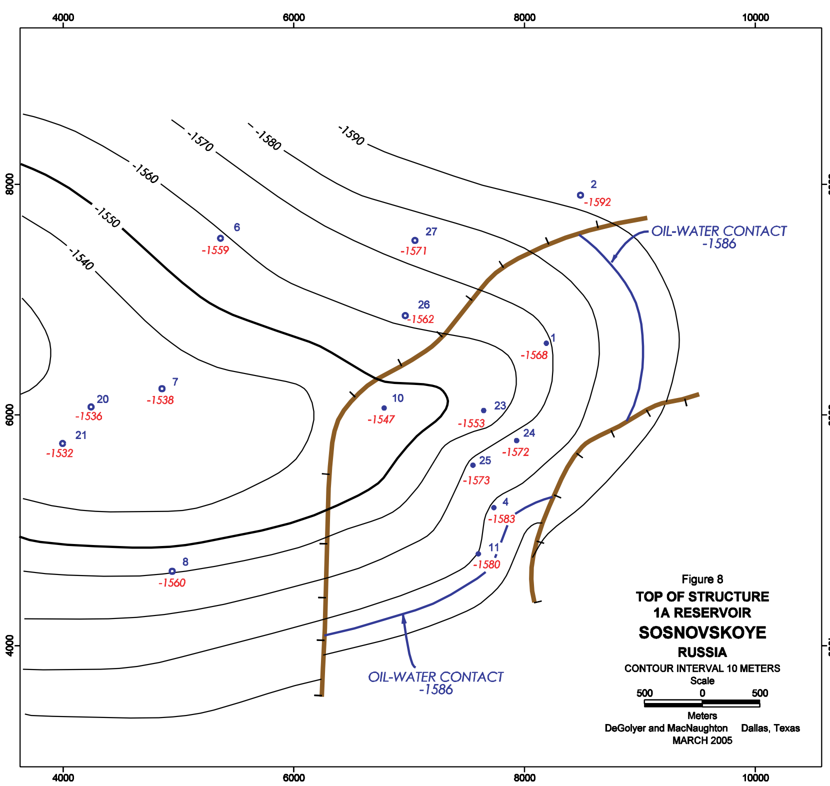


Figure 8
TOP OF STRUCTURE
1A RESERVOIR
SOSNOVSKOYE
RUSSIA
CONTOUR INTERVAL 10 METERS
DeGolyer and MacNaughton Dallas, Texas
MARCH 2005

The D3dzr 1-B reservoir is a channel or bar sand cutting across the south flank of a four-way closure. The dimensions of this reservoir are 7.0 by 1.0 kilometer. The top of reservoir is 1,557 meters TVDSS. An OWC is estimated at 1,600 meters TVDSS. Three wells penetrate this reservoir. The net oil reservoir map for the D3dzr 1-B reservoir has an average net thickness of 1.6 meters of oil. The average reservoir parameters are as follows: porosity equals 18 percent, water saturation equals 21 percent, permeability equals 0.033 darcy, average crude gravity equals 34 °API, the GOR equals 98.8 m^3/ton, and the initial reservoir pressure equals 17.3 MPa.

The D3jr I-V reservoir is an east-dipping structure with a stratigraphic pinchout on the west flank. The dimensions of this reservoir are 2.2 by 2.3 kilometers. The top of reservoir is 1,582 meters TVDSS. An OWC is estimated at 1,585 meters TVDSS. Two wells penetrate this reservoir. The net oil reservoir map for the D3jr I-V reservoir has an average net thickness of 1.9 meters TVDSS. The average reservoir parameters are as follows: porosity equals 16 percent, water saturation equals 19 percent, permeability equals .240 darcy, average crude gravity equals 33 °API, the GOR equals 78 m^3/ton, and the initial reservoir pressure equals 17.3 MPa.

Reserves for the Sosnovskoye field were estimated using the volumetric method. Original condition net oil isopach maps were constructed to delineate estimated reservoir area and reservoir volume. Estimates of average reservoir volumetric factors were applied to determine OOIP. The total OOIP associated with proven reserves for the Sosnovskoye field was estimated to be 14.59 million barrels and the OOIP associated with proven-plus-probable reserves was also estimated to be 23.92 million barrels. These estimates are based on estimated reservoir volume, average porosity and water saturation, and an oil formation volume factor of 1.318. The field proven reserves are fully developed with eight producing wells. The drive mechanism utilised for the volumetric estimation of reserves is depletion. Field production began in 1994 and cumulative oil production, as of March 31, 2005, is approximately 1,903,000 barrels. The Sosnovskoye field produced an average of 412 BOPD in March 2005. The estimated proven reserves recovery factor for the field is 21.9 percent. Future development plans for the field include drilling nine additional wells for probable reserves. The estimated proven-plus-probable reserves recovery factor for the field is 25.0 percent. The slightly higher proven-plus-probable reserves recovery factor was utilised for the possibility of an improved performance of existing wells and an improved recovery for the likelihood of water injection initiation in the future. The projected producing life of the Sosnovskoye field is until 2040.

Classification of Reserves

Petroleum reserves included in this report are classified by degree of proof as proven or probable. Proven reserves are judged to be economically producible in future years from known reservoirs under existing economic and operating conditions and assuming continuation of current regulatory practices using conventional production methods and equipment. Definitions of proven and probable reserves classifications used in this report are in accordance with reserves definitions presented in chapter 19 of *The Listing Rules* of the United Kingdom Listing Authority. The possible reserves presented in this report have been prepared in accordance with the reserves definitions adopted by the SPE and WPC. The petroleum reserves are classified as follows:

> *Proven* — Proven reserves means, in respect of mineral companies primarily involved in the extraction of oil and gas resources, those reserves which on the available evidence and taking into account technical and economic factors have a better than 90-percent chance of being produced.
>
> *Probable* — Probable reserves means, in respect of mineral companies primarily involved in the extraction of oil and gas resources, those reserves which are not yet "proven" but which on the available evidence and taking into account technical and economic factors have a better than 50-percent chance of being produced.
>
> *Possible* — Possible reserves are defined as reserves that may exist but are less well defined as well control than probable reserves. Possible reserves include those based largely on log interpretation and other evidence of hydrocarbon saturation in zones behind the pipe in existing wells, possible extensions to proved and probable reserves areas where indicated by geophysical and geological studies, and those to be recovered by enhanced recovery methods where the data are insufficient to classify the reserves as proved or probable.

The extent to which probable and possible reserves ultimately may be reclassified as proven reserves is dependent upon future drilling, testing, and well performance. The degree of risk to be applied in evaluating probable and possible reserves is influenced by economic and technological factors as well as the time element. Probable and possible reserves in this report have not been adjusted in consideration of these additional risks and therefore are not comparable with proven reserves.

Possible reserves have been included in this report for the sake of completeness. However, no economic value has been evaluated or included in this report for these possible reserves.

Estimation of Reserves

Summary

Estimates of the proven, probable, and possible oil and sales-gas reserves, as of March 31, 2005, attributable to certain properties owned by UEHL, expressed in thousands of barrels (10^3bbl) or millions of cubic feet (10^6ft^3) are as follows:

Working-Interest Reserves Summary

	Proven		**Probable***		**Possible***	
Field	**Oil (10^3bbl)**	**Sales Gas (10^6ft^3)**	**Oil (10^3bbl)**	**Sales Gas (10^6ft^3)**	**Oil (10^3bbl)**	**Sales Gas (10^6ft^3)**
Nefedovskoye	928	0	3,630	0	1,837	0
Potapovskoye	2,332	0	12,771	0	3,492	0
Zotovskoye	2,120	0	1,180	0	155	0
Okruzhnoye	20,099	0	2,739	0	10,287	56,340
Yuzhno-Tyebukskoye	3,097	0	322	0	268	177
Sosnovskoye	1,064	0	2,973	0	746	1,801
Peschanoozerskoye	26,193	0	10,232	0	11,079	49,123
Total	**55,833**	**0**	**33,847**	**0**	**27,864**	**107,441**

* Probable and possible reserves have not been adjusted for risk.

UEHL has represented that it completed the acquisition of Arcticneft's Peschanoozerskoye field in July 2005. For this report the working interest in the reserves evaluation of this field was zero percent from March 31, 2005, through July 15, 2005. After July 15, 2005, the working interest in the Peschanoozerskoye field was increased to the 100 percent ownership acquired by UEHL. Consequently, the production for the Peschanoozerskoye field from April 1, 2005, through July 15, 2005, was not included in the estimates of reserves and net present values presented in this report.

Procedure/Methodology

Estimates of reserves were prepared by the use of standard geological and engineering methods generally accepted by the petroleum industry. The method or combination of methods used in the analysis of each reservoir was tempered by experience with similar reservoirs, stage of development, quality and completeness of basic data, and production history.

When applicable, the volumetric method was used to estimate the OOIP and original gas in place (OGIP). Structure maps were prepared to delineate each reservoir, and isopach maps were constructed to estimate reservoir volume. Electrical logs, radioactivity logs, core analyses, and other available data were used to prepare these maps as well as to estimate representative values for porosity and water saturation.

Estimates of ultimate recovery were obtained after applying recovery factors to OOIP or OGIP. These recovery factors were based on consideration of the type of energy inherent in the reservoirs, analyses of the petroleum, the structural positions of the properties, and the production histories. When applicable, material-balance and other engineering methods were used to estimate recovery factors. An analysis of reservoir performance, including production rate, reservoir pressure, and GOR behavior, was used in the estimation of reserves.

In certain cases, when the previously named methods could not be used, reserves were estimated by analogy with similar wells or reservoirs for which more complete data were available.

Reserves estimates presented herein are generally based on consideration of data through March 2005.

The proven reserves forecast contained herein terminates at the economic limit as defined under the Classification of Reserves heading of this report. If a production license expires before the economic production limit is reached, production that could be obtained after the concession expiration has been classified as proven if such production otherwise qualifies as proven reserves under the reserves definitions.

Reserves estimated in this report are supported by details of drilling results through March 2005, analyses of available geological data, well-test results, pressures, available core data, and production performance. This report takes into account all relevant information supplied to DeGolyer and MacNaughton by UEHL.

Gas volumes reported herein are reported as sales-gas volumes expressed at a temperature base of 60 degrees Fahrenheit (°F) and a pressure base of 14.71 pounds per square inch (psi). Sales gas is defined as the total gas to be produced from the reservoirs after reduction for separation, fuel usage, flaring, reinjection, pipeline losses, and plant processing.

Oil volumes estimated herein are the volumes of oil resulting from normal field separation. Estimates of oil are expressed in barrels. In these estimates 1 barrel equals 42 U.S. gallons.

All gas reserves evaluated herein are classified as possible reserves due to a lack of long-term sales contracts. As possible reserves, the gas evaluated herein has been given no economic value in this report.

The forecast for the period 2005 through 2009 of the estimated working-interest proven and proven-plus-probable oil is presented in the following table, expressed in thousands of barrels (10^3bbl).

	Oil Production Forecast	
Year	**Proven (10^3bbl)**	**Proven Plus Probable* (10^3bbl)**
2005	1,551	1,551
2006	3,017	3,035
2007	3,749	3,838
2008	3,819	4,109
2009	3,708	4,327

* Probable reserves have not been adjusted for risk.

** Revenue values associated with proven-plus-probable reserves are shown in the Valuation of Reserves section of this report.

Valuation of Reserves

Revenue values of the proven and proven-plus-probable reserves were developed using methods generally accepted by the petroleum industry. A production forecast of the proven and proven-plus-probable reserves was prepared using the development plan for each field.

A range of net present values of the proven and proven-plus-probable reserves has been determined for Scenario B (Base Case) and two price sensitivity cases, Scenario A and Scenario C.

Crude oil price assumptions are stated in terms of net back prices, which have been calculated based upon adjustments to benchmark Oman, Brent, or Urals crude oil pricing. Netback prices are the net prices received for crude oil, after deductions for transportation, export tariffs, customs duties, and any applicable commissions or fees.

Scenario B (Base Case)

Net back prices, as provided by UEHL, are shown below for Scenario B. The price and cost assumptions of Scenario B are shown as follows:

Oil prices, expressed in United States dollars per barrel (U.S.$/bbl), are as follows:

Fields	**Year**	**Export Market (percent)**	**Domestic Market (percent)**	**Export Oil Price (U.S.$/bbl)**	**Domestic Oil Price (U.S.$/bbl)**
Nefedovskoye, Potapovskoye, Zotovskoye (Chepetskoye NGDU)	2005	35	65	22.46	21.52
	2006			22.46	21.52
	2007			21.15	19.42
	2008+			19.84	19.84
Okruzhnoye (Petrosakh)	2005	97	3	27.65	21.52
	2006			27.65	21.52
	2007			26.96	19.42
	2008+			26.28	19.84
Yuzhno-Tybukskoye and Sosnovskoye (CNPSEI)	2005	35	65	22.60	21.52
	2006			22.60	21.52
	2007			21.29	19.42
	2008+			19.98	19.84
Peschanoozerskoye (Arcticneft)	2005	100	0	32.47	—
	2006			32.47	—
	2007			29.97	—
	2008+			27.47	—

The netback prices shown above reflect a Brent crude marker pricing of $48 per barrel in 2005 and 2006, $43 per barrel in 2007, and $38 per barrel in 2008 and beyond.

Unescalated cost data for the proven and proven-plus-probable reserves were provided by UEHL. Cost data were held constant through the life of the project. The capital investment and operating expense forecasts were reviewed in detail and modified in accordance with the production forecast. Abandonment costs were included in the analysis when applicable. The tax provisions were held constant to remain unchanged from current legislation.

The oil reserves values herein have been subjected to the appropriate taxes due to the Russian Government.

Corporate overhead costs have not been considered in the valuation of the proven and proven-plus-probable reserves.

For the purposes of this report, two cases are presented: the pre-profits tax case and post-profits tax case. A 24-percent profits tax, consistent with current legislation, has been used for the post-profits tax case. Taxable income was based on the netback price with deductions for operating expenses, depreciation, abandonment costs, and other taxes.

Capital investments, net to the working interests evaluated herein, amount to U.S.$90.82 million for development of the proven reserves and U.S.$176.401 million for development of the proven-plus-probable reserves.

Estimated gross operating expenses were based on the operator's projection of future operating expenses. The unescalated gross operating expenses for the period 2005 through 2009 for the proven and proven-plus-probable reserves, expressed in millions of U.S. dollars (10^6 U.S.$), are estimated as follows:

	Gross Unescalated Operating Expense Forecast	
Year	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
2005	4.992	4.992
2006	8.755	8.789
2007	9.827	10.006
2008	9.949	10.458
2009	9.787	10.741

Gross unescalated capital investment for the period 2005 through 2009 for the proven and proven-plus-probable reserves, expressed in millions of U.S. dollars (10^6 U.S.$), are estimated as follows:

	Gross Unescalated Capital Investment Forecast	
Year	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
2005	8.630	8.661
2006	25.400	26.720
2007	12.690	16.660
2008	5.460	15.860
2009	6.770	17.180

Gross unescalated abandonment costs have been estimated to be U.S.$3.141 million for the proven reserves and U.S.$4.815 million for the proven-plus-probable reserves.

Estimates of the Scenario B net present value derived from the proven and proven-plus-probable reserves, as of March 31, 2005, of petroleum interests owned by UEHL in Russia, discounted at rates of 8, 10, and 12 percent, in millions of U.S. dollars (10^6 U.S.$) are presented in the following table:

	Valuation of Reserves Summary—Scenario B (Base Case)			
	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	909.425	1,396.850	692.608	1,060.793
Net Present Value at 8 Percent	479.085	641.779	358.897	477.313
Net Present Value at 10 Percent	417.870	543.960	311.740	402.357
Net Present Value at 12 Percent	367.450	465.774	272.996	342.651
Profits Tax Applied	0	0	219.204	338.678

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

Sensitivity Cases

Two price sensitivity cases, referred to herein as Scenario A and Scenario C, were prepared at the request of UEHL. A brief discussion of the economic assumptions for each case follows.

Scenario A

The export prices were held constant according to the following table. The domestic prices were held constant through 2007, then were increased and held constant for the life of each field. Initial estimates of operating expenses and capital costs were held constant for the life of each field.

Fields	Year	Export Market (percent)	Domestic Market (percent)	Export Oil Price (U.S.$/bbl)	Domestic Oil Price (U.S.$/bbl)
Nefedovskoye, Potapovskoye, Zotovskoye (Chepetskoye NGDU)	2005	35	65	19.05	16.06
	2006			19.05	16.06
	2007			19.05	16.06
	2008+			19.05	16.06
Okruzhnoye (Petrosakh)	2005	97	3	25.87	16.06
	2006			25.87	16.06
	2007			25.87	16.06
	2008+			25.87	16.06
Yuzhno-Tybukskoye and Sosnovskoye (CNPSEI)	2005	35	65	19.19	16.06
	2006			19.19	16.06
	2007			19.19	16.06
	2008+			19.19	16.06
Peschanoozerskoye (Arcticneft)	All	100	0	25.97	—

The netback prices shown above reflect a Brent crude marker pricing of $35 per barrel throughout the lives of the projections.

Scenario C

The export prices were held constant according to the following table. The domestic prices were held constant through 2007, then were increased and were held constant for the life of each field. Initial estimates of operating expenses and capital costs were held constant for the life of each field.

Fields	Year	Export Market (percent)	Domestic Market (percent)	Export Oil Price (U.S.$/bbl)	Domestic Oil Price (U.S.$/bbl)
Nefedovskoye, Potapovskoye, Zotovskoye (Chepetskoye NGDU)	2005	35	65	23.99	23.98
	2006			23.99	23.98
	2007			23.99	23.98
	2008+			23.99	23.99
Okruzhnoye (Petrosakh)	2005	97	3	33.88	23.98
	2006			33.88	23.98
	2007			33.88	23.98
	2008+			33.88	23.99
Yuzhno-Tybukskoye and Sosnovskoye (CNPSEI)	2005	35	65	24.14	23.98
	2006			24.14	23.98
	2007			24.14	23.98
	2008+			24.14	23.99
Peschanoozerskoye (Arcticneft)	All	100	0	34.39	—

The netback prices shown above reflect a Brent crude marker pricing of $52.86 throughout the lives of the projections. This was the March 31, 2005, actual Brent price.

Estimates of the net present value, using discount rates of 8, 10, and 12 percent, of the future net revenue to be derived from the proven and proven-plus-probable reserves, as of March 31, 2005, of the properties evaluated herein are presented as follows for each of the two sensitivity cases. Values are expressed in millions of U.S. dollars (10^6 U.S.$).

Valuation of Reserves Summary—Scenario A

	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	845.403	1,305.214	643.827	991.007
Net Present Value at 8 Percent	439.065	591.534	328.447	439.094
Net Present Value at 10 Percent	381.327	499.234	283.939	368.340
Net Present Value at 12 Percent	333.814	425.536	247.411	312.045
Profits Tax Applied	0	0	203.879	316.737

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

Valuation of Reserves Summary—Scenario C

	Future Net Revenues and Net Present Values			
	Before Profits Tax		After Profits Tax	
	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)	Proven (10^6 U.S.$)	Proven Plus Probable (10^6 U.S.$)
Future Net Revenue	1,208.265	1,843.922	919.888	1,400.888
Net Present Value at 8 Percent	636.238	854.779	478.374	639.252
Net Present Value at 10 Percent	555.233	726.182	416.166	540.888
Net Present Value at 12 Percent	488.535	623.215	365.046	462.338
Profits Tax Applied	0	0	291.633	446.645

Notes:

1. Values attributable to probable reserves have not been adjusted for risk.
2. Arcticneft's working interest in the Peschanoozerskoye field was zero percent through July 15, 2005, and 100 percent thereafter.

PROFESSIONAL QUALIFICATIONS

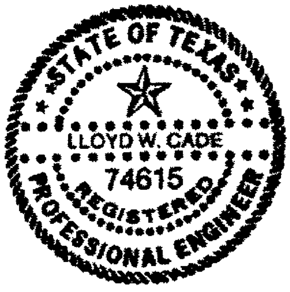
DeGolyer and MacNaughton is a Delaware corporation with offices at One Energy Square, Dallas, Texas 75206, U.S.A. The firm has been providing petroleum consulting services throughout the world for more than 65 years. The firm's professional engineers, geologists, geophysicists, petrophysicists, and economists are engaged in the independent appraisal of oil and gas properties, evaluation of hydrocarbon and other mineral prospects, basin evaluations, comprehensive field studies, equity studies, and studies of supply and economics related to the energy industry. Except for the provision of professional services on a fee basis, DeGolyer and MacNaughton has no commercial arrangement with any other person or company involved in the interests which are the subject of this report.

The evaluation has been supervised by Mr. Lloyd W. Cade. Mr. Cade is a Senior Vice President with DeGolyer and MacNaughton, a Division Manager within the company, a Registered Professional Engineer in the State of Texas, and a member of the Society of Petroleum Engineers. He has 23 years of oil and gas industry experience.

Submitted,

DeGolyer and MacNaughton

DeGOLYER and MacNAUGHTON



Lloyd W. Cade, P.E.

Lloyd W. Cade, P.E.
Senior Vice President
DeGolyer and MacNaughton

TABLE 1
SUMMARY OF FUTURE NET REVENUE FROM TOTAL PROVED RESERVES
as of
MARCH 31, 2005
for
CERTAIN ASSETS
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

Subsidiary Field	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Urals Energy Net Future Net Revenue (10^3U.S.$)	Urals Energy Net Present Value at 10 Percent (10^3U.S.$)
ZAO Petrosakh														
Okruzhnoye	20,099	0	545,530	47,286	30,460	5,000	1,265	93,221	6,924	2,728	84,029	274,617	266,818	129,873
ZAO Chepetskoye NGDU														
Nefedovskoye	928	0	19,507	4,088	2,150	0	43	3,975	318	98	2,243	6,592	6,592	4,364
Potapovskoye	2,332	0	46,956	14,655	3,440	0	69	7,797	530	235	4,903	15,327	15,327	3,577
Zotovskoye	2,120	0	41,999	7,038	2,670	0	53	7,532	411	210	5,820	18,265	18,265	9,688
Total	**5,380**	**0**	**108,462**	**25,781**	**8,260**	**0**	**165**	**19,304**	**1,259**	**543**	**12,966**	**40,184**	**40,184**	**17,629**
OOO CNPSEI														
Sosnovskoye	1,064	0	21,584	9,005	0	0	288	4,145	0	108	1,964	6,074	6,074	4,143
Yuzhno-Tyebukskoye	3,097	0	62,850	16,254	40	0	362	11,508	6	314	8,296	26,070	26,070	17,153
Total	**4,161**	**0**	**84,434**	**25,259**	**40**	**0**	**650**	**15,653**	**6**	**422**	**10,260**	**32,144**	**32,144**	**21,296**
ZAO Arcticneft														
Peschanoozerskoye	26,193	0	721,017	77,494	45,560	1,500	1,061	119,139	7,247	3,605	111,949	353,462	353,462	142,942
Grand Total	**55,833**	**0**	**1,459,443**	**175,820**	**84,320**	**6,500**	**3,141**	**247,317**	**15,436**	**7,298**	**219,204**	**700,407**	**692,608**	**311,740**

TABLE 2
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED RESERVES
as of
MARCH 31, 2005
for
ZAO PETROSAKH
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	771	0	21,859	1,562	6,000	0	0	4,677	317	109	3,438	5,756	5,593	5,366
2006	1,541	0	43,665	3,051	18,000	2,500	0	9,343	715	219	6,707	3,130	3,041	2,676
2007	2,050	0	56,527	3,692	6,000	2,500	0	9,327	837	282	9,463	24,426	23,732	18,897
2008	1,963	0	52,828	3,583	0	0	0	8,716	772	264	8,768	30,725	29,852	21,518
2009	1,629	0	43,836	3,162	0	0	0	7,233	706	220	7,094	25,421	24,699	16,115
2010	1,355	0	36,464	2,818	0	0	0	6,017	642	182	5,723	21,082	20,484	12,098
2011	1,192	0	32,082	2,612	40	0	0	5,293	577	160	4,915	18,485	17,960	9,603
2012	1,076	0	28,950	2,465	40	0	0	4,777	513	145	4,340	16,670	16,196	7,838
2013	978	0	26,304	2,342	40	0	0	4,340	449	132	3,858	15,143	14,713	6,446
2014	892	0	24,007	2,235	40	0	0	3,961	384	120	3,441	13,826	13,434	5,327
2015	821	0	22,107	2,145	40	0	0	3,648	320	110	3,099	12,745	12,383	4,445
2016	764	0	20,565	2,073	40	0	0	3,393	255	103	2,824	11,877	11,539	3,750
2017	715	0	19,242	2,012	40	0	0	3,175	191	96	2,590	11,138	10,822	3,183
2018	674	0	18,116	1,958	40	0	0	2,989	126	91	2,393	10,519	10,220	2,722
2019	637	0	17,156	1,636	40	0	0	2,831	61	86	2,294	10,208	9,918	2,390
2020	607	0	16,338	1,598	40	0	0	2,696	19	81	2,396	9,508	9,238	2,016
2021	581	0	15,637	1,565	40	0	0	2,580	7	78	2,595	8,772	8,523	1,683
2022	536	0	14,423	1,231	20	0	0	2,380	6	73	2,569	8,144	7,913	1,415
2023	429	0	11,537	1,095	0	0	0	1,903	6	57	2,026	6,450	6,267	1,014
2024	322	0	8,651	960	0	0	0	1,428	5	43	1,485	4,730	4,595	673
2025	183	0	4,932	787	0	0	127	814	4	25	755	2,420	2,352	312
2026	141	0	3,805	733	0	0	126	627	4	19	544	1,752	1,702	204
2027	108	0	2,902	691	0	0	127	479	3	15	375	1,212	1,177	128
2028	81	0	2,179	658	0	0	126	360	3	11	239	782	760	75
2029	53	0	1,418	622	0	0	127	234	2	7	98	328	319	29
Subtotal	**20,099**	**0**	**545,530**	**47,286**	**30,460**	**5,000**	**633**	**93,221**	**6,924**	**2,728**	**84,029**	**275,249**	**267,432**	**129,923**
Remaining	**0**	**0**	**0**	**0**	**0**	**0**	**632**	**0**	**0**	**0**	**0**	**(632)**	**(614)**	**(50)**
Total	**20,099**	**0**	**545,530**	**47,286**	**30,460**	**5,000**	**1,265**	**93,221**	**6,924**	**2,728**	**84,029**	**274,617**	**266,818**	**129,873**

Present Value at (10^3U.S.$)	
8 Percent	**147,295**
12 Percent	**115,369**

TABLE 3
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED RESERVES
as of
MARCH 31, 2005
for
ZAO CHEPETSKOYE NGDU
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	252	0	5,507	919	1,290	0	0	1,522	26	28	728	994	994	954
2006	323	0	7,143	1,303	860	0	0	1,972	43	35	913	2,017	2,017	1,774
2007	243	0	4,917	1,218	0	0	0	812	39	25	681	2,142	2,142	1,705
2008	246	0	4,901	1,220	1,290	0	0	808	62	24	654	843	843	608
2009	356	0	7,064	1,334	2,600	0	0	1,166	111	36	936	881	881	576
2010	404	0	8,000	1,383	1,310	0	0	1,319	129	39	1,085	2,735	2,735	1,615
2011	424	0	8,410	1,404	880	0	0	1,389	137	43	1,151	3,406	3,406	1,821
2012	405	0	8,036	1,303	20	0	4	1,325	123	40	1,108	4,113	4,113	1,990
2013	368	0	7,326	1,267	10	0	5	1,209	112	37	987	3,699	3,699	1,620
2014	298	0	5,928	1,113	0	0	4	978	101	29	757	2,946	2,946	1,169
2015	255	0	5,077	1,069	0	0	4	838	89	25	601	2,451	2,451	879
2016	221	0	4,419	954	0	0	5	730	76	23	500	2,131	2,131	693
2017	175	0	3,469	743	0	0	21	572	56	18	400	1,659	1,659	489
2018	149	0	2,972	638	0	0	0	490	48	15	331	1,450	1,450	386
2019	133	0	2,644	620	0	0	5	437	39	13	269	1,261	1,261	304
2020	120	0	2,412	609	0	0	6	397	29	11	228	1,132	1,132	246
2021	107	0	2,124	592	0	0	5	350	21	11	178	967	967	192
2022	91	0	1,831	577	0	0	5	303	12	10	141	783	783	140
2023	82	0	1,635	568	0	0	6	270	4	8	123	656	656	106
2024	63	0	1,281	388	0	0	26	211	2	6	127	521	521	76
2025	60	0	1,193	384	0	0	0	197	0	6	132	474	474	63
2026	55	0	1,111	379	0	0	0	183	0	5	131	413	413	50
2027	51	0	1,035	375	0	0	0	171	0	6	116	367	367	40
2028	46	0	908	369	0	0	0	150	0	4	92	293	293	28
2029	41	0	833	365	0	0	0	137	0	4	79	248	248	23
Subtotal	**4,968**	**0**	**100,176**	**21,094**	**8,260**	**0**	**96**	**17,936**	**1,259**	**501**	**12,448**	**38,582**	**38,582**	**17,547**
Remaining	**412**	**0**	**8,286**	**4,687**	**0**	**0**	**69**	**1,368**	**0**	**42**	**518**	**1,602**	**1,602**	**82**
Total	**5,380**	**0**	**108,462**	**25,781**	**8,260**	**0**	**165**	**19,304**	**1,259**	**543**	**12,966**	**40,184**	**40,184**	**17,629**

Present Value at (10^3U.S.$)	
8 Percent	**20,308**
12 Percent	**15,441**

TABLE 4
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED RESERVES
as of
MARCH 31, 2005
for
OOO CNPSEI
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	270	0	5,906	1,237	0	0	0	1,628	0	30	723	2,288	2,288	2,195
2006	440	0	9,662	1,990	20	0	0	2,662	0	47	1,190	3,753	3,753	3,302
2007	542	0	10,896	2,191	20	0	0	1,798	1	56	1,644	5,186	5,186	4,129
2008	503	0	10,040	2,117	0	0	0	1,657	1	49	1,491	4,725	4,725	3,406
2009	433	0	8,631	1,976	0	0	0	1,424	1	43	1,244	3,943	3,943	2,573
2010	384	0	7,635	1,876	0	0	0	1,260	0	39	1,070	3,390	3,390	2,002
2011	317	0	6,345	1,747	0	0	0	1,046	1	31	844	2,676	2,676	1,431
2012	176	0	3,490	1,461	0	0	0	577	0	18	344	1,090	1,090	527
2013	158	0	3,162	1,290	0	0	0	521	1	16	320	1,014	1,014	445
2014	147	0	2,907	1,264	0	0	0	480	0	14	274	875	875	346
2015	133	0	2,661	1,239	0	0	0	439	0	14	233	736	736	265
2016	105	0	2,079	903	0	0	29	343	1	10	189	604	604	196
2017	96	0	1,912	886	0	0	29	315	0	9	161	512	512	151
2018	88	0	1,763	872	0	0	29	291	0	10	134	427	427	114
2019	83	0	1,629	858	0	0	28	269	0	8	111	355	355	85
2020	71	0	1,426	698	0	0	29	236	0	7	109	347	347	76
2021	38	0	756	354	0	0	144	124	0	4	66	64	64	13
2022	33	0	660	344	0	0	0	109	0	3	48	156	156	28
2023	28	0	563	334	0	0	0	93	0	3	32	101	101	16
2024	26	0	524	331	0	0	36	87	0	2	17	51	51	7
2025	25	0	490	327	0	0	36	80	0	3	10	34	34	5
2026	23	0	460	324	0	0	36	76	0	2	5	17	17	2
2027	21	0	431	321	0	0	37	71	0	2	1	(1)	(1)	0
2028	21	0	406	319	0	0	36	67	0	2	0	(18)	(18)	(2)
2029	0	0	0	0	0	0	181	0	0	0	0	(181)	(181)	(16)
Subtotal	**4,161**	**0**	**84,434**	**25,259**	**40**	**0**	**650**	**15,653**	**6**	**422**	**10,260**	**32,144**	**32,144**	**21,296**
Remaining	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total	**4,161**	**0**	**84,434**	**25,259**	**40**	**0**	**650**	**15,653**	**6**	**422**	**10,260**	**32,144**	**32,144**	**21,296**

Present Value at (10^3U.S.$)	
8 Percent	**22,951**
12 Percent	**19,823**

TABLE 5
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED RESERVES
as of
JULY 16, 2005
for
ZAO ARCTICNEFT
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	258	0	8,314	1,274	1,340	0	0	1,417	28	42	1,311	2,902	2,902	2,785
2006	713	0	22,955	2,411	4,020	0	0	3,914	108	114	3,852	8,536	8,536	7,508
2007	914	0	27,173	2,726	4,020	150	0	4,483	185	136	4,562	10,911	10,911	8,689
2008	1,107	0	30,185	3,029	4,020	150	0	4,981	258	151	5,005	12,591	12,591	9,075
2009	1,290	0	35,166	3,315	4,020	150	0	5,802	323	176	5,846	15,534	15,534	10,136
2010	1,466	0	39,938	3,589	4,020	150	0	6,590	382	200	6,650	18,357	18,357	10,842
2011	1,631	0	44,477	3,850	4,020	150	0	7,338	436	222	7,412	21,049	21,049	11,254
2012	1,791	0	48,804	4,099	4,020	150	0	8,053	483	244	8,136	23,619	23,619	11,431
2013	1,940	0	52,872	4,332	4,020	150	0	8,724	524	264	8,814	26,044	26,044	11,409
2014	2,027	0	55,253	4,469	4,020	150	0	9,117	559	277	9,180	27,481	27,481	10,899
2015	2,011	0	54,831	4,445	4,020	150	0	9,047	588	274	9,028	27,279	27,279	9,792
2016	1,997	0	54,411	4,421	4,020	150	0	8,978	610	272	8,878	27,082	27,082	8,800
2017	1,826	0	49,772	4,154	0	0	0	8,212	542	249	8,035	28,580	28,580	8,407
2018	1,558	0	42,473	3,735	0	0	0	7,008	472	212	6,698	24,348	24,348	6,483
2019	1,307	0	35,625	3,342	0	0	0	5,878	404	178	5,445	20,378	20,378	4,912
2020	1,072	0	29,210	2,973	0	0	0	4,820	336	146	4,292	16,643	16,643	3,631
2021	850	0	23,170	2,302	0	0	0	3,823	275	116	3,330	13,324	13,324	2,632
2022	642	0	17,511	1,977	0	0	0	2,889	220	88	2,360	9,977	9,977	1,784
2023	448	0	12,196	1,348	0	0	0	2,013	172	61	1,531	7,071	7,071	1,144
2024	247	0	6,738	1,035	0	0	0	1,112	128	33	597	3,833	3,833	561
2025	92	0	2,513	791	0	0	0	414	92	13	0	1,203	1,203	160
2026	86	0	2,349	783	0	0	0	388	61	12	0	1,105	1,105	133
2027	81	0	2,200	774	0	0	0	363	37	11	0	1,015	1,015	110
2028	76	0	2,068	766	0	0	0	341	18	10	0	933	933	92
2029	71	0	1,935	758	0	0	0	319	6	10	28	814	814	72
Subtotal	**25,501**	**0**	**702,139**	**66,698**	**45,560**	**1,500**	**0**	**116,024**	**7,247**	**3,511**	**110,990**	**350,609**	**350,609**	**142,741**
Remaining	**692**	**0**	**18,878**	**10,796**	**0**	**0**	**1,061**	**3,115**	**0**	**94**	**959**	**2,853**	**2,853**	**201**
Total	**26,193**	**0**	**721,017**	**77,494**	**45,560**	**1,500**	**1,061**	**119,139**	**7,247**	**3,605**	**111,949**	**353,462**	**353,462**	**142,942**

Present Value at (10^3U.S.$)	
8 Percent	**168,343**
12 Percent	**122,363**

TABLE 6
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED-PLUS-PROBABLE RESERVES
as of
MARCH 31, 2005
for
CERTAIN ASSETS
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

Subsidiary Field	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Urals Energy Net: Future Net Revenue (10^3U.S.$)	Urals Energy Net: Present Value at 10 Percent (10^3U.S.$)
ZAO Petrosakh														
Okruzhnoye	22,838	0	619,230	50,734	50,460	5,000	1,665	105,381	10,004	3,096	92,295	300,595	292,058	136,335
ZAO Chepetskoye NGDU														
Nefedovskoye	4,558	0	93,211	8,995	14,640	0	293	16,136	1,813	466	13,924	36,944	36,944	16,724
Potapovskoye	15,103	0	303,917	27,085	23,800	0	476	50,195	3,665	1,520	47,442	149,734	149,734	27,606
Zotovskoye	3,300	0	65,084	9,532	8,260	0	165	11,341	1,241	325	8,625	25,595	25,595	11,187
Total	**22,961**	**0**	**462,212**	**45,612**	**46,700**	**0**	**934**	**77,672**	**6,719**	**2,311**	**69,991**	**212,273**	**212,273**	**55,517**
OOO CNPSEI														
Sosnovskoye	4,037	0	80,502	21,290	3,870	61	333	13,909	605	403	9,648	30,383	30,383	12,338
Yuzhno-Tyebukskoye	3,419	0	69,289	16,759	470	0	366	12,571	72	346	9,337	29,368	29,368	18,897
Total	**7,456**	**0**	**149,791**	**38,049**	**4,340**	**61**	**699**	**26,480**	**677**	**749**	**18,985**	**59,751**	**59,751**	**31,235**
ZAO Arcticneft														
Peschanoozerskoye	36,425	0	999,900	93,516	68,340	1,500	1,517	165,155	10,755	4,999	157,407	496,711	496,711	179,270
Grand Total	**89,680**	**0**	**2,231,133**	**227,911**	**169,840**	**6,561**	**4,815**	**374,688**	**28,155**	**11,155**	**338,678**	**1,069,330**	**1,060,793**	**402,357**

TABLE 7
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED-PLUS-PROBABLE RESERVES
as of
MARCH 31, 2005
for
ZAO PETROSAKH
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Urals Energy Net: Future Net Revenue (10^3U.S.$)	Urals Energy Net: Present Value at 10 Percent (10^3U.S.$)
2005	771	0	21,859	1,562	6,000	0	0	4,677	317	109	3,438	5,756	5,593	5,366
2006	1,541	0	43,665	3,051	18,000	2,500	0	9,343	715	219	6,707	3,130	3,041	2,676
2007	2,050	0	56,527	3,692	6,000	2,500	0	9,327	837	282	9,463	24,426	23,732	18,897
2008	2,053	0	55,244	3,696	6,000	0	0	9,115	895	276	9,097	26,165	25,422	18,324
2009	1,837	0	49,449	3,425	6,000	0	0	8,159	944	248	7,899	22,774	22,127	14,438
2010	1,665	0	44,795	3,207	6,000	0	0	7,391	985	224	6,919	20,069	19,499	11,517
2011	1,542	0	41,494	3,053	2,040	0	0	6,847	935	207	6,278	22,134	21,506	11,497
2012	1,373	0	36,950	2,840	40	0	0	6,096	842	185	5,446	21,501	20,890	10,111
2013	1,230	0	33,104	2,660	40	0	0	5,463	748	165	4,744	19,284	18,736	8,208
2014	1,107	0	29,787	2,505	40	0	0	4,914	654	149	4,143	17,382	16,889	6,697
2015	1,004	0	27,019	2,375	40	0	0	4,459	560	135	3,644	15,806	15,357	5,513
2016	920	0	24,742	2,269	40	0	0	4,082	467	124	3,238	14,522	14,109	4,585
2017	847	0	22,791	2,177	40	0	0	3,761	372	114	2,894	13,433	13,052	3,839
2018	785	0	21,133	2,100	40	0	0	3,487	278	106	2,604	12,518	12,162	3,239
2019	733	0	19,721	1,756	40	0	0	3,253	185	98	2,426	11,963	11,623	2,801
2020	688	0	18,518	1,700	40	0	0	3,056	113	93	2,464	11,052	10,739	2,343
2021	650	0	17,491	1,652	40	0	0	2,886	71	87	2,607	10,148	9,859	1,947
2022	594	0	15,997	1,304	20	0	0	2,639	41	80	2,537	9,376	9,110	1,629
2023	479	0	12,875	1,158	0	0	0	2,125	21	65	2,050	7,456	7,244	1,172
2024	363	0	9,769	1,012	0	0	0	1,612	8	49	1,566	5,522	5,366	786
2025	211	0	5,685	822	0	0	167	938	4	28	855	2,871	2,789	370
2026	153	0	4,117	748	0	0	166	679	4	21	593	1,906	1,852	223
2027	108	0	2,902	691	0	0	167	479	3	14	365	1,183	1,149	125
2028	81	0	2,179	658	0	0	166	359	3	11	230	752	731	71
2029	53	0	1,417	621	0	0	167	234	2	7	88	298	289	26
Subtotal	**22,838**	**0**	**619,230**	**50,734**	**50,460**	**5,000**	**833**	**105,381**	**10,004**	**3,096**	**92,295**	**301,427**	**292,866**	**136,400**
Remaining	**0**	**0**	**0**	**0**	**0**	**0**	**832**	**0**	**0**	**0**	**0**	**(832)**	**(808)**	**(65)**
Total	**22,838**	**0**	**619,230**	**50,734**	**50,460**	**5,000**	**1,665**	**105,381**	**10,004**	**3,096**	**92,295**	**300,595**	**292,058**	**136,335**

Present Value at (10^3U.S.$)	
8 Percent	**155,899**
12 Percent	**120,155**

TABLE 8
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED-PLUS-PROBABLE RESERVES
as of
MARCH 31, 2005
for
ZAO CHEPETSKOYE NGDU
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	252	0	5,507	919	1,290	0	0	1,522	26	28	728	994	994	954
2006	323	0	7,143	1,303	860	0	0	1,972	43	35	913	2,017	2,017	1,774
2007	243	0	4,917	1,218	0	0	0	812	39	25	681	2,142	2,142	1,705
2008	246	0	4,901	1,220	1,290	0	0	808	62	24	654	843	843	608
2009	489	0	9,752	1,475	4,330	0	0	1,610	146	49	1,401	741	741	484
2010	780	0	15,633	1,783	5,190	0	0	2,579	242	78	2,393	3,368	3,368	1,989
2011	1,017	0	20,422	2,033	4,750	0	0	3,369	320	102	3,197	6,651	6,651	3,555
2012	1,146	0	23,030	2,169	3,890	0	0	3,799	374	115	3,615	9,068	9,068	4,390
2013	1,177	0	23,675	2,206	3,880	0	0	3,907	421	119	3,670	9,472	9,472	4,150
2014	1,184	0	23,842	2,213	3,870	0	0	3,935	465	119	3,638	9,602	9,602	3,808
2015	1,311	0	26,395	2,347	5,600	0	29	4,354	536	132	3,998	9,399	9,399	3,373
2016	1,392	0	27,927	2,346	4,310	0	30	4,609	573	139	4,228	11,692	11,692	3,800
2017	1,343	0	26,926	2,215	3,880	0	29	4,442	595	136	3,993	11,636	11,636	3,422
2018	1,278	0	25,605	2,144	2,610	0	29	4,224	586	127	3,706	12,179	12,179	3,243
2019	1,117	0	22,403	1,978	880	0	29	3,698	536	112	3,347	11,823	11,823	2,850
2020	1,037	0	20,783	1,651	20	0	147	3,428	357	104	3,145	11,931	11,931	2,603
2021	983	0	19,720	1,596	20	0	0	3,255	313	98	2,958	11,480	11,480	2,268
2022	938	0	18,821	1,468	20	0	0	3,106	265	95	2,820	11,047	11,047	1,974
2023	892	0	17,918	1,420	10	0	17	2,956	220	90	2,680	10,525	10,525	1,704
2024	818	0	16,448	1,345	0	0	16	2,714	178	82	2,457	9,656	9,656	1,415
2025	756	0	15,187	1,278	0	0	17	2,505	143	76	2,297	8,871	8,871	1,176
2026	701	0	14,082	1,219	0	0	16	2,324	111	71	2,162	8,179	8,179	982
2027	642	0	12,899	1,158	0	0	17	2,129	82	63	2,026	7,424	7,424	806
2028	576	0	11,592	929	0	0	82	1,912	39	58	1,889	6,683	6,683	658
2029	512	0	10,291	861	0	0	0	1,698	25	52	1,684	5,971	5,971	532
Subtotal	**21,153**	**0**	**425,819**	**40,494**	**46,700**	**0**	**458**	**71,667**	**6,697**	**2,129**	**64,280**	**193,394**	**193,394**	**54,223**
Remaining	**1,808**	**0**	**36,393**	**5,118**	**0**	**0**	**476**	**6,005**	**22**	**182**	**5,711**	**18,879**	**18,879**	**1,294**
Total	**22,961**	**0**	**462,212**	**45,612**	**46,700**	**0**	**934**	**77,672**	**6,719**	**2,311**	**69,991**	**212,273**	**212,273**	**55,517**

Present Value at (10^3U.S.$)	
8 Percent	**70,374**
12 Percent	**44,423**

TABLE 9
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED-PLUS-PROBABLE RESERVES
as of
MARCH 31, 2005
for
OOO CNPSEI
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Urals Energy Net: Future Net Revenue (10^3U.S.$)	Urals Energy Net: Present Value at 10 Percent (10^3U.S.$)
2005	270	0	5,906	1,237	0	31	0	1,628	1	30	722	2,257	2,257	2,166
2006	458	0	10,045	2,024	1,310	30	0	2,768	27	49	1,220	2,617	2,617	2,302
2007	631	0	12,689	2,370	1,310	0	0	2,093	54	64	1,904	4,894	4,894	3,897
2008	702	0	13,990	2,513	1,720	0	0	2,309	84	70	2,093	5,201	5,201	3,749
2009	711	0	14,132	2,526	0	0	0	2,332	78	71	2,119	7,006	7,006	4,571
2010	639	0	12,727	2,385	0	0	0	2,100	72	64	1,875	6,231	6,231	3,680
2011	553	0	10,987	2,212	0	0	0	1,813	64	55	1,572	5,271	5,271	2,818
2012	389	0	7,730	1,885	0	0	0	1,274	59	38	1,003	3,471	3,471	1,680
2013	354	0	7,039	1,816	0	0	0	1,163	52	35	883	3,090	3,090	1,354
2014	326	0	6,455	1,758	0	0	0	1,065	46	32	783	2,771	2,771	1,099
2015	275	0	5,457	1,520	0	0	0	900	39	27	642	2,329	2,329	836
2016	233	0	4,629	1,436	0	0	0	764	32	24	500	1,873	1,873	608
2017	215	0	4,282	1,401	0	0	0	706	27	21	440	1,687	1,687	496
2018	201	0	3,969	1,371	0	0	0	655	19	20	387	1,517	1,517	405
2019	184	0	3,680	1,341	0	0	0	607	14	19	336	1,363	1,363	328
2020	168	0	3,334	1,168	0	0	0	550	7	16	313	1,280	1,280	279
2021	155	0	3,072	1,140	0	0	0	507	2	16	289	1,118	1,118	222
2022	141	0	2,797	1,114	0	0	0	462	0	14	262	945	945	169
2023	127	0	2,509	1,086	0	0	0	413	0	12	240	758	758	122
2024	118	0	2,332	928	0	0	37	385	0	12	232	738	738	108
2025	108	0	2,145	910	0	0	36	355	0	11	200	633	633	84
2026	99	0	1,970	892	0	0	37	325	0	9	170	537	537	65
2027	93	0	1,836	739	0	0	36	303	0	9	179	570	570	61
2028	86	0	1,712	728	0	0	70	282	0	9	154	469	469	46
2029	61	0	1,214	399	0	0	217	200	0	6	138	254	254	23
Subtotal	**7,297**	**0**	**146,638**	**36,899**	**4,340**	**61**	**433**	**25,959**	**677**	**733**	**18,656**	**58,880**	**58,880**	**31,168**
Remaining	**159**	**0**	**3,153**	**1,150**	**0**	**0**	**266**	**521**	**0**	**16**	**329**	**871**	**871**	**67**
Total	**7,456**	**0**	**149,791**	**38,049**	**4,340**	**61**	**699**	**26,480**	**677**	**749**	**18,985**	**59,751**	**59,751**	**31,235**

Present Value at (10^3U.S.$)	
8 Percent	**34,919**
12 Percent	**28,131**

TABLE 10
PROJECTION OF FUTURE NET REVENUE FROM TOTAL PROVED-PLUS-PROBABLE RESERVES
as of
JULY 16, 2005
for
ZAO ARCTICNEFT
URALS ENERGY HOLDINGS LIMITED
RUSSIA

SCENARIO B—BASE CASE

													Urals Energy Net	
Year	Oil (10^3bbl)	Sales Gas (10^6m^3)	Future Gross Revenue (10^3U.S.$)	Operating Expenses (10^3U.S.$)	Drilling Capital Costs (10^3U.S.$)	Other Capital Costs (10^3U.S.$)	Abandonment Costs (10^3U.S.$)	Production Taxes (10^3U.S.$)	Asset Taxes (10^3U.S.$)	Miscellaneous Taxes (10^3U.S.$)	Profit Tax (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Future Net Revenue (10^3U.S.$)	Present Value at 10 Percent (10^3U.S.$)
2005	258	0	8,314	1,274	1,340	0	0	1,417	28	42	1,311	2,902	2,902	2,785
2006	713	0	22,955	2,411	4,020	0	0	3,914	108	114	3,852	8,536	8,536	7,508
2007	914	0	27,173	2,726	6,700	150	0	4,483	240	136	4,506	8,232	8,232	6,555
2008	1,107	0	30,185	3,029	6,700	150	0	4,981	364	151	4,894	9,916	9,916	7,148
2009	1,290	0	35,166	3,315	6,700	150	0	5,802	476	176	5,680	12,867	12,867	8,395
2010	1,577	0	42,963	3,763	6,700	150	0	7,089	579	215	6,992	17,475	17,475	10,322
2011	1,912	0	52,121	4,289	6,700	150	0	8,600	672	260	8,558	22,892	22,892	12,239
2012	2,230	0	60,793	4,788	6,700	150	0	10,031	754	304	10,037	28,029	28,029	13,565
2013	2,530	0	68,943	5,255	6,700	150	0	11,375	827	345	11,421	32,870	32,870	14,400
2014	2,757	0	75,162	5,613	6,700	150	0	12,402	889	376	12,449	36,583	36,583	14,508
2015	2,875	0	78,347	5,796	6,700	150	0	12,927	941	392	12,918	38,523	38,523	13,829
2016	2,983	0	81,319	5,967	2,680	150	0	13,418	902	406	13,433	44,363	44,363	14,416
2017	2,930	0	79,866	5,883	0	0	0	13,178	799	400	13,188	46,418	46,418	13,653
2018	2,723	0	74,228	5,559	0	0	0	12,247	696	371	12,167	43,188	43,188	11,500
2019	2,320	0	63,232	4,927	0	0	0	10,434	594	316	10,153	36,808	36,808	8,872
2020	1,920	0	52,337	4,302	0	0	0	8,635	494	262	8,179	30,465	30,465	6,647
2021	1,544	0	42,086	3,389	0	0	0	6,945	399	210	6,443	24,700	24,700	4,878
2022	1,192	0	32,467	2,836	0	0	0	5,357	315	162	4,789	19,008	19,008	3,398
2023	859	0	23,433	1,994	0	0	0	3,866	240	117	3,319	13,897	13,897	2,249
2024	532	0	14,477	1,479	0	0	0	2,389	175	73	1,784	8,577	8,577	1,257
2025	253	0	6,903	1,044	0	0	0	1,139	121	34	502	4,063	4,063	539
2026	86	0	2,349	782	0	0	0	387	77	12	0	1,091	1,091	131
2027	81	0	2,200	774	0	0	0	363	43	11	0	1,009	1,009	109
2028	76	0	2,068	766	0	0	0	342	18	10	0	932	932	92
2029	71	0	1,935	759	0	0	0	319	4	10	0	843	843	75
Subtotal	**35,733**	**0**	**981,022**	**82,720**	**68,340**	**1,500**	**0**	**162,040**	**10,755**	**4,905**	**156,575**	**494,187**	**494,187**	**179,070**
Remaining	**692**	**0**	**18,878**	**10,796**	**0**	**0**	**1,517**	**3,115**	**0**	**94**	**832**	**2,524**	**2,524**	**200**
Total	**36,425**	**0**	**999,900**	**93,516**	**68,340**	**1,500**	**1,517**	**165,155**	**10,755**	**4,999**	**157,407**	**496,711**	**496,711**	**179,270**

Present Value at (10^3U.S.$)	
8 Percent	**216,121**
12 Percent	**149,942**

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DeGolyer and MacNaughton
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STUDY
as of
MARCH 31, 2005
on the
GROSS PROSPECTIVE RESOURCES
attributable to
CERTAIN PROSPECTS
of
URALS ENERGY HOLDINGS LIMITED
in
VARIOUS REGIONS
of
RUSSIA

FOREWORD

Scope of Investigation

This report presents estimates, as of March 31, 2005, of the gross prospective petroleum resources of certain prospects in various basins in Russia. This report has been prepared at the request of Urals Energy Holdings Limited (UEHL). The prospective resources interests evaluated herein are owned by UEHL. As of the date of this report, UEHL owned a 97.16-percent interest in the PetroSakh license (Sakhalin Island) and a 50-percent interest in the Timan Pechora license, Western Siberia. ZAO Petrosakh owns the Sakhalin offshore license, which includes the following prospects: East Okruzhnoye West Fault Block, East Okruzhnoye East Fault Block, North Rymnikskaya, Pilengskaya, Aprelskaya, South Rymnikskaya, Nizkaya, Vitnitskaya, Ploskaya, Beresovskaya, and North Berezovskaya. OOO Urals Nord owns the Timan Pechora license, which includes the following prospects: Alfinsky, Belugin, Fakel, West Sorokin, and Nadezhdinsky. We have been advised by UEHL that, subsequent to the date of this report, UEHL acquired a 100-percent interest in the Timan Pechora license. This report has estimated gross prospective resources; therefore, net interest owned by UEHL has not been applied to the license areas and prospects.

The prospective resources in this report are expressed as gross resources. Gross resources are defined as the total estimated petroleum that is potentially recoverable after March 31, 2005. The prospects are located in the Sakhalin Island region of Russia and the Timan Pechora basin of Western Siberia, Russia.

The prospective resources estimated herein are those volumes of petroleum that are potentially recoverable from accumulations yet to be discovered. The definitions of resources applied are in agreement with the petroleum resources definitions approved in February 2000 by the Society of Petroleum Engineers, the World Petroleum Congresses, and the American Association of Petroleum Geologists and are discussed in detail in the Classification of Resources section of this report. Because of the uncertainty of commerciality and the lack of sufficient exploration drilling, the resources estimated herein cannot be classified as reserves. The resources estimates in this report are provided as a means of comparison to other resources and do not provide a means of direct comparison to reserves. Tables 1 and 2 summarise the estimated prospective oil resources for 16 prospects, as of March 31, 2005, adjusted for geologic risk.

At the request of UEHL, a model was prepared to estimate quantities that might be realised from the resources estimated herein should these resources be successfully discovered and developed. A possibility exists that the prospects will not result in successful discoveries and development, in which case there could be no positive potential present worth.

Estimates of prospective resources should be regarded only as estimates that may change as additional information becomes available. Not only are such prospective resources estimates based on that information which is currently available, but such estimates are also subject to the uncertainties inherent in the application of judgmental factors in interpreting such information. Prospective resources quantities should not be confused with those quantities and values that are associated with reserves due to the additional risks involved. The quantities that might actually be recovered may differ significantly from the estimates presented herein. Estimates of prospective resources should be regarded only as estimates that may change as additional information becomes available.

Authority

This report was authorised by Mr. William R. Thomas, Chief Executive Officer, UEHL.

Source of Information

In the preparation of this report we have relied, without independent verification, upon information furnished by or on behalf of UEHL with respect to the property interests to be evaluated, subsurface data as they pertain to the target objectives and prospects, and various other information and technical data that were accepted as represented.

CLASSIFICATION OF RESOURCES

Petroleum resources included in this report are classified as prospective resources. Because of the lack of commerciality or sufficient exploration drilling, the prospective resources estimated herein cannot be classified as reserves. The petroleum resources are classified as follows:

Prospective Resources — Those quantities of petroleum that are estimated, on a given date, to be potentially recoverable from undiscovered accumulations.

The estimation of resources quantities for an accumulation is subject to both technical and commercial uncertainties and, in general, may be quoted as a range. The range of uncertainty reflects a reasonable range of estimated potentially recoverable volumes. In all cases, the range of uncertainty is dependent on the amount and quality of both technical and commercial data that are available and may change as more data become available.

Low, Median, Best, and High Estimates — Estimates of petroleum resources in this report are expressed using the terms low estimate, median estimate, best estimate, and high estimate to reflect the range of uncertainty.

A detailed explanation of the probabilistic terms used herein is included in the Glossary of Probabilistic Terms in the appendix bound with this report. For probabilistic estimates of petroleum resources, the expected value* (EV), an outcome of the probabilistic analysis, is used for the best estimate. The low estimate reported herein is the P_{90}* quantity derived from probabilistic analysis. This means that there is at least a 90-percent probability that, assuming the prospect is discovered and developed, the quantities actually recovered will equal or exceed the low estimate. The median estimate is the P_{50}* quantity derived from probabilistic analysis. This means that there is at least a 50-percent probability that, assuming the prospect is discovered and developed, the quantities actually recovered will equal or exceed the median estimate. The high estimate is the P_{10}* quantity derived from probabilistic analysis. This means that there is at least a 10-percent probability that, assuming the prospect is discovered and developed, the quantities actually recovered will equal or exceed the high estimate.

Uncertainties Related to Prospective Resources — The volume of petroleum discovered by exploration drilling depends on the number of prospects that are successful as well as the volume that each success contains. Reliable forecasts of these volumes are, therefore, dependent on accurate predictions of the number of discoveries that are likely to be made if the entire portfolio of prospects is drilled. The accuracy of this forecast depends on the portfolio size, and an accurate assessment of the probability of geologic success* (P_g).

Probability of Geologic Success — P_g is defined as the probability of discovering reservoirs which flow petroleum at a measurable rate. P_g is estimated by quantifying the probability of each of the following individual geologic factors: trap, source, reservoir, and migration. The product of these four probabilities or chance factors is computed as P_g.

In this report estimates of prospective resources are presented both before and after adjustment for P_g. Total prospective resources estimates are based on the probabilistic summation of the volumes for the total inventory of prospects.

Application of P_g to estimate the P_g-adjusted prospective resources volumes does not equate prospective resources with reserves or contingent resources. P_g-adjusted prospective resources volumes cannot be compared directly to or aggregated with either reserves or contingent resources. Estimates of P_g are interpretative and are dependent on the quality and quantity of data currently made available. Future data acquisition, such as additional drilling or seismic acquisition, can have a significant effect on P_g estimation. These additional data are not confined to the study area, but also include data from similar geologic settings or technological advancements that could affect the estimation of P_g.

Predictability versus Portfolio Size — The accuracy of forecasts of the number of discoveries that are likely to be made is somewhat constrained by the number of prospects in the exploration portfolio. The size of the portfolio and P_g together are helpful in gauging the limits on the reliability of these forecasts. A high P_g, which indicates a high chance of discovering measurable petroleum, may not require a large portfolio to ensure that at least one discovery will be made (assuming the P_g does not

* See Glossary of Probabilistic Terms.

change during drilling of some of the prospects). By contrast, a low P_g, which indicates a low chance of discovering measurable petroleum, could require a large number of prospects to ensure a high confidence level of making even a single discovery. The relationship between portfolio size, P_g, and the probability of a fully unsuccessful drilling program that results in a series of wells not encountering measurable hydrocarbons is referred to herein as the predictability versus portfolio size relationship* (PPS). It is critical to be aware of PPS, because an unsuccessful drilling program, which results in a series of wells that do not encounter measurable hydrocarbons, can adversely affect any exploration effort, resulting in a negative present worth.

For a large prospect portfolio, the P_g-adjusted best estimate of the prospective resources volume should be a reasonable estimate of the recoverable petroleum quantities found if all prospects are drilled. When the number of prospects in the portfolio is small and the P_g is low, the recoverable petroleum actually found may be considerably smaller than the P_g-adjusted best estimate would indicate. It follows that the probability that all of the prospects will be unsuccessful is smaller when a large inventory of prospects exist.

Prospect Technical Evaluation Stage — A prospect can often be subcategorised based on its current stage of technical evaluation. The different stages of technical evaluation relate to the amount of geologic, geophysical, engineering, and petrophysical data, as well as the quality of available data.

Mature Prospect — A mature prospect is a potential accumulation that is sufficiently well defined to be a viable drilling target. For a mature prospect, sufficient data and analyses exist to identify and quantify the technical uncertainties, determine reasonable ranges of geologic chance factors, engineering and petrophysical parameters, and estimate prospective resources.

Immature Prospect — An immature prospect is less well defined and requires additional data and/or evaluation to be classified as a mature prospect. An example would be a poorly defined closure mapped using sparse regional seismic data in a basin containing favorable source and reservoir(s). An immature prospect may or may not be elevated to mature prospect status depending on the results of additional technical work.

Threshold Economic Field Size — The threshold economic field size (TEFS) is the minimum amount of producible petroleum required to recover the total capital expenditure used to establish the prospect as having a present worth greater than zero. These investments include expenditures required to establish and prove profitable production and to conduct delineation or confirmation drilling. All geologic, geophysical, lease and/or contract-area acquisition costs and other anticipated field delineation costs are included in the estimation of TEFS as well. The TEFS must therefore be large enough to generate through production revenues a positive present worth at 10 percent interest after payment for all investments related to exploration, delineation, and interest. The present worth per resources volume methodology is a standard industry practice used to estimate resources value if a prospect is successfully discovered and developed. This methodology is directly formulated from the discounted cash flow analysis, which is fundamental to the present worth estimation. Accordingly, where this methodology is employed to estimate TEFS, no additional provision should be made for field development costs.

Probability of Economic Success — The probability of economic success* (P_e) is defined as the probability that a given discovery will be economically viable. It takes into account P_g, market identification and access thereto, pricing uncertainties, timing, TEFS, capital costs, operating expenses, the proposed development plan, and other business and economic factors.

* See Glossary of Probabilistic Terms.

ESTIMATION OF RESOURCES

Estimates of prospective resources were prepared by the use of standard geological and engineering methods generally accepted by the petroleum industry. The method or combination of methods used in the analysis of the reservoirs was tempered by experience with similar reservoirs, stage of development, and quality and completeness of basic data.

The probabilistic analysis of the prospective resources in this report considered the uncertainty in the amount of petroleum that may be discovered and the P_g. The uncertainty analysis addresses the range of possibilities for any given volumetric parameter. Low, median, best, and high estimates of prospective resources were estimated to address this uncertainty. The P_g analysis addresses the probability that the identified prospects will encounter petroleum that flows at a measurable rate. The P_e analysis addresses the probability that the prospective resources will be economically viable. P_e analysis has not been applied and P_e-adjusted and TEFS-adjusted prospective resources have not been estimated herein.

Standard probabilistic methods were used in the uncertainty analysis. Probability distributions were estimated from representations of porosity, petroleum saturation, net hydrocarbon thickness, geometric correction factor, recovery factor, fluid properties, and productive area for each prospect. These representations were prepared based on known data, analogy, and other standard estimation methods including experience. Statistical measures describing the probability distributions of these representations were identified and input to a Monte Carlo simulation to produce low estimate, median estimate, best estimate, and high estimate prospective resources for each prospect.

In this report, the 16 prospects are referred to as mature prospects to reflect the current stage of technical evaluation. A brief summary of the prospects follows.

Sakhalin Island Prospects

Prospective resources were estimated for the 11 prospects in the Sakhalin Island area of Russia. The license expires November 2006, but is expected to be extended by spudding two wells before year-end 2006. The primary objective is the Tertiary clastics section. Trapping of petroleum is formed as a result of compressional-transpressional tectonic events in the region. Reservoir quality can be enhanced by fracturing related to dip rate and proximity to faults.

East Okruzhnoye West Fault Block Prospect

The prospect is a structural faulted four-way dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.400.

East Okruzhnoye East Fault Block Prospect

The prospect is a structural faulted four-way dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.400.

North Rymnikskaya Prospect

The prospect is a densely faulted and fractured, structural four-way dip closure. The critical risk factor is trap, as multiple leak points may exist given fault/lithology-juxtaposition geometries. The P_g for the prospect is 0.250.

Pilengskaya Prospect

The prospect is a three-way faulted dip closure in the footwall. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.250.

Aprelskaya Prospect

The prospect is a three-way faulted dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.300.

South Rymnikskaya Prospect

The prospect is a three-way faulted dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.360.

Nizkaya Prospect

The prospect is a three-way faulted dip closure. The main trapping fault may have 50 to 60 meters of vertical separation. The hanging wall rolls into a high-angle thrust fault. The critical risk factors are trap and reservoir. The $P_g$for the prospect is 0.300.

Vitnitskaya Prospect

The prospect is a densely fractured and faulted three-way dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.250.

Ploskaya Prospect

The prospect is a combination stratigraphic-structural three-way faulted dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.250.

Beresovskaya Prospect

The prospect is a three-way faulted dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.250.

North Berezovskoye Prospect

The prospect is a three-way faulted dip closure. The critical risk factors are trap and reservoir. The P_g for the prospect is 0.250.

Timan Pechora Basin

Prospective resources were estimated for five prospects in the Timan Pechora basin of Western Siberia, Russia. The exploration licenses expire January 31, 2008.

Alfinsky Prospect

The prospect is a stratigraphic/structural trap. The prospect is seismically defined as a domal carbonate buildup. The objective is the III_{src}. The critical risk factor is reservoir. The P_g for the prospect is 0.245.

Belugin Prospect

The prospect is a stratigraphic/structural trap. The prospect is seismically defined as a domal carbonate buildup. The objective is the III_{f2} (D_3f_2). The critical risk factor is reservoir. The P_g for the prospect is 0.245.

Fakel Prospect

The prospect is a stratigraphic/structural trap. The prospect is seismically defined as a domal carbonate buildup. The objectives are the $III_{f2\text{-}3}$ (D_2zv-D_3dzr) and the III-IV (S_2). The critical risk factor is reservoir. The P_g for the prospect is 0.245.

West Sorokin Prospect

The prospect is a stratigraphic/structural trap. The prospect is seismically defined as a domal carbonate buildup. The objectives are the III_{src}($D3_{src}$) and the $III_{3\text{-}1}$(D_3-D_1). The critical risk factor is reservoir. The P_g for the prospect is 0.245.

Nadezhdinsky Prospect

The prospect is a stratigraphic/structural trap. The prospect is seismically defined as a domal carbonate buildup. The objective is the III_{f2} (D_3f_2). The critical risk factor is reservoir. The P_g for the prospect is 0.245.

Quantitative Risk Assessment and the Application of P_g

Minimum, modal, and maximum representations of productive area were interpreted from maps, available seismic data, and/or analogy. Low, mean, and high representations for the petrophysical parameters (porosity, petroleum saturation, and net hydrocarbon thickness) and engineering parameters (recovery factor and fluid properties) were also made based on available well data, regional data, analog field data, and global experience. Individual probability distributions for net rock volume, petrophysical, and engineering parameters were produced from these representations and are summarised in Table 3.

The distributions for the variables were derived from (1) scenario-based interpretations, (2) the geologic, geophysical, petrophysical, and engineering data provided, (3) local, regional, and global knowledge, and (4) field and case studies in the literature. The parameters used to model the recoverable volumes were productive area, net hydrocarbon thickness, geometric correction factor, porosity, petroleum saturation, formation volume factor, and recovery efficiency. Minimum, mean, and maximum representations were used to statistically model and shape the input P_{90}, P_{50}, and P_{10} parameters. Productive area and net hydrocarbon thickness was modeled using truncated lognormal distributions. Truncated normal and triangular distributions were used to model geometric correction factor, formation volume factor, and recovery efficiency. Porosity and petroleum saturation were modeled using truncated normal distributions. Latin hypercube sampling was used to better represent the tails of the distributions.

Each individual volumetric parameter was investigated using a probabilistic approach with attention to variability. Deterministic data were used to anchor and shape the various distributions. The net rock volume parameters had the greatest range of variability and therefore had the greatest impact on the uncertainty of the simulation. The volumetric parameter variability was based on the structural and stratigraphic uncertainties due to the depositional environment and quality of the seismic data. Analog field data were statistically incorporated to derive uncertainty limits and constraints on the net pore volume. Uncertainty associated with the depth conversion, seismic interpretation, gross sand thickness mapping, and net hydrocarbon thickness assumptions were also derived from studies of analogous reservoirs, multiple interpretative scenarios, and sensitivity analyses.

A P_g analysis was applied to estimate the volumes that may actually result from drilling these prospects. In the P_g analysis, the P_g estimates were made for each prospect from the product of the probabilities of the four geologic chance factors: trap, reservoir, migration, and source.* The P_g-adjusted best estimate of the prospective resources was made by application of the P_g to the best estimate of the prospective resources (the product of P_g and the best estimate).

Estimates of gross prospective resources and the P_g estimates, as of March 31, 2005, evaluated herein are shown in Tables 1 and 2. The P_g-adjusted best estimate of the prospective resources was then made by the product of P_g and the best estimate for each of the individual prospects. These results for the individual prospects were then summed to produce the total P_g-adjusted best estimate prospective resources.

Application of the P_g factor to estimate the P_g-adjusted prospective resources volumes does not equate prospective resources with reserves or contingent resources. P_g-adjusted estimates of prospective resources volumes cannot be compared directly to or aggregated with either reserves or contingent resources. Estimates of P_g are interpretive and are dependent on the quality and quantity of data currently available. Future data acquisition, such as additional drilling or seismic acquisition can have a significant effect on P_g estimation. These additional data are not confined to the area of study, but also include data from similar geologic settings or from technological advancements that could affect the estimation of P_g.

* See Glossary of Probabilistic Terms.

SUMMARY AND CONCLUSIONS

UEHL owns interests in prospective resources in certain prospects located in various regions in Russia. Should these prospects result in successful discoveries and development, estimates of the probabilistically determined gross prospective resources, as of March 31, 2005, are summarised as follows, expressed in thousands of barrels (Mbbl):

	Low Estimate (Mbbl)	Median Estimate (Mbbl)	Best Estimate (Mbbl)	High Estimate (Mbbl)
Gross Prospective Oil Resources	89,756.0	143,312.6	150,769.4	226,219.0

Notes:

(1) Low, median, best, and high estimates follow the SPE/WPC/AAPG guildelines for prospective resources.

(2) Low, median, best, and high estimates in this table are P_{90}, P_{50}, EV, and P_{10}, respectively.

(3) Only EV's can be arithmetically summed; P_{90}, P_{50}, and P_{10} cannot be arithmetically summed.

(4) P_g is defined as the probability of discovering reservoirs which flow petroleum at a measurable rate.

(5) P_g has not been applied to the numbers in this table.

(6) Application of P_g does not equate prospective resources to contingent resources or reserves.

(7) Recovery factor is applied to prospective resources in this table.

The P_g-adjusted best estimate prospective resources, as of March 31, 2005, for the prospects evaluated herein with interests owned by UEHL are as follows, expressed in thousands of barrels (Mbbl):

	P_g-Adjusted Best Estimate (Mbbl)
Gross Prospective Oil Resoures	44,015.3

Note:

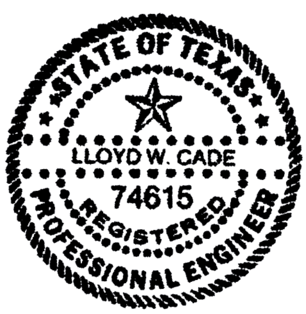
Application of P_g does not equate prospective resources to contingent resources or reserves.

Submitted,

DeGolyer and MacNaughton

DeGOLYER and MacNAUGHTON

SIGNED: June 21, 2005



Lloyd W. Cade, P.E.

Lloyd W. Cade, P.E.
Senior Vice President
DeGolyer and MacNaughton

TABLE 1
ESTIMATES OF THE GROSS PROBABILISTIC PROSPECTIVE OIL RESOURCES
as of
MARCH 31, 2005
for
URALS ENERGY HOLDINGS LIMITED
in
CERTAIN OIL PROSPECTS
VARIOUS CONCESSIONS
RUSSIA

	Gross Probabilistic Oil Resources Summary					
Prospect	**Low Estimate (Mbbl)**	**Median Estimate (Mbbl)**	**High Estimate (Mbbl)**	**Best Estimate (Mbbl)**	**Probability of Geologic Success, P_g (decimal)**	**P_g-Adjusted Best Estimate (Mbbl)**
Vostochno Okruzhnoye West Block	1,859.2	4,154.8	9,086.9	4,898.3	0.400	1,959.3
Severo Rymnikskaya	9,344.4	22,555.1	57,993.8	29,421.2	0.250	7,355.3
Pilengskaya	4,170.0	9,597.4	22,803.0	12,201.0	0.250	3,050.3
Aprelskaya	9,991.9	24,432.8	62,310.9	31,771.8	0.300	9,531.5
Yuzhno Rymnikskaya	8,622.3	21,329.8	53,577.1	27,327.2	0.360	9,837.8
Nizkaya	1,677.7	4,247.0	10,253.8	5,504.7	0.300	1,651.4
Vitnitskaya	4,456.8	9,810.5	21,523.8	11,877.2	0.250	2,969.3
Ploskaya	940.5	2,312.1	5,607.9	2,940.7	0.250	735.2
Beresovskaya	670.7	1,687.2	3,987.2	2,097.5	0.250	524.4
North Berezovskoye	802.6	1,901.2	4,612.1	2,462.4	0.250	615.6
Vostochno Okruzhnoye East Block	1,872.6	4,450.4	9,946.0	5,288.5	0.400	2,115.4
Alfinsky	801.3	1,705.8	3,785.5	2,089.5	0.245	511.9
Belugin	1,157.8	2,522.2	5,316.2	2,949.8	0.245	722.7
Fakel	596.1	1,052.1	1,795.5	1,153.7	0.245	282.7
West Sorokin	1,872.9	3,780.2	7,630.3	4,415.5	0.245	1,081.8
Nadezhdinsky	1,857.6	3,803.5	7,534.9	4,370.3	0.245	1,070.7
Statistical Aggregate	**89,756.0**	**143,312.6**	**226,219.0**	**150,769.4**	**0.292**	**44,015.3**

Notes:

(1) Low, median, best, and high estimates follow the SPE/WPC/AAPG guidelines for prospective resources.

(2) Application of P_g does not equate prospective resources to contingent resources or reserves.

(3) Low, median, best, and high estimates in this table are P_{90}, P_{50}, EV, and P_{10}, respectively.

(4) Only EV's can be arithmetically summed; P_{90}, P_{50}, and P_{10} cannot be arithmetically summed.

(5) P_g is defined as the probability of discovering reservoirs which flow petroleum at a measurable rate.

(6) Recovery factor is applied to prospective resources in this table.

(7) P_g has been rounded for presentation purposes.

TABLE 2
PROBABILITY DISTRIBUTIONS
as of
MARCH 31, 2005
for
URALS ENERGY HOLDINGS LIMITED
in
CERTAIN PROSPECTS
for
MONTE CARLO SIMULATION
RUSSIA

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_{0}	Expected Value
Alfinsky	IIIsrc	Area, acres	91	163	278	472	865	302
		Gross interval, feet	50	77	112	162	243	116
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.70	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.701	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.197	1.163	1.120	1.080	1.050	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	987,186	2,898,548	5,841,726	11,761,370	30,876,460	6,944,473
		Prospective Gross ultimate recovery, barrels	184,450	801,257	1,705,792	3,785,520	12,819,460	2,089,529
Aprelskaya	Pileng	Area, acres	411	737	1,255	2,132	3,838	1,364
		Gross interval, feet	102	185	316	538	969	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.73	0.41
		Porosity, decimal	0.113	0.143	0.180	0.219	0.273	0.181
		Oil saturation, decimal	0.402	0.486	0.550	0.614	0.728	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.341	1.304	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	11,661,730	37,677,320	83,920,740	197,854,100	629,771,600	104,896,200
		Prospective Gross ultimate recovery, barrels	1,694,350	9,991,938	24,432,840	62,310,850	201,444,400	31,771,800

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_0	Expected Value
Belugin	IIIf2 (D3f2)	Area, acres	205	353	574	934	1,601	616
		Gross interval, feet	35	54	78	113	171	82
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.69	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.701	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.197	1.163	1.120	1.080	1.052	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	1,058,455	4,347,730	8,340,176	17,321,450	59,890,800	9,893,935
		Prospective Gross ultimate recovery, barrels	325,726	1,157,782	2,522,183	5,316,229	19,427,800	2,949,814
Beresovskaya	Pileng	Area, acres	54	99	169	287	534	184
		Gross interval, feet	50	93	158	269	492	172
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.73	0.41
		Porosity, decimal	0.113	0.143	0.180	0.219	0.270	0.181
		Oil saturation, decimal	0.403	0.486	0.550	0.614	0.710	0.550
		Formation volume factor, Bo	1.497	1.452	1.396	1.341	1.302	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	774,642	2,534,790	5,742,918	12,946,540	32,684,220	6,967,530
		Prospective Gross ultimate recovery, barrels	233,561	670,691	1,687,164	3,987,195	11,931,420	2,097,486
Fakel	IIIf2-3 (D2zv-D3dzr)	Area, acres	82	123	179	259	395	186
		Gross interval, feet	20	31	45	65	100	47
		Geometric Correction Factor, decimal	0.40	0.48	0.57	0.65	0.69	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.700	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.196	1.163	1.120	1.080	1.051	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	262,797	818,069	1,499,999	2,805,390	6,103,378	1,717,861
		Prospective Gross ultimate recovery, barrels	47,090	220,102	442,748	891,973	2,769,086	513,255

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_{0}	Expected Value
Fakel	III-IV (S2)	Area, acres	103	154	224	324	496	233
		Net pay, feet	20	31	45	65	98	47
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.70	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.700	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.199	1.163	1.120	1.080	1.052	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	407,501	1,035,289	1,910,709	3,588,246	8,251,995	2,139,420
		Prospective Gross ultimate recovery, barrels	75,293	276,451	553,022	1,120,693	2,894,097	640,428
Nadezhdinsky	IIIf2 (D3fr2)	Area, acres	342	524	760	1,102	1,679	792
		Gross interval, feet	41	62	89	130	199	93
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.70	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.701	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.199	1.163	1.120	1.080	1.052	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	2,620,521	6,885,213	12,797,820	23,650,560	58,645,410	14,555,200
		Prospective Gross ultimate recovery, barrels	544,453	1,857,576	3,803,468	7,534,906	25,267,250	4,370,349
Nizkaya	Pileng	Area, acres	69	126	215	365	663	233
		Gross interval, feet	101	186	316	537	982	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.76	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.276	0.181
		Oil saturation, decimal	0.401	0.486	0.550	0.614	0.707	0.550
		Formation volume factor, Bo	1.499	1.452	1.396	1.341	1.303	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	1,874,275	6,270,328	14,610,530	33,390,770	129,775,200	18,240,390
		Prospective Gross ultimate recovery, barrels	481,727	1,677,700	4,247,007	10,253,810	30,553,740	5,504,728

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_0	Expected Value
North Berezovskoye . . .	Pileng	Area, acres	63	115	195	332	597	212
		Gross interval, feet	51	93	158	268	494	172
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.77	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.271	0.181
		Oil saturation, decimal	0.406	0.486	0.550	0.614	0.717	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.342	1.301	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	497,910	2,906,591	6,581,989	15,316,680	55,274,470	8,199,897
		Prospective Gross ultimate recovery, barrels	135,299	802,627	1,901,214	4,612,102	21,328,600	2,462,444
Pilengskaya	Pileng	Area, acres	157	288	491	834	1,516	534
		Gross interval, feet	102	186	316	537	982	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.74	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.270	0.181
		Oil saturation, decimal	0.405	0.486	0.550	0.614	0.741	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.341	0.767	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	3,311,769	14,980,360	32,890,820	74,481,660	387,239,100	40,969,780
		Prospective Gross ultimate recovery, barrels	928,488	4,169,973	9,597,422	22,803,040	108,760,500	12,201,030
Ploskaya	Pileng	Area, acres	77	138	234	398	716	255
		Gross interval, feet	52	93	158	269	481	172
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.75	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.271	0.181
		Oil saturation, decimal	0.401	0.486	0.550	0.614	0.710	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.342	1.303	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	985,436	3,442,953	7,834,451	17,790,950	54,318,530	9,793,799
		Prospective Gross ultimate recovery, barrels	250,744	940,468	2,312,058	5,607,859	15,864,170	2,940,689

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_{0}	Expected Value
Severo Rymnikskaya . . .	Pileng	Area, acres	374	688	1,171	1,993	3,649	1,274
		Gross interval, feet	104	186	316	538	973	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.72	0.41
		Porosity, decimal	0.113	0.143	0.180	0.219	0.270	0.181
		Oil saturation, decimal	0.401	0.486	0.550	0.614	0.713	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.342	1.300	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	10,824,980	35,058,580	77,715,230	184,774,500	572,707,100	98,287,460
		Prospective Gross ultimate recovery, barrels	3,245,474	9,344,423	22,555,130	57,993,830	196,468,100	29,421,240
Vitnitskaya	Pileng	Area, acres	204	360	510	672	741	512
		Gross interval, feet	103	186	316	537	981	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.72	0.41
		Porosity, decimal	0.113	0.143	0.180	0.219	0.273	0.181
		Oil saturation, decimal	0.404	0.486	0.550	0.614	0.731	0.550
		Formation volume factor, Bo	1.498	1.452	1.396	1.341	1.304	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	4,273,723	16,022,860	33,934,630	70,056,940	203,353,500	39,542,420
		Prospective Gross ultimate recovery, barrels	978,548	4,456,783	9,810,530	21,523,810	50,871,410	11,877,160
Vostochno Okruzhnoye .	Pileng	Area, acres	74	153	222	320	431	230
East Block		Gross interval, feet	103	186	316	537	984	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.72	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.277	0.181
		Oil saturation, decimal	0.407	0.486	0.550	0.614	0.722	0.550
		Formation volume factor, Bo	1.495	1.452	1.396	1.342	1.303	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	2,402,409	7,113,198	14,898,600	31,901,340	82,041,620	17,708,510
		Prospective Gross ultimate recovery, barrels	558,017	1,872,646	4,450,412	9,945,965	24,653,300	5,288,499

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_{0}	Expected Value
Vostochno Okruzhnoye . West Block	Pileng	Area, acres	82	150	213	280	309	213
		Gross interval, feet	103	186	316	537	974	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.73	0.41
		Porosity, decimal	0.114	0.143	0.180	0.218	0.273	0.181
		Oil saturation, decimal	0.406	0.486	0.550	0.614	0.732	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.341	1.303	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	2,607,510	7,002,215	14,152,170	28,857,060	88,643,950	16,377,320
		Prospective Gross ultimate recovery, barrels	663,434	1,859,209	4,154,780	9,086,883	24,041,040	4,898,256
West Sorokin	III3-1 (D3-D1)	Area, acres	82	123	179	259	393	186
		Net pay, feet	20	31	45	65	100	47
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.70	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.133	0.155	0.180	0.206	0.242	0.180
		Oil saturation, decimal	0.528	0.636	0.700	0.764	0.848	0.700
		Formation volume factor, Bo	1.247	1.210	1.159	1.096	1.053	1.154
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	424,523	985,391	1,868,308	3,435,830	7,597,892	2,083,510
		Prospective Gross ultimate recovery, barrels	91,900	263,237	545,622	1,068,017	2,267,964	623,839
West Sorokin	IIIsrc (D3src)	Area, acres	202	372	632	1,074	1,966	687
		Gross interval, feet	41	62	89	130	199	93
		Geometric Correction Factor, decimal	0.41	0.48	0.57	0.65	0.70	0.57
		Net to Gross ratio, decimal	0.30	0.38	0.50	0.62	0.70	0.50
		Porosity, decimal	0.095	0.100	0.118	0.141	0.155	0.119
		Oil saturation, decimal	0.700	0.759	0.844	0.918	0.950	0.841
		Formation volume factor, Bo	1.196	1.163	1.120	1.080	1.051	1.120
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	2,061,769	5,157,658	10,714,350	22,050,960	78,561,130	12,648,120
		Prospective Gross ultimate recovery, barrels	422,419	1,376,678	3,203,514	6,945,115	28,095,020	3,791,641

Prospect	Reservoir	Parameter	P_{100}	P_{90}	P_{50}	P_{10}	P_0	Expected Value
Yuzhno Rymnikskaya . . .	Pileng	Area, acres	355	636	1,083	1,840	3,349	1,177
		Gross interval, feet	101	186	316	538	994	344
		Geometric Correction Factor, decimal	1.00	1.00	1.00	1.00	1.00	1.00
		Net to Gross ratio, decimal	0.20	0.28	0.40	0.53	0.74	0.41
		Porosity, decimal	0.113	0.143	0.180	0.218	0.273	0.181
		Oil saturation, decimal	0.405	0.486	0.550	0.614	0.708	0.550
		Formation volume factor, Bo	1.496	1.452	1.396	1.341	1.300	1.395
		Recovery efficiency, decimal	0.125	0.200	0.300	0.400	0.477	0.300
		Prospective OOIP, barrels	7,911,842	31,227,870	73,490,020	175,356,200	501,779,300	91,162,470
		Prospective Gross ultimate recovery, barrels	1,848,765	8,622,263	21,329,820	53,577,050	165,662,400	27,327,220

PART IV

RISK FACTORS

The risk factors below are associated with the Company, its subsidiaries and the Company's shares. Before acquiring shares in the Company, each potential investor should carefully consider the risks and uncertainties described below. The risks and uncertainties below are not the only ones faced but represent some of the risks that the Directors believe are material. If any of the following risks actually occur, the Company's business, financial condition or results of operations could be adversely affected. In that case, the trading price of the Company's shares could decline and the Company's investors could lose all or part of their investment.

Risks Related to the Company's Business

There are risks associated with the Company's strategy of growth and diversification through acquisitions.

As part of the Company's growth and core business, the Company intends to pursue further acquisitions of businesses similar to the Company's businesses. The Company's ability to grow and create value for its investors through such acquisitions will depend on the availability of suitable acquisition candidates at an acceptable cost, the Company's ability to compete effectively for these acquisition candidates and the availability of capital to complete such acquisitions and the ability of the Company to integrate successfully any businesses acquired. These risks could be heightened if the Company completes several acquisitions within a relatively short period of time. The benefits of an acquisition may often take considerable time to develop, and the Company cannot guarantee that any acquisition will in fact produce the intended benefits.

In addition, acquisitions and integration of those acquisitions involve a number of risks, including:

- inaccurate assessment of assets and liabilities, disclosed or undisclosed;
- diversion of management's attention from the Company's core businesses;
- potential loss of key employees or clients of the acquired businesses;
- maintenance of uniform standards, controls, procedures and policies; and
- increase in the Company's indebtedness and contingent liabilities, which could in turn restrict its ability to access additional capital when needed or to pursue other important elements of the Company's business strategy.

The Company cannot give any assurance that it will be able to successfully integrate any business, products, technologies or personnel that the Company might acquire in the future, and its failure to do so could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Exploratory drilling involves numerous risks, including the risk that the Company will encounter no commercially productive oil reservoirs, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company is developing and exploring oil reservoirs in various geographic areas, primarily in the Far East, in the Urals-Volga region and in Timan Pechora Basin (including areas within Nenets Autonomous Okrug and Komi Republic) of European Russia. Successfully developing oil properties requires an assessment of recoverable reserves, future oil prices, operating costs, potential environmental and other liabilities and other factors. Such assessments are necessarily inexact. Exploration may involve unprofitable efforts, not only with respect to dry wells, but also with respect to wells that are productive, but do not produce sufficient net revenues to return a profit after drilling, operating and other costs, which may exceed initial estimates. Future reserve realisations and production will be dependent on the Company's success in these exploration efforts, and no assurance can be given that the Company will be successful. In particular, Petrosakh's planned exploration efforts on the Pograninchny license offshore Sakhalin Island could result in unsuccessful wells which could adversely affect the business, results of operations and prospects of the Company and the value of its shares. The cost of drilling, completing and operating wells is uncertain. The Company may also incur cost overruns or may be required to curtail, delay or cancel drilling operations because of a variety of factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment. The Company's overall drilling activity or drilling activity within a particular project area may be unsuccessful. If unsuccessful, the business, results of operations and prospects of the Company, and the value of its shares could be adversely affected.

If the Company fails to acquire or find and develop additional reserves, the Company's reserves and production will decline from their current levels.

Except to the extent that the Company conducts successful geological study and production activities or acquires properties containing Proved reserves, or both, the Company's Proved reserves will decline as reserves are extracted. According to the D&M Report, as of 31 March 2005, the Company's subsidiaries had Proved reserves of approximately 56 MMBO, Probable reserves of approximately 34 MMBO, and Possible reserves of approximately 28 MMBO and 108 BCF of gas, and in addition, maximum prospective resources of 226 MMBO. The volume of production from oil wells generally declines as reserves are depleted. Part of the Company's long term strategy is dependent on the Company's success in developing the reserves that it has and in acquiring and/or discovery additional reserves. If the Company is not successful in finding additional reserves through its exploration efforts, its total Proved reserves and production will decline over time, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company's development projects involve many uncertainties and operating risks that can prevent it from realizing profits and can cause substantial losses.

The Company's development projects may be delayed or unsuccessful for many reasons, including cost overruns, lower oil prices, equipment shortages and mechanical difficulties. These projects will also often require the use of new and advanced technologies, which can be expensive to develop, purchase and implement and may not function as expected.

The Company's operations depend in part on the availability, quality and cost of supplies provided by third parties and on the availability of pipeline access and markets for the Company's production. Interruptions or disruptions could result in a delay in the Company's operations and adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The reserve data in this document are only estimates and are inherently uncertain, and the Company's actual production, revenues and expenditures with respect to its reserves may differ materially from these estimates.

The reserve data included in this document are estimates based primarily on internal engineering analyses that were prepared by D&M, independent petroleum engineers, based upon certain information provided by the Company, without independent verification. The financial estimates were calculated using oil prices in effect at recent dates specified in the D&M Report. Any significant price changes could have a material effect on the quality and present values of the Company's Proved and Probable reserves.

Petroleum engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact manner. Estimates of the value and quantity of economically recoverable oil and gas reserves, rates of production, future net revenues and cash flows and the timing of development expenditures necessarily depend upon a number of variable factors and assumptions, including the following:

- historical production from the area compared with production from other comparable producing areas;
- interpretation of geological and geophysical data;
- the assumed effects of regulations by governmental agencies;
- assumptions concerning future oil and gas prices;
- capital expenditures; and
- assumptions concerning future operating costs, severance and excise taxes, development costs and workover and remedial costs.

Because all reserve estimates are subjective, each of the following items may differ materially from those assumed in estimating reserves:

- the quantities and qualities of oil and gas that are ultimately recovered;
- the production and operating costs incurred;

- the amount and timing of future development expenditures; and
- future oil and gas sales prices.

Many of the factors, assumptions and variables involved in estimating reserves are beyond the Company's control and may prove to be incorrect over time. This is especially true in Russia, where there has been political and economic uncertainty in the past. Results of drilling, testing and production after the date of the estimates may require substantial upward or downward revisions in the Company's reserve data. Furthermore, different reserve engineers may make different estimates of reserves and cash flows based on the same available data. Actual production, revenues and expenditures with respect to reserves will vary from estimates and the variances may be material. Any downward adjustment could lead to lower future production and adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The discounted and undiscounted pre-tax future net revenues included elsewhere in this document should not be considered as the market value of the reserves attributable to the Company's properties. The Company's actual pre-tax future net revenues will be affected by factors such as:

- the amount, timing and cost of actual production;
- supply, demand and price for oil and gas and petroleum products;
- cost and availability of transportation; and
- changes in governmental regulations (including taxation).

In addition, the discount factor the Company used to calculate its discounted pre-tax future net revenues is not necessarily the most appropriate discount factor based on the cost of capital in effect from time to time and the risks associated with the Company and the oil and gas industry in general. Any substantial decline in projected net revenues resulting from production of reserves could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

As a result of missing financial and other information of Arcticneft and poor management of Arcticneft in prior periods, not all potential liabilities may have been identified.

The due diligence process conducted by the Company and its advisers prior to the purchase of Arcticneft on 11 July 2005 identified certain omissions in relation to the historical financial information and other records relating to Arcticneft. Arcticneft has not retained most of its financial records (including third party contracts, tax declarations, bank statements and other information) to support its Russian financial statements for the financial years ended 31 December 2002 and 2003. Certain supporting financial information and financial records in respect of the 2004 financial year are also not available. As a result, the Company is not able to verify the financial performance or assets and liabilities of Arcticneft for the financial years 2002 and 2003, or any liabilities that subsequently may arise in relation to those periods. Due to the absence of accounting records Arcticneft is unable to prepare any IFRS financial statements for the 2002 and 2003 financial years based on the available financial information. Although IFRS financial statements for Arcticneft for 2004 have been prepared, due to Arcticneft's inability to determine that all its obligations are completely and accurately reported in its financial statements, ZAO PricewaterhouseCoopers Audit is unable to express an audit opinion on such statements. See Report of ZAO PricewaterhouseCoopers Audit in Part V herein.

Arcticneft has not reconciled its tax obligations with the regional and federal tax authorities and significant positive and negative differences exist between its records and the tax authority's records. Arcticneft may have difficulty substantiating its tax position due to a lack of appropriate supporting documents.

The Company has identified potential liabilities to which Arcticneft may be subject that are set out in Arcticneft's unaudited financial statements for the year ended 31 December 2004. If these liabilities are claimed and realised, or if such liabilities prove to be larger than currently estimated by the Company, their resultant settlement may have a material adverse impact on the cash flow of Arcticneft and its financial performance and could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

In addition to the potential liabilities and costs that the Company has been able to identify, there may be other liabilities and costs arising from the 2002 and 2003 financial years to which Arcticneft may be subject, either now or in the future, of which the Company is currently unaware. Such potential liabilities may also have a material impact on the cash flow available to Arcticneft and its financial performance in the periods in which they accrued and could therefore adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company also identified significant weaknesses in Arcticneft's internal control procedures over financial statements preparation, tax reporting and budgeting. For example, certain customary accounting checks and balances were either not applied or were improperly applied. Consequently, Arcticneft may not have recorded payables and receivables appropriately.

The sale and purchase agreement for the acquisition of Arcticneft includes certain warranties from affiliates of LUKOIL that are limited by time and amount. The Company may not be able to recover compensation for a breach of these warranties so as to make good any loss, damage, cost, expense or liability that Arcticneft may suffer, directly or indirectly, arising as a result of the missing information noted above or other liabilities. Although the Company is not aware of any actual or potential claims or liabilities that might be revealed by such information if it were available, save as detailed above, the Company cannot be certain that such liabilities or claims do not exist.

As set out above, Arcticneft's liabilities and obligations may be greater than is currently expected (whether or not the Company knows of such liabilities and obligations) and it may not be possible to recover some or all of any such liabilities and obligations under the sale and purchase agreement. Arcticneft may also suffer fines and penalties relating to such obligations or liabilities. This could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The failure of Arcticneft to retain at least 5 board members could invalidate decisions passed by the board.

Arcticneft's board had 4 board members. Following a change in Russian legislation, as from 17 March 2004 Arcticneft should have ensured that its board retained at least 5 board members. As a result, any decisions taken by the board members from March 2004 to 15 July 2005 may be open to challenge in court. Any successful challenge could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company depends on key management and personnel, the loss of whom could have an adverse impact on its business.

The Company's growth and future success depend in significant part upon the continued contributions of a number of its management and personnel, including its Managing Director and Chief Executive Officer, William R. Thomas, its Chairman Viatcheslav V. Rovneiko and the General Director of its Russian companies, Leonid Y. Dyachenko. Managing the Company's growth requires, among other things, stringent control of the Company's financial condition and operations, continued development of its management controls, and attracting and training new personnel. The Company's success is dependent on the ability of its management to operate its business and to manage the ongoing changes from its growth and potential future acquisitions. The Company cannot assure investors that the services of its management personnel will continue to be available to it and the loss of any one of them could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

A material part of the Company's revenue is derived from the sale of oil that it produces. A substantial or extended decline in prices for crude oil and refined products could adversely affect the Company's revenues, cash flows and profitability.

The Company's revenues, profitability and future rate of growth depend substantially upon the prevailing prices for crude oil and refined products. Historically, prices for crude oil and refined products have fluctuated widely in response to changes in many factors. The Company does not and will not have control over the factors affecting prices for crude oil and refined products. In addition, the Company does not currently engage in any material hedging transactions or other derivatives trading to reduce the impact of fluctuations of oil prices on the Company.

At times, excess world supplies have depressed oil prices. Lower oil prices also may reduce the amount of oil and oil products that the Company can produce economically or reduce the economic viability of projects planned or in development. Declines in oil prices could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Historic tax liabilities may arise to the Company or its subsidiaries.

The Company believes that adequate provisions have been made in the IFRS accounts for tax liabilities which may arise if the relevant tax authorities view the Company's or its subsidiaries' historic tax affairs in an unfavourable light. The Company's business, results of operations and prospects and the value of its shares could be adversely affected if actual tax liabilities exceed such provisions.

The Company's predecessors used tax-optimisation mechanisms that may be challenged by the tax authorities.

The Company's subsidiaries have historically benefited significantly from the use of tax optimisation mechanisms employed by some of its predecessors. If, however, tax-optimisation mechanisms used by the Company's predecessors are challenged due to changes to the tax regime or other reasons, the Company may have to pay significantly higher taxes in the future, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares. In addition, if the various initiatives others have used to reduce the tax burden of the Company's subsidiaries are successfully challenged by the Russian tax authorities, the Company may face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company may not be able to finance its planned capital expenditures to expand its exploration and production and refining and marketing operations due to lower oil prices and/or higher costs.

The Company expects to finance its planned 2005 to 2007 capital expenditures out of cash flows from the Company's operating activities and out of proceeds of the offering. If, however, oil prices fall below the price assumptions used in the Company's internal modeling for the calculation of cash flows, it may be required to finance its planned capital expenditures for future years through outside sources, including bank borrowings and offerings of debt or equity securities, or both, in the domestic or international capital markets. The Company may also seek external financing in an effort to preserve adequate cash reserves. If necessary, some of these external financings may be secured by the Company's exports of oil. Due to a variety of factors, including perceived risks related to the Company's operational performance, regulatory developments or a deterioration in the Russian economy, the Company may not be able to raise additional capital on acceptable terms. If the Company seeks finance through offerings of equity securities, it may have to sell stock at prices lower than those paid by a portion of the Company's current shareholders, leading to dilution, or it may have to sell stock or debt instruments with rights superior to those of holders of the Company's shares. Nonetheless, the Company cannot assure investors that it will be able to raise the financing on acceptable terms when needed, and may be unable to take advantage of opportunities or meet unexpected financial requirements. This could cause it to delay or abandon its planned capital expenditures. If the Company is unable to obtain necessary financing, it will have to reduce its capital expenditures. Any such reduction could adversely affect the business, results of operation and prospects of the Company, and the value of its shares.

The Company encounters competition from other oil companies in all areas of its operations, including the acquisition of licenses, exploratory prospects and producing properties.

The oil industry is extremely competitive. The Company primarily competes with other Russian oil companies, including some of the Russian major companies such as LUKOIL, YUKOS, Surgutneftegaz, Rosneft, TNK—BP, Tatneft, Sibneft and Russneft, as well as certain of the larger and most sophisticated international oil companies doing business in Russia. The Company competes with these Russian companies for access to markets and equipment, labour and capital required to develop and operate the Company's properties. The Company also competes for the acquisition of oil licenses and properties in Russia. The Company's competitors may have access to greater financial and other resources and accordingly may be able to pay more for exploratory prospects and productive oil properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects, including operatorships and licenses, than the Company's financial or human resources permit. Full implementation of Russia's Production Sharing Law could substantially increase the interest of foreign and domestic companies in oil production in Russia and further increase the level of competition the Company faces. Domestic competitors may also be strengthened if they acquire additional assets through the privatisation processes, or through mergers, joint ventures or other forms of business combinations. Any of the above factors could adversely affect the business, results of operation and prospects of the Company, and the value of its shares.

The Company's operations may be affected by significant operating hazards and natural disasters that result in losses for which the Company has limited insurance.

Geological study, exploration for and production, refining and transportation of crude oil, refined products and natural gas are hazardous. Natural disasters, operator error or other occurrences can result in:

- spills;
- blow-outs;
- craterings;
- fires;
- explosions;
- equipment failure;
- loss of well control; and
- other unexpected and dangerous conditions

causing personal injuries or death, personal damage, environmental damage, interruption of operations, damage or destruction of wells production facilities and other property and could adversely affect the business, results of operation and prospects of the Company, and the value of its shares.

The insurance industry in Russia is in its development stage. Many forms of insurance common in other parts of the world designed to protect against the perils mentioned above are not yet generally available in some of the areas where the Company operates.

The Company maintains insurance against some, but not all, potential risks and losses affecting the operations of its subsidiaries. The Company's insurance may not be adequate to cover all of the Company's losses or liabilities. Also, the Company cannot predict the continued availability of insurance at current cost. The Company currently has no insurance coverage for third party losses in connection with personal injury, property or environmental damage arising from accidents on the Company's properties or relating to the Company's operations. The Company also does not carry any business interruption insurance. Until the Company is able to obtain adequate insurance for coverage of its assets, it may be exposed to substantial risks including a risk that losses and liabilities arising from accidents could significantly increase the Company's costs and could adversely affect the business, results of operation and prospects of the Company, and the value of its shares.

Certain of the Company's operating subsidiaries operate in areas of harsh weather conditions.

Both Petrosakh and Arcticneft have operations that are located in areas where the surrounding ocean is frozen for several months of the year, and they are unable to sell crude oil during that time as it is sold through ocean-going tankers. Supplies are difficult to obtain for much of the year due to frozen roads and winter conditions. Further, wells can only be drilled on the licensed areas of some of the Company's subsidiaries during certain months of the year. These conditions could result in disruptions in the Company's development and operating programmes that could adversely affect the business, results of operations and cash flows and prospects of the Company, and the value of its shares.

Risks Related to the Economic Situation in Russia

The Company sells a portion of its crude oil and refined products in the Russian market, and although these prices have improved recently, such prices have historically been lower than in the international market.

Historically, oil prices in the Russian market have been below prices in the international export market. While the Russian government ceased to control domestic crude oil prices directly in early 1995, domestic crude oil prices have remained below international spot market levels primarily due to large regional surpluses in Russia, increasing domestic supplies and reduced demand resulting from Russia's economic weakness. Domestic Russian prices for refined products have historically also been subject to government price controls, although not to the same degree as was the case for oil prices, and have also remained below world market prices for refined petroleum products. The Company cannot assure investors that the Russian government will not implement price controls in the future for political or other reasons.

The political situation in Russia could adversely affect the Company and its business could be harmed if governmental instability recurs.

Political conditions in Russia were highly volatile in the 1990s, as evidenced by the frequent conflicts between the president and parliament and the succession of six different prime ministers since the beginning of 1998. This instability negatively impacted Russia's business and investment climate. Future changes in the government, major policy shifts or a lack of consensus between Russia's parliament and the administration of its current president, Vladimir Putin, could disrupt or reverse economic and regulatory reforms. Any deterioration of Russia's investment climate could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Conflicts between Russian federal and regional authorities and other political conflicts could create an uncertain operating environment for the Company that could hinder the Company's long-term planning ability and could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The delineation of authority among Russia's many regions, internal republics and the federal government as well as among the branches of government is often unclear. The Russian political system is therefore vulnerable to tension and conflict between federal and regional authorities over various issues, including tax revenues, authority for regulatory matters and regional autonomy. The conflicts within the regions or between the regions and the federal government could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Economic instability in Russia could adversely affect the Company's business.

Since the dissolution of the Soviet Union in the early 1990s, Russia's economy has been undergoing a rapid transformation from a one party state with a centrally planned economy to a pluralist democracy with a market-oriented economy. This transformation has been marked by periods of significant instability, and the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to Russian enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and grey market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organised crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the Russian population.

Operating in such an economic environment may make it more difficult for the Company to operate its business and finance its activities.

The Company cannot assure investors that recent positive trends in the Russian economy, such as the increase in the gross domestic product, a relatively stable ruble and a reduced rate of inflation, will continue or will not be abruptly reversed. Moreover, the recent fluctuations in international oil and gas prices, the strengthening of the ruble in real terms relative to the U.S. dollar and the consequences of a relaxation in monetary policy, or other factors, could adversely affect Russia's economy and the business, results of operations and prospects of the Company, and the value of its shares.

Fluctuations in the global or Russian economies could disrupt the Company's ability to operate its business in Russia and could discourage foreign and local investment and spending, which could adversely affect its production.

Russia's economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. In addition, the Russian economy is especially sensitive to the price of oil on the world market. Recent international terrorist activity has had a significant effect on international finance and commodity prices. Any future acts of terrorism of such magnitude could have an adverse effect on the international financial and commodities markets, the global economy and world oil prices. A steep decline in the world price of oil could slow or disrupt the Russian economy because Russia produces and exports large amounts of oil. These developments could severely limit the Company's access to capital and could disrupt the operation of its business and discourage foreign and local investment and spending, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company is only able to conduct banking transactions with a limited number of creditworthy Russian banks as the Russian banking system remains underdeveloped.

Russia's banking and other financial systems are not well developed or regulated and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent applications. There are currently a limited number of creditworthy Russian banks that the Company can conduct banking transactions with as the August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans. Most creditworthy Russian banks are located in Moscow and St. Petersburg and there are fewer creditworthy Russian banks in the regions outside of Moscow and St. Petersburg. Another prolonged or more serious banking crisis or the bankruptcy of one or more of the banks which receive or hold the Company's funds could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company faces inflation and foreign exchange risks that could adversely affect the Company's results of operations.

Russia has experienced high levels of inflation since the early 1990s. Inflation increased dramatically following the August 1998 financial crisis. The government's history of printing money to pay back wages, pensions and some of its debt has prompted concerns of hyperinflation. Due to high inflation and other economic and political pressures, the ruble lost significant value against the U.S. dollar and other foreign currencies in 1998 and 1999. The Russian Central Bank has imposed various currency-trading restrictions in attempts to support the ruble or to maintain a rate of devaluation that is in line with inflation. The effectiveness of these restrictions depends on many political and economic factors, including the ability of the Russian government and the Russian Central Bank to finance budget deficits without recourse to monetary emissions, to control inflation and to maintain sufficient foreign currency reserves to support the ruble.

Substantially all of the Company's revenues are correlated to some extent with U.S. dollar crude oil prices, while most of the Company's costs are denominated in rubles. The Company's results of operations are, therefore, significantly affected by the relative movements of ruble inflation and exchange rates. In particular, the Company's operating margins are generally adversely affected by a real appreciation of the ruble against the U.S. dollar (i.e., by an inflation rate that is higher than the rate at which the ruble is devaluing against the U.S. dollar) because this will generally cause the Company's costs to increase in real terms relative to its revenues. Recently the ruble has appreciated against the U.S. dollar. Continued real appreciation of the ruble against the U.S. dollar or other foreign currencies could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Conversely, the nominal depreciation of the ruble results in losses in the value of ruble-denominated monetary assets, such as ruble deposits, domestic debt instruments and accounts receivable. The decline in the nominal value of the ruble against the U.S. dollar also reduces the U.S. dollar value of tax savings arising from tax incentives for capital investment and the depreciation of the Company's property, plant and equipment since their basis for tax purposes is denominated in rubles at the time of the investment or acquisition. Increased tax liability would increase the Company's total expenses and could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Russia's physical infrastructure is in poor condition, which could disrupt normal business activity.

Russia's physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission, communication systems and building stock. During the winter of 2000 to 2001, electricity and heating shortages in Russia's far-eastern Primorye region seriously disrupted the local economy. The federal government is actively considering plans to reorganise the nation's rail, electricity and telephone systems. Any such reorganisation may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. The poor state of certain of Russia's physical infrastructure can disrupt the transportation of goods and supplies, add costs to doing business in Russia and interrupt business operations. Such disruptions, additional costs or business interruption could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Failure to register rights to real property may have an adverse effect on the Company's ability to transfer and dispose of its property, and also negative tax consequences.

Russian law requires that all rights to (and, as a consequence, all transactions in respect of) immovable property located in Russia (including, without limitation, ownership title and leases, but excluding leases of less than one year in duration) be registered in the Unified State Register of Rights to Immovable Property and Transactions (the "Register"). Some of the subsidiaries of the Company cannot confirm that their rights have been duly registered. Title to the immovables will not be recognised unless it has been duly registered in the Register. In addition, the immovable may only be transferred, as well as mortgaged, to a third party once it has been duly registered in the Register.

If there are delays in registration, this may be viewed by the state authorities as an attempt to avoid a potential property tax liability, which generally becomes payable following submission for the registration of ownership title. Consequently, where a subsidiary has failed to register their rights immediately, this may expose the subsidiary to tax liability.

Failure to obtain rights to land plots underneath the Company's immovables may lead to demolition of, or loss of rights to, the Company's property.

Some of the Company's subsidiaries cannot confirm rights to land plots underlying certain of their immovable property. Under Russian law, if any immovable property has been built, constructed or otherwise created on a land plot in respect of which the actual owner of such constructed immovable property has not secured legally recognised rights, such action would constitute an unauthorised occupation (samovolnoye zanyatiye) of the relevant land plot and the immovable property so constructed would be viewed as an unauthorised construction (samovolnaya pastroika). The unauthorised occupier of a land plot does not get title to any unauthorised construction erected on such land plot.

Under Russian law, an unauthorised occupier of land (or its legal successors or assignees, as applicable) could be held liable to pay a variety of administrative penalties (which could also be imposed on its directors, officers and employees) and/or, more importantly, to pay damages to the landowner and either (a) to remove the relevant immovable property at its own expense or (b) to transfer it into the landowner's ownership virtually at cost.

If any of the foregoing events occur, they could adversely affect the Company's business, results of operations and prospects, and the value of its shares.

Risks Related to the Legal and Regulatory Environment in Russia

The Company's export capacity is limited by the Russian government's restrictions on exports of oil from Russia through an export quota system.

Russian oil companies are allocated a quota to export approximately 30% to 35% of their production by Transneft, the Russian state pipeline system owner. To date, these restrictions have not materially affected the Company's ability to export oil. However, these restrictions have put downward pressure on Russian domestic crude oil and refined product prices, which may impact the Company's margins for domestic refined product sales. The Company cannot assure investors as to when the Russian government or Transneft will lower or eliminate these restrictions, or whether these restrictions will be increased. The continuance of restrictions could adversely affect the Company's business, results of operations and prospects and the value of its shares.

The Company is particularly dependent on Transneft, a state-owned company that controls Russia's trunk pipeline network, for the transport of a portion of the Company's crude oil, and the Company's ability to export crude oil is limited by the system for allocating access to Transneft's pipelines.

Approximately 90% of the crude oil produced in Russia and approximately 30% of the Company's crude oil is transported through the Transneft system of trunk pipelines, which is a state-owned monopoly. Similar to other oil companies in Russia, the Company is dependent on Transneft for the transportation of some of its crude oil. The Transneft pipeline system is subject to breakdowns and leakage and could benefit from additional capital investment. Transneft may refuse or be unable to transport the Company's crude oil as a result of a significant disruption in the pipeline system or for other reasons. This could adversely affect the Company's business, results of operations and prospects and the value of its shares.

Russian government authorities regulate access to Transneft's pipeline network. Pipeline capacity, including export pipeline capacity, is allocated quarterly to oil producers, generally in proportion to the volume of oil produced and delivered to the trunk pipeline network during the prior quarter. Although part of the Company's strategy is to increase the amount of crude oil that the Company's subsidiaries produce, it may not receive sufficient pipeline capacity in the future to transport all of its requirements. In such an event the Company's business, results of operations and prospects, and the value of its shares could be adversely affected.

The Russian government can mandate deliveries of oil and refined products at less than market prices, adversely affecting the Company's revenue and relationships with other customers.

In the past, the Russian government has directed Russian oil companies to deliver oil or refined products to certain customers, and these government-directed deliveries may take precedence over market sales. The government has in the past also mandated export sales for the purpose of obtaining foreign currency for government use. Government-directed deliveries may take several forms. The Company may be directed to make deliveries to government agencies, the military, railways, agricultural producers or remote regions, or to specific consumers or refineries, or to domestic refineries in general. If this occurs, such government directed deliveries could disrupt the Company's relations with its customers, lead to delays in payments for oil and refined products or result in sales at below market price, with an adverse effect on the Company's business, results of operations and prospects, and value of its shares.

The Company's and its subsidiaries' licenses may be suspended, restricted or terminated prior to their expiration, or may not be extended prior to expiration.

The licensing regime in Russia for the exploration, development and production of crude oil and natural gas is governed primarily by the Subsoil Law and a large number of regulations issued thereunder. The Company currently conducts its operations under numerous geological study, exploration and production licenses, substantially all of which are held by the Company's subsidiaries. The Company's geological study, exploration and production licenses expire between 2006 and 2067. The Subsoil Law provides that fines may be imposed and the Company and its subsidiaries' licenses may be suspended, restricted, or terminated if one of the Company's subsidiaries that holds a license fails to comply with license requirements or Subsoil Law, or in particular fails to make timely payments of levies and taxes for the use of the subsoil.

Recently the Russian government has proposed, and submitted to parliament for approval, rules that would restrict or limit companies with foreign ownership from participating in auctions for subsoil licenses. Should such proposals become law, the Company's ability to compete in obtaining or renewing licenses could be materially adversely affected.

The Company's subsidiaries may not be able to, or may voluntarily decide not to, comply with the license requirements for some or all of these license areas. If the subsidiary fails to fulfil the specific terms of any of its licenses or if it operates in the license areas in a manner that violates Russian law, government regulators may impose fines on the subsidiary or suspend or terminate its licenses. Further, the subsidiary may have to increase spending to comply with license terms. Any suspension, restriction or termination of a subsidiary's licenses could have an adverse effect on the Company's business, results of operations and prospects, and the value of its shares.

Currently, the Company's subsidiary, Urals Nord, is not in compliance with the obligations under one of its licenses. The Company has not received any notice of withdrawal or suspension from the authorities and is determining whether to try to amend the license terms or relinquish the license as there are no wells on the relevant site that are capable of producing oil or gas, and the prospectivity of the area under such license has not been determined by the Company.

Part of the Company's planned exploration development programme depends upon its ability to extend its geological study, exploration and production licenses or to obtain an exploration and production license on the Pogranichny Subsoil Area offshore Sakhalin Island now owned by Petrosakh. Although the Company has taken steps to extend the current geological study license or obtain an exploration and production license, there is no assurance that it will be able to do so. If the Company is unable to extend its rights over the Pogranichny area, its plans may be curtailed, the resources there will be unavailable to the Company, and the Company's projected reserves and cash flow will be less than planned, which could adversely affect the Company's business, results of operations and prospects, and the value of the Company's shares.

In addition, since the Company did not own or control most of its subsidiaries when they obtained their subsoil licenses, the Company cannot be certain that all of the licenses of its subsidiaries were issued, or the preceding and current licenses were re-issued, in accordance with all applicable law and regulations at the time issued. If it is determined that any of the mineral licenses held by the Company's subsidiaries were issued and/or re-issued in violation of applicable laws, such licenses would be subject to revocation. A loss of any such license could have an adverse effect on the Company's business, results of operations and prospects, and the value of its shares.

If the Company fails to receive permits and authorisations or properly perform work, it may be required to delay cease or reduce its investment programme.

The business environment in Russia is highly bureaucratic. To comply with the terms of the Company and its subsidiaries' licenses and authorisations, and to operate the Company and its subsidiaries' business as currently contemplated, the Company and its subsidiaries are required to obtain permits or approvals, including those established by the environmental protection laws and regulations, to conduct operations, such as land allotments, approvals of design and feasibility studies, pilot projects and development plans and for the construction of any facilities on site. The Company and its subsidiaries obtain these permits regularly based on their operations. If the Company and its subsidiaries fail to receive permits and authorisations or properly perform work, they may be required to delay or cease the relevant operations which could adversely affect the Company's business, results of operations and prospects, and the value of the Company's shares.

Russia's developing legal system creates a number of uncertainties for the Company's business.

The following aspects of Russia's legal system create uncertainty with respect to many of the legal and business decisions that are made by the Company. Many of these risks do not exist in countries with more developed legal systems:

- inconsistencies among laws, presidential decrees and ministerial orders and among local, regional and federal legislation and regulations;
- decrees, resolutions, regulations and decisions adopted without clear constitutional or legislative basis by governmental authorities and agencies with a high degree of discretion. In the past, the Russian government has arbitrarily nullified or terminated contracts, withdrawn licenses, conducted sudden and unexpected tax audits, criminal prosecutions and civil actions and used common defects in share issuances and registrations as pretexts for court claims and other demands to invalidate such issuances and registrations and/or to avoid transactions;
- changes to existing Russian law as currently in effect that make it more difficult for the Company to conduct its business or prevent it from completing certain transactions;
- substantial gaps in the regulatory structure created by the delay or absence of implementing regulations for certain legislation;
- the lack of judicial and administrative guidance on interpreting applicable rules and the limited precedential value of judicial decisions; and
- bankruptcy procedures that are not well developed and are subject to abuse.

Lack of independence and inexperience of certain members of the Russian judiciary and the difficulty of enforcing court decisions in Russia and governmental discretion in instigating, joining and enforcing claims could prevent the Company from obtaining effective redress in a Russian court proceeding, including in respect of expropriation or nationalisation.

Russia has an understaffed and underfunded judiciary, with limited experience in interpreting and applying market-oriented legislation, whose independence may be subject to undue influence. The independence of the Russian judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. Judges and courts are generally inexperienced in the area of business and corporate law. In addition, most court decisions are not readily available to the public. Enforcement of court judgments can in practice be very difficult in Russia. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims. The Company may be subject to such claims and may not be able to receive a fair hearing or be able to recover costs incurred defending politically motivated claims. Additionally, court judgments are not always enforced or followed by law enforcement agencies. The enforcement of the Company's contracts, including those agreements under which it has acquired its subsidiaries, depends on the proper application of the relevant laws by Russian courts. If such contracts cannot be enforced, the Company may be unable to assert its rights thereunder against prior vendors, affecting the value of the warranties that are secured in such contracts. The matters described above could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

These uncertainties extend to property rights. There is limited experience in enforcing legislation enacted to protect private property against nationalisation and expropriation. As a result, the Company may not be able to obtain proper redress in the courts, and it may not receive adequate compensation if in the future the Russian government decides to nationalise or expropriate some or all of the Company's assets. Although the companies previously owned by the shareholders, not the Company, participated in the original privatisations of the Company's assets, re-nationalisation could occur, and if this occurs, this could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

If the Company or a subsidiary is found to not be in compliance with applicable laws or regulations, it could be exposed to additional costs, which might hinder the Company or subsidiary's ability to operate its business.

The Company cannot assure investors that regulators, judicial authorities or third parties will not challenge the Company or a subsidiary's compliance with applicable laws, decrees and regulations.

The Ministry of Natural Resources of the Russian Federation and other state authorities, conduct periodic inspections and have the right to conduct inspections during the year. The shares of some Russian subsidiaries appear to have been issued and transferred not in compliance with applicable laws and the employment agreements with employees of some Russian subsidiaries required by law appear not to be in place. Although the Company uses its best efforts to comply with laws, decrees and regulations, it cannot assure investors that in the course of future inspections conducted by the Ministry of Natural Resources or other state authorities, the Company will not be found to have violated any laws, decrees or regulations, that it will be able to cure such violations within any grace periods permitted by such authorities, and that such findings will not result in the imposition of fines or penalties or more severe sanctions, including the suspension, restriction or termination of the subsidiaries' licenses, any of which could increase its estimated costs and adversely affect the business, results of operations and prospects of the subsidiary or Company, and the value of the Company's shares.

Russia's unpredictable acknowledgement and enforcement of foreign court judgments or arbitral awards give rise to significant uncertainties.

Some of the Company's directors and executive officers and certain of the experts named in this document reside in Russia. A significant part of the Company's assets and a substantial portion of the assets of such persons are located in Russia. Russia is not party to any multilateral or bilateral treaties with most Western jurisdictions for the mutual enforcement of court judgments. Consequently, should a judgment be obtained in an English court, it is highly unlikely to be given direct effect in Russian courts. However, Russia (as successor to the Soviet Union) is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"). A foreign arbitral award obtained in a state that is party to the New York Convention should be recognised and enforced by a Russian court (subject to the qualifications provided for in the New York Convention and compliance with Russian civil procedure regulations and other procedures and requirements established by Russian legislation). There is also a risk that Russian procedural legislation will be changed by way of introducing further grounds preventing foreign court judgments and arbitral awards from being recognised and enforced in Russia. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of Russian courts or other officials, thereby introducing delays and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in Russia.

Russia's unpredictable federal and local tax systems give rise to significant uncertainties and risks that complicate the Company's tax planning and business decisions.

Before the introduction of the Tax Code on 1 January 1999, the tax system in Russia was subject to frequent change, varying interpretations and inconsistent enforcement at the federal, regional and local levels and the system of tax collection was relatively ineffective resulting in continual imposition of new taxes in an attempt to raise state revenue. In some instances, even though unconstitutional, Russian tax authorities have applied certain taxes retroactively. In addition to the Company's substantial tax burden, these conditions complicate the Company's tax planning and related business decisions. This uncertainty related to Russian tax laws exposes the Company to potentially significant fines and penalties and to enforcement measures despite its best efforts at compliance, and could result in a greater than expected tax burden. For example, on 14 July 2005 the Russian Constitutional court passed a decision pursuant to which the statute of limitation for tax liabilities may be extended beyond the 3 years term established in the tax law, if a taxpayer is considered obstructing or hindering a tax inspection under a court decision. There is no definition for such "obstruction" and there is a risk that the tax authorities may abuse their powers for its wide interpretation in the court claims against taxpayers.

Effective 1 January 2002, Profits Tax chapter of the RF Tax Code was introduced as part of the general process of tax reform in Russia and in connection with the introduction of new approaches to the taxation of oil companies, included a reduction in the corporate income tax rate from 35% to 24%. In addition, the mineral restoration tax and royalty tax (calculated at effective rates of approximately 6% and 8%, respectively, of oil and gas revenues recognised for Russian statutory purposes) and the excise tax on crude production of approximately US $0.30 per barrel were replaced with a mineral resources extraction tax. Through 31 December 2006, the base rate of the mineral resources extraction for crude oil is set at 419 rubles per metric ton and is adjusted depending on the market price of the Urals blend of oil and the ruble exchange rate. As of 1 January 2007, the unified rate is set at 16.5% of oil and gas reserves recognised for Russian statutory purposes.

The Russian government is in the process of revising the Russian tax system. The new tax system has, thus far, reduced the number of taxes and the overall tax burden on businesses and simplified the tax laws. However, the revised tax system relies to a certain extent on the judgments of local tax officials and fails to address many of the existing problems. Even if further reforms to tax legislation are enacted, they may not result in a reduction of the tax burden on Russian companies and the establishment of a more efficient tax system. Conversely, they may introduce additional tax collection measures.

Although the Company will undertake to minimise such exposures with effective tax planning, it cannot assure investors that additional tax exposure will not arise in the future. Additional tax exposure could cause the Company's financial results to suffer. In addition, financial statements of Russian companies are not consolidated for tax purposes under Russian law. As a result, each entity in the Company's group pays its own Russian taxes and may not offset its profit or loss against the loss or profit of another entity in the group. Accordingly, the Company may have to pay significantly higher taxes, which could have a material adverse effect on its business, results of operations and prospects of the Company, and the value of its shares.

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant (more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts and their use in politically motivated investigations and prosecutions. The Company believes and has been advised that the prices it uses are not in violation of these rules. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the prices used by the Company and propose adjustments. If such price adjustments are ultimately implemented, the Company's future financial results and the value of its shares could be adversely affected. In addition, the Company could face losses associated with any additional taxes claimed and related interest and possible penalties, which would have an adverse impact on the Company's financial condition and results of operations and the value of its shares.

Restrictive currency regulations may interfere with the Company's ability to conduct routine business transactions.

The Company sells crude oil and refined products on both the export market and the domestic Russian market. The Company's crude oil export revenues are denominated in foreign currencies, while domestic sales revenues are denominated in rubles. The Company's Russian subsidiaries are currently required to repatriate their proceeds from export sales and convert into rubles 10% of the same. The percentage of proceeds required to be converted into rubles may be increased or decreased from time to time by the Russian authorities. Restrictions on the Company's ability to convert its ruble revenues into foreign currencies, or to reconvert the rubles it obtains pursuant to the mandatory repatriation and conversion requirements, may adversely affect the business, results of operations and prospects of the Company, and the value of its shares. The ruble is not convertible outside Russia, so the Company's ability to hedge against fluctuations by converting to other currencies is significantly limited. Within Russia, the Company's ability to convert rubles into other currencies is subject to rules and procedures that increasingly restrict the purposes for which conversion and payment in foreign currencies are allowed.

Some transactions between the Company's subsidiaries and interested parties or affiliated companies require the approval of disinterested directors or shareholders and its failure to obtain approvals could cause its business to suffer.

The Company's subsidiaries are required under Russian law to obtain the approval of disinterested directors or shareholders for transactions with "interested parties". In general terms, interested parties include shareholders, the board of directors, members of any management body of a company, the chief executive of the company, and any person that owns, together with that person's relatives and affiliates, at least 20% of the company's voting shares, or a person who otherwise has the right to give mandatory instructions to the company, if any entities in which these entities or individuals own the above specified interest or occupy the above specified positions and/or a close relative and/or affiliate of such person, is:

- a party to a transaction with the company, whether directly or as a representative or intermediary;
- a beneficiary of the transaction;
- the owner of at least 20% of the shares in the company that is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary to the transaction; or
- a member of the board or any management body of the company that is a party which is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary to the transaction.

Due to the technical requirements of Russian law, such parties within the Company's consolidated group may be deemed to be "interested parties" also with respect to certain transactions between entities within the Company's group and themselves. It is possible one or more of that the Company's subsidiaries might not be able to obtain the necessary approval, which is a majority vote of the "disinterested directors" or "disinterested shareholders," for a transaction it deems to be very important or advantageous. The failure to obtain necessary approvals for transactions within the Company's consolidated group could adversely affect the Company's business, results of operations and prospects, and the value of its shares.

In addition, the concept of "interested parties" is defined with reference to the concepts of "affiliated persons" and "group of persons" which are subject to many different interpretations under Russian law. Moreover, the provisions of Russian law defining which transactions must be approved as "interested party" transactions are subject to different interpretations. The Company's subsidiaries cannot be certain that their application of and compliance with these concepts will not be subject to challenge. Any such challenge could result in the invalidation of transactions that are important to the Company's business.

Under Cyprus law, being the law of the Company's place of incorporation, directors are not allowed to vote in respect of any contract or arrangement in which they are interested except in certain specified circumstances benefiting the company or if such restriction is relaxed or suspended by the company.

For further details on this restriction, see paragraph 4.2 of Part VII of this document.

Russian law may expose the Company to liability for actions taken by its subsidiaries, equity affiliates or joint venture entities.

Under Russian law, the Company may be jointly and severally liable for any obligations of a subsidiary, equity affiliate or joint venture entity under a transaction if:

- the Company has the ability to issue mandatory instructions to the subsidiary, equity affiliate or joint venture entity and that ability is provided for by the charter of the subsidiary, equity affiliate or joint venture entity or in a contract between the Company and them; and
- the subsidiary, equity affiliate or joint venture entity concluded the transaction pursuant to the Company's mandatory instructions.

In addition, the Company may have secondary liability for any obligations of a subsidiary, equity affiliate or joint venture entity if:

- the subsidiary, equity affiliate or joint venture entity becomes insolvent or bankrupt due to the Company's actions or its failure to act; and
- the Company has the ability to make decisions for the subsidiary, equity affiliate or joint venture entity as a result of the Company's ownership interest, the terms of a contract between the Company and them, or in any other way.

In either of these circumstances, the shareholders of the subsidiary, equity affiliate or joint venture entity may seek compensation from the Company for the losses sustained by the subsidiary, equity affiliate or a joint venture entity if the Company knew that the action taken pursuant to its instructions or the failure to act would result in loss. This type of liability could result in significant obligations and adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company may be unable to recover funds from the Company's Russian subsidiaries or equity affiliates.

From time to time, the Company transfers funds to its Russian subsidiaries and equity affiliates in the form of loans, advances or equity contributions. The Company cannot assure investors that its subsidiaries will be able to pay principal or interest on loans or advances or distribute dividends without incurring significant costs, expenses, fees or charges.

If the Russian Federal Antimonopoly Service were to conclude that the Company acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the divestiture of the Company or other assets, adversely affecting its acquisition strategy and results of operations.

The Company's business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the Russian Federal Antimonopoly Service or its predecessor agencies. In part, relevant legislation restricts the acquisition or founding of companies by groups of companies or individuals acting in concert without this approval or notification. While the Company believes that it has complied in all material respects with the applicable legislation for its acquisitions or founding of new companies, this legislation is sometimes vague and subject to varying interpretations. If the Russian Federal Antimonopoly Service were to conclude that an acquisition or creation of a new company was carried out in contravention of applicable legislation, it could impose administrative sanctions and require the divestiture by the Company of members of its group or other assets. Any such actions or requirements could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

The Company may incur material costs to comply with health, safety and environmental laws and regulations.

The Company's operations are subject to the health, safety and environmental risks inherent in the oil and industry. The Company believes that its health, safety and environmental concerns are substantially similar to those faced by other major Russian oil companies. The Company incurs, and expects to continue to incur, substantial capital and operating costs to comply with increasingly complex laws and regulations covering the protection of the environment and health and safety. Although the measures taken by the Company in relation to health, safety and environmental regulations have not had an adverse effect on its business, results of operations or prospects to date, the Company cannot assure investors that the future cost of such measures and liabilities attributable to environmental damage will not have an adverse effect on such matters or on the value of its shares. To date, the Company's financial statements do not contain any provision or reserve for any potential health, safety or environmental liabilities.

New laws and regulations, the imposition of tougher requirements in licenses, increasingly strict enforcement of, or new interpretations of, existing environmental laws, regulations and licenses, or the discovery of previously unknown contamination may require further expenditures to:

- modify operations;
- install pollution control equipment;
- perform site clean-ups;
- curtail or cease certain operations; or
- pay fees, fines, or make other payments for discharges or other breaches of environmental standards.

Activities of the Company's subsidiaries may be suspended if the subsidiary has not complied with all environmental laws and regulations

The Company has not been able to confirm that all of its subsidiaries have the necessary state ecological expert assessment of their projects. Under Russian laws and regulations, a positive state ecological expert assessment is required before the placement, design, construction, reconstruction and commissioning of buildings, installations and other facilities. Financing of, and operations within, all projects and programmes are also subject to the positive opinion of the state ecological expert commission. Implementation of projects, including construction of any field facilities, without such positive opinion is prohibited. The state authorities may suspend the relevant activity if the party conducting the activity does not have such positive opinion. Further, a court may impose on the Company's subsidiaries an obligation to compensate damaged persons for any losses incurred as a result of the applicable party's failure to obtain a positive opinion of the state ecological expert commission. In addition, fines payable to the state budget, or criminal liability, depending on the actual circumstances, may be imposed on the relevant party and its key managers. If it is ultimately determined that the Company's subsidiaries do not have all of the relevant ecological assessments, their activities could be suspended and they could be held liable for damages or fines. If such were to occur, the relevant subsidiary may not be able to continue to operate or produce oil which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Unlawful, selective or arbitrary government action may have an adverse effect on the Company's business and the value of an investment in shares.

Government authorities have a high degree of discretion in Russia and at times some subordinate officials exercise their discretion arbitrarily without being duly controlled by other authorities, without hearing or prior notice, and sometimes in a manner that may not be in full accordance with the law. Moreover, the Russian government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Other government actions negatively affecting the commercial sector include withdrawal of licenses, unexpected tax audits, criminal prosecutions, civil actions and interference in affairs of private persons and organisations. According to Russian and international press reports, federal and local government entities have in some cases used legal loopholes and procedural ambiguities to invalidate share issuances and registrations or to void transactions, merely for political purposes. Government action, if directed at the Company, could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

For example, the Russian Federal Service for Financial Markets ("FSFM") has publicly expressed its disapproval of foreign exchange listings of securities of foreign issuers the main assets of which are shares or participation interests in Russian companies. Although the current Russian legislation does not prevent the admission of the Company to AIM because the Company is not a Russian issuer there is no assurance that FSFM's possible unfavourable opinion of the Placing will not result in arbitrary governmental action against the Company or its Russian subsidiaries.

If any of the Company's subsidiaries is forced into liquidation due to negative net assets, its results of operations could suffer.

Under Russian legislation, if a stock company's net assets fall below certain minimum legal requirements, it is required to decrease its charter capital and in certain circumstances governmental authorities may seek involuntary liquidation of such company. The net assets of some subsidiaries of the Company are below the legal minimum, but as a practical matter, the Directors believe that the Company and its subsidiaries are solvent and continue to meet all of their obligations to creditors. The Company and its subsidiaries are nonetheless taking action to rectify the situation. Recent court decisions in Russia suggest that the aforementioned ground alone is usually not deemed adequate to result in the involuntary liquidation of a company, as courts will examine the overall financial situation of such company, including its ability to meet its obligations to creditors in a timely fashion. However, if involuntary liquidation were to occur, or if the entities in question were in fact unable to meet their obligations to creditors, the Company may need to restructure its operations, which could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Russian courts may force a Russian legal entity into liquidation on the basis of formal non-compliance with certain requirements of Russian law.

Russian law provides for certain requirements which should be complied with in the course of establishing and reorganising a Russian company. Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation of such entity or during its operation. Some Russian courts in deciding whether or not to order the liquidation of a company have looked beyond the fact that the company failed to fully comply with all applicable legal requirements and have taken into account other factors, such as the financial standing of the company and its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation. This judicial approach is supported by a recent decision of the Constitutional Court of the Russian Federation that held that even repeated violations of law may not serve as a basis for an involuntary liquidation of a company, and instead consideration should be given to whether the liquidation would be a disproportionate sanction for such violations. Some of the Company's subsidiaries may have failed from time to time to fully comply with all the applicable legal requirements (e.g. untimely capital contributions in the course of foundation, etc); however, the Company believes that none of its subsidiaries should be subject to liquidation on such grounds because none of the possible violations was significant, has caused any damage to anyone or has had any other negative consequences; in addition, the Company's subsidiaries' financial condition has been satisfactory at all times, and it and its subsidiaries have always been capable of meeting all of their respective tax and other third party obligations in a timely fashion. However, weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions of a Russian court or a governmental authority difficult, if not impossible, to predict. Therefore, you should not rely on the Company's interpretations of Russian law. If a Russian court or a governmental authority takes a position unfavourable to the Company, it could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Russian legislation may not adequately protect against expropriation and nationalisation.

The Russian government has enacted legislation to protect foreign investment and other property against expropriation and nationalisation. In the event that such property is expropriated or nationalised, legislation provides for fair compensation. However, there is no assurance that such protections would be enforced. This uncertainty is due to several factors, including:

- the apparent lack of political will to enforce legislation to protect property against expropriation and nationalisation;
- the lack of independent judiciary and sufficient mechanisms to enforce judgments; and
- reported corruption among government officials.

Expropriation or nationalisation of the Group's business would be detrimental to its operations and have an adverse effect upon its subsidiaries' and the Company's business, results of operations and prospects, and the value of the Company's shares.

Risks Related to the Social Environment in Russia

Crime and corruption could disrupt the Company's ability to conduct its business and could adversely affect its financial condition and results of operations.

The political and economic changes in Russia since the early 1990s have resulted in reduced policing of society and increased lawlessness. Organised criminal activity has reportedly increased significantly, particularly in large metropolitan centres. In addition, the Russian and international press have reported high levels of official corruption in Russia and other countries of the former Soviet Union, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials have engaged in selective investigations and prosecutions to further commercial interests of the government and individual officials. Additionally, published reports indicate that a significant number of Russian media regularly publish slanted articles in return for payment. The Company's business, results of operations and prospects and the value of its shares could be adversely affected by illegal activities, corruption or by claims implicating it in illegal activities or corruption.

Social instability in Russia could lead to increased support for renewed centralised authority and a rise in nationalism or violence, which could restrict the Company's ability to conduct its business effectively.

Social instability in Russia, coupled with difficult economic conditions in certain regions, has led to increased support for centralised authority and a rise in nationalism. The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labour and social unrest and increased support for a renewal of centralised authority, increased nationalism, with restrictions on foreign involvement in the economy of Russia, and increased violence. These sentiments could lead to restrictions on foreign ownership of Russian companies in the oil and gas industry or large-scale nationalisation or expropriation of foreign-owned assets or businesses. Any such development could adversely affect the business, results of operations and prospects of the Company, and the value of its shares.

Risk Factors Associated with the shares

Share price volatility and limited liquidity.

The share price of publicly traded emerging companies can be highly volatile. The price at which the shares will be quoted and the price which investors may realise for their shares will be influenced by a large number of factors, some specific to the Company and its operations and some which may affect the Company's quoted sector, or quoted companies generally. These factors could include the performance of the Company's development and production programmes, large purchases or sales of the shares, currency fluctuations, oil prices and general economic conditions.

There is no trading history regarding the shares and Admission should not be taken as implying that there will be a liquid market for the shares. Moreover, shares of the Company have never been freely traded and there can be no assurance that there will be a market for them. It is likely to be more difficult for an investor to realise its investment on AIM than to realise an investment in a company whose shares are quoted on the Official List of the United Kingdom Listing Authority.

The market price of the shares may not reflect the underlying value of the Company's net assets. The price at which investors may dispose of their shares in the Company may be influenced by a number of factors, some of which may pertain to the Company, and others of which may be extraneous. Investors may realise less than the original amount invested.

Following the listing and placement of shares, certain of the Company's original shareholders will continue to own a disproportionately large block of shares and voting rights attendant thereto. Although the Company has taken steps to include in the Company's Articles of Association appropriate rights to protect minority shareholders, the largest shareholders will continue to have significant influence on the activities of the group through their large holdings.

PART V

ACCOUNTANTS' REPORTS

The following reports have been prepared by the Company and audited by ZAO PricewaterhouseCoopers Audit

- Consolidated Financial Statements for Urals Energy Public Company Holdings Limited (formerly Urals Energy Holdings Limited) 2004 and 2003
- Financial Statements for Petrosakh 2004, 2003 and 2002
- Financial Statements for Arcticneft 2004
- Financial Statements for CNPSEI 2004, 2003 and 2002

The Company believes that the financial statements in this Part V of this document may not necessarily reflect what the actual results of operations, financial position and cash flows of the Company and its subsidiaries would have been had these been under the Company's control throughout the periods presented.

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

International Financial Reporting Standards
Consolidated Financial Statements

31 December 2004 and 2003

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4 August 2005

Dear Sirs

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 4 August 2005 ("Admission Document")

Basis of preparation

The financial information set out below is based on the audited consolidated financial statements of the Company for the years ended 31 December 2004 and 2003 prepared in accordance with International Financial Reporting Standards ("IFRS") on the basis described in Note 3, to which no adjustment was considered necessary.

Responsibility

Such financial statements are the responsibility of the directors of the Company, who approved their issue.

The directors of the Company are responsible for the contents of the Admission Document in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards 200 issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that previously obtained by us relating to the audits of the financial statements underlying the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting polices are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

Opinion

In our opinion, the financial information gives, for the purposes of the Admission Document dated 4 August 2005 a true and fair view of the state of affairs of the Company as at the dates stated and the results of its operations and its cash flows for periods then ended.

Declaration

For the purposes of paragraph 1.2 of Annex I of the AIM PD Rules we are responsible for this report as part of the Admission Document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Admission Document in compliance with Annex I of the AIM PD Rules.

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Consolidated Financial Statements 2004 and 2003

(expressed in US$ thousands)

CONSOLIDATED BALANCE SHEET

As at 31 December	Note	2004	2003
Assets			
Current assets			
Cash and cash equivalents		1,395	10
Restricted cash		26	—
Accounts receivable and prepayments	6	3,706	20
Inventories	7	2,247	—
Total current assets		7,374	30
Non-current assets			
Property, plant and equipment	8	100,622	—
Other non-current assets		292	—
Total assets		108,288	30
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and accrued expenses	10	3,019	669
Taxes payable	11	1,917	—
Short-term borrowings and current portion of finance lease obligations	9	38,815	—
Advances from customers		5,102	—
Amount due for acquisition of ZAO Petrosakh	5	9,899	—
Total current liabilities		58,752	669
Long-term liabilities			
Long-term finance lease obligations	12	1,556	—
Dismantlement provision	13	950	—
Deferred tax liability	18	17,751	—
Total long-term liabilities		20,257	—
Total liabilities		79,009	669
Minority interest		1,327	—
Shareholders' equity			
Share capital	14	209	20
Share premium	14	42,172	10
Unpaid capital	14	(11,324)	—
Translation difference		1,236	—
Retained earnings/(deficit)		(4,341)	(669)
Total shareholders' equity		27,952	(639)
Total liabilities and shareholders' equity		108,288	30

Approved by the Board of Directors, 18 July 2005.

W.R. Thomas
Chief Executive Officer

S. Buscher
Chief Financial Officer

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Consolidated Financial Statements 2004 and 2003

(expressed in US$ thousands)

Consolidated Statement of Operations

	Note	Year ended 31 December 2004	Period from inception 10 November through 31 December 2003
Revenues			
Gross revenues	15	8,184	—
Less: excise taxes and export duties		(783)	—
Net revenues		7,401	—
Operating costs			
Cost of production	16	(4,062)	—
Selling, general and administrative expenses	17	(7,115)	(669)
Total operating costs		(11,177)	(669)
Operating loss		(3,776)	(669)
Interest income		82	—
Interest expense	19	(574)	—
Foreign currency gains/(losses)		211	—
Other non-operating gains/(losses)		222	—
Loss before income tax		(3,835)	(669)
Income tax (charge)/benefit	18	177	—
Loss after income tax		(3,658)	(669)
Minority interest		(14)	—
Net loss		(3,672)	(669)
Earnings/(losses) per share adjusted for subsequent share split (expressed in US$ per share)—basic		(0.2125)	(0.1675)

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Consolidated Financial Statements 2004 and 2003

(expressed in US$ thousands)

CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	Year ended 31 December 2004	Period from inception 10 November through 31 December 2003
Cash flows from operating activities			
Profit/(loss) before income tax		(3,835)	(669)
Adjustments for:			
Depreciation and depletion		522	—
Non-cash expenses	14	1,928	—
Interest income		(82)	—
Interest expense		574	—
Effect of currency translation		(1,168)	—
Operating cash flows before changes in working capital		(2,061)	(669)
Increase in inventories		(331)	—
Increase in accounts receivables and prepayments		(869)	(20)
Increase in accounts payable and accrued expenses		3,260	669
Decrease in taxes payable		(140)	—
Increase in other liabilities and provisions		307	—
Cash generated from/(used in) operations		166	(20)
Interest paid		52	—
Net cash generated from/(used in) operating activities		218	(20)
Cash flows from investing activities			
Acquisitions of subsidiaries, net of cash acquired	5	(39,976)	—
Purchase of property, plant and equipment		(1,146)	—
Acquisition of associates		(264)	—
Net cash used in investing activities		(41,386)	—
Cash flows from financing activities			
Proceeds from borrowings		28,937	—
Contributions from shareholders		871	30
Cash proceeds from issuance of ordinary shares	14	12,797	—
Net cash generated from financing activities		42,605	30
Effect of exchange rate changes		(26)	—
Net increase in cash and cash equivalents		1,411	10
Cash and cash equivalents at the beginning of the period		10	—
Cash and cash equivalents at the end of the period		1,421	10

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Consolidated Financial Statements 2004 and 2003

(expressed in US$ thousands)

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Notes	Share capital	Share premium	Unpaid capital	Translation Difference	Retained earnings/ (accumulated deficit)	Total shareholders' equity
Balance at inception 10 November 2003		20	—	—		—	20
Contribution from shareholders		—	10	—	—		10
Effect of currency translation		—	—	—		—	—
Net (loss) for the period		—	—	—		(669)	(669)
Balance at 31 December 2003		20	10	—	—	(669)	(639)
Issuance of shares	14	189	41,291	(11,324)	—	—	30,156
Contribution from shareholders	14	—	871	—	—	—	871
Effect of currency translation		—	—	—	1,236	—	1,236
Net profit for 2004		—	—	—	—	(3,672)	(3,672)
Balance at 31 December 2004		209	42,172	(11,324)	1,236	(4,341)	27,952

(tabular amounts expressed in US$ thousands)

1. Activities

Urals Energy Holdings Limited ("Urals Energy", or the "Company") was incorporated as a limited liability company in Cyprus on 10 November 2003. The Company was formed to act as a holding company for the Shareholder's investments in the Russian oil and gas exploration and production sector. Pursuant to a Shareholder Agreement dated 28 July 2004, the Shareholders contributed certain assets including ZAO Chepetskoye NGDU to the Company, (see notes 5 and 14). On 26 October 2004, the Company acquired OOO CNPSEI and on 19 November 2004, acquired ZAO Petrosakh, (see notes 5). In April 2005, the Company acquired the remaining 50 percent of OOO Urals Nord. In July 2005, the Company completed the acquisition of ZAO Arcticneft.

The registered office of Urals Energy is at 31 Evagorou Avenue, Suite 34, CY-1066, Nicosia, Cyprus. In July 2005, the Company changed its name to Urals Energy Public Company Limited.

Urals Energy and its subsidiaries (the "Group") are primarily engaged in oil and gas exploration and production in the Russian Federation and processing of crude oil for distribution on both the Russian and international markets. At 31 December 2004, the Group employed approximately 620 people.

The Group comprise of the following subsidiaries:

Entity	Nature	Jurisdiction	Economic interest at 31 December 2004
ZAO Petrosakh	Exploration & production	Sakhalin	97.2%
OOO CNPSEI	Exploration & production	Komi	100.0%
ZAO Chepetskoye NGDU	Exploration & production	Udmurtia	100.0%
OOO Urals Energy	Management	Moscow	100.0%
OOO Urals-Nord(1)	Exploration	Nenetsky	50.0%
Urals Energy (UK) Limited(1)	Management	London	100.0%

(1) Pursuant to the Shareholder Agreement, these companies are held by certain shareholders for the beneficial ownership of Urals Energy. OOO Urals-Nord and Urals Energy (UK) Limited were transferred to Urals Energy in April and June 2005, respectively.

2. Liquidity

Since inception the Company has accumulated substantial borrowings to fund its acquisitions. These borrowings are primarily from related parties, are short-term in nature and are secured by the assets and shares of the subsidiaries. Management is currently reviewing alternative plans to fund its 2005 cash flow requirements. Such plans include, among others, the possibility of restructuring existing debt obligations, raising additional equity and/or debt financing. As discussed in Note 23, subsequent to 31 December 2004, the Company has raised US$ 25,000 thousand from a private placement of its shares, and has obtained US$ 42,000 thousand in long-term borrowings. Management believe they have sufficient financial resources to meet their current operating needs for 2005.

3. Basis of preparation of the financial statements and significant accounting policies

(a) Basis of preparation

These consolidated financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS"). The Company maintains its financial statements in accordance with IFRS in US dollars, the Group's operating subsidiaries maintain their accounting records in Russian Rouble ("RR") and prepare their statutory financial statements in accordance with the Federal Law on Accounting. The financial statements are based on the statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

The consolidated financial statements have been prepared under the historical cost convention. The preparation of consolidated financial statements in conformity with IFRS requires management to make prudent estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of revenues and expenses during the reporting period.

Estimates have principally been made in respect to fair value allocation of purchase consideration, abandonment provision, depletion methodology, deferred profits taxes, provision for impairment of receivables and inventory. Actual results could differ from these estimates.

(b) Measurement and presentation currency

The United States Dollar ("US dollar or US$") is the presentation currency for the Group's operations as the majority of the Company's operations is conducted in US dollars and management have used the US dollar accounts to manage the Group's financial risks and exposures, and to measure its performance. Financial statements of the Russian subsidiaries are measured in Russian Roubles and presented in US dollars in accordance with SIC 30 "Reporting currency—Translation of Measurement Currency to Presentation Currency". Balance sheet items denominated in foreign currencies have been remeasured using the exchange rate at the respective balance sheet date. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income or loss. The US dollar to Russian Rouble exchange rates were 27.75 and 29.45 as of 31 December 2004 and 2003, respectively.

(c) Group accounting

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over the operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the consideration provided or liabilities incurred or assumed at the date of acquisition plus costs directly attributable to the acquisition.

All intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interest at the balance sheet date represents the minority shareholders' portion of the fair values of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders' equity. Where the losses applicable to the minority in a consolidated subsidiary exceed the minority interest in the equity of the subsidiary, the excess and any further losses applicable to the minority are charged against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good for the losses. If the subsidiary subsequently reports profits, the majority interest is allocated all such profits until the minority's share of losses previously absorbed by the majority has been recovered.

(d) Property, plant and equipment

Oil and gas assets

Property, plant and equipment acquired as part of a business combination is recorded at fair value at the acquisition date. All subsequent additions are recorded at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion and impairment. Oil and gas exploration and production activities are accounted for in accordance with the successful efforts method. Under the successful efforts method, costs of successful development and exploratory wells are capitalised. Costs of unsuccessful exploratory wells are expensed upon determination that the well does not justify commercial development. Other exploration costs are expensed as incurred.

Depletion of capitalised costs of Proved oil and gas properties is calculated using the units-of-production method for each field based upon Proved reserves for property acquisitions and Proved developed reserves for exploration and development costs. Reserves are estimated though the shorter of useful life and license period. Oil and gas reserves for this purpose are determined in accordance with Society of Petroleum Engineers definitions and were estimated by DeGolyer and MacNaughton, the Company's independent reservoir engineers.

Gains or losses are not recognised for normal retirements of oil and gas properties subject to composite depreciation, depletion and amortisation. Gains or losses from other retirements or sales are included in the determination of net income.

Non oil and gas assets

Property, plant and equipment of subsidiaries are recorded at fair values at the acquisition date. All other property, plant and equipment at that date are stated at historical cost less depreciation.

Depreciation of property, plant and equipment is calculated using the straight-line method over their estimated remaining useful lives, as follows:

	Total useful life
Refinery and related equipment	19
Buildings	20
Other assets	6 to 20

(e) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events and when it is Probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions, including those related to dismantlement, abandonment and site restoration, are evaluated and re-estimated annually, and are included in the financial statements at each balance sheet date at their expected net present values using discount rates which reflect the economic environment in which the Company operates.

Changes in provisions resulting from the passage of time or changes in the discount rates applied are reflected in the statement of income each year under financial items. Other changes in provisions, relating to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change.

The provision for dismantlement liability is recorded on the balance sheet, with a corresponding amount being recorded as part of property, plant and equipment in accordance with IAS 16.

(f) Leases

Leases of property, plant and equipment where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term, with the comparison being made based on the current annual extraction level.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(g) Impairment of assets

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell or value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

(h) Inventories

Inventories of extracted crude oil, materials and supplies and construction equipment are valued at the lower of the weighted-average cost and net realisable value. General and administrative expenditure is excluded from inventory costs and expensed in the period incurred.

(i) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the statement of operations.

(j) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks.

(k) Value added tax

Value added taxes related to sales are payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where provision has been made against debtors deemed to be uncollectible, a bad debt expense is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for statutory accounting purposes when it becomes due.

(l) Borrowings

Borrowings are recognised initially at the fair value of the proceeds received/given, respectively (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense/income, respectively, over the period of the borrowings. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

The loans advanced by the Company to its shareholder is classified as a "loan originated by the enterprise" in accordance with IAS 39 and stated at amortised cost.

(m) Deferred income taxes

Deferred income tax is calculated at rates enacted at the balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from depreciation on property, plant and equipment, provisions, fair value adjustments to long-term items, and expenses which are charged to the statement of operations before they become deductible for tax purposes.

Deferred income tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is Probable that future taxable profit or temporary differences will be available against which they can be utilised.

Deferred income tax assets and liabilities are offset when the Company has a legally enforceable right to set off current tax assets against current liabilities, when deferred tax balances relate to the same regulatory body, and when they relate to the same taxable entity.

(n) Employee benefits

Social costs

The Group incurs employee costs related to the provision of benefits such as health insurance. These amounts principally represent an implicit cost of employing production workers and, accordingly, have been charged to statement of operations.

Pension costs

The Group makes required contributions to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

(o) Revenue recognition

Revenues are recognised when crude oil or refined products are dispatched to customers and title has transferred. Revenues from non-cash sales are recognised at the fair value of the goods or services sold, which approximates the fair value of the goods or services received in exchange. Net revenues are stated exclusive of export duties and excise taxes, and of value added taxes.

(p) New accounting developments

In December 2003, the IASB released 15 revised International Accounting Standards and withdrew one IAS standard. The revised standards are all mandatory for periods starting on or after 1 January 2005. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004.

The revised and amended standards are as follows: IAS 1, *Presentation of Financial Statements*; IAS 2, *Inventories*; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 10, *Events after the Balance Sheet Date*; IAS 16, *Property, Plant and Equipment*; IAS 17, *Leases*; IAS 19, *Employee Benefits*; IAS 21, *The Effects of Changes in Foreign Exchange Rates*; IAS 24, *Related Party Disclosures*; IAS 27, *Consolidated and Separate Financial Statements*; IAS 28, *Investments in Associates*; IAS 32, *Financial Instruments: Disclosure and Presentation*; IAS 33, *Earnings per Share*; IAS 39, *Financial Instruments: Recognition and Measurement*; IAS 36, *Impairment of Assets* and IAS 38, *Intangible Assets*.

The new standards and interpretations are as follows: IFRS 2, *Share-based Payment*; IFRS 3, *Business Combinations*; IFRS 4, *Insurance Contracts*; IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*; IFRS 6, *Exploration for and Evaluation of Mineral Resources*; IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*; IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments*; IFRIC 3, *Emission Rights*; IFRIC 4, *Determining whether an Arrangement contains a Lease*; IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12.

The Group expects to adopt all relevant new, revised and amended standards and the new IFRIC interpretations from their respective effective date, the majority of which are effective as of 1 January 2005.

Other than the effect of adoption of IFRS 3 discussed above, management does not believe the adoption of these standards will have a material impact on the Group's financial position, statements of income or of cash flows.

4. Segment information

The Group operates in one business segment which is crude oil exploration and production. The Group assesses its results of operations and makes its strategic and investment decisions based on the analysis of its profitability as a whole. The Group operates within one geographical segment, which is the Russian Federation.

5. Acquisitions

On 19 November 2004, Urals Energy entered into arrangements to acquire a 97.2 percent equity interest in ZAO Petrosakh ("Petrosakh") for US$ 44,899 thousand. Total consideration comprised US$ 35,000 thousand, payable on completion, US$ 6,000 thousand payable on 30 April 2005, US$ 3,899 thousand payable on 31 October 2005 and the assumption/repayment of debt recorded at Petrosakh of US$ 11,100 thousand. The deferred consideration bears interest at 9.5 percent. Petrosakh was acquired by several special purpose entities and was consolidated in accordance with IFRS 3 with effect from 1 December 2004. It was consolidated although the Company did not own a majority of the voting rights because the Company had the right to appoint the Board of Directors and through contractual arrangements was exposed to substantially all the residual risks and rewards of Petrosakh operations. The interests held by the special purpose entities were transferred to the Company at original cost on 28 March 2005. The acquisition of Petrosakh was accounted for using the purchase method of accounting from 1 December 2004. The shares in Petrosakh have been pledged to the previous shareholders until all payments under the sales and purchase agreement have been fulfilled. In June 2005, all outstanding payables for Petrosakh acquisition were settled using the Paribas loan facility (see Note 23 (b)). The pledge on Petrosakh shares has been transferred to secure the Paribas loan.

Petrosakh is an integrated oil and gas exploration and production company located on Sakhalin Island in the Russian Far East. Petrosakh operates the Okruzhnoye and Pogranichnoye onshore oil fields licenses and has an exploration license for the off-shore part of the Pogranichnoye field. During 2004, Petrosakh produced 128,486 tons of crude oil and refined 20,340 tons of crude oil.

On 26 October 2004, Urals Energy entered into arrangements to acquire a 100 percent equity interest in OOO CNPSEI ("CNPSEI") for US$ 6,800 thousand. Total consideration comprised US$ 4,000 thousand, payable on completion and US$ 2,800 thousand payable in instalments through June 2005. CNPSEI was acquired by several special purpose entities and was consolidated in accordance with IFRS 3 with effect from 1 December 2004. It was consolidated although the Company did not own a majority of the voting rights because the Company had the right to appoint the Board of Directors and through contractual arrangements was exposed to substantially all the residual risks and rewards of CNPSEI's operations. The interests held by the special purpose entities were transferred to the Company at original cost on 28 March 2005. The acquisition of CNPSEI was accounted for using the purchase method of accounting from 1 November 2004.

CNPSEI is an oil and gas exploration and production company located in the Komi region of northern Russia. CNPSEI operates the Sosnovskoye and Yuzhnotebukskoye onshore oil field licenses. During 2004, CNPSEI produced 52,743 tons of crude oil.

On 4 October 2004, Urals Energy acquired a 100 percent interest in ZAO Chepetskoye NGDU ("Chepetskoye"), from one of its principal shareholders for nominal consideration. This acquisition was contemplated as part of the Urals Energy Shareholder Agreement dated 28 July 2004, whereby shareholders would contribute cash or assets for their equity interests in Urals Energy (see Note 14). Chepetskoye was recognised initially at its fair value of US$ 5,902 thousand. This transaction was accounted for using the purchase method of accounting from 1 August 2004. Chepetskoye is an oil and gas exploration and production company located in the Udmurtia region of the Russian Federation. Chepetskoye operates the Zapadno-Krasnogorsky onshore oil field licenses. During 2004, it produced 36,806 tons of crude oil.

(tabular amounts expressed in US$ thousands)

At 31 December 2004, a 50 percent interest in OOO Urals-Nord (Urals-Nord), a newly created entity, which has licenses to Beluginisky, Zapadno-Sorokinskiy, Fakelniy, Nadezhdinskiy and Alfinskiy fields, was held for the beneficial ownership of Urals Energy by an affiliate of a shareholder. The transfer of Urals-Nord to the Company was contemplated as part of the Shareholder Agreement (see Note 1). At 31 December 2004, the total cost of this investment is US$ 204 thousand. This entity has no operations and has been accounted for as an associate and recorded in other non current assets at 31 December 2004.

The following table summarises the fair values of the net assets acquired at the date of acquisition of control. Fair values for non current assets were determined by management based on independent appraisal prepared by DeGolyer and MacNaughton and American Appraisal.

Entity acquired	Petrosakh	CNPSEI	Chepetskoye
Acquisition date for control	1 December 2004	1 November 2004	1 August 2004
Cash and cash equivalents	373	1	158
Other current assets	3,258	1,016	654
Oil and gas properties	58,595	7,886	15,768
Other property, plant and equipment	13,220	1,520	401
Other non current assets	59	—	—
Total Assets	75,505	10,423	16,981
Current liabilities	(12,805)	(2,101)	(8,916)
Long-term liabilities	(2,205)	(105)	(155)
Deferred income taxes	(14,284)	(1,417)	(2,008)
Total Liabilities	(29,294)	(3,623)	(11,079)
Fair value of net assets acquired	46,211	6,800	5,902
Minority's share in net assets	(1,312)	—	—
Total consideration	44,899	6,800	5,902
Income of subsidiary included in consolidated net profit	505	472	106

Had these acquisitions been completed on 1 January 2004, consolidated net revenues and net loss would have been US$ 33,708 thousand and US$ 3,018 thousand respectively.

6. Accounts receivable and prepayments

	2004	2003
Accounts and notes receivable—trade (zero provision for impairment at 31 December 2004 and 2003, respectively)	70	—
Advances to suppliers	453	—
Recoverable taxes including VAT	1,720	—
Prepaid taxes, other than value added tax	410	—
Receivables from related parties (see Note 22 (c))	723	20
Other	330	—
Total accounts receivable and prepayments	3,706	20

(tabular amounts expressed in US$ thousands)

7. Inventories

	2004	2003
Crude oil	1,184	—
Petroleum products	592	—
Materials and supplies	471	—
Total inventories	2,247	—

8. Property, plant and equipment

	Oil and gas properties	Refinery and related equipment	Buildings	Other Assets	Assets under construction	Total
Cost						
Balance at 1 January 2004	—	—	—	—	—	—
Translation difference	1,933	124	14	57	50	2,178
Acquisitions of subsidiaries	82,490	8,560	975	3,582	2,024	97,631
Additions	—	—	—	133	1,217	1,350
Transfers	579	—	—	—	(579)	—
Balance at 31 December 2004	85,002	8,684	989	3,772	2,712	101,159
Accumulated depreciation						—
Balance at 1 January 2004	—	—	—	—	—	—
Translation difference	(14)	—	—	(1)	—	(15)
Acquisitions of subsidiaries	—	—	—	—	—	—
Depreciation charge	(505)	—	—	(17)	—	(522)
Balance at 31 December 2004	(519)	—	—	(18)	—	(537)
Net Book Value						
Balance at 1 January 2004	—	—	—	—	—	—
Balance at 31 December 2004	84,483	8,684	989	3,754	2,712	100,622

The Group's oil fields are situated in the Russian Federation on land owned by the Russian government. The Company holds licenses and pays production taxes to extract oil and gas from the fields. The licenses expire between 2012 and 2024, but may be extended. Management intends to renew the licenses as the properties are expected to remain productive subsequent to the license expiration date.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, amounting to US$ 935 thousand at 31 December 2004, are included in the cost of oil and gas properties. The Group has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred.

Leased assets

In 1998, ZAO Petrosakh entered into a finance lease agreement with Sakhalin Oil Company, a shareholder of Petrosakh. This agreement has a term of 14 years and provides Petrosakh with the right to use oil and gas wells located on its oil field.

(tabular amounts expressed in US$ thousands)

Assets subject to the lease agreement comprise oil and gas properties:

	2004	2003
Cost—capitalised finance leases	740	—
Accumulated depletion	(2)	—
	738	—

OOO CNPSEI leases several wells from OAO Tebukneft under short-term operating lease arrangements. This company may experience difficulties in maintaining production volumes if such lease arrangements are not renewed as they expire.

Pledged assets

At 31 December 2004, property, plant and equipment with carrying net book value of US$ 1,610 thousand was pledged to secure the Group's borrowing.

9. Short-term borrowings and current portion of finance lease obligations

	2004	2003
Alfa Eco M	10,993	—
Related party borrowings (see Note 22 (b))	27,493	—
Interest payable	224	—
Current portion of finance lease obligations (see Note 12)	105	—
Total short-term borrowings and current portion of finance lease obligations	38,815	—

Alfa Eco M is related to the previous shareholders of Petrosakh (see Note 5). The loan is rouble denominated, bears interest at 9.5 percent per annum and is repayable in October 2005.

10. Accounts payable and accrued expenses

	2004	2003
Trade payables	236	—
Advances from and payables to related parties (see Note 22 (a), (c))	861	544
Wages and salaries	278	—
Payable under guarantee arrangements (see Note 22 (d))	1,073	—
Other payable and accrued expenses	571	125
Total accounts payable and accrued expenses	3,019	669

11. Taxes payable

	2004	2003
Value added tax	577	—
Unified production tax	654	—
Other taxes payable	686	—
Total taxes payable	1,917	—

(tabular amounts expressed in US$ thousands)

12. Finance lease obligations

	2004	2003
Finance lease obligations	1,661	—
Less: current portion of finance lease obligations	(105)	—
Total long-term finance lease obligations	1,556	—

The finance lease obligations have an effective interest rate of 13.0 percent and are secured by the leased assets as the assets revert to the lessor in the event of default.

Finance lease liability—minimum lease payments:	2004	2003
Not later than 1 year	419	—
Later than 1 year and not later than 5 years	1,677	—
Later than 5 years	1,677	—
	3,773	—
Future finance charges on finance leases	(2,112)	—
Present value of finance lease liability	1,661	—

The present value of finance lease liability matures as follows:	2004	2003
Not later than 1 year	105	—
Later than 1 year and not later than 5 years	908	—
Later than 5 years	648	—
Total finance lease obligations	1,661	—

13. Dismantlement provision

The dismantlement provision represents the net present value of the estimated future obligation for dismantlement, abandonment and site restoration costs which are expected to be incurred at the end of the production lives of the oil and gas fields. The discount rate used to calculate the net present value of the dismantling liability was 13.0 percent.

As further discussed in Note 20 (f), environmental regulations and their enforcement are under development by governmental authorities. Consequently, the ultimate dismantlement, abandonment and site restoration obligation may differ from the estimated amounts and this difference could be significant.

14. Shareholders' equity

Urals Energy was created on 10 November 2003. Share capital at incorporation comprised 10,000 authorised and issued ordinary shares with a nominal value of one Cyprus Pound (CYP). On 28 July 2004, the shareholders signed a Shareholder Agreement (the "Agreement") whereby, the Company issued an additional 90,000 ordinary shares for total consideration of US$ 41,500 thousand which represented a premium of CYP 218.6 per share. The share issuance was to be settled with asset contributions with a fair value of US$ 17,517 thousand (comprising a 100 percent interest in Chepetskoye valued at US$ 5,902 thousand, shareholder advances to group companies totalling US$ 9,687 thousand and expenses incurred on behalf of the Company totalling US$ 1,928 thousand) and cash of US$ 23,983 thousand. The contributions to capital have been recorded as share premium. At 31 December 2004, US$ 11,324 thousand of such share premium had not been received and has been recorded as unpaid capital. Subsequent to 31 December 2004, all unpaid capital has been paid.

(tabular amounts expressed in US$ thousands)

14. Shareholders' equity (Continued)

In addition to contributions in accordance with the Shareholder's Agreement, the shareholders also contributed their equity interest in OOO Urals Energy with a fair value of US$ 871 thousand. This contribution has been recorded as additional paid-in capital.

In June 2005, the Company issued 23,585 ordinary shares to Nafta (B) NV, a company owned by one of the shareholders for total consideration of US$ 25,000 thousand. The share issuance was settled with a cash contribution of US$ 18,380 thousand and conversion of US$ 6,620 thousand in existing debt of Nafta B.

15. Revenues

	2004	2003
Crude oil	—	
Export sales	2,546	—
Domestic sales (Russian Federation)	3,774	—
Petroleum (refined) products—domestic sales	1,643	—
Other sales	221	—
Total gross revenues	8,184	—

16. Cost of production

	2004	2003
Depreciation and depletion	522	—
Unified production tax	1,394	—
Cost of purchased products (see Note 22 (a))	1,178	—
Wages and salaries including payroll taxes	588	—
Materials	189	—
Other	191	—
Total cost of production	4,062	—

17. Selling, general and administrative expenses

	2004	2003
Selling and transportation expenses	434	—
General and administrative expense	3,062	280
Wages and salaries including payroll taxes	3,293	389
Other taxes	312	—
Loss on disposal of assets	14	—
Total selling, general and administrative expenses	7,115	669

18. Income tax

	2004	2003
Current tax expense	103	—
Deferred tax charge/(benefit)—movement in temporary differences	(280)	—
Income tax charge/(benefit)	(177)	—

(tabular amounts expressed in US$ thousands)

18. Income tax (Continued)

Profit/(loss) before taxation for financial reporting purposes is reconciled to tax expense as follows:

	2004	2003
Loss before income tax	(3,835)	(669)
Theoretical tax charge at statutory rate of 24 percent (2003: 24 percent) thereon	(920)	(161)
Income not assessable for income tax purposes	(10)	—
Expenses and losses not deductible for income tax purposes	748	161
Effect of currency translation, tax penalties and interest	5	—
Income tax charge/(benefit)	(177)	—

Urals Energy is subject to profits tax rate of 10 percent, however since the Group's operating subsidiaries are subject to tax rates of 24 percent, the above reconciliation has been performed using 24 percent. Deferred tax asset and liabilities are measured at the tax rate applicable in the jurisdiction where the Company or its subsidiaries operate. The net effect of the change on deferred tax balances recognised as at 31 December 2004 is reflected in the statement of income for the year ended 31 December 2004.

The movement in deferred tax assets and liabilities during the year is as follows:

	2004	Translation difference	Charged/ (credited) to the statement of operations	Effect of acquisitions	2003
Deferred tax liabilities					
Property, plant and equipment	18,765	372	(40)	18,433	—
Receivables	—	—	—	—	—
Inventories	127	2	—	125	—
Payables	—	—	—	—	—
Borrowings received	145	2	—	143	—
Other deductible temporary differences	—	—	—	—	—
Deferred tax assets					
Receivables	(167)	(56)	21	(132)	—
Dismantlement provision	(228)	(5)	—	(223)	—
Payables	(342)	(5)	—	(337)	—
Inventories	(205)	(3)	—	(202)	—
Other deductible temporary differences	(344)	(32)	(261)	(51)	—
Net deferred tax liability	17,751	275	(280)	17,756	—

There is no concept of consolidated tax returns in the Russian Federation, and consequently, tax losses and current tax assets of different subsidiaries can not be set off against current tax liabilities and taxable profits of other subsidiaries, accordingly, taxes may accrue even where there is a net consolidated tax loss. Similarly deferred tax asset of one subsidiary can not be offset against deferred tax liability of another subsidiary. As at 31 December 2004, deferred tax asset in the amount of US$ 434 thousand (2003: US$ 67 thousand) has not been recorded for the deductible temporary differences for which it is not Probable that sufficient taxable profit will be available to allow the benefit of that deferred tax asset to be utilised.

(tabular amounts expressed in US$ thousands)

18. Income tax (Continued)

The Group has not recognised deferred tax liability in respect of temporary differences associated with investments in subsidiaries as the Group is able to control the timing of the reversal of those temporary differences and does not intend to reverse them in the foreseeable future.

19. Interest expense

	2004	2003
Interest expense on Alfa Eco M loan	115	—
Interest expenses on finance lease	34	—
Accretion of discount on dismantlement provision	22	—
Interest on other loans (see Note 9)	403	—
Total interest expense	574	—

20. Contingencies, commitments and operating risks

(a) Operating environment of the Company

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

(b) Sales and royalty commitments

In accordance with Petrosakh's license terms, Petrosakh is required to sell 20.0 percent of annual oil production in the form of petroleum products to the Sakhalin Island region.

In accordance with the sale purchase agreement to acquire Petrosakh, the Company agreed to pay a perpetual royalty to the previous shareholders of US$ 0.25 per ton of crude oil produced from the currently unproved off-shore licensed area. Management's estimate of the fair value of this obligation is not material.

(c) Capital commitments

Exploration licenses—investment commitments

In accordance with the Pogranichnoye off-shore license agreement, Petrosakh must conduct certain exploratory work, which includes, but is not limited to, performing seismic prospecting and drilling two exploratory wells by 2006. Management currently estimate such expenditure to approximate US$ 19,000 thousand.

In accordance with the Pogranichnoye on-shore license agreement, Petrosakh must conduct exploratory works including drilling two exploration wells in 2007 and 2008.

Other capital commitments

At 31 December 2004, the Company had no other significant contractual commitments for capital expenditures.

20. Contingencies, commitments and operating risks (Continued)

(d) 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 may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. 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.

As at 31 December 2004 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is Probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

(e) Insurance policies

At 31 December 2004, the Company held limited insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks. Since the absence of insurance alone does not indicate an asset has been impaired or a liability incurred, no provision has been made in these financial statements.

(f) Restoration, rehabilitation and environmental costs

The Group has operated in the upstream and refining oil industry in the Russian Federation for many years and its activities have had 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 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.

(g) Legal proceedings

During the year, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

(h) Oilfield licenses

The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licenses. Management of the Group correspond 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 license could result in fines, penalties or license 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.

21. Financial risks

(a) Foreign exchange risk

The Company has substantial amounts of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure.

The Company does not have formal arrangements to mitigate foreign exchange risks.

(b) Interest rate risk

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The primary sources of the Company's funds are low interest loans received from its shareholder and companies affiliated with shareholder. The Company obtains funds from, and deposits its cash surpluses with, banks at current market interest rates, and does not utilise hedging instruments to manage its exposure to changes in interest rates. The details of interest rates associated with the Company's borrowings are discussed in Notes 9 and 22 (b). The carrying value of the Company's receivables, payables and borrowings approximate their fair values.

(c) Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Group has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

(d) Commodity and pricing risk

The Group's operations are significantly affected by the prevailing price of crude oil both in the international oil market and in the Russian Federation. Crude oil prices have historically been highly volatile, dependent upon the balance between supply and demand and particularly sensitive to OPEC production levels. Crude oil prices in the Russian Federation are significantly below international levels primarily due to constraints on the export of crude oil. Also, domestic crude oil prices are contract specific as there is no active market for domestic crude oil and marker prices are not available. There is typically no straight correlation between domestic and international oil prices. The Group's subsidiary—Petrosakh, operates on Sakhalin Island where the surrounding ocean is not navigateable for several months of the year, this further increases the expose to commodity price risk.

22. Related-party transactions

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 Related Party Disclosures. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding at 31 December 2004 and 2003 are detailed below. Transactions were entered into with related parties during the ordinary course of business.

(tabular amounts expressed in US$ thousands)

22. Related-party transactions (Continued)

(a) Trading relationships with related parties

The Group has transactions in the ordinary course of business with ZAO NC Urals, Chepetskoye (through July 2004, when contributed by the Group shareholder to Urals Energy), Urals ARA NV and Nafta (B) NV which all are controlled by major shareholders. These transactions include sales and purchases of crude oil and petroleum products. Below are the annual sales, purchases and receivable balances for each year presented:

	2004	2003
Sales of crude oil on export markets	2,212	—
Associated volumes, tons	9,000	—
Sales of petroleum products on domestic markets	212	—
Associated volumes, tons	2,000	—
Purchases of crude oil	1,178	—
Associated volumes, tons	10,950	—
Accounts and notes receivable	1,412	—
Commission revenue	24	—
Trade advances received	800	—

(tabular amounts expressed in US$ thousands)

22. Related-party transactions (Continued)

(b) Lending relationships with related parties

At 31 December 2004 the Group has received unsecured borrowings from shareholders and companies controlled by shareholders at market rates. The loans from UEN Trading are for general purposes to fund working capital needs. The loan form Nafta B and the shareholders were to purchase Petrosakh.

Name of party	Relationship	2004	Currency	Interest rate	Date of repayment
Nafta B NV	Controlled by shareholder	6,822	Euro	10.0%	February 2005
Radwood Business Inc.	Shareholder	500	US$	LIBOR plus 2%	March 2005
Polaris Business Limited	Shareholder	300	US$	LIBOR plus 2%	March 2005
Citara International Limited	Shareholder	5,000	US$	LIBOR plus 2%	March 2005
Fantin Finance Limited	Shareholder	3,000	US$	LIBOR plus 2%	March 2005
Texas Oceanic Petroleum LLC	Shareholder	1,500	US$	LIBOR plus 2%	March 2005
Hillsilk Limited	Shareholder	330	US$	LIBOR plus 2%	March 2005
UEN Trading Limited	Controlled by shareholder	8,660	US$	10-15%	March-December 2005
Other	Controlled by shareholder	1,381			
Loans payable		27,493			
Interest payable		117			
Total related party borrowings		27,610			

(c) Other transactions and balances with companies controlled by shareholders are as follows:

	2004	2003
Loans receivable	723	20
Other payable and accrued expenses	61	544
Interest expense—net	135	—
Management fees received	208	—
Rental fees paid included in selling, general and administrative expense	264	—
Other services income included in other non-operating income	232	—

22. Related-party transactions (Continued)

(d) Guarantees issued to parties related to previous shareholders of subsidiaries

In September 2004, CNPSEI issued a US$ 1,500 thousand guarantee to secure borrowings of OOO Neftegazrazvitiye, the former shareholder. The loan bearing 14.0 percent interest annual fixed rate. OOO Neftegazrazvitiye defaulted on its obligations and therefore failed to repay the loan. CNPSEI, as the guarantor, was obliged to repay the loan. As at 31 December 2004, CNPSEI repaid US$ 407 thousand of the loan including interest, by March 2005 the remaining US$ 1,073 thousand including interest was paid by CNPSEI. In March 2005, the guarantee was terminated. These guarantee obligations was recognised at fair value in the purchase price adjustment in the accompanying financial statements.

(e) Compensation to senior management

Compensation paid to senior management for their services in full time or part time executive management positions comprises a contractual salary. In 2004 compensation of US$ 1,917 thousand (2003: US$ 425 thousand) paid to senior management and is included in selling, general and administrative expenses.

23. Subsequent events

(a) Acquisitions

On 11 July 2005, the Company concluded the acquisition of a 100.0 percent equity interest in ZAO Arcticneft ("Arcticneft") from OAO LUKOil for approximately US$ 32.5 million. An advance of US$ 3.0 million was paid on 24 May 2005 (in accordance with the preliminary term sheet), US$16.5 was paid on completion and the remaining US$13.0 million is payable before September 2005. As part of this acquisition, approximately US$7.6 million in payables of Arcticneft to Lukoil must be repaid by October 2005. In addition, the Company reached an agreement to settle a dispute between ZAO Arcticneft and OOO Start ("Start"), whereby the Company will acquire certain operating assets from Start for US$3.0 million, and Start will cease any litigation against Arcticneft. Arcticneft is an oil and gas exploration and production company located on the Kolguev Island in the Nenetsky autonomous region of northern Russia. Arcticneft operates the Peschanoozerskoye onshore oil field. During 2004, it produced 73,136 tons of crude oil. Management are currently reviewing their fair value allocations for this transaction, consequently believe it is not practicable to disclose such balances at this time.

On 25 April 2005, Urals Energy acquired the remaining 50.0 percent interest in OOO Urals-Nord from the minority shareholders for US$ 14.0 million payable in cash by July 2005.

(b) Borrowings

In March 2005, Chepetskoye obtained a US$ 10,000 thousand, 5-year US dollar, denominated, 11.0 percent fixed interest loans from OAO Bank Zenit and CNPSEI obtained a US$ 2,000 thousand, 5-year US dollar denominated 11.0 percent fixed loan from OAO Bank Zenit. The bank loans are for funding working capital and certain capital projects. The loans are secured by liens on various assets of these subsidiaries and the facilities contain cross default provisions.

In June 2005, Petrosakh entered into a 2-year US$ denominated credit facility for US$ 20,000 thousand with ZAO BNP Paribas Bank to finance Urals Energy for US$ 4,500 thousand, repay loan from Alfa-Eco M in the amount US$ 11,100 thousand (see Note 5) and fund working capital and various capital projects of Petrosakh. This variable interest debt facility bears interest at LIBOR plus 5.0 percent and is repayable through December 2006. The loan is collateralised by pledge of Petrosakh shares to ZAO BNP Paribas Bank, assignment of crude oil export contract and a floating pledge over Petrosakh's crude oil inventories. Further, the facilities contain cross default provisions. This facility is repayable with the proceeds of the committed export contracts.

23. Subsequent events (Continued)

In May 2005, Urals Energy obtained US$ 4,500 thousand US dollar denominated loan from Nafta (B) to fund working capital. The loan bears interest at 10.0 percent and is repayable in June 2005.

In July 2005, the Company entered a convertible preferred note agreement with RP Capital Group for up to US$ 15.0 million. The Company has issued US$ 10.0 million, 10.0 percent subordinated, unsecured "A" notes due December 2006, and can issue a further US$5.0 million "B" note. The notes are issued at 100.0 percent and accrete daily up to 117.0 percent on maturity. The Company may redeem the notes before maturity upon 30 day notice and payment of a 10.0 percent redemption fee. RP Capital has the option to extend maturity of the notes for a further 12 months. If, before maturity, the Company issues shares in an initial public offering ("IPO"), provided such offering is at least US$ 60.0 million, the notes must be converted to ordinary shares at a conversion discount from the IPO price of 20.0 percent. The conversion discount is further increased by 1.5 percent per month after 15 August 2005 until an IPO occurs.

In July 2005, the Company amended its loan agreements with Radwood Business Inc., Polaris Business Limited, Citara International Limited, Fantin Finance Limited and Texas Oceanic Petroleum LLC (who collectively at 31 December 2004, provided US$ 9.3 million, Libor plus 2.0 percent unsecured notes to the Company,) whereby, the loan interest is restated to 15.0 percent per annum, effective from the origination of the loan. The loans are repayable on 31 December 2005, however may be redeemed early at the Company's option.

(c) Shareholder capital transactions

On 16 May 2005, US$ 1,000 thousand of the shareholder loan due to Texas Oceanic Petroleum LLC totalling US$ 1,500 thousand at 31 December 2004 was converted to equity as settlement of Texas Oceanic Petroleum's unpaid share capital.

As discussed in note 14, on 20 May 2005, Urals Energy issued 23,585 additional ordinary shares to Nafta B for US$ 25,000 thousand.

PricewaterhouseCoopers

ZAO PETROSAKH

International Financial Reporting Standards
Financial Statements

31 December 2004, 2003 and 2002

PRICEWATERHOUSECOOPERS

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4 August 2005

Dear Sirs

ZAO Petrosakh (the "Company")

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 4 August 2005 ("Admission Document")

Basis of preparation

The financial information set out below is based on the audited financial statements of the Company for the years ended 31 December 2004, 2003 and 2002 prepared in accordance with International Financial Reporting Standards ("IFRS") on the basis described in Note 2, to which no adjustment was considered necessary.

Responsibility

Such financial statements are the responsibility of the directors of the Company, who approved their issue.

The directors of the Company are responsible for the contents of the Admission Document in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards 200 issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that previously obtained by us relating to the audits of the financial statements underlying the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting polices are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

Opinion

In our opinion, the financial information gives, for the purposes of the Admission Document dated 4 August 2005 a true and fair view of the state of affairs of the Company as at the dates stated and the results of its operations and its cash flows for each of years then ended.

Declaration

For the purposes of paragraph 1.2 of Annex I of the AIM PD Rules we are responsible for this report as part of the Admission Document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Admission Document in compliance with Annex I of the AIM PD Rules.

ZAO Petrosakh

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

BALANCE SHEETS

As at 31 December	Notes	2004	2003	2002
Assets				
Current assets				
Cash and cash equivalents		889	161	250
Trade and other receivables	4	1,745	1,476	5,927
Prepaid expenses and other current assets		93	18	19
Inventories	5	1,242	1,200	1,295
Loan provided	6	—	—	5,110
Total current assets		3,969	2,855	12,601
Non-current assets				
Property, plant and equipment	7	23,288	26,277	27,566
Total non-current assets		23,288	26,277	27,566
Total assets		27,257	29,132	40,167
Liabilities and shareholders' equity				
Current liabilities				
Short-term loans and current portion of finance lease obligations	8	11,206	9,047	12,991
Trade and other payables	9	886	1,383	8,308
Taxes payable	10	1,340	580	376
Other liabilities		—	149	124
Total current liabilities		13,432	11,159	21,799
Long-term liabilities				
Finance lease obligations	11	1,556	1,001	1,021
Dismantlement provision	12	681	519	517
Deferred tax liability	13	2,595	3,242	2,090
Total long-term liabilities		4,832	4,762	3,628
Total liabilities		18,264	15,921	25,427
Shareholders' equity				
Share capital	14	21,999	20,779	18,578
Share premium	14	164,515	154,987	—
Loan payable to shareholder	14	—	—	144,301
Additional contribution	14	28,160	26,063	24,003
Translation difference		(98)	230	—
Retained earnings / (deficit)		(205,583)	(188,848)	(172,142)
Total shareholders' equity		8,993	13,211	14,740
Total shareholders' equity and liabilities		27,257	29,132	40,167

Approved on behalf of the Board of Directors 14 July 2005.

Yuriy V. Motovilov
General Director

Galina N. Spiridonova
Chief Accountant

ZAO Petrosakh

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

STATEMENTS OF OPERATIONS

Year ended 31 December	Notes	2004	2003	2002
Revenues				
Gross revenues	15	28,576	23,534	26,983
Less: excise taxes and export duties		(5,366)	(3,512)	(3,254)
Net revenues		23,210	20,022	23,729
Operating costs				
Cost of production	16	(10,497)	(10,059)	(11,358)
Selling, general and administrative expenses	17	(3,805)	(3,788)	(5,713)
Exploration expenses	18	(5,347)	(653)	(5,603)
Other operating expenses		(312)	(178)	(107)
Total operating costs		(19,961)	(14,678)	(22,781)
Operating profit		3,249	5,344	948
Interest and other income		21	685	364
Interest expense	19	(2,495)	(3,353)	(3,105)
Monetary gain		—	—	9,628
Foreign currency gains/(losses)		(99)	1,306	(8,185)
Other non-operating gains/(losses)		26	271	363
Profit before income tax		702	4,253	13
Income tax (charge)/benefit	13	(712)	(2,277)	215
Net (loss)/profit		(10)	1,976	228

ZAO Petrosakh

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

STATEMENTS OF CASH FLOWS

Year ended 31 December	Notes	2004	2003	2002
Profit before income tax		702	4,253	13
Adjustments for:				
Interest income		—	(680)	(285)
Interest expense		2,495	3,353	3,105
Provision for (reversal of) bad debts		(13)	312	(48)
Provision for (reversal of) inventory		(137)	—	—
Provision for (reversal of) unused vacations		(158)	—	—
Depreciation and depletion		2,888	3,533	2,877
Write-off of unsuccessful exploratory well and other oil and gas property		1,633	—	—
(Gain)/loss on disposal of long-lived assets		330	55	(9)
Dismantlement provision		—	2	(460)
Non-cash transactions		(1,666)	(1,242)	(5,574)
Effect of currency translation		98	(1,231)	—
Monetary effect on non-operating balances		—	—	(496)
Net operating cash flow before changes in working capital		6,172	8,355	(877)
Decrease in inventories		168	96	2,519
Decrease/(increase) in trade and other receivables		(208)	4,139	(1,564)
Decrease/(increase) in prepaid expenses and other current assets		(73)	7	(9)
(Decrease)/increase in trade and other payables		(582)	(2,925)	5,192
Increase/(decrease) in taxes payable		724	205	(72)
Increase/(decrease) in other liabilities and provisions		(354)	25	(12)
Cash generated from operations		5,847	9,902	5,177
Interest paid		(2,398)	(2,376)	(522)
Income tax paid		—	(7)	—
Net cash inflow from operating activities		3,449	7,519	4,655
Cash flows from investing activities				
Purchase of property, plant and equipment		(424)	(266)	(523)
Proceeds from sale of assets		72	—	10
Proceeds from repayment of loans		—	11,680	—
Loan advanced		—	(10,973)	—
Net cash inflow/(outflow) from investing activities		(352)	441	(513)
Cash flows from financing activities				
Repayment of loans		(11,276)	(13,336)	—
Proceeds from loans		14,003	10,973	2,143
Proceeds from (repayment of) other loans		—	(764)	2,604
Finance lease principal payments		(365)	(20)	(117)
Contribution from shareholders		582	161	660
Distribution to majority shareholder	14	(6,941)	(6,305)	(11,350)
Tax effect on distribution to majority shareholder	14	1,666	1,242	2,013
Net cash outflow from financing activities		(2,331)	(8,049)	(4,047)
Effects of inflation on cash and cash equivalents		—	—	(23)
Effects of translation difference on cash and cash equivalents		(38)	—	—
Net (decrease)/ increase in cash and cash equivalents		728	(89)	72
Cash and cash equivalents at the beginning of the period		161	250	178
Cash and cash equivalents at the end of the period		889	161	250

Significant non-cash transactions are discussed in Note 23.

ZAO Petrosakh

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Notes	Share capital	Share premium	Translation reserve	Loan from shareholder	Additional contribution	Accumulated deficit	Total
Balance at 1 January 2002		18,578	—	—	—	18,031	(162,752)	(126,143)
Contribution from ultimate shareholder	14	—	—	—	144,301	—	—	144,301
Effect of deferred tax liability release		—	—	—	—	5,031	—	5,031
Contribution from companies affiliated with majority shareholder	14	—	—	—	—	941	—	941
Distribution to shareholder	6	—	—	—	—	—	(281)	(281)
Distribution to majority shareholder	14	—	—	—	—	—	(9,337)	(9,337)
Net profit for 2002		—	—	—	—	—	228	228
Balance at 31 December 2002		18,578	—	—	144,301	24,003	(172,142)	14,740
Issuance of additional shares	3,14	677	143,624	—	(144,301)	—	—	—
Contribution from companies affiliated with majority shareholder	14	—	—	—	—	161	—	161
Distribution to majority shareholder	14	—	—	—	—	—	(5,063)	(5,063)
Effect of currency translation		1,524	11,363	230	—	1,899	(13,619)	1,397
Net profit for 2003		—	—	—	—	—	1,976	1,976
Balance at 31 December 2003		20,779	154,987	230	—	26,063	(188,848)	13,211
Contribution from companies affiliated with majority shareholder	14	—	—	—	—	441	—	441
Distribution to majority shareholder	14	—	—	—	—	—	(5,275)	(5,275)
Effect of currency translation		1,220	9,528	(328)	—	1,656	(11,450)	626
Net profit / (loss) for 2004		—	—	—	—	—	(10)	(10)
Balance at 31 December 2004		21,999	164,515	(98)	—	28,160	(205,583)	8,993

1. Activities

(a) Organisation

ZAO Petrosakh ("Petrosakh", or the "Company") was incorporated on 15 July 1991. The core activities are exploration, production and sale of crude oil, processing, transportation and sale of petroleum products. The Company holds licenses for Okruzhnoe and Pogranichnoe fields which expire in 2012 and 2017, respectively. The Company operates oil-extraction and processing facilities in the Sakhalin region of the Russian Federation. Petrosakh produces crude oil all year round, however sales are restricted in the nine months when the seas are not navigateable due to ice formations. The Company employed an average of 327, 322 and 389 people during 2004, 2003 and 2002, respectively.

In November 2004, the Company was acquired by Urals Energy Holdings Limited ("Urals Energy") and affiliated entities. Previously the Company was controlled by Alfa Group, a Russian Financial Industrial Group.

The Company is registered in Russian Federation, 693009, Sakhalin region, Yuzhno-Sakhalinsk, Kommunisticheskiy str. 32.

(b) Liquidity

The Company has a working capital deficit at 31 December 2004 totalling US$ 9,463 thousand and as noted above has seasonal sales. Historically, Petrosakh has relied on its parent company to finance its current operations. The Company's ability to meet its obligations and maintain operations is dependent on continuing support from its parent.

2. Basis of preparation and summary of significant accounting policies

(a) Basis of preparation

These financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards, including International Accounting Standards and Interpretations issued by the IASB ("IFRS").

The Company maintains its statutory accounting records and prepares statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR") in Russian rouble ("RR"). The Company's financial statements are based on the statutory accounting records, which are maintained under the historical cost convention, with adjustments and reclassifications for the purpose of presentation in accordance with IFRS.

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the financial statements, and the reported amount of revenues and operating costs during the reporting period. The most significant estimates relate to realisation of inventories, allowance for doubtful accounts, deferred taxation, economic useful life of fixed assets, reserve estimates used to calculate depreciation, depletion and amortisation and the estimation of the dismantlement provision. Actual results could differ from these estimates.

(b) Measurement and presentation currency

The Russian Rouble is the measurement currency for the Company's operations as the majority of the Company's business is conducted in Russian Roubles and management have historically used the Russian Roubles accounts to manage the Company's financial risks and exposures, and to measure its performance. Balance sheet items denominated in foreign currencies have been remeasured using the exchange rate at the respective balance sheet date. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income or loss. The US dollar to RR exchange rates were 27.75, 29.45 and 31.78 as of 31 December 2004, 2003 and 2002, respectively.

(tabular amounts expressed in US$ thousands)

These financial statements have been presented in US dollars ("US$") in accordance with pronouncements of SIC 30 "Reporting Currency—Translation from Measurement Currency to Presentation Currency". Since the measurement currency (RR) is no longer the currency of hyperinflationary economy effective from 1 January 2003, the guidelines followed in translating RR amounts were:

- Assets and liabilities for the balance sheets presented are translated at the closing rate existing at the date of each balance sheet presented.
- Income and expense items for the period presented are translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates.
- Equity items other than the net profit (loss) for the period that is included in the balance of retained earnings are translated at the closing rate existing at the date of each balance sheet presented.
- All exchange differences resulting from translation are recognised directly in equity.
- Corresponding figures have been translated to US$ as a matter of arithmetic computation using the official rate of the Central Bank of the Russian Federation at 31 December 2003 of RR 29.45 (2002: RR 31.78) to US$1.

The US$ amounts are presented solely for the convenience of the reader and should not be construed as a representation that the RR amounts have been or could have been converted to US$ at this rate.

(c) Accounting for the effect of inflation

Prior to 1 January 2003, the economy of the Russian Federation was considered hyperinflationary and accordingly, the Company applied IAS 29 *Financial Reporting in Hyperinflationary Economies* (IAS 29). Subsequent to 1 January 2003 the economic characteristics of the Russian Federation indicated that hyperinflation had ceased, and the Company no longer applied the provisions of IAS 29. The amounts expressed in the measuring unit current at 31 December 2002 were treated as the basis for the carrying amounts in these financial statements.

Prior to 1 January 2003 IAS 29 required that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. The adjustments and reclassifications made to the statutory accounts for the purpose of IFRS reporting include the restatement for changes in the general purchasing power of the Russian Rouble ("RR") in accordance with IAS 29.

Corresponding figures, for the year ended 31 December 2002, were restated for the changes in the general purchasing power of the RR at 31 December 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat"), and from indices obtained from other published sources for years prior to 1992. The indices used to restate corresponding figures, based on 1988 prices (1988 = 100) for the five years ended 31 December 2002, and the respective conversion factors, are:

Year	Indices	Conversion Factor
1998	1,216,546	2.24
1999	1,661,619	1.64
2000	1,996,075	1.37
2001	2,371,679	1.15
2002	2,730,373	1.00

The main guidelines followed in restating the corresponding figures were:

- All corresponding amounts, were stated in terms of the measuring unit current at 31 December 2002;
- Monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002.

(tabular amounts expressed in US$ thousands)

- Non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of participants' funds were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002.
- All items in the statement of operations and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to 31 December 2002.
- Gains or losses that arose as a result of holding monetary assets and liabilities for the reporting period ended 31 December 2002 were included in the statement of operations as a monetary gain or loss.

(d) Exchange rate restrictions and controls

Exchange restrictions and currency controls exist relating to converting the RR into other currencies. The RR is not freely convertible in most countries outside of the Russian Federation.

(e) Property, plant and equipment

Basis of valuation

Property, plant and equipment are recorded at purchase or construction cost. At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. No significant impairment write-down was required in the periods presented.

Assets relating to oil-producing properties

The Company follows the successful efforts method of accounting for its oil and gas properties whereby property acquisitions, successful exploratory wells, development costs and support equipment and facilities are capitalised. Unsuccessful exploratory wells are charged to expense at the time the wells or other exploration activities are determined to be non-productive. Overheads and all other exploration costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation of capitalised costs of proved oil and gas properties is calculated using the units-of-production method based upon total proved reserves for property acquisitions and proved developed reserves for exploration and development costs. Proved developed oil and gas reserves for depletion purposes were 499, 958 and 1,113 thousand tons at 31 December 2004, 2003 and 2002, respectively. Oil and gas reserves for this purpose are determined in accordance with Society of Petroleum Engineers definitions and were estimated by DeGolyer and McNaughton, the Company's independent reservoir engineers.

Depreciation is calculated on the amounts of property, plant and equipment other than assets relating to oil producing properties on a straight-line basis. The prevailing depreciation periods, which approximate to the estimated useful economic lives of the respective assets, are as follows:

Buildings	20 years
Refining and related equipment	19 years
Other assets	6-20 years

Disposals and retirement

Gains or losses are not recognised for the retirement of oil and gas properties subject to composite depletion. Gains or losses from other retirements or sales are included in the determination of net income.

Repair and maintenance costs

Maintenance and repairs are expensed as incurred.

Interest costs

Interest costs are charged to income as incurred.

(f) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions, including those related to dismantlement, abandonment and site restoration, are evaluated and re-estimated annually, and are included in the financial statements at each balance sheet date at their expected net present values using discount rates which reflect the economic environment in which the Company operates.

Changes in provisions resulting from the passage of time or changes in the discount rates applied are reflected in the statement of income each year under financial items. Other changes in provisions, relating to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change.

(g) Inventories

Inventories are valued at the lower of the weighted-average cost and net realisable value.

Costs include those directly attributable to extracting the crude oil and gas and those directly attributable to bringing materials and supplies and construction equipment to their present location and condition. General and administrative expenditure is excluded from inventory costs and expensed in the period incurred.

(h) Leases

Leases of property, plant and equipment where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges using the effective yield method. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

(i) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks, which are considered by the Company at the time of deposit to have minimal risk of default.

(j) Deferred income taxes

Deferred income tax is calculated at rates enacted at the balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from application of IAS 29, depreciation on property, plant and equipment, provisions, fair value adjustments to long-term items, and expenses which are charged to the statement of income before they become deductible for tax purposes.

Deferred income tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit or temporary differences will be available against which they can be utilised.

Deferred income tax assets and liabilities are offset when the Company has a legally enforceable right to set off current tax assets against current liabilities.

(k) Foreign currencies

As discussed in Note 2 (b), while the financial statements are presented in US dollars the Company's measurement currency is the Russian rouble. Transactions denominated in a currency other than RR are recorded at the exchange rate ruling on the transaction date. Monetary assets and liabilities denominated in foreign currency are translated into RR at the official exchange rate of the Central Bank of the Russian Federation at the balance sheet date. Foreign currency exchange differences arising from the translation of assets and liabilities and from the settlement of transactions are reflected in the statement of income as a net foreign exchange gain or loss.

(l) Loans payable and receivable

Borrowings are recognised initially at the fair value of the proceeds received or given, (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense or income, over the period of the borrowings.

The loan advanced by the Company to its shareholder is classified as a "loan originated by the enterprise" in accordance with IAS 39 and stated at amortised cost.

(m) Revenue recognition

Revenues are recognised when crude oil or refined products are dispatched to customers and title has transferred. Revenues from non-cash sales are recognised at the fair value of the goods or services sold, which approximates the fair value of the goods or services received in exchange. Net revenues are stated exclusive of export duties and excise taxes, and of value added taxes.

(n) Measurement of trade and other receivables

Accounts receivable are recorded at original invoice amount (including VAT), as payment is normally due from customers within 30 days. Accounts receivable are written down to their estimated recoverable amount by recording a provision for doubtful accounts based on an analysis of expected future cash flows relating to doubtful receivables. Bad debts are written off when identified.

(o) Value added taxes

Value added taxes related to sales are payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability.

(p) Retirement benefit obligations

The Company makes contributions in accordance with Russian statutory requirements, (which are calculated as a percentage of current gross salary), to the State Pension Scheme of the Russian Federation and such expense is charged to the statement of income as incurred.

(q) Transactions with shareholder

Net results of transactions with shareholder that constitute capital transactions are charged to shareholders' equity in the form of distributions and/or contributions to/from shareholder. The distributions/contributions to/from shareholder are presented in the financial statements net of any tax charge/benefits arising for the Company from such transactions. When such transactions represent interest free loans payable and receivable, they are accounted for as discussed in Note 2 (l).

(tabular amounts expressed in US$ thousands)

3. Acquisitions

In 2003, the Company acquired 100 percent of OOO Petroinvest from Alfa Eco and Alfa Eco M, (parties related to the controlling Alfa shareholder at that time). The Company issued 13,400 shares with a fair value of approximately US$ 144,301 to Alfa Eco and Alfa Eco M in exchange for their holdings. The acquired subsidiary had a loan receivable from the Company, which it has transferred to the Company and ceased its operations (see Note 14).

4. Trade and other receivables

	2004	2003	2002
Accounts and notes receivable—trade (net of provision of US$nil at 31 December 2004, 2003 and 2002)	59	46	447
Advances to suppliers	346	—	82
Taxes recoverable, including Value Added Tax	1,032	1,377	1,581
Prepaid taxes, other than value added tax	280	20	79
Trade receivables from related parties (see Note 22)	—	—	3,647
Other receivables	28	33	91
Total trade and other receivables	1,745	1,476	5,927

Taxes recoverable relate to input Value Added Tax (VAT) (see Note 2(o)) incurred with respect to purchases and are available for offset against future output VAT following placing the item of equipment into use and the settlement of outstanding balances payable in relation to inventories purchased.

At 31 December 2003 other receivables are shown net of provision for doubtful accounts in the amount US$ 129 thousand (2002: US$ 753 thousand) which was fully released during 2004.

5. Inventories

	2004	2003	2002
Crude oil	613	158	383
Petroleum products	367	747	254
Materials and supplies	262	295	658
Total inventories	1,242	1,200	1,295

At 31 December 2004 inventories of materials and supplies are presented net of provisions for obsolescence and adjustments to reduce cost to net realisable value of US$ 1,414 thousand (2003: US$ 1,466 thousand and 2002: US$ 1,958 thousand).

6. Loan provided

In 2001, the Company provided US dollars denominated an interest free loan to Sakhalin Oil Company, a minority shareholder. The loan was due for repayment on 31 December 2002. In December 2002 the term of loan was extended until 30 June 2003. As a result, the difference between the nominal value and the fair value of the loan in the amount of US$ 281 thousand, net of income tax of US$ 89 thousand, was recognised in shareholders' equity as a distribution to a shareholder.

In 2003, the loan was repaid via mutual offset against payables to Alfa Eco M. The difference between the carrying value of the loan and payable balance settled totalling US$ 1,128 thousand was recognised in shareholders' equity as a distribution to a shareholder in 2003.

(tabular amounts expressed in US$ thousands)

7. Property, plant and equipment

	Oil and Gas properties	Refining and related equipment	Buildings	Assets under Construction	Other	Total
Cost						
Balance at 1 January 2003	22,170	75,782	4,571	441	3,830	106,794
Translation difference	1,756	5,994	362	32	282	8,426
Additions	181	—	—	3	82	266
Disposals	(42)	(4)	—	(43)	(295)	(384)
Balance at 31 December 2003	24,065	81,772	4,933	433	3,899	115,102
Balance at 1 January 2004	24,065	81,772	4,933	433	3,899	115,102
Translation difference	1,479	5,033	302	27	241	7,082
Additions	317	—	—	2	106	425
Disposals	(1,633)	(5)	—	(358)	(171)	(2,167)
Balance at 31 December 2004	24,228	86,800	5,235	104	4,075	120,442
Accumulated Depreciation Balance at 1 January 2003	(12,096)	(61,651)	(2,430)	—	(3,051)	(79,228)
Translation difference	(1,077)	(4,897)	(198)	—	(221)	(6,393)
Depreciation and depletion	(1,946)	(1,087)	(259)	—	(241)	(3,533)
Disposals	33	4	—	—	292	329
Balance at 31 December 2003	(15,086)	(67,631)	(2,887)	—	(3,221)	(88,825)
Balance at 1 January 2004	(15,086)	(67,631)	(2,887)	—	(3,221)	(88,825)
Translation difference	(989)	(4,188)	(187)	—	(208)	(5,572)
Depreciation and depletion	(1,620)	(761)	(252)	—	(255)	(2,888)
Disposals	—	1	—	—	130	131
Balance at 31 December 2004	(17,695)	(72,579)	(3,326)	—	(3,554)	(97,154)
Net book value						
Balance at 31 December 2002	10,074	14,131	2,141	441	779	27,566
Balance at 31 December 2003	8,979	14,141	2,046	433	678	26,277
Balance at 31 December 2004	6,533	14,221	1,909	104	521	23,288

The Company's oil fields are situated on Sakhalin Island in the Russian Federation on land owned by the Russian government. The Company holds licenses and pays royalties to extract oil and gas from the field. The licenses expire between 2012 and 2017, but may be extended. Management intends to renew the licenses as the properties are expected to remain productive subsequent to the license expiration date.

Estimated costs of dismantling oil and gas production and processing facilities, including abandonment and site restoration costs, amounting to US$ 734 thousand, US$ 691 thousand and US$ 641 thousand at 31 December 2004, 2003 and 2002, respectively, are included in the cost of oil and gas properties. The Group has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred beginning 2002 through 2022.

Leased assets

On 1 August 1998 the Company entered into a finance lease agreement with Sakhalin Oil Company, a shareholder of the Company. This agreement has a term of 14 years and provides the Company with the right to use oil and gas wells located on its oil field.

(tabular amounts expressed in US$ thousands)

Assets subject to the lease agreement comprise oil and gas properties:

	2004	2003	2002
Cost-capitalised finance leases	1,657	1,315	1,218
Accumulated depletion	(990)	(772)	(634)
	667	543	584

Fully depreciated assets

At 31 December 2004, 2003 and 2002 the gross carrying value of fully depreciated property, plant and equipment still in use was US$ 1,542 thousand, US$ 1,449 thousand and US$ 1,698 thousand, respectively.

8. Short-term loans and current portion of finance lease obligations

	2004	2003	2002
Loans from banks	—	—	3,000
Other borrowings	10,994	8,144	9,509
Interest payable	107	642	214
Current portion of finance lease obligations (see Note 11)	105	261	268
Short-term loans and current portion of long-term liabilities	11,206	9,047	12,991

Loans from banks

At 31 December 2002, borrowings from banks comprised the following:

Name of bank	Amount of loan	Currency	Interest rate	Date of repayment
Alfa Bank	500	US$	14.25%	April 2003
Alfa Bank	2,500	US$	14.25%	April 2003
	3,000			

The loan in the amount of US$ 2,500 thousand was secured by the guarantees of Alfa Eco, Alfa Eco M, and by a pledge of 5,999,999 shares of Nimir Petroleum Petrosakh Limited by Janow Properties Limited. It was also secured by a pledge of 16,686 shares of the Company.

Other borrowings

At 31 December 2004, 2003 and 2002, other borrowings comprised the following:

Name of organisation	2004	2003	2002	Currency	Interest rate	Date of repayment
Alfa Eco M (see Note 22)	—	6,507	9,723	RR	25.0%	April 2004
Alfa-Eco (see Note 22)	—	2,279	—	RR	30.0%	December 2004
Alfa-Eco M (see Note 22)	11,100	—	—	RR	9.5%	October 2005
	11,100	8,786	9,723			

During 2004, the Company replaced all outstanding loans and interest due to Alfa Eco and Alfa Eco M with a single loan bearing interest of 9.5 percent, according to a Novation agreement. At 31 December 2004 the principal amount of the new loan was recorded at fair value of US$ 10,993 thousand, using a 13.0 percent effective interest rate, and the difference compared with nominal value in the amount US$ 441 thousand was recorded in the statement of changes in shareholder's equity. This loan is unsecured and in accordance with the acquisition of Petrosakh by Urals Energy is required to be repaid by October 2005. As discussed in note 24, on 1 June 2005 the Company obtained new financing from ZAO "BNP Paribas Bank" and repaid the Alfa-Eco M loan. Shareholder loans in prior years were fair valued at origination using on effective interest rate of 23.0 percent.

(tabular amounts expressed in US$ thousands)

9. Trade and other payables

	2004	2003	2002
Trade payables	105	365	7,666
Advances from customers	601	905	522
Wages and salaries	180	113	120
Total trade and other payables	886	1,383	8,308

10. Taxes payable

	2004	2003	2002
Value added tax	454	—	160
Unified production tax	377	348	20
Other taxes and accruals	509	232	196
Total taxes payable	1,340	580	376

11. Finance lease obligations

	2004	2003	2002
Finance lease obligations	1,661	1,262	1,289
Less: current portion of finance lease obligations	(105)	(261)	(268)
Total long-term finance lease obligations	1,556	1,001	1,021

The finance lease obligations has an effective interest rate of 13 percent (2003 and 2002: 20 percent) and is secured by the leased assets as the assets revert to the lessor in the event of default.

	2004	2003	2002
Finance lease liability—minimum lease payments:			
Not later than 1 year	419	313	307
Later than 1 year and not later than 5 years	1,677	1,251	1,304
Later than 5 years	1,677	1,251	1,456
	3,773	2,815	3,067
Future finance charges on finance leases	(2,112)	(1,553)	(1,778)
Present value of finance lease liability	1,661	1,262	1,289

	2004	2003	2002
The present value of finance lease liability matures as follows:			
Not later than 1 year	105	261	268
Later than 1 year and not later than 5 years	908	676	675
Later than 5 years	648	325	346
Total finance lease obligations	1,661	1,262	1,289

(tabular amounts expressed in US$ thousands)

12. Dismantlement provision

	2004	2003	2002
Balance at 1 January	519	517	862
Effect of currency translation	36	42	—
Monetary gain	—	—	(73)
Change in the estimated liability	(17)	(174)	(459)
Increase in the discounted amount during the year	143	134	187
Balance at 31 December	681	519	517

The dismantlement provision represents the net present value of the estimated future obligation for dismantlement, abandonment and site restoration costs. The discount rate used to calculate the net present value of the dismantling liability was 13 percent.

As further discussed in Note 21 (g), environmental regulations and their enforcement are under development by governmental authorities. Consequently, the ultimate dismantlement, abandonment and site restoration obligation may differ from the estimated amounts and this difference could be significant.

13. Income tax

Income tax charge/(benefit) comprises the following:

	2004	2003	2002
Current tax expense	1,666	1,249	2,013
Deferred tax charge/(benefit)—movement in temporary differences	(954)	1,028	(2,228)
Income tax charge/(benefit)	712	2,277	(215)

Profit before taxation for financial statement reporting purposes is reconciled to tax charge/(benefit) as follows:

	2004	2003	2002
Profit before income tax	702	4,253	13
Theoretical tax charge at statutory rate of 24 percent (for all years) thereon	168	1,021	3
Income not assessable for income tax purposes	(36)	(85)	(98)
Expenses and losses not deductible for income tax purposes	641	1,294	2,648
Non-recognised deferred tax asset movement	—	—	842
Non-temporary elements of monetary gain	—	—	(854)
Change in statutory base	—	—	(1,530)
Inflation effect on deferred tax balance at the beginning of the year	—	—	(1,233)
Effect of currency translation, tax penalties and other non-temporary differences	(61)	47	7
Income tax charge/(benefit)	712	2,277	(215)

The non-temporary impact of monetary gain reflects the effect on the theoretical tax charge of inflation with respect to non-monetary items of a non-temporary nature (primarily shareholders' equity and net deferred tax liability).

Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 percent for all years presented.

(tabular amounts expressed in US$ thousands)

	2004	Translation difference	2004 Change	2003	Translation difference	2003 Change	2002
Deferred tax liabilities							
Property, plant and equipment	3,138	259	(899)	3,778	277	(510)	4,011
Inventories	265	163	(584)	686	42	108	536
Payables	—	—	—	—	63	(862)	799
Borrowings received	144	5	139	—	13	(180)	167
Deferred tax assets							
Receivables	—	(8)	412	(404)	(86)	764	(1,082)
Dismantlement provision	(163)	(240)	201	(124)	(26)	6	(104)
Payables	(373)	172	(90)	(455)	—	(228)	(227)
Inventories	(339)	(151)	(188)	—	(62)	847	(785)
Loan provided	—	(4)	215	(211)	—	(211)	—
Prepaid expenses	—	(1)	29	(28)	(96)	1,287	(1,219)
Other deductible temporary differences	(77)	(28)	(49)	—	(1)	7	(6)
Net deferred tax liability	2,595	167	(814)	3,242	124	1,028	2,090

Included in 2004 change is deferred tax liability in the amount US$ 140 thousand recognised in equity as contribution from shareholders.

14. Shareholders' equity

Share capital and share premium

	2004		2003		2002	
	Shares	Amount	Shares	Amount	Shares	Amount
Authorised, issued and fully paid shares	30,964	21,999	30,964	20,779	17,564	18,578

Each share has a par value of RR 1,488. Share capital is stated in terms of the purchasing power of the Russian rouble at 31 December 2002 and converted to US dollars.

The shareholders had funded the Company via loans from OOO Petroinvest. At 31 December 2002, such loans totalled US$ 144,301 thousand and were recorded as a component of shareholders equity. In 2003, the Company issued 13,400 shares to the shareholders to acquire Petroinvest. The fair value of the shares issued was considered to be equal to the book value of the loans provided. As a result, the Company settled a corresponding loan due to OOO Petroinvest. The difference between nominal value of shares issued and consideration received was reflected as share premium.

Distributable reserves

The statutory accounting reports are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation. For the year ended 31 December 2004, the Company had a statutory net profit of US$ 224 thousand (2003: losses of US$ 145 thousand and 2002: losses of US$ 2,179 thousand), as reported in the Company's statutory accounting reports.

Distributions to majority shareholder

During 2004, the Company made payments of US$ 5,275 thousand, net of income tax benefit of US$ 1,666 thousand (2003: US$ 5,063 thousand, net of income tax benefit of US$ 1,242 thousand and 2002: US$ 9,337 thousand, net of income tax benefit of US$ 2,013 thousand) to parties related to Alfa Eco. These payments are made in the form of tax deductible services and are classified as an equity movement in accordance with the substance of the transaction.

(tabular amounts expressed in US$ thousands)

Contributions from companies affiliated with majority shareholder

Contribution from shareholder of US$ 441 thousand (2003: US$ 161 and 2002: US$ 941) represents the difference between the nominal value and the fair value at the date of origination of interest-free loans received by the Company from Alfa.

15. Revenues

	2004	2003	2002
Crude oil			
Export sales	22,186	19,239	21,806
Domestic sales (Russian Federation)	839	2,208	1,591
Petroleum (refined) products—domestic sales	5,551	2,087	3,586
Total gross revenues	28,576	23,534	26,983

As discussed in Note 22, a significant portion of sales are sold using Alfa Group entities as agents or commissioners.

16. Cost of production

	2004	2003	2002
Wages and salaries including payroll taxes	1,728	1,462	1,388
Depreciation and depletion	2,888	3,533	2,877
Materials	1,073	1,581	2,456
(Reverse)/ write down of inventories	(137)	(764)	322
Unified production tax	4,612	3,859	3,826
Other	333	388	489
Total cost of production	10,497	10,059	11,358

17. Selling, general and administrative expenses

	2004	2003	2002
Selling and transportation expenses	877	477	2,937
Bad debt expense/(release)	(13)	312	71
General and administrative expense	1,145	1,561	815
Wages and salaries including payroll taxes	967	656	687
Taxes other than income	683	782	1,203
Loss on assets disposal and other SG&A expenses	146	—	—
Total selling, general and administrative expenses	3,805	3,788	5,713

18. Exploration expenses

Included in exploration expenses in 2004 are expenditures of US$ 3,750 thousand (2003: US$ 430 thousand, 2002: US$ 5,024 thousand) incurred in relation to seismic surveys of the prospective license area (see Note 21 (f)) and liquidation of unsuccessful exploratory well on the on-shore Pribrezhnoe field in the amount US$ 1,565 thousand.

(tabular amounts expressed in US$ thousands)

19. Interest expense

	2004	2003	2002
Imputed interest expense on short-term RR denominated loans from Alfa Eco M accrued at 13% p.a. (2003 and 2002: 25%) (see Note 8)	115	1,826	2,117
Imputed interest expense on finance lease to Sakhalin Oil Company accrued at 13% p.a. (2003 and 2002: 20%) (see Note 11)	409	267	271
Increase in the discounted amount of dismantlement provision during the year (see Note 12)	126	134	187
Interest on loans (see Note 8)	1,845	1,126	425
Other	—	—	105
Total interest expense	2,495	3,353	3,105

20. Financial risks

(a) Foreign exchange risk

The Company has substantial amounts of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure.

The Company does not have formal arrangements to mitigate foreign exchange risks.

(b) Interest rate risk

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The primary sources of the Company's funds are interest-free loans received from its shareholder and companies affiliated with shareholder. The implicit interest rate for these loans is disclosed in Note 19. The Company obtains funds from, and deposits its cash surpluses with, banks at current market interest rates, and does not utilise hedging instruments to manage its exposure to changes in interest rates. The details of interest rates associated with the Company's borrowings are discussed in Notes 11 and 8.

(c) Credit risk

Cash and cash equivalents are deposited only with banks that are considered by the Company at the time of deposit to have minimal risk of default.

The financial assets, which potentially subject the Company to credit risk, consist principally of trade receivables. The Company has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Company has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Company beyond the provision already recorded.

(d) Commodity and pricing risk

The Company's operations are significantly affected by the prevailing price of crude oil both in the international oil market and in the Russian Federation. Crude oil prices have historically been highly volatile, dependent upon the balance between supply and demand and particularly sensitive to OPEC production levels. Crude oil prices in the Russian Federation are significantly below international levels primarily due to constraints on the export of crude oil. Also, domestic crude oil prices are contract specific as there is no active market for domestic crude oil and marker prices are not available. There is typically no straight correlation between domestic and international oil prices. Petrosakh, operates on Sakhalin Island where the surrounding ocean is not navigateable for several months of the year, this further increases the expose to commodity price risk.

21. Contingencies, commitments and operating risks

(a) Operating environment

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

(b) 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 Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments. As a result, significant additional taxes, penalties and interest may be assessed. 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.

Current Russian tax legislation is based on the formal manner in which transactions are documented and the underlying accounting treatment as prescribed by Russian accounting and tax rules. The Company has structured certain transactions so as to take advantage of this formal based tax legislation and reduce the overall effective tax rate. These financial statements include certain reclassifications to reflect the underlying economic substance of these transactions.

As at 31 December 2004, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued in these financial statements.

(c) Legal proceedings

The Company is a party to certain legal proceedings arising in the ordinary course of business. Management believe there are no current legal proceedings or other claims outstanding, which could have a material adverse effect on the results of operations or financial position of the Company as at 31 December 2004.

(d) Insurance

At 31 December 2004, the Company held limited insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks. Since the absence of insurance alone does not indicate an asset has been impaired or a liability incurred, no provision has been made in these financial statements.

(e) Sales commitments

In accordance with the conditions of the license, the Company must sell 20 percent of produced oil in the Sakhalin Island region.

(tabular amounts expressed in US$ thousands)

(f) Capital commitments

Exploration licenses—investment commitments

In accordance with the Pogranichnoye off-shore license agreement, the Company must conduct certain exploratory work, which includes, but is not limited to, performing seismic prospecting and drilling 2 exploratory wells by 2006. Management currently estimate such expenditure to approximate US$ 19,000 thousand.

In accordance with the Pogranichnoye on-shore license agreement, Petrosakh must conduct exploratory works including drilling 2 exploration wells in 2007 and 2008.

Other capital commitments

At 31 December 2004, the Company had no other significant contractual commitments for capital expenditures.

(g) Restoration, rehabilitation and environmental costs

The Company has operated in the upstream and refining oil industry in the Russian Federation for many years and its activities have had 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 Company periodically evaluates its obligation related thereto. The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter 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 Company.

22. Related party transactions

In November 2004, the Company was acquired by Urals Energy Holdings Limited and as a result the Alfa Group and its affiliates ceased to be related parties. However at 31 December 2004 the Company had significant loans outstanding as described further in this Note.

The Company had significant transactions with entities, associated with the Alfa Group. The related party transactions are summarised as follows:

Trading with related parties

	2004	2003	2002
Crude oil sales where Alfa Group entities act as an agent	14,687	15,727	18,552
Associated volumes, tons	*82,351*	*122,737*	*167,025*
Associated receivable balance	—	—	3,647
Commission fee paid to Alfa Group	662	61	84

Loans to/from related parties

At 31 December 2004, the Company had an outstanding short-term loan payable to Alfa-Eco M, member of the Alfa Group, totalling US$ 11,100 thousand (2003: US$ 8,786 thousand and 2002: US$ 9,723 thousand payable to Alfa-Eco and Alfa-Eco M) (see Note 8). At 31 December 2004, 2003 and 2002, the loans were recorded at fair value, which is the net present value at the date of origination amortised over the loan period using the effective interest rate. The discount rate used to calculate the net present value of the loan was 13 percent (2003: 25 and 2002: 25 percent).

During 2004, the Company recognised a gain of US$ 441 thousand, net of tax of US$ 139 thousand (2003: US$ 161 thousand, net of income tax of US$ 51 thousand and 2002: US$ 941 thousand, net of income tax of US$ 297 thousand), as the difference between the face value and the net present value of the loan received during the year. The gain is recognised in shareholders' equity as a contribution from shareholder.

At 31 December 2002, the Company had outstanding short-term loans payable to Alfa Bank, a member of Alfa Group, totalling US$ 3,000 thousand (see Note 8). Interest paid during the year 2002 was US$ 232 thousand.

In May 2003, the Company advanced a non-interest bearing loan to SibTEK Ugol, a member of Alfa Group, totalling US$ 10,973 thousand. The loan was repaid in December 2003.

Guarantees issued in favour of related parties

As at 31 December 2002, the Company had guaranteed a US dollar denominated loan issued by Natexis Banques Populaires to Alfa-Eco M, a related party, amounting to US$ 8,000 thousand plus interest, which accrues at a rate of LIBOR plus 6.5 percent. The guarantee expired in 2003.

Compensation paid to senior management

Compensation paid to senior management for their services in full time or part time executive management positions comprises a contractual salary. In 2004 compensation of US$ 49 thousand (2003: US$ 46 thousand and 2002: US$ 114 thousand) paid to senior management and is included in selling, general and administrative expenses.

Other transactions and balances with related parties

The Company entered into a finance lease agreement with Sakhalin Oil Company, a minority shareholder (see Notes 7 and 11). Furthermore, during 2004, 2003 and 2002 the Company made distributions to its shareholder and a member of Alfa Group (see Note 14).

In 2003 the Company transferred the loan due from shareholder to Alfa Eco M, a member of Alfa Group, for a settlement of a corresponding accounts payable balance due to Alfa Eco M in the amount of US$ 4,000 thousand. The difference in the amount of US$ 1,128 thousand between the carrying value of the loan and payable balance settled was recognised in the shareholders' equity as a distribution to shareholder.

Other balances and transactions with related parties are disclosed in Notes 3, 4 and 8.

23. Significant non-cash transactions

Petroleum products sales of US$ 407 thousand in 2003 (2002: US$ 1,395 thousand) and crude oil sales of US$ nil in 2003 (2002: US$ 3,627 thousand) were settled through exchange or barter transactions.

As discussed in Note 6, in 2003 the Company transferred the loan due from shareholder to Alfa Eco M, a member of Alfa Group, for a settlement of a corresponding accounts payable balance due to Alfa Eco M in the amount of US$ 4,000 thousand. This transaction was excluded from cash flows from investing activity.

24. Subsequent event

In June 2005, the Company entered into a 2-year dollar denominated credit facilities for US$ 20,000 thousand with ZAO "BNP Paribas Bank" to finance Urals Energy for US$ 4,500 thousand, repay the loan from Alfa-Eco M in the amount US$ 11,100 thousand (see Note 8) and fund working capital and various capital projects of the Company. This variable interest debt facility bears composite interest at LIBOR plus 5.0 percent and is repayable through December 2006. The loan is collateralised by a pledge on the Company's shares, assignment of certain crude oil export contract, pledge on crude oil stored in the Company's tanks and is guaranteed by Urals Energy. This facility is repayable with the proceeds of the committed export contracts.

PricewaterhouseCoopers

ZAO Arcticneft

International Financial Reporting Standards
Financial Statements

31 December 2004

PRICEWATERHOUSECOOPERS

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AUDITORS' REPORT

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4 August 2005

Dear Sirs

ZAO Arcticneft (the "Company")

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 4 August 2005 ("Admission Document")

Basis of preparation

The financial information set out below is based on the unaudited financial statements of the Company for the year ended 31 December 2004 prepared in accordance with International Financial Reporting Standards ("IFRS") on the basis described in Note 2.

Responsibility

Such financial statements are the responsibility of the directors of the Company, who approved their issue.

The directors of the Company are responsible for the contents of the Admission Document in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We were engaged to conduct our work in accordance with the Statements of Investment Circular Reporting Standards 200 issued by the Auditing Practices Board, and on the basis of the results of our audit of the balance sheet of Arcticneft as of 31 December 2004, and the related statement of operations, of cash flows and of changes in shareholders' equity for the year then ended in accordance with International Auditing Standards.

Opinion

As discussed in Note 2 (a), prior to September 2003, the management of the Company engaged in several material transactions, which may not have complied with their fiduciary responsibilities to the Company, and accordingly, this management group was replaced by the shareholders. After departure, management have discovered inconsistencies in some accounting records and certain supporting documents are missing from the Company's records. Further, the Company has not reconciled its tax obligations with the regional and federal tax authorities and significant positive and negative differences exist between the Company's records and the tax authority's records. Consequently, the current management is unable to confirm whether all material assets and obligations of the Company are completely and accurately reported in the financial statements. There were no alternative procedures we could perform to enable us to obtain sufficient audit evidence regarding these transactions.

As discussed in Note 19 (c), the Company is a plaintiff in a title claim over 37 of the Company's producing wells. These wells were sold to a third party in October 2003, under a court appointed auction to satisfy unpaid creditors. In July 2005, the Company entered into an arrangement to settle the claims over 37 wells. These arrangements are subject to various conditions that must be satisfied before the wells can be transferred back to Arcticneft.

Because of the significance of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements of the Company.

Declaration

For the purposes of paragraph 1.2 of Annex I of the AIM PD Rules we are responsible for this report as part of the Admission Document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Admission Document in compliance with Annex I of the AIM PD Rules.

ZAO Arcticneft

Financial statements for the year ended 31 December 2004

(expressed in US$ thousands)

BALANCE SHEETS

As at 31 December	Notes	2004	2003
Assets			
Current assets			
Cash and cash equivalents	4	3,414	797
Trade and other receivables	5	889	1,065
Inventories	6	2,062	1,706
Total current assets		6,365	3,568
Non-current assets			
Property, plant and equipment	7	56,567	58,707
Total assets		62,932	62,275
Liabilities and shareholders' equity			
Current liabilities			
Short-term loans	8	665	6,725
Trade and other payables	9	7,270	7,698
Taxes payable	10	9,156	6,591
Total current liabilities		17,091	21,014
Long-term liabilities			
Long-term loans	8	9,122	3,320
Dismantlement provision	11	810	697
Deferred tax liability	12	11,010	11,413
Total long-term liabilities		20,942	15,430
Total liabilities		38,033	36,444
Shareholders' equity			
Share capital	13	274	258
Additional paid in capital	13	3,477	2,130
Retained earnings	13	21,241	23,333
Translation difference		(93)	110
Total shareholders' equity		24,899	25,831
Total liabilities and shareholders' equity		62,932	62,275

Approved by the Board of Directors 13 July 2005

Vyacheslav A. Ivanov General Director	Svetlana A. Solovyeva Chief Accountant

ZAO Arcticneft

Financial statements for the year ended 31 December 2004

(expressed in US$ thousands)

STATEMENT OF OPERATIONS

Year ended 31 December	Notes	2004
Revenues		
Gross revenues	14	17,940
Less: excise taxes and export duties		(3,501)
Net revenues		14,439
Operating costs		
Cost of production	15	(12,643)
Selling, general and administrative expenses	16	(3,338)
Total operating costs		(15,981)
Operating loss		(1,542)
Interest and other income		284
Interest expense	17	(1,501)
Foreign currency gains/(losses)		(222)
Other non-operating gains/(losses)		162
Loss before income tax		(2,819)
Income tax charge	12	(729)
Net loss		(3,548)

ZAO Arcticneft

Financial statements for the year ended 31 December 2004

(expressed in US$ thousands)

Statement of Cash Flows

Year ended 31 December	2004
Cash flows from operating activities	
Loss before income tax	(2,819)
Adjustments for:	
Interest expense	1,501
Depreciation and depletion	5,558
(Gain)/loss on disposal of long-lived assets	(6)
Operating cash flow before changes in working capital	4,234
Increase in inventories	(242)
Decrease in trade and other receivables	233
Decrease in trade and other payables	(866)
Increase in taxes payable	2,079
Cash generated from operations	5,438
Interest paid	(431)
Income tax paid	(2,147)
Net cash generated from operating activities	2,860
Cash flows from investing activities	
Proceeds from loans	2,429
Loans advanced	(2,429)
Purchase of property, plant and equipment	(37)
Proceeds from sale of assets	20
Net cash used in investing activities	(17)
Cash flows from financing activities	
Proceeds from loans	5,687
Repayment of loans	(6,057)
Net cash used in financing activities	(370)
Effects of translation difference on cash and cash equivalents	144
Net increase in cash and cash equivalents	2,617
Cash and cash equivalents at the beginning of the period	797
Cash and cash equivalents at the end of the period	3,414

ZAO Arcticneft

Financial statements for the year ended 31 December 2004

(expressed in US$ thousands)

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Note	Share capital	Additional paid in capital	Translation difference	Retained earnings	Total shareholders' equity
Balance at 1 January 2004		258	2,130	110	23,333	25,831
Fair value adjustment to loans from shareholders	8	—	1,121	—	—	1,121
Effect of currency translation		16	226	(203)	1,456	1,495
Net profit for the year		—	—	—	(3,548)	(3,548)
Balance at 31 December 2004		274	3,477	(93)	21,241	24,899

ZAO Arcticneft

Notes to the financial statements

(tabular amounts expressed in US$ thousands)

1. General information

The core activities of ZAO Arcticneft (the "Company") are the production and sale of crude oil. The Company holds the license for the Peschanoozerskoe field, which is valid through 2067. The Company operates on the island of Kolguev in the Barents Sea in Northern Russia. The Company produces crude oil all year round, however sales are restricted in the winter months when the Barents Sea is frozen.

The Company was founded in 1998 and was owned and operated by NK LUKOil and its affiliated entities. In July 2005, the Company was acquired by Urals Energy Holdings Limited ("Urals Energy").

The Company's registered address is 1 Arctichesky Street, Naryanmar, Russian Federation. The Company employed approximately 350 people during 2004.

2. Basis of preparation and summary of significant accounting policies

(a) Russian statutory records

The Company maintains its accounting records in Russian Rouble ("RR") and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation (Russian GAAP). These financial statements are based on statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

Prior to September 2003, the management of the Company engaged in several material transactions, which may not have complied with their fiduciary responsibilities to the Company, and accordingly, this management group was replaced by the shareholders. After departure, management have discovered inconsistencies in some accounting records and some supporting documents were missing from the Company's records. As a result the statutory accounting records contain balances that cannot be supported. Further, the Company has not reconciled its tax obligations with the regional and federal tax authorities and significant positive and negative differences exist between the Company's records and the tax authority's records.

The Company is presently challenging in the Arbitration Court, the legality of some of the historic transactions (see note 19 (c)). The Company's ability to defend its position may be impaired due to the lack of appropriate documentation.

As discussed below, these IFRS financial statements have been prepared by adjusting the Russian statutory records to align then to IFRS. Such adjustment include write-off of unsupported receivables, advances and loans provided and accruals for unrecorded liabilities and probable exposures. Actual results could differ.

Subsequent to September 2003, new management and accounting teams were appointed to the Company and since this time the accounting records have improved. However due to the significance of the transactions and balances in existence at 31 December 2003, management remain unable to confirm whether all material assets and obligations of the Company are completely and accurately reported in the accompanying financial statements.

(b) Liquidity

Over reporting period the Company has accumulated substantial borrowings to fund its recurring losses. These borrowings were provided by parties related to the previous shareholders. As part of the acquisition by Urals Energy, these historic borrowings will be repaid or restructured along with a majority of the accounts payable to the previous shareholders by October 2005. As discussed above, the Company's cash flow from operations is seasonal and dependent on commodity prices. Historically, the Company has supplemented its cash flow from operations with additional borrowings and may continue to do so. The Company's ability to meet its obligations and maintain operations is contingent upon the continuing support from Urals Energy.

(c) First time adoption of IFRS

These financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS") in force at 31 December 2004. None of the revised standards have been early adopted for the purposes of these financial statements. IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied in preparing these financial statements. The accompanying financial statements represent the first time adoption of IFRS by the Company. The policies set out below have been applied to 2004. The Company has taken the exemption available under IFRS 1 to record certain property, plant and equipment using an independent appraisal value to approximate deemed cost in its transition balance sheet.

No reconciliation of the effect of transition from Russian GAAP to IFRS on the Company's equity and its net loss are presented due to the matters discussed in note 2 (a).

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of revenues and expenses during the reporting period. Estimates have principally been made in respect to fair values of non-current assets at the transition balance sheet, deferred income taxes, provisions for impairment of receivables loans and receivables, and accrues for potential obligations. Actual results could differ from these estimates.

(d) Measurement and presentation currency

The Russian Rouble is the measurement currency for the Company's operations as the majority of the Company's business is conducted in Russian Roubles. Balance sheet items denominated in foreign currencies have been remeasured using the exchange rate at the respective balance sheet date. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income or loss. The US dollar to Russian Rouble exchange rates were 27.75 and 29.45 as of 31 December 2004 and 2003, respectively.

These financial statements have been presented in US dollars ("US$") in accordance with pronouncements of SIC 30 Reporting Currency—Translation from Measurement Currency to Presentation Currency. The guidelines followed in translating RR amounts were:

- Assets and liabilities for the balance sheets presented are translated at the closing rate existing at the date of each balance sheet presented.
- Income and expense items for the period presented are translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates.
- Equity items other than the net profit (loss) for the period that is included in the balance of retained earnings are translated at the closing rate existing at the date of each balance sheet presented.
- All exchange differences resulting from translation are recognised directly in equity.
- Corresponding figures are translated to US$ as a matter of arithmetic computation using the official rate of the Central Bank of the Russian Federation at 31 December 2003 of RR 29.45 to US$ 1.

The US$ amounts are presented solely for the convenience of the reader and should not be construed as a representation that the RR amounts have been or could have been converted to US dollars at this rate.

(e) Property, plant and equipment

As discussed in Note 2 (c), the Company has adopted IFRS for the first time effective 1 January 2004. The Company has elected to utilise exemptions available for first-time adopters under IFRS 1 and has recorded its properties, plant and equipment at appraised value. Management has estimated the fair values based on reports prepared by American Appraisal (AAR), Inc., an independent appraiser and DeGolyer and McNaughton, an independent reservoir engineer.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. If the asset's carrying amount is greater than its estimated recoverable amount an impairment write-down is immediately recorded.

The Company follows the successful efforts method of accounting for its oil and gas properties whereby property acquisitions, successful exploratory wells, development costs and support equipment and facilities are capitalised. Unsuccessful exploratory wells are charged to expense at the time the wells or other exploration activities are determined to be non-productive. Overheads and all other exploration costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortisation of capitalised costs of proved oil and gas properties is calculated using the units-of-production method based upon total proved reserves for property acquisitions and proved developed reserves for exploration and development costs. Proved developed oil and gas reserves for depletion purposes were 692 thousand tons at 31 December 2004. Oil and gas reserves for this purpose are determined in accordance with Society of Petroleum Engineers definitions and were estimated by DeGolyer and McNaughton, the Company's independent reservoir engineers.

Depreciation is calculated on administrative building on a straight-line basis. The prevailing depreciation period, which approximates to its estimated useful economic life, is 20 years.

Gains or losses are not recognised for normal retirements of oil and gas properties subject to composite depreciation, depletion and amortisation. Gains or losses from other retirements or sales are included in the determination of net income.

(f) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions, including those related to dismantlement, abandonment and site restoration, are evaluated and re-estimated annually, and are included in the financial statements at each balance sheet date at their expected net present values using discount rates which reflect the economic environment in which the Company operates.

Changes in provisions resulting from the passage of time or changes in the discount rates applied are reflected in the statement of income each year under financial items. Other changes in provisions, relating to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change.

The provision for dismantlement liability is recorded on the balance sheet, with a corresponding amount being recorded as part of property, plant and equipment.

(g) Inventories

Inventories are valued at the lower of the weighted-average cost or net realisable value.

Costs include those directly attributable to extracting crude oil and gas and those directly attributable to bringing materials and supplies and construction equipment to their present location and condition. General and administrative expenditure is excluded from inventory costs and expensed in the period incurred.

(h) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the statement of operations.

(i) Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks.

(j) Value added tax

Value added tax related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

(k) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of operations over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(l) Deferred income taxes

Deferred income tax is calculated at rates enacted at the balance sheet date, using the liability method, for all temporary differences between the tax base of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from depreciation on property, plant and equipment, provisions, fair value adjustments to long-term items, and expenses which are charged to the statement of income before they become deductible for tax purposes.

Deferred income tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit or temporary differences will be available against which they can be utilised.

Deferred income tax assets and liabilities are offset when the Company has a legally enforceable right to set off current tax assets against current liabilities.

(m) Retirement benefit obligations

The Company makes contributions in accordance with Russian statutory requirements, (which are calculated as a percentage of current gross salary), to the State Pension Scheme of the Russian Federation and such expense is charged to the statement of income as incurred.

(tabular amounts expressed in US$ thousands)

(n) Revenue recognition

Revenues are recognised when crude oil or refined products are dispatched to customers and title has transferred. Revenues from non-cash sales are recognised at the fair value of the goods or services sold, which approximates the fair value of the goods or services received in exchange. Net revenues are stated exclusive of export duties and excise taxes, and of value added taxes.

(o) Non-cash transactions

Non-cash transactions are recorded at their fair value. The fair value of non-cash transactions from crude oil sales is determined by the market value of crude oil.

Non-cash transactions have been excluded from the investing and financing activities components in the accompanying statement of cash flows.

3. Segment information

The Company operates in one business segment which is crude oil production. The Company assesses its results of operations and makes its strategic and investment decisions based on the analysis of its profitability as a whole. The Company operates within one geographical segment, which is the Russian Federation.

4. Cash and cash equivalents and supplemental cash flow information

Included in cash and cash equivalents at 31 December 2004 and 2003 are Russian Rouble denominated amounts totalling RR 2,904 thousand (US$ 105 thousand) and RR 23,434 thousand (US$ 796 thousand), respectively. At 14 June, 2005, the Company's current account had been frozen by the tax authorities for non payment of tax obligations.

5. Trade and other receivables

	2004	2003
Related party accounts receivable (see Note 20 (c))	367	—
Taxes recoverable including VAT	427	983
Other receivables (impairment provision of US$ 3,909 thousand and US$ 11,155 thousand at 31 December 2004 and 2003)	95	82
Total trade and other receivables	889	1,065

The impairment provisions relate primarily to transactions entered into prior to October 2003 and which remain uncollected at the balance sheet date.

6. Inventories

	2004	2003
Crude oil	1,201	253
Petroleum products	446	764
Materials and supplies (zero provision for obsolescence and slow-moving stock at 31 December 2004 and 2003)	415	689
Total inventories	2,062	1,706

(tabular amounts expressed in US$ thousands)

7. Property, plant and equipment

	Oil and gas properties	Refinery and related equipment	Buildings	Other Assets	Assets under construction	Total
Cost						
Balance at 1 January 2004	54,625	507	1,083	1,566	926	58,707
Translation difference	3 358	31	67	96	57	3,609
Additions	—	—	—	69	—	69
Transfers	617	—	—	(633)	16	
Disposals	(16)	—	—	(21)	(9)	(46)
Balance at 31 December 2004	58,584	538	1,150	1,077	990	62,339
Accumulated depreciation						
Balance at 1 January 2004	—	—	—	—	—	—
Translation difference	(207)	(2)	(1)	—	(4)	(214)
Depreciation charge	(5,390)	(49)	(28)	—	(91)	(5,558)
Disposals	—	—	—	—	—	—
Balance at 31 December 2004	(5,597)	(51)	(29)	—	(95)	(5,772)
Net book value						
Balance at 1 January 2004	54,625	507	1,083	1,566	926	58,707
Balance at 31 December 2004	52,987	487	1,121	1,077	895	56,567

The Company's oil field is located on Kolguev Island, in Nenetsky region of the Russian Federation. The Company holds the license and pays production taxes to extract oil from the field. The license expires in 2067.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs total US$ 739 thousand and US$ 697 thousand at 31 December 2004 and 2003, respectively. These costs are included in the cost of oil and gas properties and amortised on units of production basis. The Company has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred.

8. Short-term and long-term loans

	2004	2003
Loans from related party (Note 20 (c))	9,604	9,632
Interest payable	183	413
Total short-term and long-term loans	9,787	10,045

(tabular amounts expressed in US$ thousands)

At 31 December 2004 related party borrowings comprised the following:

Name of organisation	2004	Currency	Interest rate	Date of repayment
OAO LUKOIL	9,122	US$	0.1%	September 2006
Arkhangelskgeoldobycha (OAO LUKOIL)	264	US$	0.1%	January 2004
Naryanmarneftegaz (OAO LUKOIL)	401	US$	0.1%	November 2005
	9,787			

During 2004, the Company received loans from NK LUKOil and Naryanmarneftegaz, related parties, in the nominal amount US$ 5,780 thousand with bearing interest of 0.1%. The loan was recorded at fair value of US$ 4,305 thousand and the difference of US$ 1,475 thousand net of deferred tax of US$ 354 thousand was recognised in the statement of shareholders equity as an additional paid in capital. This loan was unsecured and is repayable in September 2006. As part of the acquisition by Urals Energy in July 2005, the parties agreed that the three above loans would be repaid before October 2005.

9. Trade and other payables

	2004	2003
Advances from and payables to related parties (see Note 20 (c))	5,144	4,253
Trade payables	35	—
Advances from customers	382	—
Wages and salaries	115	105
Other payable and accrued expenses	1,594	3,340
Total trade and other payables	7,270	7,698

As part of the acquisition by Urals Energy, the parties have agreed that the majority of these accounts payable would be repaid by October 2005. Accrued expenses include managements estimation of quantifiable probable obligations as a result of the transactions engaged in prior to October 2003, (see note 2 (a)). Actual results could differ from these estimates and this difference could be significant.

10. Taxes payable

	2004	2003
Value added tax	1,476	1,452
Profits tax (corporate)	6,137	3,612
Income tax (employees)	664	1,051
Unified production tax	196	32
Other taxes and accruals	683	444
Total taxes payable	9,156	6,591

The recovery of value added tax and the deductibility of expenses for profits tax purposes requires the Company to comply with strict documentary requirements as established in the Russian tax code. As discussed in Note 2 (a), the Company may have difficulty substantiating its position due to the lack of appropriate supporting documents, accordingly, an accrual of US$ 8,646 thousand and US$ 5,915 thousand at 31 December 2004 and 2003 has been recovered which represents management's estimation of quantifiable probable tax exposures. Actual results could differ from these estimates and this difference could be significant.

(tabular amounts expressed in US$ thousands)

11. Dismantlement provision

	2004
Balance at 1 January	697
Effect of currency translation	45
Increase in the discounted amount during the year	68
Balance at 31 December	810

The dismantlement provision represents the net present value of the estimated future obligation for dismantlement, abandonment and site restoration costs. The discount rate used to calculate the net present value of the dismantling liability was 13.0 percent.

As further discussed in Note 19 (f), environmental regulations and their enforcement are under development by governmental authorities. Consequently, the ultimate dismantlement, abandonment and site restoration obligation may differ from the estimated amounts and this difference could be significant.

12. Income tax

Income tax charge/ (benefit) comprises the following:

	2004
Current tax expense	2,147
Deferred tax charge/(benefit)—movement in temporary differences	(1,418)
Income tax charge/(benefit)	729

Profit before taxation for financial statement reporting purposes is reconciled to tax charge/ (benefit) as follows:

	2004
Loss before income tax	(2,819)
Theoretical tax charge at statutory rate of 24 percent	(676)
Income tax provision	1,975
Income not assessable for income tax purposes	(730)
Tax penalties and interest	160
Effect of currency translation	—
Income tax charge/(benefit)	729

Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 percent.

(tabular amounts expressed in US$ thousands)

	2004	Translation difference	Change	2003
Deferred tax liabilities				
Property, plant and equipment	10,474	631	(1,119)	10,962
Receivables	16	1	15	—
Payables	44	3	—	41
Borrowings received	792	45	46	701
Deferred tax assets				
Receivables	—	—	—	—
Dismantlement provision	(194)	(11)	(16)	(167)
Payables	(69)	(3)	(66)	—
Inventories	(53)	(5)	76	(124)
Net deferred tax liability	11,010	661	(1,064)	11,413

As discussed in Note 8, during 2004, the Company received loans from parties related to the controlling shareholder which were recorded at fair value, resulting in US$ 1,121 thousand being recognised in equity, net of deferred tax totalling US$ 354 thousand.

13. Shareholders' equity

At 31 December 2004 and 2003, the Company's share capital comprises 7,600 authorised, issued and fully paid ordinary shares with nominal value RR 1,000 converted at historic US dollar rates.

The statutory accounting reports are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation. For the year ended 31 December 2004, the Company had a statutory net profit available for distribution of US$ 546 thousand as reported in the Company's statutory accounting reports.

14. Revenues

	2004
Crude oil—Export sales	16,058
Petroleum (refined) products	
Export sales	881
Domestic sales (Russian Federation)	1,001
Total gross revenues	17,940

As discussed in Note 20(a), the Company made significant sales to related parties.

(tabular amounts expressed in US$ thousands)

15. Cost of production

	2004
Wages and salaries including payroll taxes	2,608
Depreciation and depletion	5,558
Materials	1,170
Unified production tax	2,582
Other	725
Total cost of production	12,643

16. Selling, general and administrative expenses

	2004
Transportation expenses	719
General and administrative expense	545
Wages and salaries including payroll taxes	581
Taxes other than income	797
Fines and penalties	673
Loss on disposal of fixed assets	23
Total selling, general and administrative expenses	3,338

17. Interest expense

	2004
Imputed interest expense on long-term RR denominated loans from NK LUKOil accrued at 13% per annum (Note 8)	1,284
Increase in the discounted amount of dismantlement provision during the year (Note 11)	68
Interest on loans	149
Total interest expense	1,501

18. Financial risks

Foreign exchange risk

The Company has substantial amounts of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure. The Company does not have formal arrangements to mitigate foreign exchange risks.

Credit risk

Cash and cash equivalents are deposited with banks that are considered by the Company at the time of deposit to have minimal risk of default.

The financial assets which potentially subject the Company to credit risk consist principally of trade receivables. The Company has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment, represents the maximum amount exposed to credit risk. The Company has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Company beyond the provision already recorded.

Commodity and pricing risk

The Company operations are significantly affected by the prevailing price of crude oil in the international oil market. Crude oil prices have historically been highly volatile, dependent upon the balance between supply and demand and particularly sensitive to OPEC production levels. The Company operates on Kolguev Island where the surrounding seas are not navigateable for several months of the year, this further increases the expose to commodity price risk.

19. Contingencies, commitments and operating risks

(a) Operating environment

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

(b) 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 Company 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. As a result, significant additional taxes, penalties and interest may be assessed. 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.

At 31 December 2004, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued in these financial statements.

(c) Legal proceedings

The Company is party to several legal proceedings arising in the ordinary course of business and as a result of the historic transactions entered into prior to October 2003. The ultimate resolution of these matters cannot be determined and could have a material adverse effect on the results of operations or financial position of the Company.

In 2003, certain creditors initiated proceedings against the Company to recover their alleged tax and overdue balances totalling RR 38.1 million. In June 2003, bailiffs were appointed to expropriate corporate assets and sell subsequently sell them to satisfy these obligation, and on 10 October 2003, 37 of the Company's oil wells were sold to OOO Start, for total consideration of RR 23.5 million. Title to these assets was transferred to OOO Start and the obligations deemed settled. The Company then initiated arbitration proceeding in the St. Petersburg courts to recover these assets. On 22 April 2004, the Arbitration Court of first instance ruled that the bailiff's procedures were procedurally incorrect. OOO Start appealed this decision on the basis that it was not granted proper notice of the proceedings and was not able to defend its rights, and on 20 December 2004, the Appeal Court returned this matter to a Court of first instance. Despite the fact that title to these wells is in dispute, the Company has retained all relevant production infrastructure and licenses, including the sub-soil license and title to all hydrocarbons extracted. Throughout this period, the Company has continued to operate these wells. In July 2005, the

(tabular amounts expressed in US$ thousands)

Company entered into an arrangement to settle the claims over the 37 wells. These arrangements are subject to various conditions that must be satisfied before the wells can be transferred back to the Company.

(d) Insurance

At 31 December 2004, the Company held limited insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks. Since the absence of insurance alone does not indicate an asset has been impaired or a liability incurred, no provision has been made in these financial statements.

(e) Capital commitments

At 31 December 2004, the Company had no significant contractual commitments for capital expenditures.

(f) Restoration, rehabilitation and environmental costs

The Company has operated in the upstream oil industry in the Russian Federation for many years and its activities have had 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 Company periodically evaluates its obligation related thereto. The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter 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 Company.

20. Related party transactions

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 Related Party Disclosures. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions in the reporting period or had significant balances outstanding at 31 December 2004 and 2003 are detailed below.

(a) Presented below are the transactions with related parties:

	2004
Export crude oil sales—LITASCO (OAO LUKOIL)	
—Associated amounts	12,702
—Associated volumes, tons (from annual production of 73,126 tons)	*53,523*
Export crude oil products—LITASCO (OAO LUKOIL)	
—Associated amounts	736
—Associated volumes, tons	*3,184*
Domestic crude oil products—Naryanmarneftegaz	741
—Associated volumes, tons	2,100

(b) Presented below are services rendered by related parties to the Company during 2004:

Name of related party	Type of services	2004
Lukom-A-Arkhangelsk	Security services	99
NK LUKOil	Consulting and communication services	284

(tabular amounts expressed in US$ thousands)

(c) Presented below are outstanding balances with related parties:

	2004	2003
Accounts receivable	**367**	**—**
Naryanmarneftegaz, subsidiary of NK LUKOil	367	—
Accounts payable	**5,144**	**4,253**
Arcticneft—Trading (Archangelsk)	3,772	3,772
Arcticneft—Trading (Kola),	484	—
LUKOil-Arctic Tanker (OAO LUKOIL)	288	271
Naryanmarneftegaz (OAO LUKOIL)	251	11
Transavia Garantia	74	141
OAO LUKOIL	49	—
Arcticneft-Murmansk	20	19
LUKOil-Inform (OAO LUKOIL)	1	25
Other	205	14
Loans payable	**9,787**	**10,045**
OAO LUKOIL	9,122	6,560
Arkhangelskgeoldobycha (OAO LUKOIL)	264	2,784
Naryanmarneftegaz (OAO LUKOIL)	401	373
Other	—	328

(d) Compensation paid to senior management for their services in full time or part time executive management positions comprises a contractual salary. In 2004, compensation of US$ 210 thousand paid to senior management and is included in selling, general and administrative expenses.

PricewaterhouseCoopers

OOO CNPSEI

International Financial Reporting Standards
Financial Statements

31 December 2004, 2003 and 2002

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AUDITORS' REPORT

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4 August 2005

Dear Sirs

OOO CNPSEI (the "Company")

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 4 August 2005 ("Admission Document")

Basis of preparation

The financial information set out below is based on the audited financial statements of the Company for the years ended 31 December 2004, 2003 and 2002 prepared in accordance with International Financial Reporting Standards ("IFRS") on the basis described in Note 2, to which no adjustment was considered necessary.

Responsibility

Such financial statements are the responsibility of the directors of the Company, who approved their issue.

The directors of the Company are responsible for the contents of the Admission Document in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards 200 issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that previously obtained by us relating to the audits of the financial statements underlying the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting polices are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

Opinion

In our opinion, the financial information gives, for the purposes of the Admission Document dated 4 August 2005 a true and fair view of the state of affairs of the Company as at the dates stated and the results of its operations and its cash flows for the years then ended.

Without qualifying our opinion, we draw your attention to Note 22, the Company had extensive transactions with related parties including the previous controlling shareholders, because of these relationships, it is possible that the terms of these transactions are not the same as those that would have resulted from transactions with unrelated parties.

Declaration

For the purposes of paragraph 1.2 of Annex I of the AIM PD Rules we are responsible for this report as part of the Admission Document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Admission Document in compliance with Annex I of the AIM PD Rules.

OOO CNPSEI

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

Balance Sheets

As at 31 December	Notes	2004	2003	2002
Assets				
Current assets				
Cash and cash equivalents	5	108	66	370
Restricted cash		26	—	94
Trade and other receivables	6	1,311	422	384
Prepaid expenses		31	17	17
Inventories	7	143	182	187
Total current assets		1,619	687	1,052
Non-current assets				
Property, plant and equipment	8	5,518	4,841	4,341
Total non-current assets		5,518	4,841	4,341
Total assets		7,137	5,528	5,393
Liabilities and participants' funds				
Current liabilities				
Short-term loans	9	857	—	—
Trade and other payables	10	1,841	126	115
Taxes payable	11	317	159	35
Total current liabilities		3,015	285	150
Long-term liabilities				
Dismantlement provision	12	107	82	61
Deferred tax liability	13	242	440	438
Total long-term liabilities		349	522	499
Total Liabilities		3,364	807	649
Participants' funds				
Charter capital	14	4,369	4,116	3,815
Retained earnings / (deficit)	14	(551)	621	929
Translation difference		(45)	(16)	—
Total participants' funds		3,773	4,721	4,744
Total liabilities and participants' funds		7,137	5,528	5,393

Approved on behalf of the Board of Directors: 14 July 2005.

Vasily K. Tereschenko
Acting General Director

Natalya N. Sergeeva
Chief Accountant

OOO CNPSEI

Financial Statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

STATEMENTS OF OPERATIONS

Year ended 31 December	Notes	2004	2003	2002
Revenues				
Gross revenues	15	7,473	3,886	5,470
Less excise taxes and export duties		(1,038)	(403)	(355)
Net revenues		6,435	3,483	5,115
Operating costs				
Cost of production	16	(4,366)	(2,372)	(2,557)
Selling, general and administrative expenses	17	(1,714)	(1,024)	(1,146)
Exploration expenses		—	—	(137)
Total operating costs		(6,080)	(3,396)	(3,840)
Operating Profit		355	87	1,275
Interest and other income		2	7	47
Interest expense	18	(30)	(10)	(7)
Monetary loss		—	—	(175)
Foreign currency gains/(losses)		18	(1)	18
Other non-operating gains/(losses)	19	(1,444)	(5)	39
Profit/(loss) before income tax		(1,099)	78	1,197
Income tax (charge)/benefit	13	(94)	16	(492)
Net (loss)/profit		(1,193)	94	705

OOO CNPSEI

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

Statements of Cash Flows

Year ended 31 December	Notes	2004	2003	2002
Profit/(loss) before income tax		(1,099)	78	1,197
Adjustments for:				
Interest income		—	(6)	—
Interest expense		30	5	7
Foreign exchange (gain)/losses		(18)	—	(18)
Provision for bad debts		586	11	4
Depreciation and depletion		382	262	265
Write-off of unsuccessful exploratory well and other oil and gas property		—	—	138
Non-cash settlements of income tax		—	91	—
Monetary effect		—	—	264
Other		9	12	(42)
Net operating cash flow/(outflow) before changes in working capital		(110)	453	1,815
Decrease in inventories		48	19	49
Increase in trade and other receivables		(1,407)	(25)	(57)
Decrease/(increase) in prepaid expenses and other current assets		(13)	2	(7)
(Decrease)/increase in trade and other payables		1,644	2	(3)
(Decrease)/increase in taxes payable		143	115	(31)
Cash generated from operations		305	566	1,766
Income tax paid		(319)	(75)	(308)
Net cash generated from/(used in) operating activities		(14)	491	1,458
Cash flows from investing activities				
Purchase of property, plant and equipment		(753)	(434)	(475)
Net cash used in investing activities		(753)	(434)	(475)
Cash flows from financing activities				
Proceeds from loans		828	—	—
Distribution to participants	14	—	(476)	(1,607)
Net cash generated from/(used in) financing activities		828	(476)	(1,607)
Effects of inflation on cash and cash equivalents		—	—	(165)
Effects of translation differences on cash and cash equivalents		7	21	—
Net increase/(decrease) in cash and cash equivalents		68	(398)	(789)
Cash and cash equivalents at the beginning of the period		66	464	1,253
Cash and cash equivalents at the end of the period		134	66	464

OOO CNPSEI

Financial statements for the year ended 31 December 2004, 2003 and 2002

(expressed in US$ thousands)

STATEMENTS OF CHANGES IN PARTICIPANTS' FUNDS

	Note	Charter capital	Translation difference	Retained earnings/ (deficit)	Total participants' funds
Balance at 1 January 2002		3,815	—	1,830	5,645
Distribution to participants	14	—	—	(1,607)	(1,607)
Net profit for the year		—	—	706	706
Balance at 31 December 2002		3,815	—	929	4,744
Distribution to participants	14	—	—	(476)	(476)
Effect of currency translation		301	(16)	74	359
Net profit for the year		—	—	94	94
Balance at 31 December 2003		4,116	(16)	621	4,721
Effect of currency translation		253	(29)	21	245
Net profit for the year		—	—	(1,193)	(1,193)
Balance at 31 December 2004		4,369	(45)	(551)	3,773

1. Activities

The core activities of OOO CNPSEI ("the Company") are exploration, production and sale of crude oil. The Company holds licenses for Sosnovskoye and Yuzhnotebukskoye fields which expire in December 2017. The Company operates oil-extraction facilities in the Komi Republic of the Russian Federation.

The Company was founded by Ukhta City Committee of Communist Party of Soviet Union in 1990. In 1991 the Company was re-organised through liquidation and was re-founded by five individuals. From August 2003 through October 2004 the Company was owned by OOO Neftegazrazvitiye ("Neftegazrazvitiye"). In October 2004, the Company was acquired by Urals Energy Holdings Limited ("Urals Energy") and its affiliated entities.

The Company employed an average 169, 171 and 194 people during 2004, 2003 and 2002, respectively.

The Company is registered in Russian Federation, 169400, Komi republic, Ukhta, Pervomayskaya str. 18.

2. Basis of preparation and summary of significant accounting policies

(a) First time adoption of IFRS

These financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS") in force at 31 December 2004. None of the revised standards have been early adopted for the purposes of these financial statements. IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied in preparing these financial statements. The accompanying financial statements represent the first time adoption of IFRS by the Company. The policies set out below have been consistently applied to all the years presented. The Company has taken the exemption available under IFRS 1 to record certain property, plant and equipment using fair values to approximate deemed cost in its transition balance sheet (see Note 3).

The Company maintains its accounting records in Russian Rouble ("RR") and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation (Russian GAAP). The financial statements are based on statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS. A reconciliation and description of the effect of transition from Russian GAAP to IFRS on the Company's equity and its net loss are presented in Note 3.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of revenues and expenses during the reporting period. Estimates have principally been made in respect to fair values of non-current assets at the transition balance sheet, deferred income taxes and the provision for impairment of receivables. Actual results could differ from these estimates.

(b) Measurement and presentation currency

The Russian Rouble is the measurement currency for the Company's operations as the majority of the Company's business is conducted in Russian Roubles and management have historically used the Russian Roubles accounts to manage the Company's financial risks and exposures, and to measure its performance. Balance sheet items denominated in foreign currencies have been remeasured using the exchange rate at the respective balance sheet date. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income or loss. The US dollar to RR exchange rates were 27.75, 29.45 and 31.78 as of 31 December 2004, 2003 and 2002, respectively.

These financial statements have been presented in US dollars ("US$") in accordance with pronouncements of SIC 30 Reporting Currency—Translation from Measurement Currency to Presentation

(tabular amounts expressed in US$ thousands)

Currency. Since the measurement currency (RR) is no longer the currency of hyperinflationary economy effective from 1 January 2003, the guidelines followed in translating RR amounts were:

- Assets and liabilities for the balance sheets presented are translated at the closing rate existing at the date of each balance sheet presented.
- Income and expense items for the period presented are translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates.
- Equity items other than the net profit (loss) for the period that is included in the balance of retained earnings are translated at the closing rate existing at the date of each balance sheet presented.
- All exchange differences resulting from translation are recognised directly in equity.
- Corresponding figures have been translated to US$ as a matter of arithmetic computation using the official rate of the Central Bank of the Russian Federation at 31 December 2003 of RR 29.45 (2002: RR 31.78) to US$1.

The US$ amounts are presented solely for the convenience of the reader and should not be construed as a representation that the RR amounts have been or could have been converted to US$ at this rate.

(c) Accounting for the effect of hyperinflation

Prior to 1 January 2003, the economy of the Russian Federation was considered hyperinflationary and accordingly, the Company applied IAS 29 *Financial Reporting in Hyperinflationary Economies* (IAS 29). Subsequent to 1 January 2003 the economic characteristics of the Russian Federation indicated that hyperinflation had ceased, and the Company no longer applied the provisions of IAS 29. The amounts expressed in the measuring unit current at 31 December 2002 were treated as the basis for the carrying amounts in these financial statements.

Prior to 1 January 2003 IAS 29 required that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. The adjustments and reclassifications made to the statutory accounts for the purpose of IFRS reporting include the restatement for changes in the general purchasing power of the Russian Rouble ("RR") in accordance with IAS 29.

Corresponding figures, for the year ended 31 December 2002, were restated for the changes in the general purchasing power of the RR at 31 December 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat"), and from indices obtained from other published sources for years prior to 1992. The indices used to restate corresponding figures, based on 1988 prices (1988 = 100) for the five years ended 31 December 2002, and the respective conversion factors, are:

Year	Indices	Conversion Factor
1998	1,216,546	2.24
1999	1,661,619	1.64
2000	1,996,075	1.37
2001	2,371,679	1.15
2002	2,730,373	1.00

The main guidelines followed in restating the corresponding figures were:

- All corresponding amounts, were stated in terms of the measuring unit current at 31 December 2002;
- Monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002.
- Non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of participants' funds were restated

from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002.

- All items in the statement of operations and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to 31 December 2002.
- Gains or losses that arose as a result of holding monetary assets and liabilities for the reporting period ended 31 December 2002 were included in the statement of operations as a monetary gain or loss.

(d) Property, plant and equipment

As discussed in Note 2 (a), the Company has adopted IFRS for the first time effective 1 January 2002. The Company has elected to utilise exemptions available for first-time adopters under IFRS 1 and has recorded its properties, plant and equipment at revalued cost in accordance with Russian statutory requirements. Such revaluation was performed on 1 January 1997. From 1 January 1997 through 1 January 2003, additions, disposals and period end balances were adjusted for the impact of IAS 29 as disclosed in Note 2 (c) above.

Subsequent to 1 January 2002, additions to property, plant and equipment are recorded at historical cost. Historical cost includes expenditure that is directly attributable to the acquisition of the items. All other repair and maintenance costs are charged to the statement of operations during the financial period in which they were incurred. After being recognised as assets all items of property, plant and equipment are carried at their cost less any accumulated depreciation and any accumulated impairment losses.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. If the asset's carrying amount is greater than its estimated recoverable amount an impairment write-down is immediately recorded.

The Company follows the successful efforts method of accounting for its oil and gas properties whereby property acquisitions, successful exploratory wells, development costs and support equipment and facilities are capitalised. Unsuccessful exploratory wells are charged to expense at the time the wells or other exploration activities are determined to be non-productive. Overheads and all other exploration costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortisation of capitalised costs of proved oil and gas properties is calculated using the units-of-production method based upon total proved reserves for property acquisitions and proved developed reserves for exploration and development costs. Proved developed oil and gas reserves for depletion purposes were 448, 501 and 540 thousand tons at 31 December 2004, 2003 and 2002, respectively. Oil and gas reserves for this purpose are determined in accordance with Society of Petroleum Engineers definitions and were estimated by DeGolyer and McNaughton, the Company's independent reservoir engineers.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the statement of operations.

(e) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions, including those related to dismantlement, abandonment and site restoration, are evaluated and re-estimated annually, and are included in the financial statements at each balance sheet date at their expected net present values using discount rates which reflect the economic environment in which the Company operates.

Changes in provisions resulting from the passage of time or changes in the discount rates applied are reflected in the statement of income each year under financial items. Other changes in provisions, relating to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change.

The provision for dismantlement liability is recorded on the balance sheet, with a corresponding amount being recorded as part of property, plant and equipment.

(f) Inventories

Inventories are valued at the lower of the weighted-average cost or net realisable value.

Costs include those directly attributable to extracting crude oil and gas and those directly attributable to bringing materials and supplies and construction equipment to their present location and condition. General and administrative expenditure is excluded from inventory costs and expensed in the period incurred.

(g) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the statement of operations.

(h) Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks.

(i) Value added tax

Value added tax related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

(j) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of operations over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(k) Deferred income taxes

Deferred income tax is calculated at rates enacted at the balance sheet date, using the liability method, for all temporary differences between the tax base of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from application of IAS 29, depreciation on property, plant and equipment, provisions and expenses which are charged to the statement of income before they become deductible for tax purposes.

Deferred income tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit or temporary differences will be available against which they can be utilised.

Deferred income tax assets and liabilities are offset when the Company has a legally enforceable right to set off current tax assets against current liabilities.

(l) Retirement benefit obligations

The Company makes contributions in accordance with Russian statutory requirements, (which are calculated as a percentage of current gross salary), to the State Pension Scheme of the Russian Federation and such expense is charged to the statement of income as incurred.

(m) Revenue recognition

Revenues are recognised when crude oil or refined products are dispatched to customers and title has transferred. Revenues from non-cash sales are recognised at the fair value of the goods or services sold, which approximates the fair value of the goods or services received in exchange. Net revenues are stated exclusive of export duties and of value added taxes.

(n) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(o) Non-cash transactions

Non-cash transactions are recorded at their fair value. The fair value of non-cash transactions from crude oil sales is determined by the market value of crude oil.

Non-cash transactions have been excluded from the investing and financing activities components in the accompanying statement of cash flows.

3. Effect of the transition from Russian GAAP to IFRS on the Company's financial position, financial performance and cash flows

Reconciliation of charter capital:

	As of 1 January 2002	As of 31 December 2004
Charter capital under Russian GAAP	4	4
Indexation of share capital under IAS 29	3,810	4,365
Charter capital under IFRS	3,814	4,369

(tabular amounts expressed in US$ thousands)

Reconciliation of participants' funds:

	As of 1 January 2002	As of 31 December 2004
Participants' funds under Russian GAAP	4,238	4,512
Deemed cost adjustment to property, plant and equipment[(1)]	1,623	1,616
Additional depreciation charge	—	(586)
Effect of inflation accounting[(2)]	641	732
Difference in accounting for property, plant and equipment disposals	(422)	—
Accrual of expenses[(3)]	(26)	(1,188)
Interest accrual	—	(46)
Impairment of receivables[(4)]	—	(1,031)
Deferred tax adjustment[(5)]	(409)	(236)
Participants' funds under IFRS	5,645	3,773

(1) Deemed cost adjustment of property, plant and equipment relates to first the adoption of IFRS and the exceptions taken as discussed in Note 2 (d).

(2) As discussed in Note 2 (c), IFRS required restatement to a measurement unit current at the balance sheet date while Russian accounting required no similar adjustment.

(3)/(4) Different measurement and legislation criteria under Russian accounting results in the need to record accruals and provisions for fair presentation under IFRS.

(5) The above adjustments have been tax affected and the difference recorded as deferred tax liability.

The Company has utilised the exemption available to first-time adopters under IFRS 1 with regard to determining carrying value of property, plant and equipment at the transition date. The management has recorded the Company's property, plant and equipment in the transition balance sheet at revalued amounts under Russian GAAP as at 1 January 1997 as adjusted for IAS 29 through 1 January 2003, and used such values as the deemed cost of these assets at that date.

Reconciliation of the loss incurred for 12 months ended 31 December 2004:

	12 months ended 2004
Net profit under Russian GAAP	915
Impairment of receivables	(993)
Accrual of expenses	(1,072)
Additional depreciation charge	(226)
Deferred tax adjustment	214
Interest accrual	(18)
Other	(13)
Net profit/(loss) under IFRS	(1,193)

4. Segment information

The Company operates in one business segment which is crude oil production. The Company assesses its results of operations and makes its strategic and investment decisions based on the analysis of its profitability as a whole. The Company operates within one geographical segment, which is the Russian Federation.

5. Cash and Cash Equivalents and Supplemental Cash Flow Information

Included in cash and cash equivalents at 31 December 2004, 2003 and 2002 are Russian Rouble denominated amounts totalling RR 1,601 thousand (US$ 58 thousand), RR 1,931 thousand (US$ 66 thousand) and RR 8,395 thousand (US$ 264 thousand), respectively.

(tabular amounts expressed in US$ thousands)

6. Trade and other receivables

	2004	2003	2002
Accounts and notes receivable—trade (net of provision of US$ 608, US$ nil and US$ nil at 31 December 2004, 2003 and 2002, respectively)	11	21	101
Advances to suppliers	26	5	9
Recoverable taxes, including Value Added Tax	476	237	111
Prepaid taxes, other than value added tax	34	19	124
Trade receivables from related parties (Note 22)	758	130	—
Other receivables	6	10	39
Total trade and other receivables	1,311	422	384

7. Inventories

	2004	2003	2002
Crude oil	16	39	—
Materials and supplies	127	143	187
Total inventories	143	182	187

(tabular amounts expressed in US$ thousands)

8. Property, plant and equipment

	Equipment on Oil and Gas properties	Assets under Construction	Total
Cost			
Balance at 1 January 2002	3,651	1,294	4,945
Translation difference	—	—	—
Additions	218	430	648
Disposals	(83)	(350)	(433)
Balance at 31 December 2002	3,786	1,374	5,160
Translation difference	319	94	413
Additions	522	416	938
Disposals	(65)	(516)	(581)
Balance at 31 December 2003	4,562	1,368	5,930
Translation difference	283	89	372
Additions	96	762	858
Disposals	(28)	(91)	(119)
Balance at 31 December 2004	4,913	2,128	7,041
Accumulated Depreciation			
Balance at 1 January 2002	(637)	—	(637)
Translation difference	—	—	—
Depreciation and depletion	(265)	—	(265)
Disposals	83	—	83
Balance at 31 December 2002	(819)	—	(819)
Translation difference	(73)	—	(73)
Depreciation and depletion	(262)	—	(262)
Disposals	65	—	65
Balance at 31 December 2003	(1,089)	—	(1,089)
Translation difference	(80)	—	(80)
Depreciation and depletion	(382)	—	(382)
Disposals	28	—	28
Balance at 31 December 2004	(1,523)	—	(1,523)
Net book value			
Balance at 31 December 2002	2,967	1,374	4,341
Balance at 31 December 2003	3,473	1,368	4,841
Balance at 31 December 2004	3,390	2,128	5,518

The Company's oil fields are situated in Komi Republic in the Russian Federation on land owned by the Russian government. The Company holds licenses and pays production taxes to extract oil and gas from the field. The licenses expire in December, 2017, but may be extended. Management intends to renew the licenses as the properties are expected to remain productive subsequent to the license expiration date. 91 thousand tons are expected to be produced after license expiration.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, amounting to US$ 74 thousand, US$ 64 thousand and US$ 53 thousand at 31 December 2004, 2003 and 2002, respectively, are included in the cost of oil and gas properties. The Company has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred beginning 2002 through 2029.

(tabular amounts expressed in US$ thousands)

The Company leases 5 wells from OAO Tebukneft under short-term operating lease arrangements. The Company may experience difficulties in maintaining production volumes if such lease arrangements are not renewed.

Subsequent to 31 December 2004 certain property, plant and equipment with carrying net book value of US$ 441 thousand was pledged to secure Company's borrowing (see Note 23).

9. Short-term loans

	2004	2003	2002
Related party borrowings	840	—	—
Interest payable	17	—	—
Total short-term loans	857	—	—

At 31 December 2004 related party borrowings comprised the following:

Name of organisation	2004	Currency	Interest rate	Date of repayment
Urals Energy (Note 22 (d))	330	US$	15.0%	October 2005
Urals Energy (Note 22 (d))	80	US$	15.0%	November 2005
Urals Energy (Note 22 (d))	430	US$	15.0%	November 2005
	840			

10. Trade and other payables

	2004	2003	2002
Trade payables	87	48	24
Advances from related parties (Note 22 (c))	573	—	—
Wages and salaries	62	52	91
Payables under guarantee arrangements (Note 22 (b))	1,073	—	—
Other payable and accrued expenses	46	26	—
Total trade and other payables	1,841	126	115

11. Taxes payable

	2004	2003	2002
Value added tax	117	25	1
Unified production tax	168	102	—
Other taxes and accruals	32	32	34
Total taxes payable	317	159	35

12. Dismantlement provision

	2004	2003	2002
Balance at 1 January	82	60	49
Effect of currency translation	5	5	—
Change in the estimated liability	7	7	5
Increase in the discounted amount during the year	13	10	7
Balance at 31 December	107	82	61

The dismantlement provision represents the net present value of the estimated future obligation for dismantlement, abandonment and site restoration costs. The discount rate used to calculate the net present value of the dismantling liability was 13 percent for all periods.

(tabular amounts expressed in US$ thousands)

As further discussed in Note 21 (g), environmental regulations and their enforcement are under development by governmental authorities. Consequently, the ultimate dismantlement, abandonment and site restoration obligation may differ from the estimated amounts and this difference could be significant.

13. Income tax

Income tax charge/(benefit) comprises the following:

	2004	2003	2002
Current tax expense	310	16	409
Deferred tax charge/(benefit)—movement in temporary differences	(216)	(32)	83
Income tax charge/(benefit)	94	(16)	492

Profit before taxation for financial statement reporting purposes is reconciled to tax charge/(recovery) as follows:

	2004	2003	2002
Profit/(loss) before income tax	(1,099)	78	1,199
Theoretical tax charge at statutory rate of 24 percent	(264)	19	288
(Income)/expenses which are not deductible or assessable for taxation purposes	358	(35)	7
Inflation effect on current income tax	—	—	19
Inflation effect on retained earnings at the beginning of the year	—	—	178
Income tax charge/(benefit)	94	(16)	492

The non-temporary impact of monetary gain reflects the effect on the theoretical tax charge of inflation with respect to non-monetary items of a non-temporary nature (primarily participants' funds and net deferred tax liability).

Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 percent for all years presented.

	2004	Translation difference	Charged/ (credited) to statement of operations	2003	Translation difference	Charged/ (credited) to statement of operations	2002
Deferred tax liabilities							
Property, plant and equipment	422	27	(66)	461	35	(33)	459
Inventories	—	—	—	—	—	—	—
Payables	—	—	—	—	—	—	—
Other	—	—	(4)	4	—	—	4
Deferred tax assets							
Receivables	(138)	(7)	(131)	—	—	—	—
Dismantlement provision	(26)	(1)	(5)	(20)	(1)	(4)	(15)
Payables	(6)	—	(5)	(1)	1	(1)	(1)
Inventories	(10)	(1)	(5)	(4)	(1)	6	(9)
Other	—	—	—	—	—	—	—
Net deferred tax liability	242	18	(216)	440	34	(32)	438

(tabular amounts expressed in US$ thousands)

14. Participants' funds

The statutory accounting reports are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation. For the year ended 31 December 2004, the Company had a statutory net profit available for distribution of US$ 915 thousand (2003: US$ 273 thousand and 2002: US$ 1,195 thousand), as reported in the Company's statutory accounting reports.

During the years ended 31 December 2003 and 2002 the Company's participants declared and paid dividends of US$ 476 thousand and US$ 1,607 thousand, respectively.

15. Revenues

	2004	2003	2002
Crude oil			
Export sales	4,109	2,656	3,634
Domestic sales (Russian Federation)	3,339	1,229	1,799
Petroleum (refined) products—domestic sales	—	—	10
Other sales	25	1	27
Total gross revenues	7,473	3,886	5,470

As discussed in Note 22, a significant proportion of sales are to related parties. Total volumes of crude oil sold were 53,654 tons, 38,875 tons and 48,671 tons in 2004, 2003 and 2002 respectively.

16. Cost of production

	2004	2003	2002
Wages and salaries including payroll taxes	846	481	487
Depreciation and depletion	382	262	265
Materials	480	401	358
Unified production tax	1,939	1,021	1,073
Other	719	207	374
Total cost of production	4,366	2,372	2,557

17. Selling, general and administrative expenses

	2004	2003	2002
Selling and transportation expenses	292	199	292
Bad debt expense	586	11	4
General and administrative expense	291	249	211
Wages and salaries including payroll taxes	469	483	572
Taxes other than income	73	81	64
Loss on assets disposal and other SG&A expenses	3	1	3
Total selling, general and administrative expenses	1,714	1,024	1,146

18. Interest expense

	2004	2003	2002
Increase in the discounted amount of dismantlement provision during the year (Note 12)	13	10	7
Interest on loans (Note 9)	17	—	—
Total interest expense	30	10	7

(tabular amounts expressed in US$ thousands)

19. Other non-operating gains/(losses)

	2004	2003	2002
Guarantee expenses (Note 22 (b))	(1,441)	—	—
Other gains and losses	(3)	(5)	39
Total other non-operating gains/(losses)	(1,444)	(5)	39

20. Financial risks

Foreign exchange risk

The Company has substantial amounts of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure.

The Company does not have formal arrangements to mitigate foreign exchange risks.

Credit risk

Cash and cash equivalents are deposited only with banks that are considered by the Company at the time of deposit to have minimal risk of default.

The Financial assets, which potentially subject the Company to credit risk, consist principally of trade receivables. The Company has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Company has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Company beyond the provision already recorded.

21. Contingencies, commitments and operating risks

(a) Operating environment

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

(b) 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 Company 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. As a result, significant additional taxes, penalties and interest may be assessed. 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.

As at 31 December 2004, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued in these financial statements.

(tabular amounts expressed in US$ thousands)

(c) Legal proceedings

The Company is a party to certain legal proceedings arising in the ordinary course of business. Management believe there are no current legal proceedings or other claims outstanding, which could have a material adverse effect on the results of operations or financial position of the Company as at 31 December 2004.

(d) Insurance

At 31 December 2004, the Company held limited insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks. Since the absence of insurance alone does not indicate an asset has been impaired or a liability incurred, no provision has been made in these financial statements.

(e) Capital commitments

At 31 December 2004, the Company had no contractual commitments for capital expenditures.

(f) Guarantees issued

At 31 December 2004 the Company has US$ 1,500 thousand guarantee issued to secure borrowings of Neftegazrazvitiye (see Note 22 (b)).

(g) Restoration, rehabilitation and environmental costs

The Company has operated in the upstream oil industry in the Russian Federation for many years and its activities have had 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 Company periodically evaluates its obligation related thereto. The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter 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 Company.

22. Related party transactions

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 Related Party Disclosures. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions or had significant balances outstanding at 31 December 2004, 2003 and 2002 are detailed below.

(a) Presented below are the transactions and the outstanding balances with Neftegazrazvitiye:

	2004	2003	2002
Export crude oil sales where Neftegazrazvitiye acts as an agent	2,094	1,049	—
Associated volumes, tons	*9,900*	*6,099*	—
Domestic crude oil sales to Neftegazrazvitiye	2,432	909	—
Associated volumes, tons	*28,846*	*14,031*	—
Associated receivable balance (Note 6)	—	130	—
Commission fee paid	23	8	—

(tabular amounts expressed in US$ thousands)

(b) In September 2004, the Company issued a US$ 1,500 thousand guarantee to secure the borrowings of Neftegazrazvitiye. The loan bore 14 percent interest annual fixed rate. The borrower defaulted on its obligations and the Company, as the guarantor, was obliged to repay the loan. As at 31 December 2004 the Company repaid US$ 407 thousand of the loan including interest. Subsequent to 31 December 2004, the remaining guaranteed portion was paid. In March 2005 the guarantee was terminated as the Company met all of its guarantee obligations. The full guaranteed amount has been has been expensed in these financial statements.

(c) Presented below are the transactions and the outstanding balances with OOO Urals Energy ("UER"), which is an affiliate of a Urals Energy:

	2004	2003	2002
Export crude oil sales where UER acts as an agent	730	—	—
Associated volumes, tons	*3,150*	—	—
Domestic crude oil sales to UER	894	—	—
Associated volumes, tons	*6,734*	—	—
Associated receivable balance (Note 6)	758	—	—
Associated payable balance (Note 10)	573		
Commission fee paid to UER	22	—	—

(d) At 31 December the Company has loans from Urals Energy provided for funding working capital and certain capital projects. The loans totalled US$ 840 thousand (see Note 9).

(e) Compensation paid to senior management for their services in full time or part time executive management positions comprises a contractual salary. In 2004 compensation of US$ 132 thousand (2003: US$ 194 thousand and 2002: US$ 304 thousand) paid to senior management and is included in selling, general and administrative expenses.

23. Subsequent events

In March 2005, the Company obtained US$ 2,000 thousand, a 5-year US dollar fixed interest loan from OAO Bank Zenit, for funding working capital and certain capital projects. The loan is secured by liens on various assets of the Company. The loan bears interest at 11.0 percent per annum.

In March 2005, the Company issued a US$ 10,000 thousand guarantee to secure the borrowings of ZAO Chepetskoye NGDU, a fellow subsidiary of Urals Energy.

PricewaterhouseCoopers

PART VI

UNAUDITED PRO FORMA FINANCIAL INFORMATION

The unaudited pro forma financial information appearing in this Part VI was prepared to illustrate the effect on the consolidated statement of operations of the Company if the acquisitions of Petrosakh, CNPSEI and Arcticneft had occurred on 1 January 2004 and on the consolidated balance sheet as if the acquisition of Arcticneft had occurred as at 31 December 2004. The information in the unaudited pro forma financial information was extracted from the audited statements contained herein. This unaudited financial information is based on estimates and assumptions deemed appropriate by the Company and is presented for illustrative purposes only. Such information should not be relied upon as an indication of the results that the Company would have achieved if the acquisitions had occurred on the above assumed dates, nor should it be used as an indication of the results that it will achieve during any period following the acquisitions. For further discussion of unaudited pro forma financial information see the paragraph headed "Pro Forma Financial Information" in Part II of this document.

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)
Unaudited Pro Forma Financial Information

31 December 2004

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Unaudited Pro Forma Consolidated Financial Information 2004

Basis of preparation

The unaudited pro forma consolidated financial information set out below has been prepared to illustrate the effect on the consolidated statement of operations of Urals Energy Public Company Limited, (formerly Urals Energy Holdings Limited) as if the acquisitions of Petrosakh, CNSPEI and Arcticneft had occurred on 1 January 2004 and on the consolidated balance sheet as if the acquisition of Arcticneft had occurred as at 31 December 2004. The information, which is produced for illustrative purposes only, by its nature addresses a hypothetical situation and therefore does not represent the actual financial position of the Group. No adjustments have been made to reflect any transactions other than as set out in the unaudited pro forma financial information.

The information in the unaudited pro forma financial information was extracted from the Accountant's reports of Urals Energy Public Company Limited, Petrosakh, CNSPEI and Arcticneft as set out in Part VI of this document. The financial statements of Arcticneft are unaudited. Management of Arcticneft have not maintained appropriate accounting records and evidence supporting its costs and obligations, accordingly the Accountants Report states they are unable to form an opinion on whether the financial statements of Arcticneft are true and fair. The pro forma financial information does not take account of the trading results or movements in working capital of Arcticneft between 31 December 2004 and the date of acquisition by Urals Energy on 11 July 2005.

This unaudited financial information is based on estimates and assumptions deemed appropriate by the Company and is presented for illustrative purposes only. Such information should not be relied upon as an indication of the results that the Company would have achieved if the acquisitions had occurred on the above assumed dates, nor should it be used as an indication of the results that it will achieve during any period following the acquisitions.

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Unaudited Pro Forma Consolidated Financial Information 2004

(expressed in US$ thousands)

PRO FORMA CONSOLIDATED BALANCE SHEET

As at 31 December 2004	Urals Energy Public Company Limited	ZAO Arcticneft	Adjustments [a]	Pro Forma
Assets				
Current assets				
Cash and cash equivalents	1,395	3,414	—	4,809
Restricted cash	26	—	—	26
Accounts receivable and prepayments	3,706	889	—	4,595
Inventories	2,247	2,062	—	4,309
Total current assets	7,374	6,365	—	13,739
Non-current assets				
Property, plant and equipment	100,622	56,567	1,479	158,668
Other non-current assets	292	—	—	292
Total assets	108,288	62,932	1,479	172,699
Liabilities and shareholders' equity				
Current liabilities				
Accounts payable and accrued expenses	3,019	665	—	3,684
Taxes payable	1,917	7,270	—	9,187
Short-term borrowings	38,815	9,156	—	47,971
Advances from customers	5,102	—	—	5,102
Amount due for acquisition of ZAO Petrosakh and ZAO Arcticneft	9,899	—	26,378	36,277
Total current liabilities	58,752	17,091	26,378	102,221
Non-current liabilities				
Long-term finance lease obligations	1,556	9,122	—	10,678
Dismantlement provision	950	810	—	1,760
Deferred tax liability	17,751	11,010	—	28,761
Total non-current liabilities	20,257	20,942	—	41,199
Total liabilities	79,009	38,033	26,378	143,420
Minority interest	1,327	—	—	1,327
Shareholders' equity				
Share capital	209	274	(274)	209
Share premium	42,172	3,477	(3,477)	42,172
Unpaid capital	(11,324)	—	—	(11,324)
Translation difference	1,236	(93)	93	1,236
Retained earnings/(deficit)	(4,341)	21,241	(21,241)	(4,341)
Total shareholders' equity	27,952	24,899	(24,899)	27,952
Total liabilities and shareholders' equity	108,288	62,932	1,479	172,699

Approved by the Board of Directors, 18 July 2005.

W.R. Thomas
Chief Executive Officer

S. Buscher
Chief Financial Officer

Urals Energy Public Company Limited
(formerly Urals Energy Holdings Limited)

Unaudited Pro Forma Consolidated Financial Information 2004

(expressed in US$ thousands)

PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

Year ended 31 December 2004	Urals Energy Public Company Limited	ZAO Petrosakh	OOO CNPSEI	ZAO Arcticneft	Adjustments [b]	[c]	[d]	Pro Forma
Revenues								
Gross revenues	8,184	28,576	7,473	17,940	(3,521)	—	—	58,652
Less: excise taxes and export duties	(783)	(5,366)	(1,038)	(3,501)	183	—	—	(10,505)
Net revenues	7,401	23,210	6,435	14,439	(3,338)	—	—	48,147
Operating costs								
Cost of production	(4,062)	(10,497)	(4,366)	(12,643)	1,449	(5,386)	—	(35,505)
Selling, general administrative and other expenses	(7,115)	(3,805)	(1,714)	(3,338)	588	—	—	(15,384)
Exploration expense	—	(5,347)	—	—	—	—	—	(5,347)
Other operating expenses	—	(312)	—	—	—	—	—	(312)
Total operating costs	(11,177)	(19,961)	(6,080)	(15,981)	2,037	(5,386)	—	(56,548)
Operating profit/(loss)	(3,776)	3,249	355	(1,542)	(1,301)	(5,386)	—	(8,401)
Interest income	82	21	2	284	—	—	—	389
Interest expense	(574)	(2,495)	(30)	(1,501)	318	—	(3,291)	(7,573)
Foreign currency gains/(losses)	211	(99)	18	(222)	5	—	—	(87)
Other non-operating gains/(losses)	222	26	(1,444)	162	1,442	—	—	408
(Loss)/profit before income tax	(3,835)	702	(1,099)	(2,819)	464	(5,386)	(3,291)	(15,264)
Income tax (charge)/benefit	177	(712)	(94)	(729)	16	—	—	(1,342)
(Loss)/profit after income tax	(3,658)	(10)	(1,193)	(3,548)	480	(5,386)	(3,291)	(16,606)
Minority interest	(14)	—	—	—	—	—	—	(14)
Net (loss)/profit	(3,672)	(10)	(1,193)	(3,548)	480	(5,386)	(3,291)	(16,620)

(tabular amounts expressed in US$ thousands)

1. Adjustments to the pro forma financial information

Adjustments to the pro forma consolidated balance sheet

[a] The acquisition of Arcticneft by Urals Energy will be accounted for using the purchase method of accounting in accordance with IFRS 3 Business Combinations. IFRS 3 requires management to assess the fair value of the assets acquired and the liabilities assumed at the acquisition date. The difference between the fair value of the consideration given and the assets acquired and liabilities assumed will be treated as either goodwill or negative goodwill. Goodwill will be capitalised and periodically assessed for impairment, while any excess of the fair value of the net assets over the purchase consideration will be immediately recorded in the statement of operations. Since management have not completed the fair value assessment as at this date, the balance sheet information has been extracted without adjustment from the unaudited financial statements of Arcticneft.

The calculation of excess of the purchase consideration over the fair value of net assets acquired has been determined as follows:

	Amount
Purchase price	35,500
Less debt assumed	(9,122)
Net consideration payable	26,378
Assets acquired and liabilities assumed	24,899
Excess of the purchase consideration over fair value of net assets acquired	1,479

Excess of the purchase consideration over the fair value of net assets acquired totalling US$ 1,479 thousand has been recorded in property, plant and equipment in the pro forma balance sheet. The net consideration payable has been recorded within short-term payables.

Adjustments to the pro forma consolidated statement of operations

[b] The consolidated statement of operations for Urals Energy includes the financial results of Petrosakh and CNPSEI from their respective acquisition dates of 1 December 2004 and 1 November 2004. The aggregation of Urals Energy with Petrosakh and CNPSEI results in the duplication of these results during this period and accordingly a consolidation adjustment has been recorded to eliminate this duplication in the pro forma financial information.

[c] The purchase accounting adjustment for the acquisition of Petrosakh, CNPSEI and Arcticneft resulted in a fair value uplift to property, plant and equipment over the historic IFRS book value totalling US$ 53,481 thousand. The fair value uplift relates primarily to the acquired reserves. Had these acquisitions been completed as of 1 January 2004, additional depletion of US$ 5,386 thousand would have been recorded. This adjustment was recorded to the pro forma financial information.

[d] The acquisition of Petrosakh, CNPSEI and Arcticneft will result in incremental indebtedness totalling approximately US$ 34,500 thousand. Incremental interest on such borrowings at 9.5 percent per annum totalling US$ 3,291 has been recorded in the pro forma financial information.

(tabular amounts expressed in US$ thousands)

2. Cost of production

	Urals Energy Public Company Limited	ZAO Petrosakh	OOO CNPSEI	ZAO Arcticneft	Adjustments	Pro Forma
Depreciation and depletion	522	2,888	382	5,558	5,323	14,673
Unified production tax	1,394	4,612	1,939	2,582	(730)	9,797
Cost of purchased products	1,178	—	—	—	—	1,178
Wages and salaries including payroll taxes	588	1,728	846	2,608	(321)	5,449
Materials	189	1,073	480	1,170	(169)	2,743
Other	191	196	719	725	(166)	1,665
Total cost of production	**4,062**	**10,497**	**4,366**	**12,643**	**3,937**	**35,505**

3. Selling, general, administrative and other expenses

Year ended 31 December 2004	Urals Energy Public Company Limited	ZAO Petrosakh	OOO CNSPEI	ZAO Arcticneft	Adjustments	Pro Forma
Selling and transportation expenses	434	877	292	719	—	2,322
Bad debt expense/ (release)		(13)	586	545	—	1,118
General and administrative expense	3,062	1,145	291	581	(166)	4,913
Wages and salaries including payroll taxes	3,293	967	469	797	(222)	5,304
Taxes other than income	312	683	73	673	(200)	1,541
Loss on assets disposal and other SG&A expenses	14	146	3	23	—	186
Total selling, general and administrative expenses	7,115	3,805	1,714	3,338	(588)	15,384

PART VII
ADDITIONAL INFORMATION

1. **General**

1.1 Save as disclosed in this document, the Directors are not aware of any exceptional factors which have influenced the Company's recent activities.

1.2 Save as disclosed herein, there are no patents or other intellectual property rights, licenses or particular contractors which are or may be of fundamental importance to the business of the Company.

1.3 Save as disclosed in this document, there have been no known material changes in the financial or trading position of the Company since 31 December 2004, the date to which consolidated IFRS financial statements of the Company have been drawn up.

1.4 Save as disclosed, there are no significant recent trends concerning the development of the Company's business since 31 December 2004.

1.5 Save as disclosed the Company has no significant investments in progress. The Company continues to actively seek acquisitions in accordance with its growth and acquisition strategy.

1.6 The minimum amount which, in the opinion of the Directors, must be raised under the Placing to satisfy the matters described in "Use of Proceeds" in Part II of this document is $100 million.

2. **The Company**

2.1 The Company was incorporated as a limited liability company by shares and registered in Cyprus on 10 November 2003 under the name Urals Energy Holdings Limited by the filing of its original Memorandum of Association with the Companies Registrar of Cyprus. On 18 July 2005, the Company resolved to change its name to Urals Energy Public Company Limited and the Company's name changed in July 2005.

2.2 The Company's registered number is 142893 and its registered office and principal place of business is Evagoras Building, Office 34, 3rd Floor, 31 Evagoras Avenue, CY-1066, Nicosia, Cyprus. The telephone number of the registered office is: 00 35 722 451 686. The total number of employees of the Company and its subsidiaries is approximately 1,008.

2.3 The liability of the shareholders of the Company is limited. Under the Companies Law, Cap. 113 a shareholder of a corporation is not personally liable for the acts of the corporation, save that a shareholder may become personally liable by reason of his or her own acts.

2.4 The Company owns and conducts business in Russia through the following six Russian companies:

- OOO Urals Energy

Full name	Limited Liability Company Urals Energy
Short name	Urals Energy LLC
Date of acquisition by the Company	originally founded by an affiliate of the Company (01.12.2003) and direct 100% ownership subsequently transferred to the Company (17.08.2004)
Date of registration	01.12.2003
Main State Registration Number (OGRN)	1037789006122
Taxpayer's Identification Number (INN)	7715502682
Registered address	6 Oktyabrskaya Ul., Moscow, 127018, Russia
Mailing address	6 Oktyabrskaya Ul., Moscow, 127018, Russia
Charter capital	300,000 rubles

Ownership by the Company	100%
Board of Directors	None
President Appointed by GMS (resolution of the sole shareholder)	Leonid Dyachenko

- OOO URALS-NORD

Full name	Limited Liability Company URALS-NORD
Short name	URALS-NORD LLC
Date of acquisition by the Company	50% ownership interest acquired by an affiliate of a shareholder of the Company as of date of registration (09.07.2003) and subsequently transferred to the Company (28.03.2005); The other 50% ownership interest acquired by the Company on 25.04.05
Date of registration	09.07.2003
Main State Registration Number (OGRN)	1038302274526
Taxpayer's Identification Number (INN)	2983001467
Registered address	23 Ul. Lenina, Apt. 50, Naryan-Mar, 166000, Russia
Mailing address	6 Oktyabrskaya Ul., Moscow, 127018, Russia
Charter capital	10,000 rubles
Ownership by the Company	100%
Board of Directors	None
General Director Appointed by GMS (resolution of the sole participant)	Valery Ulanov

- ZAO Chepetskoye NGDU

Full name	Closed Joint Stock Company Chepetskoye NGDU
Short name	CJSC Chepetskoye NGDU
Date of acquisition by the Company	Direct ownership of 100% share in Chepetskoye NGDU was transferred to the Company on 4.10.2004
Date of registration	20.05.1993
Date of re-registration	09.08.2002
Main State Registration Number (OGRN)	1021800672013
Taxpayer's Identification Number (INN)	1802000920
Registered Address	2a Ul. Lenina, vil. Agricol, Krasnogorsky region, Udmurt Republic, 427650, Russia
Mailing address	2a Ul. Lenina, vil. Agricol, Krasnogorsky region, Udmurt Republic, 427650, Russia
Charter capital	10,000 rubles
Description of shares	10,000 registered shares with the nominal value of 1 ruble per share

Registrar of shareholders	held by the company itself
Ownership by the Company	100%
Board of Directors	None
General Director Appointed by GMS (the sole shareholder)	Vyacheslav A. Ivanov

- OOO Center for Scientific Production and Social and Economic Initiatives (CNPSEI LLC)

Full name	Limited Liability Company Tsentr nauchno-proizvodstvennykh i sotsialno-economicheskikh initsiativ (*Center for Scientific Production and Social and Economic Initiatives*)
Short name	CNPSEI LLC
Date of acquisition by the Company	Acquisition by the Company of 20% and by affiliates of its shareholders of 80% on 27.10.2004, acquisition by the Company of direct 100% ownership interest on 28.03.2005
Date of registration (through reorganisation of the previously existing entity)	20.11.1992
Date of re-registration	25.09.2002
Main State Registration Number (OGRN)	1021100733169
Taxpayer's Identification Number (INN)	1102004768
Registered Address	18 Pervomaiskaya Ul., Ukhta, Komi Republic, 169400, Russia
Mailing address	18 Pervomaiskaya Ul., Ukhta, Komi Republic, 169400, Russia
Charter capital	119,356,04 rubles
Ownership by the Company	100%
Board of Directors	None
General Director Appointed by GMS (Resolution of the sole shareholder)	Viktor Maklygin

- ZAO Petrosakh

Full name	Closed Joint Stock Company Petrosakh
Short name	CJSC Petrosakh
Date of acquisition by the Company	Acquisition by the Company of 19.44% and by affiliates of its shareholders of 77.72% of shares of Petrosakh on 19.11.2004 and acquisition by the Company of direct ownership of 97.16% on 7.4.2005
Date of registration	15.07.1991
Date of re-registration	15.11.2002
Main State Registration Number (OGRN)	1026500535577
Taxpayer's Identification Number (INN)	6501037203

Registered Address	32 Kommunistichesky Prospect, Office 406, Yuzhno-Sakhalinsk, Sakhalin Oblast, 693009, Russia	
Mailing address	32 Kommunistichesky Prospect, Office 406, Yuzhno-Sakhalinsk, Sakhalin Oblast, 693009, Russia	
Charter capital	46,074,432 rubles	
Description of shares	30,964 registered shares with the nominal value of 1,488 rubles per share	
No. of declared shares	0	
Registered shareholders	ZAO IRKOL	
Number of shareholders	2	
Ownership of the Company		30,086 cs = 97.16%
Other shareholder	Regional State Unitary Enterprise Sakhalin Oil Company	878 cs = 2.84%
Board of Directors 7 members (5 constitute a quorum)	Alexei Antipov Leonid Dyachenko Yurly Motovilov Aleksey Ogarev ***Viatcheslav Rovneiko (Chairman)*** Alexander Vladimirovich Romanov (represents Sakhalin Oil Company) William Thomas Each elected by GMS (cumulative voting)	
General Director	Yuriy Motovilov	

- ZAO Arcticneft

Full name	Closed Joint Stock Company Arcticneft
Short name	CJSC Arcticneft
Date of acquisition by the Company	11.07.2005
Date of registration	02.07.1998
Date of re-registration in 2002	26.09.2002
Main State Registration Number (OGRN)	1028301646845
Taxpayer's Identification Number (INN)	8300004226
Registered address	1 Arktichesky pereulok, posyolok Iskateley Nenets Autonomous Okrug, 166700, Russia
Mailing address	47 ul. Polyarnye Zori, Murmansk, 183025 Russia
Amount of the charter capital	7,600,000 rubles
Description of shares	7,600 registered shares with the nominal value of 1,000 rubles per share
No. of declared shares	0
Registrar of shareholders	Share register held by the company itself
Ownership by the Company	7,600 shares (100%)
Board of Directors 5 members (3 constitute quorum) Elected by GMS (cumulative voting)	Leonid Dyachenko Steven Buscher Aleksey Ogarev ***Viatcheslav Rovneiko (Chairman)*** William Thomas
General Director Appointed by BoD	Vyacheslav Alexandrovich Ivanov

3. Share Capital of the Company

3.1 General

The Company was incorporated on 10 November 2003, and had 10,000 authorised shares with a par value of CY£1.00 per share for a total authorised share capital of CY£10,000. On 28 July 2004, the Company issued an additional 90,000 authorised shares with a par value of CY£1.00 per share and on 20 May 2005, the Company issued an additional 23,585 authorised shares with a par value of CY£1.00. On 18 July 2005, the Company resolved a share split whereby 400 shares were issued for every 1 share of the Company and the total authorised capital was changed to CY£250,000 with a par value of CY£.0025 each. At the date of this document, the authorised and issued share capital of the Company is as follows:

Authorised			Issued and fully paid	
Number	Amount		Number	Amount
100,000,000	CY£250,000	Shares of CY£.0025	53,084,482	CY£132,711.21

Other than the holdings of the Directors, or their connected persons which are set out below in this paragraph, the Company is aware of the following persons who, as at the date of this document, directly or indirectly, jointly or severally, hold 3% or more of the Company's share capital immediately prior to the Placing:

Name	Number of Shares	Percentage of Share Capital
Alexei V. Ogarev[1]	2,610,756	4.918%

(1) Held through ownership of connected persons.

The Company is not aware of any person who either alone or, together with any person with whom he is connected, will or could exercise control over the Company immediately following Admission.

The holdings of the Directors and the major shareholders set out in the table above are, at the date of this document, or will, following the Placing, be as follows:

	Share Capital as at the date of this document		Percentage of Enlarged Issued Share Capital following Admission[1][2]
	Number of Shares	Percentage of Share Capital	
Directors			
Viatcheslav V. Rovneiko[3]	18,132,639	34.158	21.931
Gueorgui N. Ramzaitsev[3]	18,132,639	34.158	21.931
Leonid Y. Dyachenko[3]	6,445,558	12.142	7.796
William R. Thomas[3]	4,196,263	7.905	5.075
Major Shareholders			
Alexei V. Ogarev[3]	2,610,756	4.918	3.158

Notes:

(1) Assuming no Over-allotment Shares are acquired pursuant to the Over-allotment Arrangements and subject to the stock lending arrangements described in paragraph 8.2.2 of this Part VII.

(2) Assuming the conversion of the RP Explorer Notes into shares on the date of Admission but for the avoidance of doubt excluding Stephen M. Buscher's shares received upon the exercise of his outstanding options.

(3) Held through ownership of connected persons.

3.2 Shares

The holders of shares are entitled to one vote for each share held of record on all matters submitted to a vote of the shareholders. Holders of shares are entitled to receive ratably only those dividends as may be declared by the Board out of funds legally available, as well as any distributions to the shareholders. Details of the Company's dividend policy are set out in "Dividend Policy" in Part II of this document.

In the event of the Company's liquidation, dissolution or winding up, holders of shares are entitled to share ratably in all of the Company's assets remaining after the Company pays its liabilities.

The rights attaching to the shares provided for in the Company's Memorandum of Association and Articles of Association are set out in paragraph 4 of this Part VII. The rights attaching to the shares are also subject in all respects to applicable Cypriot law.

3.3 Preferred Shares

The Company has no authorised Preferred Shares and has no present plan to authorise or issue Preferred Shares.

3.4 Convertible Notes

On 11 July 2005, the Company entered an investment agreement with RP Explorer Master Fund ("RP Explorer") whereby the Company agreed to issue to RP Explorer an unsecured convertible preferred 'A' note in the amount of $10 million and an unsecured convertible preferred 'B' note in the amount of $5 million. Pursuant to such agreement, the Company issued the $10 million, 10% subordinated, unsecured notes due 15 December 2006. The notes are issued at 100% and accrete daily up to 117% on maturity. The Company may redeem the notes before maturity on 30 days notice and payment of a 10% redemption fee. RP Explorer has the option to extend maturity of the notes for a further 12 months. If, before maturity, the Company issues shares in an IPO, provided such offering is at least $60 million, the notes must be converted to shares at a conversion discount from the IPO price of 20%. The conversion discount is further increased by 1.5% per month after 15 August 2005 until an IPO occurs. As part of such arrangements, RP Explorer agreed not to transfer the notes to any third party and not to sell its shares upon conversion for a period of 180 days following Admission without the consent of MSIL as the Company's Nominated Advisor in order to maintain an orderly market and not to adversely affect the market or price for the Company's shares.

3.5 Option Programme

The Company has established a Compensation Committee of the Board of Directors in order to determine compensation of the Company's key employees, including the Chief Executive, the Chief Financial Officer, the President and General Directors of the Russian subsidiaries and other key personnel as may be determined from time to time by the Compensation Committee. The Company intends to establish a stock option programme pursuant to which the key employees will be granted options to subscribe for shares, such grants to be based on a number of factors including the growth and financial performance of the Company in addition to the efforts and contributions of such persons to the Company's performance. The stock option programme will allocate options to the key employees which stock will vest over a three to five year time frame and which will be priced in the discretion of the Compensation Committee. Any options which have not vested will be subject to forfeiture by an employee whose employment is terminated prior to such vesting event. It is the intention of the Company that the total amount of stock that would be available pursuant to the option programme to be established will not exceed 5% of the total ordinary share capital of the Company outstanding at any time.

3.6 Treasury Shares and Repurchase Undertakings

The Company does not have any shares in treasury and has no present plan to buy back any shares. Under Cyprus law there are restrictions on the Company's ability to repurchase its own shares which make it difficult to predict whether the Company will ever be in a position to repurchase its own shares, once issued.

4. **Memorandum and Articles of Association**

4.1 Memorandum of Association

The following is a brief summary of certain material provisions of the Company's Memorandum of Association as will be in effect immediately prior to the Placing:

(a) The purpose of the Company is to carry on business as a holding and trading company. The objects of the Company are set out in full in Clause 3 of its Memorandum of Association.

(b) The Company has an authorised share capital of CY£250,000 at the date of this document.

4.2 Articles of Association

In this paragraph, "Law" means the Companies Law, Cap. 113 of Cyprus and any successor statute or as the same may from time to time be amended. The current Articles of Association of the Company (the "Articles") were adopted by the Company on 18 July 2005. The Articles of Association incorporate by reference Part I of Table A in the First Schedule to the Law. To the extent of a conflict between the Articles and Table A, the terms of the Articles will prevail.

The following is a brief summary of certain material provisions of the Articles as will be in effect immediately prior to the Placing:

Directors

(a) The management of business and the conduct of the affairs of the Company are vested in the Directors. There shall be a minimum of three Directors and there shall be no maximum number of Directors. The Company may by ordinary resolution increase or decrease the number of Directors from time to time. An alternate Director is not counted in determining the number of Directors.

(b) At the first annual general meeting of the Company, all the Directors (other than the Managing Director) will retire from the office. At the annual general meeting of the Company one-third of the Directors (other than the Managing Director) for the time being, or if their number is not 3 or a multiple of 3, then the number nearest one-third will retire from the office. The Directors to retire in every year will be those who have been longest in office since their last election or as between persons who became Directors on the same day, those to retire will be determined by lot. The Company at a meeting at which a Director retires may fill the vacated office by electing a person thereto. A retiring Director is eligible for re-election and may serve an unlimited number of terms.

(c) Each Director may nominate another Director or any other person to act as his alternate Director. An alternate Director is subject to the same regulations as the other Directors, and is entitled to vote at any meeting at which his appointor is not present. An alternate Director is counted in the quorum. An alternate Director may be removed at any time by his appointor.

(d) The Directors have the power at any time to appoint any individual to be a Director so as to fill a vacancy or to add to the existing Directors up to the maximum number of Directors then allowed. At any time, the Company at a general meeting may (without prejudice to the above powers of the Directors) appoint any person a Director and determine the period for which such person is to hold office by resolution of the shareholders with each shareholder having the number of votes equal to the product of the number of his shares multiplied by the number of Directors. In addition, the Company may by ordinary resolution of which special notice had been given (28 days) remove a Director. Any such Director will receive special notice of the meeting and is entitled to be heard at the meeting.

(e) The Directors may elect a chairman of their meetings and determine the period for which he is to hold office; but if no such chairman is elected, or if at any meeting the chairman is not present within 5 minutes after the time appointed for holding the same, the Directors present may choose one of themselves to be chairman of the meeting.

(f) The Directors may delegate any of their powers to committees consisting of such member or members of their body as they think fit; any committee so formed will in the exercise of the powers so delegated conform to any regulations that may be imposed on it by the Directors.

(g) The remuneration of the Directors will from time to time be determined by the Company in the general meeting on the recommendation of remuneration committee. Any Director performing special or extraordinary services in the conduct of the Company's business or in discharge of his duties as Director, or who travels or resides abroad in discharge of his duties as Director may be paid such extra remuneration as determined by the Directors. In addition, Directors are paid their traveling, hotel and incidental expenses properly incurred in the conduct of the Company's business or in the discharge of their duties as Directors.

(h) A Director who is in any way interested in a contract or proposed contract with the Company must disclose his interest at a meeting of the Directors in accordance with 191 of the Law.

(i) Any Director may act by himself or his firm in a professional capacity for the Company (other than as an auditor) and he or his firms will be entitled to remuneration for professional services as if he were not a Director.

(j) A Director will not vote in respect of any contract or arrangement in which he is interested, and if he does, his vote will not be counted, nor will he be counted in the quorum present at the meeting, unless his interest arises under one or more of the following circumstances:

 (i) the giving to him of any security or indemnity in respect of money lent or an obligation incurred by him for the benefit of the Company;

 (ii) the giving to a third party of any security or indemnity in respect of any obligation or debt of the Company for which he has assumed responsibility in whole or in part under a guarantee or indemnity or by the giving of security;

 (iii) the subscription by him for shares or debentures of the Company; and

 (iv) any contract or arrangement with any other company in which he is interested as an officer of the Company or as holder of shares or other securities;

provided, however, these prohibitions may be suspended or relaxed by the Company in a general meeting.

(k) The Directors on behalf of the Company may pay or contribute to fund any gratuity, pension or allowance on retirement to any Director (or his widow or dependants) who has held a salaried office or place of profit under the Company.

(l) A Director may be or become an officer of, or otherwise interested in, the Company or hold a place of profit under the Company (other than the office of auditor). No such Director so interested will be accountable to the Company by reason of his being a Director for any benefit which he derives from such office, place of profit or interest.

(m) A Director, notwithstanding his interest in the Company, may be counted in the quorum present at any meeting at which he or any other Director is appointed to hold any such office or place of profit under the Company or at which the terms of any such appointment are arranged, and each of the Directors concerned will be entitled to vote and be counted in the quorum except as regards his own appointment.

(n) The Directors may meet for the dispatch of business, adjourn and otherwise regulate their meetings as they think fit and questions arising at any meeting will be decided by an 80% majority of votes of all the Directors whether voting or not. Provided that if in the future the Directors designate one or more independent non-executive Directors, the majority of votes required shall be a 75% majority vote of all the Directors whether voting or not.

(o) The quorum necessary for the Directors to transact business is all Directors present in person or through their alternates. If within half an hour from the time appointed for the meeting a quorum is not present, it shall stand adjourned to the same day in the next week, at the same time and place or to such other day and at such other time and place as the Directors may determine which, however, shall not be later than 10 days after the original meeting. At the adjourned meeting 80% of the Directors present in person or through their alternates shall form a quorum.

Notice

(a) A notice may be given by the Company to any shareholder either personally or by sending it by post, email or facsimile to him or to his registered address. Where a notice is sent by post, service of the notice shall be deemed to be effected, provided that it has been properly mailed, addressed, and posted, at the expiration of 24 hours after same is posted. Where a notice is sent by email or facsimile it shall be deemed to be effected as soon as it is sent, provided there will be the relevant transmission confirmation.

(b) A notice may be given by the Company to the joint shareholders of a share by giving the notice to the joint shareholder first named in the register of shareholders in respect of the share.

(c) A notice may be given by the Company to the persons entitled to a share in consequence of the death or bankruptcy of a shareholder by sending it through the post in a prepaid letter addressed to them by name, or by the title of representative of the deceased, or trustee of the bankrupt, or by any like descriptions, at the address, if any, supplied for the purpose by the persons claiming to be so entitled, or (until such an address has been so supplied) by giving the notice in any manner in which the same might have been given if the death or bankruptcy had not occurred.

(d) Notice of every general meeting shall be given in any manner described above to:

(i) every shareholder except those shareholders who have not supplied to the Company a registered address for the giving of notices to them;

(ii) every person upon whom the ownership of a share devolves by reason of his being a legal personal representative or a trustee in bankruptcy of a shareholder where the shareholder but for his death or bankruptcy would be entitled to receive notice of the meeting; and

(iii) the auditor for the time being of the Company.

(e) No other person shall be entitled to receive notices of general meetings.

Borrowing Powers

The Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital and to issue debentures, debenture stock, and other securities whether out right or as security for any debt, liability or obligation of the Company or of any third party.

Capitalisation of Profits

The Company in general meeting may upon the recommendation of the Directors resolve:

(i) to capitalise any sum, being the whole or part of the amount for the time being standing to the credit of any reserve account, profit and loss account or otherwise available for distribution to shareholders; and

(ii) that the sum be applied for the benefit of shareholders in full satisfaction of their interest in the capitalised sum, in the proportions to which those shareholders would have been entitled in a distribution of the sum by way of dividend by applying the sum in paying up in part or full unissued shares.

Meetings

(a) Subject to the Law, the Company will in each year hold a general meeting as its annual general meeting of shareholders on such day and at such place as the Directors determine.

(b) Special meetings of shareholders may be called at any time by the Board or by requisition in accordance with Section 126 of the Law.

Pre-emption rights

Under the Law, all new shares in the Company issued in consideration of cash must be offered in the first instance to the shareholders on a date certain as determined by the Directors and in proportion to their participation in the share capital of the Company. Each shareholder will have no less than 14 days following its receipt of the notice of the offer, which notice will identify the proposed terms and conditions of the offer, to notify the Company of its desire to exercise its pre-emption right on the same terms and conditions proposed in the notice. The Company may by ordinary resolution of a general meeting, before the issue of any new shares, disapply the shareholders' pre-emption rights as to the issue of such new shares if the Directors furnish at the general meeting a written report that describes the reasons in favour of the disapplication of the shareholders' pre-emption rights and provides information to support the proposed price of the new shares.

Transfer of Shares

(a) Subject to the Law, all transfer of shares may be effected by transfer in writing in the usual or common form or in such other form as the Directors may approve.

(b) The registration of transfers may be suspended at such times and for such periods as the Directors may from time to time determine; provided, however, that such registration cannot be suspended for more than 30 days in any year.

Voting Rights (shares)

(a) Except as otherwise provided herein and subject to any special terms as to voting on which any share may be issued (no such shares currently being an issue), each shareholder is entitled to attend and vote, may attend and vote in person or by proxy and, where the shareholder is a corporation, by a duly authorised representative at meetings of shareholders or classes thereof. On a show of hands every shareholder present in person (or, being a corporation, present by a duly authorised representative) is entitled to one vote and on a poll every shareholder present in person or by proxy is entitled to one vote for every share of which he is holder. When two or more persons hold the same share jointly, the more senior shareholder, which seniority is determined by the order in which the name of the shareholder stands in the register of members, may vote the joint share to the exclusion of the other joint holders.

(b) No shareholder is entitled to vote at any general meeting unless all calls and other amounts payable by him in respect of shares have been fully paid.

(c) The shareholders shall vote cumulatively for the appointment of Directors and accordingly each shareholder may cast any number of his votes for any candidate at an election of Directors.

(d) A shareholder can appoint more than one proxy each to vote for such part of the shareholder's shares as the shareholder shall designate in the instrument appointing the relevant proxy. Under Cyprus law, proxy holders are entitled to participate and vote at meetings.

Alteration of Capital

(a) The Company may by ordinary resolution (i) increase the share capital by a sum to be divided into shares of such amount, (ii) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares, (iii) subdivide its existing shares, or any of them, into shares of smaller amount than is fixed by the Memorandum of Association subject to the Section 60(1)(d) of the Law and (iv) cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person.

(b) The Company may by special resolution reduce its share capital, any capital redemption reserve fund or any share premium account in any manner and with, and subject to, any incident authorised, and consent required, by law.

Dividends

The Company in a general meeting may declare dividends to be paid out of profits but no dividend will exceed the amount recommended by the Directors. The Directors may declare interim dividends as appear to the Directors to be justified by the profits of the Company. Any dividends declared and paid on shares by the Company shall be apportioned and paid proportionately to the extent such shares are paid or credited as paid for during any portion(s) of a period in which the dividend is paid.

Winding Up

If the Company is wound up, the liquidator may:

(i) with the sanction of an extraordinary resolution passed by shareholders of the Company, divide among the shareholders in kind the whole or any part of the property of the Company;

(ii) for that purpose set a value as the liquidator considers fair on any property to be so divided; and

(iii) decide how the division is to be carried out as between the shareholders or different classes of shareholders.

Calls and Forfeiture

Subject to the Law, Directors may make calls on the shareholders in respect of any money unpaid on their shares (whether on account of the nominal amount of the shares or by way of premium) which is not, by the terms of issue of those shares, made payable at fixed times. The Directors may revoke a call, and, if not precluded from doing so by the AIM Rules, may postpone a call, and a call may be required to be paid by installments.

If a shareholder fails to pay a call or installment of a call on or before the day appointed for payment of the call or installment, the Directors may, at any time afterwards while any part of the call or installment remains unpaid, serve a notice on the shareholder requiring payment of so much of the call or installment as is unpaid, together with any interest that has accrued and all expenses of the Company incurred as a result of the non-payment.

If the requirements of the notice served on the shareholder relating to the call are not complied with, any share in respect of which the notice has been given may, at any time thereafter, before the payment required by the notice has been made, be forfeited by resolution of the Directors.

Refusal of Registration

The Directors may refuse to register any transfer of shares or other securities which are not fully paid or on which the Company has a lien, provided that the Directors do not decline to register a transfer so as to prevent dealings in publicly traded shares from taking place on an open and proper basis. The Director must refuse to register any transfer of shares or other securities when required by the Law. If the Directors decline to register a transfer, the Company must within 2 months after the date of lodgement of such transfer give to the lodging party written notice of the refusal.

Variation of Class Rights

If at any time the share capital is divided into different classes of shares, the rights attached to any class (unless otherwise provided by the terms of issues of shares of that class) may not, whether or not the Company is being wound up, be varied without the sanction of an extraordinary resolution passed at a separate general meeting of the holders, in person or by proxy, of two-thirds of the issued shares of that class or a resolution passed by a simple majority at a separate general meeting if at least half of the issued shares capital is represented at such a meeting.

Indemnity of Directors

Every Director, officer, agent, auditor, secretary and full-time employee for the time being of the Company will be indemnified by the Company out of the Company's assets against any liabilities incurred by that person in executing his or her duties including liability incurred by him or her in defending any proceeding (whether civil or criminal) in which judgement is given in his or her favour or in which the person is acquitted or in connection with an application in relation to such proceedings in which the court grants relief to the person under Law or other applicable law.

5. **Directors' and others' interests in shares**

5.1 The interests of the Directors (all of which are beneficial unless otherwise stated) and (so far as is known to the Directors or could with reasonable diligence be ascertained by them) persons connected with the Directors within the meaning of section 346 of the Act (a "connected person") in the issued share capital of the Company as at the date of this document and which, if the Company were subject to the Act, would be required to be notified to the Company pursuant to sections 324 and 328 of the Act or shown in the register which would be maintained under section 325 of the Act if that Act applied (but excluding any options over shares), are or will be as follows:

	As at the date of this document		Following the Placing(1)(2)	
Name	**Number of Shares**	**Percentage of Shares**	**Number of Shares**	**Percentage of Enlarged Issued Share Capital**
Directors				
Viatcheslav V. Rovneiko(3)	18,132,639	34.158	18,132,639	21.931
Gueorgui N. Ramzaitsev(3)	18,132,639	34.158	18,132,639	21.931
Leonid Y. Dyachenko(3)	6,445,558	12.142	6,445,558	7.796
William R. Thomas(3)	4,196,263	7.905	4,196,263	5.075

Notes:

(1) Assuming no Over-allotment Shares are acquired pursuant to the Over-allotment Arrangements and subject to the stock lending arrangements described in paragraph 8.2.2 of this Part VII.

(2) Assuming the conversion of the RP Explorer Notes into shares on the date of Admission but for the avoidance of doubt excluding Stephen M. Buscher's shares received upon the exercise of his outstanding options.

(3) Held through ownership of connected persons.

5.2 As at the date of this document no options or restricted stock have been granted to Directors (or their connected persons).

6. **Additional information on the Directors**

6.1 Other than their directorships of the Company, the current directorships and partnerships of the Directors and partnerships held by them in five years preceding the date of this document are as follows:

Director	Current Directorships/Partnerships	Past Directorships/Partnerships
Viatcheslav V. Rovneiko	Urals Energy NV Urals ARA NV OOO Rose Garden Petrosakh Arcticneft	None
William R. Thomas	Texas Oceanic Petroleum LLC Petrosakh Arcticneft	Urals Energy NV
Leonid Y. Dyachenko	OOO Urals Nord Petrosakh Arcticneft	None
Gueorgui N. Ramzaitsev	Nafta (B) NV Ukhtaneft Belgium NV Urals ARA NV	None

6.2 Loans by the Directors or related parties:

The Directors or their related persons have made the following loans to the Company:

	Details of loan notes				
	Description				
Lender	Outstanding amount	Interest rate	Drawdown Date	Due Date	Amount outstanding (including accrued interest) ($)[3]
Nafta B NV[1]	$ 3,000,000	10%	26/05/05	15/08/05	$ 3,068,219
Penrith Trading Ltd[2] . . .	$ 3,000,000	LIBOR plus 2%	29/06/05	27/09/05	$ 3,012,053

(1) Mr. Rovneiko and Mr. Ramzaitsev each beneficially own 42.2% of Nafta (B) NV through various entities.

(2) Mr. Dyachenko beneficially owns 50% of Penrith Trading Ltd, and this loan, together with all accrued interest will be paid in full prior to Admission.

(3) The payoff amounts are as of 31 July 2005.

Each of the loans set out above will be repaid in the period immediately following Admission out of the proceeds of the Placing.

6.3 None of the Directors has an unspent conviction for indictable offences nor have any of the Directors been the subject of any public criticisms by statutory or regulatory authorities (including recognised professional bodies) and none of them have ever been disqualified by a court from acting as a director of, or from acting in the management or conduct of the affairs of any company. Certain of the Directors who have been resident in Belgium have been interviewed in connection with an investigation in Belgium in relation to tax compliance of an oil trading entity unrelated to the Company. The Company did not do business or sell oil to the entity under investigation nor has the Company ever had any contractual or other relationship with such entity. The investigation process in Belgium is a closed and confidential process and no formal charges have been filed.

6.4 None of the Directors has been a director of a company at the time of, or within the twelve months preceding, the commencement of a receivership, liquidation, administration, company voluntary arrangement or a composition or arrangement with creditors of that company or a partner of a partnership at the time of or within the twelve months preceding any compulsory liquidation, administration, receivership or partnership voluntary arrangement of that partnership. None of the Directors (nor any partnership of which a director has been a partner) is or has been bankrupt has made an individual voluntary arrangement with his creditors, or suffered the appointment of a receiver over any of his (or in the case of a partnership, the partnership's) assets.

7. **Directors' contracts, employment agreements and emoluments**

The total annual compensation of the principal executive officers of the Company and of OOO Urals Energy, collectively, is $2.5 million. The Chief Executive Officer, the Chairman of the Board of Directors, the Chief Financial Officer and the Senior Vice President, Exploration and Production of the Company, and the President and Senior Vice President of Corporate Services of OOO Urals Energy are parties to written agreements for three year terms, with further renewals by mutual consent. Such agreements require that such persons spend substantially all of their time on the business of the Company and its subsidiaries and obligate such persons to maintain confidentiality regarding the Company's business and limit their right to have business dealings with customers or solicit employees after the termination of their service with the Company. Such agreements also provide for certain termination payments in the event such contracts are terminated without cause. In the case of the Chief Executive, such termination payment is equal to two years' compensation and in the case of the remaining Directors, such payment is equal to one years' compensation. The executive officers will also be eligible to participate in a stock option programme to be implemented by the Board of Directors and the Compensation Committee of the Board of Directors. See paragraph 3.5 of this Part VII.

William R. Thomas has served as a Director of the Company since 10 November 2003. The remaining Directors have served since 19 July 2005.

8. **Material Contracts**

Save as set out in this document, the following are the only contracts (being contracts otherwise than in the ordinary course of business) which have been entered into by members of the Company and its subsidiaries within the two years immediately preceding the date of this document and are or may be material to the Company and its subsidiaries or have been entered into by any member of the Company and its subsidiaries at any time and contain any provision under which the Company and its subsidiaries has any obligation or entitlement which is material to the Company and its subsidiaries at the date of this document.

8.1 Material Contracts

8.1.1 *Licenses*

ZAO Petrosakh

1. License No. SHOM 10974 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Pogranichny Subsoil Area	geological allotment	geological study	29 January 2001	01 February 2006

2. License No. YUSKH 00250 NR

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Pogranichny Progib	geological allotment	combined (geological study, exploration & production)	21 May 1997	December 2017

3. License No. YUSKH 00249 NE

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Okruzhnoye Oil Field	mining allotment	production	21 May 1997	December 2012

OOO URALS-NORD

1. License No. NRM 12143 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Beluginsky Subsoil Area	geological allotment	geological study	22 January 2004	31 January 2008

2. License NRM 12142 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Phakelny Subsoil Area	geological allotment	geological study	22 January 2004	31 January 2008

3. License NRM 12141 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Nadezhdinsky Subsoil Area	geological allotment	geological study	22 January 2004	31 January 2008

4. License NRM 12140 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Alfinsky Subsoil Area	geological allotment	geological study	22 January 2004	31 January 2008

5. License NRM 12139 NP

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Zapadno-Sorokinsky Subsoil Area	geological allotment	geological study	22 January 2004	31 January 2008

ZAO Chepetskoye NGDU

1. License IZHV 00387 NE

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Zapadno-Krasnogorsky Area (Zotovskoye, Nefyodovskoye & Potapovskoye Oil Fields)	mining allotment	combined (exploration & production)	12 April 1999	12 April 2024

OOO CNPSEI

1. License No. SYK 11311 NE

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Sosnovskoye Oil Field	mining allotment	combined (exploration & production)	24 October 2002	18 December 2017

2. License SYK 11310 NE

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Yuzhno-Tebukskoye Oil Field	mining allotment	combined (exploration & production)	24 October 2002	18 December 2017

ZAO Arcticneft

1. License No. NRM 00451 NE

license area name	*license area status*	*type*	*date of issue*	*expiry date*
Peschanoozerskoye oil and gas condensate field	mining allotment	production of hydrocarbons	19 February 1999	13 December 2067

8.1.2 *Acquisition Agreements*

The Company, OAO "ARKHANGELSKGEOLDOBYCHA" and OOO "LUKOILKALININGRADMORNEFT" (together the "Sellers") entered into an agreement on 11 July 2005 for the acquisition of shares in Arcticneft by the Company. The total consideration payable is approximately $32.5 million. Approximately $19.5 million has already been paid to the Sellers. The Company must provide approximately RUR 374 million (approximately $13 million) financing to Arcticneft to refinance its indebtedness to LUKOIL on or before 1 September 2005. Further, the current payables to LUKOIL recorded on and in the books of Arcticneft in the amounts of RUR 195 million and RUR 9.8 million must be repaid on or before 1 October 2005. The Company has executed a pledge over the shares in Arcticneft as security for its obligations to make these further payments. The Sellers have given warranties about their title to the shares and limited warranties about Arcticneft, subject to certain disclosures.

On 28 March 2005, the Company acquired 50% of the participation interests in Urals Nord from an affiliate of one of the shareholders as part of the contribution by such shareholder to the equity of the Company pursuant to a Shareholders Agreement dated 28 July 2004. On 25 April 2005, the Company acquired the remaining 50% interest in OOO Urals-Nord from certain third parties for an agreed consideration of $14 million payable in cash by 27 October 2005. $1.54 million has been paid toward this purchase on 6 June 2005 and the remaining amount is expected to be paid on or before the due date.

On 19 November 2004, the Company acquired a 19.44% interest in Petrosakh, and through certain special purpose entities entered into arrangements to acquire a total, including the above 19.44% interest, of 97.16% in Petrosakh. Although the Company did not own a direct interest of the voting shares, it had the right to direct the actions of Petrosakh and controlled the appointment of the Board of Directors through contractual arrangements. The shares held by the special purpose entities were ultimately transferred to the Company at their cost on 7 April 2005. The shares in Petrosakh have been pledged to secure the Paribas loan. See paragraph 8.1.4 of this Part VII.

On 26 October 2004, the Company acquired 20% of CNPSEI from, and entered into arrangements with certain special purpose entities to acquire the remaining 80% equity interest in CNPSEI. Although the Company did not own a direct interest of the voting rights, it had the right to direct the actions of CNPSEI and appointed the board of directors through contractual arrangements. The interests held by the special purpose entities were transferred to the Company at their cost on 28 March 2005.

On 4 October 2004, the Company acquired a 100% interest in Chepetskoye from one if its principal shareholders as part of the Urals Energy Shareholder Agreement dated 28 July 2004, whereby shareholders would contribute cash or assets for their equity interests in the Company. Entities affiliated with the contributing shareholder had acquired the interest in Chepetskoye on 17 June 2003.

8.1.3 *Crude Offtake Agreements*

The Company's Russian subsidiaries sell a portion of their oil production and refined products directly to buyers in the local Russian markets in the areas where their assets are located. These sales are under short term contracts for Russian market prices. None of such contracts are material to the overall revenue of the Company.

The Company's Russian subsidiaries also sell oil to the export markets through OOO Urals Energy as its commissionaire whereby OOO Urals Energy acts as an agent for securing oil sales. The oil of the Russian subsidiaries is sold to the Company under long and short term contracts so that the Company is able to aggregate supply and sell it onward to third parties. The Company has entered into 2 long term contracts for the sale of oil with Petraco Oil Company Ltd. whereby oil is sold on arms-length terms as follows:

- Agreement dated 12 May 2005 covering the delivery of 190,000 metric tonnes of oil during the period from 1 May 2005 to 30 November 2006. Deliveries can be effected at a number of export points for Russian oil, provided that up to 95,000 metric tonnes can be delivered at the Okruzhnoye Terminal in Sakhalin. The price for such oil shall be based on international prices as published in "Platts Crude Oil Marketwire". For delivered oil with an API gravity of more than 32°, a premium of $0.003 per each 1/10° above 32° will be paid.
- An additional agreement to the above 12 May 2005 agreement executed in connection with and as support for the BNP Paribas $20 million financing arrangement (see paragraph 8.1.4 of this Part VII), whereby the Company agrees to deliver oil from Okruzhnoye, Sakhalin for a term of 20 months from the effective date of the contract. The prices paid shall be based on an average of Dubai and Oman oil prices as specified in "Platts Crude Oil Marketwire", plus a premium for Okruzhnoye quality oil in accordance with market practice, but in each case less $1 for freight and insurance.

The Company will continue to manage its oil and refined product sales in a manner that the management believes will achieve market prices for domestic Russian and export markets.

8.1.4 *Credit and Loan Agreements*

In March 2005, Chepetskoye and CNPSEI obtained a $12 million 5-year US dollar denominated 11.0% fixed interest loans from OAO Bank Zenit, for funding working capital and certain capital projects. The loan was obtained by entering into two credit facility agreements, one between OAO Bank Zenit and Chepetskoye for up to $10 million, and another between OAO Bank Zenit and CNPSEI for up to $2 million. The loan is secured by liens on various fixed assets of these producing subsidiaries and is guaranteed by the Company. Further, the facility contains cross default provisions to each of these subsidiaries. The Company intends to use proceeds of the Placing to repay the loan.

Arcticneft is a party to Loan Agreements with OAO LUKOIL pursuant to which Arcticneft owes LUKOIL approximately $13 million, plus accrued interest. Pursuant to the Sale and Purchase Agreement whereby the Company acquired Arcticneft, the Company is obliged to loan or capitalise Arcticneft with sufficient funds to discharge the said loan to LUKOIL. Until the said loan is discharged, the obligation to do so is secured by a pledge by the Company of the shares of Arcticneft to LUKOIL. The Company intends to use proceeds of the Placing to repay the loan.

In June 2005, Petrosakh entered into a Crude Oil Pre-Export Finance Facility with BNP Paribas in an amount of $20 million to be repaid out of proceeds from the sale of oil to the export market which is produced by Petrosakh. The term of the Facility is to the end of 2006, with an option to BNP Paribas to extend the maturity to end 2007. The loan is guaranteed by the Company and by OOO Urals Energy. The facility is secured by the oil sales contracts through which oil is sold into the export market and other security arrangements including a pledge of oil produced and the shares it holds in Petrosakh. If the loan is not repaid by 30 September 2005, the Company originally undertook to pledge the shares of Petrosakh that it owns to BNP Paribas, however, the shares have been pledged to BNP Paribas in any event. The facility bears interest at LIBOR plus 5%.

On 30 June 2005, the Company entered into an advance payment agreement with Petraco Oil Company Ltd. whereby Petraco advanced the sum of $10 million toward the payment of 25,000 metric tonnes of future oil deliveries from Arcticneft, said quantities to be delivered between August and September 2005. The Company entered into certain undertakings with Petaco to ensure that such oil is delivered to Petraco. If the above quantity is not delivered pursuant to the agreement, then the Company must reimburse any unrecovered sums to Petraco at an interest rate of LIBOR plus 6.5% by the end of December 2005.

On June 29, 2005, the Company entered into a loan agreement with Penrith Trading Limited. The loan principal amount is $3 million and bears interest at LIBOR plus 2% per annum, is unsecured and is due on 27 September 2005. The Company will pay this loan in full prior to Admission.

In November 2004, the Company entered into loan agreements with each of Radwood Business Inc., Polaris Business Limited, Citara International Limited, Fantin Finance Limited and Texas Oceanic Petroleum LLC, pursuant to which such parties collectively loaned the Company a total of $9.3 million, in each case at a stated interest rate of LIBOR plus 2% per annum.

Pursuant to an addendum to each loan agreement dated 16 May 2005, the Company agreed to pay each of said lenders, in addition to the above stated interest rate, an amount equal to 50% of the unpaid principal in the event the shares of the Company were admitted to trading on a recognized international stock exchange on or before 31 December 2005 and the net proceeds were in excess of US$50.0 million, in consideration for each of the lenders, *inter alia*, (i) agreeing to refrain from demanding payment or otherwise causing the loans to become due and payable prior to 31 December 2005 and (ii) agreeing to subordinate the loans to any third party loans on satisfactory terms.

On 2 August 2005, Citara International Limited assigned by novation its rights under its loan agreement with the Company to UEN Cyprus Limited.

Also on 2 August 2005, the Company amended its loan agreements with Radwood Business Inc., Polaris Business Limited, UEN Cyprus Limited (as successor-in-interest to Citara International Limited), Fantin Finance Limited and Texas Oceanic Petroleum LLC to eliminate the 50% premium, fix the interest rate at 15% per annum from inception, amend the maturity date to 31 December 2005, and provide that such loans are convertible into shares of the Company on 4 August 2005 at a value of $2.65 per share. Based upon the principal and accrued outstanding interest to 4 August 2005, a conversion into the shares at the above stated exchange value resulted in the issuance to each of such companies of the following shares in return for the cancellation of the respective loans:

Name of Party	New Shares
Radwood Business Inc.	196,263
Polaris Business Limited	117,757
UEN Cyprus Limited	1,962,623
Fantin Finance Limited	1,177,574
Texas Oceanic Petroleum LLC	196,263

8.1.5 *Nafta (B) NV*

In May 2005, the Company entered into a loan agreement with Nafta (B) NV, a company owned in part and controlled by Viatcheslav Rovneiko and Gueorgui N. Ramzaitsev two of the investors in the Company, whereby Nafta (B) NV loaned $4.5 million to the Company. This loan is secured by a pledge by the Company of the shares of Chepetskoye. To date the outstanding principal of this loan is $3 million. Separately, the Company advanced on behalf of Nafta (B) NV the ruble equivalent of the sum of $750,000 to an unrelated third party. This amount is to be repaid by Nafta (B) NV to the Company.

On 20 May 2005, the Company issued 23,585 ordinary shares to Nafta (B) NV for total consideration of $25 million. The share issuance was settled with a cash contribution of $18.38 million and conversion of $6.62 million in existing debt of the Company to Nafta (B) NV.

8.1.6 *Issuance of Convertible Notes*

On 11 July 2005, the Company entered an investment agreement with RP Explorer whereby the Company agreed to issue to RP Explorer an unsecured convertible preferred 'A' note in the amount of $10 million and an unsecured convertible preferred 'B' note in the amount of $5 million. Pursuant to such agreement, the Company issued $10 million, 10% subordinated, unsecured notes due 15 December 2006. The notes are issued at 100% and accrete daily up to 117% on maturity. The Company may redeem the notes before maturity upon 30 day notice and payment of a 10% redemption fee. RP Explorer has the option to extend maturity of the notes for a further 12 months. If, before maturity, the Company issues shares in an IPO, provided such offering is at least $60 million, the notes must be converted to shares at a conversion discount from the IPO price of 20%. The conversion discount is further increased by 1.5% per month after 15 August 2005 until an IPO occurs. As part of such arrangements, RP Explorer agreed not to transfer the notes to any third party and not to sell its shares upon conversion for a period of 180 days following Admission without the consent of MSIL as the Company's Nominated Advisor in order to maintain an orderly market and not to adversely affect the market or price for the Company's shares.

8.1.7 *Options*

Stephen M. Buscher, the CFO of the Company, whose mailing address is 3 St. James Square, London SW 1 U.K. has the right to exercise options to subscribe for up to $250,000 of shares in the Company at a per share value that would apply if the Company had a total equity value of $131 million. Fifty percent (50%) of the total options may be exercised on August 1, 2006 and 50% may be exercised on August 1, 2007, both only as long as Mr. Buscher remains employed by the Company on such dates.

8.2 Underwriting arrangements

8.2.1 *Underwriting Agreement*

MSSL, the Company and the Directors have entered into an underwriting agreement on 4 August 2005, whereby on the terms and subject to the conditions contained therein the Company will issue and MSSL will procure subscribers for or, failing which, itself subscribe for the Placing Shares.

In addition, the Company has entered into the Over-allotment Arrangements with MSSL pursuant to which, subject to certain conditions, at MSSL's request the Company will issue and MSSL will procure subscribers (or itself subscribe) for up to a further 4,000,050 shares for the purposes of allowing MSSL to meet over-allotments, if any, in connection with the Placing and to cover any short positions resulting from stabilisation transactions. The number of shares to be issued pursuant to the Over-allotment Arrangements, if any, will be determined no later than 2 September 2005.

In consideration for its services under the Underwriting Agreement, MSSL will receive a commission of 6.5 per cent of the amount equal to the Placing Price multiplied by the number of Placing Shares issued to subscribers procured by MSSL or to MSSL itself under the Underwriting Agreement, and the number of Over-allotment Shares (if any) issued under the Over-allotment Arrangements. The Company may also, in its absolute discretion, pay to MSSL a further commission of up to two per cent of the aggregate proceeds received by the Company in connection with the Placing, such fee to be determined on or before Admission.

The obligations of MSSL under the Underwriting Agreement are conditional upon, amongst other things: (i) the Company and each of the Directors having complied with all their obligations and having satisfied all conditions to be satisfied by any of them under the Underwriting Agreement and certain other documents which are to be performed or satisfied on or prior to Admission; (ii) Admission having occurred; and (iii) there having occurred no material adverse change in the business of the Company or its subsidiaries. In addition, MSSL has the right to terminate the Underwriting Agreement at any time before Admission in certain specified circumstances.

The Underwriting Agreement contains warranties given by the Company and the Directors as to the accuracy of the information contained in this document and other matters relating to the Company and its business. The Company has also agreed to indemnify MSSL and its affiliates and their respective directors, officers and employees against certain liabilities that they may incur under the Underwriting Agreement.

The Underwriting Agreement contains certain undertakings given by the Company to MSIL. These include an undertaking to take various actions to enable the Depositary Interests to be settled through CREST.

In addition, the Company has undertaken that it shall not, without MSSL's prior written consent, before the earlier of 2 September 2005 and the termination of MSSL's obligations under the Underwriting Agreement, declare, make or pay any dividend or other distribution on any of its share capital. In addition, the Company and the Directors have undertaken that they each shall not, without Morgan Stanley's prior written consent, during a period of 365 days from the date of Admission, directly or indirectly, offer, issue, lend, sell or contract to sell, issue options in respect of, or otherwise dispose of, directly or indirectly, or announce an offering or issue of, any shares (or any interest therein or in respect thereof) or any other securities exchangeable for or convertible into, or substantially similar to, shares or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing, save in respect of shares issued pursuant to the Placing. The Directors' obligations are subject to certain exceptions including (a) a transfer of shares to any connected person of the relevant Director provided that, prior to any such transfer, the relevant transferee has agreed to be bound by transfer restrictions on the same terms as those applicable to the relevant Director, and (b) the acceptance of a takeover offer for the Company or the provision of an irrevocable undertaking to accept such an offer.

8.2.2 *Stock Lending Agreement*

In connection with the Over-allotment Arrangements, UEN Cyprus Limited has entered into a stock lending agreement (the "Stock Lending Agreement") with MSSL under which MSSL is able (but is not obliged) to borrow from UEN Cyprus Limited up to 4,000,050 shares held by UEN Cyprus Limited. The purpose of the loan is, amongst other things, to allow MSSL to settle, at Admission, any over-allotments made in connection with the Placing. If MSSL borrows any shares under the Stock Lending Agreement it will be required to return equivalent securities to UEN Cyprus Limited, expected to be by no later than 2 September 2005.

8.2.3 *Nominated Adviser and Broker Agreement*

The Company, MSIL and MSSL have entered into a nominated adviser and broker agreement dated 4 August 2005 under which MSIL has accepted its appointment as the Company's nominated adviser and MSSL has accepted its appointment as the Company's broker for the purpose of the AIM Rules. The Company will pay MSIL and MSSL an aggregate yearly fee of £50,000 in addition to the costs and expenses incurred by MSIL and MSSL in carrying out their obligations under the agreement. The agreement contains certain undertakings, confirmations and indemnities given by the Company to each of MSIL and MSSL. The appointment of MSIL and MSSL may be terminated by the Company (on the one hand) and MSIL or MSSL (on the other) on immediate notice.

8.2.4 *Lock-in Arrangements*

Lock-in agreements have been entered into by each of the related parties and applicable employees (all as defined in the AIM Rules) being UEN Cyprus Ltd, Belding Enterprise Ltd, Abacus (Cyprus) Limited, Texas Oceanic Petroleum Company LLC, Nafta (B) NV, Viatcheslav V. Rovneiko, Gueorgui N. Ramzaitsev and Fantin Finance Limited (such people being referred to as the "Lock-in Parties") with MSIL and the Company. The Lock-in Parties hold approximately 97.75% of the Pre-Admission Share Capital.

The Lock-in Parties and Hillsilk Limited, which holds approximately 1.66% of the Pre Admission Share Capital, have agreed (subject to certain limited exceptions), for the period up to and including the date 365 days after Admission in the case of the Lock-in Parties, and 180 days after Admission in the case of Hillsilk Limited (the "Lock-in Period"), without the prior written consent of MSIL not to (i) offer, lend, sell, deposit, contract to sell, mortgage, pledge, create liens over, charge, assign, create any other security interest or equity over, issue options, warrants or other derivative instruments in respect of, or grant any option to purchase, or otherwise dispose of, directly or indirectly, any shares held by them at any time during the Lock-in Period (or any other securities convertible into or exchangeable for shares or which carry rights to subscribe for or purchase shares or any interest therein or in respect thereof, including any warrants in issue from time to time); (ii) enter into any swap or other arrangement which transfers to another, in whole or in part, the economic consequences of ownership of any share or any interest therein; or (iii) announce any intention to do, or agree to do, any of the foregoing.

In addition, the Lock-in Parties have agreed that after the expiration of their applicable Lock-in Period, and for so long as they remain interested in not less than 3% of the share capital of the Company, they will agree to restrict their sales in a manner determined by MSIL as the Nominated Adviser for a further 365 days in order to maintain an orderly market.

The Lock-in Parties, Hillsilk Limited and the Company have given certain representations and warranties to MSIL in connection with the lock-up and orderly trading arrangements described above.

RP Explorer, after conversion of its notes described in paragraph 8.1.6, will become the holder of shares in the Company and in connection therewith has agreed that for a period of 180 days following Admission it will restrict its sale of shares in a manner determined by MSIL as the Nominated Advisor for the Company so as to maintain an orderly market. Following Admission, RP Explorer will hold 2,929,651 shares.

9. **Litigation**

In 2003, certain creditors initiated proceedings against Articneft to recover alleged tax and overdue balances totalling 38.1 million rubles. In June 2003, bailiffs were appointed to seize assets of Arcticneft and on 10 October 2003, 37 of the Company's oil wells were sold to OOO Start, for a total consideration of 23.5 million rubles. Title to these assets was transferred to OOO Start and the obligations deemed settled. The Company then initiated arbitration proceedings in the courts to recover these assets. In July 2005, the Company entered into an arrangement to settle the claims over the 37 wells. The arrangement is subject to various conditions that must be satisfied before the wells can be transferred back to Arcticneft. Upon satisfaction of the conditions, the parties intend to withdraw their claims, and thereupon the Company and Arcticneft will pay an aggregate $3 million in settlement and title to the 37 wells will be returned to Arcticneft.

Other than the foregoing, neither the Company nor any of its subsidiaries are engaged in, nor has pending or threatened against it, any legal or arbitration proceedings which may have or have had during the twelve months prior to the publication of this document a significant effect on the Company or a Company's subsidiary's financial position or profitability.

10. **Working Capital**

The Directors are of the opinion that, having made due and careful enquiry, the working capital available to the Company following the Placing will be sufficient for its present requirements, that is for at least twelve months from the date of Admission.

11. **Taxation**

The following is intended only as a general guide and is not intended to be, nor should it be considered to be, legal or tax advice to any particular holder of shares or Depositary Interests. Accordingly, potential investors should satisfy themselves as to the overall tax consequences, including the consequences under English, Russian and Cyprus law and practice, of acquisition, ownership and disposition of shares or Depositary Interests in their own particular circumstances, by consulting their own professional advisers.

11.1 United Kingdom taxation

The comments below are of a general nature and are based on current English law and HM Revenue & Customs practice published as of the date of this document, both of which are subject to change, possibly with retroactive effect. These comments are not exhaustive. Prospective investors should consult with their own taxation advisers as to the UK tax consequences for them associated with acquisition, holding and disposing of the shares or Depositary interests. This summary: (i) only addresses certain UK tax consequences for persons resident for tax purposes in the UK (except insofar as express reference is made to the treatment of non-UK tax residents) who hold the shares or Depositary Interests as capital assets and does not address the tax consequences which may be relevant to certain other categories of holder, for example, dealers in securities or employees; (ii) assumes that the holder does not either directly or indirectly control more than 5% of the share capital, voting power or profits (or assets on a winding up) of the Company; and (iii) assumes that the holder does not hold the shares or Depositary Interests in trust. Special rules, not covered here, apply to individual holders of the shares or Depositary Interests who are resident or ordinarily resident in the UK but are not domiciled in the UK.

11.1.1 Taxation of Chargeable Gains

A disposal of shares or Depositary Interests by a holder who is resident or, in the case of an individual, ordinarily resident in the UK for UK tax purposes may give rise to a chargeable gain or allowable loss for the purposes of UK taxation of chargeable gains (subject to any available exemptions or reliefs). A holder who is not resident in the UK for tax purposes but who carries on a trade, profession or vocation in the UK through a branch or agency (in the case of a non-corporate holder) or, in the case of a corporate holder, a permanent establishment and has used, held or acquired the shares or Depositary Interests for the purpose of such trade, profession or vocation may also be subject to UK taxation on chargeable gains on a disposal of those shares or Depositary Interests (subject to any available exemptions or reliefs). Special rules may apply to tax gains on disposals made by individuals at a time when they are temporarily not resident or ordinarily resident in the UK.

Any chargeable gain (or allowable loss) will be calculated by reference to the consideration received for the disposal of the shares or Depositary Interests less the cost of acquisition of such shares or Depositary Interests and certain other allowable deductions in respect of shares or Depositary Interests as prescribed in UK tax legislation.

For a holder within the charge to UK corporation tax, an indexation allowance on the acquisition cost of the shares or Depositary Interests may be available to reduce the amount of chargeable gain (but not increase the amount of allowable loss) realised on a subsequent disposal. For an individual holder, taper relief may be available to reduce the proportion of any chargeable gain subject to tax.

11.1.2 Dividends

Any holder of shares or Depositary Interests who is resident in the UK will generally be subject to UK income tax or corporation tax on the gross amount of any dividends received from the Company before deduction of any applicable overseas withholding taxes. As such dividends will be foreign income for the purposes of UK taxation they will be subject to a different tax regime from that applying to dividends received from UK resident companies. In particular, the dividends will not carry a UK tax credit, unlike dividends received from a UK resident company. Dividends received by holders within the charge to UK corporation tax in respect thereof will generally be taxed at the prevailing UK corporation tax rate (the basic rate of which is currently 30%). An individual holder will generally be chargeable to UK income tax on the dividends at the current rate of 10% or, to the extent that the gross amount of the dividend when treated as the top slice of his or her income exceeds the threshold for higher rate tax, at the current rate of 32.5%. Any overseas withholding tax suffered on the dividends by a holder of shares or Depositary Interests who is tax resident in the UK may be eligible for double taxation relief under UK tax laws either though credit against any UK tax liability in respect of the dividends (subject to certain restrictions or limitations) or through deduction in arriving at taxable income, to the extent that such withholding tax cannot be reclaimed by the holder under any applicable double taxation convention.

11.1.3 UK Stamp Duty and Stamp Duty Reserve Tax

There is generally no liability to UK stamp duty or stamp duty reserve tax on the issue of shares by the Company or the issue of Depositary Interests by, or the surrender of Depositary Interests to, the Depositary.

If a transfer of shares is completed by an instrument of transfer and it later became necessary to have that instrument stamped in the UK, UK stamp duty would be payable at the rate of 0.5% of the value of the consideration for the transfer (other than in respect of a transfer of shares to the Depositary in return for the issue of Depositary Interests by the Depositary to the transferor of those shares, where fixed UK stamp duty of £5 should be payable on the instrument of transfer); interest and, potentially, penalties may also be payable. It would be necessary to have the instrument of transfer stamped if the transfer is to be registered on a UK branch share register of the Company. In addition, any instrument effecting or evidencing the transfer of shares registered on a UK branch register, or in the case of other shares which is executed in the UK, or which relates to any matter or thing done or to be done in the UK, may not (except in criminal proceedings) be given in evidence or be available for any purpose whatsoever in the UK unless duly stamped. Whether or not an instrument of transfer is stamped, however, will not affect the registration of the future transfer of shares in the Company's principal share register (kept outside the UK) or the fact that that registration will constitute the primary evidence of the transferee's title to the shares. Where the transfer will only be registered on the Company's principal share register, therefore, it is unlikely that it will ever become necessary to stamp the instrument of transfer and pay duty at the rate mentioned above (or any related interest or penalties).

A charge to UK stamp duty reserve tax will arise in respect of an agreement to transfer shares, where the shares are registered in any register kept in the UK by or on behalf of the Company (there are current proposals for such a register to be kept).

An agreement to transfer such shares will give rise to stamp duty reserve tax at the rate of 0.5% of the amount or value of the consideration payable, such stamp duty reserve tax generally being payable by the transferee. The liability to stamp duty reserve tax will be cancelled, or any stamp duty reserve tax paid refunded, if the agreement is completed by a duly stamped transfer within 6 years of either the date of the agreement or (if the agreement is conditional) the date when the agreement becomes unconditional.

UK stamp duty reserve tax will be payable on an agreement to transfer Depositary Interests within CREST at the rate of 0.5% of the amount or value of the consideration payable for the transfer. It is not expected that an instrument subject to UK stamp duty would be created in respect of such a transfer.

Higher rates of UK stamp duty reserve tax (at 1.5% of the price for, or value of, the Depositary Interests) would be payable if Depositary Interests are issued or transferred to certain clearance services or depositary receipt schemes.

11.1.4 Inheritance Tax

Shares or Depositary Interests beneficially owned by an individual may (subject to certain exemptions and reliefs) be subject to UK inheritance tax on the death of the individual or, in certain circumstances, if the shares or Depositary Interests are the subject of a gift or other transfer of value by the individual.

For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift under particular rules applied to gifts where the donor reserves or retains some benefit. UK inheritance tax is not generally chargeable on gifts to individuals or to certain types of settlements made more than seven years before the death of the donor.

Holders should consult an appropriate professional adviser if they make a gift or transfer of value of any kind or intend to hold any shares or Depositary Interests through trust arrangements. Holders should also seek professional advice in a situation where there is a potential for a double charge to UK inheritance tax and an equivalent tax in another jurisdiction.

11.1.5 Close Companies

UK tax legislation contains special rules which apply to close companies, as defined in section 414 of the Income and Corporation Taxes Act 1988. The Company may fall within a definition of a close company for these purposes or may be regarded as a close company if it were UK resident. As a result, certain transactions entered into by the Company or other members of the Group may have tax implications for holders of shares or Depositary Interests. Holders should consult their own professional advisers on the potential impact of the close company rules.

11.2 Russian Taxation and Charges

The Russian tax system includes federal (established by the federal authorities and applied to all entities doing business in Russia), regional (established by the Russian Tax Code and regional authorities and applied to entities registered or doing business in a particular region) and local (established by the Russian Tax Code and local authorities and applied to entities registered or doing business in particular municipalities) taxes.

The comments below are of a general nature based on the various Russian laws described above as of the date of this document, which are subject to change, possibly with retroactive effect. However, in accordance with the Russian Tax Code legislative acts on taxes and fees which in any way worsen the situation of a taxpayer shall not be retroactive. The comments consist of brief descriptions of the major federal, regional and local taxes and some obligatory payments, which formally are not treated as taxes, applicable to the Company's Russian subsidiaries.

Profits Tax

Provisions in the Profit Tax chapter of the Russian Tax Code became effective 1 January 2002 and replaced the provisions of the Profits Tax Law existing since the early 1990s. There is a single profit tax system, but payments are split between federal and regional budgets. The statutory profit tax rate is 24%. From 1 January 2005 the tax payment is split 6.5% payable to the federal budget and 17.5% payable to the regional budget. The Profits Tax chapter of the Russian Tax Code provides for the following important elements of the profit tax regime:

- There is no concept of consolidated taxes and accordingly each legal entity is required to compute and pay its profits tax to the respective authorities;
- Taxable profit calculation is based on the accrual method;
- Generally, expenses including exploration costs and unsuccessful development costs are deductible for tax purposes if they are "economically justified and properly documented"; however, certain business expenses are subject to specific limitations and other specific guidelines which need to be observed;
- Fixed assets can be depreciated on a straight-line or a double-rate declining balance method (accordingly the amount of depreciation in the early years may be significantly increased, if a taxpayer chooses the double declining rate) using the statutory life of the assets. According the Law #58-FZ on the introduction of amendments to the Part 2 of the Russian Tax Code of 6 June 2005, starting from 1 January 2006 the taxpayer is allowed to deduct capital expenditures in an amount of up to 10% of the respective fixed assets value in the relevant reporting period.
- Loss carry-forward, which allows taxpayers to offset tax losses against profits in future tax periods, is available over the next ten years; provided, however, that the amount of such carry-forwards may not exceed 30% of the tax base in any tax period. According to the Law #58-FZ on the introduction of amendments to the Part 2 of the Russian Tax Code of 6 June 2005, the above limitation on the amount of loss carry-forward is extended to 50% effective 1 January 2006 and, subsequently, the limitation is abolished effective 1 January 2007.

The Profits Tax chapter of the Tax Code permits the regional legislative bodies to decrease the rate of profit tax payable to the regional budget from the current rate of 17.5% down to 13.5% for certain categories of taxpayers, and, thereby, the overall profit tax rate from 24% down to 20%.

Withholding Income Tax

Russian Tax Code provides that income earned by foreign companies from sources in Russia, which are not related to business activities performed in Russia through a PE are subject to withholding tax. Tax should be withheld and paid to the budget by the tax agent simultaneously with the income payable to a foreign company and further remitted to the budget.

Unless otherwise provided in the applicable Double Tax Treaty, the following tax rates are applicable:

- 10% on freight income;
- 15% on dividends income. The current treaty between Russia and Cyprus provides that the withholding tax rate is reduced to 5% if the direct investments by the Cypriot company in the Russian company exceeds the equivalent of US$100,000, otherwise the rate of withholding tax is reduced to 10%.
- 20% on all other kinds of income (including interest income received from Russian companies). There is no withholding tax on interest or royalties paid from a Russian company to a Cyprus company according to the current treaty between Russia and Cyprus.

Income received by a foreign company from the disposal of shares of a Russian company whose immovable property makes up less than 50% of its assets is not subject to withholding tax.

Income received by a foreign company from the disposal of shares of a Russian company whose immovable property makes up more than 50% of its assets is subject to withholding tax at the rate of 20%. However, a foreign company may choose to deduct the costs related to the acquisition of those shares and in this case profits received from this shares disposal will be subject to 24% withholding tax. The current Double Tax Treaty between Russia and Cyprus provides that such income is not subject to Russian withholding tax.

According to the Russian Tax Code, to apply the reduced rates or other favorable provisions of the respective Double Tax Treaty (e.g. Cyprus) the foreign company should provide its tax residency certificate. Accordingly, if the foreign company is not treated as a tax resident in the country of incorporation it cannot benefit from the respective Double Tax Treaty provisions.

Permanent Establishment ("PE") of a Foreign Company

According to Russian tax legislation, a foreign company creates a PE in Russia if it carries out business activities through a branch, a representative office or any other permanent place of business on a regular basis. Management, as an essential function of any business, is viewed as business activities for the purposes of PE recognition. Although a definition of a "regular basis" is not provided in the Russian Tax Code, the tax authorities' approach is that if a foreign company conducts business activity in the territory of Russia for a period exceeding 30 days in a calendar year, such activity shall be considered "regular". This 30 days periods is also used as a threshold for tax registration requirements.

Starting from the moment of creation of a PE, a foreign company is subject to taxation with respect to its income attributable to its PE in Russia. If a foreign company creates a PE as a result of its management all income of the foreign company (including dividends and interest) may be attributable to this PE and subject to Russian taxation.

Value Added Tax and Import Customs Duties

Value-added tax ("VAT") of 18% (10% in the case of certain foods, children's goods, medicines, books and printed periodicals) is imposed on domestic sales of goods, types of work and services and on import of goods into Russia. Import VAT is assessed on the customs value of imported goods inclusive of customs duties. Exports of goods including exports of oil are subject to 0% VAT (which effectively means a VAT exemption for the exporter with entitlement to claim input VAT offset under applicable conditions and procedures).

A number of goods, types of work, and services are exempt from VAT. An exemption from VAT applies to certain goods imported into Russia, e.g. technological equipment, its components and spare parts contributed to the charter capital of Russian companies. Import customs duties are generally imposed at rates ranging from 5% to 25% on a wide range of imported goods. If certain conditions established by Russian legislation are met, there may be a reduction of customs duty rates or exemption from customs duties, e.g. imported goods which qualify as fixed assets used for production activities contributed by foreign investors to the charter capital of Russian companies are exempt from import customs duties.

Mineral Resources Extraction Tax

From 1 January 2002 through 31 December 2006, the mineral resources extraction tax with respect to crude oil will be based on the amount of oil produced. The tax rate applicable from 1 January 2005 until 31 December 2006 is 419 rubles per tonne of crude oil, subject to an adjustment using a special coefficient reflecting the dynamics of world oil prices and the ruble exchange rate as follows:

$$\frac{\text{(Urals Blend price per barrel—\$9.00)* ruble/exchange rate}}{261}$$

Commencing 1 January 2007, with respect to the production of oil, the mineral resources extraction tax will be levied at the rate of 16.5% of the value of extracted natural resources, which may be calculated by reference to actual sale prices or the deemed value of natural resources net of transportation and commercial costs and export duties.

Oil-related Export Duties

In early 1999, the government re-introduced export customs duties on crude oil and oil products. Following increases in world oil prices, the export customs duties have been steadily increasing. In September 2001 and in May 2004, the Law on Customs Tariff (the "Law on Customs Tariff") was amended to establish procedures for calculating the maximum rates of export customs duties for crude oil based on the average world price of Urals Blend for the two preceding months.

The rates of customs duties established by the Russian government in accordance with the framework set out in the amended Law on Customs Tariff are as follows:

Average World Price for Urals Crude Oil Blend[(1)]	Maximum export customs duties
Up to $109.5 per tonne	0%
$109.5 to $146 per tonne	35% of the difference between the average world price per tonne and $109.5
$146 to $182.5 per tonne	$12.78 per tonne plus 45% of the difference between the average world price per tonne and $146
Greater than $182.5 per tonne	$29.2 per tonne plus 65% of the difference between the average world price per tonne and $182.5

Notes:

(1) The Urals crude oil blend is calculated as the price for Urals Blend on world markets (Mediterranean and Rotterdam) for the two months immediately preceding the current two-month period.

Starting from 1 June 2005 the actual rate of export duties is $136,2 per tonne.

Oil-related Payments for the Right to Survey and Explore Oil Fields and Prospect for Minerals

Payments for the right to survey and explore oil fields and prospect for minerals are linked to the size of the license area provided to the user of the subsoil. The minimum and the maximum annual rates payments are set by the Subsoil Law. The rate for the right to survey oil fields is from 120 (50 for offshore areas) ruble/sq.km to 360 (150 for offshore areas) ruble/sq.km, and the rate for the right to explore for minerals is from 5,000 (4,000 for offshore areas) ruble/sq.km to 20,000 (16,000 for offshore areas) ruble/sq.km. Exact rates for specific areas are set by the Federal Subsoil Use Agency, except for off-shore areas, where exact rates are set by the government.

Current Excise Tax on Oil Products

Excise Tax is applicable to gasoline, diesel fuel and motor oil. The rates are as follows:

	Oil Product Rate per tonne from 1 January 2005, ruble
Gasoline with octane numbers not exceeding "80"	2,657
Gasoline with octane numbers exceeding "80"	3,629
Diesel fuel	1,080
Motor oil	2,951

State Pension Fund Contributions

State Pension Fund contributions are payable by employers at a regressive rate schedule from 14% to the fixed amount of 56,800 rubles, depending on the level of the employee's annual wages.

Unified Social Tax

Currently, a unified social tax is assessed on gross payroll according to a regressive rate schedule ranging from 26% to 2%, depending on the level of the employee's annual wages. The State Pension Fund contributions are credited against unified social tax liability.

Accident Insurance Contributions

Employers are liable for obligatory contributions to the Social Security Fund for insurance for work-related injuries and diseases at rates ranging from 0.2% to 8.5%, depending on the type of activity carried out by the employer. These contributions are assessed on gross payroll.

Local and Regional Taxes

In addition to the federal taxes described above each Russian region and locality imposes, respectively, certain regional and local taxes within the limits provided by the RF Tax Code. Thus, the responsibilities of the regional (local) authorities are limited to establishing the tax rates, exemptions and reporting procedures.

Property Tax—regional tax

Property tax is currently levied at a rate of up to 2.2.% of the average annual statutory book value of fixed assets (except for land) per annum.

Land Tax—local tax

As of 1 January 2005, land tax is levied at a rate of up to 1.5% on the cadastre value of a land plot (a reduced rate of up to 0.3% applies to agricultural land or land plots under residential housing). Land tax applies to owners of land.

12 Cyprus Tax

Tax Residency in Cyprus

In accordance with Cyprus income tax laws, a company is tax resident in Cyprus if its management and control is exercised in Cyprus. There is no definition in the Cyprus income tax laws as to what constitutes management and control. It is understood that the definition per the OECD model convention in relation to a place of effective management is the one followed by the Cyprus tax authorities.

As per the relevant definition:

"The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

Therefore, as a minimum, management and control is considered to be exercised where the Board of Directors meet and take decisions.

Cyprus tax rates

With the introduction of a new Cyprus tax legislation, effective as from 1 January 2003, Cyprus tax resident companies are subject to corporation tax on their taxable profits at the rate of 10%. For the years 2003 and 2004 only, any profits above CY£1,000,000 are subject to an additional corporation tax of 5%.

Cyprus tax resident companies are eligible for treaty benefits under the Cyprus Double Tax Treaty network.

Profit from disposal of securities

Any gains derived by the Cyprus company on disposal of Russian securities would be exempt from Russian withholding tax under the provisions of the Double Tax Treaty between Cyprus and Russia, provided that the Cyprus company does not create a PE in Russia, Russian taxes may arise in respect of such profits (refer to the Russian tax section).

Any gains derived by a Cyprus tax resident company from disposal of 'qualifying' securities (shares, debentures, bonds, founders' shares and other securities of companies or other legal persons, incorporated under a law in Cyprus or abroad and options thereon) are exempt from Cyprus income tax. Any gains derived from disposal of non-qualifying securities may be subject to income tax at the rates prescribed above if such a disposal is deemed to be of a trading nature.

Any gains from disposal of securities which is deemed to be of a capital nature is not subject to Cyprus income tax and it is also outside the scope of capital gains tax provided that the company whose securities are disposed does not hold any immovable property situated in Cyprus.

Dividend income

Under the provisions of the Double Tax Treaty between Cyprus and Russia, provided that the Cypriot company does not create a PE in Russia the rate of Russian withholding tax on dividends would be reduced to 5% if the amount of the Cypriot company's investment in a Russian company is not less than $100,000; or to 10% if such investment is less than $100,000. In the event the Cypriot company creates a PE in Russia, Russian taxes may arise in respect of such dividends (refer to the Russian tax section).

Dividend income (whether received from Cyprus resident or non-resident companies) is exempt from Cyprus income tax. Dividend income is also exempt from Special Contribution for Defence under "defence contribution" under certain participation holding conditions.

In most cases no taxes are expected to be suffered in Cyprus, either due to a participation exemption, or if not, due to double tax relief under the provisions of the Cyprus—Russia Double Tax Treaty, provided the proper documentation can be provided to the Cyprus tax authorities. Double Tax relief is available by way of credit for foreign tax against Cyprus tax payable in respect of the same item for which the credit is claimed. The credit takes into consideration both the Russian withholding tax suffered and the attributable Russian corporation tax suffered on the profits out of which the dividend was paid.

If the participation exemption does not apply and the credit granted under the double tax relief provisions is not enough to obtain full credit against the Cyprus tax of 15%, some taxes may be payable in Cyprus.

Interest income

Under the provisions of the Double Tax Treaty between Cyprus and Russia, provided that the Cypriot company does not create a PE in Russia, interest payments from a Russian company to the Cypriot company would be exempt from Russian withholding tax. In the event the Cypriot company creates a PE in Russia, Russian taxes may arise in respect of such interest income (refer to the Russian tax section).

Any interest received, which is deemed to be of a trading nature ("active" income), will be subject to income tax in Cyprus at the rate of 10% (after deduction of business expenses) and will be exempt from the defence contribution. Any interest received which is deemed to be "passive income" will be subject to a 5% effective income tax rate, after the deduction of business expenses and also to a 10% defence contribution on the gross amount before the deduction of any expenses.

It is expected that any interest income received by the Cypriot company from financing its subsidiaries will be deemed by the Cyprus Commissioner of Income Tax as of a trading nature and be taxed at the rate of 10%, after the deduction of business expenses.

Cyprus withholding taxes

No Cypriot withholding taxes will apply with respect to any distribution of dividends and interest by a company to non-Cyprus tax resident shareholders (companies and individuals) and Cyprus tax resident companies. Dividends payable to individuals tax resident of Cyprus are subject to 15% defence contribution.

The Cyprus tax legislation includes deemed distribution provisions. These provisions do not apply to profits attributable to non-Cyprus tax resident shareholders (companies or individuals).

Any profits attributable to shareholders (companies or individuals) who are Cyprus tax residents are subject to the deemed distribution provisions. These provide that a company, which does not distribute 70% of its profits after tax, as defined by the relevant tax law, within two years after the end of the relevant tax year will be deemed to have distributed as dividend 70% of these profits. A defence contribution at 15% will be payable at the end of the two years on such deemed dividend to the extent that it is attributable to shareholders (companies or individuals) who are Cyprus tax residents. The amount of deemed distribution is reduced by the actual dividend paid out of the profits of the relevant year during the relevant two years.

Capital Duty

Capital duty is payable in respect to the authorised and issued share capital of a Cypriot company upon its incorporation and upon subsequent changes thereon. The capital duty rates for subsequent changes of the authorised and issued share capital are as follows:

- 0.6% on the nominal value of additional authorised share capital
- CY£10 flat duty on every issue, whether the shares are issued at their nominal value or at a premium.

Stamp Duty

Stamp duty arises in Cyprus on "documents" (i.e. contracts/agreements) that relate to:

(i) assets located in Cyprus

(ii) transactions or things that will take place in Cyprus

The Cyprus stamp duty rates for contracts are calculated on the value of each contract as follows:

- 0.15% for the first CY£100.000
- 0.2% thereafter

VAT

As from 1 February 2002, the Cypriot VAT legislation applied to all Cyprus registered companies. The legislation was subsequently amended to its current form on 1 May 2004, the date of Cyprus' accession to the EU.

The provisions of the new VAT legislation are beneficial to the majority of Cypriot companies engaged in activities outside Cyprus. This is because in the majority of the situations although no VAT is charged on the sales made by such companies (the legislation is not aiming at taxing transactions taking place outside Cyprus) the companies have the right to claim refund of any VAT suffered on expenses and acquisitions made in Cyprus.

Pure holding companies, whose only income is from dividends, are not considered as 'business persons' for VAT purposes. As a result they are outside the scope of the Cyprus VAT legislation. However, if they are engaged in any other activities (such as the granting of loans) then they fall within the scope of the Cyprus VAT legislation.

Registration for most Cypriot companies with overseas activities is voluntary but in some cases it will be compulsory.

The granting of loans and provisions of guarantees by the Cypriot holding company are exempt activities, hence no VAT must be charged on any interest income or guarantee if any. If the granting of loans and the provision of guarantees is made to companies resident outside the EU, then this is an activity for which the right to claim the amount of the related input VAT is granted—whereas this right is not granted when such loans are provided to EU resident companies.

13. **Intellectual Property**

The Company currently has trade mark applications pending in the European Community and Cyprus for the word mark URALS ENERGY and for the Company's emblem consisting of a U Device. International applications designating the UK, USA, Estonia, Georgia and Lithuania have been filed based on the applications in Cyprus. The UK Trade Mark Office has accepted both marks for publication. The US Trade Mark Office has accepted the U Device for publication but has objected to the word mark based on geographic misdescription. The Company has responded to this objection. Examination of the application in the three remaining countries of Estonia, Georgia and Lithuania is still awaited.

The applications may be opposed by third parties in the future. In those countries where no applications have yet been made third parties may secure registration for identical or similar rights which could block the company in securing its own trade mark rights.

14. **Consents and Responsibility Statements**

14.1 The Directors of the Company, whose names appear on page 8, accept responsibility, individually and collectively, for the information contained in this document and compliance with the AIM Rules. To the best knowledge and belief of the Directors, who have taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and there is no omission likely to affect the import of such information.

14.2 PricewaterhouseCoopers has given and has not withdrawn its written consent to the inclusion in this document of its reports set out in Parts V and VI of this document, and references to its reports and its name in the form and context in which they appear, and has authorised the contents of those parts of this document.

14.3 D&M has given and not withdrawn its written consent to the issue of this document with their name included in it and with inclusion therein of its report and references thereto in the form and context in which they are included for the purposes of Annex I to the AIM PD Rules.

14.4 D&M accepts responsibility for the information contained in the D&M Report set out in Part III of this document and to the best knowledge and belief of D&M, having taken reasonable care to ensure that such is the case, the information contained in such report is in accordance with the facts and does not omit anything likely to affect the import of such information.

15. **Availability of documents for inspection**

Copies of the following documents will be available for inspections during normal business hours on any weekday (excluding public holidays) at the offices of Akin Gump Strauss Hauer & Feld, No. 1 Ropemaker Street, CityPoint, Level 32, London EC2Y 9AW from the date of this document until the fourteenth day after Admission:

15.1 the Memorandum and Articles of Association of the Company;

15.2 the D&M Report, a copy of which appears in Part III;

15.3 the Accountants' Reports, a copy of which appears in Part V;

15.4 the service contracts for the Directors and certain members of management referred to in paragraph 7 of this Part VII;

15.5 copies of the material contracts referred to in paragraph 8.1 of this Part VII;

15.6 the letters of consent referred to in paragraphs 14.2 and 14.3 of this Part VII.

16. **Availability of this document**

Copies of this document will be available for collection only, free of charge, from the offices of Akin Gump Strauss Hauer & Feld, No. 1 Ropemaker Street, CityPoint, Level 32, London EC2Y 9AW during nominal office hours on any weekday (Saturdays and public holidays excepted) for a period of not less than one month from the date of Admission.

4 August 2005

DEFINITIONS AND GLOSSARY OF TERMS

DEFINITIONS

"£"	British pounds
"$" or "U.S. dollar"	United States dollars
"Act"	UK Companies Act 1985 (as amended from time to time)
"Admission"	admission to trading of the shares on the AIM
"AIM"	the AIM market operated by the London Stock Exchange
"AIM PD Rules"	the rules adopted by the FSA implementing the Prospectus Directive (2003/71/EC)
"AIM Rules"	the rules applicable to AIM companies and their nominated advisers as published by the London Stock Exchange from time to time
"Arcticneft"	ZAO Arcticneft
"Chepetskoye"	ZAO Chepetskoye NGDU
"CIS"	Commonwealth of Independent States
"CNPSEI"	OOO CNPSEI
"Company"	Urals Energy Public Company Limited
"Connected person"	as defined in section 324 of the Act
"COTU"	crude oil topping units
"CREST"	the computerised settlement system, operated by CRESTCo Limited, which facilitates the transfer of title to shares in uncertificated form
"CY£"	Cyprus pounds
"D&M"	DeGolyer and MacNaughton
"D&M Report"	the report by D&M and the study by D&M on the gross prospective resources owned by the Company and on the proven, probable and possible reserves owned by the Company, each dated 13 July 2005
"Depositary"	Computershare Investor Services PLC
"Depositary Interest"	a dematerialised depositary interest representing one share
"DMNG"	Dalmorneftegeophysika
"Enlarged Issued Share Capital"	the shares in issue immediately following Admission assuming the RP Explorer Notes had then been converted into shares in the Company, no other options or convertible notes over or in respect of the shares are exercised or converted at that time and no acquisition of Over-allotment Shares
"E&P"	exploration and production
"Federal Anti-Monopoly Service"	the Russian Federal Antimonopoly Service

"Federal Subsoil Use Agency"	the Russian Federal Subsoil Use Agency
"Federal Tariffs Service"	the Russian Federal Tariffs Service
"FSA"	the Financial Services Authority of the United Kingdom
"FSFM"	the Russian Federal Service for Financial Markets
"FSMA"	the Financial Services and Markets Act 2000 (as amended from time to time)
"IPO"	initial public offering
"Law"	Companies Law, Cap. 113 of Cyprus
"LIBOR"	the London Inter-Bank Offering Rate
"Lock-in Parties"	UEN Cyprus Ltd, Belding Enterprise Ltd, Texas Oceanic Company LLC, Nafta (B) NV, Viatcheslav V. Rovneiko, Gueorgui N. Ramzaitsev, Abacus (Cyprus) Limited and Fantin Finance Limited
"Lock-in Period"	a period up to and including the date 365 days after Admission in the case of the Lock-in Parties, as extended, and a period up to and including the date 180 days after Admission in the case of Hillsilk Limited
"London Stock Exchange"	London Stock Exchange plc
"Ministry of Natural Resources"	the Russian Ministry of Natural Resources
"Ministry of Industry and Energy"	the Russian Ministry of Industry and Energy
"MSIL" or "Nominated Advisor"	Morgan Stanley & Co. International Limited
"MSSL"	Morgan Stanley Securities Limited
"New York Convention"	the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards
"Nimir"	Nimir Petroleum Petrosakh Limited
"NPV"	net present value
"Official List"	the official list of securities that have been admitted to listing by the United Kingdom Listing Authority
"Over-allotment Arrangements"	the arrangements described in Part II of this document pursuant to which the Over-allotment Shares may be made available
"Over-allotment Closing Date"	no later than 2 September 2005
"Over-allotment Shares"	the 4,000,050 shares which are subject to the Over-allotment Arrangements
"PE"	a permanent establishment under Russian (tax) law
"Petrosakh"	ZAO Petrosakh
"Placing"	the placing of shares on behalf of the Company
"Placing Price"	the price so indicated on page 7 of this document

"Placing Shares"	the 26,667,000 shares of the Company being placed (excluding, for the avoidance of doubt, the Over-allotment Shares)
"Pre-Admission Share Capital"	the issued share capital of the Company immediately prior to Admission
"Production Sharing Law"	the Russian Federal Law "On Production Sharing Agreements"
"Prospectus Rules"	the Prospectus Rules published by the FSA, as amended
"RP Explorer"	RP Explorer Master Fund, whose registered address is M&C Corporate Services Limited, PO Box 309 GT, Ugland House, South Church Street, George Town Grand Cayman, Cayman Islands
"RP Explorer Notes"	the convertible notes issued by the Company to RP Explorer pursuant to an investment agreement dated 11 July 2005 as set out in paragraph 3.4 of Part VII of this document
"ruble" or "RUR"	the official currency of Russia
"Russian Tax Code"	the tax code of Russia from time to time
"Sakhalin Oblast"	the Sakhalin region of Russia
"Schlumberger"	Schlumberger Logelco Inc.
"shares"	shares in the capital of the Company
"Subsoil Law"	the Russian Law on Subsoil Use
"Subsoil Regulations"	the regulations issued under the Subsoil Law
"U Device"	the trademark device used by the Company
"Underwriting Agreement"	the conditional agreement dated 4 August 2005 between (1) the Company, (2) which the Directors and (3) MSSL
"United Kingdom" or "UK"	the United Kingdom of Great Britain and Northern Ireland
"United Kingdom Listing Authority"	the FSA acting in its capacity as the competent authority for the purposes of Part VI of FSMA
"Urals Blend"	an international oil quality grading
"Urals Nord"	OOO Urals Nord
"VAT"	value-added tax
"ZAO PricewaterhouseCoopers Audit"	the auditors of the Company registered by the Registration Chamber (registration certificate #008.890 issued 28 February 1992) and holding an audit license authorised by the Ministry of Finance of the Russian Federation and the RF Federal Securities Commission.

GLOSSARY

ABC1	recoverable proved and probable reserves
2D	two dimensions
3D	three dimensions
anticline	a convex fold in rock
API	American Petroleum Institute
block	an area designated by a government or any authority, entity or representative of a government for allocation to oil and gas exploration companies with a view to granting of hydrocarbon exploration and production rights
BOPD	barrels of oil per day
Carboniferous	a period of geologic time falling within the Paleozoic Era, around 340 to 280 million years ago, coming after the Devonian period
Devonian	a period of geologic time falling within the Paleozoic Era, around 400 to 345 million years ago, coming after the Silurian period
faulted accumulation	an accumulation of hydrocarbons that migrates to and gathers along a sealed line of fracture along which one section of the earth's crust has been displaced relative to another
field	area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structure feature and/or stratigraphic condition
g/cm3	grams per cubic centimetre
gas-lift	the process of raising or lifting fluid from a well by means of gas injected down the well through tubing or tubing casing annulus. Injected gas aerates the fluid to make it exert less pressure than the formation pressure, consequently forcing the fluid out of the wellbore
gravity	a property of a material that compares its weight to its volume
horizon	sedimentary deposits of a certain period
Middle Carboniferous	an epoch of geologic time during the middle-to-late Paleozoic Era between 360 to 280 million years ago
Miocene Age	an epoch of geologic time falling within the Cenozoic Era and the Neogene Period, around 23 to 5.3 million years ago
MMBO	million barrels of oil
MMBOE	million barrels of oil equivalent
Probable	those reserves which are not yet Proved but which on the available evidence and taking into account technical and economic factors have a better than 50-percent chance of being produced
Proved or Proven	those reserves which are as the available evidence and taking into account technical and economic factors have a better than 90-percent chance of being produced
re-perforated	the process of opening additional holes in the downhole pipe to allow oil to flow into the pipe and be recovered

reservoir	subsurface body of rock having sufficient porosity and permeability to store and transmit fluids
SG&A	Selling, General and Administrative Expense
stratigraphic	relates to the composition sequence and correlation of stratified rocks
Triassic Age	an period of geologic time falling within the Mesozoic Era, around 245 to 202 million years ago, followed by the Jurassic period
up-hole completion	the installation of equipment in a well necessary to produce oil or gas, in this case, at a shallower depth (i.e. up the hole) than the existing completion or work
Vertical Seismic Profile (VSP)	measurements made in a vertical wellbore using geophones inside the wellbore and a source at the surface near the well
water injection well	a newly drilled or abandoned well into which water is pumped to stimulate the flow of oil from other wells producing from the same horizon into which the water is pumped

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URALS ENERGY