Independent auditor's report

To the Board of Directors of Naftna Industrija Srbije a.d., Novi Sad

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Naftna Industrija Srbije a.d., Novi Sad (the "Company") and its subsidiaries (together "the Group") as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

What we have audited

The Group consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of profit and loss and other comprehensive income for the year then ended;
- the consolidated statement of changes in shareholders' equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Law on Auditing that are relevant to our audit of the consolidated financial statements in the Republic of Serbia. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

PricewaterhouseCoopers d.o.o., Omladinskih brigada 88a, 11070 Belgrade, Republic of Serbia
T: +381 11 3302 100, F:+381 11 3302 101, www.pwc.rs

pwc

Our audit approach

Overview

- We set the overall group materiality at 1,604,500 thousand Serbian dinars (hereafter "RSD"), which represents 5% of five years average profit before tax.

- We conducted audit work at 9 reporting units in 4 countries.
- The group engagement team audited Serbian subsidiaries, while PwC network firms in Bulgaria, Romania and Bosnia and Herzegovina audited NIS foreign subsidiaries in the respective countries.
- Our audit scope addressed 99% of the Group's revenues and 100% of the Group's absolute value of underlying profit before tax.

- Recoverability of carrying amount of property, plant and equipment
- Estimation of decommissioning and environmental protection provisions

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, if any, both individually and in aggregate on the consolidated financial statements as a whole.

Overall group materiality	RSD 1,604,500 thousand
How we determined it	5% of five-year average profit before taxation
Rationale for the materiality benchmark applied	Given that current year profit before taxation has been materially impacted by volatility of the market price of crude oil, we determined that our materiality should be based on five-year average profit before taxation, which is more representative of sustained business performance. We have chosen 5% which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector.

pwc

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above RSD 80,200 thousand as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
Recoverability of carrying amount of property, plant and equipment Impact of crude oil volatility in recent years has been disclosed in the Note 3.8 to the consolidated financial statements. During 2017, the spot price of Brent crude oil has improved compared to 2016, averaging 52 United States dollars for the barrel (2016: $41/b) (Hereafter referred to as "USD"). The recoverability of the carrying amount of property, plant and equipment, which amounts to RSD 264,049,497 thousand, is dependent upon the future cash flows of the business. Bearing in mind the generally long-lived nature of the Group's property, plant and equipment, the most critical assumption is management's view on the long-term oil price outlook, beyond the next three to four years. Although crude oil prices and outlooks have improved during 2017, (average spot price increased year over year by 24% compared to 2016), management concluded that a conservative approach is required for NIS's long-term oil price outlook, due to still present market uncertainties. The revision of the price outlook and change in investment decisions triggered the management's assessment of recoverability of property, plant and equipment. This testing was performed by management for relevant cash generating units (CGUs) during the fourth quarter 2017 and no impairment loss has been identified and accounted for. The Company calculated the assets' value in use and no comparison to fair value less cost to sell was necessary. We focused on this area due to significance of the financial statement line and involvement of high degree judgment and estimation uncertainty of the future business results, growth rates, commodity prices, discount rates etc.	We first assessed management's macroeconomic assumptions, which include both short-term and long-term views on commodity prices, inflation rates and discount rates. The price assumptions underlying management's asset recoverability models represent a critical judgement in the process. We compared the short-term price assumptions used by management to the market forward curves. We also compared the short and long-term assumptions, mainly weighted average cost of capital ("WACC"), used by management for discounting future cash flows, to the WACC derived by PwC valuation experts and projections of fuel markets growth in Southeast Europe ("SEE") with views published by respected industry bodies, which provided a range of relevant third-party data points. Furthermore, we compared the growth rates, profitability and capital expenditure levels ("CAPEX") to other vertically integrated companies in SEE and in the world. We have completed independent sensitivity analyses on projections of crude oil market prices and WACC rate used to assess the variances that may reasonably arise. We found the assumptions as well as managements' conclusions to be consistent with our expectations and no exception have been noted.

Estimation of decommissioning and environmental protection provisions

Provisions associated with decommissioning and restoration are disclosed in Note 26 to the Consolidated Financial Statements; a description of the accounting policy and key judgements and estimates is included in Note 2 and Note 3.

The calculation of decommissioning and environmental protection provisions requires significant management judgement because of the inherent complexity in estimating future costs.

The decommissioning of oil and gas infrastructure is an evolving activity and consequently there is limited historical precedent against which to benchmark estimates of future costs. These factors increase the complexity involved in determining accurate accounting provisions that are material to the Group's consolidated statement of financial position.

Management reviews decommissioning and environmental protection provisions on an annual basis for exploration and evaluation assets as well for refining assets. This review incorporates the effects of any changes in local regulations, management's expected approach to decommissioning, cost estimates, discount rates, and the effects of changes in exchange rates.

We critically assessed management's annual review of provisions recorded. In particular, we focused on those assets where changes to the cost estimate directly impact the consolidated statement of comprehensive income rather than being recognised as an asset.

Testing involved understanding of the mandatory or constructive obligations with respect to the decommissioning of each asset based on the estimated useful life of assets and relevant cost to complete restoration.

Of particular note, we performed the following procedures:

- Identified and tested the cost assumption which have the most significant impact on provisions by reviewing the actual costs incurred during the year and comparing them to the prior years;

- Considered the competence and objectivity of the experts who produced the cost estimates by using valuation experts to evaluate reasonableness of the discount rate applied to the cost assumptions and compared it to the Serbian treasury notes for the similar periods;

- Verified the mathematical accuracy of the underlying models;

- Verified the completeness of data by cross referencing with other non-financial data and other work performed on property, plant & equipment;

- Verified the change in oil well status compared to the prior year through physical examination.

The aforementioned procedures were performed with regards to the decommissioning and environmental protection provisions recorded for all production wells on the territory of Serbia, which represents the largest part of total decommissioning and environmental protection provision of the Group.

Our procedures confirmed that management's estimate of future decommissioning and restoration costs are appropriate.

How we tailored our group audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the consolidated financial statements as a whole, taking into account the geographic and management structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

In establishing the scope of our audit work, we determined the nature and extent of work to be performed both at the reporting units and at the consolidated level. Where the work is performed by the local reporting unit auditors, we perform consolidated level oversight and review procedures to ensure sufficient evidence has been obtained to support our opinion on the consolidated financial statements taken as a whole. All local reporting unit audits are undertaken by PwC network firms.

Our approach to determining the scope of the audit of NIS is a three-step process whereby reporting units are deemed to be within the scope for audit testing based on meeting one or more of the following criteria:

1) Significant contribution, greater than 8%, to income before taxation, revenue or total assets. These reporting units are subject to full scope audits;
2) The presence of a significant risk, either at the reporting unit as a whole or relating to a specific financial statement line item. This includes financial statement line items impacted by the risks of material misstatement identified in our planning and reported on in our areas of focus below; or
3) The most significant other reporting units that enable us to satisfy our coverage criteria on each financial statement line item and to add elements of unpredictability in our scope.

Based on this process, we identified 9 reporting units in four countries that, in our view, required directed audit procedures over specific financial statement line items. Together, these reporting units accounted for 99% of revenue and 98% of total assets.

As a result of its structure and size, NIS also has several small reporting units that are individually immaterial but, in aggregate, make up a material portion of its profit before taxation, revenue or total assets. These are covered by the work that we perform at the consolidated level, which includes three main components:

1) Overall analytical review procedures: A significant proportion of the remaining reporting units not selected for procedures at an individual component level were subject to analysis of year-on-year movements at the consolidated level, with a focus on higher risk balances and unusual movements. Those reporting units not subject to the above overall analytical review procedures were individually, and in the aggregate, immaterial.
2) Tests of financial systems, processes and controls: We tested pervasive controls applied at the consolidated level. Additionally, NIS has five reporting units which are located in Serbia and which are under direct control of NIS management. Our audit work, in which we tested the design and operating effectiveness of systems and controls at these locations, was led by our group audit team. The results from this testing are reviewed throughout the year and considered in our continuous update of group audit scope.
3) Testing of specific transactions: In addition, at the consolidated level we performed specific transaction testing, including impairment of goodwill, litigations and confirmations of cash and cash equivalents balances.

Other information

Management is responsible for the other information. The other information comprises the Annual report (but does not include the consolidated financial statements and our auditor's report thereon), which is expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Pawel Peplinski.

PricewaterhouseCoopers d.o.o. Belgrade

PricewaterhouseCoopers d.o.o. Belgrade
Belgrade, Republic of Serbia
30 January 2018

PricewaterhouseCoopers d.o.o. Beograd*

This version of our report/ the accompanying documents is a translation from the original, which was prepared in Serbian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.