

## IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE EITHER (1) QIBS (AS DEFINED BELOW) THAT ARE ALSO QUALIFIED PURCHASERS (AS DEFINED BELOW) OR (2) NON-U.S. PERSONS (AS DEFINED BELOW) LOCATED OUTSIDE OF THE UNITED STATES.

**IMPORTANT:** You must read the following before continuing. The following applies to the prospectus (the "**Prospectus**") following this page and you are therefore advised to read this page carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from the Issuer, the Guarantor and Joint Lead Managers (as defined in the Prospectus) as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE NOTES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "**U.S. SECURITIES ACT**"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION, AND THE NOTES MAY NOT BE OFFERED OR SOLD, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE U.S. SECURITIES ACT) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE U.S. SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE ATTACHED PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER AND, IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. PERSON OR U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THE PROSPECTUS OR THIS TRANSMISSION IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE U.S. SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS. IF YOU HAVE GAINED ACCESS TO THIS TRANSMISSION CONTRARY TO ANY OF THE FOREGOING RESTRICTIONS, YOU ARE NOT AUTHORISED AND WILL NOT BE ABLE TO PURCHASE ANY OF THE NOTES DESCRIBED IN THE PROSPECTUS.

**Confirmation of your representation:** In order to be eligible to view the Prospectus or make an investment decision with respect to the said securities, prospective investors must be either (1) Qualified Institutional Buyers ("**QIBs**") (within the meaning of Rule 144A ("**Rule 144A**") under the U.S. Securities Act who are also qualified purchasers as defined in Section 2(a)(51) of the U.S. Investment Company Act 1940 (the "**Investment Company Act**") ("**QPs**"); or (2) non-U.S. persons (as defined in Regulation S under the U.S. Securities Act ("**Regulation S**")) located outside the United States. The Prospectus is being sent to you at your request and, by accessing the Prospectus, you shall be deemed to have represented to the Issuer, the Guarantor and Joint Lead Managers that (1) you and any customers you represent are either: (a) QIBs who are also QPs; or (b) you and any customers you represent are non-U.S. persons (as defined in Regulation S) outside of the United States; (2) unless you're a QIB who is also QP, the electronic mail address that you gave us and to which this e-mail has been delivered is not located in the U.S.; (3) you are a person who is permitted under applicable law and regulation to receive the Prospectus; and (4) you consent to delivery of the Prospectus by electronic transmission.

You are reminded that the Prospectus has been delivered to you on the basis that you are a person into whose possession the Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver the Prospectus to any other person.

The materials relating to this offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licenced broker or dealer, and the lead manager(s) or any affiliate of the lead manager(s) is a licenced broker or dealer in the relevant jurisdiction, the offering shall be deemed to be made by the lead manager(s) or such affiliate on behalf of the Issuer in such jurisdiction.

The Prospectus may only be distributed to, and is directed at (a) persons who have professional experience in matters relating to investments falling within article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or (b) high net worth entities falling within article 49(2)(a) to (d) of the Order, and other persons to whom it may be lawfully communicated, falling within article 49(1) of the Order (all such persons together being referred to as "**relevant persons**"). Any person who is not a relevant person should not act or rely on this document or any of its contents.

**The Prospectus has been sent to you in electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Issuer, the Guarantor and Joint Lead Managers, any person who controls them or any director, officer, employee or agent of them or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from the Joint Lead Managers.**



SOUTHERN GAS CORRIDOR

## SOUTHERN GAS CORRIDOR CJSC

(incorporated as a closed joint stock company in the Republic of Azerbaijan)

**US\$1,000,000,000 6.875% Guaranteed Notes due 2026**  
**(to be consolidated and form a single series with the U.S.\$ 1,000,000,000 6.875 % Guaranteed Notes due 2026 issued on 24 March 2016)**  
**unconditionally and irrevocably guaranteed by**  
**The Republic of Azerbaijan**  
**Issue Price: 107.469%**

Southern Gas Corridor CJSC (the "Issuer") is issuing U.S.\$1,000,000,000 6.875% Guaranteed Notes due 2026 (the "Further Notes") to be consolidated and form a single series with the U.S.\$1,000,000,000 6.875% Guaranteed Notes due 2026 issued by the Issuer on 24 March 2016 (the "Original Notes", and, together with the Further Notes, the "Notes"). The Further Notes will be consolidated and form a single series with the Original Notes on 24 March 2017.

The Prospectus has been approved by the Central Bank of Ireland (the "Central Bank"), as competent authority under Directive 2003/71/EC as amended by Directive 2010/73/EU (together, the "Prospectus Directive"). The Central Bank only approves this Prospectus as meeting the requirements imposed under Irish and European Union ("EU") law pursuant to the Prospectus Directive. Such approval relates only to the Further Notes of the Issuer which are to be admitted to trading on the Main Securities Market of the Irish Stock Exchange Plc (the "Irish Stock Exchange") or other regulated markets for the purposes of Directive 2004/39/EC or which are to be offered to the public in any Member State of the European Economic Area. Application has been made to the Irish Stock Exchange for the Further Notes to be admitted to the Official List of the Irish Stock Exchange (the "Official List") and trading on its regulated market.

Interest on the Notes is payable semi-annually in arrear on 24 March and 24 September in each year. Payments on the Notes will be made without deduction for or on account of taxes of the Republic of Azerbaijan to the extent described under "Terms and Conditions of the Further Notes – Condition 10 (Taxation)".

The Original Notes represent the first tranche and the Further Notes will represent the second tranche, both within the same series of Notes.

The Notes are constituted by a deed of covenant entered into by the Issuer on 18 March 2016 (the "Deed of Covenant") and will have the benefit of a deed of guarantee entered into by the Republic of Azerbaijan as guarantor on 18 March 2016 (the "Deed of Guarantee", or the "Guarantee"). The Deed of Covenant and the Deed of Guarantee were entered into in respect of the Original Notes and envisaged further issues being added to the series; they therefore do not require amendment in order to apply to the Further Notes, which represent the second tranche of the same series of Notes.

The Notes mature on 24 March 2026. The Notes are redeemable on a Change of Control Event (as defined in Condition 9) but are otherwise not redeemable prior to maturity. See "Terms and Conditions of the Further Notes – Condition 9 (Redemption and Purchase)".

Further Notes which are offered and sold in reliance on Regulation S will be represented by beneficial interests in a permanent global Note (the "Unrestricted Global Note") in registered form, without interest coupons attached, which will be registered in the name of a nominee for, and shall be deposited on or about 15 March 2017 (the "Closing Date") with a common depository for, and in respect of interests held through Euroclear Bank SA/NA ("Euroclear") and Clearstream Banking, *société anonyme* ("Clearstream, Luxembourg"). Further Notes which are offered and sold in reliance on Rule 144A will be represented by beneficial interests in a permanent global Note (the "Restricted Global Note" and, together with the Unrestricted Global Note, the "Global Notes") in registered form, without interest coupons attached, which will be deposited on or about 15 March 2017 (the "Closing Date") with a custodian for, and registered in the name of Cede & Co. as nominee for The Depository Trust Company ("DTC"). The Further Notes will be offered and sold in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000. See "Terms and Conditions of the Further Notes – Condition 1 (Form, Denomination and Title)". Interests in the Restricted Global Note will be subject to certain restrictions on transfer. See "Form of the Notes and Transfer Restrictions". Beneficial interests in the Global Notes will be shown on, and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Clearstream, Luxembourg and their participants. Except as described herein, certificates for Notes will not be issued in exchange for beneficial interests in the Global Notes.

**NEITHER THE FURTHER NOTES NOR THE GUARANTEE HAVE BEEN OR WILL BE REGISTERED UNDER THE U.S. SECURITIES ACT, OR ANY STATE SECURITIES LAW, AND THE FURTHER NOTES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, ANY U.S. PERSON (AS SUCH TERMS ARE DEFINED IN REGULATION S), EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE U.S. SECURITIES ACT. THE FURTHER NOTES MAY BE OFFERED AND SOLD ONLY (I) OUTSIDE OF THE UNITED STATES TO PERSONS OTHER THAN U.S. PERSONS AS DEFINED IN AND IN ACCORDANCE WITH REGULATION S UNDER THE U.S. SECURITIES ACT AND (II) IN THE UNITED STATES TO PURCHASERS THAT ARE QUALIFIED INSTITUTIONAL BUYERS AS DEFINED IN RULE 144A UNDER THE U.S. SECURITIES ACT ("QIBS") THAT ARE ALSO QUALIFIED PURCHASERS AS DEFINED IN SECTION 2(A)(51)(A) OF THE UNITED STATES INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "INVESTMENT COMPANY ACT") AND THE RULES AND REGULATIONS THEREUNDER ("QPS"), IN EACH CASE ACTING FOR THEIR OWN ACCOUNT OR THE ACCOUNT OF ONE OR MORE QIBS THAT ARE ALSO QPS IN RELIANCE ON AND IN COMPLIANCE WITH RULE 144A. SEE "FORM OF THE NOTES AND TRANSFER RESTRICTIONS".**

The Issuer may be a "covered fund" as defined in Section 13 of the Bank Holding Company Act (the "Volcker Rule"). However, the Issuer does not believe that an investment in the Notes would constitute an acquisition of an "ownership interest" (as defined in the Volcker Rule regulation) in a covered fund. See "Subscription and Sale – Covered Fund".

The Original Notes were rated Ba1 by Moody's Deutschland GmbH ("Moody's") and BB+ by Fitch Ratings Limited ("Fitch") and it is expected that the rating of the Notes will remain the same immediately after the issuance of the Further Notes (except that the Further Notes will be rated by Moody's Investor Services Inc.). The Guarantor is rated Ba1 by Moody's Investor Service, Inc., BB+ (outlook negative) by Fitch and BB+ by Standard & Poor's Credit Market Services Europe Limited ("S&P"). The Issuer is not and will not be rated by Moody's, Fitch or S&P. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. Each of Moody's, Moody's Investor Services, Fitch and S&P is established in the European Union (the "EU"), Moody's is domiciled in Germany, each of Moody's Investor Services, Fitch and S&P is domiciled in the United Kingdom, and is included in the list of credit rating agencies registered in accordance with Regulation (EC) No. 1060/2009 on Credit Rating Agencies as amended by Regulation (EU) No. 513/2011 (the "CRA Regulation"). This list is available on the ESMA website (<http://www.esma.europa.eu/page/list-registered-and-certified-CRAs>) (last updated 1 December 2015).

Prospective investors should have regard to the factors described under the section headed "Risk Factors" beginning on page 7.

Citigroup

J.P. Morgan

UniCredit Bank

10 March 2017

This Prospectus constitutes a prospectus for the purpose of Article 5 of Directive 2003/71/EC as amended by Directive 2010/73/EU (together, the "**Prospectus Directive**") and for the purpose of giving information with regard to the Issuer and its subsidiaries (the "**Group**"), the Republic of Azerbaijan acting through the Ministry of Finance (the "**Guarantor**" or the "**Republic of Azerbaijan**" or the "**Republic**") and the Notes which, according to the particular nature of the Issuer, the Guarantor and the Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer and the Group and the economic, fiscal and the political condition of the Guarantor, and of the rights attaching to the Notes. The Issuer and the Guarantor, having taken all reasonable care to ensure that such is the case, accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer and the Guarantor, the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Neither the Joint Lead Managers nor any of their directors, affiliates, advisers or agents has made an independent verification of the information contained in this Prospectus in connection with the issue or offering of the Notes and no representation or warranty, express or implied, is made by the Joint Lead Managers or any of their directors, affiliates, advisers or agents with respect to the accuracy or completeness of such information. Nothing contained in this Prospectus is, is to be construed as, or shall be relied upon as, a promise, warranty or representation, whether to the past or the future, by the Joint Lead Managers or any of their respective directors, affiliates, advisers or agents in any respect. The contents of this Prospectus are not, are not to be construed as, and should not be relied on as, legal, business or tax advice and each prospective investor should consult its own legal and other advisers for any such advice relevant to it.

No person is authorised to give any information or make any representation not contained in this Prospectus in connection with the issue and offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by any of the Issuer or the Guarantor or the Joint Lead Managers or any of their directors, affiliates, advisers or agents. The delivery of this Prospectus does not imply that there has been no change in the business and affairs of the Issuer or economic, fiscal or political condition of the Guarantor since the date hereof or that the information herein is correct as of any time subsequent to its date.

This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy the Notes by any person in any jurisdiction where it is unlawful to make such an offer or solicitation. The distribution of this Prospectus and the offer or sale of the Notes in certain jurisdictions is restricted by law. This Prospectus may not be used for, or in connection with, and does not constitute, any offer to, or solicitation by, anyone in any jurisdiction or under any circumstance in which such offer or solicitation is not authorised or is unlawful. In particular, this Prospectus does not constitute an offer of securities to the public in the United Kingdom. No prospectus has been or will be approved in the United Kingdom in respect of the Notes. Consequently this document is being distributed only to, and is directed at (a) persons who have professional experience in matters relating to investments falling within article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or (b) high net worth entities falling within article 49(2)(a) to (d) of the Order, and other persons to whom it may be lawfully communicated, falling within article 49(1) of the Order (all such persons together being referred to as "**relevant persons**"). Any person who is not a relevant person should not act or rely on this document or any of its contents. Persons into whose possession this Prospectus may come are required by the Issuer, the Guarantor and the Joint Lead Managers to inform themselves about and to observe such restrictions. Further information with regard to restrictions on offers, sales and deliveries of the Notes and the distribution of this Prospectus and other offering material relating to the Notes is set out under "Subscription and Sale" and "Form of the Notes and Transfer Restrictions".

The Notes may be offered and sold only (i) outside of the United States to persons other than U.S. persons as defined in and in accordance with Regulation S under the Securities Act and (ii) in the United States to purchasers that are QIBs that are also QPs, in each case acting for their own account or the account of one or more QIBs that are also QPs in reliance on and in compliance with Rule 144A. Each U.S. purchaser of Notes is hereby notified that the offer and sale of any Notes to it may be being made in reliance upon the exemption from the registration requirements of the U.S. Securities Act provided by Rule 144A.

Unless otherwise specified or the context so requires, references to "**US Dollars**" and "**US\$**" are to United States dollars, references to "**euro**", "**EUR**" and "**€**" are to the currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European

Community, as amended, and references to "**Manat**" and "**AZN**" are to the lawful currency of the Republic of Azerbaijan. References to "**billions**" are to thousands of millions.

The language of the prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under applicable law.

**In connection with the issue of the Notes, J.P. Morgan Securities plc (or any person acting on behalf of any Stabilising Manager(s)) may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that J.P. Morgan Securities plc (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the relevant Stabilising Manager(s) (or person(s) acting on behalf of any Stabilising Manager(s)) in accordance with all applicable laws and rules.**

## FORWARD-LOOKING STATEMENTS

Certain statements included herein may constitute "forward-looking statements" within the meaning of Section 27A of the U.S. Securities Act and Section 21E of the United States Securities Exchange Act of 1934, as amended (the "**Exchange Act**"); however, this Prospectus is not entitled to the benefit of the safe harbour created thereby. Such statements, certain of which can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "are expected to", "intends", "will", "will continue", "should", "could", "would be", "seeks", "approximately", "estimates", "predicts", "projects", "aims" or "anticipates", or similar expressions or the negative thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans or intentions, involve a number of risks and uncertainties. Such forward-looking statements are necessarily dependent on assumptions, data or methods that may be incorrect or imprecise and that may be incapable of being realised. Therefore undue reliance should not be placed on them. Such forward-looking statements relate to, among other things, the Issuer's and the Guarantor's current intentions, plans, estimates, assumptions, beliefs and expectations.

Forward looking statements speak only as of the date on which they are made and the Issuer and the Guarantor undertake no obligation to update publicly any of them in light of new information or future events. Forward looking statements involve inherent risks and uncertainties. Forward looking statements include, but are not limited to, (i) plans with respect to the implementation of business plans and economic policy, (ii) expectations about revenues, expenses and expenditure and the behaviour of the economy if certain economic policies are implemented (iii) the outlook for the Issuer's business and the economies in which it operates as well as inflation, exchange rates, interest rates, commodity prices, foreign investment, balance of payments, trade and fiscal balances, and (iv) estimates of the Group's borrowings as well as the Guarantor's external debt repayment and debt service.

The Issuer and the Guarantor caution that a number of important factors could cause actual results to differ materially from those contained in any forward looking statement. The information contained in this Prospectus identifies important factors that could cause such differences, including, but not limited, to adverse external factors such as:

- price and demand/supply fluctuations in condensate and natural gas;
- condensate and natural gas transportation tariffs;
- economic and political conditions in Azerbaijan, Turkey, Europe and international markets;
- changes in foreign exchange rates or prevailing interest rates, which could adversely affect the Republic of Azerbaijan's balance of payments and external reserves or the Issuer's ability to service the Notes; and
- adverse events in other emerging market countries, which could dampen foreign investment or adversely affect the trading price of the Notes; and

adverse domestic factors, such as:

- plans for and changes in economic or other policies which could affect inflation, growth rates and/or other aspects of the Azerbaijani economy;
- the pace of implementation of any economic or monetary policies;
- plans or policies in respect of privatisations;
- budgetary plans;
- changes in tariff and tax requirements (including tax rate changes, new tax laws and revised tax law interpretations);
- a decline in foreign direct investment, an increase in the level of domestic and external debt, a decrease in Azerbaijan's fiscal revenues or an increase in debt service requirements;
- any deterioration in political or economic stability or in investor perceptions thereof; and

- the timing, impact and other uncertainties of future actions; and

adverse factors in relation to the business and operations of the Group and the projects in which it holds or will hold interests (the "**projects**"), such as:

- operational limitations, including availability of equipment, equipment failures, labour disputes and processing limitations;
- the availability or cost of transportation routes and fees charged for arranging transportation of hydrocarbons;
- unplanned events or accidents affecting the operations or facilities of the projects;
- reservoir performance, drilling results and the implementation and execution of the projects;
- weather conditions and the impact on the projects;
- changes in the regulations and policy of the governments of Azerbaijan, Turkey and other neighbouring countries;
- incidents or conditions affecting the export of condensate and natural gas; and
- overall business and government regulatory conditions.

The sections of this Prospectus entitled "*Risk Factors*", "*Republic of Azerbaijan*" and "*The Economy*" contain a more complete discussion of the factors that could adversely affect the Guarantor and, thereby, the Issuer. In light of these risks, uncertainties and assumptions, the forward looking events described in this Prospectus may not occur. Neither the Issuer nor the Guarantor is obliged to, and does not intend to, update or revise any forward looking statements made in this Prospectus whether as a result of new information, future events or otherwise, except as may be required by law or applicable regulations. All subsequent written and oral forward looking statements attributable to the Issuer, the Guarantor or to persons acting on their behalf are expressly qualified in their entirety by the cautionary statements referred to above and contained elsewhere in this Prospectus.

All subsequent written or oral forward looking statements attributable to the Issuer, the Guarantor, or persons acting on their behalf, are expressly qualified in their entirety by the cautionary statements contained throughout this Prospectus. As a result of these risks, uncertainties and assumptions, a prospective purchaser of the Notes should not place undue reliance on these forward looking statements.

#### AVAILABLE INFORMATION

The Issuer is not currently required to file periodic reports under Sections 13 or 15 of the Exchange Act with the U.S. Securities and Exchange Commission. To permit compliance with Rule 144A in connection with resales and transfers of Notes, the Issuer has agreed that, for so long as any of the Notes are "restricted securities" within the meaning of Rule 144(a)(3) under the U.S. Securities Act, the Issuer will provide to any holder or beneficial owner of such restricted securities, or to any prospective purchaser of such restricted securities designated by a holder or beneficial owner, upon the request of such holder, beneficial owner or prospective purchaser, the information required to be provided by Rule 144A(d)(4) under the U.S. Securities Act, if at the time of such request the Issuer, is not a reporting company under Section 13 or Section 15(d) of the Exchange Act or exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act. See "*Terms and Conditions of the Further Notes – Condition 17 (Provision of Certain Information)*".

## ENFORCEMENT OF ARBITRATION AWARDS AND FOREIGN JUDGMENTS

The Notes, the Guarantee, the Deed of Covenant and the fiscal agency agreement entered into between the Issuer and the Agents named therein on 18 March 2016 (as amended or supplemented from time to time, the "**Fiscal Agency Agreement**") are governed by English law and the Issuer and the Guarantor have agreed in the Notes and the Fiscal Agency Agreement, the Issuer has agreed in the Deed of Covenant and the Guarantor has agreed in the Deed of Guarantee that disputes arising thereunder are subject to arbitration in London, England. See "*Terms and Conditions of the Further Notes – Condition 20 (Governing Law and Arbitration)*".

The Republic of Azerbaijan and the United Kingdom are parties to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (the "**Convention**") and, accordingly, an arbitral award from the United Kingdom under the Convention should generally be recognised and enforceable in the Republic of Azerbaijan provided the conditions to enforcement set out in the Convention are met. The conditions to recognition and enforcement of an arbitral award include requirements that there should be an "agreement in writing" signed by the parties, that the parties have capacity to enter into such agreement and that the agreement is valid under the law to which the parties have subjected it. The Issuer and the Guarantor believe that the agreements in the Notes and the Guarantee satisfy those conditions and, therefore, subject to the satisfaction of the other conditions specified in the Convention, an arbitral award under the Notes or the Guarantee should be recognised and enforced in the Republic of Azerbaijan. However, although the Republic of Azerbaijan is a signatory to the Convention, the enforcement of such award in local courts remains largely untested.

An arbitral award may also form the basis for a judgment in a court outside Azerbaijan and it may be possible to enforce such a judgment in Azerbaijan. Grounds for refusal to recognise and enforce judgments of foreign courts are established in the Code of Civil Procedure of the Republic of Azerbaijan (the "**Civil Procedure Code**") and, additionally, the legal assistance treaties of the Republic of Azerbaijan with other countries. Judgments of a court established in a country with which Azerbaijan has a legal assistance treaty will be recognised and enforced in accordance with the terms of any such treaty and the Civil Procedure Code. The Supreme Court of the Republic of Azerbaijan will not (other than at its own discretion) enforce any judgment obtained in a court established in a country other than the Republic of Azerbaijan unless such country allows for reciprocal enforcement of Azerbaijani court judgments. There is no treaty providing for reciprocal enforcement of court judgements, nor are there any such reciprocal enforcement procedures in place between Azerbaijan and either the United Kingdom or the United States. See "*Risk Factors – Foreign judgments may not be enforceable in Azerbaijan and enforcement of arbitral awards is dependent on compliance with procedural requirements*".

Further the Issuer is a closed joint stock company organised under the laws of the Republic of Azerbaijan and its directors and all principal officers are residents of the Republic of Azerbaijan. The Guarantor is a sovereign state. As a result, it may not be possible (a) to effect service of process upon the Issuer, the Guarantor or any such person outside the Republic of Azerbaijan, (b) to enforce against any of them, in courts of jurisdictions other than the Republic of Azerbaijan, judgments obtained in such courts that are predicated upon the laws of such other jurisdictions or (c) to enforce against any of them, in the Republic of Azerbaijan's courts, judgments obtained in jurisdictions other than the Republic of Azerbaijan, including judgments obtained in the courts of England and judgments obtained in the United States predicated upon the civil liability provisions of the federal securities laws of the United States.



## PRESENTATION OF FINANCIAL AND CERTAIN OTHER INFORMATION

### The Issuer

The Issuer was incorporated on 31 March 2014.

The Issuer maintains its books of account in US Dollars. The financial information of the Group set forth herein, has, unless otherwise indicated, been derived from (i) its reviewed unaudited interim condensed consolidated statement of financial position and statements of income, cash flows and changes in equity as of and for the eleven months ended 30 November 2015 and the eleven months ended 30 November 2016 (the "**Interim Financial Statements**") and (ii) its audited consolidated statement of financial position and statements of income, cash flows and changes in shareholders' equity as of and for the year ended 31 December 2015 and as of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014 (the "**Audited Financial Statements**" and together with the Interim Financial Statements, the "**Financial Statements**"). The Audited Financial Statements were prepared in accordance with International Financial Reporting Standards ("**IFRS**"), and the Interim Financial Statements were prepared in accordance with IAS 34 Interim Financial Reporting ("**IAS 34**").

The Audited Financial Statements were audited, and reported on without qualification, by Ernst & Young Holdings CIS B.V., independent auditors ("**E&Y**") in accordance with International Standards on Auditing. The Interim Financial Statements were reviewed by E&Y in accordance with International Standards on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.

Certain amounts which appear in this Prospectus have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

### The Guarantor

All references in this Prospectus to the "**Government**" or to the "**Milli Majlis**" are to the central government, comprising the Cabinet of Ministers of the Republic of Azerbaijan, or to the Milli Majlis of Azerbaijan, the parliament respectively; and references to the "**CIS**" are to the Commonwealth of Independent States.

Gross Domestic Product ("**GDP**") is a measure of the total value of final products and services produced in a country. "**Nominal GDP**" measures the total value of final production in current prices. "**Real GDP**" measures the total value of final production in constant prices, thus allowing historical GDP comparisons that exclude the effect of inflation. For the purposes of this Prospectus, the Issuer has provided Real GDP and real growth figures calculated by third parties, which adjust for price changes. Unless otherwise stated, references in this Prospectus to "**GDP**" are to Real GDP figures.

References to the "**State Budget**" are to the budget of the Republic of Azerbaijan. References to the "**Consolidated Budget**" are to the consolidated budget of the Republic of Azerbaijan which comprises (i) the State Budget, (ii) the budget of the Nakhchivan Autonomous Republic, (iii) the budget of the State Social Protection Fund under the Ministry of Labour and Social Protection of Population of the Republic of Azerbaijan (the "**State Social Protection Fund**") and (iv) the budget of State Oil Fund of the Republic of Azerbaijan.

References to laws, including the budget, refer to such laws (and the budget), as amended from time-to-time.

Unless otherwise stated, all annual information, including budgetary information for Azerbaijan, is based on calendar years. Unless otherwise stated, all statistical information for any period ending in 2015 or 2016 is preliminary and subject to revision and amendment. Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same item of information may vary reflecting such rounding, and figures which are totals may not be the sum of their components.

Statistical data appearing in this Prospectus has, unless otherwise stated, been obtained from the State Statistical Committee of Azerbaijan, the Ministry of Finance, the Ministry of Economy and the Central Bank of Azerbaijan (the "**CBA**"). Statistics are maintained by these sources in Manat, US Dollars or Euros, as applicable. Similar statistics may be obtained from other sources, although the underlying

assumptions and methodology, and consequently the resulting data, may vary from source to source. Although every effort has been made to include in this Prospectus the most reliable and the most consistently presented data, no assurance can be given that such data were compiled or prepared on a basis consistent with international standards. The Issuer and the Guarantor each confirm, however, that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading.

Information included in this Prospectus and identified as being derived from information published by the Republic of Azerbaijan or one of its agencies or instrumentalities is included herein on the authority of such publication as a public official document of the Republic of Azerbaijan. All other information herein with respect to the Republic of Azerbaijan is included herein as a public official statement made on the authority of the Ministry of Finance.

### **Certain Reserves Information**

The reserves figures contained in this Prospectus, unless otherwise stated, are taken from reserves analyses prepared by the professional engineering staff of BP Exploration (Shah Deniz) Limited ("**BP**"). BP calculates reserves using the internationally accepted reserve estimation standards under the Petroleum Resources Management System sponsored by the Society for Petroleum Engineers, the American Association of Petroleum Geologists, World Petroleum Council and the Society for Petroleum Evaluation Engineers ("**PRMS**"). PRMS standards differ in certain material respects from reserves reporting requirements required by the U.S. Securities and Exchange Commission.

The reserves figures included in this Prospectus may differ from figures previously published due to different methodologies and standards in calculating such reserves figures. To the extent that the reserves figures included in this Prospectus show increased levels of reserves as compared to previously published figures, it is primarily a result of the differences in methodologies and standards and does not necessarily reflect increases in reserves or in reserves that are economically viable to extract. See "*Risk Factors-Risk Factors Relating to the Issuer's Business and Industry-The reported quantities or classifications of the condensate and natural gas reserves in the Shah Deniz field may be lower than estimated because of inherent uncertainties in the calculation of reserves.*"

References in this Prospectus to "tonnes" are to metric tonnes. One metric tonne equals 1,000 kilograms.

### **Data Dissemination**

In 2001, Azerbaijan subscribed to the IMF's Special Data Dissemination Standard (the "**SDDS**"), which is designed to improve the timeliness and quality of information of subscribing member countries. The SDDS requires subscribing member countries to provide schedules indicating, in advance, the date on which data will be released, (the "**Advance Release Calendar**"). For Azerbaijan, precise dates or "no-later-than dates" for the release of data under the SDDS are disseminated no later than three months in advance through the Advance Release Calendar, which is published on the Internet under the IMF's Dissemination Standards Bulletin Board. Summary methodologies of all data and data dissemination practices (metadata) to enhance transparency of statistical compilation are also provided on the Internet under the IMF's Dissemination Standards Bulletin Board. That website and any information on it are not part of this Prospectus.

### **Rounding**

Certain amounts which appear in this Prospectus have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

### **Alternative Performance Measures**

The selected financial data set forth in this Prospectus, in addition to the conventional financial performance measures established by IFRS, contains certain alternative performance measures (such as EBITDA, debt, capitalisation etc.) ("**APMs**") that are presented for purposes of a better understanding of the trend of operations and the financial condition and provides a more meaningful depiction for investors of the underlying fundamentals of the Group's business. Where used, the relevant metrics are identified as APMs and accompanied by an explanation of each such metric's components and calculation method.

Such measures should, however, not be considered as a substitute for those required by IFRS.

## EXCHANGE RATES

The following tables set forth the exchange rate history for the periods indicated, expressed in Manat per US Dollar and Manat per Euro, respectively, and not adjusted for inflation, as published by the CBA:

### Manat to US Dollar Exchange Rate History

Year	Low	High	Average	Period End
	<i>(Manat per US\$1.00)</i>			
2017 <sup>(1)</sup> .....	1.7296	1.9200	1.8023	1.7475
2016.....	1.4900	1.7707	1.5971	1.7707
2015.....	0.7844	1.5594	1.0285	1.5594
2014.....	0.7842	0.7845	0.7844	0.7844
2013.....	0.7843	0.7850	0.7845	0.7845
2012.....	0.7845	0.7865	0.7856	0.7850
2011.....	0.7862	0.7977	0.7895	0.7865
2010.....	0.7979	0.8039	0.8026	0.7979
2009.....	0.8015	0.8080	0.8039	0.8031
2008.....	0.8005	0.8455	0.8211	0.8010

<sup>(1)</sup> Period from 1 January 2017 to 28 February 2017

### Manat to Euro Exchange Rate History

Year	Low	High	Average	Period End
	<i>(Manat per €1.00)</i>			
2017 <sup>(1)</sup> .....	1.8293	2.0719	1.9182	1.8505
2016.....	1.6595	1.8716	1.7656	1.8644
2015.....	0.8770	1.7094	1.1402	1.7046
2014.....	0.9522	1.0932	1.0417	0.9522
2013.....	1.0023	1.0836	1.0428	1.0780
2012.....	0.9487	1.0601	1.0106	1.0377
2011.....	1.0168	1.1765	1.0987	1.0178
2010.....	0.9561	1.1666	1.0646	1.0560
2009.....	1.0060	1.2130	1.1198	1.1499
2008.....	1.0093	1.3269	1.2086	1.1292

<sup>(1)</sup> Period from 1 January 2017 to 28 February 2017

As of 9 March 2017, the exchange rates published by the CBA were AZN 1.7563 = US\$1 and AZN 1.8494 = €1, respectively.

The rates in the above tables may differ from the actual rates used in the preparation of the information appearing in this Prospectus. For ease of presentation, certain financial information included herein is presented as translated into US Dollars. The inclusion of these exchange rates is not meant to suggest that any amount of the currencies specified above has been, or could be, converted into the applicable currency at the rates indicated or at any other rate.

The Group's financial statements have been presented in US Dollars.

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## GENERAL DESCRIPTION OF THE ISSUER, THE PROJECTS, THE GUARANTOR AND THE OFFERING

### General Description of the Issuer, the Projects and the Guarantor

#### The Issuer

The Issuer was incorporated on 31 March 2014 pursuant to Presidential Decree No. 287 dated 25 February 2014 (the "**Presidential Decree**"). The Issuer was established to consolidate, manage and finance the Republic of Azerbaijan's interests in the Projects. The Issuer holds an economic interest in each, but is not the direct operator of, any of the Projects.

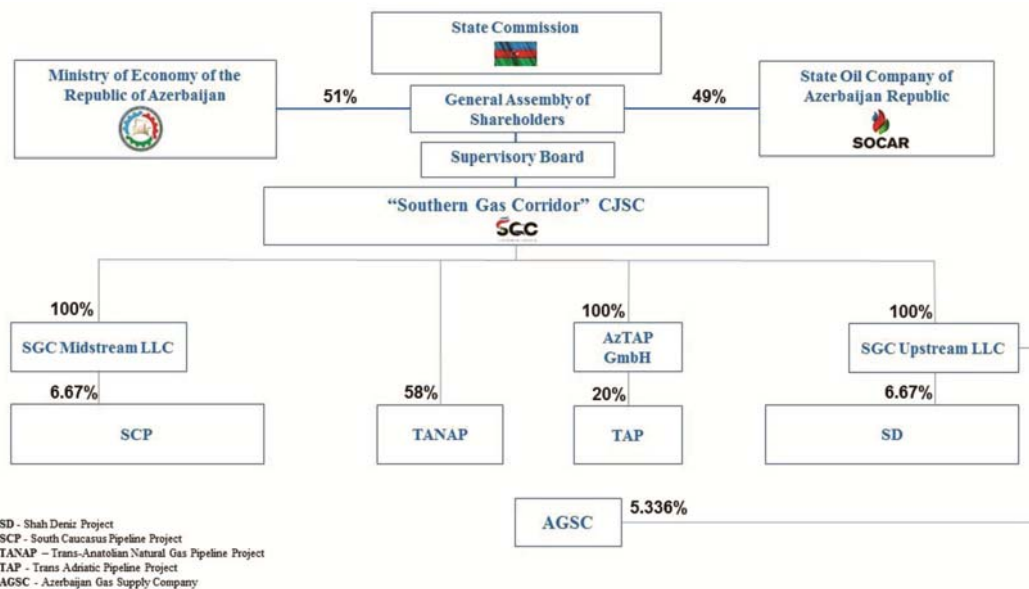
The Issuer's capital is directly and indirectly wholly owned by the Republic of Azerbaijan, with 51% of the Issuer's capital held by the Ministry of Economy of the Republic of Azerbaijan and 49% of the Issuer's capital held by the State Oil Company of Azerbaijan Republic ("**SOCAR**"), which in turn is wholly owned by the Republic of Azerbaijan. As of 30 November 2016, the Issuer's share capital was US\$1,740.8 million.

The Supervisory Board of the Issuer comprises the First Deputy Prime Minister (Chairman), the Minister of Energy, the Minister of Economy, the President of SOCAR and the Executive Director of the State Oil Fund of the Republic of Azerbaijan ("**SOFAZ**"). The State Commission, which was established in October 2013, oversees the Issuer's activities.

For the eleven months ended 30 November 2016, the Group's total revenue was US\$103.4 million and its loss was US\$52.9 million. As of 30 November 2016, the Group's total assets were US\$7,983.6 million and its total equity was US\$2,916.9 million.

#### Organisational Structure of the Issuer

The following chart sets forth the organisational structure of the Issuer:



#### The Projects

The Southern Gas Corridor project aims to increase European energy supply by bringing gas resources from the Caspian Sea to markets in Europe. The Southern Gas Corridor comprises the following four projects (collectively, the "**Projects**"): (i) the full-field development of the Shah Deniz natural gas and condensate field (the "**Shah Deniz field**"), (ii) the expansion of the South Caucasus Pipeline ("**SCP**"), (iii) the construction of the Trans-Anatolian Natural Gas Pipeline ("**TANAP**") and (iv) the construction of the Trans Adriatic Pipeline ("**TAP**"). Day-to-day operations of each of the Projects are managed by their respective operating companies (each, an "**Operating Company**").

The Projects comprise upstream and midstream operations located principally in Azerbaijan as well as in Turkey. SCP transports natural gas from the Shah Deniz field to the Georgian-Turkish border. The gas transported through SCP, once expanded, will also be further transported via TANAP (once constructed) to consumers in Turkey as well as to Italy and other European countries through TAP which will run from the Turkish-Greek border via Greece and Albania across the Adriatic Sea to southern Italy. The Projects have been developed in partnership with major international companies in the oil and gas industry and anticipate the first deliveries of natural gas from the Shah Deniz field to Turkey in 2018 and the first deliveries of gas to European customers in 2020.

The Issuer, through its wholly owned subsidiary SGC Upstream LLC ("**SGC Upstream**"), has a 6.67% interest in the production sharing agreement (a "**PSA**") relating to the Shah Deniz field (the "**Shah Deniz PSA**"), which is operated by BP Exploration (Shah Deniz) Limited ("**BP**"), and a 5.336% share in Azerbaijan Gas Supply Company Limited ("**AGSC**"), which is a marketing vehicle of the parties to the Shah Deniz PSA in respect of the natural gas produced from the Shah Deniz field. Through its wholly owned subsidiary SGC Midstream LLC ("**SGC Midstream**"), the Issuer holds a 6.67% interest in the South Caucasus Pipeline Company Limited ("**SCPC**"), which owns the SCP. The SCP is operated, through SCPC, by BP (as technical operator) and SOCAR Midstream Operations LLC ("**SMO**") (as commercial operator). The Issuer also has a 58.0% share in TANAP Doğalgaz İletim A.Ş. ("**TANAP A.Ş.**"), which is the Operating Company for TANAP. In addition, the Issuer holds, through its wholly owned subsidiary AzTAP GmbH, a 20.0% share in Trans Adriatic Pipeline AG ("**TAP AG**"), which is the Operating Company for TAP. Operational management of the Issuer's stakes in the Projects is conducted by SOCAR's affiliates, pursuant to an operator services agreement between the Issuer and some of its subsidiaries and SOCAR. See "*— SOCAR Service Agreement*" for additional information.

The Shah Deniz field was discovered in 1999 and is considered one of the world's largest gas condensate fields, with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP. Total production from the Shah Deniz field during the period from 2007 to 2045 is expected to reach 458.8 billion cubic meters of natural gas and 616.1 million barrels of condensate, according to BP. In the year ended 31 December 2015, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.53 billion cubic metres and 0.97 million barrels, respectively. In the year ended 31 December 2016, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.59 billion cubic metres and 1.11 million barrels of condensate, respectively.

### **The Guarantor**

Azerbaijan (officially the Republic of Azerbaijan (*Azərbaycan Respublikası*)) is located at the crossroads of Eastern Europe and Western Asia, in the South Caucasus region of Eurasia. It occupies a land area of 86,600 square km, of which 12% is forests, 1.7% is inland water and 55.1% is agricultural land. Its territory also includes the Azerbaijani sector of the Caspian Sea.

The country is situated between 44° and 52° of east longitude, 38° and 42° of north latitude and Azerbaijan's capital, Baku, is located on the 40° parallel.

Azerbaijan has a 765 km border with Iran in the south, a 15 km border with Turkey in the south-west, a 390 km border with Russia in the north, a 480 km border with Georgia in the north-west and a 1,007 km border with Armenia in the west.

The population of Azerbaijan was approximately 9.8 million as of 31 December 2016. Population density is estimated at approximately 112 persons per square km, with approximately 53.1% of the population living in urban areas. Baku, the capital of the country and its largest city, has an estimated population of 2.25 million. Other large cities include Ganja with an estimated population of 331,400 and Sumgayit with an estimated population of 339,000.

During the last 10 years, almost US\$190 billion has been invested in the economy and the country's strategic foreign exchange reserves stand at approximately US\$37.6 billion as of 31 December 2016 (with the CBA holding approximately US\$4.6 billion (including government deposits) and SOFAZ holding approximately US\$33 billion of foreign reserves). As of 28 February 2017, the CBA's foreign reserves stood at approximately US\$4.4 billion. Economic growth since 2000 has transformed the country from a low income category to an upper middle income country according to the World Bank's classification. The country's poverty rate has also been reduced from above 50% in 2001 to 5.0% in 2015, based on

internal classifications. The quality of life has also improved considerably, which is reflected in increased life expectancy, access to better healthcare, education and other social services.

Between 2005 and 2008, GDP grew by 2.4 times, making Azerbaijan one of the most rapidly developing economies in the world. The fastest year on year rate of growth was recorded in 2006, when GDP increased by 34.5%. The economy of Azerbaijan has continued on a solid growth path in the period 2010 to 2015, with growth of 28.1%. The impact of the global financial crisis on the economy was limited and, while GDP from the non-hydrocarbon industrial sector declined by approximately 10% in 2009, positive growth quickly returned in 2010 and by the end of that year GDP exceeded pre-2009 levels. In 2011, 2012, 2013 and 2014, growth across non-oil and gas GDP was robust, increasing by 9.4%, 9.7%, 10.0%, 7.0%, respectively, with a decline in non-oil and gas GDP growth in 2015. In 2016, non-oil and gas GDP decreased by 4.5%.

Due to declining oil prices, in February 2015, the CBA devalued the Manat by 34% to 1.05 Manats per US Dollar and moved the Manat away from a dollar peg in an effort to ease the strain of lower oil prices on budget revenue and make Azerbaijan's exports more competitive. On 21 December 2015, the CBA moved to a floating exchange rate, subject to an existing requirement for commercial banks to buy or sell Manat at a range of not more than 4% from the officially set exchange rate, abandoning the Manat's dollar-euro basket peg. This caused a further devaluation of the Manat of 47% against the US Dollar. In January 2017, the CBA eliminated this 4% exchange rate corridor to permit the Manat float freely against other currencies.

State Budget revenues in 2016 were AZN 17.499 billion compared with AZN 17.498 billion in 2015. The Government's objective is to increase revenue generation from the non-oil sector and gradually decrease the reliance on transfers from SOFAZ for budget purposes. Transfers from SOFAZ in 2016 were AZN 7.6 billion, which was AZN 0.5 billion (6.3%) less than in 2015.

In 2016, State Budget expenditures were AZN 17.7 billion compared with AZN 17.8 billion in 2015, a 0.23% decrease. The State Budget aims to balance a social development target with the need to upgrade the country's public infrastructure. A significant share of the expenditures was directed towards raising economic potential, ensuring energy, food, environmental and transport security, further promoting entrepreneurship and agricultural activity, particularly following the Manat devaluation and the expected rise in inflation caused thereby.

The State Budget deficit in 2016 was AZN 0.2 billion, primarily due to devaluation of the Manat in December 2015 and falling oil prices. As planned, the State Budget deficit was covered through issuances of securities, revenues from privatisation, foreign grants and foreign loans.

The forecasted State Budget revenues and expenditures for 2017 are AZN 16.3 billion and AZN 16.9 billion, respectively.

The 2017 State Budget assumes revenues of AZN 16.3 billion, which represents an AZN 1.2 billion, or 6.9%, decrease from actual revenues in 2016. The 2017 State Budget envisions expenditures of AZN 16.9 billion, a decrease of AZN 0.8 billion, or 4.5%, from actual expenditures in 2016.

The Government expects a budget deficit of AZN 645 million in 2017. The deficit is expected to be covered through issuances of securities, revenues from privatisation, foreign grants and foreign loans.



## General Description of the Offering

<b>Issuer:</b>	Southern Gas Corridor CJSC
<b>Guarantor:</b>	The Republic of Azerbaijan
<b>Fiscal Agent:</b>	Citibank, N.A., London Branch
<b>Paying and Transfer Agent:</b>	Citibank, N.A., London Branch
<b>Registrar:</b>	Citigroup Global Markets Deutschland AG
<b>The Further Notes:</b>	US\$1,000,000,000 6.875% Guaranteed Notes due 2026 (to be consolidated and form a single series with the US\$1,000,000,000 6.875% Guaranteed Notes due 2026, on 24 March 2017)
<b>Issue Price:</b>	107.469% of the principal amount of the Further Notes (excluding accrued interest).
<b>Issue Date:</b>	15 March 2017
<b>Maturity Date:</b>	24 March 2026
<b>Interest Rate:</b>	The Further Notes will bear interest at the rate of 6.875% per annum from and including 15 March 2017 to but excluding the Maturity Date (as defined in " <i>Terms and Conditions of the Further Notes</i> ").
<b>Yield:</b>	5.80%
<b>Interest Payment Dates:</b>	Interest will be payable semi-annually in arrear on 24 March and 24 September in each year, commencing on 24 March 2017.
<b>Withholding Taxes:</b>	The Further Notes may be subject to withholding taxes in Azerbaijan or other jurisdictions. See " <i>Taxation</i> ".
<b>Status:</b>	The Further Notes will constitute direct, general, unconditional, unsubordinated and (subject to <i>Terms and Conditions of the Further Notes – Condition 5 (Negative Pledge and Other Covenants)</i> ) unsecured obligations of the Issuer. The Further Notes will rank and will at all times rank <i>pari passu</i> without any preference among themselves and at least <i>pari passu</i> in right of payment with all other present and future unsecured and unsubordinated obligations of the Issuer, save only for such obligations as may be preferred by provisions of law that are both mandatory and of general application.
<b>The Guarantee:</b>	The Guarantor has, in the Deed of Guarantee, irrevocably and unconditionally guaranteed to each holder of a Note, the due and punctual payment of all sums from time to time payable by the Issuer in respect of such Note, and to each Accountholder (as defined in <i>Terms and Conditions of the Further Notes – Condition 6 (Definitions)</i> ) the due and punctual payment of all sums from time to time payable by the Issuer to such Accountholder in respect of the Direct Rights (as defined in the Deed of Covenant), in each case as set out in the Deed of Guarantee
<b>Status of the Guarantee:</b>	The Guarantor has undertaken in the Deed of Guarantee that its obligations thereunder constitute direct, unconditional and (subject to Clause 6.2 ( <i>Negative Pledge</i> ) of the Deed of Guarantee) unsecured obligations and rank <i>pari passu</i> with all other unsecured External Indebtedness (as defined in <i>Terms and Conditions of the Further Notes – Condition 6 (Definitions)</i> ) of the Guarantor from

time to time outstanding, provided, further, that the Guarantor shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due under the Deed of Guarantee and *vice versa*.

**Cross Default/Cross Acceleration:**

The Further Notes will have the benefit of a cross default clause with respect to Indebtedness (as defined in *Terms and Conditions of the Further Notes – Condition 6 (Definitions)*) of the Group (see *Terms and Conditions of the Further Notes – Condition 12(c) (Cross Default with respect to Indebtedness of the Group)*). The Further Notes will also have the benefit of a cross acceleration clause with respect to Public External Indebtedness of the Guarantor (see "*Terms and Conditions of the Further Notes – Condition 12(d) (Cross Acceleration with respect to Public External Indebtedness of the Guarantor)*").

**Negative Pledge:**

The Further Notes will have the benefit of a negative pledge with respect to Relevant Indebtedness (as defined in *Terms and Conditions of the Further Notes – Condition 6 (Definitions)*) or any Indebtedness Guarantee (as defined in *Terms and Conditions of the Further Notes – Condition 6 (Definitions)*). The Guarantee will have the benefit of a negative pledge in respect of Public External Indebtedness of the Guarantor.

**Covenants:**

The Further Notes will have the benefit of the following covenants: (i) negative pledge; (ii) financial information; and (iii) maintenance of business.

**Optional Redemption or Purchase upon a Change of Control Event:**

Upon the occurrence of a Change of Control Event (as defined in *Terms and Conditions of the Further Notes – Condition 9(b) (Optional Redemption or Purchase upon a Change of Control Event)*), at the option of the holder of a Note, the Issuer shall redeem (or may, at the Issuer's option, purchase or procure the purchase of) such Note.

**Use of Proceeds:**

The net proceeds of the issue of the Further Notes, after deduction of the total expenses related to the admission to trading, expected to amount to approximately US\$1,073,828,000, will be used to finance the Group's capital expenditure commitments relating to the Projects and for the Issuer's general corporate purposes.

**Form of the Notes:**

Further Notes which are offered and sold in reliance on Regulation S will be represented by beneficial interests in the Unrestricted Global Note in registered form, without interest coupons attached, which will be registered in the name of a nominee for, and shall be deposited on or about the Closing Date with a common depository for and registered in the nominee name of the common depository in respect of interests held through Euroclear and Clearstream, Luxembourg. Further Notes which are offered and sold in reliance on Rule 144A will be represented by beneficial interests in the Restricted Global Note in registered form, without interest coupons attached, which will be deposited on or about the Closing Date with a custodian for, and registered in the name of Cede & Co. as nominee for DTC for and in respect of interests held through Euroclear and Clearstream, Luxembourg. The Further Notes will be offered and sold in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000. See "*Terms and Conditions of the Further Notes – Condition 1*

*(Form, Denomination and Title)*".

Interests in the Global Notes will be subject to certain restrictions on transfer. See "*Form of the Notes and Transfer Restrictions*".

Beneficial interests in the Global Notes will be shown on, and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Clearstream, Luxembourg and their participants.

Except as described in "*Form of the Notes and Transfer Restrictions*", certificates for Notes will not be issued in exchange for beneficial interests in the Global Notes.

**Listing and Clearing:**

Application has been made to list the Further Notes on the Irish Stock Exchange. The Further Notes have been accepted for clearance through the DTC, Clearstream, Luxembourg and Euroclear systems. The Further Notes will be consolidated and form a single series with the Original Notes on 24 March 2017, and until such time will be represented by a temporary ISIN, Common Code and CUSIP. The Common Code and ISIN for the Unrestricted Notes and Common Code, ISIN and CUSIP for the Restricted Notes are as follows:

***Unrestricted Notes***

Temporary ISIN: XS1533917008

ISIN: XS1319820897

Temporary Common Code: 153391700

Common Code: 131982089

***Restricted Notes***

Temporary ISIN: US84390LAB80

ISIN: US84302LAA08

Temporary Common Code: 111731144

Common Code: 098266950

Temporary CUSIP: 84302L AB8

CUSIP: 84302L AA0

**Governing Law:**

The Further Notes and the Guarantee will be governed by, and shall be construed in accordance with, English law.

**Selling Restrictions:**

The offering and sale of the Further Notes is subject to applicable laws and regulations including, without limitation, those of the United States, the United Kingdom, Italy and the Republic of Azerbaijan. See "*Subscription and Sale*".

**Ratings:**

The Original Notes were rated Ba1 by Moody's and BB+ by Fitch and it is expected that the rating of the Notes will be the same immediately after the issuance of the Further Notes (except that the Further Notes will be rated by Moody's Investor Services Inc.). The Issuer will not be rated by Moody's or Fitch.

The Guarantor is rated Ba1 negative by Moody's Investor Services Inc., BB+ (outlook negative) by Fitch and BB+/B (outlook negative)

by S&P.

A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

**Risk Factors:**

Prospective investors should have regard to the factors described under the section headed "*Risk Factors*" beginning on page 7.

## RISK FACTORS

*The Issuer and the Guarantor believe that the following factors may affect the Issuer's ability to fulfil its obligations under the Notes and the Guarantor's ability to fulfil its obligations under the Guarantee. All of these factors are contingencies, which may or may not occur, and the Issuer and the Guarantor are not in a position to express a view on the likelihood of any such contingency occurring. In addition, factors that the Issuer believes are material for the purpose of assessing the market risks associated with the Notes are also described below.*

*The Issuer and the Guarantor believe that the factors described below represent the principal risks inherent in investing in the Notes, but the inability of the Issuer or the Guarantor to pay interest, principal or other amounts on or in connection with the Notes may occur for other reasons and the Issuer and the Guarantor do not represent that the statements below regarding the risks of holding the Notes are exhaustive. Additional risks and uncertainties not presently known to the Issuer or the Guarantor or those that the Issuer or the Guarantor currently considers to be immaterial may also have an adverse effect on the Issuer or the Guarantor. Prospective investors should make such inquiries as they deem appropriate in connection with the Notes, read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.*

### **Risk Factors Relating to the Issuer and the Guarantor**

***The Group's revenues and profitability and Azerbaijan's economy and the State Budget are dependent on condensate and natural gas prices, which are currently low, historically volatile and are affected by a variety of factors beyond the Issuer's control, as well as production levels.***

The Issuer has a minority interest in the Shah Deniz field and consequently receives a share of revenues from the sales of condensate and natural gas produced from the field. Therefore, the Group's revenues and profitability are dependent on the prevailing condensate and natural gas prices, both of which are subject to fluctuation and volatility and are affected by a number of factors beyond the Issuer's control.

There is a strong correlation between the condensate and crude oil prices, and, as a result, volatility in crude oil prices is likely to cause fluctuations in the price of condensate. Crude oil prices are currently at levels significantly below the average price for the 2011-2015 period and have been particularly volatile recently. Between April 2011 and June 2014, the Brent crude price fluctuated between approximately US\$95/bbl and US\$120/bbl. Starting in late June 2014, oil prices began to decline, with the price of Brent crude decreasing from approximately US\$115/bbl in June 2014 to approximately US\$55/bbl by the end of 2014. International crude oil prices continued to decline in 2015 and into 2016, falling below US\$28/bbl in January 2016, the lowest Brent crude oil price since 2004. While crude oil prices have recovered to a certain extent since January 2016 levels, they remain significantly lower than in recent years. In its February 2017 report, the U.S. Energy Information Administration (the "EIA") forecasted that the Brent crude oil spot price will average US\$55/bbl in 2017 and US\$57/bbl in 2018, while several financial institutions have issued reports forecasting crude oil prices to remain depressed (compared to the average price for the 2011-2015 period) for an extended period of time. Oil prices have a considerable impact on the Issuer's business, financial condition, cash flows and results of operations and low oil prices are expected to have a negative effect. There can be no assurance that crude oil prices will not continue to deteriorate or that a recovery in crude oil prices will be forthcoming.

Profits derived from condensate and gas sales from the Shah Deniz field are determined in large part by the difference between the income received from the sales of condensate and gas produced and received under the relevant production sharing agreement ("PSA") and operating costs, as well as costs incurred in transporting and selling these products. Therefore, lower condensate and gas prices may reduce the amount of condensate and gas that the Shah Deniz Operating Company is able to economically produce or may reduce the economic viability of production from specific wells or of projects planned or in development because production costs would exceed anticipated income from such production. Any further declines (even relatively modest) in oil or gas prices or any resulting curtailment in the Shah Deniz Operating Company's overall production volumes may result in a reduction in net income, which could reduce the income received by the Issuer. Such outcome could also increase the amount of funding from other sources (such as debt financing and equity contributions) required to fund the Group's capital expenditure commitments under the Projects.

Prices for crude oil (and consequently condensate) and natural gas are subject to significant fluctuations in response to a variety of factors beyond the Issuer's control, including:

- global and regional supply and demand, and expectations regarding future supply and demand, for crude oil, gas and petroleum products;
- the ability and willingness of the members of the Organisation of Petroleum Exporting Countries ("OPEC"), and other crude oil and gas producing nations, to set and maintain specified levels of production;
- economic conditions and their impact on the Operating Companies' customers, including demand for oil and gas, other competing sources of supply of oil and gas and the prices charged by those other suppliers;
- global and regional socioeconomic and political conditions and military developments, particularly in the Middle East and other oil and gas-producing regions;
- terrorism or the threat of terrorism that may affect production, supply, transportation or demand for crude oil, gas and refined petroleum products;
- weather conditions and natural disasters and their impact on production, supply and demand for crude oil and gas;
- the ability of suppliers, transporters and purchasers to perform on a timely basis, or at all, under their agreements (including risks associated with physical delivery);
- access to pipelines, railways and other means of transporting crude oil, gas and petroleum products;
- exchange rate fluctuations;
- potential impact of derivative transactions on petroleum exchanges and over-the-counter markets;
- the development, availability, price and acceptance of alternative fuels and competition from other energy sources;
- Azerbaijan and foreign governmental regulations and actions, including export restrictions and taxes; and
- geopolitical uncertainty, market uncertainty and speculative activities.

Continued low, or a further decline in, oil and gas prices would have a material adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

In addition, Azerbaijan is highly dependent on oil and gas revenues. In 2016, the hydrocarbon sector accounted for an estimated 34.1% of GDP and 87.0% of export earnings, according to the State Statistical Committee. Reductions in oil and gas revenues could have a material adverse effect on Azerbaijan's economy and the ability of Azerbaijan to service the Notes. Azerbaijan's oil and gas revenues are a function of the level of oil and gas production in the country and prevailing world hydrocarbon prices, and since the State Budget has historically been dependent on transfers from SOFAZ, a decline in its income from oil and gas could place substantial strains on its ability to make those transfers without prejudicing its primary function, which is to act as an inter-generational reserve of the proceeds of the country's oil and gas reserves.

A staff team from the IMF visited Baku during 28 January 2016 until 3 February 2016 on a fact-finding visit and to discuss areas of technical assistance cooperation. On 3 February 2016, the IMF issued a press release stating that economic growth and balance of payments pressures are likely to remain major challenges for Azerbaijan in the near term. In May 2016, an IMF team visited Baku to hold discussions in the context of the 2016 Article IV Consultation. On 9 September 2016, the IMF concluded the Article IV Consultation with Azerbaijan. In their press release dated 14 September 2016, the IMF stated that

Azerbaijan's near-term economic prospects remain weak and that the difficult external environment could hamper macroeconomic outcomes in the near future.

According to SOCAR and the Ministry of Energy, Azerbaijan's proven oil reserves are estimated at 7 billion barrels as of 31 December 2016 and, in the absence of future discoveries or modernisation of current oil fields, production is currently expected to start trending downwards by 2018, with reserves exhausted in approximately 25 to 30 years. Reserves are subject to uncertainty and may be lower than estimated, see “– *Risk Factors Relating to the Issuer – The reported quantities or classifications of the condensate and natural gas reserves in the Shah Deniz field may be lower than estimated because of inherent uncertainties in the calculation of reserves.*” Oil exports are also expected to decline over the same period. Maintaining current oil production levels requires substantial investment in exploration and development from oil companies, which Azerbaijan may not be able to attract. Furthermore, future exploration for oil and gas may have to be in zones, such as deepwater fields, where extraction may prove more difficult and expensive than in the current coastal fields. Such exploration may only be economically viable on the basis of elevated oil prices.

In addition, the production of hydrocarbons in Azerbaijan is highly concentrated, with the Azerbaijan International Operating Company (“**AIOC**”), the operating company for the PSA for the Azeri-Chirag-Gunashli (“**ACG**”) and SOCAR, accounting for substantially all of oil production and a portion of gas production. As a consequence of this concentration, any production interruptions or shortfalls that affect either of these two entities could have a material adverse effect on Azerbaijan's economy.

Furthermore, Azerbaijan is party to an agreement concluded in November 2016 among OPEC and non-OPEC states to reduce crude oil production by a total of 1.5 mmbbl/d. Pursuant to the agreement, Azerbaijan has committed to reduce its crude output by 30 kbbbl/d for an undetermined period of time. The decrease in crude oil revenues resulting from this production cut, and any similar production decreases in the future, may have a material adverse effect on the Azerbaijan's economy.

Many developed countries are also actively trying to develop alternative sources of energy or alternative methods of increasing domestic oil and gas production to reduce their dependence on imported oil and gas. Any significant development of either of these alternatives to imported oil and gas could adversely affect oil and gas prices and demand and the resulting oil and gas revenues of the Group and/or Azerbaijan. Any such unplanned reduction in revenues could negatively affect economic growth and have a material adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes as well as Azerbaijan's affairs, political and economic condition.

### **Risk Factors Relating to the Guarantor**

***Azerbaijan may not be able to sufficiently expand or prevent the further contraction of the non-hydrocarbon sectors of its economy.***

In recent years, the Government has attempted to diversify the economy away from overreliance on the hydrocarbons sector. The importance of such diversification of the economy has been demonstrated by the effects of record low oil prices and oil price volatility experienced in early 2016 and 2015, respectively. In addition, the construction sector, which is largely reliant on state-funded infrastructure projects, has experienced a slow down and contraction, with real GDP growth of 21.3% in 2013 reducing to 8.8% in 2014, negative 13.4% and 22.9% in 2015 and 2016, respectively. (See “*The Economy – GDP by sector*”). Policies aimed at encouraging growth in non-hydrocarbon sectors include providing tax incentives to industries such as agriculture, construction, technology, tourism and manufacturing and making investments in the form of loans available from the entrepreneur support fund. However, the non-hydrocarbon sector only grew by 1.1% in 2015 and decreased by 4.5% in 2016 as compared to 7.0% in 2014 and 10.0% in 2013 and continued development of such sectors relies to a significant degree on government spending. A reduction in the level of such government spending may adversely affect the development of the non-hydrocarbon sector. Deficiencies in infrastructure levels, lack of private investment, shortages of skilled labour, a developing financial sector and a challenging business environment, including difficulties in receiving licences and enforcing contracts present challenges to the implementation by Azerbaijan of an economic diversification strategy. Azerbaijan may not be able to achieve the economic growth it needs to offset any decline in GDP caused by a decline in revenues from the export of hydrocarbon products. Any failure to grow the non-hydrocarbon sectors of its economy may

constrain Azerbaijan's economic growth, which may in turn result in a material adverse effect on Azerbaijan's ability to meet its debt obligations.

***Azerbaijan's oil and gas exports are dependent on the BTC and SCP.***

Although Azerbaijan utilises other means of transport to export its hydrocarbon products, the ability of Azerbaijan to export its oil and gas to international markets will continue to be largely dependent on the Baku-Tbilisi-Ceyhan Pipeline (the "BTC") and the SCP. There is a risk that the BTC and SCP, or any alternative export route, may be subject to shutdowns due to technical reasons, accidents, armed conflict or political tensions in the countries they pass through (including Georgia and Turkey). Any disruption to or shutdown of the pipelines may have a material adverse effect on Azerbaijan's ability to export its hydrocarbon products and, by extension, the Azerbaijan economy.

***Devaluation of the Manat could have a material adverse effect on Azerbaijan's economy.***

Due to declining oil prices, in February 2015, the CBA devalued the Manat by 34% to 1.05 Manats per US Dollar and moved the Manat away from a dollar peg in an effort to ease the strain of lower oil prices on budget revenue and make Azerbaijan's exports more competitive. On 21 December 2015, the CBA moved to a floating exchange rate, subject to an existing requirement for commercial banks to buy or sell Manat at a range of not more than 4% from the officially set exchange rate, abandoning the Manat's dollar-euro basket peg. This caused a further devaluation of the Manat of 47% against the US Dollar. The devaluation in December 2015 was the result of the CBA's decision to stop protecting the value of the Manat against falling oil prices, as the CBA's interventions in the exchange markets to protect the value of the Manat by purchasing Manats were depleting the CBA's foreign reserves. In January 2017, the CBA eliminated this 4% exchange rate corridor to permit the Manat float freely against other currencies. Since the beginning of 2016 the Manat has further depreciated against the US Dollar and the official exchange rate as of 6 March 2017 was AZN 1.7548 = US\$1.

The devaluations of the Manat have had, and any further devaluations in the future could have, a material adverse effect on Azerbaijan's economy, and in particular the rate of inflation as a result of higher import prices and rising demand for exports. Higher inflation has resulted in reduced purchasing power of the Azerbaijan's population. The banking sector has also been adversely affected and experienced capital losses, deposit withdrawals, liquidity shortages and deterioration in consumer creditworthiness.

If the CBA intervenes in the currency markets in the future in an effort to support the Manat, Azerbaijan's external position and/or balance of payments could decline. Further depreciation of the Manat against the US Dollar, or a further reduction of foreign reserves as a result of CBA intervention in the currency markets, could result in a material adverse effect on Azerbaijan's economy and ability to meet its debt obligations. In addition, devaluation of the Manat and the resulting inflation could adversely impact the purchasing power of Azerbaijan's population, which could negatively affect the economy. See "*Monetary and Financial System – Banking Regulation and Prudential Standards – Impact of the recent Manat devaluation and regulative measures taken by the CBA in 2015*".

***High inflation could have a material adverse effect on Azerbaijan's economy.***

As a result of lower oil prices and the devaluation of the Manat, Azerbaijan's inflation rate rose sharply from 4.0% in 2015 to 12.4% in 2016. According to the Ministry of Economy, the target inflation rate for 2017 is 7.3%. In the past, shortly after it gained independence, Azerbaijan experienced very high levels of inflation due to price increases in the non-oil industry and the fast-growing energy sector.

Although tighter monetary and/or fiscal policies may help to curb inflation, the impact on inflation of higher food, fuel and other import prices is beyond Azerbaijan's control. There can be no assurance that the inflation rate will not continue to rise in the future. Inflation has fluctuated widely in recent years, partly as a result of a strong increase in government revenues and, thus, spending, lack of competition and growing reliance on food imports. Azerbaijan's inflation rate was, 5.7% in 2010, 7.9% in 2011, 1.1% in 2012, 2.4% in 2013, 1.4% in 2014, 4.0% in 2015 and 12.4% in 2016. It is possible that Azerbaijan's inflation rate will continue to fluctuate or increase in the near future. A high rate of inflation could reduce the competitiveness of the domestic economy and could adversely affect the overall economy and Azerbaijan's ability to meet its debt obligations.



***If the Government is unable to achieve budgetary targets and limit Azerbaijan's fiscal deficit, Azerbaijan's economic growth may be adversely affected.***

Azerbaijan's consolidated fiscal deficit has risen in recent years, reaching 4.78% of GDP in 2015 as a result of a significant decline in oil prices. While the 2016 budget execution resulted in a consolidated budget surplus of 0.25% of GDP, this was principally due to a threefold increase in the share of SOFAZ revenues in the budget revenues resulting from the devaluation of the Manat (as most of SOFAZ revenues are denominated in foreign currencies), as well as a decline in budget expenditures pursuant to the Government's fiscal consolidation program. The 2017 budget envisions a consolidated budget deficit of 14.2% of GDP. The financing of Azerbaijan's deficit may lead to increased external indebtedness and/or reduction of foreign reserves as additional transfers may be required from SOFAZ to fund the deficit. The Government intends to increase non-oil revenues, in addition to optimisation of expenditures, with the target of funding all recurrent expenditures with non-oil revenues by 2020. However, if the Government is not able to increase non-oil revenues or raise sufficient debt to address the deficit, it may be forced to reduce capital and/or current expenditures. The increasing fiscal uncertainty may also serve to discourage foreign investment in Azerbaijan. If the Government is not able to implement policies to achieve budgetary targets and limit Azerbaijan's fiscal deficit, it may result in a material adverse impact on the Azerbaijani economy.

***Challenges in the implementation of economic and financial reforms, and the lack of available financing, may have a negative effect on the performance of Azerbaijan's economy.***

In order to ensure sustainable growth of Azerbaijan's economy, the Government has implemented a wide range of economic, financial and banking system reforms, and improvements of the legal and regulatory environment. The Government is pursuing these measures to promote private sector investments, diversify the economy away from the hydrocarbon sector and facilitate access to credit to further foster private investment in Azerbaijan by both local and foreign investors. Although the Government intends to continue implementing these reforms, any challenges or delay in their implementation may materially and adversely affect Azerbaijan's economic, political and/or financial condition.

Continued pursuit of long-term objectives will depend on a number of factors including continued political support in Azerbaijan and across multiple government ministries, adequate funding and the outcome of policy reviews, improved security, energy sector reform and availability of human capital. In order to fund these plans, capital expenditure was AZN 4.2 billion in 2016, and the Government has budgeted capital expenditure of AZN 5.2 billion for 2017.

The significant funding requirements for these plans may prove difficult to meet, and the funding requirements for these initiatives may lead to an increase in Azerbaijan's outstanding debt and/or necessitate the introduction of revenue raising measures. The introduction of such revenue raising policies may make Azerbaijan a less attractive environment for investment by domestic and/or foreign investors. If fiscal resources prove inadequate, it may not be possible to pursue adequately the public capital projects.

The economic and other assumptions underlying the objectives set forth in these plans including with respect to oil prices and production, GDP growth, inflation, external debt and the fiscal deficit may not be accurate or realised, which may undermine Azerbaijan's ability to achieve sustainable growth and widespread reforms. Failure to achieve one or more of the objectives or complete certain public capital projects set forth in these plans may render it difficult to achieve other stated objectives, and Azerbaijan's ability to achieve its strategic objectives may be further affected by many factors beyond its control. Moreover, some planned reforms may disadvantage certain existing stakeholders, who may resist such reforms. If the Government is not able to fund or implement its medium-term objectives, or if there is a delay in such funding or implementation, then the Government may not be able to meet its long-term strategic objectives, which could result in an adverse effect on the economy of Azerbaijan.

***The banking sector remains highly concentrated and underdeveloped.***

Azerbaijan's banking system is highly concentrated and underdeveloped, with weak governance and underwriting standards. The Azerbaijan banking system is regulated and supervised by the Financial Markets Supervision Agency ("FIMSA"), which became operational on 10 March 2016 and took over the duties of the Financial Monitoring Service under the Central Bank of Azerbaijan.

The International Bank of Azerbaijan (the “**IBA**”), a state-controlled bank, accounts for a significant percentage of the assets of the banking sector and recently experienced an increase in problem loans and a decline in its liquidity position as a result of turbulent market conditions and other factors, including the devaluation of the Manat. As a result, the President of the Republic of Azerbaijan issued Decree N<sup>o</sup> 507 on 15 July 2015 (the “**Decree**”) which provides for the transfer of certain problem assets (the “**Affected Assets**”) of the IBA to Agrarkredit Closed Joint Stock Company Non-banking Credit Organisation (“**Agrarkredit**”), which is owned by the Republic of Azerbaijan.

Devaluation of the Manat has adversely impacted the IBA's financial position. Based on preliminary figures, IBA reported a net loss of approximately AZN 1.4 billion for 2016 and negative equity in the amount of approximately AZN 0.7 billion as of 31 December 2016. The losses were principally due to approximately AZN 1.1 billion of currency translation losses resulting from the bank's large short unhedged currency position (approximately AZN 6 billion as of 31 December 2016, based on preliminary figures) and a 13% Manat depreciation in 2016. To offset the foregoing developments, in January 2017 the Government made a AZN 600 million capital injection in IBA's share capital. In addition, as of 31 December 2016, Affected Assets with a gross book value of approximately AZN 10 billion have been transferred, and the IBA has received payment of AZN 9.93 billion in cash. Further transfers of the Affected Assets are expected in 2017. Several management changes took place at IBA at the end of 2016, including a new chairman, deputy chairmen and new directors general. In addition, the role of FIMSA as a financial markets regulator in Azerbaijan has been expanding, including through its involvement in the IBA recapitalisation and asset transfers discussed above.

If either Agrarkredit or the IBA were to encounter further liquidity problems, there could be severe economic effects for Azerbaijan's financial system and further calls for state support. As of 31 December 2015, more than 43 banks were licensed to operate in Azerbaijan. Since 31 December 2015, the licences of Bank of Azerbaijan OJSC, Gencebank OJSC, United Credit Bank OJSC, Texnika Bank OJSC, Qafqaz Inkishaf Bankı OJSC, Atrabank OJSC, Parabank OJSC, Zaminbank OJSC, Kredobank OJSC, Dekabank OJSC and Bank Standard CJSC were revoked by the CBA and FIMSA. As of 31 December 2016, there were 32 licenced banks in Azerbaijan. The main reasons for revocation were failure to comply with the requirements on minimum amount of total capital and total capital adequacy ratio, failure to fulfil their obligations to creditors and to conduct their activities in a prudential and in a trustworthy manner. The banking licences of eleven banks have been revoked by the CBA and FIMSA in 2016. Compensation payments are currently being made by the Deposit Insurance Fund to the depositors of such banks. In accordance with the recent amendments made to the “Law on Deposit Insurance”, in the event the liquid assets necessary to compensate the depositors are not sufficient, the Fund may request the Central Bank to provide funds. The Central Bank may provide to the Deposit Insurance Fund a credit secured by a government guarantee. As a result of issuing such government guarantees, there could be an increase in Azerbaijan's sovereign debt levels.

Continuing difficulties in the banking system may result in or require further state support, so diverting resources from other sectors of the economy and the economic diversification initiatives. It may also result in further relaxation of prudential norms although there can be no assurance that such an approach will lead to improvements in the health of the banking sector. Therefore, a potential recapitalisation of the IBA remains a risk and may result in a material increase in Government liabilities.

In addition, small or medium enterprise banking accounts for only a small proportion of the sector. As a result, banks are prone to cyclical performance driven by their exposure to corporate banking, and a downturn in the cycle has the potential to impact the quality of banks' assets particularly given the high concentration of deposits and loans. The tightening of local currency liquidity remains a central risk to the banking sector.

Dollarisation remains a problem, particularly after the devaluation of the Manat, with approximately 70.6% of deposits held in foreign currency as of 31 December 2016. As a result of high dollarisation, the Central Bank's ability to impact domestic monetary conditions remains restricted. The main challenges include the implementation of monetary policy decisions in the banking system and real economy and increased speculative investments in US Dollars due to expectations of devaluation. In December 2015, the CBA announced that it had abandoned the dollar-euro basket peg of the Manat and had switched to a floating exchange rate regime, as a result of intensifying external economic shocks. In 2016, the Central Bank's position was one of minimal intervention in the foreign exchange market, with a policy of intervention only for the purpose of stabilising significant exchange rate fluctuations, and avoiding exchange benchmarks. The devaluation caused and may continue to cause individuals and companies to

convert their deposits to dollars, which may create a mismatch between banks' loans and deposits. Further dollarisation may create a greater mismatch between banks' loans and deposits, which could have an adverse effect on liquidity and on the economy of Azerbaijan. Since March 2016, in order to mitigate the effects of dollarisation, new macro-prudential limits were placed on dollar lending.

As of 31 December 2016, the banking sector's holdings of foreign currency loans amounted to approximately 47.9% of total loans and approximately 24.3% of total assets. As a result of the Manat's devaluation in 2016, and despite the recapitalisation and consolidation in the Azerbaijan banking sector as described above, the percentage of non-performing loans ("NPLs") increased significantly from 6.9% as of 31 December 2015 to 24.0% as of 31 December 2016. Further increases in NPLs or weaknesses in the banking sector generally may result in a material adverse impact on Azerbaijan's economy, the Government's financial condition and the State's reserves.

***Azerbaijan is involved in a conflict with Armenia and there may be an outbreak of armed conflict.***

Azerbaijan was involved in armed conflict with Armenia in the Nagorno-Karabakh region of Azerbaijan from the late 1980s to 1994 and tensions over the area remain high. A ceasefire between Azerbaijan and Armenia was achieved in 1994. As part of the international peace process, the Minsk Group was established by the Organisation for Security and Co-operation in Europe ("OSCE") to negotiate a political settlement. Azerbaijan has repeated its commitment to peaceful settlement of the conflict through this process. Azerbaijan is pursuing the speedy resolution of the conflict. Talks are ongoing, but no settlement has been reached, and rhetoric from both sides remains hostile. Azerbaijan's primary objective in the ongoing peace process is to ensure the withdrawal of Armenian armed forces from the Nagorno-Karabakh region and other occupied territories of Azerbaijan, which will allow forcibly displaced Azerbaijanis to return to their places of origin.

In the past, a number of skirmishes between Armenian and Azerbaijani forces and breaches of ceasefire have taken place along the line of contact. The most recent intense escalation at the line of contact took place in early April 2016 and resulted in the deaths of hundreds of people, including civilians, and was considered the worst escalation of the conflict in the last 20 years. A ceasefire was agreed between Armenia and Azerbaijan under the mediation efforts of the Russian Federation on 5 April 2016. Nevertheless, smaller scale skirmishes continue on a frequent basis, with the most recent occurring on 25 February 2017. The mediation efforts of the OSCE Minsk Group towards peaceful settlement of the conflict are ongoing, however, there can be no guarantee that a major armed confrontation will not break out again. In addition, the conflict has resulted in approximately 1 million refugees and internally displaced persons. Most of these refugees and internally displaced persons rely on the Government for temporary housing and subsistence, which requires the allocation of additional financial resources from the State Budget. An outbreak of armed conflict, which in turn could lead to an increased number of displaced persons reliant on state welfare, increased violence, political instability and the threat of terrorism, could have a material adverse effect on Azerbaijan's economy.

***Azerbaijan may be affected by political unrest in surrounding countries and disputes with and between its neighbours.***

Like other countries in the region, Azerbaijan could be affected by political unrest both within its borders and in surrounding countries, and any resulting military action may have an effect on the world economy and political stability of other countries. Azerbaijan is bordered by Russia to the north, Georgia to the north-west, Armenia and Turkey to the west and Iran to the south. Each of these countries has been involved in political and military disputes in recent years and certain surrounding countries, such as Turkey, have experienced terrorist attacks in recent years.

In August 2008, the conflict in the Tskhinvali Region/South Ossetia of Georgia escalated as Georgian troops engaged with local militias and Russian forces that crossed the international border. In the days that followed the initial outbreak of hostilities, Georgia declared a state of war as Russian forces launched bombing raids deep into Georgia, targeted and destroyed Georgian infrastructure, blockaded part of the Georgian coast, took control of Tskhinvali and the Abkhazia region and landed marines on the Abkhaz coast. After five days of heavy fighting, the Georgian forces were defeated, enabling the Russians to enter Georgia uncontested and occupy the cities of Poti, Gori, Senaki and Zugdidi. During this period, transit through the SCP crossing Georgia was temporarily stopped, cutting off one of Azerbaijan's principal export routes for gas. Future such occurrences, whether in Georgia, in one of the Republic's other neighbours or in the region generally, could have a material adverse effect on Azerbaijan's economy.

The conflict in Syria has resulted in a number of collateral incidents involving Russia and Turkey that had an adverse impact on the relations between the two countries. In November 2015, a Russian war plane was shot down by Turkish F-16 fighters during an airspace dispute close to the Turkish-Syrian border. The pilot of the Russian plane was killed, as was a Russian marine sent to rescue the crew. The incident sparked a major bilateral crisis, with Russia imposing a number of economic sanctions on Turkey, including a suspension of visa-free travel to Russia for Turkish citizens, restrictions on imports of Turkish holidays and a ban on package holidays. In December 2016, the Russian Ambassador to Turkey, Andrey Karlov, was killed in Ankara by an armed assailant who was later killed by security forces. In February 2017, three Turkish soldiers were accidentally killed and eleven Turkish soldiers were wounded by a Russian jet during airstrikes against so called Islamic State of Iraq and Syria (“ISIS”) in northern Syria’s Al-Bab region. While the situation has improved in recent months as a result of rapprochement between the two countries, any future tension between Russia and Turkey could have a material adverse effect on Azerbaijan's economy.

On 6 July 1998, Russia and Kazakhstan signed an agreement on the delimitation of the seabed of the northern Caspian Sea for the purposes of exercising their sovereign right of exploitation of the Caspian Sea's subsoil. On 29 November 2001, Azerbaijan and Kazakhstan signed a similar delimitation agreement. On 23 September 2002, Azerbaijan and Russia signed an agreement on delimitation of adjacent areas of the Caspian Sea. On 14 May 2003, Azerbaijan, Kazakhstan and Russia signed a trilateral agreement on the convergence point of the delimitation lines of the adjacent areas of the Caspian Sea. Negotiations among the five states adjacent to the Caspian Sea are ongoing on a bilateral and multilateral level regarding the potential drafting of a convention on the legal status of the Caspian Sea. There is no guarantee that territorial disputes with other adjoining countries, which could impact either production from Azerbaijan’s existing oil and gas deposits or the development of new reserves, will not occur in the future.

In addition, recent tensions between the United States and Iran, Russia and Georgia and the potential for unrest among regional militant groups could likewise lead to instability in the region. Furthermore, Azerbaijan and other countries in the region could be affected by terrorism and by military or other action taken against sponsors of terrorism in the region, which could, in turn, have an adverse effect on Azerbaijan’s economy. While Azerbaijan has expressed its intent to aid in the resolution of regional tensions through diplomatic means, there is no assurance that the tensions will be resolved or that tensions will not increase.

***Azerbaijan may be negatively affected by corruption or allegations of corruption.***

Azerbaijan is a member of the Extractive Industries Transparency Initiative in relation to its state oil fund, and the Republic continues to work towards improving accountability and governance standards in the hydrocarbons sector. However, independent analysts, including Transparency International, have identified crime and corruption as a problem in Azerbaijan. Of the 176 countries and territories included in the 2016 Corruption Perceptions Index published by Transparency International, the Republic ranked number 123, indicating that a perception of public sector corruption occurring within the country remains widespread. Any future allegations of corruption in Azerbaijan could have a negative effect on the ability of the Republic to attract foreign investment, and thus have a negative effect on both the economy of Azerbaijan and the ability of Azerbaijan to meet its debt obligations.

***The development of Azerbaijan’s physical infrastructure may require further investment.***

While the Government has made large investments into infrastructure over the last few years, some of Azerbaijan’s physical infrastructure remains in poor condition, which could constrain parts of Azerbaijan’s socio-economic development plans. Particularly affected are rail networks and power transmission systems. A deterioration of Azerbaijan’s physical infrastructure, if coupled with a failure to improve existing infrastructure, could harm the national economy, disrupt the transportation of goods and supplies and adversely affect the economy’s competitive ranking and growth prospects, including its ability to meet GDP and other growth targets.

***Failure to implement economic and fiscal reforms may have a negative effect on the performance of Azerbaijan’s economy.***

The Government continues to implement economic and financial system reforms in order to improve the legal and regulatory environment, promote the private sector, diversify the economy and facilitate access

to credit. The Government is also pursuing various fiscal reforms to control expenditure and improve the tax system.

The need for substantial investment in many enterprises has driven the Government's privatisation programme in the past. There have not been any significant privatisations in recent years, and there remains a need for substantial investment in many sectors of Azerbaijan's economy and there are areas in which economic performance in the private sector is still constrained by an inadequate business infrastructure. Recently, the President of the Republic announced the planned large-scale privatisation of state-owned enterprises. Furthermore, the considerable amount of non-cash transactions in the economy and the significant size of the shadow economy (including underreporting of income) adversely affect the implementation of reforms and hamper the efficient collection of taxes.

A staff team from the IMF visited Baku during 28 January 2016 until 3 February 2016 on a fact-finding visit and to discuss areas of technical assistance cooperation. On 3 February 2016, the IMF issued a press release stating that economic growth and balance of payments pressures are likely to remain major challenges for Azerbaijan in the near term. In addition, policy priorities include formulating and pre-announcing a multi-year fiscal consolidation plan, bolstering the monetary policy framework to support the move to exchange rate flexibility, strengthening the financial sector and supervision and undertaking structural reforms to make the economy more diverse. In May 2016, an IMF team visited Baku to hold discussions in the context of the 2016 Article IV Consultation. On 9 September 2016, the IMF concluded the Article IV consultation with Azerbaijan. In their press release dated 14 September 2016, the IMF stated that Azerbaijan's near-term economic prospects remain weak and that the difficult external environment could hamper macroeconomic outcomes in the near future. The IMF also stressed the need to institute reforms to secure macroeconomic and financial stability and promote a diversified and private sector-led economy. In addition, the IMF recommended reducing tax exemptions and strengthening tax administration, implementing pension reform plans, improving monetary transmission and the functioning of the foreign exchange market and closely monitoring the banking system.

Although the Government intends to proceed with its economic, financial and fiscal reforms, there can be no assurance that these reforms will be implemented or if they are so implemented that they will have the expected consequences. Failure to implement economic, financial and fiscal reforms or unexpected consequences resulting from implementation may have a negative effect on Azerbaijan's economy, affairs and political condition and its ability to meet its debt obligations.

***There are risks associated with the underdevelopment and evolution of the legislative, tax and regulatory framework in Azerbaijan.***

Since the break-up of the Soviet Union, the Government has introduced laws, regulations and legal structures to foster the development of a market system and integration with the world economy. However, the legislation is frequently contradictory, inadequate or incomplete and is susceptible to conflicting interpretations and overlapping jurisdictions between government bodies. In certain cases, legislation or implementing regulations may be unpublished or unavailable. Moreover, the absence of definitive interpretations of many of the provisions of these new laws, and the absence of a truly independent judiciary, can make the application of laws uncertain. In addition, Azerbaijan may introduce legislation relating to corporate governance or otherwise affecting the hydrocarbons sector, which could result in higher compliance and other costs for the Group. Such compliance costs could be material.

The commitment of Government officials and agencies to comply with legal obligations and negotiated agreements has not always been reliable, and there is a tendency for the authorities to take arbitrary action. Legal redress for breach or unlawful action may not be readily available, or may be subject to significant delays. These factors, which are not uncommon to transitional legal systems, make an investment in the Notes subject to higher risks and greater uncertainties than would be the case for an investment in securities of a company from a more developed legal system.

***GDP may be volatile in the near future.***

According to figures compiled by the CBA, Azerbaijan's GDP has over the period of 2010 to 2015 continued to grow in real terms, increasing by 5.0% in 2010, 0.1% in 2011, 2.2% in 2012, 5.8% in 2013, 2.8% in 2014 and 1.1% in 2015. However, in 2016 Azerbaijan's GDP declined by 3.1%. Any slowdown in Azerbaijan's development could result in a further decrease in GDP in subsequent periods, and there can be no assurance that GDP will recover to match growth rates experienced in previous years.

***The Government expects to increase borrowings in 2017 and in future years, and high levels of debt or failure to adequately manage its debt could have a material adverse effect on Azerbaijan's economy and its ability to meet its debt obligations.***

The Government anticipates that it will likely have fiscal deficits in 2017 and 2018, which may require it to significantly increase its debt levels. Azerbaijan's debt to GDP ratio increased to 28.3% as of 31 December 2015 compared to 11.2% as of 31 December 2014 and subsequently decreased to 22.3% as of 31 December 2016.

Any significant future borrowings beyond sustainable thresholds, including domestic debt to finance Azerbaijan's fiscal deficits, borrowing under credit agreements entered into with lenders and the issuance of further external debt in the international capital markets, could increase Azerbaijan's risk of external debt distress, including risks related to the Notes. Relatively high levels of debt through continued borrowing or decreasing GDP may materially and adversely affect Azerbaijan's economy.

Any failure to adequately manage Azerbaijan's current and future debt, including new borrowings beyond sustainable levels, may adversely impact Azerbaijan economy and its ability to meet its debt obligations.

***Many of Azerbaijan's important businesses and enterprises operate in a weak regulatory environment.***

When compared to their equivalents in more developed countries, the large state-owned enterprises in Azerbaijan operate in weak regulatory environments. This leads to a lack of transparency and inefficiencies. Many state-owned enterprises are monopolies and some still carry out regulatory roles in addition to their commercial roles as well as having responsibility for social programs, such as education or healthcare, that in other countries are responsibilities of the state. Given the sizeable budgets of some state-owned enterprises (such as SOCAR), a lack of financial discipline could contribute to inflation and any transfer of social responsibilities could lead to a large increase in state spending. The absence of independent regulators across many sectors is also likely to impede the development of competition, which may have a material adverse effect on the development of Azerbaijan's economy.

***Financial and statistical information published by Azerbaijan may be unreliable.***

Although a number of government ministries, along with the CBA, produce statistics on Azerbaijan and its economy, there can be no assurance that these statistics are completely accurate or as reliable as those compiled in more developed countries. Assumptions on which certain statistical data, such as expected GDP growth rates, future oil prices, oil production levels and exchange rates, are based may also be imprecise. As a result, such data may prove to be incorrect or imprecise. These statistics may also be limited in scope and published less frequently than those in more developed countries, such that adequate monitoring of key fiscal and economic indicators may be difficult. See "*Presentation of Financial and Certain Other Information—Certain Reserves Information*".

In addition, comparing national and international data sources can yield inconsistencies. Prospective investors should be aware that figures relating to Azerbaijan's GDP and many other aggregate figures cited in this Prospectus may be subject to some degree of uncertainty. Furthermore, standards of accuracy, methodology and underlying assumptions may vary from ministry to ministry and from period to period. Prospective investors should be aware that none of these statistics has been independently verified by any party.

***An investment in a developing country such as Azerbaijan is subject to substantially greater risks than an investment in a more developed country.***

An investment in a country such as Azerbaijan, which achieved independence 25 years ago and whose economy is still developing, is subject to substantially greater risks than an investment in a country with a more developed economy and a more mature political and legal system. Although progress has been made since the country's Constitution came into effect in November 1995 in reforming Azerbaijan's economy and political and judicial systems, to a large extent Azerbaijan is still developing the necessary legal infrastructure and regulatory framework that is essential to support market institutions, the effective transition to a market economy and broad-based social and economic reforms. As a consequence, an investment in Azerbaijan carries risks which are not typically associated with investing in more mature markets. These higher risks include, but are not limited to, higher volatility, limited liquidity, a narrow

export base and the need to develop the infrastructure necessary to accelerate economic growth in the non-hydrocarbons sector.

Generally, investment in securities of issuers in emerging markets, such as Azerbaijan, is only suitable for sophisticated investors who fully appreciate the significance of risks involved in, and are familiar with, investing in emerging markets and investors are urged to consult their own legal, tax and financial advisers before making an investment. Investors should also note that emerging markets such as Azerbaijan are subject to rapid change and that the information set out in this Prospectus may become outdated relatively quickly.

The disruptions recently experienced in the international capital markets have led to reduced liquidity and increased credit risk premiums for certain market participants and have resulted in a reduction of available financing. In addition, the availability of credit to entities operating within the emerging markets is significantly influenced by levels of investor confidence in such markets as a whole and so any factors that impact market confidence (for example, a decrease in credit ratings or state or central bank intervention in one market) could affect the price or availability of funding for entities within any of these markets, which in turn may have a material adverse effect on the overall economy.

In recent years, there have been changes to the outlook of ratings for Azerbaijan, with the downgrading of some Azerbaijani companies. On 21 December 2015, Moody's Investors Service, Inc. downgraded the long-term deposit ratings of VTB Bank (Azerbaijan) OJSC, Bank of Baku OJSC and UniBank Commercial Bank OJSC with a negative outlook. Moody's Investors Service, Inc. also changed the outlook to negative from stable on the long-term deposit ratings of Xalq Bank OJSC, Bank Respublika OJSC and Kapital Bank OJSC, while the banks' ratings were affirmed. On 5 February 2016 S&P reduced SOCAR's credit rating to BB from BB+ and on 29 February 2016 Fitch downgraded SOCAR's credit rating from BBB- to BB+. On 5 August 2016 S&P confirmed SOCAR's rating at BB and assigned a negative outlook. On 4 May 2016 Moody's confirmed SOCAR's Ba1 rating and changed the outlook to negative. On 1 March 2016, Fitch downgraded Azerenerji's rating from BBB- to BB+ with negative outlook. On 2 March 2016, Fitch downgraded Azerbaijan Mortgage Fund's rating from BBB- to BB+ with negative outlook.

On 13 April 2016, Fitch took negative rating actions towards certain Azerbaijani banks following the devaluation of the Manat in December 2015 and sovereign downgrade in February 2016. Seven of the eight Fitch-rated banks in Azerbaijan are rated as either Negative Outlook or Watch. The support-driven IDRs of Access Bank (BB+), IBA (BB) and Pasha Bank (BB-) are underpinned by potential support from international shareholders (Access) or the Azerbaijani authorities (IBA), and the Negative Outlooks reflect that on the sovereign. Other banks' ratings are rated 'B' or below, reflecting their vulnerable standalone credit profiles. Fitch also downgraded Access Bank's stability rating from BB- to B+. On 1 June 2016, Moody's Investors Service, Inc. maintained its negative outlook on Azerbaijan's banking system for the next 12-18 months.

On 10 November 2016, Fitch downgraded Azerbaijan-based Demirbank OJSC's Long-Term Issuer Default Rating (IDR) to 'CCC' from 'B-' and Viability Rating (VR) to 'f' from 'ccc'.

On 6 February 2017, Moody's Investors Service, Inc. withdrew UniBank Commercial Bank's ratings, including its long-term local and foreign-currency deposit rating of B3 and short-term local and foreign-currency ratings of Not-Prime.

On 6 February 2017, Moody's Investors Service, Inc. downgraded the following ratings of the IBA: long-term local and foreign-currency deposit rating to B1 from Ba3, senior unsecured debt rating to B1 from Ba3 and long-term subordinated debt rating to B2 from B1.

On 29 January 2016, S&P reduced Azerbaijan's credit rating to BB+ from BBB- due to the sharp fall in oil prices and an increase of external risks, and on 29 July 2016 S&P confirmed Azerbaijan's BB+ rating with a negative outlook. On 5 February 2016, Moody's downgraded Azerbaijan's government bond and issuer ratings to Ba1 from Baa3 and on 29 April 2016 Moody's confirmed Azerbaijan's Ba1 rating with a negative outlook. On 26 February 2016, Fitch downgraded Republic of Azerbaijan's long-term credit rating from BBB- to BB+ with a negative outlook. On 30 January 2017, S&P confirmed the long-term and short-term sovereign credit ratings of Azerbaijan in foreign and local currency at the level of BB + / B., all ratings with negative outlook. On 13 February 2017, Moody's Investors Service, Inc. confirmed Azerbaijan's long term issuer rating, as well as senior unsecured debt ratings at Ba1. On 27 February

2017, Fitch affirmed Azerbaijan's long-term foreign and local-currency issuer default ratings (IDR) at 'BB+' with negative outlooks.

In the event of further ratings downgrades, raising capital may become more difficult and borrowing costs for future borrowings may increase. Any negative action by a ratings agency could have a material adverse effect on the development of Azerbaijan's economy.

***Risk Factors Relating to the Issuer's Business and Industry***

*The Issuer was established to consolidate, manage and finance the Republic of Azerbaijan's interests in the following four projects: (i) the full-field development of the Shah Deniz natural gas and condensate field, (ii) the expansion of the South Caucasus Pipeline, (iii) the construction of the Trans-Anatolian Natural Gas Pipeline, and (iv) the construction of the Trans Adriatic Pipeline. Day-to-day operations of each of the Projects are managed by their respective operating companies. The Issuer holds an economic interest in each Project but is not an operator of any of the Projects. See "Business" for additional information. The Issuer is directly and indirectly wholly owned by the Republic of Azerbaijan, with 51% held by the Ministry of Economy of Azerbaijan and 49% held by SOCAR, which in turn is wholly owned by the Republic of Azerbaijan. The following risk factors may affect the Issuer, the Projects and/or the Operating Companies.*

***The Issuer may be adversely affected by current global economic conditions.***

The current global economic environment and the volatility of international markets have caused governments and central banks to undertake unprecedented interventions designed to stabilise global and domestic financial systems, stimulate new lending and support structurally important industries and institutions, such as banks, which are at risk of failing. Many developed economies have experienced recessions over the past several years and growth has slowed in many emerging economies, with serious adverse consequences for commodity prices (including condensate and natural gas), asset values, employment levels, consumer confidence and levels of economic activity. Numerous governments and central banks have responded to these economic conditions by adopting programmes to make substantial funds and guarantees available to boost economic activity, liquidity and confidence in their financial systems. It is not known whether these responses will be effective in addressing the economic and market conditions that exist at present. The impact of the reversal or withdrawal of such programmes is also uncertain.

As demand and prices for commodities, including condensate and natural gas, tend to be impacted by economic conditions, any further or renewed deterioration in the global economic environment could result in declines in demand and prices for condensate and natural gas and cause the Group's revenue, profitability and/or cash flows to decrease, which in turn would have a material adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Issuer conducts most of its operations through PSAs or jointly controlled entities in which it has a non-controlling interest.***

The Issuer directly or through its subsidiaries is party to the Shah Deniz field PSA and owns minority interests in jointly controlled operating entities in respect of the SCP expansion project and the project for the construction of the TAP, and has non-controlling interests in these Projects. In addition, the Issuer has a majority interest in the jointly controlled operating entity in respect of the TANAP construction project but is not the operator of this Project. See "Business—The Projects" for additional information. The Issuer may in the future hold non-controlling interests in other projects. Although it has a considerable degree of influence, the Issuer does not control the operations or the assets of these entities, nor can it unilaterally make major decisions with respect to such entities. This lack of control constrains the Issuer's ability to cause such entities to take action that would be in the best interests of the Issuer or refrain from taking actions that would be adverse to the interests of the Issuer and may result in operational or production inefficiencies, increased costs or delays, which could, in turn, adversely affect the revenues, cash flows and profits generated by the Issuer from the production and development operations of such jointly controlled entities.



***The Issuer depends on the Operating Companies to complete, manage and operate the Projects.***

The Issuer depends on the Operating Companies (including their management) to complete, manage and operate the Projects and has limited control over the Projects' day-to-day operations. Consequently, the Issuer is exposed to the risks that the Projects may not be completed on budget and/or on time and the risks that, when completed, the Projects may not be managed successfully, profitably and in line with the Issuer's expectations. Negligence or poor work quality by any of the Operating Companies may result in construction delays or failure to complete a Project according to planned specifications, in a timely manner or at all. This could have an adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Group is leveraged and has embarked on long-term growth plans that will entail an increased debt burden over the coming years.***

As a result of the Group's large capital expenditures, the Group is leveraged, with total debt outstanding of US\$4.3 billion (including accrued interest) as of 30 November 2016. The Issuer estimates that the Group's total net financing requirements in connection with its capital expenditure commitments under the Projects will be approximately US\$4.77 billion, which are expected to be incurred between 28 February 2017 and 2019.

The Issuer is currently engaged in a number of capital expenditure-intensive projects with joint ventures (see "*Business—The Projects*"). The Issuer expects that such programmes will require the Issuer to assume additional debt and may be a drain on the Group's cash resources.

As the Issuer's debt levels continue to increase in the future, there can be no assurance that it will be able to refinance its indebtedness at maturity on terms that are favourable or acceptable to the Issuer, or at all. Any failure by the Issuer or its subsidiaries to refinance their outstanding indebtedness may adversely impact the Issuer's ability to meet their capital expenditure commitments under the Projects, which could, in turn, negatively affect the Group's future revenue and cash flows, which would adversely impact the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Group is dependent on the economic and political conditions prevailing in the countries where the Projects are located.***

*Azerbaijan*

A substantial proportion of the Projects' operations (in particular the Shah Deniz field and part of the SCP) are located in Azerbaijan. Gross capital expenditures relating to the Shah Deniz 2 (as defined below) and SCP expansion Projects account for approximately 68.7% of the total gross capital expenditures relating to the Projects. The Issuer's share of gross capital expenditures relating to the Shah Deniz and SCP projects for 2017 to 2019 is expected to comprise approximately 33.1% of its total gross capital expenditures relating to the Projects. As a result, the Group is largely dependent on the economic and political conditions prevailing in Azerbaijan. See "*Risks Relating to Azerbaijan*" for a discussion of risks relating to Azerbaijan.

*Turkey*

The TANAP, which represents a significant component of the Southern Gas Corridor project, is located in Turkey. Gross capital expenditures relating to TANAP represent approximately 19.8% of the total gross capital expenditures relating to the Projects. The Issuer's share of gross capital expenditures relating to TANAP for 2016 to 2019 is expected to comprise approximately 54.2% of its total gross capital expenditures relating to the Projects. It is anticipated that approximately 37.5% of the natural gas from the Shah Deniz 2 transported through this pipeline will be sold to consumers in Turkey. As a result, the Group is dependent on the economic and political conditions prevailing in Turkey.

The Republic of Turkey has from time to time experienced volatile political, economic and social conditions and two financial crises, in 1994 and in 2000/2001. Turkey's economy was also adversely impacted by the global financial and economic crisis in 2008-2009. If similar conditions recur or if the current global slowdown persists or worsens, this may adversely affect Turkey's economy.

Turkey has been a parliamentary democracy since 1923. Since its formation in 1923, Turkey has had 64 governments, and political disagreements have frequently resulted in early elections. In the June 2015 national elections, no political party won an overall majority to form a single party government. After the election, attempts to form a coalition failed and on 1 November 2015, a snap election was held. In the November 2015 elections, the Justice and Development Party received 49.50% of the eligible votes and on 24 November 2015, it formed a single party government. There can be no assurance as to the tenure of the new government or that it will be successful in implementing its economic, fiscal and other policies.

On 15 July 2016, a coup d'état was attempted in Turkey against state institutions, including, but not limited to the Turkish Government, carried out by a faction within the army which the Turkish Government has associated with the Gulen movement (officially designated by the Turkish Government as a terrorist group called FETÖ in May 2016). The coup plotters attempted to overthrow the Turkish Government by seizing control of several key institutions and buildings in Ankara, Istanbul, and elsewhere, but failed to do so as there was strong public opposition against the coup plotters. On 21 July 2016, the Turkish Parliament approved the declaration of a three-month state of emergency in order to enable the authorities to take swift and effective action against those responsible for the failed coup, which also resulted in the temporary suspension of the European Convention on Human Rights. On 3 October 2016, the Parliament approved an extension of a three-month-long state of emergency by a further three months. On 3 January 2017, the Parliament approved a further extension of the state of emergency by another three months. The extended state of emergency beginning 19 October 2016 is scheduled to expire 20 April 2017.

The coup attempt has resulted in greater civilian control of the military and significant changes in the military hierarchy and command structure. Furthermore, Turkish authorities are continuing to search for coup participants and others with alleged links to the Gulen movement, and may detain, arrest, fire or suspend more people. These actions have been the subject of criticism by the EU and others and may lead to strain in Turkey's relationships with other countries, such as the tension with the United States associated with Turkish requests to extradite Fethullah Gulen.

As of 15 December 2016, public prosecutors have taken legal action against approximately 100,000 people in connection with the failed coup. Of those detained, a substantial number were military personnel (approximately 10,000 people, including 178 generals). Around 40,000 people have been arrested as of 15 December 2016, including police officers, soldiers, judiciary members, local administrators and civilians. As of 4 January 2017, nearly 120,000 government officials have been fired or suspended from various public institutions (including approximately 3,000 judges and prosecutors), the deans of all universities have resigned and the licenses of approximately 21,000 teachers working at private institutions have been terminated due to their alleged links to the Gulen movement. In addition, more than 100 media outlets have been closed, including newspapers, TV channels, radio stations and magazines. Since 4 January 2017, some previously suspended government officials have been reinstated. Following the coup, there have also been raids on businesses with links to the Gulen movement. Furthermore, Turkish government has scheduled a referendum for 16 April 2017 to decide on certain matters relating to the country's presidential system. If adopted, the proposed changes would expand the Turkish President's powers. Any further negative changes in the political environment of Turkey may have a material adverse effect on Azerbaijan's economy.

The Turkish military establishment has historically been an important factor in Turkish government and politics, interfering with civilian authority in 1960, 1971 and 1980. Each time, the military withdrew after the election of a new civilian government and the introduction of changes to the legal and political systems.

In late May 2013, demonstrations began in Istanbul's Taksim Gezi Park with respect to planned urban development, which were followed by wider protests, demonstrations and strikes in a number of cities. Since these events, Turkey has experienced other forms of civil unrest, including public demonstrations and political protests. In 2015, numerous anti-government demonstrations were organised and held throughout Turkey, some of which were related to the ongoing conflict in Syria and some related to the conflict between the government and Kurdistan Workers Party ("PKK"), with a number of terrorist attacks taking place. Following a two-year ceasefire, in early 2015 a peace plan was agreed between the government and PKK. However, the ceasefire collapsed in July 2015 when 18 Turkish police and soldiers were killed in PKK-linked attacks. In response to the attacks, the Turkish military conducted airstrikes against PKK positions in Turkey and northern Iraq and classified PKK as a terrorist group. Several terrorist attacks followed, including a bombing in October 2015 in Ankara outside the central railway

station as a result of which more than 100 people were killed and more than 400 people were injured. Furthermore, in response to Turkey joining the U.S.- led coalition against ISIS, a suicide bombing by a suspected member of ISIS took place in January 2016 in Istanbul killing 10 people. Multiple attacks took place in Turkey in 2016, and early 2017 for some of which the PKK and Kurdistan Freedom Hawks have claimed responsibility. There can be no assurance that further civil unrest, public demonstrations or protests, or terrorist attacks will not occur as a result of the conflict with PKK, ISIS or for other reasons.

In addition, the conflict in Syria has resulted in a number of collateral incidents involving Russia and Turkey that had an adverse impact on the relations between the two countries. In November 2015, a Russian war plane was shot down by Turkish F-16 fighters during an airspace dispute close to the Turkish-Syrian border. The pilot of the Russian plane was killed, as was a Russian marine sent to rescue the crew. The incident sparked a major bilateral crisis, with Russia imposing a number of economic sanctions on Turkey, including a suspension of visa-free travel to Russia for Turkish citizens, restrictions on imports of Turkish holidays and a ban on package holidays. In December 2016, the Russian Ambassador to Turkey, Andrey Karlov, was killed in Ankara by an armed assailant who was later killed by security forces. In February 2017, three Turkish soldiers were accidentally killed and eleven Turkish soldiers were wounded by a Russian jet during airstrikes against ISIS in northern Syria's Al-Bab region. While the situation has improved in recent months as a result of rapprochement between the two countries, any future tension between Russia and Turkey could have a material adverse effect on the Turkish economy, particularly as Russia is a significant economic and trade partner of Turkey, with tourists from Russia accounting for a substantial proportion of the country's tourism revenue.

Furthermore, the Turkish Lira has depreciated significantly in recent years, falling from approximately 1.5 Lira per US\$1.00 in March 2011 to approximately 3.7 Lira per US\$1.00 in January 2017, while stock indices have experienced significant declines and volatility in recent years.

In addition, once constructed, TAP will connect directly to TANAP on the Turkish-Greek border and transport gas via Greece and Albania, across the Adriatic Sea to southern Italy. Consequently, the development and operation of TAP will depend on economic and political conditions prevailing in those countries.

Any further or renewed deterioration in economic and/or political conditions in the Republic of Azerbaijan, the Republic of Turkey, Greece, Albania or Italy could have a material adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

Furthermore, although transportation tariffs charged by SCP, TANAP and TAP are set for long-term periods pursuant to gas transportation agreements entered into between pipeline Project participants, there can be no assurance that the governments of the aforementioned countries will not seek to interfere and reduce such tariffs, which could lead to a decrease in the Group's revenue.

***A downgrade of Azerbaijan's credit rating is likely to result in a downgrade of the Notes' rating.***

The Notes' credit ratings are dependent on the credit ratings assigned to the Republic of Azerbaijan. Consequently, any downgrade of the sovereign rating is likely to result in a downgrade of the Notes' rating. While S&P does not currently rate the Notes, on 29 January 2016 S&P, and on 26 February 2016, Fitch, downgraded the Republic of Azerbaijan's long-term credit rating from BBB- to BB+ with a negative outlook. On 5 February 2016, Moody's Investors Service, Inc. downgraded Azerbaijan's issuer ratings to Ba1 from Baa3. On 29 April 2016, Moody's Investors Service, Inc. confirmed Azerbaijan's Ba1 rating with a negative outlook. On 29 July 2016, S&P confirmed Azerbaijan's BB+/B rating with a negative outlook. On 30 January 2017, S&P confirmed the long-term and short-term sovereign credit ratings of Azerbaijan in foreign and local currency at the level of BB + / B., all ratings with negative outlook. On 13 February 2017, Moody's Investors Service, Inc. confirmed Azerbaijan's long term issuer rating, as well as senior unsecured debt ratings at Ba1. On 27 February 2017, Fitch affirmed Azerbaijan's long-term foreign and local-currency issuer default ratings (IDR) at 'BB+' with negative outlooks. The downgrades were principally due to the impact on Azerbaijan economy of recent declines in international crude oil prices and decreasing foreign reserves. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

***The Government of Azerbaijan, which owns and controls the Issuer, may cause the Issuer to engage in business practices that may not be in the interests of the Noteholders and may determine the appointment or removal of members of the Issuer’s management team.***

The Issuer was established to consolidate, manage and finance the Republic of Azerbaijan’s interests in the Projects, which are the core assets of the Southern Gas Corridor project, a strategic project for the Government of Azerbaijan (the “**Government**”). The Issuer is directly and indirectly wholly owned by the state and is controlled by the Government. In addition, three of the five members of the supervisory board of the Issuer (the “**Supervisory Board**”) are members of the Government and one member of the Supervisory Board is a member of the Parliament of Azerbaijan. The Government, by virtue of its direct and indirect shareholding in the Issuer, also has power to appoint and remove members of the Supervisory Board, the General Director and other key management personnel of the Issuer. There can be no assurance that the Government will not cause the Issuer to engage in business practices that may materially affect the Issuer’s ability to operate on a commercial basis or in a way that is inconsistent with the best interests of the Noteholders.

As has been the case in the past with other state-owned companies, the Government may cause the Issuer to engage in activities outside of its core activities or acquire assets other than on an arm’s length basis. The Government may also cause the Issuer to acquire unprofitable businesses in order to consolidate the Government’s oil and gas holdings and improve efficiencies. Furthermore, the Government could claim title to the Issuer’s interests in future projects or acquisitions. The Government may also impose social duties on the Issuer, such as constructing social and recreational infrastructure, engaging in charitable activities and implementing community development programmes, which could be a significant drain on the Group’s profits. In addition, there can be no assurance that the Government will not make material management changes at the Issuer, which could be disruptive to the Issuer’s operations and the Issuer’s ability to pay interest on and/or principal of the Notes.

***Fluctuations in foreign currency exchange rates may adversely affect the Group.***

The Issuer incurs indebtedness and receives Government capital contributions in US Dollars and most of the Group’s revenues are in US Dollars. The Group’s past and future capital expenditures in relation to the Projects are also denominated in US Dollars, with the exception of its capital expenditures relating to the TAP project, which are denominated in Euros and, to a lesser extent, in Swiss Francs. Therefore, the Issuer is exposed to the exchange rate risk arising from fluctuation in the exchange rate between the US Dollar and the Euro and, to a lesser extent, between the US Dollar and the Swiss Franc. In particular, if the value of the US Dollar relative to the Euro or the Swiss Franc decreases, this makes the value of the Group’s capital expenditure commitments relating to the TAP project higher, in US Dollars terms, which would require the Issuer to make capital expenditures relating to the TAP project in amounts larger than budgeted, potentially resulting in additional funding needs for the Group. The Group does not presently engage in any hedging transactions in relation to its foreign exchange rate risk exposure.

In addition, as the Group’s financial statements are presented in US Dollars, changes in foreign currency exchange rates can affect the Group’s revenues or financial results due to transaction gains or losses related to revaluing certain asset and liability balances that are denominated in currencies other than the US Dollar. Moreover, significant and unforeseen changes in foreign currency exchange rates may cause the Issuer to fail to achieve its stated projections for revenue and operating income, which could have a material adverse effect on the Group’s business, results of operations and financial condition and the Issuer’s ability to pay interest on and/or principal of the Notes.

***The Operating Companies rely on the services of third parties.***

The Operating Companies rely to a large extent on external contractors to for the development and maintenance of the Projects and related infrastructure. For example, a significant majority of the construction works and maintenance services required for the Projects are carried out by external contractors. The Operating Companies rely on external contractors to perform major works in Azerbaijan, Turkey and Georgia and other countries where the Projects are implemented, such as construction and maintenance of pipelines, repairs and maintenance of equipment, drilling systems, pumping units, electrochemical protection systems and maintenance of other general buildings and structures. As a result, the Issuer is largely dependent on the satisfactory and timely performance by external contractors of the Operating Companies and the fulfilment of their obligations on time and budget. If an external contractor fails to perform its obligations satisfactorily, on time and in line with the budget, this may lead to delays,

cost overruns and/or curtailment of the production and/or transportation or delivery of oil and gas and related products, which could materially adversely impact the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Operating Companies may encounter interruptions in the availability of production or supply infrastructure.***

Oil and gas development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities are conducted. Future interruptions or delays in the availability of infrastructure, including drilling rigs (in particular), pipelines and storage tanks, on which the Operating Companies' development and production activities are dependent, could result in disruptions to the Projects, increase costs and/or prevent the Operating Companies from implementing the Projects, thus adversely impacting the Issuer. Due to the geological complexity of the Caspian Sea shelf, there are few service providers in the region that have suitable offshore drilling, pipe-laying and other required equipment. A lack of availability of suitable service equipment, including drilling platforms and pipe-laying equipment, could delay the Projects and increase their costs.

In addition, as Azerbaijan's only international sea or ocean waterway access is through the Caspian Sea, which does not connect to an ocean by natural waterway, it may be more time consuming and costly to transport equipment and/or supplies (such as drilling rigs) into the country, which may result in delays and/or additional costs in connection with the implementation of the Projects or making repairs to the Projects' facilities or related infrastructure once the Projects are operational.

***The Issuer relies heavily on oil and gas transportation infrastructure operated by third parties to transport condensate and natural gas to markets outside Azerbaijan.***

Azerbaijan's condensate and natural gas are exported primarily through pipelines, and also by rail and sea, using routes through other countries. Condensate produced from the Shah Deniz field is currently exported through the BTC (which transported 83.6% and 85.1% of the total crude oil and condensate produced in Azerbaijan in the year ended 31 December 2016 and in the year ended 31 December 2015, respectively). Natural gas produced from the Shah Deniz field is transported to Turkey and Georgia via the SCP (which transported 24.3% (7.15 billion cubic meters excluding volumes delivered to BTC) and 22.9% (6.65 billion cubic meters excluding volumes delivered to BTC) of the total natural gas produced in Azerbaijan in the year ended 31 December 2016 and in the year ended 31 December 2015, respectively). Consequently, the Issuer is significantly dependent on the BTC and SCP operating without material disruptions and on the intergovernmental agreements between Azerbaijan and Georgia, Turkey and other countries to transport oil and gas abroad, which, if amended, could adversely affect the ability to transport the Issuer's condensate and natural gas entitlements.

Any failures or shutdowns of these pipeline systems or any reduction or cessation in the availability of these pipelines, whether due to maintenance breakdowns, security issues, acts of terrorism, political developments or natural disasters, among other things, would materially adversely affect exports, which, in turn, would have a material adverse effect on the Projects and, consequently, the current and/or future revenues and cash flows of the Group derived from such operations, which could materially adversely impact the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Operating Companies face drilling and production risks and hazards that may affect their ability to produce condensate and natural gas at expected levels and costs and/or the timely completion of the Projects.***

The Issuer's future success will depend, in significant part, on the Operating Companies' ability to develop, independently or pursuant to PSAs, condensate and natural gas reserves in a timely and cost effective manner in the Shah Deniz field, to expand the SCP and to construct the TANAP and TAP. Drilling and pipe-laying activities may be unsuccessful, and the actual costs incurred to drill and operate wells, to complete well workovers and to lay pipes and install related equipment (such as compressors) will have a significant impact on the Projects' profitability.

Drilling activities may be curtailed, delayed or cancelled because of a variety of factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, premature declines in reservoirs, blowouts, uncontrollable flows of condensate, natural gas or

well fluids, pollution and other environmental risks, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment. Similar factors, if they materialise, could have an adverse impact on the construction of pipelines.

In addition, condensate and gas exploration activities may result in unproductive wells or wells that are not economically feasible to develop. The Operating Companies cannot be certain that there will not be delays. Completion of a well does not guarantee a profit on the investment or recovery of drilling, completion and operating costs. Also, drilling hazards or environmental damage could greatly increase the cost of operations and various field operating conditions may adversely affect the production from successful wells.

The Projects are also subject to risks associated with natural disasters, fire, explosion, blowouts, encountering formations with abnormal pressure, the level of water cut, cratering and condensate spills, and escapes of gas and reservoir performance, each of which could result in decreases in production or transportation volumes, a loss of condensate and/or gas, substantial damage to the wells and/or pipelines, production facilities or other property, damage to the environment, or personal injury or death. For example, there have been several fatalities in connection with the implementation of the Projects. These risks, when materialised, could result in lower revenues and/or increased costs for the Group and/or claims against the relevant Operating Company, which could have a material adverse impact on the Issuer.

Any of these drilling, exploration, production and pipeline construction risks and hazards could have a material adverse effect on the Projects and consequently on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The Operating Companies' development, construction, production, transportation and other activities could be negatively affected by adverse weather conditions.***

A large number of the Projects' facilities and large segments of the related infrastructure and networks are located in areas that experience severe weather conditions, particularly in winter, and extreme variability in winter and summer weather, which can accelerate wear and tear on pipelines and related equipment. For example, Azerbaijan's climate is characterised by harsh winters and hot summers. While the coastal areas of Turkey have a temperate Mediterranean or Oceanic climate, conditions can be much harsher in the arid interior of Turkey. Winters on the Anatolian plateau in Turkey are especially severe. Areas in Georgia can experience heavy rainfall and snowy winters. Harsh weather conditions and the remoteness of certain of the Projects' locations may make it difficult to gain access to conduct development and construction activities and to carry out repair or maintenance quickly. In addition, winter storms may negatively affect the production levels of the Shah Deniz field due to the inability of staff and equipment to reach drilling sites and other facilities. There can be no assurance that adverse weather conditions will not negatively affect the Projects in the future, which could, in turn, have a material adverse effect on the Group's business, financial condition and results of operations and the Issuer's ability to pay interest on and/or principal of the Notes.

***Some parts of the Projects, including the operations in the Shah Deniz field, are in remote or otherwise inaccessible areas.***

Because of the remote location of some parts of the Projects, including many of the operations in the Shah Deniz field, in particular those offshore in the Caspian Sea, the relevant Operating Company will not always have ready access to equipment or facilities to address problems such as, among other things, equipment breakdowns and failures, and delays may occur in procuring the necessary materials or supplies required to carry out development and construction activities and/or necessary maintenance and repairs. In addition, equipment breakdowns and failures affecting certain key parts of Shah Deniz's facilities, such as the Shah Deniz's transportation operations and the interface between the field gathering system and its processing facilities, might, in turn, affect Shah Deniz's ability to use all of its facilities and substantially curtail or stop production. Similarly, operating in remote areas exposes these operations to risks caused by poor infrastructure, such as power outages, which can reduce oil and gas production and/or transportation volumes.

The remote location of some parts of the Projects also makes these assets and related infrastructure susceptible to acts of terrorism or sabotage, as large segments of natural gas and condensate pipelines are

located in unpopulated areas and have easy access and limited (if any) security arrangements, making them relatively easy targets. In addition, political unrest or military actions may limit the Operating Companies' ability to access or utilise certain of their assets. As a result, the Operating Companies may not be able to immediately respond to or repair damage resulting from such acts, which could have a material adverse effect on the Group's business, financial condition and results of operations.

***The Shah Deniz reserves are located in the Caspian Sea, which is bordered by five littoral states and negotiations regarding the territorial division of the Caspian Sea may cause tensions with Azerbaijan's neighbouring countries.***

The Caspian Sea was divided, under the Russo-Persian Treaty of Friendship in 1921, into Iranian and Soviet zones by drawing a boundary line across the sea between Astara and Husseingholi. The Soviet sector was further divided utilising the median line principle, which extended an equal distance from the coasts of the former socialist republics (now Azerbaijan, Kazakhstan, Russia, and Turkmenistan) to the centre of the sea until the boundaries met. Since the dissolution of the Soviet Union, the international legal status of the Caspian Sea has remained uncertain and is currently the subject of international negotiations amongst the five littoral states.

Although Azerbaijan has signed bilateral agreements on the division of the Caspian Sea with both Kazakhstan and Russia, and a trilateral agreement with Kazakhstan and Russia, tensions amongst neighbouring states have not been resolved by any multilateral regime for the seabed as a whole. The failure by the states to reach an agreement, or any convention or agreement that results in an unfavourable division of the Caspian Sea for Azerbaijan, or action taken in violation of the existing agreements may cause the country's condensate and natural gas reserves to be reduced and result in additional tensions in the region. The occurrence of either of these events could have a material adverse effect on the Azerbaijani economy, regional stability and the Projects, as well as the revenues and cash flows derived therefrom.

***The Projects require significant capital expenditures, and the Issuer may be unable to finance some or all of its share of the planned capital expenditures in the Projects.***

The Projects require significant capital expenditures related to development and construction activities as well as compliance with environmental laws and regulations. Since its inception in March 2014, the Issuer has had high levels of capital spending and investment to fund the acquisition of its interests in the Projects and its share of the Projects' capital expenditures. The Issuer funds, and expects to fund in the future, its capital expenditures out of the proceeds of debt securities issuances, loans, as well as through its revenues and equity contributions by the Government.

Although the Issuer expects significant further contributions from the Government, there can be no assurance that the Government support will be forthcoming or on terms favourable to the Issuer. If such support does not materialise, the Issuer could have difficulty financing its funding commitments in respect of the Projects. In addition, while the Issuer has estimates for the costs of each Project, these estimates are preliminary and subject to substantial revision due to potential inadequate provisions and contingencies, as well as errors in the estimation of the costs or due to factors outside of the Issuer's control, such as, *inter alia*, requirements of the governments of the countries in which the Projects are located, availability of construction materials and contractors, changes in oil and gas prices and foreign currency exchange rates and delays. If costs are greater than expected or budgeted, the Issuer will be responsible for some or all of such costs.

In addition, if the international oil and/or gas prices remain low or decrease further, the Issuer may have to finance more of its planned capital expenditures from outside sources, including bank borrowings and offerings of debt securities in the domestic and international capital markets. The Issuer may be unable to raise or may be prevented from raising the financing required for its future capital expenditures on acceptable terms or at all. Lack of sufficient funds in the future may require the Issuer to delay or terminate some of its anticipated projects. Although the Issuer may also seek financing from the Government, through capital increases or otherwise, the Issuer can give no assurance that it will receive additional financing from the Government or otherwise source such funding on acceptable terms or at all.

In addition, if other participants in the Projects are unable to meet their capital expenditure commitments related to the Projects, the remaining participants are required on some of the Projects to cover the

shortfall. As a result, the Issuer's share of the Projects' capital expenditures may increase temporarily, resulting in larger capital expenditure requirements for the Issuer than anticipated and/or budgeted.

If the Issuer is unable to raise necessary financing from the Government, banks or the capital markets, it will have to reduce planned capital expenditures and/or divest a portion of or its entire interest in some or all of the Projects. For example, in such circumstances, any such reduction in capital expenditures could adversely affect the Issuer's ability to realise its strategy and objectives. Such reduction in capital expenditure could have a material adverse effect on the Issuer's financial condition and results of operations.

***The Issuer may not be able to manage its business effectively if it cannot retain and hire a sufficient number of experienced managers and skilled accounting and other personnel.***

The Issuer's activities require, among other things, stringent control of financial systems and operations, the continued development of the Issuer's management and financial control, the ability to attract and retain sufficient numbers of qualified management and accounting and other personnel, the continued training of such personnel, the presence of adequate supervision and the continued consistency in the quality of its services. Failure to manage the Issuer's business and growth effectively, including through the retention of qualified and experienced managers and accounting and other personnel, could have a material adverse effect on the Issuer's business and profitability.

***The Group is exposed to interest rate risk.***

The Group is exposed to interest rate risk on its indebtedness that bears interest at floating rates. As of 30 November 2016, the Group had total debt outstanding in an aggregate amount of US\$4.3 billion (including accrued interest), all of which, except for the Original Notes issued in March 2016, bore interest at floating rates, determined by reference to LIBOR for US Dollar deposits. The Group does not presently engage in any hedging transactions in relation to its interest rate risk exposure. Any failure by the Issuer to manage its exposure to interest rate risk may have a material adverse effect on the Group's business, results of operations and financial condition and the Issuer's ability to pay interest on and/or principal of the Notes.

***The insurance coverage of the Operating Companies may not be adequate to cover losses arising from potential operational hazards and unforeseen interruptions.***

The Operating Companies generally maintain insurance coverage in respect of the Projects' assets, facilities and operations (see "*Business—Insurance*" for additional information). However, in general the amount of such insurance coverage may be more limited than that which would normally be required and/or acquired in more developed markets due to the availability of insurance coverage or otherwise. Therefore, an incident resulting in losses may not be covered or, if covered, the insurance proceeds may not be sufficient to cover the losses. Accordingly, the Issuer may suffer material losses from uninsurable, uninsured or underinsured risks.

***The Projects are subject to developing and uncertain environmental regulations, non-compliance with which could result in severe fines and/or suspension or permanent shut down of activities.***

The Projects are subject to the environmental risks inherent in oil and gas exploration, production and transportation. In Azerbaijan, there are problems relating to the maturity of fields at past production sites, some of which have been exploited for over 150 years. For example, poor environmental awareness in the past resulted in a number of incidents of oil leaks due to pipeline failures. Temporary reservoirs for the storage of drilling mud, liquid waste and oil were not maintained, replaced or closed properly, causing severe pollution of certain regions, including in Baku, Absheron, Salyan, Shirvan, Muradkhanli and Neftchala. In total, an area of approximately 100 km<sup>2</sup> has been polluted by hydrocarbon waste products in these six regions. In Azerbaijan, the Ministry of Ecology and Natural Resources (the "**MENR**") monitors pollution and land contamination. In Turkey, the key regulatory authority is the Ministry of Environment and Urbanisation (the "**MOE**").

The legal framework in Azerbaijan for environmental protection is underdeveloped and not consistently applied and the responsibility of current oil and gas operators in respect of both historic and ongoing environmental damage is unclear. While the Operating Companies' policies are to comply with applicable environmental regulations in Azerbaijan, certain environmental regulations adopted by the Government



have not been published or made publicly available, so the content of such regulations is often uncertain. In Turkey, environmental legislation is relatively new, with the introduction of specific environmental requirements dating back to 1986. Since 2000, the MOE has tended to enforce environmental regulations more aggressively. The governments of Azerbaijan, Turkey, Georgia, Greece, Italy, Albania and/or regulatory bodies in the EU generally may impose stricter environmental regulations or apply existing regulations more strictly, including regulations regarding discharges into air and water, the handling and disposal of solid and hazardous waste, land use and reclamation and remediation of contamination.

Compliance with present and future environmental requirements may make it necessary for the Operating Companies, at costs which are as yet unknown but may be substantial, to undertake new measures in connection with the storage, handling, transport, treatment or disposal of hazardous materials and waste and the remediation of past contamination. In addition, local communities or interest groups, who are concerned about the environmental impact of the Operating Companies' operations either within Azerbaijan, Turkey or other countries may take action intended to disrupt the Operating Companies' activities or attract negative media attention. While the Operating Companies aim to maintain positive relationships with such groups, it is possible that the Operating Companies may experience delays, disruption or increased costs in relation to certain of the Projects which are not foreseen or provisioned for.

The costs of environmental compliance in the future and potential liability due to any environmental damage that may be or may have been caused by the Operating Companies could be material, and the Issuer could be materially adversely affected by future actions and fines imposed on the Operating Companies by the MENR, the MOE and other government authorities in Azerbaijan and Turkey. Provisions in the Group's accounts relating to remediation costs for environmental liabilities may prove to be insufficient, which could have a material adverse effect on the Issuer's financial condition, cash flows and the Issuer's ability to pay interest on and/or principal of the Notes.

Although the Issuer and the Operating Companies are required to comply with all applicable environmental laws and regulations, it cannot, given the changing nature of environmental regulations, guarantee that they are or will be in compliance at all times. Any failure to comply with environmental requirements by the Operating Companies could subject them and/or the Issuer to, among other things, civil liabilities and penalty fees and possibly temporary or permanent shutdown of their operations. Moreover, the Issuer cannot be certain that its environmental liabilities will not increase due to recent and future acquisitions. Any imposition of environmental fines, increases in the costs associated with compliance or suspension or revocation of licences or contracts could result in the Operating Companies incurring substantial costs or having to modify their operations in order to maintain compliance or acquire or maintain licences and contracts, which could have a material adverse impact on the Projects and as a result, on the Issuer.

***Environmental concerns, such as international policy initiatives to address climate change or direct action by activist groups may hamper the Projects.***

International initiatives to address climate change, such as policy and regulatory actions to reduce greenhouse gas emissions, could affect the Projects (and consequently the Issuer) by affecting the balance of demand for and supply of various types of fuels, in particular the demand for oil and gas energy. Policy approaches that promote the use of alternative energy sources, including renewables, biofuels, hydro-electric power, wind power and nuclear power in Europe and provide incentives for the consumption of energy generated from such sources could have an adverse impact on the Issuer.

In September 2000, the Government ratified the Kyoto Protocol of the United Nations Framework Convention on Climate Change (the "**Kyoto Protocol**"), which is intended to limit or discourage emissions of greenhouse gases such as carbon dioxide. In addition, the 2015 United Nations Climate Change Conference was held in Paris from 30 November to 12 December 2015 and resulted in the so called 'Paris Agreement', a global agreement which will govern greenhouse gas emissions from 2020. Parties to the agreement have agreed, among other things, to reduce their carbon output "as soon as possible" and to keep global warming "to well below 2 degrees Centigrade." The agreement was adopted by consensus of the representatives of the 196 parties attending the conference and the document has entered into force. Azerbaijan signed the Paris Agreement in New York on 22 April 2016. The Paris Agreement was ratified by Azerbaijan on 28 October 2016. Under the terms of the Paris Agreement, it entered into force for Azerbaijan on 8 February 2017.

Ratification of the Kyoto Protocol and the Paris Agreement has had and will continue to have, an impact on environmental regulation in Azerbaijan. The effect of such ratification in other countries is still unclear; accordingly, potential compliance costs associated with the implementation of the Kyoto Protocol and the Paris Agreement are unknown. Nonetheless, the effects are likely to include increases in the cost of electricity and transportation, restrictions on emissions levels, additional costs for emissions in excess of permitted levels and increased costs for monitoring, reporting and financial accounting. In addition, concerns about global warming and limits on greenhouse gas emissions have resulted in investors divesting their investments in coal and other fossil fuel extracting companies. Investor policy changes or initiatives may result in reduced demand for condensate and/or natural gas and/or increase operating or funding costs, any of which could have a material adverse impact on the Issuer.

In addition, demonstrations or other actions by activist groups could be disruptive to the implementation and/or operation of the Projects, which could have a material adverse impact on affected Projects and, in turn, the Issuer.

***The Group's results depend on the Operating Companies' ability to obtain, retain or renew required drilling rights, licences, concessions, permits and other authorisations necessary for their operations, many of which are subject to change, and certain formalities of which may not always be satisfied.***

The Operating Companies conduct their exploration, appraisal and development operations pursuant to rights under PSAs, service contracts and licences, concessions, permits and other authorisations and approvals (together, "licences") from governmental and local authorities. In addition, completion of the pipelines requires the agreement and cooperation of the countries through which the pipelines will run and, in turn, these countries may need to seek EU or other external approvals in order for construction to proceed.

The ability of the Operating Companies to operate depends on the granting and continued validity of such licences, which are subject to the discretion of the relevant governmental authorities and cannot be guaranteed. Each of the Operating Companies may face significant financial penalties and/or litigation or have its existing and future licences suspended, terminated or revoked, or may fail to win approval for extensions or renewals of such licences if they fail to fulfil the specific terms of any of their existing or future licences or if they operate in a manner that violates applicable laws or regulations, any of which could result in increased costs, reputational harm and/or failure to achieve their strategy. Government authorities may also, upon renewal or extension of a licence, or at any other time, impose unilateral changes to the key terms of any of the Operating Companies' licences, including terms relating to price, volume of production, cost recovery and liability.

In addition, the nature of the jurisdictions in which the Operating Companies operate is such that certain formalities with regard to the execution of agreements may not, in a small number of cases, be satisfied, and government consents may not in all cases be formally received. Non-compliance with certain technical obligations under the Operating Companies' licences may give rise to enforcement action by the relevant authorities, and the Operating Companies may not be successful in enforcing any or all rights under their agreements or defending against claims regarding licence invalidity, particularly against governmental authorities. Although governmental authorities may agree to waivers and extensions, such authorities are also generally entitled to revoke the Operating Companies' licences in such circumstances or refuse applications for further licences because of non-compliance. Moreover, the Operating Companies may, for commercial, legal, or other reasons, be unable to comply with certain specific terms or requirements of the licences they hold, including the meeting of specified deadlines for prescribed tasks and other obligations set out in the work programmes attached to their licences in circumstances that may entitle the relevant authority to suspend or withdraw the terms of such licence.

Even where the relevant Operating Company is in compliance with the terms of its licences and all applicable laws and regulations, any of their licences could be revoked, materially altered or successfully challenged by a government agency or regulator or by third parties. In addition, administration and interpretation of the laws and regulations governing the Operating Companies' licences by government authorities vary considerably and may be underdeveloped, untested and subject to change, challenge or invalidation. The Operating Companies therefore have limited control over whether or not such licences and other regulatory requirements (or renewals or extensions thereof) are granted, when such licences or renewals may be granted, the terms on which they are granted or renewed, any fees, levies, taxes, duties or other costs payable in connection therewith and the general tax regimes to which the Operating Companies' assets in the relevant jurisdiction will be subject.

As a result of third-party administration and interpretation of their licences, the nature and timing of the Operating Companies' activities, or their ability to execute their strategy according to plan or at all, may be materially and adversely affected, including by substantial delays or material increases in costs. Any inability of the Operating Companies to comply with the terms of their licences, successfully defend against claims, or obtain, retain or renew their licences on satisfactory terms, could have a material adverse effect on the Group's business, financial condition and results of operations.

***Certain of the Issuer's business associates are subject to U.S. and EU sanctions and the ongoing or future impact of such sanctions may have an adverse effect on the Issuer.***

The U.S. government imposes economic sanctions and trade embargoes with respect to certain countries in support of its foreign policy and national security goals. These laws and regulations are administered by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), and in certain instances by the U.S. Department of State. U.S. Economic Sanctions impose restrictions on U.S. persons and, in certain circumstances, non-U.S. persons with respect to activities or transactions with certain countries, governments, entities or individuals that are the target of the relevant U.S. economic sanctions. Under applicable U.S. economic sanctions, U.S. persons also are prohibited from facilitating such activities or transactions, and non-U.S. persons are prohibited from causing other persons to violate applicable prohibitions. The United Kingdom, the other Member States of the EU and various other countries (such as Australia, Canada, Japan and Switzerland), as well as the United Nations, have also implemented measures aimed at prohibiting or restricting engagements in financial and other dealings with sanctioned countries, entities and individuals.

In connection with the recent civil disturbances and political instability in Ukraine, including the annexation of Crimea in March 2014 and the ongoing military action in Eastern Ukraine, the United States and the EU have imposed sanctions on certain individuals and companies in Russia, including Lukoil (a privately-owned Russian energy company). The Issuer has had and continues to have various business relationships with Lukoil as consequence of Lukoil's 10% interest in the Shah Deniz PSA and ownership of 10% of SCPC's shares. In addition, certain Iranian entities continue to be the subject of the United States government imposed sanctions on Iran. The Issuer has had and continues to have business relationships with Naftiran Intertrade Co. (NICO) Limited and NICO SPV Limited (collectively, "NICO"), which are subsidiaries of National Iranian Oil Company, an Iranian government owned oil and gas corporation. These business relationships primarily relate to NICO's 10% stakes in the Shah Deniz PSA and SCPC.

While the Issuer has not been sanctioned and has not engaged in, and does not intend to engage in, any actions that would cause it to be sanctioned by any relevant authority, there can be no assurance that because of these relationships or otherwise the Issuer will not be sanctioned in the future. If the Issuer were to be sanctioned in the future, some of its investors, in the United States, in the EU and in other jurisdictions where sanctions similar to the U.S. Economic Sanctions apply, may be required (by operation of law or regulations or under internal investment policies, or both) to divest their interests in the Notes and some potential investors may forgo the purchase of Notes. Moreover, under such circumstances, other counterparties to the Issuer, both U.S. and non-U.S. and including various sources of funding for the Issuer, may be required, or may decide for reputational reasons or otherwise, to cease their business relationships with or divest their investments in the Issuer. Furthermore, the Issuer may have difficulty obtaining new financing in the future. Any of these factors could have a material adverse effect on the Group's business, financial condition, cash flows or results of operations and on the price of the Notes.

In addition, as a result of the imposition of sanctions on certain Russian financial institutions, any availability of funding from Russian banks to which the Issuer may wish to have access may be limited as such banks may be unable to offer funds, particularly in US Dollars, to companies at an acceptable cost, if at all. Accordingly, the Issuer's available funding sources may become more limited.

***Corruption or allegations of corruption in Azerbaijan could adversely affect the Issuer's business and prospects.***

The political and economic changes in Azerbaijan following the fall of the Soviet Union have resulted in reduced policing of society and increased crime. Although Azerbaijan was a pioneer in joining the Extractive Industries Transparency Initiative ("EITI"), a coalition of governments, companies, civil society groups, investors and international organisations established to strengthen governance by

improving transparency and accountability in resource-rich countries and has organised SOFAZ in a manner that increases transparency in the accumulation and use of state oil revenues, Azerbaijan continues to be regarded by some independent observers, including Transparency International, as having problems with corruption. Azerbaijan's EITI status was downgraded in April 2015 from "compliant" to "candidate", although during several EITI meetings held in 2015 and 2016 the participants discussed corrective actions and execution of an action plan for restoration of Azerbaijan's EITI compliant country status. On 26 October 2016, the International Board of EITI announced a final decision on Azerbaijan's fulfilment of its obligations in accordance with EITI standards. The Board has retained the status of "candidate" for Azerbaijan. EITI has recognised the situation in Azerbaijan as unsatisfactory regarding Standard 1.3 of the EITI Standard, "Participation of civil society." Azerbaijan was invited to prepare a new plan of corrective actions which was assessed by the Board during its meeting on 9 March 2017 in Bogota, Colombia, ahead of its third meeting to assess validation against the Standard scheduled to commence on 26 July 2017. On 9 March 2017, the EITI Board decided that whilst progress had been made on these actions, they had not been fully completed and, therefore, Azerbaijan's membership in EITI was suspended. Suspension of Azerbaijan's EITI membership could adversely affect the ability of the Issuer to receive financing from multilateral creditors.

In addition, of the 176 countries and territories included in the 2016 Corruption Perceptions Index published by Transparency International, Azerbaijan ranked number 123, indicating that a perception of public sector corruption occurring within the country remains widespread.

The international press has reported instances of corruption of officials in Azerbaijan and other former Soviet Union countries. Press reports have also described instances in which state officials have engaged in selective investigations and prosecutions to further commercial interests of select constituencies. Corruption has many implications for a country, including increasing the rise of political instability, distorting the decision-making process and adversely affecting its international reputation. Failure to address these issues, corruption in the public sector and any future allegations of or perceived risk of corruption in Azerbaijan could have an adverse effect on the political stability of Azerbaijan and on its economy which, in turn, may have a material adverse effect on Azerbaijan's ability to meet its debt obligations, including those under the Guarantees, and on the ability of Azerbaijan and the Issuer to attract foreign investment and thus have a negative effect on the Issuer's business and prospects.

***As the Group's financial statements are prepared using the financial statements of, or the information provided by, the Operating Companies, the process of preparing the Group's financial statements is normally lengthy and is subject to delays.***

The Group's financial statements are prepared using the financial statements of, or the information provided by, the Operating Companies. Therefore, the timing of the preparation of the Group's financial statements is dependent on the availability of the Operating Companies' financial statements and/or information, which makes it difficult for the Issuer to prepare annual or interim IFRS consolidated financial statements in a timely manner. In addition, delays by the Operating Companies in preparing their financial statements or providing required information could cause delays in preparing the financial statements of the Group. Notwithstanding these deficiencies, the Issuer believes that its financial systems are sufficient to ensure compliance with the requirements of the Irish Stock Exchange as a listed entity. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Issuer will be unable to comply with its obligations as a company with securities admitted to the Irish Stock Exchange.

***The reported quantities or classifications of the condensate and natural gas reserves in the Shah Deniz field may be lower than estimated because of inherent uncertainties in the calculation of reserves.***

The Issuer relies on data provided by BP, the Operating Company of the Shah Deniz field, for estimates of condensate and gas reserves in the Shah Deniz field. There are numerous uncertainties inherent in estimating the quantity of reserves and in projecting future rates of production, including many factors beyond the Issuer's control. Estimating the quantity of reserves is a subjective process, and estimates made by different experts often vary significantly. In addition, the results of drilling, testing and production subsequent to the date of an estimate may result in revisions to that estimate. Accordingly, reserves estimates may be different from the quantity of condensate and natural gas that is ultimately recovered and, consequently, revenue could be less than that currently expected. The significance of such estimates is highly dependent upon the accuracy of the assumptions on which they are based, the quality of the information available and the ability to verify such information against industry standards.

If the assumptions upon which the estimates of reserves of condensate or natural gas that the Issuer relies on have been based are incorrect, the Operating Company may be unable to produce the estimated levels of condensate or gas, and the Issuer's future operations, financial condition and ability to meet its debt obligation could be materially adversely affected.

***The Operating Companies rely on technology systems and applications which may fail.***

The Operating Companies are reliant on certain technology systems and exploration and appraisal applications for the development and operation of the Projects. The Operating Companies' systems and applications could be exposed to, and significantly disrupted by, amongst other things, damage or interruption from telecommunications failure, fire or natural disaster, unauthorised entry and malicious computer code, power loss, human error and acts of war or terrorism. Such damage or interruption may materially adversely affect the Group's business and financial condition.

***The Issuer's growth and expansion may place significant demands on its systems, internal controls and senior management, which may restrict the Issuer's ability to successfully execute its strategy.***

Substantial growth in a relatively short period of time has placed, and may continue to place, significant demands and strains on the Issuer's systems, internal controls and senior management. Management of this growth and expected future growth requires, among other things:

- the continued investment in and development of financial and management controls and information technology systems;
- implementation of additional or updated internal controls, including financial and other reporting procedures;
- effective co-ordination among management, logistical, technical and finance teams;
- personnel training and hiring of new personnel; and
- continued access to financing.

If the Issuer is unable to successfully integrate new personnel or systems, or otherwise fails to successfully manage its growth, it could experience a material adverse effect on its business, financial condition and results of operations.

***The Issuer has a limited operating and financial history for investors to evaluate the Issuer's operating and financial performance and ability to implement its business strategy.***

The Issuer was incorporated in March 2014. As a result, the Issuer has a limited operating history, and, therefore, limited historical financial information for investors to evaluate the Issuer's operating performance and ability to implement its business strategy.

***The Issuer's corporate governance policies are based on Azerbaijani law and may be less stringent than those generally applicable to companies operating in more developed markets.***

The Issuer's existing corporate governance policies are generally based upon the laws governing companies incorporated in Azerbaijan. These corporate governance policies are different from, and may be less stringent than, those generally applicable to companies organised in the United Kingdom, the United States or other jurisdictions.

**Risk Factors Relating to the Notes**

***The Notes may not be a suitable investment for all investors.***

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or incorporated by reference in this Prospectus or any applicable supplement;

- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes;
- (iv) understand thoroughly the terms of the Notes; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

***An active trading market for the Notes may not develop and any trading market that does develop may be volatile.***

The trading market for the Notes will be influenced by economic and market conditions in the Republic of Azerbaijan and, to varying degrees, interest rates, currency exchange rates and inflation rates in other countries, such as the United States, the European Union Member States and elsewhere. There can be no assurance that an active trading market for the Notes will develop. If a market does develop, it may not be liquid. In addition, liquidity may be limited if the Republic of Azerbaijan makes large allocations of the Notes to a limited number of investors. Investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Notes. If the Notes are traded after their initial issuance, they may trade at a discount to their offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions and the economic and political condition of the Republic of Azerbaijan.

***Credit ratings may not reflect all risks.***

The credit rating(s) assigned to the Notes at any time may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

***Legal investment considerations may restrict certain investments.***

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent the Notes are legal investments for it, the Notes can be used as collateral for various types of borrowing and other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

***The Issuer is relying on Section 3(c)(7) of the U.S. Investment Company Act for its exemption from registration thereunder and may be a “covered fund” under the Volcker Rule.***

Final rules implementing Section 619 of the Dodd-Frank Act (the “**Volcker Rule**”) have been adopted and became effective on 21 July 2015, subject to two additional one-year extensions announced by the Federal Reserve which together would extend until 21 July 2017 the period for covered banking entities to conform their ownership interests in and sponsorship of certain entities to the Volcker Rule. As of that date and thereafter, the Volcker Rule would generally prohibit covered banking entities and other entities subject to the Volcker Rule from, among other things, acquiring or retaining an “ownership interest” in a “covered fund” (each as defined in the Volcker Rule).

As the Issuer is relying on Section 3(c)(7) of the U.S. Investment Company Act for its exemption from registration thereunder, unless the Issuer qualifies for an exemption under the Volcker Rule, it may be considered to be a covered fund. The Issuer will not seek to qualify for any exemption to the Volcker Rule. There is no assurance that the Issuer will seek such an exemption in the future or that, if the Issuer did so, it would be successful. If the Issuer is a “covered fund” subject to the Volcker Rule, then covered banking entities and other entities subject to the Volcker Rule would be restricted from acquiring and

retaining Notes or any other interests in the Issuer that qualify as “ownership interests” under the Volcker Rule.

While the Issuer does not believe that an investment in the Notes would constitute acquiring or retaining an ownership interest in a covered fund, each investor in the Notes must make its own determination as to whether the investor is a covered banking entity or otherwise subject to the Volcker Rule, whether the Issuer is a “covered fund” under the Volcker Rule, whether its investment in the Notes would or could in the future be restricted or prohibited by any provisions of the Volcker Rule, whether any extension of the Volcker Rule conformance period would be applicable to such investor’s investment in the Notes, and the potential impact of the Volcker Rule on its investment, any marketability or liquidity in connection therewith and on its portfolio generally. The Volcker Rule and interpretations thereunder are still uncertain, may restrict or discourage the acquisition of Notes by covered banking entities, and may adversely affect the marketability or liquidity of the Notes. Investors in the Notes are responsible for analysing their own regulatory positions, and none of the Issuer, the Joint Lead Managers, the Fiscal Agent or any of their respective affiliates makes any representation to any prospective investor or purchaser of the Notes regarding the application of the Volcker Rule to the Issuer or to such investor’s investment in the Notes on the Issue Date or at any time in the future.

***The Notes contain a “collective action” clause under which the terms of the Notes may be amended, modified or waived without the consent of all the Noteholders.***

The terms and conditions of the Notes (the “Conditions”) contain provisions regarding amendments, modifications and waivers, commonly referred to as “collective action” clauses. Such clauses permit defined majorities to bind all Noteholders, including Noteholders who did not vote and Noteholders who voted in a manner contrary to the majority.

In the future, the Issuer may issue debt securities which contain collective action clauses in the same form as the collective action clauses in the Conditions. If this occurs, then this could mean that the Notes would be capable of aggregation with any such future debt securities. This means that a defined majority of the holders of such debt securities (when taken in the aggregate) would be able to bind all holders of debt securities in all the relevant aggregated series, including the Notes.

Any modification or actions relating to Reserved Matters (as defined in the Conditions), including in respect of payments and other important terms, may be made to the Notes with the consent of the holders of 75% of the aggregate principal amount outstanding of the Notes, and to multiple series of debt securities which may be issued by the Issuer with the consent of both (i) the holders of 66<sup>2/3</sup>% of the aggregate principal amount outstanding of all debt securities being aggregated and (ii) the holders of 50% in aggregate principal amount outstanding of each series of debt securities being aggregated. In addition, under certain circumstances, including the satisfaction of the Uniformly Applicable condition (as more particularly described in the Conditions), any such modification or action relating to reserved matters may be made to multiple debt securities with the consent of 75% of the aggregate principal amount outstanding of all debt securities being aggregated only, without requiring a particular percentage of the holders in any individual affected debt securities to vote in favour of any proposed modification or action. Any modification or action proposed by the Issuer may, at the option of the Issuer, be made in respect of some debt securities only and, for the avoidance of doubt, the provisions may be used for different groups of two or more debt securities simultaneously. At the time of any proposed modification or action, the Issuer will be obliged, *inter alia*, to specify which method or methods of aggregation will be used by the Issuer.

There is a risk therefore that the Conditions of the Notes may be amended, modified or waived in circumstances whereby the holders of debt securities voting in favour of an amendment, modification or waiver may be holders of different debt securities and, as such, less than 75% of the Noteholders would have voted in favour of such amendment, modification or waiver. In addition, there is a risk that the provisions allowing for aggregation across multiple debt securities may make the Notes less attractive to purchasers in the secondary market on the occurrence of an Event of Default or in a distress situation. Further, any such amendment, modification or waiver in relation to the Notes may adversely affect their trading price.

***Foreign judgments may not be enforceable in Azerbaijan and enforcement of arbitral awards is dependent on compliance with procedural requirements.***

In the absence of reciprocity arrangements, of which very few are in force, Azerbaijan's courts exercise a great degree of discretion and can refuse to enforce a judgment of a court established in a country other than Azerbaijan, invoking statutory grounds for setting aside foreign judgments by asserting, for example, that the matter is subject to the exclusive jurisdiction of Azerbaijan's courts or the courts of the country where the foreign or non-Azerbaijani judicial decision was adopted do not enforce the decisions of Azerbaijan's courts on a reciprocal basis.

Azerbaijan has not entered into treaties or other agreements providing for the reciprocal recognition and enforcement of judgments of courts with the United Kingdom or many other countries. Although Azerbaijan is a signatory to the New York Convention and, accordingly, an arbitral award should generally be recognised and enforceable in Azerbaijan provided the conditions to enforcement set out in the New York Convention are met, the enforcement of foreign arbitral awards in local courts against Azerbaijan remains largely untested. Azerbaijan's courts can be arbitrary in their decisions and the possibility cannot be excluded that judges may misapply the laws of Azerbaijan (including, *inter alia*, those concerning grounds for declining enforcement). In addition, it is difficult to predict how Azerbaijan's courts would interpret such notions as "public policy", "general principles of the laws" and "sovereignty" which could each be used as grounds for rejecting enforcement of arbitral awards.

In addition, Azerbaijan's waiver of sovereign immunity described in the Conditions constitutes a limited and specific waiver and under no circumstances shall it be interpreted as a general waiver by Azerbaijan. In particular, no immunity is waived with respect to particular assets such as diplomatic premises or other property or assets used solely or mainly for official state purposes in the Republic of Azerbaijan or elsewhere.

Furthermore, the Issuer is organised and existing under the laws of Azerbaijan and a sizable portion of its businesses, assets and operations are located in Azerbaijan and its directors and principal officers are residents of the Republic of Azerbaijan. The Guarantor is a foreign sovereign state. As a result, it may not be possible to effect service of process upon the Issuer, the Guarantor or any such person outside of Azerbaijan or to enforce against any of them, in courts or jurisdictions other than Azerbaijan, judgments obtained in such courts that are predicated on laws of such jurisdictions, or enforce against any of them within Azerbaijan, judgments obtained in a jurisdiction other than Azerbaijan.

***There is a risk that the choice of English law as the governing law of the Notes and the Guarantee might not be applied by the courts of Azerbaijan.***

The Notes and the Guarantee are expressed to be governed by English law (see "*Terms and Conditions of the Further Notes*" and "*The Deed of Guarantee*"). Whilst the choice of English law to govern the Notes and the Guarantee is explicitly allowed under the laws of Azerbaijan, the Law "On International Private Law" of the Republic provides for certain restrictions in the application of foreign law, namely:

- Article 4 prohibits the application of foreign law where it contradicts the Constitution or laws of Azerbaijan adopted by referendum;
- Article 5.1 provides for "imperative" rules of the laws of Azerbaijan to be applied irrespective of the applicable governing law; and
- Article 24.4 invalidates choices of law designed to avoid, *inter alia*, the application of Azerbaijan's "imperative" rules.

Whilst none of the Conditions nor the Deed of Covenant, the Deed of Guarantee or the Fiscal Agency Agreement contain any provisions which contradict the Constitution or its laws adopted by referendum as currently in force, there can be no assurance that this will continue to be the case in the event of future amendments to the Constitution or its laws adopted by referendum. As regards "imperative" rules, the most likely general meaning of the term is the "mandatory rules of Azerbaijan laws and regulations" as used in Article 390.2 of the Civil Code of the Republic of Azerbaijan (the "**Civil Code**"). However, due to the lack of clear guidance as to the application and interpretation of "imperative" rules there can be no assurance that any applicable provisions of English law or the provisions of the Conditions, the Deed of Covenant, the Deed of Guarantee and the Fiscal Agency Agreement will not be overridden by relevant



provisions of the laws of Azerbaijan which could be deemed to be “imperative” rules. By way of example, certain provisions of the Conditions or the Guarantee dealing with waivers and the binding nature of determinations by a single party might not be enforceable in Azerbaijan.

Furthermore, although the Conditions, the Deed of Covenant, the Deed of Guarantee, and the Fiscal Agency Agreement also provide that any non-contractual obligations arising out of or in connection with them shall be governed by English law, the Law “On International Private Law” would require a court in Azerbaijan to apply the law of Azerbaijan to certain non-contractual obligations, such as claims for compensation for damage caused in Azerbaijan or unjust enrichment that occurred in Azerbaijan.

***Payments made in respect of the Notes are subject to withholding tax. Noteholders will therefore need to rely on Condition 10 (Taxation) of the Notes in respect of gross-up obligations.***

Payments made in respect of Notes will be subject to withholding tax. Generally, payments of interest on borrowed funds made by an Azerbaijan entity are subject to Azerbaijan withholding tax at the rate of 10%, unless, with respect to non-residents, such withholding tax is reduced or eliminated pursuant to the terms of an applicable double tax treaty. Given that payment of interest will be made through the Paying Agents and Euroclear and Clearstream, Luxembourg and that there are very few international capital markets transactions by Azerbaijani issuers, it could be difficult for holders of Notes to prove to their local tax authorities that a withholding tax has been applied to interest payments and, therefore, to obtain the benefit of any applicable double tax treaty relief or credit for tax withheld.

Additionally, pursuant to the Law on Amendments to the Tax Code of the Republic of Azerbaijan in force from 1 January 2017 (the “**Amendment Law**”), the direct or indirect payments by Azerbaijani tax residents to persons established (registered) in low tax jurisdictions are treated as Azerbaijani source income and are subject to a 10% withholding tax. The list of such jurisdictions is yet to be determined by the President of the Republic of Azerbaijan. In the event any holders of the Notes are established (registered) in such jurisdictions, payments indirectly made by the Issuer to such holders of the Notes, including those which are not otherwise subject to the withholding tax (e.g. the principal amount of the Notes) could be potentially subject to a 10% withholding tax. In the absence of any established practice, it is difficult to predict the approach that the tax authorities will take in relation to the payments to low tax jurisdictions.

The Issuer is obliged to increase payments in accordance with the provisions of Condition 10 (*Taxation*) of the Notes so that the net payments received by holders of the Notes will not be less than the amounts they would have received in the absence of such withholding. Azerbaijani tax law prohibits one person taking responsibility for the discharge of another person’s tax obligation and there is an argument that a contractual gross up is therefore prohibited. Although the existing practice is that the Azerbaijan authorities have not challenged the enforceability of a foreign-law-governed contractual gross-up obligation, there is no judicial precedent on the enforceability of such gross-up provisions.

## TERMS AND CONDITIONS OF THE FURTHER NOTES

*The following is the text of the terms and conditions of the Further Notes which, subject to amendment and completion and except for the text in italics, will be endorsed on each Definitive Note Certificate (if issued).*

The US\$1,000,000,000 6.875% Guaranteed Notes due 2026 (the "**Further Notes**") of Southern Gas Corridor CJSC (the "**Issuer**") will, pursuant to Condition 18 (*Further issues*), on 24 March 2017 be consolidated and form a single series with the US\$1,000,000,000 6.875% Guaranteed Notes due 2026 issued by the Issuer on 24 March 2016 (the "**Original Notes**", and, together with the Further Notes, the "**Notes**", which expression includes any further notes issued pursuant to Condition 18 (*Further issues*) and forming a single series with the Original Notes and the Further Notes). The Notes are (a) constituted by and subject to, and have the benefit of, a deed of covenant dated 18 March 2016 (as may be further amended or supplemented from time to time, the "**Deed of Covenant**") of the Issuer, (b) have the benefit of a deed of guarantee of the Republic of Azerbaijan acting through the Ministry of Finance, (the "**Guarantor**") dated 18 March 2016 (as amended or supplemented from time to time, the "**Deed of Guarantee**" or the "**Guarantee**") and (c) are the subject of a fiscal agency agreement dated 18 March 2016 (as amended or supplemented from time to time, the "**Fiscal Agency Agreement**") between the Issuer, the Guarantor, Citibank, N.A., London Branch as fiscal agent (the "**Fiscal Agent**", which expression includes any successor fiscal agent appointed from time to time in connection with the Notes), the other paying and transfer agents named therein (together with the Fiscal Agent, the "**Agents**", which expression includes any successor or additional paying and transfer agents appointed from time to time in connection with the Notes) and Citigroup Global Markets Deutschland AG, in its capacity as Registrar (the "**Registrar**", which expression shall include any successor registrar appointed from time to time in connection with the Notes).

Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement and are subject to their detailed provisions. The Noteholders are bound by, and are deemed to have notice of all the provisions of the Fiscal Agency Agreement applicable to them. Copies of the Fiscal Agency Agreement are available for inspection during normal business hours at the Specified Offices (as defined in the Fiscal Agency Agreement) of the Agents. References to "**Conditions**" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

### 1. **FORM, DENOMINATION AND TITLE**

- (a) **Form and denomination:** The Notes are in registered form, serially numbered.

Notes sold (i) in offshore transactions to persons other than U.S. persons (as defined in Regulation S ("**Regulation S**") under the Securities Act of 1933, as amended (the "**Securities Act**")) in reliance upon Regulation S will be issued in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000 and (ii) to qualified institutional buyers (as defined in Rule 144A ("**Rule 144A**") under the Securities Act) ("**QIBs**") that are also qualified purchasers (as defined in Section 2(a)(51)(A) under the U.S. Investment Company Act of 1940, as amended (the "**Investment Company Act**")) ("**QPs**") in reliance on Rule 144A will be issued in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000 (each denomination referred to in (i) and (ii), an "**Authorised Holding**").

- (b) **Title:** Title to the Notes will pass by transfer and registration as described in Conditions 2 (*Registration*) and 3 (*Transfer of Notes*). The holder (as defined below) of any Note will (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as its absolute owner for all purposes whether or not it is overdue and regardless of any notice of ownership, trust or any other interest in it, any writing thereon by any Person (as defined below) (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof; and no Person will be liable for so treating the holder.

In these Conditions, "**Person**" means any individual, company, corporation, firm, partnership, joint venture, association, unincorporated organisation, trust or other judicial entity, including, without limitation, any state or agency of a state or other entity,

whether or not having separate legal personality, "**Noteholder**" or "**holder**" means the Person in whose name a Note is for the time being registered in the Register (as defined below) (or, in the case of joint holders, the first named thereof) and "**holders**" shall be construed accordingly.

*A certificate in definitive form (a "**Definitive Note Certificate**") will be issued to each Noteholder in respect of its registered holding.*

*Notes sold to QIBs that are also QPs in the United States in reliance on Rule 144A under the Securities Act will be represented by a Restricted Global Note. Notes sold to investors outside the United States who are not U.S. persons in reliance on Regulation S under the Securities Act will be represented by an Unrestricted Global Note. The Unrestricted Global Note will be deposited with, and registered in the name of a nominee for, a common depository for Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**"). The Restricted Global Note will be deposited with a custodian for, and registered in the name of, Cede & Co., as nominee of DTC.*

*Ownership of beneficial interests in the Restricted Global Note will be limited to persons that have accounts with DTC or persons that may hold interests through such participants. Ownership of beneficial interests in the Unrestricted Global Note will be limited to Persons that have accounts with Euroclear or Clearstream, Luxembourg or Persons that may hold interests through such participants. Beneficial interests in the Global Notes will be shown on, and transfers thereof will be effected through, records maintained in book-entry form by DTC and its participants or by Euroclear, Clearstream, Luxembourg and their participants as applicable. Global Notes will be exchangeable for Notes in definitive form only in certain limited circumstances specified in the Global Note.*

- (c) **Third party rights:** No Person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

## 2. **REGISTRATION**

The Issuer will cause a register (the "**Register**") to be kept at the Specified Office of the Registrar in which will be entered the names and addresses of the holders of the Notes and the particulars of the Notes held by them and all transfers and redemptions of the Notes.

## 3. **TRANSFER OF NOTES**

- (a) **Transfer:** Each Note may, subject to the terms of the Fiscal Agency Agreement and to Conditions 3(b) (*Formalities Free of Charge*), 3(c) (*Closed Periods*) and 3(e) (*Regulations Concerning Transfer and Registration*), be transferred in whole or in part in an Authorised Holding by lodging the relevant Definitive Note Certificate (with the endorsed form of application for transfer in respect thereof duly executed and duly stamped where applicable) at the Specified Office of the Registrar or any Paying and Transfer Agent. A Note may be registered only in the name of, and transferred only to, a named person or persons. No transfer of a Note will be valid unless and until entered on the Register.

The Registrar will within five Business Days (as defined below) of any duly made application for the transfer of a Note, register the transfer and deliver a new Definitive Note Certificate to the transferee (and, in the case of a transfer of part only of a Note, deliver a Definitive Note Certificate for the untransferred balance to the transferor), at the Specified Office of the Registrar, or (at the risk and, if mailed at the request of the transferee or, as the case may be, the transferor otherwise than by ordinary mail, at the expense of the transferee or, as the case may be, the transferor) mail the Definitive Note Certificate by uninsured mail to such address as the transferee or, as the case may be, the transferor may request.

- (b) **Formalities Free of Charge:** Such transfer will be effected without charge subject to (i) the person making such application for transfer paying or procuring the payment of any taxes, duties and other governmental charges in connection therewith, (ii) the Registrar being satisfied with the documents of title and/or identity of the person making the application and (iii) such reasonable regulations as the Issuer may from time to time agree with the Registrar.
- (c) **Closed Periods:** Neither the Issuer nor the Registrar will be required to register the transfer of any Note (or part thereof) during the period of 15 days immediately prior to the due date for any payment of principal or interest in respect of the Notes.
- (d) **Business Day:** In these Conditions, "**Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in both New York City and the city in which the Specified Office of the Registrar or, as the case may be, the Paying and Transfer Agent is located.
- (e) **Regulations Concerning Transfer and Registration:** All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes in Schedule 1 to the Fiscal Agency Agreement. The regulations may be changed by the Issuer with the approval of the Registrar.
- (f) **Authorised Holdings:** No Note may be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred are Authorised Holdings.

#### 4. STATUS AND GUARANTEE

- (a) The Notes constitute direct, general, unconditional, unsubordinated and (subject to Condition 5 (*Negative Pledge and Other Covenants*)) unsecured obligations of the Issuer. The Notes rank and will at all times rank *pari passu* without any preference among themselves and at least *pari passu* in right of payment with all other present and future unsecured and unsubordinated obligations of the Issuer, save only for such obligations as may be preferred by provisions of law that are both mandatory and of general application.
- (b) The Guarantor has, in the Deed of Guarantee, unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by the Issuer in respect of the Notes. That guarantee (the "**Guarantee**") constitutes the direct, unconditional and (subject to Clause 6.2 of the Guarantee (*Negative Pledge*)), unsecured obligations of the Guarantor and rank and will rank *pari passu*, without preference among themselves, with all other unsecured External Indebtedness of the Guarantor, from time to time outstanding, **provided, further, that** the Guarantor shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due under the Guarantee and *vice versa*.

#### 5. NEGATIVE PLEDGE AND OTHER COVENANTS

- (a) **Negative Pledge:** So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement) the Issuer shall not, and shall not permit any of its Subsidiaries to, create, incur, assume or permit to arise or subsist any Security Interest (other than a Permitted Security Interest) upon the whole or any part of the undertaking, assets or revenues, present or future, of the Issuer or any Subsidiary to secure any Relevant Indebtedness or any Indebtedness Guarantee in respect of any Relevant Indebtedness unless, at the same time or prior thereto, the Issuer's obligations under the Notes are secured equally and rateably therewith or have the benefit of such other arrangement as may be approved by an Extraordinary Resolution (as defined in Condition 14 (*Meetings of Noteholders; Written Resolutions*)).

- (b) **Financial Information:** The Issuer shall deliver to the Fiscal Agent and make available to investors through the facilities of the Stock Exchange:
- (i) as soon as they become available, but in any event within 210 days after the end of each of its financial years, a copy of the Issuer's audited consolidated financial statements for such financial year audited in accordance with International Financial Reporting Standards; and
  - (ii) as soon as they become available but in any event within 150 days following the end of each first half year of each of its financial years, any consolidated financial statements for such period that the Issuer may prepare and which are reviewed or audited in accordance with International Accounting Standards 34;

each accompanied by the notes thereto and the Issuer's external auditors' audit opinion or review report, as the case may be, and certified by an authorised signatory of the Issuer to the effect that the information included in such statements presents fairly, in all material respects, in accordance with International Financial Reporting Standards or International Accounting Standards 34, as the case may be, the consolidated financial position of the Issuer and its Subsidiaries as of the end of the period to which those statements relate and its financial performance and cash flows for the period then ended.

- (c) **Maintenance of Business:** In each case that will be material in the context of the Notes, the Issuer shall, and shall procure that each of its Subsidiaries shall (i) take all actions as are required of it under applicable regulations in each jurisdiction in which it operates, and (ii) otherwise maintain in effect such licences as are required for the normal conduct of its business, activities and operations, and (iii) take all actions as are required of it to maintain any material rights, privileges, titles to property, franchises and the like that are required in the normal conduct of its business, activities and operations, and if any such failure shall occur, it will remedy such failure within 30 days after notice thereof has been given to the Issuer or the relevant Subsidiary, as the case may be.

## 6. DEFINITIONS

For the purposes of these Conditions:

"**Code**" means the US Internal Revenue Code of 1986;

"**Control**" means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or through contractual control or otherwise, to direct the management of or elect or appoint a majority of the board of directors or other persons performing similar functions in lieu of, or in addition to, the board of directors of a corporation, trust, financial institution or other entity;

"**External Indebtedness**" means any Indebtedness which is expressed, denominated or payable, or, at the option of the relevant creditor may be payable, in any currency other than the lawful currency of the Republic of Azerbaijan;

"**FATCA**" means (i) sections 1471 to 1474 of the Code or any associated regulations or other official guidance, (ii) any treaty, law, regulation or other official guidance enacted in any other jurisdiction, or relating to an intergovernmental agreement between the US and any other jurisdiction, which (in either case) facilitates the implementation of the foregoing or (iii) any agreement pursuant to the implementation of the foregoing with the US Internal Revenue Service, the US government or any governmental or taxation authority in any other jurisdiction;

"**FFI**" means a "foreign financial institution" as such term is defined pursuant to FATCA;

"**Group**" means the Issuer and its Subsidiaries taken as a whole;

"**Indebtedness**" means, any indebtedness of any Person for or in respect of (i) moneys borrowed, (ii) amounts raised by acceptance under any acceptance credit facility, (iii) amounts raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or similar instruments, (iv) the amount of any liability in respect of leases or hire purchase contracts

which would, in accordance with generally accepted accounting standards in the jurisdiction of incorporation of the lessee, be treated as finance or capital leases, (v) the amount of any liability in respect of any purchase price for assets or services the payment of which is deferred primarily as a means of raising finance or financing the acquisition of the relevant asset or service or (vi) amounts raised under any other transaction (including any forward sale or purchase agreement and the sale of receivables or other assets on a "with recourse" basis) having the commercial effect of a borrowing;

**"Indebtedness Guarantee"** means in relation to any Indebtedness of any Person, any obligation of another Person to pay such Indebtedness including (without limitation) (i) any obligation to purchase such Indebtedness, (ii) any obligation to lend money, to purchase or subscribe shares or other securities or to purchase assets or services in order to provide funds for the payment of such Indebtedness, (iii) any indemnity against the consequences of a default in the payment of such Indebtedness and (iv) any other agreement to be responsible for repayment of such Indebtedness;

**"Material Subsidiary"** means any Subsidiary of the Issuer that has either (i) assets which constitute 10% or more of the total assets of the Issuer and its Subsidiaries on a consolidated basis as at the later of the date of the Original Financial Statements and the date of the financial statements most recently delivered to the Fiscal Agent pursuant to Condition 5(b) (*Financial Information*) or (ii) adjusted profit which accounts for 10% or more of the consolidated adjusted profit of the Issuer for the period covered by the Original Financial Statements or, as the case may be, the period covered by the financial statements most recently delivered to the Fiscal Agent and made available to investors through the facilities of the Stock Exchange pursuant to Condition 5(b) (*Financial Information*) and for which purpose the adjusted profit of a Subsidiary or the Issuer, as the case may be, shall be its profit before income tax excluding extraordinary items, the cumulative effect of accounting changes and profit attributable to non-controlling interests;

**"Original Financial Statements"** means the unaudited interim reviewed consolidated financial statements of the Issuer as at and for the nine months ended 30 September 2015;

**"Participating FFI"** means an FFI that is a "participating foreign financial institution" as from the effective date of withholding on "passthru payments" (as such terms are defined pursuant to FATCA);

**"Public External Indebtedness"** means External Indebtedness which (i) is in the form of, or represented by, bonds, notes, or other securities and (ii) is, or is capable of being quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over-the-counter or on any other securities market;

**"Public External Indebtedness Guarantee"** means any Indebtedness Guarantee in respect of any Public External Indebtedness;

**"Permitted Security Interest"** means:

- (a) any Security Interest upon property to secure Relevant Indebtedness or any Indebtedness Guarantee in respect of Relevant Indebtedness incurred for the purpose of financing the acquisition or construction of such property and any renewal and extension of such Security Interest which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, **provided that** the aggregate principal amount of the Relevant Indebtedness and Indebtedness Guarantees secured thereby is not increased;
- (b) any Security Interest existing on property at the time of its acquisition (and not created in contemplation of such acquisition) to secure Relevant Indebtedness or any Indebtedness Guarantee in respect of Relevant Indebtedness and any renewal and extension of such Security Interest which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, **provided that** the aggregate principal amount of the Relevant Indebtedness and Indebtedness Guarantees secured thereby is not increased;

- (c) any Security Interest securing Relevant Indebtedness or any Indebtedness Guarantee in respect of Relevant Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction, development or exploitation of a project (including any renewal or extension thereof **provided that** the principal amount secured by any such additional encumbrance does not exceed the principal amount outstanding and secured by the original encumbrance), **provided that** (a) the holders of such Relevant Indebtedness or such Indebtedness Guarantee in respect of Relevant Indebtedness, as the case may be, expressly agree to limit their recourse to the assets and revenues (including insurance proceeds) of such project as the principal source of repayment of such Relevant Indebtedness and (b) the property over which such Security Interest is granted consists solely of such assets and revenues or revenues or claims which arise from the operation, failure to meet specifications, exploitation, sale or loss of, or failure to complete, or damage to, such properties;
- (d) any Security Interest on any assets securing Relevant Indebtedness or any Indebtedness Guarantee in respect of Relevant Indebtedness which arises pursuant to any order or attachment, distraint or similar legal process arising in connection with court proceedings so long as the execution or other enforcement thereof is effectively stayed and the claims secured thereby are being contested in good faith by appropriate proceedings; and
- (e) any Security Interest arising by operation of law, **provided that** such Security Interest is not created or permitted to be created by the Issuer to secure any Relevant Indebtedness or any Indebtedness Guarantee in respect of Relevant Indebtedness;

**"Relevant Indebtedness"** means any Indebtedness which (i) is in the form of, or represented by, bonds, notes, or other debt securities and (ii) is, or is capable of being, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over the-counter or on any other securities market;

**"Security Interest"** means any lien, pledge, hypothecation, mortgage, security interest, charge or other encumbrance or arrangement having a similar legal and economic effect including, without limitation, anything analogous to any of the foregoing under the laws of any jurisdiction;

**"Stock Exchange"** means the Irish Stock Exchange Plc or any stock exchange or market on which the Notes are listed or admitted to trading, from time to time; and

**"Subsidiary"** means, in relation to any company (the **"first Person"**) at any particular time, any other company (the **"second Person"**) whose affairs and policies the first Person controls or has the power to control, whether by ownership of share capital, contract, the power to appoint or remove members of the governing body of the second Person or otherwise.

## 7. INTEREST

- (a) **Interest Accrual:** Each Further Note bears interest from 15 March 2017 (the **"Issue Date"**) at the rate of 6.875% per annum (the **"Rate of Interest"**) payable semi-annually in arrear on 24 March and 24 September in each year (each, an **"Interest Payment Date"**), subject as provided in Condition 8 (*Payments*). Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date is herein called an **"Interest Period"**.
- (b) **Cessation of Interest:** Each Note will cease to bear interest from the due date for final redemption unless, upon due surrender of the relevant Note, payment of principal is improperly withheld or refused. In such case it will continue to bear interest at such rate (after as well as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment) in accordance with Condition 16 (*Notices*).

- (c) **Calculation of Interest for an Interest Period:** The amount of interest payable in respect of each Note for any Interest Period shall be calculated by applying the Rate of Interest to the principal amount of such Note, dividing the product by two and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).
- (d) **Calculation of Interest for any other Period:** If interest is required to be calculated for any period other than an Interest Period, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

The determination of the amount of interest payable under Conditions 7(c) (*Calculation of Interest for an Interest Period*) and 7(d) (*Calculation of Interest for any other Period*) by the Paying and Transfer Agent shall, in the absence of manifest and proven error, be binding on all parties.

## 8. PAYMENTS

- (a) **Principal:** Payment of principal in respect of each Note and payment of interest due other than on an Interest Payment Date will be made to the person shown in the Register at the close of business on the Record Date (as defined below) and subject to the surrender (or, in the case of part payment only, endorsement) of the relevant Definitive Note Certificate at the Specified Office of the Registrar or of the Paying and Transfer Agents.
- (b) **Interest:** Payments of interest due on an Interest Payment Date will be made to the persons shown in the Register at close of business on the Record Date.
- (c) **Record Date:** Each payment in respect of a Global Certificate will be made to the person shown as the Noteholder in the Register at the close of business on the Clearing System Business Day before the due date for payment (the "**Record Date**"), where "**Clearing System Business Day**" means a day on which each clearing system for which the Global Certificate is being held is open for business.
- (d) **Payments:** Each payment in respect of the Notes pursuant to Conditions 8(a) (*Principal*) and (b) (*Interest*) will be made by United States dollar cheque drawn on a branch of a bank in New York City mailed to the holder of the relevant Note at his address appearing in the Register. However, upon application by the holder to the Specified Office of the Registrar or any Paying and Transfer Agent not less than 15 days before the due date for any payment in respect of a Note, such payment may be made by transfer to a United States dollar account maintained by the payee with a bank in New York City.

Where payment is to be made by cheque, the cheque will be mailed, on the business day preceding the due date for payment or, in the case of payments referred to in Condition 8(a) (*Principal*), if later, on the business day on which the relevant Definitive Note Certificate is surrendered (or endorsed as the case may be) as specified in Condition 8(a) (*Principal*) (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder).

Where payment is to be made by transfer to a United States dollar account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated, in the case of principal, on the later of the due date for payment and the day on which the relevant Definitive Note Certificate is surrendered (or, in the case of part payment only, endorsed) and, in the case of interest and other amounts on the due date for payment.

- (e) **Agents:** The names of the initial Paying and Transfer Agents and Registrar and their Specified Offices are set out below. The Issuer and the Guarantor reserve the right under the Fiscal Agency Agreement by giving to the relevant Agent concerned at least 60 days' prior written notice, which notice shall expire at least 30 days before or after any due date for payment in respect of the Notes, remove any Agent or the Registrar (including in circumstances where the Paying and Transfer Agent does not become or ceases to be,



a Participating FFI at a time when the Issuer would be required to withhold or deduct any amount from any payment made by it to the Paying and Transfer Agent pursuant to FATCA) and to appoint successor or additional Agents or another Registrar, **provided that** it will at all times maintain:

- (i) a Fiscal Agent;
- (ii) a Paying and Transfer Agent in at least one major European city; and
- (iii) a Registrar.

Notice of any such removal or appointment and of any change in the Specified Office of any Agent or Registrar will be given to Noteholders in accordance with Condition 16 (*Notices*) as soon as practicable.

- (f) **Payments subject to Fiscal Laws:** All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 10 (*Taxation*) and any withholding or deduction required pursuant to FATCA. Neither the Issuer nor any Agent nor any other person will be obliged to make any additional payments to the Noteholders in respect of any amounts withheld or deducted pursuant to FATCA. No commissions or expenses shall be charged to the Noteholders in respect of such payments.
- (g) **Delay in Payment:** Noteholders will not be entitled to any interest or other payment in respect of any delay in payment resulting from (i) the due date for payment not being a business day or (ii) a cheque mailed in accordance with this Condition 8 (*Payments*) arriving after the due date for payment or being lost in the mail.
- (h) **Business Days:** In this Condition, "**business day**" means any day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in New York City and, in the case of surrender of a Definitive Note Certificate, in the place of the Specified Office of the Registrar or relevant Paying and Transfer Agent, to whom the relevant Definitive Note Certificate is surrendered.

## 9. REDEMPTION AND PURCHASE

- (a) **Scheduled redemption:** Unless previously purchased and cancelled as provided below, each Note will be redeemed at its principal amount on 24 March 2026 subject as provided in Condition 8 (*Payments*).
- (b) **Optional Redemption or Purchase upon a Change of Control Event:** If at any time while any Note remains outstanding a Change of Control Event (as defined below) occurs, the Issuer shall, at the option of the holder of any such Note, upon the holder of such Note giving notice to the Issuer as provided in this Condition 9(b) any time during the Change of Control Put Period (as defined below), redeem (or may, at the Issuer's option, purchase or procure the purchase of, in accordance with Condition 9(e) (*Purchase*)) such Note on the Redemption Date (as defined below) at 100 per cent. of its principal amount together with interest accrued (or, where purchased, together with an amount equal to interest so accrued) to but excluding the Redemption Date.

If a Change of Control Event occurs, then within 14 days of the occurrence of the Change of Control Event, the Issuer shall give notice (a "**Change of Control Notice**") to the Noteholders in accordance with Condition 16 (*Notices*) specifying the nature of the Change of Control Event and the procedure for exercising the put option contained in this Condition 9(b).

To exercise the put option pursuant to this Condition 9(b), a holder of any such Note must deliver at the specified office of any Agent or the Registrar during the Change of Control Put Period, a duly signed and completed notice of exercise (an "**Exercise Notice**") in the form (for the time being current and which may, if the certificate for such Notes is held in a clearing system, be any form acceptable to the clearing system

delivered in any manner acceptable to the clearing system) obtainable from the specified office of any Agent or the Registrar in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition 9(b) accompanied by the certificate for such Notes or evidence satisfactory to the relevant Agent or the Registrar that the certificate for such Notes will, following the delivery of the Exercise Notice, be held to its order or under its control.

The Issuer shall redeem (or may, at the Issuer's option, purchase or procure the purchase of, in accordance with Condition 9(e) (*Purchase*)) the Notes the subject of each Exercise Notice on the date (the "**Redemption Date**") which is the earlier of seven days after the expiration of the Change of Control Put Period, or (if no Change of Control Notice is given by the Issuer) 90 days after the relevant Exercise Notice is given, unless previously redeemed or purchased and cancelled. An Exercise Notice given by a holder of any Note shall be irrevocable except where, on or prior to the Redemption Date, an Event of Default has occurred and is continuing, in which event such holder, at its option, may elect by notice to the Issuer to withdraw the Exercise Notice.

For the purpose of this Condition 9(b):

- (i) a "**Change of Control Event**" will be deemed to have occurred upon the Guarantor ceasing to Control the Issuer; and
  - (ii) "**Change of Control Put Period**" means the period commencing on the occurrence of a Change of Control Event (whether or not the Issuer has given a Change of Control Notice in respect of such event) and ending 90 days after such occurrence or, if later, 90 days after the date on which the Change of Control Notice is given to Noteholders as required by this Condition 9(b), **provided that** if no Change of Control Notice is given, the Change of Control Put Period shall not end.
- (c) **Compulsory Sale:** If, at any time, the Issuer determines that any beneficial owner of Notes, or any account for which such beneficial owner purchased Notes, who is required to be a QIB that is also a QP is not a QIB that is also a QP, the Issuer may: (i) require such beneficial owner to sell its interest in the Notes to a person (A) who is a QIB that is also a QP, and who is otherwise qualified to purchase such Notes in a transaction exempt from registration under the Securities Act; or (B) to a non-U.S. person purchasing the Notes in an offshore transaction pursuant to Regulation S; or (ii) require such beneficial owner to sell its interest in such Notes to the Issuer or an affiliate of the Issuer or transfer its interest in such Notes to a person designated by or acceptable to the Issuer. The Issuer has the right to refuse to permit a transfer of interests in such Notes to a person who is not both a QIB and a QP.
- (d) **No other Redemption:** The Issuer shall not be entitled to redeem the Notes otherwise than as provided in this Condition 9.
- (e) **Purchase:** The Issuer, the Guarantor and any of the Issuer's Subsidiaries may at any time purchase or procure others to purchase for its account Notes in the open market or otherwise and at any price. The Notes so purchased may be held or resold (**provided that** such resale is outside the United States or, in the case of any Notes resold pursuant to Rule 144A, is only made to QIBs that are also QPs and is otherwise in compliance with all applicable laws) or surrendered for cancellation at the option of the Issuer or otherwise, as the case may be in compliance with Condition 9(f) (*Cancellation of Notes*) below. The Notes so purchased, while held by or on behalf of the Issuer, the Guarantor or any such Subsidiary, shall not entitle the holder to vote at any meeting of the Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of the Noteholders or for the purposes of Condition 14 (*Meetings of Noteholders; Written Resolutions*).
- (f) **Cancellation of Notes:** All Notes which are submitted for cancellation pursuant to Condition 9(e) (*Purchase*) will be cancelled and may not be reissued or resold. For so

long as the Notes are admitted to trading on the Stock Exchange and the rules of such exchange so require, the Issuer shall promptly inform the Stock Exchange of the cancellation of any Notes under this Condition 9(f).

## 10. TAXATION

- (a) All payments made by or on behalf of the Issuer under or in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by or within the Republic of Azerbaijan or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note:
- (i) **Other Connection:** presented for payment by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note by reason of his having a present or former connection with the Republic of Azerbaijan but excluding any connection arising merely from the holding of such Note, the enforcement of rights under such Note or the receipt of any payments in respect of such Note;
  - (ii) **Presentation more than 30 days after the Relevant Date:** where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder of it would have been entitled to such additional amounts on surrendering such Definitive Note Certificate for payment on the last day of such period of 30 days; or
  - (iii) **Payment by another Paying and Transfer Agent:** where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by surrendering the relevant Definitive Note Certificate to another Paying and Transfer Agent in a Member State of the European Union.

Notwithstanding anything to the contrary in this Condition 10, neither the Issuer nor any Agent or any other person shall be required to pay any additional amounts with respect to any withholding or deduction imposed on or in respect of any Note pursuant to FATCA.

- (b) **Taxing jurisdiction:** If the Issuer becomes subject at any time to any taxing jurisdiction other than the Republic of Azerbaijan, references in this Condition 10 (*Taxation*) to the Republic of Azerbaijan shall be construed as references to the Republic of Azerbaijan and/or such other jurisdiction.

**"Relevant Date"** means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received in New York City by the Fiscal Agent on or prior to such due date, the date on which, the full amount plus any accrued interest having been so received, notice to that effect shall have been given to the Noteholders. Any reference in these Conditions to principal and/or interest shall be deemed to include any additional amounts which may be payable under this Condition or any undertaking given in addition to or substitution for it under the Fiscal Agency Agreement.

## 11. PRESCRIPTION

Claims in respect of principal and interest will become void unless the relevant Definitive Note Certificate is surrendered for payment as required by Condition 8 (*Payments*) within a period of 10 years in the case of principal and five years in the case of interest from the appropriate Relevant Date.

## 12. EVENTS OF DEFAULT

The Fiscal Agent shall upon receipt of written requests to the Issuer at the Specified Office of the Fiscal Agent from the holders of not less than 25% in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution declare the Notes, without further formality, due and payable in each case at their principal amount together with accrued interest if any of the events listed in paragraphs (a) to (i) below (each, an "Event of Default") occurs and is continuing.

- (a) **Non-payment:** The Issuer or the Guarantor, as the case may be, fails to pay any amount of principal in respect of the Notes within 15 days of the due date for payment or any interest or additional amounts in respect of the Notes within 30 days of the due date for payment; or
- (b) **Breach of other obligations:** The Issuer or the Guarantor, as the case may be, does not perform or comply with any one or more of its other obligations under the Notes or the Guarantee, respectively, which default is incapable of remedy or, if capable of remedy, is not remedied within 45 days after notice of such default has been given to the Issuer (with a copy to the specified office of the Fiscal Agent) by any holder of Notes; or
- (c) **Cross Default with respect to Indebtedness of the Group:**
  - (i) Any Indebtedness of any member of the Group is not paid when due within any originally applicable grace period; or
  - (ii) any such Indebtedness becomes (or becomes capable of being declared) due and payable prior to its stated maturity otherwise than at the option of the relevant member of the Group or (**provided that** no event of default, howsoever described, has occurred) any Person entitled to such Indebtedness; or
  - (iii) any member of the Group fails to pay when due any amount payable by it under any Indebtedness Guarantee (after the expiration of any originally applicable grace period);

**provided that** the amount of Indebtedness referred to in Conditions 12(c)(i) and/or 12(c)(ii) and/or the amount payable under any Indebtedness Guarantee referred to in Condition 12(c)(iii) individually or in the aggregate exceeds U.S.\$50,000,000 (or its equivalent in any other currency or currencies); or

- (d) **Cross Acceleration with respect to Public External Indebtedness of the Guarantor:**
  - (i) The holders of any Public External Indebtedness of the Guarantor accelerate such Public External Indebtedness or declare such Public External Indebtedness to be due and payable, or required to be prepaid (other than by regularly scheduled required payment), prior to the originally stated maturity thereof; or
  - (ii) the Guarantor fails to pay in full any principal of, or interest on any Public External Indebtedness of the Guarantor when due (after the expiration of any originally applicable grace period) or any Public External Indebtedness Guarantee given by the Guarantor shall not be honoured when due and called upon (after the expiration of any originally applicable grace period);

**provided that** the aggregate amount of the relevant Public External Indebtedness or Public External Indebtedness Guarantee in respect of which one or more of the events mentioned in this paragraph (d) shall have occurred equals or exceeds US\$50,000,000 (or its equivalent in any other currency or currencies); or

- (e) **Judgment default:** One or more final unappealable judgments or orders or arbitration awards for the payment US\$50,000,000 (or its equivalent in any other currency or currencies), is rendered or granted against the Issuer or a Material Subsidiary and continue(s) unsatisfied and unstayed for a period of 30 days after the date thereof or, if later, the date therein specified for payment; or

(f) **Bankruptcy:**

- (i) Any Person shall have instituted a proceeding or entered a decree or order for the appointment of a receiver, administrator or liquidator in any insolvency, rehabilitation, readjustment of debt, marshalling of assets and liabilities, moratorium of payments or similar arrangements involving the Issuer or any Material Subsidiary or all or substantially all of its respective properties and such proceeding, decree or order shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 45 days; or
- (ii) otherwise than for the purposes of or pursuant to an amalgamation, reorganisation or restructuring whilst solvent, the Issuer or any Material Subsidiary shall institute proceedings under any applicable bankruptcy, insolvency or other similar law now or hereafter in effect to be adjudicated a bankrupt or shall consent to the filing of a bankruptcy, insolvency or similar proceeding against it or shall file a petition or answer or consent seeking reorganisation under any such law or shall consent to the filing of any such petition, or shall consent to the appointment of a receiver, administrator or liquidator or trustee or assignee in bankruptcy or liquidation of the Issuer or any Material Subsidiary, as the case may be, or in respect of its property, or shall make an assignment for the benefit of its creditors or shall otherwise be unable or admit its inability to pay its debts generally as they become due or the Issuer or any Material Subsidiary commences proceedings with a view to the general adjustment of its Indebtedness; or

(g) **Moratorium:**

The Guarantor suspends payment of, or admits its inability to pay, its Public External Indebtedness or any part thereof or declares a general moratorium on or in respect of its Public External Indebtedness or any part thereof, or anything analogous to the foregoing occurs; or

(h) **Invalidity or unenforceability:**

- (i) Any action, condition or thing at any time required to be taken, fulfilled or done in order (A) to enable the Issuer and the Guarantor lawfully to enter into, exercise their respective rights and perform and comply with their respective obligations under and in respect of the Notes and the Guarantee, (B) to ensure that those obligations are legal, binding and enforceable and (C) to make the Global Notes, any Definitive Note Certificates, the Fiscal Agency Agreement, the Deed of Covenant and/or the Deed of Guarantee admissible as evidence in the courts of Azerbaijan is not taken, fulfilled or done; or
  - (ii) (A) the validity of the Notes, the Deed of Covenant or the Deed of Guarantee is contested by the Issuer or the Guarantor, (B) the Issuer or the Guarantor deny any of their respective obligations under the Notes, the Deed of Covenant or the Guarantee or (C) it is or it becomes unlawful for the Issuer or the Guarantor to perform or comply with all or any of their respective obligations under or in respect of the Notes, the Deed or Covenant or the Deed of Guarantee or any of such obligations shall be or become unenforceable or invalid; or
- (i) **IMF:** The Republic of Azerbaijan ceases to be a member of the International Monetary Fund.

Upon any such declaration by the Fiscal Agent, the Fiscal Agent shall give notice thereof in the manner provided in the Fiscal Agency Agreement to the Issuer and the Guarantor and the holders of the Notes in accordance with Condition 16 (*Notices*). After any such declaration by the Fiscal Agent, if all amounts then due in respect of the Notes are paid (other than amounts due solely because of such declaration) and all other defaults with respect to the Notes are cured, such declaration may be annulled and rescinded by the holders of not less than 50% of the outstanding principal amount of the Notes (the "**Required Percentage**") by written notice thereof to the

Issuer and the Guarantor at the Specified Office of the Fiscal Agent or by the passing of a resolution of the holders of not less than the Required Percentage.

13. **REPLACEMENT OF NOTES**

If any Definitive Note Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the Specified Office of the Registrar or any Paying and Transfer Agent subject to all applicable laws and Stock Exchange or other relevant authority requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may require (**provided that** the requirement is reasonable in the light of prevailing market practice). Mutilated or defaced Definitive Note Certificates must be surrendered before replacements will be issued.

14. **MEETINGS OF NOTEHOLDERS; WRITTEN RESOLUTIONS**

(a) **Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions:**

- (i) The Issuer may convene a meeting of Noteholders at any time in respect of the Notes in accordance with the provisions of the Fiscal Agency Agreement. The Issuer will determine the time and place of the meeting and will notify the Noteholders of the time, place and purpose of the meeting not less than 21 and not more than 45 days before the meeting.
- (ii) The Issuer or the Fiscal Agent will convene a meeting of Noteholders if the holders of at least 10% in principal amount of the outstanding Notes (as defined in the Fiscal Agency Agreement and described in Condition 14(i) (*Notes controlled by the Issuer or the Guarantor*)) have delivered a written request to the Issuer or the Fiscal Agent (with a copy to the Issuer) setting out the purpose of the meeting. The Fiscal Agent will agree the time and place of the meeting with the Issuer promptly. The Issuer or the Fiscal Agent, as the case may be, will notify the Noteholders within 10 days of receipt of such written request of the time and place of the meeting, which shall take place not less than 21 and not more than 45 days after the date on which such notification is given.
- (iii) The Issuer (with the agreement of the Fiscal Agent) will set the procedures governing the conduct of any meeting in accordance with the Fiscal Agency Agreement. If the Fiscal Agency Agreement does not include such procedures, or additional procedures are required, the Issuer and the Fiscal Agent will agree such procedures as are customary in the market and in such a manner as to facilitate any multiple series aggregation, if in relation to a Reserved Matter the Issuer proposes any modification to the terms and conditions of, or action with respect to, two or more series of debt securities issued by it and/or the Guarantor.
- (iv) The notice convening any meeting will specify, *inter alia*;
  - (A) the date, time and location of the meeting;
  - (B) the agenda and the text of any Extraordinary Resolution to be proposed for adoption at the meeting;
  - (C) the record date for the meeting, which shall be no more than five Business Days before the date of the meeting;
  - (D) the documentation required to be produced by a Noteholder in order to be entitled to participate at the meeting or to appoint a proxy to act on the Noteholder's behalf at the meeting;
  - (E) any time deadline and procedures required by any relevant international and/or domestic clearing systems or similar through which the Notes are traded and/or held by Noteholders;

- (F) whether Condition 14(b) (Modification of this Series of Notes only), Condition 14(c) (Multiple Series Aggregation – Single limb voting) or Condition 14(d) (Multiple Series Aggregation – Two limb voting) shall apply and, if relevant, in relation to which other series of debt securities it applies;
  - (G) if the proposed modification or action relates to two or more series of debt securities issued by it and/or the Guarantor and contemplates such series of debt securities being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group of debt securities;
  - (H) such information that is required to be provided by the Issuer in accordance with Condition 14(f) (*Information*);
  - (I) the identity of the Aggregation Agent and the Calculation Agent, if any, for any proposed modification or action to be voted on at the meeting, and the details of any applicable methodology referred to in Condition 14(g) (*Claims Valuation*); and
  - (J) any additional procedures which may be necessary and, if applicable, the conditions under which a multiple series aggregation will be deemed to have been satisfied if it is approved as to some but not all of the affected series of debt securities.
- (v) In addition, the Fiscal Agency Agreement contains provisions relating to Written Resolutions. All information to be provided pursuant to paragraph 14(a)(iv) above shall also be provided, *mutatis mutandis*, in respect of Written Resolutions.
  - (vi) A "**record date**" in relation to any proposed modification or action means the date fixed by the Issuer for determining the Noteholders and, in the case of a multiple series aggregation, the holders of debt securities of each other affected series that are entitled to vote on a Multiple Series Single Limb Extraordinary Resolution or a Multiple Series Two Limb Extraordinary Resolution, or to sign a Multiple Series Single Limb Written Resolution or a Multiple Series Two Limb Written Resolution.
  - (vii) An "**Extraordinary Resolution**" means any of a Single Series Extraordinary Resolution, a Multiple Series Single Limb Extraordinary Resolution and/or a Multiple Series Two Limb Extraordinary Resolution, as the case may be.
  - (viii) A "**Written Resolution**" means any of a Single Series Written Resolution, a Multiple Series Single Limb Written Resolution and/or a Multiple Series Two Limb Written Resolution, as the case may be.
  - (ix) Any reference to "**debt securities**" means any notes (including the Notes), bonds, debentures or other debt securities issued by the Issuer and/or the Guarantor in one or more series with an original stated maturity of more than one year.
  - (x) "**Debt Securities Capable of Aggregation**" means those debt securities which include or incorporate by reference this Condition 14 and Condition 15 (*Aggregation Agent; Aggregation Procedures*) or provisions substantially in these terms which provide for the debt securities which include such provisions to be capable of being aggregated for voting purposes with other series of debt securities.
- (b) **Modification of this Series of Notes only:**
- (i) Any modification of any provision of, or any action in respect of, these Conditions or the Fiscal Agency Agreement in respect of the Notes may be

made or taken if approved by a Single Series Ordinary Resolution, a Single Series Extraordinary Resolution or a Single Series Written Resolution, (each as defined below) as set out below.

- (ii) For the purposes of a meeting of Noteholders convened in respect of this series of Notes only and for the purposes of passing a Single Series Ordinary Resolution and/or a Single Series Extraordinary Resolution (a "**Single Series Noteholder Meeting**") at any such Single Series Noteholder Meeting, any one or more persons present in person holding Notes or proxies or representatives and holding or representing in the aggregate not less than 50% in principal amount of the Notes for the time being outstanding shall (except for the purposes of passing a Single Series Extraordinary Resolution) form a quorum for the transaction of business and no business (other than the choosing of a chairman) shall be transacted at any such Single Series Noteholder Meeting unless the requisite quorum be present at the commencement of business. The quorum at any such Single Series Noteholder Meeting convened for the purpose of passing of a Single Series Extraordinary Resolution shall (subject as provided in Condition 14(b)(iii)) be two or more persons present in person holding Notes or being proxies or representatives and holding or representing in the aggregate not less than 75% of the principal amount of the Notes for the time being outstanding.
- (iii) If within 15 minutes from the time fixed for any such Single Series Noteholder Meeting a quorum is not present, the Single Series Noteholder Meeting shall, if convened upon the requisition of Noteholders, be dissolved. In any other case it shall stand adjourned for such period, being not less than 14 days nor more than 42 days, as may be determined by the chairman either at or after the Single Series Noteholder Meeting. At such adjourned Single Series Noteholder Meeting, one or more persons present in person holding Notes or being proxies or representatives (whatever the principal amount of Notes so held or represented) shall form a quorum and may pass any resolution and decide upon all matters which could properly have been dealt with at the Single Series Noteholder Meeting from which the adjournment took place had a quorum been present at Single Series Noteholder Meeting, **provided that** at any adjourned Single Series Noteholder Meeting at which it is to be proposed a Single Series Extraordinary Resolution, the quorum shall be two or more persons so present in person holding Notes or being proxies or representatives and holding or representing in the aggregate not less than one third of the aggregate principal amount of Notes for the time being outstanding.
- (iv) A "**Single Series Ordinary Resolution**" means a resolution passed at a Single Series Noteholder Meeting duly convened and held in accordance with the procedures prescribed by the Issuer and the Fiscal Agent pursuant to Conditions 14(a), 14(b)(ii) and 14(b)(iii) in respect of any matter other than a Reserved Matter by the affirmative vote of more than 50% of the aggregate principal amount of the outstanding Notes present in person or represented by proxy.
- (v) A "**Single Series Extraordinary Resolution**" means a resolution passed at a Single Series Noteholder Meeting duly convened and held in accordance with the procedures prescribed by the Issuer and the Fiscal Agent pursuant to Condition 14(a), 14(b)(ii) and 14(b)(iii) in respect of a Reserved Matter by the affirmative vote of at least 75% of the aggregate principal amount of the outstanding Notes present in person or represented by proxy.
- (vi) A "**Single Series Written Resolution**" means a resolution in writing signed or confirmed in writing by or on behalf of the holders of:
  - (A) in the case of a Reserved Matter, at least 75% of the aggregate principal amount of the outstanding Notes; or



- (B) in the case of a matter other than a Reserved Matter more than 50% of the aggregate principal amount of the outstanding Notes.

Any Single Series Written Resolution may be contained in one document or several documents in the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders.

- (vii) Any Single Series Ordinary Resolution or Single Series Extraordinary Resolution duly passed or Single Series Written Resolution approved shall be binding on all Noteholders, whether or not they attended such Single Series Noteholder Meeting, whether or not they voted in favour thereof and whether or not they signed or confirmed in writing any such Single Series Written Resolution, as the case may be.

(c) **Multiple Series Aggregation – Single limb voting:**

- (i) In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Single Limb Extraordinary Resolution or by a Multiple Series Single Limb Written Resolution as set out below, *provided that* the Uniformly Applicable condition is satisfied.
- (ii) A "**Multiple Series Single Limb Extraordinary Resolution**" means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Issuer and the Fiscal Agent pursuant to Condition 14(a) (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*), as supplemented if necessary, which is passed by a majority of at least 75% of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate).
- (iii) A "**Multiple Series Single Limb Written Resolution**" means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation) which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of at least 75% of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate). Any Multiple Series Single Limb Written Resolution may be contained in one document or several documents in substantially the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders or one or more holders of each affected series of Debt Securities Capable of Aggregation.
- (iv) Any Multiple Series Single Limb Extraordinary Resolution duly passed or Multiple Series Single Limb Written Resolution approved shall be binding on all Noteholders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favour thereof, whether or not any other holder or holders of the same series voted in favour thereof and whether or not they signed or confirmed in writing any such Multiple Series Single Limb Written Resolution, as the case may be.
- (v) The "**Uniformly Applicable**" condition will be satisfied if:
  - (A) the holders of all affected series of Debt Securities Capable of Aggregation are invited to exchange, convert, or substitute their debt securities, on the same terms, for (i) the same new instrument or other consideration or (ii) a new instrument, new instruments or other

consideration from an identical menu of instruments or other consideration; or

(B) the amendments proposed to the terms and conditions of each affected series of Debt Securities Capable of Aggregation would, following implementation of such amendments, result in the amended instruments having identical provisions (other than provisions which are necessarily different, having regard to the currency of issuance).

(vi) It is understood that a proposal under Condition 14(c)(i) above will not be considered to satisfy the Uniformly Applicable condition if each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation (or, where a menu of instruments or other consideration is offered, each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation electing the same option from such menu of instruments).

(vii) Any modification or action proposed under Condition 14(c)(i) above may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in this Condition 14(c) may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

(d) **Multiple Series Aggregation – Two limb voting:**

(i) In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Two Limb Extraordinary Resolution or by a Multiple Series Two Limb Written Resolution as set out below.

(ii) A "**Multiple Series Two Limb Extraordinary Resolution**" means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Issuer and the Fiscal Agent pursuant to Condition 14(a) (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*), as supplemented if necessary, which is passed by a majority of:

(A) at least 66 $\frac{2}{3}$  % of the aggregate principal amount of the outstanding debt securities of affected series of Debt Securities Capable of Aggregation (taken in aggregate); and

(B) more than 50% of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).

(iii) A "**Multiple Series Two Limb Written Resolution**" means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation)

which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of:

- (A) at least 66 $\frac{2}{3}$  % of the aggregate principal amount of the outstanding debt securities of all the affected series of Debt Securities Capable of Aggregation (taken in aggregate); and
- (B) more than 50% of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).

Any Multiple Series Two Limb Written Resolution may be contained in one document or several documents in substantially the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders or one or more holders of each affected series of Debt Securities Capable of Aggregation.

- (iv) Any Multiple Series Two Limb Extraordinary Resolution duly passed or Multiple Series Two Limb Written Resolution approved shall be binding on all Noteholders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favour thereof, whether or not any other holder or holders of the same series voted in favour thereof and whether or not they signed or confirmed in writing any such Multiple Series Two Limb Written Resolution, as the case may be.
- (v) Any modification or action proposed under paragraph (a) above may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in this Condition 14(d) may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

(e) **Reserved Matters:**

In these Conditions, "**Reserved Matter**" means any proposal:

- (i) to change the date, or the method of determining the date, for payment of principal, interest or any other amount in respect of the Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the Notes or to change the method of calculating the amount of principal, interest or any other amount payable in respect of the Notes on any date;
- (ii) to change the currency in which any amount due in respect of the Notes is payable or the place in which any payment is to be made;
- (iii) to change the majority required to pass an Extraordinary Resolution, a Written Resolution or any other resolution of Noteholders or the number or percentage of votes required to be cast, or the number or percentage of Notes required to be held, in connection with the taking of any decision or action by or on behalf of the Noteholders or any of them;
- (iv) to change this definition, or the definition of "Extraordinary Resolution", "Single Series Extraordinary Resolution", "Multiple Series Single Limb Extraordinary Resolution", "Multiple Series Two Limb Extraordinary Resolution", "Written Resolution", "Single Series Written Resolution", "Multiple Series Single Limb Written Resolution" or "Multiple Series Two Limb Written Resolution";
- (v) to change the definition of "debt securities" or "Debt Securities Capable of Aggregation";
- (vi) to change the definition of "Uniformly Applicable";

- (vii) to change the definition of "outstanding" or to modify the provisions of Condition 14(i) (*Notes controlled by the Issuer or the Guarantor*);
- (viii) to change the legal ranking of the Notes or the Deed of Guarantee;
- (ix) to change any provision of the Notes describing circumstances in which Notes may be declared due and payable prior to their scheduled maturity date, as set out in Condition 12 (*Events of Default*);
- (x) to change the law governing the Notes or the Deed of Guarantee, the courts to the jurisdiction of which the Issuer and/or the Guarantor has submitted in the Notes or the Deed of Guarantee, any of the arrangements specified in the Notes to enable proceedings (including arbitration proceedings) to be taken or the Issuer's or the Guarantor's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, as set out in Condition 20 (*Governing Law and Arbitration*) or in the Deed of Guarantee;
- (xi) to impose any condition on or otherwise change the Issuer's or the Guarantor's obligation to make payments of or in respect of principal, interest or any other amount in respect of the Notes, including by way of the addition of a call option;
- (xii) to modify the provisions of this Condition 14(e);
- (xiii) to release the Guarantor under the Guarantee or to change the terms of the Guarantee or, except as permitted by any other related guarantee or security agreement, to release any such agreement guaranteeing or securing payments under the Notes or to change the terms of any such guarantee or security;
- (xiv) to exchange or substitute all the Notes for, or convert all the Notes into, other obligations or securities of the Issuer or any other person, or to modify any provision of these Conditions or the Deed of Guarantee in connection with any exchange of the Notes for, or the conversion of the Notes into, any other obligations or securities of the Issuer, which would result in the Conditions or the Deed of Guarantee as so modified being less favourable to the Noteholders which are subject to the Conditions as so modified than:
  - (A) the provisions of the other obligations or debt securities of the Issuer or any other person resulting from the relevant exchange or conversion; or
  - (B) if more than one series of other obligations or debt securities results from the relevant exchange or conversion, the provisions of the resulting series of debt securities having the largest aggregate principal amount.

(f) **Information:**

Prior to or on the date that the Issuer proposes any Extraordinary Resolution or Written Resolution pursuant to Condition 14(b) (*Modification of this Series of Notes only*), Condition 14(c) *Multiple Series Aggregation – Single limb voting*) or Condition 14(d) (*Multiple Series Aggregation – Two limb voting*), the Issuer shall publish in accordance with Condition 15 (*Aggregation Agent; Aggregation Procedures*) and provide the Fiscal Agent with the following information:

- (i) a description of the Issuer's financial condition and existing liabilities together with the economic and financial circumstances of the Guarantor which are, in the Issuer's opinion, relevant to the request for any potential modification or action, a description of the Guarantor's existing debts and a description of its broad policy reform programme and provisional macroeconomic outlook;
- (ii) if the Issuer and/or the Guarantor shall at the time have entered into any form of debt restructuring and/or shall have entered into an arrangement for financial assistance with multilateral and/or other major creditors or creditor groups

and/or an agreement with any such creditors regarding debt relief, a description of any such arrangement or agreement and where permitted under the information disclosure policies of the multilateral or such other creditors, as applicable, copies of the arrangement or agreement shall be provided;

- (iii) (A) a description of the proposed treatment of the Issuer's and/or the Guarantor's debt other than that which is within the scope of any multiple series aggregation and (B) the Guarantor's intentions with respect to its own debt securities and other major creditor groups; and
- (iv) if any proposed modification or action contemplates debt securities being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group, as required for a notice convening a meeting of Noteholders in Condition 14(a)(iv)(G).

(g) **Claims Valuation:**

For the purpose of calculating the par value of the Notes and any affected series of debt securities which are to be aggregated with the Notes in accordance with Condition 14(c) (*Multiple Series Aggregation – Single limb voting*) and Condition 14(d) (*Multiple Series Aggregation – Two limb voting*), the Issuer may appoint a calculation agent (the "**Calculation Agent**"). The Issuer shall, with the approval of the Aggregation Agent and any appointed Calculation Agent, promulgate the methodology in accordance with which the Calculation Agent will calculate the par value of the Notes and such affected series of debt securities. In any such case where a Calculation Agent is appointed, the same person will be appointed as the Calculation Agent for the Notes and each other affected series of debt securities for these purposes, and the same methodology will be promulgated for each affected series of debt securities.

(h) **Manifest error, etc.:**

The Notes, these Conditions and the provisions of the Fiscal Agency Agreement may be amended without the consent of the Noteholders to correct a manifest error. In addition, *the* parties to the Fiscal Agency Agreement may agree to modify any provision thereof, but the Issuer shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature or it is not materially prejudicial to the interests of the Noteholders.

(i) **Notes controlled by the Issuer or the Guarantor:**

For the purposes of (i) determining the right to attend and vote at any meeting of Noteholders, or the right *to* sign or confirm in writing, or authorise the signature of, any Written Resolution, (ii) this Condition 14 (*Meetings of Noteholders; Written Resolutions*) and (iii) Condition 12 (*Events of Default*), any Notes which are for the time being held by or on behalf of the Issuer or the Guarantor by or on behalf of any person which is owned or Controlled directly or indirectly by the Issuer or the Guarantor or by any public sector instrumentality of the Guarantor shall be disregarded and be deemed not to remain outstanding, where "**public sector instrumentality**" means the Central Bank of Azerbaijan or any department, ministry or agency of the government of the Republic of Azerbaijan or any corporation, trust, financial institution or other entity owned or Controlled by the government of the Republic of Azerbaijan or any of the foregoing.

A Note will also be deemed to be not outstanding if the Note has previously been cancelled or delivered for cancellation or held for reissuance but not reissued or, where relevant, the Note has previously been called for redemption in accordance with its terms or previously become due and payable at maturity or otherwise and the Issuer has previously satisfied its obligations to make all payments due in respect of the Note in accordance with its terms.

In advance of any meeting of Noteholders, or in connection with any Written Resolution, the Issuer shall provide to the Fiscal Agent a copy of the certificate prepared pursuant to Condition 15(d) (*Certificate*) which includes information on the total number of Notes which are for the time being held by or on behalf of the Issuer or the Guarantor or by or on behalf of any person which is owned or Controlled directly or indirectly by the Issuer or the Guarantor or by any public sector instrumentality of the Guarantor and, as such, such Notes shall be disregarded and deemed not to remain outstanding for the purposes of ascertaining the right to attend and vote at any meeting of Noteholders or the right to sign, or authorise the signature of, any Written Resolution in respect of any such meeting. The Fiscal Agent shall make any such certificate available for inspection during normal business hours at its Specified Office and, upon reasonable request, will allow copies of such certificate to be taken.

(j) **Publication:**

The Issuer shall publish all Extraordinary Resolutions and Written Resolutions which have been determined by the Aggregation Agent to have been duly passed in accordance with Condition 15(g) (*Manner of publication*).

(k) **Exchange and Conversion:**

Any Extraordinary Resolutions or Written Resolutions which have been duly passed and which modify any provision of, or action in respect of, the Conditions may be implemented at the Issuer's option by way of a mandatory exchange or conversion of the Notes and each other affected series of debt securities, as the case may be, into new debt securities containing the modified terms and conditions if the proposed mandatory exchange or conversion of the Notes is notified to Noteholders at the time notification is given to the Noteholders as to the proposed modification or action. Any such exchange or conversion shall be binding on all Noteholders.

15. **AGGREGATION AGENT; AGGREGATION PROCEDURES**

(a) **Appointment:**

The Issuer will appoint an aggregation agent (the "**Aggregation Agent**") to calculate whether a proposed modification or action has been approved by the required principal amount outstanding of Notes and, in the case of a multiple series aggregation, by the required principal amount of outstanding debt securities of each affected series of debt securities. In the case of a multiple series aggregation, the same person will be appointed as the Aggregation Agent for the proposed modification of any provision of, or any action in respect of, these Conditions or the Fiscal Agency Agreement in respect of the Notes and in respect of the terms and conditions or bond documentation in respect of each other affected series of debt securities. The Aggregation Agent shall be independent of the Issuer and the Guarantor.

(b) **Extraordinary Resolutions:**

If an Extraordinary Resolution has been proposed at a duly convened meeting of Noteholders to modify any provision of, or action in respect of, these Conditions and other affected series of debt securities, as the case may be, the Aggregation Agent will, as soon as practicable after the time the vote is cast, calculate whether holders of a sufficient portion of the aggregate principal amount of the outstanding Notes and, where relevant, each other affected series of debt securities, have voted in favour of the Extraordinary Resolution such that the Extraordinary Resolution is passed. If so, the Aggregation Agent will determine that the Extraordinary Resolution has been duly passed.

(c) **Written Resolutions:**

If a Written Resolution has been proposed under these Conditions to modify any provision of, or action in respect of, these Conditions and the terms and conditions of other affected series of debt securities, as the case may be, the Aggregation Agent will,

as soon as reasonably practicable after the relevant Written Resolution has been signed or confirmed in writing, calculate whether holders of a sufficient portion of the aggregate principal amount of the outstanding Notes and, where relevant, each other affected series of debt securities, have signed or confirmed in writing in favour of the Written Resolution such that the Written Resolution is passed. If so, the Aggregation Agent will determine that the Written Resolution has been duly passed.

(d) **Certificate:**

For the purposes of Condition 15(b) (*Extraordinary Resolutions*) and Condition 15(c) (*Written Resolutions*), the Issuer will provide a certificate to the Aggregation Agent up to three days prior to, and in any case no later than, with respect to an Extraordinary Resolution, the date of the meeting referred to in Condition 14(b) (*Modification of this Series of Notes only*), Condition 14(c) (*Multiple Series Aggregation – Single limb voting*) or Condition 14(d) (*Multiple Series Aggregation – Two limb voting*), as applicable, and, with respect to a Written Resolution, the date arranged for the signing of the Written Resolution.

The certificate shall:

- (i) list the total principal amount of Notes and, in the case of a multiple series aggregation, the total principal amount of each other affected series of debt securities outstanding on the record date; and
- (ii) clearly indicate the Notes and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities which shall be disregarded and deemed not to remain outstanding as a consequence of Condition 14(i) (*Notes controlled by the Issuer or the Guarantor*) on the record date identifying the holders of the Notes and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities.

The Aggregation Agent may rely upon the terms of any certificate, notice, communication or other *document* believed by it to be genuine.

(e) **Notification:**

The Aggregation Agent will cause each determination made by it for the purposes of this Condition 15 to be notified to the Fiscal Agent and the Issuer as soon as practicable after such *determination*. Notice thereof shall also promptly be given to the Noteholders.

(f) **Binding nature of determinations; no liability:**

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 15 by the Aggregation Agent and any appointed Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Guarantor, the Fiscal Agent and the Noteholders and (subject as aforesaid) no liability to any such person will attach to the Aggregation Agent or the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

(g) **Manner of publication:**

The Issuer will publish all notices and other matters required to be published pursuant to the Fiscal Agency Agreement including any matters required to be published pursuant to Condition 12 (*Events of Default*), Condition 14 (*Meetings of Noteholders; Written Resolutions*) and this Condition 15:

- (i) through any clearing system in which the Notes are held;
- (ii) in such other places and in such other manner as may be required by applicable law or regulation; and

- (iii) in such other places and in such other manner as may be customary.

16. **NOTICES**

Notices to Noteholders will be sent to them by first class mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses on the Register and will be published in such other places and in such other manner as may be required by applicable law or regulation or as may be customary. Any such notice shall be deemed to have been given on the fourth day after the date of mailing. Notices to Noteholders will be valid if published, for so long as the Notes are admitted to trading on the Stock Exchange and the rules of such exchange so require, in a leading newspaper having general circulation in Ireland (which is expected to be the Irish Times) or, if, in the opinion of the Fiscal Agent, such publication is not practicable, in a leading English language daily newspaper of general circulation in Europe. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made.

*So long as any of the Notes are represented by any Global Note, notices required to be published in accordance with Condition 16 (Notices) may be given by delivery of the relevant notice to Euroclear, Clearstream, Luxembourg and DTC for communication by them to the relevant accountholders, provided, (i) that such notice is also delivered to the Stock Exchange, and (ii) so long as the Notes are admitted to trading on the Stock Exchange and the rules of the Stock Exchange so require, publication will also be made in a leading daily newspaper having general circulation in Dublin (which is expected to be the Irish Times).*

17. **PROVISION OF INFORMATION**

The Issuer shall, during any period in which it is not subject to or in compliance with the reporting requirements of Section 13 or 15(d) of the United States Securities Exchange Act of 1934 (the "**Exchange Act**") nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, duly provide to any holder of a Note which is a "restricted security" within the meaning of Rule 144(a)(3) under the Securities Act or to any prospective purchaser of such securities designated by such Noteholder, upon the written request of such Noteholder or (as the case may be) prospective Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Registrar, the information specified in Rule 144A(d)(4) under the Securities Act.

18. **FURTHER ISSUES**

The Issuer may from time to time, without notice to or the consent of the Noteholders and in accordance with the Fiscal Agency Agreement, create and issue further notes having the same terms and conditions and security as the Notes in all respects (or in all respects except for the date for and amount of the first payment of interest) so as to be consolidated and form a single series with the Notes.

*Noteholders should note that additional securities that are treated as a single series for non-tax purposes may be treated as a separate series for U.S. federal income tax purposes. In such case, the additional securities may be considered to have been issued with original issue discount, as defined in the U.S. Internal Revenue Code of 1986, as amended, and the U.S. Treasury regulations issued thereunder, which may affect the market value of the Notes since such additional securities may not be distinguishable from the Notes.*

19. **CURRENCY INDEMNITY**

The Fiscal Agency Agreement provides that if any Noteholder receives or recovers any amount in a currency other than the Contractual Currency (as defined in the Fiscal Agency Agreement) (whether as a result of, or of the enforcement of, an arbitral award, a judgment or order of a court of any jurisdiction or otherwise), in respect of any sum expressed to be due to it from the Issuer or the Guarantor that amount will only discharge the Issuer and the Guarantor to the extent of the Contractual Currency amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not



practicable to make that purchase on that date, on the first date on which it is practicable to do so).

If that Contractual Currency amount is less than the Contractual Currency amount expressed to be due to the relevant Noteholder under the Notes, the Issuer failing whom the Guarantor will indemnify such Noteholder against any loss sustained by it as a result on the written demand of such Noteholder addressed to the Issuer or Guarantor, as the case may be, and delivered to the Issuer or Guarantor, as the case may be, or to the Specified Office of the Registrar or any Paying and Transfer Agent with its Specified Office in London. In any event, the Issuer failing whom the Guarantor will indemnify the relevant Noteholder against the cost of making any such purchase.

## 20. GOVERNING LAW AND ARBITRATION

(a) **Governing Law:** The Notes and the arbitration agreement at Condition 20(b) (*Arbitration*) (including any non-contractual obligations arising out of or in connection with the Notes and the arbitration agreement) are governed by, and shall be construed in accordance with, English law.

(b) **Arbitration:** The Issuer agrees that any claim, dispute or difference of whatever nature arising out of or in connection with the Notes (including any claim, dispute or difference of whatever nature as to the existence, termination or validity or any non-contractual obligations arising out of or in connection with the Notes) (a "**Dispute**"), shall be referred to and finally settled by arbitration in accordance with the London Court of International Arbitration ("**LCIA**") Rules (the "**Rules**") as in force at the Issue Date and as modified by this Condition 20(b), which Rules shall be deemed incorporated into this Condition 20(b). The number of arbitrators shall be three, one of whom shall be nominated by the claimant(s), one by respondent(s) and the third of whom, who shall act as presiding arbitrator, shall be nominated by the two party-nominated arbitrators, **provided that** if the claimant(s) or respondent(s) fail to nominate an arbitrator within the time limits specified by the Rules or the party-nominated arbitrators fail to nominate a presiding arbitrator within 30 days of the nomination of the second party-nominated arbitrator, such third arbitrator shall be appointed by the LCIA Court. The parties may nominate and the LCIA Court may appoint arbitrators from among the nationals of any country, whether or not a party is a national of that country. The seat of arbitration shall be London, England and the language of arbitration shall be English. Sections 45 and 69 of the Arbitration Act 1996 shall not apply.

(c) **Service of Process:**

The Issuer has appointed the Ambassador of the Republic of Azerbaijan to the Court of St. James's at the Embassy of the Republic of Azerbaijan, currently located at 4 Kensington Court, London W8 5DL, as its agent for service of process in relation to any proceedings before the English courts permitted by the Rules in connection with an arbitral proceeding pursuant to Condition 20(b), or in connection with the enforcement of any arbitral award rendered pursuant to Condition 20(b) ("**Proceedings**") and hereby undertakes that, in the event of the Ambassador of the Republic of Azerbaijan to the Court of St James's ceasing so to act or ceasing to be located in England, it will appoint another person as its agent for the service of process in England for such purposes on the written demand of a Noteholder and, failing such appointment within 14 days, such Noteholder shall be entitled to appoint such a person by written notice to the Issuer. Nothing in this paragraph shall affect the right of any Noteholder to serve process in any other manner permitted by law.

(d) **Enforcement of Awards; Waiver of Immunity:**

(i) Except as provided below in this Condition 20(d) to the extent the Issuer may in any jurisdiction claim for itself or its assets or revenues immunity from suit, arbitral process or award, judgment, execution, attachment or other order (whether in aid of execution, before judgment or otherwise) or any other legal process in respect of, in support of or in connection with (i) any arbitration proceedings to resolve a dispute under Condition 20(b) (*Arbitration*) or (ii) any

Proceedings, and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Issuer or its assets or revenues, the Issuer agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction (and consents generally to the giving of any relief or the issue of any process in connection with such Proceedings).

- (ii) The Issuer agrees that an arbitral award in connection with the Notes is conclusive and binding on it and may be enforced against it in the courts of any competent jurisdiction. In the event that the failure of a party to comply with an arbitral award requires any other party to apply to any court for enforcement of such award, the non-complying party shall be liable to the other for all costs of such litigation, including reasonable legal fees.

## DEED OF GUARANTEE

**THIS DEED OF GUARANTEE** is made on 18 March 2016

**BY:**

- (1) The Republic of Azerbaijan as guarantor (the "**Guarantor**");

**IN FAVOUR OF:**

- (2) The Holders for the time being (and from time to time), being the persons registered in the Register as the holders of the Notes referred to below (each a "**Noteholder**" or the "**holder**" of a Note); and
- (3) The Accountholders (as defined below) (together with the Noteholders, the "**Beneficiaries**" and each a "**Beneficiary**").

**WHEREAS:**

- (A) Southern Gas Corridor CJSC (the "**Issuer**") has authorised the issue of US\$1,000,000,000 6.875% Guaranteed Notes due 2026 (the "**Notes**"). In connection with the issue of the Notes, the Issuer has entered into a fiscal agency agreement dated 18 March 2016 with Citibank, N.A., London Branch (the "**Fiscal Agent**") and the other parties referred to therein (the "**Fiscal Agency Agreement**"). It is a condition precedent to the issue of the Notes that the Guarantor executes and delivers this Deed of Guarantee.
- (B) The Notes will be in registered form, will be issued and sold (i) in offshore transactions to persons other than U.S. persons (as defined in Regulation S ("**Regulation S**") under the Securities Act of 1933, as amended (the "**Securities Act**")) in reliance upon Regulation S in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000 and will be represented on issue by an unrestricted global note (the "**Unrestricted Global Note**") and (ii) to qualified institutional buyers (as defined in Rule 144A ("**Rule 144A**") under the Securities Act) which are also qualified purchasers (as defined in Section 2(a)(51)(A) under the U.S. Investment Company Act of 1940, as amended (the "**Investment Company Act**")) in reliance on Rule 144A in minimum denominations of US\$200,000 or any amount in excess thereof which is an integral multiple of US\$1,000 and will be represented on issue by one or more restricted global notes (all such notes the "**Restricted Global Note**"). Interests in each of the Unrestricted Global Note and the Restricted Global Note will be exchangeable (but only in the limited circumstances described therein) for definitive note certificates (the "**Definitive Note Certificates**").
- (C) Holders of Notes and Accountholders shall have the benefit of this Deed of Guarantee.
- (D) The Issuer has, in relation to the Notes, entered into a deed of covenant (the "**Deed of Covenant**") dated on or about the date hereof. The Notes will be constituted by the Deed of Covenant.
- (E) The Guarantor has agreed to irrevocably and unconditionally guarantee to each holder of a Note, the due and punctual payment of all sums from time to time payable by the Issuer in respect of such Note, and to each Accountholder the due and punctual payment of all sums from time to time payable by the Issuer to such Accountholder in respect of the Direct Rights, in each case as set out herein.
- (F) The execution of this Guarantee has been authorised by the Instructive Order from the Cabinet of Ministers of the Republic of Azerbaijan (the "**Cabinet of Ministers**") no. 138s dated 7 March 2016.

This deed of guarantee witnesses as follows:

1. **INTERPRETATION**

1.1 **Definitions**

"**Accountholder**" means any accountholder or participant with a Clearing System which at the Determination Date has credited to its securities account with such Clearing System one or more Entries in respect of the Unrestricted Global Note and/or Restricted Global Note, except for any Clearing System in its capacity as an accountholder of the other Clearing System;

"**Conditions**" means the terms and conditions of the Notes, as the same may be modified or supplemented in accordance with the terms thereof, and any reference to a numbered "Condition" is to the correspondingly numbered provision thereof;

"**Law on Public Debt**" means law no. 334-IIIQ of the Republic of Azerbaijan on sovereign debt adopted by the Azerbaijani Parliament (Milly Majlis) on 22 May 2007 and promulgated into law by the President of the Republic of Azerbaijan on 7 August 2007;

"**Permitted Security Interest**" means:

- (a) any Security Interest upon property to secure Public External Indebtedness or any Indebtedness Guarantee in respect of Public External Indebtedness incurred for the purpose of financing the acquisition or construction of such property and any renewal and extension of such Security Interest which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, **provided that** the aggregate principal amount of the Public External Indebtedness and Indebtedness Guarantees secured thereby is not increased;
- (b) any Security Interest existing on property at the time of its acquisition (and not created in contemplation of such acquisition) to secure Public External Indebtedness or any Indebtedness Guarantee in respect of Public External Indebtedness and any renewal and extension of such Security Interest which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, **provided that** the aggregate principal amount of the Public External Indebtedness and Indebtedness Guarantees secured thereby is not increased;
- (c) any Security Interest securing Public External Indebtedness or any Indebtedness Guarantee in respect of Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction, development or exploitation of a project (including any renewal or extension thereof **provided that** the principal amount secured by any such additional encumbrance does not exceed the principal amount outstanding and secured by the original encumbrance), **provided that** (a) the holders of such Public External Indebtedness or such Indebtedness Guarantee in respect of Public External Indebtedness, as the case may be, expressly agree to limit their recourse to the assets and revenues (including insurance proceeds) of such project as the principal source of repayment of such Public External Indebtedness and (b) the property over which such Security Interest is granted consists solely of such assets and revenues or revenues or claims which arise from the operation, failure to meet specifications, exploitation, sale or loss of, or failure to complete, or damage to, such properties;
- (d) any Security Interest on any assets securing Public External Indebtedness or any Indebtedness Guarantee in respect of Public External Indebtedness which arises pursuant to any order or attachment, distraint or similar legal process arising in connection with court proceedings so long as the execution or other enforcement thereof is effectively stayed and the claims secured thereby are being contested in good faith by appropriate proceedings; and
- (e) any Security Interest arising by operation of law, **provided that** such Security Interest is not created or permitted to be created by the Republic of Azerbaijan to secure any Public External Indebtedness or any Indebtedness Guarantee in respect of Public External Indebtedness.

Terms used but not defined in this Deed of Guarantee and defined in the Deed of Covenant or the Conditions are used herein as so defined.

1.2 **Contracts (Rights of Third Parties) Act 1999**

A Person, apart from a Noteholder or Accountholder, who is not a party to this Deed of Guarantee has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Deed of Guarantee.

1.3 **Clauses**

Any reference in this Deed of Guarantee to a Clause or sub-Clause is, unless otherwise stated, to a Clause or sub-Clause hereof.

1.4 **Headings**

Headings shall be ignored in construing this Deed of Guarantee.

1.5 **Statutes**

Any reference in this Deed of Guarantee to a statute or statutory provision shall, unless the contrary is indicated, be construed as a reference to such statute or statutory provision as the same shall have been or may be amended or re-enacted.

1.6 **Benefit of Deed of Guarantee**

Any Further Notes issued by the Issuer pursuant to Condition 18 (*Further Issues*) on or after the date of this Deed of Guarantee shall have the benefit of this Deed of Guarantee.

2. **GUARANTEE AND INDEMNITY**

2.1 **Guarantee**

The Guarantor hereby irrevocably and unconditionally guarantees:

- (a) to each holder of a Note the due and punctual payment of all sums from time to time payable by the Issuer in respect of such Note (including principal, interest and any other amounts of whatever nature or additional amounts which may become payable under such Note and including the redemption or purchase price, in the case of a redemption or purchase of Notes under Condition 9(b) (*Optional Redemption or Purchase upon a Change of Control Event*), whether such notes are redeemed by the Issuer or purchased by the Issuer or a third party, as and when the same becomes due and payable (but in any event within any originally applicable grace period relating to an event of default corresponding to such payment) by the Issuer and, accordingly, undertakes to pay to such Noteholder, within such grace period, in the manner and currency prescribed by the Conditions for payment by the Issuer in respect of such Note, any and every sum or sums which the Issuer is at any time liable to pay in respect of such Note and which the Issuer has failed to pay; and
- (b) to each Accountholder the due and punctual payment of all sums from time to time payable by the Issuer to such Accountholder in respect of the Direct Rights as and when the same become due and payable (but in any event within any originally applicable grace period relating to an event of default corresponding to such payment), and accordingly undertakes to pay to such Accountholder, within such grace period, in the manner and currency prescribed by the Conditions for payment by the Issuer in respect of the Notes, any and every sum or sums which the Issuer is at any time liable to pay to such Accountholder in respect of the Notes and which the Issuer has failed to pay.

3. **INDEMNITY**

The Guarantor irrevocably and unconditionally agrees as a primary obligation to indemnify each Beneficiary from time to time from and against any loss, liability or cost incurred by such

Beneficiary as a result of any of the obligations of the Issuer under or pursuant to any Note, the Deed of Covenant or any provision thereof being or becoming void, voidable, unenforceable or ineffective for any reason whatsoever, whether or not known to such Beneficiary or any other person, the amount of such loss being the amount which such Beneficiary would otherwise have been entitled to recover from the Issuer. Any amount payable pursuant to this indemnity shall be payable in the manner and currency prescribed by the Conditions for payments by the Issuer in respect of the Notes. This indemnity constitutes a separate and independent obligation from the other obligations under this Deed of Guarantee and shall give rise to a separate and independent cause of action.

#### 4. **TAXES AND WITHHOLDINGS**

##### 4.1 **No Withholding**

All payments by the Guarantor in respect of the Notes and the Direct Rights under this Deed of Guarantee shall be made free and clear of, and without withholding or deduction for, or on account of any present or future taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by or on behalf of any tax jurisdiction (each a "**Relevant Jurisdiction**") or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the Guarantor is compelled by law to withhold or deduct any such taxes, duties, assessments or governmental charges. In that event, the Guarantor shall increase the amounts payable as shall be necessary in order that the net amounts receivable by the relevant Beneficiaries after such withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes and/or the Direct Rights, as the case may be, in the absence of such withholding or deduction, except that no such additional amount shall be payable to any Beneficiary:

- (a) who is liable to such taxes, duties, assessments or governmental charges in respect of such Note or such Direct Rights, as the case may be, by reason of his having a present or former connection with a Relevant Jurisdiction, but excluding any connection arising merely from the holding of such Note or having the benefit of this Deed of Guarantee or the Deed of Covenant or, as the case may be, the enforcement of rights under such Note or this Deed of Guarantee or the receipt of any payments in respect of such Note or this Deed of Guarantee; or
- (b) who would have been able to avoid such withholding or deduction by presenting the relevant Note to another paying agent in a Member State of the European Union; or
- (c) more than 30 days after the Determination Date except to the extent that such Beneficiary would have been entitled to such additional amount if payment had been made on the last day of such period of 30 days.

##### 4.2 **Taxes**

The Guarantor shall indemnify each Beneficiary (other than a Beneficiary referred to in paragraphs (a), (b) or (c) of Clause 4.1 (*No Withholding*)) against any liability for or on account of any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected or assessed by or on behalf of the Republic of Azerbaijan or any political subdivision thereof or by any authority thereof or therein on or in respect of any amounts received or receivable under this Deed of Guarantee.

#### 5. **PRESERVATION OF RIGHTS**

##### 5.1 **Principal Obligor**

The obligations of the Guarantor hereunder shall be deemed to be undertaken as principal obligor and not merely as surety.

##### 5.2 **Continuing Obligations**

The obligations of the Guarantor hereunder shall constitute and be continuing obligations notwithstanding any settlement of account or other matter or thing whatsoever and, in particular,

but without limitation, shall not be considered satisfied by any intermediate payment or satisfaction of all or any of the obligations of the Issuer under or in respect of any Note or the Deed of Covenant and shall continue in full force and effect until all sums due from the Issuer in respect of the Notes and under the Deed of Covenant have been paid, and all other actual or contingent obligations of the Issuer thereunder or in respect thereof have been satisfied, in full. Furthermore, these obligations of the Guarantor are additional to, and not instead of, any security or other guarantee or indemnity at any time existing in favour of any Beneficiary, whether from the Guarantor or otherwise and may be enforced without first having recourse to the Issuer, any other person, any security or any other guarantee or indemnity. The Guarantor irrevocably waives all notices and demands of any kind.

### 5.3 **Waiver of Defences**

Neither the obligations of the Guarantor contained herein nor the rights, powers and remedies conferred upon the Beneficiaries by this Deed of Guarantee or by law shall be discharged, impaired or otherwise affected by any act, omission, matter or thing which, but for this Clause 5.3, would reduce, release or prejudice any of its obligations under this Deed of Guarantee (without limitation and whether or not known to it or any Beneficiary) including:

- (a) any incapacity or lack of power, authority or legal personality of or dissolution or change in the members or status of the Issuer or any other person; or
- (b) the winding-up, liquidation, bankruptcy, administration, moratorium or dissolution of the Issuer or analogous proceeding in any jurisdiction or any change in its status, function, control or ownership; or
- (c) the availability to the Issuer of any defence, set-off or counterclaim in respect of any of the obligations of the Issuer under or in respect of any Note or the Deed of Covenant, any of such obligations being or becoming illegal, invalid, unenforceable or ineffective or any Global Note becoming void in accordance with its terms; or
- (d) any time, waiver, consent or other indulgence being granted or agreed to be granted to, or composition with, the Issuer or any other person in respect of any of the Issuer's obligations under or in respect of any Note or the Deed of Covenant; or
- (e) any amendment, novation, supplement, extension (whether of maturity or otherwise) or restatement (in each case, however fundamental and of whatsoever nature) or replacement, waiver or release of, any obligation of the Issuer under or in respect of any Note or the Deed of Covenant or any security or other guarantee or indemnity in respect thereof including, without limitation, any change in the purposes for which the proceeds of the issue of the Notes are to be applied and any extension of or any increase of the obligations of the Issuer in respect of any Note or the addition of any new obligations for the Issuer under the Deed of Covenant; or
- (f) the taking, variation, compromise, exchange, renewal or release of, or refusal or neglect to perfect, take up or enforce, any rights against, or security over assets of, the Issuer or other person or any non-presentation or non-observance of any formality or other requirement in respect of any instrument or any failure to realise the full value of any security; or
- (g) any other act, event or omission which, but for this sub-Clause, might operate to discharge, impair or otherwise affect the obligations expressed to be assumed by the Guarantor herein or any of the rights, powers or remedies conferred upon the Beneficiaries or any of them by this Deed of Guarantee or by law; or
- (h) the making or absence of any demand on the Issuer or any other person for payment.

### 5.4 **Settlement Conditional**

- (a) Any settlement, discharge, release or other arrangement between the Guarantor and the Beneficiaries or any of them shall be conditional upon no payment to the Beneficiaries or any of them by the Issuer or any other person on behalf of the Issuer being avoided or

reduced by virtue of any laws, provisions or enactments relating to bankruptcy, insolvency, liquidation or similar laws, provisions or enactments of general application for the time being in force and, in the event of any such payment being so avoided or reduced, the Beneficiaries shall each be entitled to recover the amount by which such payment is so avoided or reduced from the Guarantor subsequently as if such settlement or discharge had not occurred.

- (b) Each Beneficiary may concede or compromise any claim that any payment, security or other disposition is liable to avoidance or restoration.

#### 5.5 **Exercise of Rights**

No Beneficiary shall be obliged before exercising any of the rights, powers or remedies conferred upon it by this Deed of Guarantee or by law:

- (a) to make any demand of the Issuer, other than, in the case of payment of principal or interest on redemption of a Definitive Note Certificate, the presentation of the relevant Definitive Note Certificate; or
- (b) to take any action or obtain judgment in any court or award in any arbitral tribunal against the Issuer; or
- (c) to make or file any claim or proof in a winding-up or dissolution of the Issuer,

and, save as aforesaid, the Guarantor hereby expressly waives presentment, demand, protest, and notice of dishonour in respect of each Note.

#### 5.6 **Deferral of Guarantor's Rights**

The Guarantor agrees that, so long as any sums are or may be owed by the Issuer in respect of any Note or under the Deed of Covenant or the Issuer is under any other actual or contingent obligation thereunder or in respect thereof, the Guarantor shall not exercise any right which it may at any time have by reason of performance by it of its obligations hereunder:

- (a) to be indemnified by the Issuer; and/or
- (b) to claim any contribution from any other guarantor of the obligations of the Issuer under or in respect of any Note or the Deed of Covenant; and/or
- (c) to take the benefit (in whole or in part and whether by way of subrogation or otherwise) of any rights of any Beneficiary against the Issuer in respect of amounts paid by the Guarantor under this Deed of Guarantee or any security enjoyed in connection with any Note or the Deed of Covenant by any Beneficiary; and/or
- (d) to bring legal or other proceedings for an order requiring the Issuer to make any payment, or perform any obligation, in respect of which the Guarantor has given a guarantee, undertaking or indemnity under this Deed of Guarantee; and/or
- (e) to claim, rank, prove or vote as a creditor of the Issuer or its estate in competition with any Beneficiary (or any trustee or agent on its behalf) however, this shall not prevent the Guarantor from registering or filing a claim against the estate, **provided that** (to the extent that any amount remains due under this Deed of Guarantee) the Guarantor will hold such claim and any amount received in respect thereof on trust for the Beneficiaries and promptly pay any amounts received (up to an amount equivalent to any amount due under this Deed of Guarantee) to the Fiscal Agent and irrevocably instruct the Fiscal Agent to immediately distribute such amounts to the Beneficiaries in respect of amounts owing under the Notes and the Deed of Covenant; and/or
- (f) to receive, claim or have the benefit of any payment, distribution or security from or on account of the Issuer, or exercise any right of set-off or counterclaim as against the Issuer.



Nothing in this Clause 5.6 shall operate to release the Issuer from its obligation to pay any fees payable pursuant to the Law on Public Debt (and any and all legislative acts adopted in furtherance thereof) in respect of the issue of this Deed of Guarantee, **provided that** the failure to make any such payments shall not release the Guarantor from its obligations under this Deed of Guarantee.

#### 5.7 **No Subrogation**

Until all amounts which may be or become payable under the Notes have been irrevocably paid in full, the Guarantor shall not by virtue of this Deed of Guarantee be subrogated to any rights of any Beneficiary or claim in competition with any Beneficiary against the Issuer.

#### 5.8 **Rights of Beneficiaries**

Until all amounts which may be or become payable by the Issuer under or in connection with the Notes and/or the Deed of Covenant have been irrevocably paid in full, each Beneficiary (or any trustee or agent on its behalf) may:

- (a) refrain from applying or enforcing any other moneys, security or rights held or received by that Beneficiary (or any trustee or agent on its behalf) in respect of those amounts, or apply and enforce the same in such manner and order as it sees fit (whether against those amounts or otherwise), and the Guarantor shall not be entitled to the benefit of the same; and/or
- (b) hold in a suspense account any moneys received from the Guarantor or on account of the Guarantor's liability under this Deed of Guarantee, without liability to pay interest on those moneys.

### 6. **STATUS AND NEGATIVE PLEDGE**

#### 6.1 **Status**

The Guarantor undertakes that its obligations hereunder will constitute direct, unconditional and (subject to Clause 6.2 (*Negative Pledge*)) unsecured obligations and rank and will rank *pari passu* with all other unsecured External Indebtedness of the Guarantor, from time to time outstanding, **provided, further, that** the Guarantor shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due under this Deed of Guarantee and *vice versa*.

#### 6.2 **Negative Pledge**

Until all amounts which may be or become payable by the Issuer under or in connection with the Notes and/or the Deed of Covenant have been irrevocably paid in full, the Guarantor undertakes that it will not create or permit to arise or subsist any Security Interest other than a Permitted Security Interest upon the whole or any part of its existing or future assets or revenues to secure any Public External Indebtedness of the Guarantor or any other Person unless, at the same time or prior thereto, the Guarantor's obligations under this Deed of Guarantee are secured equally and rateably therewith or have the benefit of such other arrangement as may be approved by an Extraordinary Resolution (as defined in the Fiscal Agency Agreement).

### 7. **COVENANTS**

The Guarantor shall obtain, comply with the terms of and do all that is necessary to maintain in full force and effect all authorisations required in or by the laws and regulations of any relevant jurisdiction to enable it lawfully to enter into and perform its obligations under this Guarantee or to ensure the legality, validity, enforceability or admissibility in evidence in any relevant jurisdiction of this Deed of Guarantee.

8. **DEPOSIT OF DEED OF GUARANTEE**

This Deed of Guarantee shall be deposited with and held by the Fiscal Agent until the date on which all the obligations of the Issuer and the Guarantor under or in respect of the Notes and the Deed of Covenant have been discharged in full following which this Deed of Guarantee shall be promptly returned to the Guarantor. The Guarantor hereby acknowledges the right of every Beneficiary to the production of a copy of this Deed of Guarantee.

9. **STAMP DUTIES AND OTHER TAXES**

The Guarantor shall pay all stamp, registration and other taxes and duties (including any interest and penalties thereon or in connection therewith) which may be payable on or in connection with the execution and performance and delivery of this Deed of Guarantee, and shall indemnify each Beneficiary against any claim, demand, action, liability, damage, cost, loss or expense (including, without limitation, legal fees and any applicable value added tax) which it incurs as a result or arising out of or in relation to any failure to pay or delay in paying any of the same.

10. **BENEFIT OF DEED OF GUARANTEE**

10.1 **Deed Poll**

This Deed of Guarantee shall take effect as a deed poll for the benefit of the Beneficiaries from time to time.

10.2 **Benefit**

This Deed of Guarantee shall enure to the benefit of each Beneficiary and its (and any subsequent) successors and assigns, each of which shall be entitled severally to enforce this Deed of Guarantee against the Guarantor.

10.3 **Assignment**

The Guarantor shall not be entitled to assign or transfer all or any of its rights, benefits and obligations hereunder. Each Beneficiary shall be entitled to assign all or any of its rights and benefits hereunder.

11. **SEVERABILITY**

In case any provision in or obligation under this Deed of Guarantee shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

12. **COMMUNICATIONS**

Any communication in respect of this Deed of Guarantee shall be by letter or fax and shall be sent to the Guarantor at:

Ministry of Finance  
83 S. Vurgun Street  
AZ1022 Baku  
Republic of Azerbaijan

Fax number: +994 12 404 4720  
Attention: Minister of Finance

or any other address of which written notice has been given to the Beneficiaries in the manner prescribed for the giving of notices in connection with the Notes. Such communications will take effect, in the case of a letter, when delivered or, in the case of a fax, when received. Communications not by letter shall be confirmed by letter but failure to send or receive the letter of confirmation shall not invalidate the original communication.

13. **CURRENCY INDEMNITY**

An amount received or recovered in a currency other than US dollars (the "**Contractual Currency**") (whether as a result of, or on the enforcement of, an arbitral award or judgment or order of a court of any jurisdiction or otherwise), by any of the Beneficiaries in respect of any sum expressed to be due to it from the Guarantor shall only discharge the Guarantor to the extent of the Contractual Currency amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so).

If that Contractual Currency amount is less than the Contractual Currency amount expressed to be due to the recipient under this Deed of Guarantee, the Guarantor shall indemnify it against any loss sustained by it as a result. In any event, the Guarantor shall indemnify the recipient against the cost of making any such purchase.

14. **GOVERNING LAW AND ARBITRATION**

14.1 **Governing Law.**

This Deed of Guarantee, including any non-contractual obligations arising out of or in connection with this Deed of Guarantee, is governed by, and shall be construed in accordance with, English law.

14.2 **Arbitration**

The Guarantor agrees that any claim, dispute or difference of whatever nature arising out of or in connection with this Deed of Guarantee, the Notes (including a claim, dispute or difference regarding existence, termination or validity or any non-contractual obligations arising out of or in connection with this Deed of Guarantee or the Notes) (a "**Dispute**"), shall be referred to and finally settled by arbitration in accordance with the London Court of International Arbitration ("**LCIA**") Rules (the "**Rules**") as in force at the Issue Date and as modified by this Clause, which Rules shall be deemed incorporated into this Clause. The number of arbitrators shall be three, one of whom shall be nominated by the claimant(s), one by respondent(s) and the third of whom, who shall act as presiding arbitrator, shall be nominated by the two party-nominated arbitrators, **provided that** if the claimant(s) or respondent(s) fail to nominate an arbitrator within the time limits specified by the Rules or the party-nominated arbitrators fail to nominate a presiding arbitrator within 30 days of the nomination of the second party-nominated arbitrator, such third arbitrator shall be appointed by the LCIA Court. The parties may nominate and the LCIA Court may appoint arbitrators from among the nationals of any country, whether or not a party is a national of that country. The seat of arbitration shall be London, England and the language of arbitration shall be English. Sections 45 and 69 of the Arbitration Act 1996 shall not apply.

14.3 **Service of Process**

The Guarantor has appointed the Ambassador of the Republic of Azerbaijan to the Court of St. James's at the Embassy of the Republic of Azerbaijan, currently located at 4 Kensington Court, London W8 5DL, as its agent for service of process in relation to any proceedings before the English courts permitted by the Rules in connection with an arbitral proceeding pursuant to Clause 14.2 (*Arbitration*), or in connection with the enforcement of any arbitral award rendered pursuant to Clause 14.2 (*Arbitration*) ("**Proceedings**") and hereby undertakes that, in the event of the Ambassador of the Republic of Azerbaijan to the Court of St James's ceasing so to act or ceasing to be located in England, it will appoint another person as its agent for the service of process in England for such purposes on the written demand of a Noteholder and, failing such appointment within 14 days, such Noteholder shall be entitled to appoint such a person by written notice to the Guarantor. Nothing in this paragraph shall affect the right of any Noteholder to serve process in any other manner permitted by law.

14.4 **Enforcement of Awards; Waiver of Immunity**

(a) Except as provided in this Clause 14.4, to the extent the Guarantor may in any jurisdiction claim for itself or its assets or revenues immunity from suit, arbitral process

or award, judgment, execution, attachment or other order (whether in aid of execution, before judgment or otherwise) or any other legal process in respect of, in support of or in connection with (i) any arbitration proceedings to resolve a dispute under Clause 14.2 (*Arbitration*) or (ii) any Proceedings, and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Guarantor or its assets or revenues, the Guarantor agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction (and consents generally to the giving of any relief or the issue of any process in connection with such Proceedings). The Guarantor does not waive any immunity with respect to: (a) any property, including any bank account, used by a diplomatic or consular mission of the Republic of Azerbaijan or its special missions or delegations to international organisations, (b) property of a military character or in use for military purposes and in each case under the control of a military authority or defence agency of the Republic of Azerbaijan or (c) property of the government of the Republic of Azerbaijan located in the territory of the Republic of Azerbaijan. The Guarantor reserves the right to plead sovereign immunity under the U.S. Foreign Sovereign Immunities Act of 1976 with respect to actions brought against it in any court of, or in, the United States of America under any United States federal or state securities law.

- (b) The Guarantor agrees that an arbitral award in connection with this Guarantee is conclusive and binding on it and may be enforced against it in the courts of any competent jurisdiction. In the event that the Guarantor fails to comply with an arbitral award and any Beneficiary or Beneficiaries, as the case may be, are thereby required to apply to any court for enforcement of such award, the Guarantor shall be liable to the Beneficiary or Beneficiaries for all costs of such enforcement, including reasonable legal fees.

15. **MODIFICATION**

The Fiscal Agency Agreement and the Conditions contain provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of this Deed of Guarantee. Any such modification may be made by supplemental deed poll if sanctioned by an Extraordinary Resolution and shall be binding on all Beneficiaries.

## **USE OF PROCEEDS**

The net proceeds of the issue of the Further Notes, after deduction of the total expenses related to the admission to trading, expected to amount to approximately US\$1,073,828,000, will be used to finance the Group's capital expenditure commitments relating to the Projects and for the Issuer's general corporate purposes.

## BUSINESS

### The Issuer

The Issuer was incorporated on 31 March 2014 pursuant to Presidential Decree No. 287 dated 25 February 2014 (the "**Presidential Decree**"). The Issuer was established to consolidate, manage and finance the Republic of Azerbaijan's interests in the Projects. The Issuer holds an economic interest in each, but is not the direct operator of, any of the Projects.

The Issuer's capital is directly and indirectly wholly owned by the Republic of Azerbaijan, with 51% of the Issuer's capital held by the Ministry of Economy of the Republic of Azerbaijan and 49% of the Issuer's capital held by SOCAR, which in turn is wholly owned by the Republic of Azerbaijan. As of 30 November 2016, the Issuer's share capital was US\$1,740.8 million. As of the date of this Prospectus, the Issuer's share capital is US\$2,415.8 million.

The Supervisory Board of the Issuer comprises the First Deputy Prime Minister (Chairman), the Minister of Energy, the Minister of Economy, the President of SOCAR and the Executive Director of SOFAZ. The State Commission, which was established in October 2013, oversees the Issuer's activities.

For the year ended 31 December 2015, the Group's total revenue was US\$151.5 million, its profit was US\$19.7 million and total comprehensive income was US\$7.2 million. For the eleven months ended 30 November 2016, the Group's total revenue was US\$103.4 million, its loss was US\$52.9 million and total comprehensive loss was US\$63.8 million. As of 30 November 2016, the Group's total assets were US\$7.98 billion and its total equity was US\$2.92 billion.

The business address of the Issuer is 121 Heydar Aliyev Avenue, SOCAR Tower, 4th floor, Baku, AZ1029, Azerbaijan, and its telephone number is +994 12 521 3091. The registered address of the Issuer is 73 Neftchilar Avenue, Baku, AZ1000, Azerbaijan.

### Overview of the Projects

The Southern Gas Corridor project aims to increase European energy supply by bringing gas resources from the Caspian Sea to markets in Europe. The Southern Gas Corridor comprises the following four projects (collectively, the "**Projects**"): (i) the full-field development of the Shah Deniz natural gas and condensate field (the "**Shah Deniz field**"), (ii) the expansion of the South Caucasus Pipeline ("**SCP**"), (iii) the construction of the Trans-Anatolian Natural Gas Pipeline ("**TANAP**") and (iv) the construction of the Trans Adriatic Pipeline ("**TAP**"). Day-to-day operations of each of the Projects are managed by their respective operating companies (each, an "**Operating Company**").

The Projects comprise upstream and midstream operations located principally in Azerbaijan as well as in Turkey. SCP transports natural gas from the Shah Deniz field to the Georgian-Turkish border. The gas transported through SCP will also be further transported via TANAP (once constructed) to consumers in Turkey as well as to Italy and other European countries through TAP which will run from the Turkish-Greek border via Greece and Albania across the Adriatic Sea to southern Italy. The Projects have been developed in partnership with major international companies in the oil and gas industry and anticipate the first deliveries of natural gas from the Shah Deniz field to Turkey in 2018 and the first deliveries of gas to European customers in 2020.

The Issuer, through its wholly owned subsidiary SGC Upstream LLC ("**SGC Upstream**"), has a 6.67% interest in the production sharing agreement (a "**PSA**") relating to the Shah Deniz field (the "**Shah Deniz PSA**"), which is operated by BP Exploration (Shah Deniz) Limited ("**BP**"), and a 5.336% share in Azerbaijan Gas Supply Company Limited ("**AGSC**"), which is a marketing vehicle of the parties to the Shah Deniz PSA in respect of the natural gas produced from the Shah Deniz field. Through its wholly owned subsidiary SGC Midstream LLC ("**SGC Midstream**"), the Issuer holds a 6.67% interest in the South Caucasus Pipeline Company Limited ("**SCPC**"), which owns the SCP. The SCP is operated, through SCPC, by BP (as technical operator) and SOCAR Midstream Operations LLC ("**SMO**") (as commercial operator). The Issuer also has a 58.0% share in TANAP Doğalgaz İletim A.Ş. ("**TANAP A.Ş.**"), which is the Operating Company for TANAP. In addition, the Issuer holds, through its wholly owned subsidiary AzTAP GmbH, a 20.0% share in Trans Adriatic Pipeline AG ("**TAP AG**"), which is the Operating Company for TAP. Operational management of the Issuer's stakes in the Projects is

conducted by SOCAR's affiliates, pursuant to an operator services agreement between the Issuer and some of its subsidiaries and SOCAR. See "*SOCAR Service Agreement*" for additional information.

The Shah Deniz field was discovered in 1999 and is considered one of the world's largest gas condensate fields, with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP. Total production from the Shah Deniz field during the period from 2007 to 2045 is expected to reach 458.8 billion cubic metres of natural gas and 616.1 million barrels of condensate, according to BP. In the year ended 31 December 2015, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.53 billion cubic metres and 0.97 million barrels, respectively. In the year ended 31 December 2016, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.59 billion cubic metres and 1.11 million barrels of condensate, respectively.

The following map shows the location of the Projects:



## History

On 29 October 2013, the President of Azerbaijan signed a decree establishing the State Commission with the purpose of overseeing and providing state support with respect to the effective and efficient implementation of the Projects. On 25 February 2014, the President of Azerbaijan signed a decree providing for establishing a company with the objective of consolidating, managing and financing the Republic of Azerbaijan's interests in the Projects. The Issuer was then incorporated on 31 March 2014.

In July 2014, the Issuer, through its subsidiary SGC Upstream, acquired a 6.67% participating interest in the Shah Deniz PSA and 5.336% of the shares in AGSC, which is a marketing vehicle of the parties to the Shah Deniz PSA in respect of the natural gas produced from the Shah Deniz field. SOCAR (in its capacity as the representative of the Republic) has a 20.0% interest in AGSC and the other participants in the Shah Deniz PSA hold the remaining 80.0% interest, proportionate to their interests in the Shah Deniz PSA. In July 2014, the Issuer also acquired, through its subsidiary SGC Midstream, 6.67% of the shares in SCPC. In addition, in July 2014 the Issuer acquired 100% of the shares of TANAP A.Ş., which was established for the implementation of the TANAP project within the territory of the Republic of Turkey. The Issuer then sold 12.0% and 30.0% of its shares in TANAP A.Ş. to BP Pipelines (TANAP) Limited and Boru Hatları ile Petrol Taşıma A.Ş. ("**BOTAŞ**"), respectively. An agreement to acquire 20.0% of the shares in TAP AG, established for the implementation of the TAP project, through the acquisition of 100% of the shares of AzTAP GmbH from SOCAR Energy Holdings AG, a subsidiary of SOCAR, was concluded in July 2014.

In July 2014, the Issuer, acting through SGC Upstream and SGC Midstream, signed a deferred sale and purchase agreement for the acquisition of a 10.0% participating interest in the Shah Deniz project, 8.0% of the shares in AGSC and 10.0% of the shares in SCPC from SOCAR's affiliates. Completion of the purchase is expected to take place in March 2023, subject to the satisfaction of certain conditions specified in the agreement. Pursuant to the terms of the agreement, as part of the purchase consideration SGC Upstream and SGC Midstream have agreed to pay until 31 December 2020 SOCAR affiliates' share of the capital expenditures relating to Shah Deniz 2 (as defined below) and the expansion of SCP.

## **Key Strengths**

The Issuer believes that its key strengths are:

- ***A strong relationship with the Government***

As a state-owned and controlled entity established to carry out the specified objectives of the Government, the Issuer benefits from a strong relationship with the Government. The Government has been assisting the Issuer by providing significant financial and strategic support and has played an important role in helping the Issuer to implement the Projects. Since the Issuer's incorporation in March 2014, the Government, directly and through SOCAR, has made contributions to the Issuer's capital totalling US\$2,415.8 million as of the date of this Prospectus.

The resolution of the State Commission dated 9 July 2014 (the "**State Commission Resolution**") provides for the financing of the Issuer through equity injections in amounts corresponding to the Issuer's forecasted capital expenditure obligations in relation to the Projects for the relevant period. In accordance with the Presidential Decree, the Ministry of Economy finances the Government's share of the equity contributions through funds received for that purpose from SOFAZ. Pursuant to the State Commission Resolution, SOCAR's portion of the equity contributions was carried out as follows: a portion of SOCAR's equity contributions in the Issuer was financed from the revenues received from the 10.0% interests held by SOCAR's affiliates in the Shah Deniz PSA and SCPC, and the remaining portion was provided by the Ministry of Finance to SOCAR from the State Budget.

Subsequent resolutions of the State Commission have further developed the existing framework. These resolutions provide that financing of the Projects is to be fulfilled using funds obtained by raising debt, and if necessary, by equity contributions from the Issuer's shareholders. These resolutions also provide that revenues deriving from 10% shares owned by SOCAR's affiliates in Shah Deniz PSA and SCP are to be used by these affiliates to cover a certain portion of their capital expenditures, while SOCAR will fund its obligations in the Issuer using the proceeds provided by the Ministry of Finance to SOCAR from the State Budget.

In addition, the Issuer's outstanding indebtedness comprises bonds issued in Azerbaijan and purchased by SOFAZ, which is required pursuant to the Presidential Decree to provide financial assistance to the Issuer in the form of long-term investments to enable it to meet its financial obligations relating to its holdings in the Projects. The Issuer's outstanding indebtedness also comprises the Original Notes as well as loans from the International Bank for Reconstruction and Development ("**IBRD**") and Asian Infrastructure Investment Bank ("**AIIB**"), all of which are guaranteed by the Government.

- ***Support from the European Union***

The European Union (the "**EU**"), through the European Parliament and the Council of the European Union, has provided support to the Southern Gas Corridor project and recognised it as an important component in achieving the objectives of its Europe 2020 Strategy. In December 2013, the EU specified the Southern Gas Corridor in its list of four priority gas corridors. The EU has also allocated €5.8 billion from the Connecting Europe Facility ("**CEF**") fund to several projects, including the Southern Gas Corridor project (there is no specific allocation of these funds among the projects).

TAP has also been included in the European Commission's ("**EC**") list of 33 priority energy security projects of common interest. In addition, in 2013 TAP secured an exemption from certain provisions of the EU Gas Directive 2009/73/EC (the "**EU Gas Directive**"), including a



third-party access exemption for the initial capacity of 10 billion cubic metres annually for gas volumes from Azerbaijan supplied under the relevant Shah Deniz gas sales agreements over a period of 25 years commencing from the date TAP's commercial operations begin. In April 2015, the regulatory authorities in TAP's host countries (Greece, Italy and Albania) updated TAP's exemption from certain provisions of the EU Gas Directive, in line with the planned commencement date of Shah Deniz 2 (as defined below) gas exports to Europe in 2020.

In 2015-2016, TANAP A.Ş. received several grants from the EC under the CEF in the total approximate amount of EUR 10.3 million to be used for environmental monitoring and engineering studies, pipeline monitoring and security, and design of commercial operations and asset integrity management systems.

In February 2017, the EC approved a CEF grant to TAP AG in the approximate amount of EUR 14 million to be used for conducting archaeological trial trench investigations and rescue excavations.

- ***Access to multiple sources of revenue***

The Group derives its revenue from its share of domestic and international sales of condensate and natural gas produced from Shah Deniz 1 (as defined below) and transportation tariffs earned by SCPC for transporting natural gas through SCP. The Group also expects to derive revenue from its shares of future international sales of condensate and natural gas produced from Shah Deniz 2 (as defined below) and transportation tariffs earned for transporting natural gas through SCP (after the expansion), TANAP and TAP once these projects are operational. Sales of natural gas from the Shah Deniz field are principally made under long-term sales contracts, which, in turn, creates more predictable margins for the sales of natural gas produced from the Shah Deniz field. The transportation tariffs are set on a long-term basis pursuant to long-term gas transportation agreements entered into between pipeline Project participants and are in most cases subject to relatively small automatic annual price escalation. Consequently, the structure of the Group's revenue base reduces the Group's exposure to fluctuations in international condensate and natural gas prices.

### **Issuer's Objectives**

Pursuant to the Presidential Decree, the Issuer was established to, and the Issuer's objectives are, to effectively and efficiently consolidate, manage and finance the Republic of Azerbaijan's interests in the Projects. The Issuer also seeks to diversify its funding base and potentially reduce its funding costs by, among other things, using other sources of debt financing, including commercial loans, loans from development finance institutions and debt capital markets.

### **The Projects**

The EU has expressed its strong support for the Southern Gas Corridor project and recognised it as an important component in achieving the objectives of its Europe 2020 Strategy. In Regulation (EU) No 1316/2013 dated 11 December 2013, the EU included the Southern Gas Corridor as one of its four priority gas corridors. The Projects, which comprise upstream and midstream operations located principally in Azerbaijan as well as in Turkey, form a core part of the Southern Gas Corridor project. The Projects comprise: (i) the full-field development of the Shah Deniz field, (ii) the expansion of the SCP, (iii) the construction of TANAP, and (iv) the construction of TAP. The Projects have been developed in partnership with the major companies in the oil and gas industry and envision first gas deliveries from the Shah Deniz field to Turkey in 2018 and first gas deliveries to European customers in 2020. The Projects have an estimated investment cost of approximately US\$43 billion and are expected to increase gas production by 16 billion cubic metres and extend the current pipeline network by 3,185 kilometres.

The Issuer, SGC Midstream LLC and SGC Upstream LLC are registered in Azerbaijan. AzTAP GmbH and Trans Adriatic Pipeline AG are registered in Switzerland. AGSC and the South Caucasus Pipeline Company Limited are registered in the Cayman Islands and TANAP Doğalgaz İletim A.Ş. is registered in Turkey.

## Shah Deniz

### Overview

On 4 June 1996, SOCAR and other international oil companies signed a PSA for the exploration, development and production of the Shah Deniz prospective area in the Azerbaijani region of the Caspian Sea. The Shah Deniz field was discovered in 1999 and is considered one of the world's largest gas condensate fields, with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP. The Shah Deniz field is located in water depths ranging from 50 metres to 500 metres on the deep water shelf of the Caspian Sea, approximately 70 kilometres south-east of Baku. Natural gas from the Shah Deniz field is transported via subsea pipelines to the Sangachal Terminal located on the coast of the Caspian Sea 55 kilometres south of Baku. From the Sangachal Terminal's gas processing facilities gas is then transported to SOCAR's pipeline, which is connected to Azerbaijan's national grid system while the remaining gas is exported via SCP.

Through its wholly owned subsidiary SGC Upstream, the Issuer holds a 6.67% interest in the Shah Deniz PSA entered into in connection with the development and exploitation of the Shah Deniz field and expiring in 2036, with extension until 2048 subject to the fulfilment of certain conditions. This interest was acquired by SOCAR's affiliate from Statoil Shah Deniz A.S. in December 2013 and was subsequently transferred to SGC Upstream. The Issuer's 5.336% stake in AGSC was purchased as part of SGC Upstream's acquisition of its interest in the Shah Deniz PSA.

Due to various factors, including production volumes of natural gas and condensate, estimated and carried forward operating costs, capital expenditures and finance costs, the State's share of revenues and production volumes and the reconciliation of provisional entitlement percentages with actualised ones for the past periods, the effective economic interest of a Shah Deniz PSA contractor party in the field (specifically, its proportion of revenues from the sales of natural gas and the volume of condensate received from the field and sold by it) is typically not equal to its share in the Shah Deniz PSA and is also subject to fluctuations from period to period. Between July 2014 (when the Issuer joined the Shah Deniz consortium) and 31 December 2016, the proportion of the Shah Deniz PSA contractor parties' (including the Group's) entitlements to gas revenues and condensate volumes from Shah Deniz field fluctuated from quarter to quarter between approximately 74.51% and 85.36%. Consequently, the Group's proportion of revenues from the sales of natural gas and condensate from the Shah Deniz field during that period varied from quarter to quarter from approximately 4.97% to approximately 5.69%. The Group expects that in the future, its share of revenues from the sales of gas and condensate from the Shah Deniz field (including Shah Deniz 2 (as defined below)), relating to 6.67% participating interest in the Shah Deniz PSA, will be in the range of between approximately 5.40% and 6.52%. It is expected that upon completion of the deferred sale of a 10.0% participating interest in the Shah Deniz project in 2023, the Group's share of revenues from the sales of gas and condensate from the Shah Deniz field (including Shah Deniz 2 (as defined below)), relating to 10.0% participating interest in the Shah Deniz PSA, will be in the range of between approximately 8.10% and 9.77%. Therefore, after acquiring this 10.0% participating interest in the Shah Deniz PSA, the Group's overall share of revenues from the sales of gas and condensate from the Shah Deniz field ((including Shah Deniz 2 (as defined below)), relating to 16.67% participating interest in the Shah Deniz PSA, is expected to be in the range of between approximately 13.51% and 16.29%.

The Shah Deniz PSA is in effect until 2036 with extension until 2048, subject to the fulfilment of certain conditions, and the remaining participating interests are held by BP (28.83%), Turkish Petroleum Overseas Company Limited (19.0%), PETRONAS Azerbaijan (Shah Deniz) Sarl (15.5%), Azerbaijan (Shah Deniz) Limited ("**AzSD**") (10.0%), LUKOIL Overseas Shah Deniz Limited (10.0%) and Naftiran Intertrade Co. (NICO) Limited (10.0%). In July 2014, AzSD, a subsidiary of SOCAR, and SGC Upstream entered into a deferred sales agreement to sell AzSD's 10.0% interest in the Shah Deniz PSA and 8.0% of the shares in AGSC to SGC Upstream. This sale is expected to close in 2023. Pursuant to the terms of this agreement, until 31 December 2020 the Issuer undertook to fund the AzSD's capital expenditure commitments in relation to the Shah Deniz 2 (as defined below) project as part of the sale consideration.

As noted above, the United States government has imposed certain sector specific economic sanctions on Iran. The Shah Deniz operation and its marketing (AGSC) and pipeline entities in which the Issuer and NICO (whose entities are indirectly owned by the Iranian government) have an interest, were excluded from the application of the US sanctions (as well as from similar recently-lifted EU sanctions), as they

fall within exceptions for certain natural gas projects. Shah Deniz 2 is also excluded from the US sanctions.

BP operates the Shah Deniz field on behalf of the other parties to the Shah Deniz PSA. See "*Regulation of the Hydrocarbons Sector in Azerbaijan—PSAs*".

### **Reserves**

The Shah Deniz field was discovered in 1999 and is considered one of the world's largest gas condensate fields, with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP. Total production from the Shah Deniz field during the period from 2007 to 2045 is expected to reach 458.8 billion cubic meters of natural gas and 616.1 million barrels of condensate, according to BP.

### **Production**

The following table sets forth natural gas and condensate production volumes from Shah Deniz 1 (as defined below) for the years indicated.

<b>Output of Shah Deniz 1</b>	<b>For the year ended 31 December</b>					
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Natural gas (billion cubic metres) .....	6.73	7.80	9.78	9.86	9.88	10.67
Condensate (million barrels) .....	13.97	16.15	19.61	18.68	18.28	20.14

Source: BP

In the year ended 31 December 2015, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.53 billion cubic metres and 0.97 million barrels, respectively. In the year ended 31 December 2016, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.59 billion cubic metres and 1.11 million barrels, respectively.

The gas buyers of Shah Deniz 1 are BOTAS, Georgian Oil and Gas Corporation, SOCAR, South Caucasus Pipeline Option Gas Company Limited and Baku-Tbilisi-Ceyhan-Pipeline Company.

### **Marketing**

SGC Upstream holds 5.336% of the shares in AGSC, which is a marketing vehicle of the parties to the Shah Deniz PSA in respect of the natural gas produced from the Shah Deniz field. SOCAR (in its capacity as the representative of the Republic) has a 20.0% interest in AGSC and the other participants in the Shah Deniz PSA hold the remaining 80.0% interest, proportionate to their interests in the Shah Deniz PSA. The Issuer's stake in AGSC was purchased as part of SGC Upstream's acquisition of its interest in the Shah Deniz PSA.

### **Development Stages**

There are two stages to the Shah Deniz field's development.

Stage 1 of the Shah Deniz field's development ("**Shah Deniz 1**") commenced in 1999 and was completed and began operations in 2006. As part of Shah Deniz 1, nine wells have been drilled (as of 31 December 2016) and a platform, onshore terminal and 692 kilometres of pipeline (SCP) to Turkey have been constructed. The current maximum production rate from Shah Deniz 1 development is approximately 10 billion cubic metres of natural gas per annum and approximately 45 thousand barrels of condensate per day.

Stage 2 of the Shah Deniz field's development ("**Shah Deniz 2**") commenced in 2014 and comprises the full field development of the Shah Deniz field and is the first subsea infrastructure in the Caspian Sea. The project includes two new bridge-linked offshore platforms, 26 gas production wells to be drilled with two semi-submersible rigs, 500 kilometres of subsea pipelines linking the wells with the offshore platform and onshore terminal, new gas and condensate processing facilities with an expanded compressor at Sangachal, upgrade of the offshore construction vessel and building a new subsea construction vessel. Shah Deniz 2 is expected to provide an additional approximately 16 billion cubic

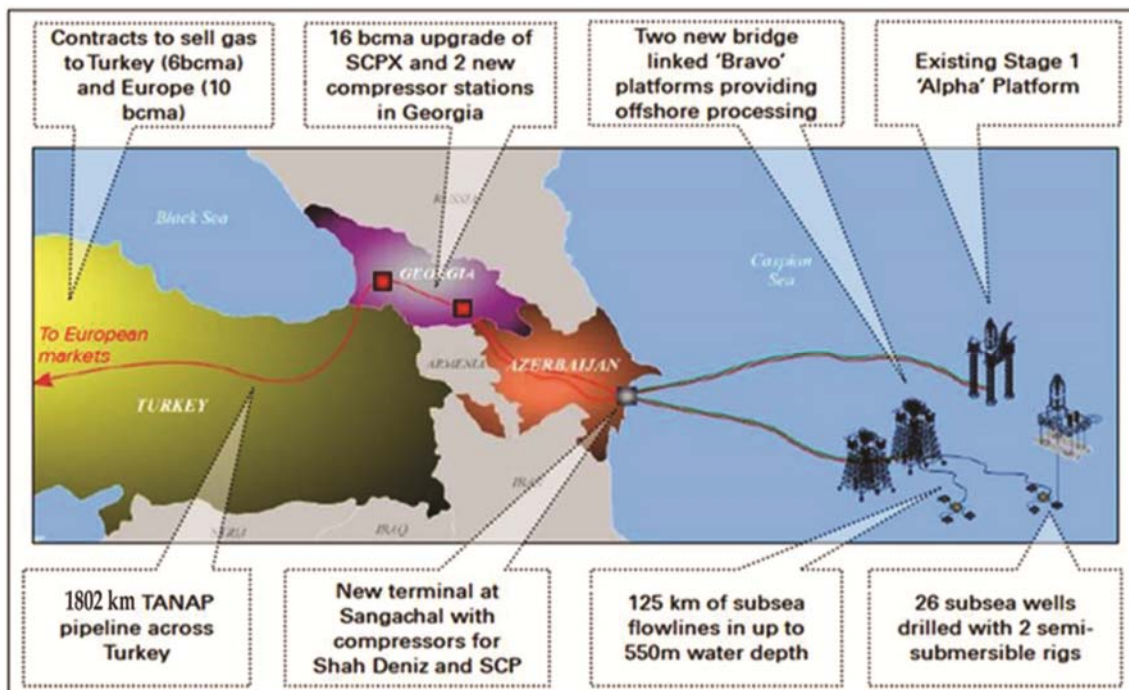
meters of natural gas per annum (plateau annual average) through the expansion of the SCP to approximately 23.4 billion cubic metres per annum. This additional volume is expected to be exported to the European Union, as well as to existing markets in Georgia and Turkey. On 19 September 2013, long-term gas sales agreements were signed with nine European companies for the sale of approximately 10 billion cubic metres of gas per annum for a period of 25 years. Shah Deniz 2 is also intended to deliver an additional up to 105 thousand barrels of condensate per day through the construction of new offshore platforms, wells, subsea pipelines and the expansion of the Sangachal Terminal.

**General Overview of the Principal Shah Deniz Value Chain Pipelines**

At present, condensate and natural gas from the Shah Deniz field are transported via subsea pipelines to the Sangachal Terminal, approximately 55 kilometres south of Baku. As of the date of this Prospectus, the daily capacity of the terminal’s processing systems is approximately 1.2 million barrels of oil and approximately 29.5 million cubic metres of natural gas from the Shah Deniz field, while the terminal’s overall processing and export capacity for natural gas, including the gas from the Azeri-Chirag-Gunashli field, is approximately 49.3 million cubic metres per day. From the Sangachal Terminal’s gas processing facilities gas is then transported to SOCAR’s pipeline, which is connected to Azerbaijan’s national grid system, while the remaining gas is exported via SCP. As part of Shah Deniz 2, the capacity of the Sangachal Terminal is expected to be increased to allow it to process an additional 16 billion cubic metres of gas per year. This expansion project is ongoing.

Shah Deniz 2 is expected to add approximately 16 billion cubic meters of natural gas per annum to the approximately 10 billion cubic meters of natural gas currently produced annually from Shah Deniz 1. From the additional 16 billion cubic meters of natural gas, approximately 6 billion cubic metres is expected to be delivered to Turkey through the expanded SCP and TANAP and approximately 10 billion cubic metres is expected to be supplied to the European customers through the expanded SCP, TANAP and TAP. See "—South Caucasus Pipeline (SCP)", "—Trans-Anatolian Pipeline Project (TANAP)" and "—Trans Adriatic Pipeline Project (TAP)" for more information regarding the SCP expansion, TANAP and TAP projects.

The following map shows the location of the Shah Deniz field and related pipelines and infrastructure:



**Capital and Operating Expenditures**

The total capital and operating expenditures relating to Shah Deniz 1 were approximately US\$9.5 billion as of 31 December 2016.

On 17 December 2013, the Shah Deniz consortium announced the final investment decision for the development of Shah Deniz 2 and signed certain addendums to the Shah Deniz PSA, according to which the parties agreed to extend the development and production period to 47 years from 7 March 2001, subject to fulfilment of certain conditions precedent. At least US\$25 million is expected to be spent by the consortium parties in order to undertake an appraisal plan to evaluate further three additional prospective areas of the contract area. According to the Shah Deniz 2 estimates, total capital expenditures for the project are expected to be approximately US\$24.9 billion, of which US\$14.5 billion has been spent as of 31 December 2016.

The Issuer's interest in the Shah Deniz PSA is 6.67%. In addition, under the terms of the deferred sale agreement entered into in July 2014 between AzSD, a subsidiary of SOCAR, and SGC Upstream (pursuant to which AzSD has agreed to sell its 10.0% interest in the Shah Deniz PSA and 8.0% of the shares in AGSC to SGC Upstream with a deferred closing in 2023, subject to fulfilment of certain conditions), effective from July 2014 and until 2020 the Issuer undertook to fund the AzSD's capital expenditure commitments in relation to the Shah Deniz 2 project as part of the sale consideration. As a result, the Issuer's total share in the capital expenditure commitments relating to the Shah Deniz 2 project is 16.67%.

### ***Current Status of Shah Deniz 2***

As of 31 December 2016, most of the major engineering, construction and supply contracts, valued at approximately US\$8.8 billion, have been awarded and work has commenced in all construction areas in the project area. The project is currently progressing, with wide scale activities ongoing at all sites and fabrication yards, including the Sangachal terminal, the ATA (AMEC/Tekfen/Azfen) fabrication yard near Baku, Baku Deepwater Jackets Factory and along the pipeline route. Of the 26 subsea planned gas/condensate producer wells, dry hole drilling operations on 12 subsea gas/condensate producer wells have already been completed. As of 31 December 2016, progress made to first gas production was 89.1%.

As of 31 December 2016, 78.35 billion cubic metres of natural gas and 156.61 million barrels of condensate had been produced, of which 26.60 billion cubic metres of natural gas have been sold to Azerbaijan, 43.77 billion cubic metres of gas have been sold to Turkey, 5.78 billion cubic metres of gas have been sold to Georgia and 1.34 billion cubic metres of gas have been sold to BTC Co., the company operating the Baku-Tbilisi-Ceyhan Pipeline (the "BTCP").

Initial exports of gas from Shah Deniz 2 to Turkey are expected to commence in 2018 and to Europe in 2020.

The gas buyers of Shah Deniz 2 will be BOTAS, Axpo Trading, Hera, ENEL, ENGIE (formerly known as GDF Suez), Shell, Gas Natural Aproveisionamientos, Uniper (formerly known as E.ON), DEPA and Bulgargaz.

### **South Caucasus Pipeline (SCP)**

#### **Overview**

In March 2001, the Turkish Government agreed to purchase natural gas produced from the Shah Deniz field over a 15-year period, beginning with 2 billion cubic metres, 3 billion cubic metres and 5 billion cubic metres in 2004, 2005 and 2006, respectively, and 6.6 billion cubic metres per annum over the remaining period from 2007 until 2021. SCP was constructed to transport natural gas from the Shah Deniz field to the Sangachal Terminal and then through Azerbaijan and Georgia to the Georgian-Turkish border and, once the SCP expansion project is completed, for further transportation through TANAP across Turkey towards Europe. SCP is also connected to the Turkish internal gas pipeline system at the border with Turkey, allowing gas to be exported from Azerbaijan to Turkey for domestic consumption. To mitigate the environmental impact from the project, SCP was built in the same corridor as BTCP. The pipeline was commissioned in June 2006. First commercial deliveries of natural gas through the pipeline commenced in December 2006.

As of 31 December 2016, SCP was 692 kilometres in length, with the segment in Azerbaijan totalling 443 kilometres and the segment in Georgia totalling 249 kilometres. SCP is a 42 inch diameter pipeline and has a current capacity of 7.41 billion cubic metres per annum. As of 31 December 2016, the SCP's facilities included a head compressor station in the Sangachal Terminal, three pig launcher and two pig

receiver stations and off-take areas in Georgia and 11 block valves (five in Azerbaijan and six in Georgia).

In the year ended 31 December 2016 and in the years 2015, 2014 and 2013, approximately 7.27, 6.8, 6.7 and 4.9 billion cubic metres, respectively, of natural gas was transported through SCP (including deliveries to BTC), representing approximately 24.8%, 23.4%, 22.6% and 16.6%, respectively, of the total natural gas produced in Azerbaijan in the respective years.

The technical and commercial operators of SCP are BP and SMO, respectively. SCPC is a joint venture that owns, operates and maintains SCP. In December 2013, SOCAR (through its subsidiary Azerbaijan (South Caucasus Pipeline) Limited) ("**AzSCP**") contracted to purchase a 6.67% interest in the SCPC from Statoil Azerbaijan A.S. and subsequently transferred it to the Issuer. As a result, SGC Midstream, a wholly owned subsidiary of the Issuer, holds a 6.67% interest in SCPC. As of 30 November 2016, the remaining direct and indirect shareholders of SCPC were as follows: BP Pipelines (SCP) Limited (28.83%), Turkish Petroleum SCP Limited (19.0%), PETRONAS South Caucasus S.A.R.L. (15.5%), AzSCP (10.0%), LUKOIL Overseas Shah Deniz Midstream Limited (10.0%) and NICO SPV Limited (10.0%).

In July 2014, AzSCP, a subsidiary of SOCAR, entered into a deferred sale and purchase agreement with SGC Midstream to sell AzSCP's 10% interest in the SCPC to SGC Midstream. This sale is expected to close in 2023. Pursuant to the terms of this agreement, until 31 December 2020 the Issuer undertook to fund the AzSCP's capital expenditure commitments in relation to SCP as part of the sale consideration.

### ***South Caucasus Pipeline Expansion***

In 2007, the governments of Azerbaijan and Turkey entered into an agreement for the sale and transit of gas across Turkey, under which SOCAR will supply approximately 89.2 billion cubic metres of gas over a 15-year period. Sales and transit began in the first quarter of 2007. On 25 October 2011, several additional agreements were signed in Izmir, Turkey in respect of the transportation and export of gas produced at Shah Deniz, including, *inter alia*, an intergovernmental agreement between the Government and the government of the Republic of Turkey and gas sales and transit agreements between SOCAR and BOTAS, the Turkish state-owned pipeline company. The signing was attended by the President of the Republic of Azerbaijan and the Prime Minister of the Republic of Turkey, as well as other top officials from both countries. The agreements provide a legal framework to regulate the sale of Shah Deniz gas to Turkey and its transportation to European markets through Turkey. SCP extends through Azerbaijan and Georgia and, after the expansion, it will be linked to TANAP at the Georgian-Turkey border, which is expected to enable the transportation of natural gas further into Turkey and to Europe.

The planned SCP expansion is an integral part of the Southern Gas Corridor project. With effect from 17 December 2013, SCPC committed to the transportation of Shah Deniz 2 natural gas through the expansion of SCP to increase its throughput capacity. As a result of the expansion, SCP's throughput capacity is expected to reach approximately 23.4 billion cubic metres annually, which would triple the current overall transportation capacity of the system. The SCP expansion envisions the construction of a new 48 inch diameter pipeline (by means of a pipeline loop) in Azerbaijani and Georgian territories that will run alongside the existing SCP pipeline for 487 kilometres, of which 424 kilometres will be in Azerbaijan, 61 kilometres in Georgia and 2 kilometres in TANAP interconnection. The new pipeline will be divided into four construction sections, with three in Azerbaijan and one in Georgia. The project also includes the expansion of the Sangachal Terminal to accommodate the new gas procession and compression facilities, the construction of cross-border metering and pigging facilities, which will tie-in to the existing SCP pipeline to avoid interruptions to gas supply, and the construction of two new compressor stations in Georgia and six new block valve stations (five of which will be in Azerbaijan and one in Georgia).

SCP expansion project is expected to be completed in 2018.

### ***Capital Expenditures***

The total costs of the SCP expansion project are expected to amount to US\$4.8 billion, of which approximately US\$3.2 billion has been spent as of 31 December 2016. The Issuer's interest in SCPC is 6.67%. In addition, under the terms of the deferred sale agreement entered into between AzSCP, a subsidiary of SOCAR, and SGC Midstream in July 2014 (pursuant to which AzSCP has agreed to sell its

10.0% interest in SCPC to SGC Midstream with a deferred closing in 2023, subject to fulfilment of certain conditions), effective from July 2014 and until 2020 the Issuer undertook to fund the AzSCP's capital expenditure commitments in relation to the SCP expansion project as part of the sale consideration. As a result, the Issuer's total share in the capital expenditure commitments relating to SCP expansion project is 16.67%.

### ***Current Status of South Caucasus Pipeline Expansion***

In 2014, most of the major contracts were awarded and work commenced along the pipeline route across Azerbaijan and Georgia. Shipments of pipe sections also began in 2014, which continued in 2015 and were completed in the second quarter of 2016.

As of 31 December 2016, key achievements in the expansion project include the acquisition of all required ownership rights or rights of way for the SCP expansion project in Azerbaijan and Georgia, commencement of construction of two compressor stations in Georgia (construction of Compressor Stations 1 and 2 in Georgia was 92% and 58% complete, respectively) and the completion of the stockpile of pipes at pipe storage yards (shipments of pipe sections started in 2014 and continued until May 2016. In total, over 40,000 sections of pipe were delivered in 19 shipments). Approximately 77% of the overall project was complete as of 31 December 2016.

### **Trans-Anatolian Natural Gas Pipeline Project (TANAP)**

#### ***Overview***

TANAP will connect directly to SCP on the Turkey-Georgia border and to TAP on the Turkish-Greek border. In December 2011, the Government entered into a Memorandum of Understanding with the Government of Turkey in relation to the construction of TANAP. TANAP is of significant economic importance to both countries, as it is expected to generate state revenues, create jobs and have other developmental and social benefits. In June 2012, further documentation was signed in connection with the TANAP project, including an inter-governmental agreement between the Government and the Government of Turkey (which was ratified by the respective legislative bodies of each country), a preliminary agreement relating to organisational issues between SOCAR and BOTAS, and a host country agreement between the Government of Turkey and the project company. In addition to transporting natural gas from the Shah Deniz field to European end customers, it is envisioned that TANAP may also be used to transport natural gas from other gas fields in Azerbaijan. TANAP is expected to commence operations in 2018.

The total length of the pipeline is expected to be 1,802 kilometres, of which 1,334 kilometres of the pipeline with a 56 inch diameter will cover the segment from the Georgian-Turkish border to the town of Eskişehir, 450 kilometres of the pipeline with a 48 inch diameter will span from Eskişehir to the Turkish-Greek border, and 18 kilometres of a dual pipeline with a diameter of 36 inches each will be in the Dardanelles. In addition to the pipeline, the TANAP project includes seven compressor stations, four measuring stations, 11 pigging stations, 49 block valve stations and two take-off stations to supply Turkey's national natural gas network. The initial annual capacity of the pipeline is expected to be 16 billion cubic metres by the end of 2018 (of which 10 billion cubic metres is expected to be allocated for deliveries to Europe and 6 billion cubic metres to Turkey). The expansion of the TANAP's initial capacity to 31 billion cubic metres per annum is planned by 2026.

The TANAP project is owned and operated by TANAP A.Ş. In July 2014, SOCAR sold its 100.0% stake in TANAP A.Ş. to the Issuer. In May 2014, SOCAR signed a share purchase agreement to sell a 30.0% interest in TANAP A.Ş. to BOTAS, the Turkish state-owned gas company, which was subsequently novated to refer to the Issuer as a seller in July 2014. The Issuer subsequently in April 2015 sold a 12.0% stake in TANAP A.Ş. to BP Pipelines (TANAP) Limited. As a result, as of 30 November 2016 the shareholders of TANAP A.Ş. were as follows: the Issuer (58.0%), BOTAS (30.0%) and BP Pipelines (TANAP) Limited (12.0%). The Issuer is considering selling a 7.0% interest in TANAP A.Ş. to SOCAR Turkey Enerji A.Ş. in 2017. Following the sale, the Group will continue to own a controlling interest in TANAP.

The EU has expressed its support for the TANAP project. See "*Key Strengths—Support from the European Union*" for more details. For example, in 2015 TANAP A.Ş. contracted to receive two grants from the EC under the CEF in the total approximate amount of EUR 4.6 million to be used for

environmental monitoring and engineering studies, respectively. In April 2016, TANAP A.Ş. contracted to receive a grant from the EC in the approximate amount of EUR 2.2 million through the CEF to be used for detailed engineering for stations, pipeline monitoring systems and security. In November 2016, TANAP A.Ş. contracted to receive a grant from the EC in the approximate amount of EUR 3.5 million through the CEF to be used for design of commercial operations and asset integrity management systems.

### ***Capital Expenditures***

The total cost of TANAP project is expected to be approximately US\$8.5 billion, of which approximately US\$3.5 billion has been spent as of 31 December 2016.

In addition, pursuant to the terms of the inter-governmental agreement between the Government and the Government of Turkey, in May 2014 SOCAR and Boru Hatlari ile Petrol Taşıma A.Ş. ("**BOTAŞ**") entered into a funding agreement for financing BOTAŞ' 5.0% interest in TANAP A.Ş. In March 2015, the Issuer entered into a novation agreement with SOCAR and BOTAŞ, where all rights and obligations under the funding agreement were transferred from SOCAR to the Issuer. According to its agreement with BOTAŞ, the Issuer has a commitment to finance BOTAŞ' 5.0% interest in TANAP's future cash call requirements until TANAP becomes operational. As a result, the Issuer's total share in capital expenditure commitments relating to the TANAP project is 63.0%.

### ***Current Status***

In October 2014, contracts for the supply of pipes for the construction of TANAP were signed. In December 2014, Fernas Construction, Sicim-Yuksel-Akkord Consortium and Tekfen Construction were chosen as contractors for the overland construction of TANAP. Two more overland construction contracts were awarded to Punj Lloyd Limited-Limak İnşaat Sanayi ve Ticaret A.Ş.-Kalyon Construction Consortium and Fernas Construction in January and September 2016, respectively. The construction of TANAP commenced in March 2015. Approximately 62% of the overall project was complete as of 31 December 2016.

## **Trans Adriatic Pipeline (TAP)**

### ***Overview***

TAP will connect directly to TANAP on the Turkish-Greek border and transport gas via Greece and Albania, across the Adriatic Sea to southern Italy. The TAP project is expected to play a key role in the EU's strategic goal of energy security and diversification of energy sources as it will be the shortest and most direct method of exporting gas from Azerbaijan to European markets.

The total length of TAP is expected to be 878 kilometres, of which 550 kilometres will be in Greece, 215 kilometres in Albania, 105 kilometres will run across the Adriatic Sea and 8 kilometres will be in Italy. The diameter of the pipeline is expected to be 48 inches, except for the subsea sections which will be 36 inches in diameter. The initial capacity of the pipeline is expected to be 10 billion cubic metres per annum, expandable to 20 billion cubic metres if needed. The TAP is also expected to have "physical reverse flow" features, which will allow gas from Italy to be diverted to Southeast Europe, if required. TAP is expected to become operational in 2019, with the first gas deliveries to European customers expected in 2020.

In August 2012, the then existing shareholders of the TAP project entered into a funding agreement with the consortium, which included an option for the consortium participants to obtain up to 50% of the equity interest in the project. In January 2013, a joint declaration was signed between the existing shareholders in the TAP project and the consortium, which provided for funding, as well as an option for the consortium participants to obtain up to 50% of the equity interest in the project. In February 2013, Albania, Italy and Greece entered into an intergovernmental agreement in support of TAP. On 28 June 2013, TAP was selected by the Shah Deniz consortium as the preferred gas transportation route to Europe, following an intensive evaluation.

In July 2013, SOCAR, BP plc and Total, acting through their respective subsidiaries (SOCAR Gas Pipelines GmbH (now called AzTAP GmbH ("**AzTAP**")), BP Gas Marketing Limited and Total Gas Transport Ventures S.A.S), exercised their option to join the TAP project. SOCAR and BP plc acquired a 20.0% interest each in TAP AG, the company which owns and operates the TAP project, while Total acquired a 10.0% interest. In December 2013, the shareholders of TAP passed the resolution to construct



TAP. In July 2014, the Issuer acquired 20.0% interest in the TAP project by purchasing AzTAP. In September 2014, Total and E.ON sold their interests in the TAP project (10.0% and 9.0%, respectively) to Fluxys Europe B.V., increasing its ownership interest from 16.0% to 19.0%, and Enagás, which acquired a 16.0% ownership interest. The other participants in the TAP project are Snam S.p.A. (20.0%), which acquired its shareholding from Statoil Holdings Netherlands B.V. in late 2015, and Axpo Trading AG (5.0%). As of 30 November 2016, the shareholders of TAP were as follows: BP Pipelines TAP Limited (20.0%), AzTAP (20.0%), Snam S.p.A. (20.0%), Fluxys Europe B.V. (19.0%), Enagas Internacional S.L.U. (16.0%) and Axpo Trading AG (5.0%).

The EU has expressed its support for the TAP project. In February 2017, the EC approved a CEF grant to TAP AG in the approximate amount of EUR 14 million to be used for conducting archaeological trial trench investigations and rescue excavations.

### ***Capital Expenditures***

The total capital expenditures relating to the TAP project are expected to be approximately €4.5 billion, of which approximately €1.5 billion has been spent as of 31 December 2016. The Issuer has a 20.0% share in such commitments, which is proportionate to its economic interest in the project.

### ***Current Status***

TAP AG is currently in the process of obtaining the relevant land rights. In December 2015 and March 2016, key construction contracts were awarded. In May 2016, the TAP groundbreaking ceremony was held in Greece with high-level diplomatic and private sector guests in attendance. Approximately 33.7% of the overall project was complete as of 31 December 2016.

### ***SOCAR Service Agreement***

In December 2014, the Issuer and some of its subsidiaries entered into an operator services agreement with SOCAR, which came into effect on 1 January 2015. Pursuant to the agreement, operational management of the Issuer's stakes in the Projects is conducted by SOCAR's affiliates on a no profit and no loss basis, with all costs and expenses incurred by SOCAR and its affiliates invoiced to and paid by the Issuer. The term of the agreement is 25 years.

### ***Employees***

As of the date of this Prospectus, the Issuer has no vacant employment positions. All of the employees were based in the Issuer's head office. None of the Issuer's employees are unionised. The Issuer has experienced no material labour disputes or strikes and considers the relations with its employees to be good.

### ***Litigation***

There are no governmental, legal or arbitration proceedings, including any such proceedings pending or threatened of which the Issuer is aware, during the last 12 months preceding the date of this Prospectus, which may have, or have had in the recent past, significant effects on the financial position or profitability of the Issuer or the Group.

### ***Insurance***

As it is not an operating company of any of the Projects, the Issuer does not maintain insurance other than insurance required under applicable legislation. The Operating Companies maintain insurance for the Projects and the terms of their insurance coverage are generally similar to those that are generally accepted in the oil and gas industry and are tailored to address the specific activities of the relevant Operating Company. The Operating Companies' insurance coverage generally includes employer's liability insurance, hazardous object insurance and directors' and officers' liability insurance and also covers property.

In addition, the Shah Deniz field Operating Company's insurance covers third party liability, terrorism insurance and insurance for damages from sudden and accidental pollution events. There is no cover for environmental damage resulting in gradual pollution. The Operating Companies' insurance relating to TANAP and TAP projects includes coverage for environmental damage caused by the relevant Operating

Company's operations, sabotage or terrorism. In case of SCP, there is no specific environmental liability cover but SCP's insurance coverage includes conventional third party liability insurance which includes cover for damages resulting from sudden and accidental pollution.

Under the Law on Compulsory Insurance, which came into force in October 2011, the Operating Companies (to the extent operating in Azerbaijan) are also required to maintain immovable property insurance and related third-party liability insurance. The new law has removed the legal requirement to maintain environmental insurance; however, it is expected that environmental damage will be covered by other types of insurance (such as liability insurance for damage caused by hazardous objects) and the new requirement for liability insurance for holders of immovable property. When entering into joint ventures or other partnerships, although the Issuer seeks to require partners to obtain the maximum amount of environmental liability insurance reasonably available, availability is often limited. The Issuer does not have a general insurance policy to cover environmental risks. Implementation of the Law on Compulsory Insurance is being phased in and the Issuer has not yet obtained the new mandatory policies.

See "*Risk Factors—Risk Factors Relating to the Issuer's Business and Industry—The Operating Companies' insurance coverage may not be adequate to cover losses arising from potential operational hazards and unforeseen interruptions*" and "*Regulation of the Hydrocarbons Sector in Azerbaijan-Other regulatory requirements-Mandatory insurance*".

### **Information Technology**

The IT management of the Operating Companies is undertaken by their respective IT departments, which generally provide the relevant Operating Company's telecommunication services, implement automatic processing control systems, develop integrated software, create databases, organise management systems, develop and implement the IT network, which includes organising the tracking of documents and the exchange of information on the network, and provide network security.

### **Anti-Bribery and Anti-Corruption**

The Issuer adopted in mid-2015 internal policies relating to anti-bribery and anti-corruption. The policies have been prepared with the assistance of external advisers and are based on international anti-corruption conventions and applicable laws (including Azerbaijani law). In addition, the Issuer's policy is to comply with applicable foreign laws and it regularly agrees to abide by similar policies of its international counterparties.

Pursuant to these policies, the Issuer has implemented a number of measures, including KYC checks in respect of counterparties, prohibitions and restrictions on accepting gifts, and certain employment practices intended to reduce, among other things, close family members and other related parties from working in the same unit.

See "*Risk Factors—Risk Factors Relating to the Republic of Azerbaijan—Change in the political, economic and legal climate could disrupt the Issuer's ability to conduct business and could adversely affect its business and prospects.*"

## SELECTED FINANCIAL AND OTHER INFORMATION

The financial information of the Group set forth below as of and for the eleven months ended 30 November 2016, as of and for the eleven months ended 30 November 2015, as of and for the year ended 31 December 2015 and as of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014 has been extracted from, should be read in conjunction with, and is qualified in its entirety by, the Financial Statements, including the notes thereto, contained elsewhere in this Prospectus.

Prospective investors should read the selected financial and other information in conjunction with the information contained in the "Risk Factors", "Management's Discussion and Analysis of Results of Operations and Financial Performance", "Business" and the Financial Statements, including the notes thereto, and other financial data appearing elsewhere in this Prospectus.

### Selected Financial Information

#### Consolidated Statement of Financial Position

	As of 30 November 2016	As of 31 December 2015	As of 31 December 2014
	(unaudited)		
	(US\$ thousands)		
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents .....	438,663	254,560	212,198
Deposits .....	—	—	33,246
Accounts receivable .....	11,476	19,004	36,820
Accrued revenue .....	2,293	3,119	13,118
Inventories .....	10,338	9,335	13,152
Other current assets .....	33,450	37,924	38,214
<b>Total current assets .....</b>	<b>496,220</b>	<b>323,942</b>	<b>346,748</b>
<b>Non-current assets</b>			
Oil and gas properties .....	453,769	490,333	512,404
Construction in progress and development costs .....	4,779,809	2,564,393	988,117
Advance payments .....	1,837,928	1,636,491	943,134
Investments in associate .....	89,414	60,740	56,432
Loan receivables .....	321,612	137,497	44,334
Deferred tax assets .....	2,884	—	—
Other non-current assets .....	2,003	2,003	2,335
<b>Total non-current assets .....</b>	<b>7,487,419</b>	<b>4,891,457</b>	<b>2,546,756</b>
<b>TOTAL ASSETS .....</b>	<b>7,983,639</b>	<b>5,215,399</b>	<b>2,893,504</b>
<b>EQUITY</b>			
Share capital .....	1,740,800	1,444,900	100,000
Additional paid in capital .....	631,768	—	—
Other reserves .....	(45,176)	(45,176)	—
Cumulative translation differences .....	(34,382)	(23,516)	(11,104)
Retained earnings .....	(22,148)	31,703	13,208
Non-controlling interest .....	646,064	339,995	—
<b>TOTAL EQUITY .....</b>	<b>2,916,926</b>	<b>1,747,906</b>	<b>102,104</b>

	As of 30 November 2016	As of 31 December 2015	As of 31 December 2014
	<i>(unaudited)</i>		
	<i>(US\$ thousands)</i>		
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables .....	205,720	197,025	54,896
Accrued liabilities .....	358,576	318,759	131,945
Current portion of long-term borrowings .....	13,273	—	—
Income tax payable .....	749	1,145	1,376
<b>Total current liabilities</b> .....	<b>578,318</b>	<b>516,929</b>	<b>188,217</b>
<b>Non-current liabilities</b>			
Long-term borrowings .....	3,721,658	2,191,873	1,854,301
Government grant .....	669,350	683,281	697,699
Decommissioning liabilities .....	71,094	52,066	37,063
Deferred revenue .....	2,863	5,283	7,662
Deferred tax liability .....	11,332	8,060	6,458
Other non-current liabilities .....	12,098	10,001	—
<b>Total non-current liabilities</b> .....	<b>4,488,395</b>	<b>2,950,564</b>	<b>2,603,183</b>
<b>TOTAL LIABILITIES</b> .....	<b>5,066,713</b>	<b>3,467,493</b>	<b>2,791,400</b>
<b>TOTAL LIABILITIES AND EQUITY</b> .....	<b>7,983,639</b>	<b>5,215,399</b>	<b>2,893,504</b>

### *Consolidated Statement of Profit or Loss and Other Comprehensive Income*

	For the eleven months ended 30 November 2016	For the eleven months ended 30 November 2015	For the year ended 31 December 2015	For the period from 31 March 2014 (inception) to 31 December 2014
	<i>(unaudited)</i>			
	<i>(US\$ thousands)</i>			
Revenue .....	103,391	136,170	151,473	76,894
Cost of Sales .....	(62,001)	(63,086)	(69,944)	(28,433)
<b>Gross Profit</b> .....	<b>41,390</b>	<b>73,084</b>	<b>81,529</b>	<b>48,461</b>
Transportation tariffs .....	(3,576)	(4,587)	(4,613)	(1,594)
General and administrative expenses .....	(11,320)	(11,475)	(12,510)	(1,489)
Other income .....	14,958	14,467	16,190	13,122
<b>Operating Profit</b> .....	<b>41,452</b>	<b>71,489</b>	<b>80,596</b>	<b>58,500</b>
Interest income .....	6,815	4,864	4,895	3,338
Finance costs .....	(73,985)	(48,449)	(56,110)	(42,715)
Share of result of associates .....	(4,977)	(7,547)	(5,856)	(2,749)
Foreign exchange loss, net .....	(20,719)	(567)	(85)	(1,955)
<b>(Loss)/profit before income tax</b> .....	<b>(51,414)</b>	<b>19,790</b>	<b>23,440</b>	<b>14,419</b>
Income tax expenses .....	(1,529)	(3,412)	(3,781)	(1,211)
<b>(Loss)/profit for the period</b> .....	<b>(52,943)</b>	<b>16,378</b>	<b>19,659</b>	<b>13,208</b>
<b>Other comprehensive loss</b>				
Exchange differences on translation of foreign operations .....	(8,188)	(8,713)	(6,411)	(5,354)
Exchange differences on translation of foreign associate .....	(2,678)	(2,034)	(6,001)	(5,750)
<b>Other comprehensive loss for the period</b> .....	<b>(10,866)</b>	<b>(10,747)</b>	<b>(12,412)</b>	<b>(11,104)</b>
<b>Total comprehensive (loss)/income for the period</b> .....	<b>(63,809)</b>	<b>5,631</b>	<b>7,247</b>	<b>2,104</b>
<b>(Loss)/profit attributable to:</b>				
Equity holder of the Group .....	(53,851)	15,287	18,495	13,208
Non-controlling interest .....	908	1,091	1,164	—
<b>Total comprehensive (loss)/income attributable to:</b>				
Equity holder of the Group .....	(64,717)	4,540	6,083	2,104
Non-controlling interest .....	908	1,091	1,164	—

## Key Financial Ratios

The following table sets forth key financial ratios used by the Issuer's management in assessing the Issuer's performance. The financial ratios set forth in this table reflect the operations of the Group.

	As of and for the eleven months ended 30 November 2016	As of and for the eleven months ended 30 November 2015	As of and for the year ended 31 December 2015	As of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014
	<i>(unaudited)</i>			
		<i>(US\$ thousands)</i>		
EBIT ( <i>US\$ thousands</i> ) <sup>(1)</sup> .....	15,756	63,375	74,655	53,796
EBITDA ( <i>US\$ thousands</i> ) <sup>(2)</sup> .....	69,230	112,054	128,513	74,929
Debt (including current portion) ( <i>US\$ thousands</i> ) <sup>(3)</sup> .....	3,734,931	2,126,742	2,191,873	1,854,301
Total equity ( <i>US\$ thousands</i> ) .....	2,916,926	1,366,590	1,747,906	102,104
Capitalisation ( <i>US\$ thousands</i> ) <sup>(4)</sup> .....	6,651,857	3,493,332	3,939,779	1,956,405
Net capitalisation ( <i>US\$ thousands</i> ) <sup>(5)</sup> .....	6,213,194	3,407,639	3,685,219	1,744,207
Net debt ( <i>US\$ thousands</i> ) <sup>(6)</sup> .....	3,296,268	2,041,049	1,937,313	1,642,103
Debt/EBITDA <sup>(7)</sup> .....	53.95	18.98	17.06	24.75
Net debt/Net capitalisation <sup>(8)</sup> .....	0.53	0.60	0.53	0.94
Debt/Total equity <sup>(9)</sup> .....	1.28	1.56	1.25	18.16
Current liquidity <sup>(10)</sup> .....	0.86	0.34	0.63	1.84
EBIT/Net of finance costs and interest income <sup>(11)</sup> .....	0.23	1.45	1.46	1.37

<sup>(1)</sup> This measure is an APM. EBIT, for any relevant period, is loss/profit before income tax plus finance costs less interest income for such period.

<sup>(2)</sup> This measure is an APM. EBITDA, for any relevant period, is EBIT plus depreciation and depletion of oil and gas properties and impairment of assets for such period.

<sup>(3)</sup> This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

<sup>(4)</sup> This measure is an APM. Capitalisation is debt plus total equity as of 30 November or 31 December of the relevant period.

<sup>(5)</sup> This measure is an APM. Net capitalisation is net debt plus total equity as of 30 November or 31 December of the relevant period.

<sup>(6)</sup> This measure is an APM. Net debt is debt minus cash and cash equivalents as of 30 November or 31 December of the relevant period.

<sup>(7)</sup> This measure is an APM. Debt/EBITDA is debt divided by EBITDA as of 30 November or 31 December of the relevant period.

<sup>(8)</sup> This measure is an APM. Net debt/Net capitalisation is net debt divided by net capitalisation as of 30 November or 31 December of the relevant period.

<sup>(9)</sup> This measure is an APM. Debt/Total Equity is debt divided by total equity as of 30 November or 31 December of the relevant period.

<sup>(10)</sup> This measure is an APM. Current liquidity is current assets divided by current liabilities as of 30 November or 31 December of the relevant period.

<sup>(11)</sup> This measure is an APM. EBIT/Net of finance costs and interest income is EBIT divided by net of finance costs and interest income as of 30 November or 31 December of the relevant period.

These non-IFRS measures are regularly used by investors and other parties to evaluate a company's operating performance. They have important limitations as analytical tools and investors should not consider them in isolation or as substitutes for analysis of the Group's results as reported under IFRS. These and similar measures are used by different companies for different purposes and are often calculated in ways that reflect the circumstances of these companies. Investors should exercise caution in comparing these measures as reported by the Issuer to the measures as reported by other companies.

The table below sets forth the reconciliation of EBIT and EBITDA to profit/loss before income tax.

	<b>For the eleven months ended 30 November 2016</b>	<b>For the eleven months ended 30 November 2015</b>	<b>For the year ended 31 December 2015</b>	<b>For the period from 31 March 2014 (inception) to 31 December 2014</b>
	<i>(unaudited)</i>			
	<i>(US\$ thousands)</i>			
(Loss)/profit before income tax .....	(51,414)	19,790	23,440	14,419
Plus finance costs .....	73,985	48,449	56,110	42,715
Less interest income .....	(6,815)	(4,864)	(4,895)	(3,338)
<b>EBIT<sup>(1)</sup></b> .....	<b>15,756</b>	<b>63,375</b>	<b>74,655</b>	<b>53,796</b>
Depreciation and depletion of oil and gas properties	53,474	48,679	53,858	21,133
<b>EBITDA<sup>(2)</sup></b> .....	<b>69,230</b>	<b>112,054</b>	<b>128,513</b>	<b>74,929</b>

(1) This measure is an APM. EBIT, for any relevant period, is loss/profit before income tax plus finance costs less interest income for such period.

(2) This measure is an APM. EBITDA, for any relevant period, is EBIT plus depreciation and depletion of oil and gas properties and impairment of assets for such period.

The following tables set forth the reconciliation of certain other key financial ratios to IFRS measures.

	<b>As of November 2016</b>	<b>As of 30 November 2015</b>	<b>As of 31 December 2015</b>	<b>As of 31 December 2014</b>
	<i>(unaudited)</i>			
	<i>(US\$ thousands)</i>			
<b>Debt reconciliation</b>				
Long-term borrowings .....	3,721,658	2,126,742	2,191,873	1,854,301
Current portion of long-term borrowings .....	13,273	—	—	—
<b>Debt<sup>(1)</sup></b> .....	<b>3,734,931</b>	<b>2,126,742</b>	<b>2,191,873</b>	<b>1,854,301</b>
<b>Capitalisation reconciliation</b>				
Debt <sup>(2)</sup> .....	3,734,931	2,126,742	2,191,873	1,854,301
Total equity .....	2,916,926	1,366,590	1,747,906	102,104
<b>Capitalisation<sup>(3)</sup></b> .....	<b>6,651,857</b>	<b>3,493,332</b>	<b>3,939,779</b>	<b>1,956,405</b>
<b>Net capitalisation reconciliation</b>				
Net debt <sup>(4)</sup> .....	3,296,268	2,041,049	1,937,313	1,642,103
Total equity .....	2,916,926	1,366,590	1,747,906	102,104
<b>Net capitalisation<sup>(5)</sup></b> .....	<b>6,213,194</b>	<b>3,407,639</b>	<b>3,685,219</b>	<b>1,744,207</b>
<b>Net debt reconciliation</b>				
Debt <sup>(6)</sup> .....	3,734,931	2,126,742	2,191,873	1,854,301
Less cash and cash equivalents .....	(438,663)	(85,693)	(254,560)	(212,198)
<b>Net debt<sup>(7)</sup></b> .....	<b>3,296,268</b>	<b>2,041,049</b>	<b>1,937,313</b>	<b>1,642,103</b>

(1) This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

(2) This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

(3) This measure is an APM. Capitalisation is debt plus total equity as of 30 November or 31 December of the relevant period.

(4) This measure is an APM. Net debt is debt minus cash and cash equivalents as of 30 November or 31 December of the relevant period.

(5) This measure is an APM. Net capitalisation is net debt plus total equity as of 30 November or 31 December of the relevant period.

(6) This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

(7) This measure is an APM. Net debt is debt minus cash and cash equivalents as of 30 November or 31 December of the relevant period.

	As of and for the eleven months ended 30 November 2016	As of and for the eleven months ended 30 November 2015	As of and for the year ended 31 December 2015	As of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014
	<i>(unaudited)</i>		<i>(US\$ thousands)</i>	
<b>Debt / EBITDA reconciliation</b>				
Debt <sup>(1)</sup> .....	3,734,931	2,126,742	2,191,873	1,854,301
EBITDA <sup>(2)</sup> .....	69,230	112,054	128,513	74,929
<b>Debt / EBITDA<sup>(3)</sup>.....</b>	<b>53.95</b>	<b>18.98</b>	<b>17.06</b>	<b>24.75</b>
<b>Net debt / Net capitalisation reconciliation</b>				
Net debt <sup>(4)</sup> .....	3,296,268	2,041,049	1,937,313	1,642,103
Net capitalisation <sup>(5)</sup> .....	6,213,194	3,407,639	3,685,219	1,744,207
<b>Net debt / Net capitalisation<sup>(6)</sup>.....</b>	<b>0.53</b>	<b>0.60</b>	<b>0.53</b>	<b>0.94</b>
<b>Debt / Total equity reconciliation</b>				
Debt <sup>(7)</sup> .....	3,734,931	2,126,742	2,191,873	1,854,301
Total equity.....	2,916,926	1,366,590	1,747,906	102,104
<b>Debt / Total equity<sup>(8)</sup>.....</b>	<b>1.28</b>	<b>1.25</b>	<b>1.25</b>	<b>18.16</b>
<b>Current liquidity reconciliation</b>				
Current assets.....	496,220	180,102	323,942	346,748
Current liabilities.....	578,318	524,801	516,929	188,217
<b>Current liquidity (current assets / current liabilities)<sup>(9)</sup>.....</b>	<b>0.86</b>	<b>0.34</b>	<b>0.63</b>	<b>1.84</b>
<b>EBIT / Net of finance costs and interest income reconciliation</b>				
EBIT <sup>(10)</sup> .....	15,756	63,375	74,655	53,796
Plus finance costs.....	73,985	48,449	56,110	42,715
Less interest income.....	(6,815)	(4,864)	(4,895)	(3,338)
<b>EBIT / Net of finance costs and interest income<sup>(11)</sup>.....</b>	<b>0.23</b>	<b>1.45</b>	<b>1.46</b>	<b>1.37</b>

(1) This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

(2) This measure is an APM. EBITDA, for any relevant period, is EBIT plus depreciation and depletion of oil and gas properties and impairment of assets for such period.

(3) This measure is an APM. Debt/EBITDA is debt divided by EBITDA as of 30 November or 31 December of the relevant period.

(4) This measure is an APM. Net debt is debt minus cash and cash equivalents as of 30 November or 31 December of the relevant period.

(5) This measure is an APM. Net capitalisation is net debt plus total equity as of 30 November or 31 December of the relevant period.

(6) This measure is an APM. Net debt/Net capitalisation is net debt divided by net capitalisation as of 30 November or 31 December of the relevant period.

(7) This measure is an APM. Debt is current portion of the borrowings plus non-current portion of the borrowings as of 30 November or 31 December of the relevant period.

(8) This measure is an APM. Debt/Total Equity is debt divided by total equity as of 30 November or 31 December of the relevant period.

(9) This measure is an APM. Current liquidity represents current assets divided by current liabilities.

(10) This measure is an APM. EBIT, for any relevant period, is loss/profit before income tax plus finance costs less interest income for such period.

(11) This measure is an APM. EBIT/Net of finance costs and interest income is EBIT divided by net of finance costs and interest income as of 30 November or 31 December of the relevant period.

The following table sets forth the reconciliation of total debt outstanding and total contractual debt outstanding under the SOFAZ Bonds.

	<b>As of 30 November 2016</b>
	<i>(US\$ thousands)</i>
Long-term borrowings due to SOFAZ (1).....	2,058,505
Eurobonds (including current portion of long-term borrowings) (2).....	1,002,031
Long-term borrowings due to BOTAS and BP (3) .....	674,395
<b>Debt (4)=(1)+(2)+(3).....</b>	<b>3,734,931</b>
Government grant at initial recognition in 2014 related to SOFAZ (5).....	704,270
Less effect of the difference between effective and nominal interest rate related to SOFAZ Bonds (6)....	(148,608)
<b>Total contractual debt outstanding under SOFAZ Bonds (7)=(1)+(5)+(6) .....</b>	<b>2,614,167</b>
<b>Total debt outstanding (including accrued interest) (8)=(4)+(5)+(6) .....</b>	<b>4,290,593</b>

## **Certain Other Information**

### ***Issuer's Share Capital***

As of 30 November 2016, the Issuer's capital was directly and indirectly wholly owned by the Republic of Azerbaijan, with 51% of the Issuer's capital held by the Ministry of Economy of the Republic of Azerbaijan and 49% of the Issuer's capital held by SOCAR. As of 30 November 2016, the Issuer's share capital was US\$1,740.8 million. As of the date of this Prospectus, the Issuer's share capital is US\$2,415.8 million.

### ***Issuer's Interests in the Projects***

As of 30 November 2016, the Issuer had, through its wholly owned subsidiary SGC Upstream, a 6.67% interest in the Shah Deniz PSA and a 5.336% share in AGSC and, through its wholly owned subsidiary SGC Midstream, a 6.67% interest in SCPC. As of 30 November 2016, the Issuer also held a 58.0% share in TANAP A.Ş. and, through its wholly owned subsidiary AzTAP GmbH, a 20.0% share in TAP AG. There have been no changes in the Issuer's interests in the Projects between 30 November 2016 and the date of this Prospectus.

### ***Participants/Shareholders of the Projects***

As of 30 November 2016, other participants in the Shah Deniz PSA were: BP (28.83%), Turkish Petroleum Overseas Company Limited (19.0%), PETRONAS Azerbaijan (Shah Deniz) Sarl (15.5%), AzSD (10.0%), LUKOIL Overseas Shah Deniz Limited (10.0%) and Naftiran Intertrade Co. (NICO) Limited (10.0%).

As of 30 November 2016, the other direct and indirect shareholders of SCPC were: BP Pipelines (SCP) Limited (28.83%), Turkish Petroleum SCP Limited (19.0%), PETRONAS South Caucasus S.A.R.L. (15.5%), AzSCP (10.0%), LUKOIL Overseas Shah Deniz Midstream Limited (10.0%) and NICO SPV Limited (10.0%).

As of 30 November 2016, the other shareholders of TANAP A.Ş. were: BOTAŞ (30.0%) and BP Pipelines (TANAP) Limited (12.0%). The Issuer is considering selling a 7.0% interest in TANAP A.Ş. to SOCAR Turkey Enerji A.Ş. in 2017.

As of 30 November 2016, the other shareholders of TAP AG were: BP Pipelines TAP Limited (20.0%), AzTAP (20.0%), Snam S.p.A. (20.0%), Fluxys Europe B.V. (19.0%), Enagas Internacional S.L.U. (16.0%) and Axpo Trading AG (5.0%). In December 2015, Snam S.p.A. acquired Statoil's 20.0% shareholding in TAP AG.

There have been no changes in the interests held in the Projects by the other participants/shareholders



between 30 November 2016 and the date of this Prospectus, except as described above.

***Capital Expenditures relating to the Projects***

As of 30 November 2016, the Issuer's interest in the Shah Deniz PSA was 6.67%. In addition, under the terms of the deferred sale agreement entered into in July 2014 between AzSD, a subsidiary of SOCAR, and SGC Upstream (pursuant to which AzSD has agreed to sell its 10.0% interest in the Shah Deniz PSA to SGC Upstream with a deferred closing in 2023, subject to fulfilment of certain conditions), effective from July 2014 and until 2020 the Issuer undertook to fund the AzSD's capital expenditure commitments in relation to the Shah Deniz 2 project as part of the sale consideration. As a result, as of 30 November 2016 the Issuer's total share in the capital expenditure commitments relating to the Shah Deniz 2 project was 16.67%.

As of 30 November 2016, the Issuer's share in SCPC was 6.67%. In addition, under the terms of the deferred sale agreement entered into between AzSCP, a subsidiary of SOCAR, and SGC Midstream in July 2014 (pursuant to which AzSCP has agreed to sell its 10.0% interest in SCPC to SGC Midstream with a deferred closing in 2023, subject to fulfilment of certain conditions), effective from July 2014 and until 2020 the Issuer undertook to fund the AzSCP's capital expenditure commitments in relation to the SCP expansion project as part of the sale consideration. As a result, as of 30 November 2016 the Issuer's total share in the capital expenditure commitments relating to SCP expansion project was 16.67%.

As of 30 November 2016, the Issuer's interest in TANAP A.Ş. was 58.0%. In addition, pursuant to the terms of the inter-governmental agreement between the Government and the Government of Turkey, in May 2014 SOCAR and BOTAS entered into a funding agreement for financing BOTAS's 5.0% interest in TANAP A.Ş. In March 2015, the Issuer entered into a novation agreement with SOCAR and BOTAS, where all rights and obligations under the funding agreement were transferred from SOCAR to the Issuer. According to its agreement with BOTAS, the Issuer has a commitment to finance BOTAS's 5.0% interest in TANAP's future cash call requirements until TANAP becomes operational. As a result, as of 30 November 2016 the Issuer's total share in capital expenditure commitments relating to the TANAP was 63.0%.

As of 30 November 2016, the Issuer's share in capital expenditure commitments relating to the TAP project was 20.0%, which is proportionate to its economic interest in the project.

There have been no changes in the Issuer's shares in capital expenditure commitments relating to the Project between 30 November 2016 and the date of this Prospectus.

## CAPITALISATION

The table below sets out the Issuer's consolidated capitalisation, which the Issuer considers to be equal to total equity and liabilities, as of 30 November 2016. This information should be read in conjunction with "Selected Financial Information", "Management's Discussion and Analysis of Results of Operations and Financial Performance" and the Financial Statements included elsewhere in this Prospectus.

	<b>As of 30 November 2016</b>
	<i>(unaudited)</i>
	<i>(US\$ thousands)</i>
<b>EQUITY</b>	
Share capital .....	1,740,800
Additional paid in capital .....	631,768
Other reserves .....	(45,176)
Cumulative translation differences .....	(34,382)
Retained earnings .....	(22,148)
<b>Equity attributable to the Group's equity holders</b> .....	<b>2,270,862</b>
Non-controlling interest .....	646,064
<b>Total equity</b> .....	<b>2,916,926</b>
<b>LIABILITIES</b>	
<b>Non-current liabilities</b>	
Long-term borrowings .....	3,721,658
Government grant .....	669,350
Decommissioning liabilities .....	71,094
Deferred revenue .....	2,863
Deferred tax liability .....	11,332
Other non-current liabilities .....	12,098
<b>Total non-current liabilities</b> .....	<b>4,488,395</b>
<b>Current liabilities</b>	
Trade and other payables .....	205,720
Accrued liabilities .....	358,576
Current portion of long-term borrowings .....	13,273
Income tax payable .....	749
<b>Total current liabilities</b> .....	<b>578,318</b>
<b>Total liabilities</b> .....	<b>5,066,713</b>
<b>Total equity and liabilities</b> .....	<b>7,983,639</b>

The Issuer's share capital was increased by US\$675.0 million in February 2017.

On 16 January 2017, the Issuer entered into a loan agreement with the IBRD for the total amount of US\$400 million for the financing of the TANAP project. On 26 January 2017, the Issuer entered into a loan agreement with the AIIB for the total amount of US\$600 million for the financing of the TANAP project. As of 28 February 2017, US\$108.4 million and US\$162.6 million have been drawn under the IBRD and the AIIB loans, respectively. See "Management's Discussion and Analysis of Results of Operations and Financial Performance—Liquidity and Capital Resources—Funding—Debt Financing—Existing Indebtedness—Loans from IBRD and AIIB" for additional information regarding these loans.

Save as described above, there has been no material adverse change in the consolidated capitalisation, indebtedness, guarantees or contingent liabilities of the Group since 30 November 2016.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL PERFORMANCE

*The following discussion and analysis of the Group's results of operations and financial performance should be read in conjunction with the Financial Statements and the related notes thereto included elsewhere in this Prospectus. The Financial Statements have been prepared in accordance with IFRS. This discussion and analysis contains forward-looking statements, which involve risks and uncertainties. See "Forward-Looking Statements". The Group's actual results could differ materially from those anticipated in the forward-looking statements contained herein for several reasons, including those set forth under "Risk Factors" and elsewhere in this Prospectus.*

### Overview

#### *The Issuer*

The Issuer was incorporated on 31 March 2014 pursuant to Presidential Decree No. 287 dated 25 February 2014. The Issuer was established to consolidate, manage and finance the Republic of Azerbaijan's interests in the Projects. The Issuer holds an economic interest in each, but is not the direct operator of, any of the Projects.

The Issuer's capital is directly and indirectly wholly owned by the Republic of Azerbaijan, with 51% of the Issuer's capital held by the Ministry of Economy of the Republic of Azerbaijan and 49% of the Issuer's capital held by SOCAR, which in turn is wholly owned by the Republic of Azerbaijan. As of 30 November 2016, the Issuer's share capital was US\$1,740.8 million. As of the date of this Prospectus, the Issuer's share capital is US\$2,415.8 million.

#### *Overview of the Projects*

The Southern Gas Corridor project aims to increase European energy supply by bringing gas resources from the Caspian Sea to markets in Europe. The Southern Gas Corridor comprises the following four projects: (i) the full-field development of the Shah Deniz field, (ii) the expansion of the South Caucasus Pipeline, (iii) the construction of the Trans-Anatolian Natural Gas Pipeline and (iv) the construction of the Trans Adriatic Pipeline. Day-to-day operations of each of the Projects are managed by their respective operating companies.

The Projects comprise upstream and midstream operations located principally in Azerbaijan as well as in Turkey. SCP transports natural gas from the Shah Deniz field to the Georgian-Turkish border. The gas transported through SCP will also be further transported via TANAP (once constructed) to consumers in Turkey as well as to Italy through TAP (once constructed), which will run from the Turkish-Greek border via Greece and Albania across the Adriatic Sea to southern Italy. The Projects have been developed in partnership with major international companies in the oil and gas industry and anticipate the first deliveries of natural gas from the Shah Deniz field to Turkey in 2018 and the first deliveries of gas to European customers in 2020.

The Issuer, through its wholly owned subsidiary SGC Upstream, has a 6.67% interest in the Shah Deniz PSA and a 5.336% share in AGSC, which is a marketing vehicle of the parties to the Shah Deniz PSA in respect of the natural gas produced from the Shah Deniz field. Through its wholly owned subsidiary SGC Midstream, the Issuer holds a 6.67% interest in SCPC, which owns the SCP. The SCP is operated by BP (as technical operator) and SMO (as commercial operator). The Issuer also has a 58.0% share in TANAP A.Ş., which is the Operating Company for TANAP. In addition, the Issuer holds, through its wholly owned subsidiary AzTAP GmbH, a 20.0% share in TAP AG, which is the Operating Company for TAP. Operational management of the Issuer's stakes in the Projects is conducted by SOCAR's affiliates, pursuant to an operator services agreement between the Issuer and some of its subsidiaries and SOCAR. See "*Business-SOCAR Service Agreement*" for additional information.

The Shah Deniz field was discovered in 1999 and is considered one of the world's largest gas condensate fields, with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP. Total production from the Shah Deniz field during the period from 2007 to 2045 is expected to reach 458.8 billion cubic meters of natural gas and 616.1 million barrels of condensate, according to BP. In the year ended 31 December 2015, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.53 billion cubic metres and 0.97 million barrels, respectively. In the

year ended 31 December 2016, the Issuer's share of the Shah Deniz field's natural gas and condensate production was 0.59 billion cubic metres and 1.11 million barrels of condensate, respectively.

## **Recent Developments**

### ***Equity Contributions***

The Issuer's share capital was increased by US\$675.0 million in February 2017.

### ***Borrowings***

On 16 January 2017, the Issuer entered into a loan agreement with the IBRD for the total amount of US\$400 million for the financing of the TANAP project. On 26 January 2017, the Issuer entered into a loan agreement with the AIIB for the total amount of US\$600 million for the financing of the TANAP project. As of 28 February 2017, US\$108.4 million and US\$162.6 million have been drawn under the IBRD and the AIIB loans, respectively. See "*Liquidity and Capital Resources—Funding—Debt Financing—Existing Indebtedness—Loans from IBRD and AIIB*" for additional information regarding these loans.

## **Significant Factors Affecting Results of Operations and Liquidity**

The main factors that have affected the Group's results of operations during the period from 31 March 2014 (inception) to 30 November 2016 and that are expected to affect the Group's results of operations in the future are: (i) changes in condensate and natural gas prices; (ii) changes in condensate and natural gas production volumes; (iii) changes in pipeline transportation volumes; (iv) changes in the share of income from jointly-controlled entities and associates; and (v) the current economic environment.

### ***Changes in condensate and natural gas prices***

The prices of condensate and natural gas internationally and in Azerbaijan have a significant impact on the Group's results of operations. The Issuer has a minority interest in the Shah Deniz field and consequently receives a share of revenues from the sales of condensate and natural gas produced from the field. Therefore, the Group's revenues and profitability are dependent on the prevailing condensate and natural gas prices, both of which are subject to fluctuation and volatility and are affected by a number of factors beyond the Issuer's control.

There is a strong correlation between the condensate and crude oil prices, and, as a result, volatility in crude oil prices is likely to cause fluctuations in the price of condensate. Crude oil prices have been particularly volatile in recent years. Between April 2011 and June 2014, the Brent crude price fluctuated between approximately US\$95/bbl and US\$120/bbl. Starting in late June 2014, oil prices began to decline, with the price of Brent crude decreasing from approximately US\$115/bbl in June 2014 to approximately US\$55/bbl by the end of 2014. International crude oil prices continued to decline in 2015 and into 2016, falling below US\$28/bbl in January 2016, the lowest Brent crude oil price since 2004. Crude oil prices have recovered some of their losses afterwards, with the Brent crude oil price rising to approximately US\$55/bbl as of the date of this Prospectus. In its February 2017 report, the EIA forecasted that the Brent crude oil spot price will average US\$55/bbl in 2017 and US\$57/bbl in 2018, while several financial institutions have issued reports forecasting crude oil prices to remain depressed (compared to the average price for the 2011-2015 period) for an extended period of time.

Profits derived from condensate and gas sales from the Shah Deniz field are determined in large part by the difference between the income received from the sales of condensate and gas produced and received under the Shah Deniz production sharing agreement (the "**Shah Deniz PSA**") and operating costs, as well as costs incurred in transporting and selling these products. Therefore, lower condensate and gas prices may reduce the amount of condensate and gas that the Shah Deniz Operating Company is able to economically produce or may reduce the economic viability of the production from specific wells or of projects planned or in development because production costs would exceed anticipated income from such production. Any further declines (even relatively modest) in oil and gas prices or any resulting curtailment in the Shah Deniz Operating Company's overall production volumes may result in a reduction in net income, which could reduce the income received by the Issuer. Such outcome could also increase the amount of funding from other sources (such as debt financing and equity contributions) required to fund the Group's capital expenditure commitments under the Projects.

### ***Changes in condensate and natural gas production volumes***

The Issuer's sales of condensate and natural gas and related profits are represented by its 6.67% share in the Shah Deniz PSA. Consequently, the Group's revenues and profits depend on the revenues and profits from the Shah Deniz field, which in turn directly depend on the volumes of condensate and natural gas produced from this field.

The following table sets forth natural gas and condensate production volumes from Shah Deniz 1 for the periods indicated.

<b>Output of Shah Deniz 1</b>	<b>For the year ended 31 December</b>					
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Natural gas ( <i>billion cubic metres</i> ) .....	6.73	7.80	9.78	9.86	9.88	10.67
Condensate ( <i>million barrels</i> ).....	13.97	16.15	19.61	18.68	18.28	20.14

*Source: BP*

Condensate and natural gas production volumes depend on a number of factors, many of which are outside the Issuer's (and often the Operating Company's) control. Such factors include scheduled stoppages to perform maintenance and repairs, unplanned disruptions to production due to hazards, adverse weather conditions or other events, availability of equipment to conduct repairs, and other factors.

### ***Changes in pipeline transportation volumes***

The Issuer holds a 6.67% interest in SCP (the pipeline is expected to be expanded further by 2018), a 58.0% stake in TANAP (which is expected to commence operations in 2018) and a 20.0% interest in TAP (which is expected to be completed in 2019). As a result, the Issuer currently receives its share of revenues from the sale of gas and condensate produced from the Shah Deniz operations and from the transportation of natural gas through SCP and, once the SCP expansion, TANAP and TAP projects are completed, the Issuer will receive its proportion of transportation revenues from the operation of these pipelines. Consequently, the Group's results of operations have been and will continue to be directly affected by condensate and natural gas transportation volumes. As the transportation tariffs are set on a long-term basis pursuant to long-term gas transportation agreements entered into between pipeline Project participants and are in most cases subject to relatively small automatic annual price escalation, changes in condensate and natural gas transportation tariffs have not had and are not expected to have a material impact on the Group's results of operations.

Condensate and natural gas transportation volumes depend on a number of factors, many of which are outside the Issuer's (and often the Operating Company's) control. Such factors include scheduled stoppages to perform maintenance and repairs, unplanned disruptions to transportation due to hazards, adverse weather conditions or other events, availability of equipment to conduct repairs, and other factors.

### ***Changes in interests in joint operations***

The Group's results of operations have been affected during the periods under review and will continue to be affected in the future by the size of the interests it holds in the Projects.

Through its wholly-owned subsidiary SGC Upstream, the Issuer holds a 6.67% interest in the Shah Deniz PSA. In July 2014, AzSD, a subsidiary of SOCAR, and SGC Upstream entered into a deferred sale and purchase agreement to sell AzSD's 10.0% interest in the Shah Deniz PSA to SGC Upstream. This sale is expected to close in 2023, subject to fulfilment of certain conditions. Consequently, effective from July 2014 the Issuer undertook to fund the AzSD's capital expenditure commitments in relation to the Shah Deniz 2 project as part of the sale consideration. As a result, the Issuer's total share in the capital expenditure commitments relating to the Shah Deniz 2 project is 16.67%, while the Issuer's share of revenues from the Shah Deniz field will continue to be based on its 6.67% interest in the Shah Deniz PSA, until the sale is completed in 2023.

SCPC is a joint venture that owns, operates and maintains the SCP pipeline. SCPC is directly and indirectly owned by seven shareholders, with BP, the largest shareholder, as its technical operator and SMO as its commercial operator. SGC Midstream, a wholly-owned subsidiary of the Issuer, holds a 6.67% interest in SCPC. In July 2014, AzSCP, a subsidiary of SOCAR, entered into a deferred sale and

purchase agreement with SGC Midstream to sell AzSCP's 10% interest in the SCPC to SGC Midstream. This sale is expected to close in 2023. Consequently, effective from July 2014 the Issuer undertook to fund the AzSPC's capital expenditure commitments in relation to the SCP pipeline expansion project as part of the sale consideration. As a result, the Issuer's total share in the capital expenditure commitments relating to the SCP expansion project is 16.67%, while the Issuer's share of revenues from the SCP will continue to be 6.67% until the sale is completed in 2023.

The TANAP is owned and operated by TANAP A.Ş. In July 2014, SOCAR sold its 100.0% stake in TANAP A.Ş. to the Issuer. In May 2014, SOCAR signed a share purchase agreement to sell a 30.0% interest in TANAP A.Ş. to BOTAS, the Turkish state-owned gas company, which was thereafter novated to refer to the Issuer as a seller in July 2014. The Issuer subsequently in April 2015 sold a 12.0% stake in TANAP A.Ş. to BP Pipelines (TANAP) Limited. As a result, as of 30 November 2016 the shareholders of TANAP A.Ş. were as follows: the Issuer (58.0%), BOTAS (30.0%) and BP Pipelines (TANAP) Limited (12.0%). The Issuer is considering selling a 7.0% interest in TANAP A.Ş. to SOCAR Turkey Enerji A.Ş. in 2017.

These and any future changes in the size of interests held by the Issuer in the Projects have had and will continue to have a direct impact on the Group's results of operations and financial condition.

### ***The current economic environment***

The economic environment globally, and in particular in Europe, Turkey, Azerbaijan and other markets where the condensate and natural gas from the Shah Deniz field is currently sold from Shah Deniz 1, and is planned to be sold from Shah Deniz 2 (once operational), has had and will continue to have a material impact on the Group's results of operations as it directly impacts the demand for condensate and natural gas in these regions. In addition, global economic environment tends to have a direct impact on condensate and natural gas prices, and consequently on the Group's financial results.

The current global economic environment and the volatility of international markets have caused governments and central banks to undertake unprecedented interventions designed to stabilise global and domestic financial systems, stimulate new lending and support structurally important industries and institutions, such as banks, which are at risk of failing. Many developed economies have experienced recessions over the past several years and growth has slowed in many emerging economies, with serious adverse consequences for commodity prices (including condensate and natural gas), asset values, employment levels, consumer confidence and levels of economic activity. In particular, rapid and substantial declines in stock indices and China and the devaluation of the Yuan by the Chinese government in the second half of 2015 and in early 2016 have raised questions regarding the condition and expected growth rate of the world's second largest economy. In addition, on 23 June 2016 the UK held a referendum to decide on the UK's membership of the EU and determined to leave the EU, resulting in a number of uncertainties in connection with the future of the UK and its relationship with the EU as well as the future strength of the EU economy. Numerous governments and central banks have responded to these economic conditions by adopting programmes to make substantial funds and guarantees available to boost economic activity, liquidity and confidence in their financial systems. It is not known whether these responses will be effective in addressing the economic and market conditions that exist at present. The impact of the reversal or withdrawal of such programmes is also uncertain.

While the Issuer is unable to estimate reliably the effects on its consolidated financial position and its results of operations of any recent or future deterioration in the prices of commodities (including condensate and natural gas) or in the financial markets, commodities and equity markets, the Group's financial condition and results of operations have been and will be negatively impacted by the economic conditions resulting from the general economic downturn and the decline in prices of, and demand for, crude oil and other commodities. Such market conditions could have an impact on, among other things, the Operating Companies' selling prices and production volumes of condensate and natural gas and the cost of the Issuer's funding, and, accordingly, have a direct impact on the Group's financial condition and results of operations. The Issuer intends to continue to evaluate the potential impact of these conditions.

### ***Devaluation of Manat***

In February 2015, the CBA devalued the Manat by 34% to 1.05 Manats per U.S.1.00 and moved the Manat away from the dollar peg, in an effort to ease the strain of lower oil prices on budget revenue and make Azerbaijan's exports more competitive. On 21 December 2015, the CBA moved to a floating

exchange rate, abandoning the Manat's dollar-euro basket peg. The foregoing measures caused the Manat to devalue against the US dollar in 2015 in the aggregate by approximately 47%. The devaluation was the result of the CBA's decision to stop protecting the value of the Manat in the face of falling oil prices, which were depleting existing foreign reserves. In 2016, the Manat depreciated by approximately 13% against the US dollar.

While most of the Group's revenues, expenses, capital expenditure commitments and funding is denominated in currencies other than Manat (principally the US Dollar), the devaluation could adversely affect the Group's future results and financial position as the devaluation has had a negative impact on the overall macroeconomic environment in Azerbaijan, resulted in increased level of inflation and introduction of capital controls, and had an adverse impact on the country's finances. If the CBA intervenes in the currency markets in an effort to support the Manat, Azerbaijan's external position and/or balance of payments could decline. The Issuer's management believes that it is taking all necessary measures to support the sustainability and development of the Group's business in the foreseeable future.

### ***Factors Affecting Comparability***

The Issuer was incorporated on 31 March 2014. The Group's existing financial statements comprise the audited consolidated financial statements as of and for the year ended 31 December 2015, the audited consolidated financial statements as of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014 and the reviewed unaudited interim condensed consolidated financial statements as of and for the eleven months ended 30 November 2016 (which include as comparables the reviewed unaudited interim condensed consolidated financial statements for the eleven months ended 30 November 2015). With the exception of the eleven months ended 30 November 2015 and 2016, due to the relatively short operating and financial history of the Group, the Group's existing financial information covers periods of varying duration and/or different periods within a year, which makes the Group's existing annual financial statements not comparable on a period-to-period basis.

### **Descriptions of Principal Income Statement Items**

Descriptions of certain principal income statement items are set forth below.

#### ***Revenue***

The Issuer has a 6.67% interest in the Shah Deniz PSA and consequently receives a share of revenues from the sales of condensate and natural gas produced from the field (which is operated by BP). The Issuer also holds a 6.67% interest in SCP (the pipeline is expected to be expanded further by 2018), a 58.0% stake in the TANAP (which is expected to become operational by 2018) and a 20.0% interest in the TAP (which is expected to be completed in 2019, with the first gas deliveries to European customers beginning in 2020). As a result, the Issuer also currently receives a share of the condensate and natural gas transportation revenues from SCP and, once the SCP expansion, the TANAP and the TAP projects are completed, the Issuer will receive its proportion of transportation revenues from these pipelines.

Revenue from sales of condensate is stated net of the price margin tax.

Revenue from sales of natural gas is stated net of excise tax.

#### ***Cost of Sales***

Cost of sales are the costs of depreciation and depletion and other costs incurred in bringing the goods and services to a saleable condition and location, adjusted for opening and closing inventories.

#### ***Operating Expenses***

All operating expenses incurred by the Issuer are classified by function and fall within one of the following areas: transportation tariffs and general and administrative expenses.

#### ***General and Administrative Expenses***

General and administrative expenses are the costs relating to the administration and management of the Issuer and include payroll costs and the costs of external functions (such as audit, legal and consulting) which are not directly involved in the production of goods or the provision of services.

### ***Transportation Tariffs***

Transportation tariffs comprise expenses incurred in relation to the handling, storage and transportation of finished products up to the point of sale.

### ***Other Operating Income***

In accordance with the Presidential Decree dated 25 February 2014, SOFAZ was instructed to finance the Group's acquisitions of interests in the Projects. Accordingly, in 2014 the Group issued 10-year bonds to SOFAZ in the aggregate amount of US\$ 2,517.0 million bearing interest at a rate of six-month LIBOR plus 1%. At initial recognition, the Group calculated the fair value of these bonds using a market rate for similar financial instruments of six-month LIBOR plus 4.5% and as a result recognised in its consolidated statement of financial position as of 31 December 2014 as a government grant US\$704.3 million of difference between the fair value and the carrying amount of the bonds. Other income is the income recognised by the Group from amortisation of this government grant during the relevant period.

### ***Interest Income***

Interest income comprises interest earned from deposits, bank accounts and loans to related and third parties.

### ***Finance Costs***

Finance costs include interest expense and provisions for asset retirement obligations, environmental obligations and disability payments.

### ***Share of Result of Associates***

Share of result of associates relates to the Group's interest in TAP AG. As of 30 November 2016, the Group indirectly held a 20.0% interest in TAP AG, which is responsible for the development and operation of the gas transportation infrastructure from the Greece/Turkey border to Southern Italy in order to deliver Caspian natural gas to European countries. The Group exercises significant influence over the entity by participating in its financial and operating decisions.

### ***Foreign Exchange Loss, Net***

Foreign exchange loss/gain represents the impact of changes in exchange rates on the monetary value of the Group's assets and liabilities denominated in currencies other than the US Dollar, the Group's reporting currency.

### ***Profit before Income Tax***

Profit before income tax represents total revenue less total expenses and is consequently the total profit assessable to income tax.

### ***Income Tax Expenses***

Income tax expenses include both current tax expenses and deferred tax charges.

Corporate income taxes have been accounted for in the Financial Statements in accordance with the applicable legislation enacted or substantively enacted by the statement of financial position date. The income tax charge is recognised in the statement of comprehensive income unless it relates to transactions that are recognised, in the same or a different period, directly in equity. Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for



deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Issuer controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income taxes are provided in full on temporary differences arising on recognition and subsequent measurement of provision for asset retirement obligation and related adjustments to cost of property, plant and equipment.

## Results of Operations

The Issuer was incorporated on 31 March 2014. The Group's existing financial statements comprise the audited consolidated financial statements as of and for the year ended 31 December 2015, the audited consolidated financial statements as of 31 December 2014 and for the period from 31 March 2014 (inception) to 31 December 2014 and the reviewed unaudited interim condensed consolidated financial statements as of and for the eleven months ended 30 November 2016 (which include as comparables the reviewed unaudited interim condensed consolidated financial statements for the eleven months ended 30 November 2015). Consequently, the Group's existing financial information for the period from 31 March 2014 (inception) to 31 December 2014 and for the year ended 31 December 2015 covers periods of varying duration and/or different periods within a year and therefore is not comparable on a period to period basis.

The following table sets forth the Issuer's consolidated results of operations for the periods indicated.

	For the eleven months ended 30 November 2016	For the eleven months ended 30 November 2015	For the year ended 31 December 2015	For the period from 31 March 2014 (inception) to 31 December 2014
	<i>(unaudited)</i>			
	<i>(US\$ thousands)</i>			
Revenue .....	103,391	136,170	151,473	76,894
Cost of sales .....	(62,001)	(63,086)	(69,944)	(28,433)
<b>Gross profit</b> .....	<b>41,390</b>	<b>73,084</b>	<b>81,529</b>	<b>48,461</b>
General and administrative expenses .....	(11,320)	(11,475)	(12,510)	(1,489)
Transportation tariffs .....	(3,576)	(4,587)	(4,613)	(1,594)
Other income .....	14,958	14,467	16,190	13,122
<b>Operating profit</b> .....	<b>41,452</b>	<b>71,489</b>	<b>80,596</b>	<b>58,500</b>
Interest income .....	6,815	4,864	4,895	3,338
Finance costs .....	(73,985)	(48,449)	(56,110)	(42,715)
Share of result of associates .....	(4,977)	(7,547)	(5,856)	(2,749)
Foreign exchange loss, net .....	(20,719)	(567)	(85)	(1,955)
<b>(Loss)/profit before income tax</b> .....	<b>(51,414)</b>	<b>19,790</b>	<b>23,440</b>	<b>14,419</b>
Income tax expenses .....	(1,529)	(3,412)	(3,781)	(1,211)
<b>(Loss)/profit for the period</b> .....	<b>(52,943)</b>	<b>16,378</b>	<b>19,659</b>	<b>13,208</b>

**Results of operations for the eleven months ended 30 November 2016 and 30 November 2015**

	<b>For the eleven months ended 30 November 2016</b>	<b>For the eleven months ended 30 November 2015</b>	<b>Change as of 30 November 2016</b>
	<i>(unaudited)</i>		<i>(%)</i>
	<i>(US\$ thousands)</i>		
Revenue .....	103,391	136,170	(24.1%)
Cost of sales .....	(62,001)	(63,086)	(1.7%)
<b>Gross profit</b> .....	<b>41,390</b>	<b>73,084</b>	<b>(43.4%)</b>
General and administrative expenses .....	(11,320)	(11,475)	(1.4%)
Transportation tariffs .....	(3,576)	(4,587)	(22.0%)
Other income .....	14,958	14,467	3.4%
<b>Operating profit</b> .....	<b>41,452</b>	<b>71,489</b>	<b>(42.0%)</b>
Interest income .....	6,815	4,864	40.1%
Finance costs .....	(73,985)	(48,449)	52.7%
Share of result of associates .....	(4,977)	(7,547)	(34.1%)
Foreign exchange loss, net .....	(20,719)	(567)	3554.1%
<b>(Loss)/profit before income tax</b> .....	<b>(51,414)</b>	<b>19,790</b>	<b>(359.8%)</b>
Income tax expenses .....	(1,529)	(3,412)	(55.2%)
<b>(Loss)/profit for the period</b> .....	<b>(52,943)</b>	<b>16,378</b>	<b>(423.3%)</b>

*Revenue*

The Group's revenue for the eleven months ended 30 November 2016 was \$103.4 million, a decrease of \$32.8 million, or 24.1%, compared to \$136.2 million in the eleven months ended 30 November 2015. This was principally as a result of the global decline in oil prices.

*Cost of sales*

The Group recorded \$62 million in cost of sales for the eleven months ended 30 November 2016, a decrease of \$1.1 million, or 1.7%, as compared to \$63.1 million in the eleven months ended 30 November 2015.

*General and administrative expenses*

The Group recorded \$11.3 million in general and administrative expenses for the eleven months ended 30 November 2016, a decrease of \$0.2 million, or 1.4%, as compared to \$11.5 million in the eleven months ended 30 November 2015.

*Transportation tariffs*

The Group recorded \$3.6 million in transportation tariffs for the eleven months ended 30 November 2016, a decrease of \$1 million, or 22%, as compared to \$4.6 million in the eleven months ended 30 November 2015. The decrease was primarily due to a decline in the transportation costs.

*Other income*

The Group's other income for the eleven months ended 30 November 2016 was \$15 million, an increase of \$0.5 million, or 3.4%, compared to \$14.5 million in the eleven months ended 30 November 2015.

*Operating profit*

The Group's operating profit for the eleven months ended 30 November 2016 was \$41.5 million, a decrease of \$30 million, or 42%, compared to \$71.5 million in the eleven months ended 30 November 2015. This was principally as a result of a decline in revenue for the period.

*Interest income*

The Group's interest income for the eleven months ended 30 November 2016 was \$6.8 million, an increase of \$1.9 million, or 40.1%, compared to \$4.9 million for the eleven months ended 30 November 2015. The increase was primarily due to an increase in interest income from current accounts and deposits.

#### *Finance costs*

The Group recorded \$74 million in finance costs for the eleven months ended 30 November 2016, a \$25.6 million, or 52.7% increase, as compared to \$48.4 million for the eleven months ended 30 November 2015. The increase was primarily due to increased interest expenses incurred after the issuance of the Original Notes in March 2016.

#### *Share of result of associates*

The Group recorded \$5 million in share of result of a single associate for the eleven months ended 30 November 2016, a decrease of \$2.5 million, or 34.1%, as compared to \$7.5 million in the eleven months ended 30 November 2015. The decrease was primarily due to a decrease in TAP employee costs and reduced consulting fees.

#### *Foreign exchange net loss*

The Group recorded a foreign exchange loss of \$20.7 million for the eleven months ended 30 November 2016, as compared to a loss of \$0.6 million in the eleven months ended 30 November 2015. The change was primarily due to an adverse change in foreign currency exchange rates, which resulted in losses incurred by the Group in respect of a portion of a capital contribution which had been made in Manat.

#### *Loss/profit before income tax*

The Group recorded \$51.4 million in loss before income tax for the eleven months ended 30 November 2016, as compared to a profit before income tax of \$19.8 million in the eleven months ended 30 November 2015. The change was primarily due to increased interest expenses incurred after the issuance of the Original Notes in March 2016, the decline in oil price and foreign exchange losses.

#### *Income tax expenses*

The Group recorded \$1.5 million in income tax expenses for the eleven months ended 30 November 2016, a decrease of \$1.9 million, or 55.2%, as compared to \$3.4 million in the eleven months ended 30 November 2015. The decrease was primarily due to a decrease in taxable profits of subsidiaries.

#### *Loss/profit for the period*

The Group recorded a loss of \$52.9 million for the period for the eleven months ended 30 November 2016, as compared to a profit of \$16.4 million in the eleven months ended 30 November 2015. The change was primarily due to the reasons explained above.

## Liquidity and Capital Resources

### Cash Flows

The following table sets out summary cash flow information for the periods indicated.

	For the eleven months ended 30 November 2016	For the eleven months ended 30 November 2015	Change	For the year ended 31 December 2015	For the period from 31 March 2014 (inception) to 31 December 2014
<i>(unaudited)</i>					
<i>(US\$ thousands, except %)</i>					
Net cash flows from operating activities .....	100,003	122,433	(18.3%)	137,249	28,426
Net cash used in investing activities .....	(2,491,624)	(1,662,667)	49.9%	(1,940,216)	(2,306,907)
Net cash from financing activities .....	2,596,050	1,413,729	83.6%	1,845,329	2,490,679
Net foreign exchange translation differences	(20,326)	—	(100.0%)	—	—
<b>Net increase in cash and cash equivalents .....</b>	<b>184,103</b>	<b>(126,505)</b>	<b>(245.5%)</b>	<b>42,362</b>	<b>212,198</b>
Cash and cash equivalents at the beginning of the period .....	254,560	212,198	20.0%	212,198	—
<b>Cash and cash equivalents at end of the period .....</b>	<b>438,663</b>	<b>85,693</b>	<b>411.9%</b>	<b>254,560</b>	<b>212,198</b>

#### Net cash flows from operating activities

The Group's net cash flows from operating activities for the eleven months ended 30 November 2016 was \$100 million, a decrease of \$22.4 million, or 18.3%, compared to \$122.4 million in the eleven months ended 30 November 2015. This was principally as a result of a decline in revenues resulting from lower oil prices.

#### Net cash used in investing activities

The Group's net cash used in investing activities was \$2,491.6 million for the eleven months ended 30 November 2016, an increase of \$828.9 million, or 49.9%, as compared to \$1,662.7 million in the eleven months ended 30 November 2015. The increase was primarily due to an increased amount of investments in construction in progress of TANAP.

#### Net cash from financing activities

The Group's net cash from financing activities for the eleven months ended 30 November 2016 was \$2,596.1 million, an increase of \$1,182.4 million, or 83.6%, compared to \$1,413.7 million in the eleven months ended 30 November 2015. This was principally as a result of proceeds of the Original Notes issued in March 2016 and capital injections by shareholders.

#### Net increase in cash and cash equivalents

The Group's net increase in cash and cash equivalents for the eleven months ended 30 November 2016 was \$184 million, while the Group's net decrease in cash and cash equivalents for the eleven months ended 30 November 2015 was \$126.5 million. These changes were due to the cumulative effect of the reasons described above.

### Financing Requirements

The total investments required for the Projects from all shareholders are estimated at approximately US\$43 billion. The Issuer's share of these investments amounts to approximately US\$12.1 billion on a gross investment basis, with the resulting net funding requirements after taking into account expected proceeds from Shah Deniz 1 and the SCP's existing operations being approximately US\$11.1 billion. Of this amount, approximately US\$5.7 billion had been spent as of 30 November 2016. In addition to these

investments, proceeds from Shah Deniz 1 and the SCP's existing operations amounting to US\$0.33 billion were re-invested by the Issuer in the Projects during the period from its incorporation on 31 March 2014 until 30 November 2016.

## **Funding**

### Equity Contributions

The Issuer's initial share capital was US\$100 million, of which the Government contributed US\$51 million and SOCAR contributed US\$49 million. The share capital of the Issuer has been increased on several occasions through capital contributions from the Government and SOCAR *pro rata* to their ownership interests. As of 30 November 2016, the Issuer's share capital was US\$1,740.8 million. As of the date of this Prospectus, the Issuer's share capital is US\$2,415.8 million.

It is expected that in the future most of the Issuer's funding requirements will be satisfied through debt financing and, to a lesser extent, capital contributions, particularly if debt financing is not available on commercially acceptable terms.

### Debt Financing

The Issuer plans to raise debt financing to fund its remaining committed capital investments in the Projects from March 2017 to 2019. These investments are expected to amount to approximately US\$5.2 billion and result in a net funding need of approximately US\$4.8 billion, taking into account expected proceeds from Shah Deniz 1 and the SCP's existing operations. Debt financing is expected to consist of one or several instruments (or tranches of instruments) including commercial loans, loans from development finance institutions and bonds. These instruments are expected to be senior unsecured and rank *pari passu* among themselves. However, the Conditions of the Notes would not restrict the Issuer from granting security over its assets in respect of certain types of borrowings.

### Existing Indebtedness

Since its incorporation in March 2014, the Group has raised financing in order to acquire its interests in the Projects and to fund its share of the capital expenditures required to develop the Projects. As of 30 November 2016, the Group's total debt outstanding amounted to US\$4.3 billion (including accrued interest) and principally comprised (i) US Dollar-denominated unsecured bonds issued by the Issuer that are listed on the Baku Stock Exchange but have been subscribed for in full by SOFAZ (the "**SOFAZ Bonds**"), (ii) the Original Notes and (iii) shareholder loans from BOTAŞ and BP to TANAP A.Ş. In addition, in January-February 2017 the Issuer entered into and made withdrawals under the loan agreements with IBRD and AIIB, as described in more detail below.

### Bonds issued to SOFAZ

In accordance with the Presidential Decree dated 25 February 2014, SOFAZ, a government fund established for funding important socio-economic projects, was issued a mandate to finance the Group's acquisitions of interests in the Projects and the obligations relating to the interests in the Project once acquired. Accordingly, in 2014 the Group issued senior, unsecured bonds to SOFAZ in the aggregate principal amount of US\$ 2,517.0 million with a maturity period of 10 years. SOFAZ Bonds bear interest at the rate of six months LIBOR plus 1%. The repayment of interest shall be made in semi-annual instalments from 2021 until 2024.

At initial recognition, the Group calculated the fair value of the SOFAZ Bonds using the market rate for similar financial instruments of six months LIBOR plus 4.5% and recognised the difference between the fair value and carrying amount of the SOFAZ Bonds as government grant in its consolidated statement of financial position.

As of 30 November 2016, the total contractual debt outstanding under the SOFAZ Bonds was US\$2,614.2 million. At a rate of 4.5% plus LIBOR, the total long-term borrowings due to SOFAZ, excluding the government grant, was US\$2,058.5 million as of that date. See "*Selected Financial and Other Information*".

## The Original Notes

In March 2016, the Issuer issued US\$1.0 billion of senior unsecured notes guaranteed by the Republic of Azerbaijan, the Original Notes. The Original Notes bear interest at a rate of 6.875% per annum, payable semi-annually in arrears on 24 March and 24 September of each year. The Original Notes mature on 24 March 2026 and are listed on the Irish Stock Exchange. The Original Notes were issued at a discount and the Group received US\$991.1 million from the issue. Transaction costs in the amount of US\$2.4 million related to the issue of the Original Notes are allocated to long-term liability.

## Loans from BOTAS and BP

As per the Term Loan Facility Agreement signed in March 2015, the shareholders of TANAP A.Ş. undertook to make available a loan facility for financing of their shares of the capital expenditures relating to TANAP. Under such loan facility, shareholder term loans in the amounts of US\$481.6 million and US\$192.8 million have been provided by BOTAS and BP, respectively, to TANAP A.Ş. as of 30 November 2016. The loans bear interest at the rate of one month LIBOR plus 5.5%. The first repayment date under the loan agreements is the earlier of (i) three months after TANAP becomes operational and the first gas passes through the pipeline and (ii) 31 December 2023. Thereafter, the repayment has to be made on a monthly basis from the first repayment date, provided that there are sufficient cash balances in the distributions account. The final repayment date for any outstanding amounts under the loans is 31 December 2036 or such later date as TANAP may set out in its target loan repayment schedule.

## Loans from IBRD and AIIB

In January 2017, the Issuer entered into loan agreements with the IBRD and the AIIB that allow it to draw up to US\$400 million and US\$600 million, respectively. Both loans are unsecured, guaranteed by the Government, bear interest at a LIBOR rate plus margin, and have 30-year maturity periods, five-year grace periods, and drawing periods expiring in mid-2021. As of 28 February 2017, US\$108.4 million and US\$162.6 million have been drawn under the IBRD and the AIIB loans, respectively.

Furthermore, the Issuer is in discussions with a number of international financial institutions and commercial banks regarding borrowings to cover the Issuer's outstanding financing requirements under the Projects.

As of 30 November 2016, all of the Group's indebtedness was denominated in US Dollars and, except for the Original Notes issued in March 2016, all Group indebtedness bore interest at floating rates. Interest accrued on the Original Notes during the eleven months ended 30 November 2016 was US\$47.6 million. For the eleven months ended 30 November 2016, the Group capitalised US\$45.6 million in borrowing costs as part of construction in progress and development costs.

## **Capital Expenditures**

The following table sets forth the Group's estimated consolidated net capital expenditures by Project for the periods indicated.

	For the year ended 31 December						
	2014	2015	2016	2017(E)	2018(E)	2019(E)	2020(E)
				(US\$ million)			
Shah Deniz.....	(1,378.5)	(671.8)	(356.0)	(861.8)	(309.8)	(70.6)	(37.4)
SCP .....	(474.0)	(198.6)	(85.1)	(99.6)	(46.5)	23.0	42.4
TANAP .....	(603.7)	(411.5)	(1,217.8)	(1,406.5)	(1,252.8)	(605.2)	281.7
TAP .....	(125.5)	(53.5)	(186.1)	(287.3)	(181.0)	(224.7)	67.8
<b>Total capital expenditures .....</b>	<b>(2,581.8)</b>	<b>(1,335.3)</b>	<b>(1,845.0)</b>	<b>(2,655.1)</b>	<b>(1,790.1)</b>	<b>(877.5)</b>	<b>354.4</b>

## **Commitments and Contingencies**

As of 30 November 2016, the Group had outstanding commitments and contingencies as follows:

### **Commitments related to the Group's participating interest in Shah Deniz PSA**

On 17 December 2013, the Shah Deniz consortium announced the final investment decision for Stage 2 development of the Shah Deniz gas field. The Group is committed to finance capital expenditures related to the Shah Deniz project based on its share of interest.

The Shah Deniz Operating Company (BP) has entered into a number of capital commitments. As of 30 November 2016, the Group estimated its share of these commitments to be US\$745.5 million.

#### ***Commitments related to SCP expansion***

The contractor parties to the Shah Deniz PSA made the final investment decision regarding the SCP expansion project on 17 December 2013. The Group has a commitment to fund the SCP expansion project in proportion with its 6.67% shares throughout the construction and initial operational phase.

As of 30 November 2016, the remaining capital expenditures relating to the SCP expansion were estimated at US\$1,633.8 million, of which the Group's share is US\$109.0 million.

#### ***Commitments related to TANAP***

As of 30 November 2016, the remaining capital expenditures relating to the TANAP project were estimated at US\$5,229.2 million, of which the Issuer's share is US\$3,032.9 million.

#### ***Commitments related to TAP***

As of 30 November 2016, the remaining capital expenditures relating to the TAP project were estimated at US\$3,460.8 million, of which the Group's share is US\$692.2 million.

#### ***Commitments under the Deferred Sale and Purchase Agreement***

In July 2014, the Issuer signed a deferred sale and purchase agreement for the acquisition of a 10.0% participating interest in the Shah Deniz project, an 8.0% share in AGSC from AzSD and a 10.0% share in SCPC from AzSCP. These transactions are expected to close in March 2023. Pursuant to the terms of the agreement, the Group shall make advance payments for these acquisitions to AzSD and AzSCP, while control will pass to the Group in 2023, provided that certain conditions precedent are satisfied. As of 30 November 2016, the Group had commitments for payments in the amount of US\$535.0 million to AzSD and has to make progress payments equal to the Shah Deniz 2 development cash call requirements of AzSD until 2020. In addition, the Group has to make progress payments equal to the SCP expansion project related cash calls requirements of AzSCP until 2020.

#### ***Commitments under the Funding Agreement with BOTAS***

On 26 May 2014, SOCAR and BOTAS entered into a funding agreement for financing BOTAS's 5% shares in TANAP A.Ş., upon acquisition of shares in TANAP A.Ş., by BOTAS (the "**Funding Agreement**"). On 23 July 2014, the Group entered into a novation agreement with SOCAR and BOTAS, where all rights and obligations under the Funding Agreement were transferred from SOCAR to the Group. According to the agreement with BOTAS, the Group has a commitment for providing interest free loan to BOTAS for financing its 5% share in TANAP A.Ş.'s future cash call requirements until TANAP becomes operational.

#### ***Off Balance Sheet Arrangements***

As of 30 November 2016, the Group had no off balance sheet arrangements. The Issuer reports all recognised contingent liabilities and commitments as provisions, or otherwise discloses them in its consolidated financial statements. Credit risk for off balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract.

#### ***Quantitative and Qualitative Disclosures about Market Risk***

In the ordinary course of business, the Group is exposed to credit, liquidity and market risks. Market risks arise from fluctuating currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may

impact financial results, the Group's overriding strategy is to maintain a strong financial position. Although there are no structured formal risk management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

### ***Foreign Exchange Risk***

Foreign exchange risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Foreign exchange risk arises primarily from future commercial transactions, recognised assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency. The Group does not have any formal procedures on managing foreign exchange risk, however, management is quite well informed on the tendencies in the economy and has undertaken steps to minimise its foreign exchange risks. Management does not hedge the Group's foreign exchange risk. The major financial instruments in a foreign currency comprise loan receivables and certain cash and cash equivalents that are denominated in Euro.

In the eleven months ended 30 November 2016, a +/-10.0% change in the US Dollar to other currencies' rate would have resulted in a positive or negative effect of US\$43,450 thousand on profit before tax.

### ***Interest Rate Risk***

The Group holds significant interest bearing assets and liabilities, as described in Note 7 and Note 10 to the Interim Financial Statements. Interest rates on existing loan agreements are fixed in the respective agreements and depend on fluctuations in LIBOR and Euro rate for cross border shareholder loans published by the Swiss federal tax authorities (ESTV). As of 30 November 2016, the Group had total debt outstanding in an aggregate amount of US\$4.3 billion (including accrued interest), all of which, except for the Eurobonds issued in March 2016, bore interest at floating rates, determined by reference to LIBOR for US Dollar deposits.

The Issuer incurs debt for general corporate purposes including financing capital expenditures, financing acquisitions and working capital needs. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding variable rate borrowings. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of the Issuer's borrowings. A hypothetical and instantaneous increase of fifty basis points in the interest rate applicable to each category by currency of floating rate financial liability held as of 30 November 2016 would have resulted in additional net interest expense of approximately US\$11,059 thousand in for the eleven months ended 30 November 2016. However, the Issuer's sensitivity to decreases in interest rates and corresponding increases in the fair value of the Issuer's debt portfolio would negatively affect results and cash flows only to the extent that the Issuer elected to repurchase or otherwise retire all or a portion of the Issuer's fixed rate debt portfolio at prices above carrying value.

### ***Credit Risk***

Financial instruments involve, to varying degrees, credit risks. The Group is subject to credit risk from its portfolio of loan receivable, cash and cash equivalents, deposits and accounts receivable and would be exposed to losses in the event of non-performance by counterparties.

The Group's exposure to credit risks arises from default of the counterparty, with a maximum exposure of US\$771.8 million as of 30 November 2016.

The Group places its cash with high credit quality financial institutions. The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade for condensate on credit terms are subject to credit verification procedures. Gas sales are made through AGSC to entities with strong financial position.

### ***Liquidity Risk***

The Group monitors its risk to a shortage of funds by reviewing its net financial debt indicator on a regular basis. The net financial debt represents the difference between total financial liabilities and cash and cash equivalents. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of loans.



## ***Taxation***

Azerbaijan's tax legislation and regulations are subject to ongoing changes and varying interpretations. Instances of inconsistent opinions are not unusual. Because of the uncertainties associated with Azerbaijan's tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued as of 30 November 2016. As of 30 November 2016, the Group's management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax positions will be sustained.

## ***Preparation of Financial Statements***

The Group's financial statements are prepared using the financial statements of, or the information provided by, the Operating Companies. Therefore, the timing of the preparation of the Group's consolidated annual or interim IFRS financial statements is dependent on the timing of the availability of the Operating Companies' financial statements and/or information. In particular, delays by the Operating Companies in preparing their financial statements or providing required information to the Issuer could cause delays in preparing the financial statements of the Group.

## ***Critical Accounting Policies and Estimates***

The Financial Statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB"). The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of commitments, guarantees and contingent liabilities, at the end of the reporting period. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

On an on-going basis, management evaluates their estimates, including those related to revenue recognition and contingencies. Management bases their estimates on various market-specific assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making assumptions about the carrying values of assets that are not readily apparent from other sources. Actual results may differ significantly from these estimates using different assumptions or conditions.

The key assumptions concerning the future and other key sources of estimation uncertainty at the date of consolidated financial statements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below. Set forth below are summaries of certain of the most critical accounting estimates and judgments required of the Issuer's management. For a full description of the Issuer's significant accounting policies, see Note 3 to the Audited Financial Statements.

### ***Reserve estimates***

Estimates of recoverable quantities of proven and probable reserves reported include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex geological and geophysical models in order to make an assessment of the size, shape, depth and quantity of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period, changes in reported reserves can impact provision of decommissioning liabilities due to changes in expected future cash flows. Reserves are integral to the amount of depreciation, depletion and amortisation charges to the consolidated statement of comprehensive income.

Natural gas and condensate reserves depend on price fluctuations as a result of change in production entitlement split between the State and contractor parties. Natural gas prices are calculated based on the long-term sales contracts provisions and depend on crude oil prices and other inputs. The current long-term Brent FOB oil price assumption used in the estimation of reserves is US\$72.34 per barrel.

The level of estimated commercial reserves is also a key determinant in assessing whether the carrying value of any of the Group's development and production assets has been impaired.

### ***Decommissioning liabilities***

Under the terms of the Shah Deniz PSA, the Group will have to make contributions to the abandonment fund when seventy percent (70%) of petroleum reserves of the Shah Deniz field are recovered. Decommissioning liabilities are stated in the amount of expected contributions related to the currently employed assets discounted at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. This valuation requires the Group to make estimates about timing of expected future cash flows and adjustment to the discount rate, and hence they are subject to uncertainty. The estimation of the decommissioning liabilities is based on the assumption that contributions to the abandonment fund will start in 2029. For further details, see Note 17 to the Audited Financial Statements.

As of 31 December 2015, if the estimated discount rate used in the calculation had been 1% higher/lower than management's estimate, the carrying amount of the provision would have been US\$7,266 lower/US\$8,584 higher, respectively.

#### ***Deferred and accrued revenue***

In the valuation of the Group's over-lift and under-lift position under the Shah Deniz PSA as of the year-end the Group used the US\$35.74 market price for Brent crude oil as of 31 December 2015.

#### ***Recoverability of oil and gas assets***

The Group assesses each asset or cash generating unit ("CGU") every reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value in use. These assessments require the use of estimates and assumptions such as long-term oil prices, discount rates, operating costs, future capital requirements, decommissioning costs, exploration potential, reserves and operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risk and uncertainty. Therefore, there is a possibility that changes in circumstances will impact these projections, which may impact the recoverable amount of assets and/or CGUs.

Given the nature of the Group's activities, information on the fair value of an asset or CGU is not practicable to identify. Consequently, the recoverable amount used in performing the impairment test described below is value-in-use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

#### ***Key assumptions used in value-in-use calculations***

The calculation of value-in-use for oil fields is most sensitive to the following assumptions:

##### *Identification of CGU*

CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets of group of assets. The management assesses that SCP, TANAP and TAP projects are being constructed with the ultimate goal of the delivering Shah Deniz field natural gas to the Georgian, Turkish and European markets. Therefore, all these projects have been considered as one CGU and the impairment test is performed at the Group level.

##### *Capital expenditures*

Capital expenditures necessary to maintain estimated production volumes are based on long-term development plans for particular field.

##### *Crude oil price*

Forecast commodity prices are publicly available. The management has used the assumptions used in the Projects' financial models. The prices of the key input (oil prices) were obtained from publicly available sources. If the forecasted prices used in the calculation had been US\$5.00 lower than management's estimate, this would not result in any impairment loss as of 31 December 2015.

### *Discount rate*

The post-tax discount rate applied to the cash flow projections of CGU was 6%. The discount rate calculation is based on the specific circumstances of the Group and derived from its incremental borrowing rate adjusted to the specific risks associated with the asset's estimated cash flows. If the estimated discount rate used in the calculation had been 1.0% higher than the management's estimate, this would not result in an impairment loss as of 31 December 2015.

### *Contingencies*

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

## MANAGEMENT

### Governance Bodies

The Issuer's management structure consists of the General Assembly of its shareholders, its Supervisory Board and its general director, who, together with other officers of the Issuer, are responsible for the day-to-day management of the Issuer. See "*Relationship with the Government—Supervisory Board and Senior Management*", "*Risk Factors—Risk Factors Relating to the Issuer's Business—The Government of Azerbaijan, which owns and controls the Issuer, may cause the Issuer to engage in business practices that may not be in the interests of the Noteholders and may determine the appointment or removal of members of the Issuer's management team*".

### General Assembly

The Issuer's General Assembly of Shareholders (the "**General Assembly**") is its highest corporate governance body with exclusive rights in relation to the following matters:

- amendments to the charter of the Issuer;
- the reorganisation and liquidation of the Issuer, where such a decision is adopted and, in due circumstances, the approval of transfer acts and division balance sheets, or the appointment of liquidation commission and approval of interim and final liquidation balance sheets;
- approval of the members and the chairman of the Supervisory Board pursuant to the relevant resolution of the State Commission;
- the amount of the Issuer's authorised capital;
- pursuant to a corresponding proposal of the Supervisory Board, approval of the Issuer's annual budget and any changes thereto, annual programs, annual reports, balance sheets, profit and loss reports and distribution of such profit and loss;
- pursuant to a corresponding proposal of the Supervisory Board, approval of the Issuer's corporate structure, staff positions, including changes therein, setting up of executive bodies, appointment of members of executive bodies, termination of their authorities in advance and approval of their salaries, identification of the duties and responsibilities of the management team, resolutions as to setting up internal audit services and appointment and termination of the internal audit manager and internal auditors;
- pursuant to a corresponding proposal of the Supervisory Board, resolutions as to the mechanisms for financing the obligations of the Issuer;
- pursuant to a corresponding proposal of the Supervisory Board, measures in regards to the purchase or sale of shares by the Issuer in any legal entity or joint enterprise, decisions about setting up branch and representative offices, their reorganisation and liquidation; and
- pursuant to a corresponding proposal of the Supervisory Board, approval of health, safety, environmental, reserve and accounting rules and procedures and changes thereto.

Decisions regarding matters within the authority of the General Assembly are made by a simple majority of votes, with each shareholder entitled to participate and vote proportionately to the number of shares it holds. The General Assembly meets annually (for ordinary meetings), and from time to time for extraordinary meetings.

### Supervisory Board

The Issuer has a supervisory board (the "Supervisory Board") of five members, whose role is to exercise overall control of the activities of the Issuer and which has authority in relation to the following matters:

- adoption of resolutions on convening the ordinary General Assembly;
- proposals to the General Assembly for their approval;

- monitoring the efficient use of the Issuer's existing shares in the Projects and the implementation of the Projects;
- approval of contracts, where the Issuer is a direct party, with total value exceeding US\$100 million;
- approval of the Issuer's development, investment, transaction, borrowing strategies and amendments thereto;
- approval of the Issuer's Project-related annual financing plans and annual payment schedules and amendments thereto;
- decisions as to issuance, repurchase, conversion, withdrawal from turnover and liquidation of the Issuer's securities;
- decision as to the inspection of the Issuer's financial business activity, and if needed, decision as to the involvement of an external auditor for this purpose;
- defining internal auditing policies and strategies, approval of work plan and procedures, instructions for internal auditors and obtaining reports on outcomes of audits conducted;
- regularly informing the State Commission on the Issuer's business;
- ensuring that there is no abuse of control of the Issuer by its shareholders; and
- approval of quarterly reports.

At least three members of the Supervisory Board must be present for a quorum. Decisions of the Supervisory Board are made by a simple majority of those who are present and eligible to vote. The decisions become binding on the Issuer once these requirements are met. See "*Relationship with the Government*".

The members of the Supervisory Board are appointed and approved by the General Assembly pursuant to the relevant resolution of the State Commission. The term of each member is three years, and members may be re-elected for subsequent terms. Currently, two members of the Supervisory Board also represent shareholders at the General Assembly. As of the date of this Prospectus, the Supervisory Board of the Issuer is comprised of:

<u>Name</u>	<u>Age</u>	<u>Appointed</u>	<u>Current Position</u>
Yagub Eyyubov .....	71	5 March 2014	Chairman of the Board
Natig Aliyev .....	69	5 March 2014	Member of the Board
Rovnag Abdullayev .....	51	5 March 2014	Member of the Board
Shahmar Movsumov .....	45	5 March 2014	Member of the Board
Shahin Mustafayev .....	51	5 March 2014	Member of the Board

Set out below is certain information regarding each member of the Supervisory Board.

#### ***Yagub Eyyubov***

Yaqub Eyyubov has been the First Deputy Prime Minister of Azerbaijan since 2003. He was born in Mingachevir city on 24 October 1945 and graduated from Azerbaijan Polytechnic Institute in 1972. He is a construction engineer, a Doctor of Technical Sciences and a professor. He began his career as a factory lathe operator in 1964. He began his studies at Azerbaijan Polytechnic Institute in 1963, but joined and served in the military from 1964 to 1967. After leaving the military, he continued his studies in 1968 and graduated in 1972. He was the chairman of the Comsomol Committee of the Construction Faculty of Azerbaijan Polytechnic Institute from 1970 until 1972, worked as a senior laboratory assistant and postgraduate fellow from 1972 until 1974 and as a deputy chairman of the party committee of Azerbaijan Polytechnic Institute from 1973 until 1974. From 1975 until 1997, he held the positions of part-time substitute senior lecturer, deputy dean, senior lecturer, assistant professor, acting dean, vice rector on educational matters and faculty chief of the Azerbaijan Engineering-Construction Institution. He was elected as an academic of the International Engineering Academy in 1994. From 1997 until 1998, he was

chairman of the State Committee on Supervision of Safe Working in Industry and Mountain-Mine Control. From 1999 until 2003, he was the Deputy Prime Minister of the Republic of Azerbaijan in the Cabinet of Ministers.

### ***Natig Aliyev***

Natig Aliyev is the Minister of Energy of Azerbaijan, having held the role since he was appointed in 2013. Prior to that, he was the Minister of Industry and Energy (which was the former name of the Ministry of Energy), to which he was appointed in 2005. He was born in Baku on 23 November 1947 and graduated from the M. Azizbayov Azerbaijan Oil and Chemistry Institution in 1970 with a specialisation as a mountain engineer-geologist. After graduating, he worked in the Complex Sea Geology-Exploration unit of "Azdənizneftkəşfiyyat" Trust. He received his candidacy of sciences from the Geology Institution of Azerbaijan Academy of Sciences in 1974 and subsequently worked as a senior science personnel. He was appointed as the head of the Geology Department of the Complex Sea Geology-Exploration unit of "Xəzərdənizneftqazsənaye" All-USSR Production Union in 1979. He started working as an instructor in the oil and chemistry department of the Azerbaijan Republic Communist Party Central Committee in 1984, and later worked as the head of division of the social-economic development department. He worked as the President and Chairman of the Board of Directors of SOCAR from 1993 until 2005, the head of the Chief Committee of the project on development of Azeri-Chirag-Gunashli fields from 1994 and the Chairman of the Board of Directors of Baku-Tbilisi-Ceyhan Company from 2002. He was elected the president of the oil-workers' congress in 2005.

### ***Rovnag Abdullayev***

Rovnag Abdullayev is the President of SOCAR, having held that role since he was appointed in December 2005. He is also a member of Parliament, and was first elected in 2005, then reelected in 2010 and 2015. He was born in Nakhchivan City on 3 April 1965. In 1982, he entered the Industrial and Civil Construction Engineering Department of Azerbaijan Construction Engineering Institute. After having served in the army, he was transferred to the Construction Engineering Institute in 1985, from which he graduated in 1989. In 1989, Mr Abdullayev started working at Neft Dashlari (Oil Rocks). In 1990, Mr Abdullayev took a position as an engineer in the Construction Department of the 28th of May Oil and Gas Production Department. In 1991, Mr Abdullayev became the Head of the Production Technology Department of the Construction and Assembling Management #3 of the "Xəzərdənizneftqazsənaye" (Caspian Sea Oil and Gas Construction) Trust. In 1997, Mr Abdullayev became the Head of the "Xəzərdənizneftqazsənaye" Trust. On 31 March 2003, he was appointed Director of the Heydar Aliyev Baku Oil Refinery. On 14 March 2008, he was appointed President of the AFFA (Azerbaijan Football Federations' Association).

### ***Shahmar Movsumov***

Shahmar Movsumov is the Executive Director of SOFAZ, having held the role since he was appointed in 2006. He was born in Nakhchivan City on 31 January 1972 and graduated from the Moscow State International Relations Institution in 1995 with a degree in International Economic Relations. He received a Masters in Public Administration from the Kennedy School of Government of Harvard University in 2004. From 1995 until 2005, he worked, for various periods, as the senior economist, group leader, head of division, deputy department director, department director and senior advisor to the Chairman of the Management board of the Central Bank of Azerbaijan. He was the General Director of the National Bank of Azerbaijan from 2005 until 2006. Mr Movsumov is also the chairperson of the Government Commission on the Extractive Industries Transparency Initiative since 2006.

### ***Shahin Mustafayev***

Shahin Mustafayev is the Minister of Economy, having held the role since he was appointed in 2013 (as the Minister of the Economy and Industry, the predecessor to the Ministry of Economy). He was born in Noyemberyan on 13 June 1965 and graduated from the Voznesenski Finance and Economic Institute, Baku branch in 1989. He began his career as chief accountant in the Baku Chief Construction Department in 1990. From 1991 until 1992, he worked as a chief account in "Spektr" small enterprise. From 1992 until 1999, he worked as a state tax inspector, senior state tax inspector, chief state tax inspector and head of department in the Nasimi district State Tax Inspectorate. From 1999 until 2000, he worked as the division head of the Economic Analysis, Registration, Reporting and Forecast of Tax Inputs Department under the Chief State Tax Inspectorate. From 2000 until 2003, he held the position of the Deputy Head

and then the Head of Economic Analysis and Organisation of Registration Department under the Ministry of Taxes. From 2003 until 2005, he worked as a chief accountant of the central accountancy and head of Registration Department at SOCAR. He served as a vice-president on economic matters of SOCAR from 2005 until 2006. He was appointed the First Deputy Tax Minister in September 2006. He was the Economic Development Minister from 31 October 2008 to 22 October 2013.

### **General Director and Senior Management**

The General Director is responsible for the day-to-day management of the Issuer. The General Director's nomination is approved by the Supervisory Board in accordance with a proposal from SOCAR. Thereafter, the General Assembly appoints the Issuer's General Director for a three-year term. The Issuer's senior management is appointed by the General Assembly. The General Director has the following authority and main responsibilities:

- basing the work of the Issuer on strategies, annual programs, plans and other documents approved by the General Assembly and the Supervisory Board;
- managing the Issuer's operations;
- representing the Issuer in relationships with third-parties, including any representations in court;
- preparing documents for approval by the General Assembly and the Supervisory Board;
- signing agreements relating to the sale or purchase of services or goods with a total value of less than US\$100 million within the Issuer's approved annual budget;
- appointing and dismissing Issuer employees (with the exception of employees whose appointment and removal are under the sole authority of the General Assembly and the Supervisory Board);
- determining salaries within the corporate structure, staffing units and annual budget approved by the General Assembly and issuing orders on motivating and disciplining employees; and
- performing other functions not within the responsibilities of the General Assembly and the Supervisory Board under the charter of the Issuer.

As of the date of this Prospectus, key members of the Issuer's senior management are:

<b>Name</b>	<b>Age</b>	<b>Appointed</b>	<b>Current Position</b>
Afgan Isayev .....	42	April 2014	General Director
Rashad Mustafayev .....	38	January 2015	Deputy General Director
Adil Pashayev .....	37	January 2017	Director of Finance Department
Fuad Sultanov .....	24	May 2015	Head of Legal Department
Ilyas Zeynalov .....	29	May 2016	Director of Commercial Department

#### ***Afgan Isayev***

Afgan Isayev was born in Baku, Azerbaijan on 3 November 1974 and graduated from Rutgers University, New Jersey, United States in 1996 with a BS degree in Finance and a BA degree in Economics with a minor in European studies. He received his MBA in Finance and Management Information Systems from Rutgers Graduate School of Management, New Jersey, United States in 1998. From 1998 to 2000, Mr Isayev worked at American Express International Bank in New York as a regional financial analyst (Central Eastern Europe and CIS markets). Between 2001 and 2002, he worked as a Risk Manager in the Strategic Alliances Group at American Express in New York. From 2002 until 2003, he worked as a Manager in the Portfolio Analysis Group at American Express in New York. In 2004, he became the deputy CEO of Bank of Baku OJSC in Baku, Azerbaijan, and was responsible for strategic development and international funding, and subsequently risk management until 2009. The next organisation where Mr Isayev pursued his career was Azerbaijan Investment Company ("AIC"), a state-owned equity fund. He worked as the executive director of AIC from 2009 until 2012. In 2012, he joined SOCAR as the General Manager of SOCAR Georgia Investments LLC. In 2013, he became the Adviser to the President of

SOCAR and in 2014, he was appointed as the General Director of the Issuer in addition to his advisory role.

***Rashad Mustafayev***

Rashad Mustafayev was born in Jalilabad, Azerbaijan on 10 June 1978 and graduated from Tafakkur University in 1998 with a Bachelor of Law degree. He received his Master of Law degree from Baku State University in 2001. In 2014 he graduated from the Academy of Public Administration under the President of the Republic of Azerbaijan with a Bachelor in Administrative Management degree. Mr. Mustafayev started his career in 2000 at the Ministry of the State Property of Azerbaijan Republic as the Lead Advisor of the Legal department. In 2001 he joined the Ministry of Economy of the Republic of Azerbaijan as the Lead Advisor of the Legal department. A year later, he became the Senior Advisor, then, in 2003, he was appointed as a division head and, following that, in 2008, he was promoted and became the Deputy Director of the Legal Department at the Ministry of Economy. In 2015, he joined the Issuer as a Deputy General Director.

***Adil Pashayev***

Adil Pashayev was born in Gadabay, Azerbaijan on 20 October 1979 and graduated from the Azerbaijan State Economic University in 2000 with a Bachelor of Science Degree in the Regulation of Economy. Mr. Pashayev received his Masters Degree in Engineering Economics and Management from the Azerbaijan State Economic University in 2002. He started his career as the Logistics Specialist at the Transport Department of “Azertrans LTD” in 2001. Between 2002 and 2014 Mr. Pashayev worked at different accounting and finance related positions (including managerial and supervisory positions) at various entities located in Azerbaijan: “Ganja Audit Organization”, “Amorgo Management and Consulting” LLC, “Binagadi Oil Company”, “Middle East Petroleum Garachuhur Operating Company” LLC, branch of “Black Gold International Oil FZCO” in Azerbaijan, “Innova Construction and Contracting” LLC and branch of “Azerbaijan International Mineral Resources Operating Company” in Azerbaijan. He joined the Issuer in 2014 as the Chief Accountant. In January 2017, he was promoted to the position of the Finance Director.

***Fuad Sultanov***

Fuad Sultanov was born in Baku, Azerbaijan on 1 January 1993 and graduated from the University of Aberdeen, United Kingdom in 2013 with a Bachelor of Laws degree with options in Management Studies. He received his Master of Laws in Oil and Gas law from the University of Aberdeen in 2014. In 2012, Mr Sultanov worked for two months with Azeri M-I Drilling Fluids LTD as an Expatriate Coordinator. He served as a Legal Intern in an aggregate period of approximately six months in 2012 and 2013 at Statoil Apsheron A.S. In 2014, he was appointed as Chief Legal Counsel of the Issuer before being promoted to the Head of the Legal Department in 2015.

***Ilyas Zeynalov***

Ilyas Zeynalov was born in Baku, Azerbaijan on 29 April 1987, and graduated from Mississippi Valley State University (“MVSU”), Mississippi, United States in 2010 with BS degree in Accounting. He received his MBA degree with a concentration in Finance from MVSU in 2014. While receiving his BS and MBA degrees, he worked in a number of positions at various university departments and facilities: as Secretary’s Assistant at the International Programs Office from 2006 to 2007, Mathematics Tutor at University College from 2006 to 2008, Resident Assistant at Residential Life from 2007 to 2010, Accounts Payable Clerk as part of Work-Study program from 2008 to 2009 and Accounting Tutor at Student Support Services (program funded by U.S. Department of Education) from 2008 to 2010. From 2010 to 2011, Mr. Zeynalov was employed in the position of Loan Servicing Specialist at Wells Fargo Home Mortgage bank in Des Moines, Iowa. From 2011 to 2012, he worked as a desk clerk at the AICPA Library in Oxford, Mississippi. From 2012 to 2014, he performed as a Professional Tutor at Student Support Services at MVSU while receiving his MBA degree. In 2014 he joined the Issuer as Senior Commercial Analyst. From mid-2015 to mid-2016, Mr Zeynalov also held the position of General Director at “SGC Upstream” LLC and “SGC Midstream” LLC. In 2016 he was appointed as the Commercial Director of the Issuer.

The business address of the Issuer is 121 Heydar Aliyev Avenue, SOCAR Tower, 4th floor, Baku, AZ1029, Azerbaijan, and its telephone number is +994 12 521 3091.



### ***Internal Auditor***

The Internal Auditor inspects the Issuer's financial and economic activity and provides its opinion on the results. Upon the request of the Internal Auditor, all bodies and officers of the Issuer submit relevant documents relating to the Issuer's financial and economic activity for the review of the Internal Auditor. The Issuer retains the records of the opinion and inspection papers of the Internal Auditor and these are available for inspection to the members of the Supervisory Board and the Issuer's shareholders or their authorised representatives at any time.

The Internal Auditor is appointed by the General Assembly pursuant to a corresponding proposal by the Supervisory Board. The Internal Auditor cannot be a member of the management, Supervisory Board or a shareholder of the Issuer.

### ***Altay Jafarov***

Altay Jafarov was born in Baku, Azerbaijan on 17 August 1985, and graduated from Baku State University in 2006 with a BS degree in International Relations and International Law. He started his career at the Ministry of Economy (formerly known as: Ministry of Economic Development/Ministry of Economy and Industry) as an Advisor in the Department of Foreign Investments and Coordination of Technical Assistance, where he worked from 2008 to 2011. From 2011 to 2013, he held the position of Leading Advisor in the Department for Cooperation with International Organizations at the same ministry. From 2013 to 2014, he worked at the Ministry of Economy as a Chief Advisor in the Department for Cooperation with International Organizations. In 2014 he was appointed as the Head of Division for Management of International Projects in the Department for Cooperation with International Organizations at the Ministry of Economy. In November 2016 he joined the Issuer as Internal Auditor.

### **Other Committees**

The Issuer also has the following committees:

- Procurement Committee;
- Remuneration Committee; and
- Inventory Appraisal Committee.

### **Management Remuneration**

All of the Issuer's employees in Azerbaijan are remunerated according to a pay grade scale set by the Issuer.

Total compensation to key management personnel of the Issuer amounted to US\$136,000 for the eleven months ended 30 November 2016 and US\$149,000 for the eleven months ended 30 November 2015.

### **Employment Contracts with Senior Management**

In general, the Issuer enters into employment contracts of indefinite duration with its senior management. Under these contracts, the senior management of the Issuer are entitled, in addition to their regular salary, to discretionary annual bonuses based on their performance.

### **Conflicts of Interest**

Several members of the management and supervisory board of the Issuer hold significant positions within the Government (or are Members of Parliament) of the Republic of Azerbaijan, and/or other entities that are owned or controlled by the Republic of Azerbaijan (which include significant commercial counterparties of the Issuer). Aside from the foregoing, there are no potential conflicts of interest between any duties of the members of the administrative, management or supervisory bodies of the Issuer towards the Issuer and their private interests and/or other duties.

The members of the Supervisory Board of the Issuer are State officials. Under applicable Azerbaijani laws, state officials are prohibited from receiving salaries or other remuneration tied to employment with

a commercial entity, such as the Issuer. Accordingly, they are prohibited from receiving or accruing salaries from the Issuer and do not receive remuneration for being members of the Supervisory Board.

## **RELATIONSHIP WITH THE GOVERNMENT**

The Issuer is ultimately 100% state-owned company organised and existing under the laws of the Republic of Azerbaijan. The Issuer was incorporated on 31 March 2014 pursuant to a Presidential Decree passed on 25 February 2014. The initial charter of the Issuer was approved at the Founding Assembly of the Shareholders of the Issuer on 5 March 2014, and was amended at Extraordinary General Assemblies of the Shareholders of the Issuer on 27 January 2015, 25 February 2015, 7 August 2015, 5 November 2015, 6 January 2016 and 8 September 2016. The annual estimate of the Issuer's income and expenditure, as well as any investment programs to be undertaken by the Issuer, are subject to the review and approval of the Government. The Issuer submits its estimated expenditures for the upcoming year to SOFAZ and various government ministries. The Ministry of Finance and SOFAZ, based on the figures provided in the estimates, allocate funds within the State Budget and SOFAZ's budget, respectively.

SOFAZ is required to finance the 51% of shares held directly by the Republic in SGC. The State Commission Resolution provides for the financing of the Issuer through bi-monthly equity injections in amounts corresponding to the Issuer's forecasted capital expenditure obligations in relation to the Projects for the relevant period. In accordance with the Decree of the President No 287, dated 25 February 2014, the Ministry of Economy finances the Government's share of the equity contributions through funds received for that purpose from SOFAZ. Pursuant to the State Commission Resolution, SOCAR's portion of the equity contributions is carried out as follows: a portion of SOCAR's equity contributions in the Issuer is financed from the revenues received from the 10.0% interests held by SOCAR's affiliates in the Shah Deniz PSA and SCPC, and the remaining portion is provided by the Ministry of Finance to SOCAR from the State Budget.

### **Share Capital**

Under the Issuer's charter its current share capital is US\$2,415.8 million, which was increased from the initial share capital of US\$100 million.

See Note 20 to the Interim Financial Statements and Note 15 to the Audited Financial Statements for additional information.

### **Supervisory Board and Senior Management**

The members of the Supervisory Board of the Issuer are State officials. Under applicable Azerbaijani laws, state officials are prohibited from receiving salaries or other remuneration tied to employment with a commercial entity, such as the Issuer. Accordingly, they are prohibited from receiving or accruing salaries from the Issuer and do not receive remuneration for being members of the Supervisory Board.

### **SOCAR Service Agreement**

In December 2014, the Issuer and some of its subsidiaries entered into an operator services agreement with SOCAR. Pursuant to the agreement, operational management of the Issuer's stakes in the Projects is conducted by SOCAR's affiliates on a no profit and no loss basis, with all costs and expenses incurred by SOCAR and its affiliates invoiced to and paid by the Issuer. The term of the agreement is 25 years.

## Related Party Transactions

The following tables set forth information regarding transactions with related parties as of the dates and for the periods indicated.

Related party	As of 30 November 2016					For the eleven months ended 30 November 2016	
	Long-term borrowings	Share capital	Additional paid-in capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
				(unaudited)			
SOFAZ.....	2,058,505	–	–	–	–	–	–
SOCAR.....	–	852,992	287,518	–	–	432,509	–
ME.....	–	887,808	344,250	–	–	495,159	–
AzSD.....	–	–	–	1,090,394	–	–	203,122
AzSCP.....	–	–	–	518,589	–	–	60,979
SOCAR MO.....	–	–	–	–	3,467	–	185
AGSC.....	–	–	–	–	7,422	61,775	–
<b>Total.....</b>	<b>2,058,505</b>	<b>1,740,800</b>	<b>631,768</b>	<b>1,608,983</b>	<b>10,889</b>	<b>989,443</b>	<b>264,286</b>
<b>Total category</b>	<b>3,721,658</b>	<b>1,740,800</b>	<b>631,768</b>	<b>1,837,928</b>	<b>11,476</b>		

Related party	As of 31 December 2015				For the eleven months ended 30 November 2015	
	Long-term borrowings	Share capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
				(US\$ thousands)		
					(unaudited)	
SOFAZ.....	1,953,942	–	–	–	–	–
SOCAR.....	–	708,001	–	–	472,948	–
ME.....	–	736,899	–	–	492,252	–
AzSD.....	–	–	887,272	–	–	388,607
AzSCP.....	–	–	457,610	–	–	103,584
SOCAR MO.....	–	–	–	3,606	–	–
AGSC.....	–	–	–	9,760	64,525	–
<b>Total.....</b>	<b>1,953,942</b>	<b>1,444,900</b>	<b>1,344,882</b>	<b>13,366</b>	<b>1,029,725</b>	<b>492,191</b>
<b>Total category</b>	<b>2,191,873</b>	<b>1,444,900</b>	<b>1,636,491</b>	<b>19,004</b>		

### AzSD

Settlements with AzSD (a subsidiary of SOCAR) during the eleven months ended 30 November 2016 are represented by US\$203.1 million advances paid for the acquisition of a 10% share in SD PSA and 8% share in AGSC under the deferred share purchase agreement (the "DSPA"). Settlements with AzSD for the eleven months ended 30 November 2015 are represented by US\$388.6 million advances paid for the acquisition of a 10% share in SD PSA and 8% share in AGSC under the DSPA. See Note 18 to the Interim Financial Statements.

### AzSCP

Settlements with AzSCP (a subsidiary of SOCAR) during the eleven months ended 30 November 2016 are represented by US\$61 million advances paid for the acquisition of a 10% share in SCPC under the DSPA. Settlements with AzSCP for the eleven months ended 30 November 2015 are represented by US\$103.6 million advances paid for the acquisition of a 10% share in SCPC under the DSPA. See Note 18 to the Interim Financial Statements.

## AGSC

AGSC is a company established by the contractor parties of the SD PSA for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas. Receipts from AGSC represent cash received in the amount of US\$61.8 million (30 November 2015: US\$64.5 million) from sale of gas to AGSC.

### Key Management Personnel

The senior management group consisted of the Group's General Director, Deputy General Director and three department directors as of 30 November 2016. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category was:

	<u>2016</u>	<u>2015</u>
Aggregate remuneration ( <i>US\$ thousands</i> ) .....	136	149
Number of persons .....	5	5

The Group also incurred expenses for management services provided by SOCAR Upstream Management International LLC and SOCAR Midstream Operations LLC in the total amount of US\$1,381,000 during the eleven months ended 30 November 2016 (30 November 2015: US\$4,193,000) under the Operator Services Agreement signed in December 2014.

## REPUBLIC OF AZERBAIJAN

### Overview

Azerbaijan (officially the Republic of Azerbaijan (*Azərbaycan Respublikası*)) is located at the crossroads of Eastern Europe and Western Asia, in the South Caucasus region of Eurasia. It occupies a land area of 86,600 square km, of which 12% is forests, 1.7% is inland water and 55.1% is agricultural land. The territory also includes the Azerbaijani sector of the Caspian Sea.

The country is situated between 44° and 52° of east longitude, 38° and 42° of north latitude and Azerbaijan's capital, Baku, is located on the 40 ° parallel.

Azerbaijan has a 765 km border with Iran in the south, a 15 km border with Turkey in the south-west, a 390 km border with Russia in the north, a 480 km border with Georgia in the north-west and a 1,007 km border with Armenia in the west.



The country is well placed on the south-eastern border of Europe on the shores of the hydrocarbon-resource rich Caspian Sea. It has direct access to the extensive and rapidly emerging markets of the Central Asian states and the Caucasus as well as the Middle East.

Azerbaijan is comprised of the Nakhchivan Autonomous Republic, 63 administrative regions and 78 towns. The major cities in Azerbaijan are Baku, Shirvan, Ganja, Khankandi, Lankaran, Mingachevir, Naftalan, Shaki, and Sumgayit. The cities of Khankandi and Shusha and the districts of Aghdam, Fuzuli, Jabrail, Kalbajar, Lachin, Qubadly, Khojaly, Khojavand and Zangilan are presently, either completely or partially, under occupation by Armenia.

The Nakhchivan Autonomous Republic is a landlocked exclave of Azerbaijan bordering Armenia in the north and east, Turkey in the south-west and Iran in the south and west. It is an autonomous republic consisting of eight administrative districts (Babak, Julfa, Kangarli, Nakhichevan city, Ordubad, Sadarak, Shakhbuz and Sharur), with its own parliament, cabinet of ministers and supreme court. Although autonomous, the Constitution and its laws are valid in Nakhchivan and Nakhchivan laws and resolutions must comply with the laws of Azerbaijan.

## Population

The population of Azerbaijan was approximately 9.8 million as of 31 December 2016. Population density is estimated at approximately 113 persons per square km, with approximately 53.1% of the population living in urban areas. Baku, the capital of the country and its largest city, has an estimated population of 2.25 million. Other large cities include Ganja with an estimated population of 331,400 and Sumgayit with an estimated population of 339,000.

The following table sets forth a breakdown of Azerbaijan's population by age and gender according to the 2009 census:

	Population		
	% of Population	Male	Female
		('000s)	
<b>Age</b>			
0-14.....	23.5	1,109	984
15-69.....	72.3	3,151	3,303
70 and over.....	4.2	154	221
Total.....	100.0	4,414	4,508
Grand Total.....		8,922	

Source: State Statistical Committee

According to the most recent census in 2009, the country's largest ethnic group is the Azerbaijanis (91.6% of the population). The larger minorities are Lezgins (2%), Russians (1.3%), Armenians (1.3%) and Talyshs (1.3%) with relatively small numbers of Avars, Turks, Tatars, Ukrainians, Georgians, Kurds and Tats. The official language is Azerbaijani and a substantial majority of the population is Muslim. The next census is expected to be conducted in 2019.

The following table sets forth details of life expectancy for Azerbaijan's population by gender since 2010:

Life Expectancy in Azerbaijan	For the year ended 31 December					
	(years)					
	2010	2011	2012	2013	2014	2015
Average.....	73.6	73.8	73.9	74.2	74.2	75.2
Men.....	70.9	71.2	71.3	71.6	71.6	72.7
Women.....	76.2	76.5	76.6	76.8	76.8	77.6

Source: State Statistical Committee

The following table describes key social indicators for Azerbaijan and, by way of comparison, for certain other countries within the region for the years indicated:

Regional Social Indicators	Azerbaijan	Georgia	Iran	Russian Federation	Turkmenistan	Kazakhstan
Life expectancy at birth, 2014 (years).....	74.2	74.9	75.4	70.1	65.6	69.4
Infant mortality rate, 2014 (per 1,000 births).....	10.2	11.3	13.9	8.5	45	13.5
Adult literacy rate, 2015 (%)....	99.8	99.8	87.2	99.7	99.7	99.8

Source: State Statistical Committee, World Bank, UNDP (Human Development Reports), UNESCO

Over the past decade, substantial improvement has been achieved in the living standards of the population. An indicator of this improvement is the increase in life expectancy in both men and women, which since 2009 has increased by 1.8 and 1.5 years to 72.7 years and 77.6 years, respectively, in 2015. Such developments were supported by the implementation of long-term social policies, particularly in the area of public health where the state has targeted programmes towards the treatment of diabetes, blood

diseases and tuberculosis, as well as promoting blood donations and developing the state's blood transfusion services.

These positive developments have also seen Azerbaijan move ahead of a number of countries in the region on some key social indicators. In addition to health programmes, the state has continued to improve education standards and secondary education is compulsory, leading to high levels of adult literacy.

## History

One of the countries of the South Caucasus, Azerbaijan reappeared on the political map of the world after the collapse of the Soviet Union in 1991. Independence was regained at the cost of thousands of Azerbaijani lives lost in the Nagorno-Karabakh conflict and the Soviet attack on the Azerbaijani nationalist movement in Baku in January 1990. Despite its short period of independence in recent times, Azerbaijan has a long history of culture and statehood.

Today's Azerbaijan is the successor of the Azerbaijan Democratic Republic (the "**ADR**") declared on 28 May 1918 by the first Azerbaijani parliament, the National Council ("**Milli Shura**"). Though short-lived (being occupied by Bolshevik Russia in 1920), the ADR was the first democratic government in the whole Islamic world. It introduced measures such as electoral rights for women, quotas in the parliament for ethnic minorities and other steps towards effective democracy which were progressive, not only in the Middle East and Eurasia, but in comparison to the mature democracies of Europe at that time.

The short-lived ADR was invaded and occupied by Soviet troops in late April 1920 and the remnants of the ADR National Army units, together with the local militia, retreated to Ganja where a major clash with joint Bolshevik/Armenian Dashnak forces took place. However, the resistance was defeated and Azerbaijan was proclaimed a Soviet Socialist Republic. A period of mass repression of the Azerbaijani people and of the country's cultural identity followed in the 1920s and 30s.

From 1922 until 1990, the Azerbaijani Soviet Socialist Republic (the "**AzSSR**") was an integral part of the Soviet Union, as one of the "founding" republics, and a major industrial and cultural centre. The disintegration of the Soviet Union brought independence to Azerbaijan, but also a serious economic and political crisis, which was compounded by ongoing aggression from the Republic of Armenia. A long and bloody military conflict began in 1988 when Armenian nationalists, backed by the former Soviet administration, launched a separatist movement in the western Azerbaijani region of Nagorno-Karabakh. See "*Republic of Azerbaijan – Bilateral Relations – Armenia*". The conflict was exacerbated further by civil conflict within Azerbaijan as political groups vied for power.

A succession of weak governments ended in 1993 when a former leader of AzSSR, Heydar Aliyev, was elected President. Aliyev's government re-established peace and stability, reinforced state infrastructure and civil rule throughout the country and launched an active foreign policy campaign aimed at the political rehabilitation of Azerbaijan internationally. Major oil and gas contracts were signed with a consortium of foreign oil companies including BP, Amoco, Total and others in 1994. From 1997 onwards, major political reforms were introduced with the aim of bringing Azerbaijan into line with international standards in the areas of the rule of law, democracy and human rights.

President Heydar Aliyev died on 12 December 2003 and his son, Ilham Aliyev, was elected President in the 2003 presidential elections. Ilham Aliyev has continued to follow the policies of his father, including European integration and democratisation, although much remains to be done in this regard.

Following his election in 2003, President Ilham Aliyev launched a series of economic reforms aimed at increasing the competitiveness of the Azerbaijani economy, integrating Azerbaijan with world economic systems and ensuring long-term socio-economic development. Key to achieving these goals is the strengthening and harnessing of Azerbaijan's economic potential, the development of non-hydrocarbons sectors, efficient use of every region in Azerbaijan, establishing favourable conditions for employment, developing private business, increasing the scope, quality and target groups of social services, and reducing poverty.

President Ilham Aliyev was re-elected for a second term in 2008 and for a third term in 2013. The next presidential elections are expected to take place in 2018.



## **Constitution and Political System**

### ***The Constitution***

The present Constitution was adopted by referendum on 12 November 1995 and amended by referenda in 2002, 2009 and 2016. The Constitution states that Azerbaijan is a democratic, legal, secular and unitary republic.

On 18 July 2016, the President signed a Decree and submitted to the Azerbaijani Constitutional Court a draft referendum act “Introducing Amendments to the Constitution of the Republic of Azerbaijan”. A public vote was held on 26 September 2016 with a turnout of over 63%. The draft referendum act introduced 29 amendments, which were adopted as a result of the vote.

The amendments included the elimination of the minimum age of 35 for presidential candidates, establishment of first vice-president and vice-president positions, granting the President additional power to dissolve the parliament and call for expedited presidential elections, lowering of the minimum age from 25 to 18 for candidates to the legislature, and a provision that would allow the adoption of laws limiting the rights of landowners for the purposes of social justice and the efficient use of land and extension of the term of a President from five to seven years.

### ***The President***

The President of the Republic is the head of state, elected by majority vote in direct elections for a term of seven years starting from the 2018 elections. The President represents Azerbaijan at home and abroad, is the commander-in-chief of the armed forces and President of the Security Council of Azerbaijan. Executive power is vested in the President.

The President may negotiate international agreements on behalf of Azerbaijan, appoint and recall Azerbaijani ambassadors and envoys and receive letters of credence and letters of recall from foreign diplomatic representatives. Presidential powers include the right to initiate legislation and to veto certain legislative acts. The President determines the timing of elections to Milli Majlis, appoints the Prime Minister upon approval by Milli Majlis, appoints vice-presidents, submits the State Budget to Milli Majlis for ratification, appoints governors of the administrative regions, approves state economic and social programmes and performs other duties defined by the Constitution.

The institution of Vice-Presidency was established through a constitutional amendment that was approved by voters during a referendum in September 2016. Among other duties, the First Vice-President executes, until the extraordinary presidential elections, the powers of the President if the President resigns or is incapacitated. Prior to the establishment of this position, such powers were vested in the Prime Minister. In the event the then current First Vice-President, who is executing the President’s powers, is unable to discharge his or her duties (due to resignation or loss of capacity), another Vice-President becomes the First Vice-President in accordance with the sequence approved by the President and assumes the powers of the President. In the event the First Vice-President is unable to execute the powers of the President and no other Vice-President is appointed, such powers are assumed by the Prime Minister. Additionally, a Vice-President has immunity and cannot be arrested, charged or sentenced during his or her term. On 21 February 2017, President Ilham Aliyev appointed his wife, First Lady Mehriban Aliyeva, as the First Vice-President. As of the date of this Prospectus no other Vice-Presidents have been appointed by the President.

### ***Cabinet of Ministers***

The Cabinet of Ministers is subordinate and accountable to the President. The Cabinet of Ministers of the day is dissolved on the day when a newly elected President takes office. The Prime Minister is the head of the Cabinet of Ministers and is appointed by the President upon approval by Milli Majlis. Other members of the Cabinet of Ministers are appointed by the President.

The Government includes 18 ministries and 9 state committees, 2 state administrations, 5 state services and the National Archive Department. As of the date of this Prospectus, the Prime Minister is Artur Rasi-zade.

## **Parliament**

The unicameral Milli Majlis is the country's legislative body and is based in Baku. Its powers include passing laws and resolutions and ratifying international agreements. Milli Majlis is comprised of 125 members, all of whom are elected by a majority system and serve a five year term. The latest Milli Majlis elections were held in November 2015. The next elections will be in November 2020.

The following table shows a breakdown of the distribution of seats in Milli Majlis (by party as of 30 September 2016):

<b>Distribution of seats in Milli Majlis</b>	<b>Seats held</b>
<b>Party</b>	
New Azerbaijan Party.....	72
Civil Solidarity Party.....	2
Motherland Party.....	1
Social Prosperity Party.....	1
Azerbaijan Political Party of Democratic Reforms.....	1
Azerbaijan Social Democratic Party.....	1
Whole Azerbaijan Popular Front Party.....	1
Civil Union Party.....	1
Great Order Party.....	1
Unity Party.....	1
National Revival Movement Party.....	1
Azerbaijan Democratic Enlightenment Party.....	1
Independent Members.....	41
Total:.....	<u>125</u>

Source: Milli Majlis

## **Judicial System**

The Azerbaijani judicial system consists of the Constitutional Court, the Supreme Court, the Courts of Appeal of the Republic of Azerbaijan and general and specialised courts. Judicial power is independent and is exercised in compliance with the Constitution, domestic legislation and ratified international agreements.

Milli Majlis appoints the judges of the Constitutional Court, the Supreme Court and the Nakhchivan Autonomous Republic Supreme Court and courts of appeal after their nomination by the President. The President appoints judges to courts. Judges are appointed for an initial term of three years, during which time they are evaluated. If the evaluation is successful, their tenure is extended until the age of 68 for Supreme Court Judges and 66 for judges of other courts upon recommendation of the Judicial Legal Council.

The Constitutional Court is the highest judicial body in respect of Constitutional matters and upholds the supremacy of the Constitution and protects citizens' rights and freedoms. It has jurisdiction over all matters relating to the interpretation of the provisions of the Constitution. In addition, the Law "On Constitutional Court" of 23 December 2003 enables citizens to apply directly to the Constitutional Court on matters related to violations of their rights and freedoms.

The Supreme Court is the highest court in the country and is responsible for equal administration of laws by all courts.

## **Legislation and regulatory developments**

Since independence, Azerbaijan has sought to establish a new legal framework to govern the principal areas of economic activity. The Government has completed a series of legal reforms designed to make the economy more market-oriented and to improve governance standards. See "*Risk Factors – Risks relating to Azerbaijan – Azerbaijan's developing legal system*".

### *The Civil Code*

Ownership rights, basic rules for commercial relations, principles of contract and property law including particular types of contractual relationships such as sale contracts, leases, credit agreements and insurance are set out in the Civil Code, which came into effect in September 2000. The Civil Code also specifies

rules governing the enforcement of obligations and the conclusion, validity, and termination of contracts. Among the provisions applicable to legal entities are provisions regulating different types and organisational forms of legal entities and the main principles of a legal entity's establishment, state registration, management, activity, liquidation and reorganisation.

### *National Reforms*

As part of the development of the Azerbaijani economy, the state has adopted several programmes of privatisation. Privatisation of state property in Azerbaijan started in 1995 with the adoption of the State Program of Privatisation of State Property in the Azerbaijan Republic, 1995-1998. This was a mass privatisation programme intended to transfer state ownership to private individuals while limiting the inflationary impact of privatisation and it focused mainly on small-scale enterprises. Together with the Law "On State Property Privatisation", the Second State Program of Privatisation of the State-Owned Property came into effect in June 2000 and allowed for the privatisation of the remaining large-scale state enterprises and strategic parts of the telecommunications, chemical, petrochemical and metallurgy sectors. See "*The Economy – Privatisation Process*".

On 16 March 2016, the President signed a decree on "Primary Directions of the Strategic Roadmaps for the National Economy and Main Sectors of the Economy". The decree is intended to ensure the sustainability of planned economic policies and reforms and calls for the preparation of a strategic roadmap that will comprehensively cover the Azerbaijani economy on both a macroeconomic and microeconomic level. In furtherance of this decree, the President signed an additional decree on 6 December 2016 on "Approval of Strategic Roadmaps for National Economy and Primary Sectors of the Economy" setting development targets and the manner in which reforms are to be implemented. This decree approved the creation of strategic roadmaps involving development plans for the national economy, the oil and gas industry, the manufacture and processing of agricultural products, the manufacture of consumer goods by small and medium size enterprises, heavy industry and machinery, manufacturing, specialised tourism, logistics and trade, affordable housing, vocational education and training, financial services, communication and information technologies and utilities.

The President signed a decree on "Additional Measures related to increasing the Performance Efficiency of Companies, whose majority shares are held by the State" on 5 September 2016. The decree commissions the relevant bodies to establish, *inter alia*, rules for assessing the performance efficiency of the above mentioned companies, corporate governance rules and standards for them based on international practice, features of the national economy and performance based remuneration system.

The President signed another decree on 21 September 2016 on the creation of a single database of goods produced in Azerbaijan. The Centre for Analyses of Economic Reforms and Communications was commissioned to establish the internet portal in three languages (Azerbaijani, English and Russian) which is expected to have data about goods produced in Azerbaijan and their manufacturers. This portal will also include a search system that will enable users to find information (product type, manufacturer, legal address, contact details etc.) about different production activities.

The President signed a decree on 22 September 2016 on "State Support for the Development of Cotton Production in the Republic of Azerbaijan", which was further amended on 2 March 2017. According to the decree, a subsidy in the amount of AZN 0.1 shall be paid for each kilogram of cotton sold to processing entities. A similar decree was signed on 15 September 2016 on "State Support for the Development of Silk Production in the Republic of Azerbaijan", which was further amended on 2 March 2017. This decree also establishes a subsidy to be paid for each kilogram of wet silkworm cocoon. The amount of the subsidy is yet to be determined by the Cabinet of Ministers.

On 6 October 2016, the President signed a decree on "Establishment of National Coordination Council on Sustainable Development". The decree created a council for the purpose of establishing national priorities in accordance with global targets of importance for the Republic, ensuring the compliance of state programs and strategies to achieve UN Sustainable Development Goals and preparing annual reports regarding the achievement of the UN Sustainable Development Goals.

### *Tax System*

The basis of the Azerbaijani tax system is the Tax Code, which came into effect in January 2001. The Tax Code recognises the existence of special tax regimes, distinct from those described above. Such regimes

are, by and large, applicable to contracting and subcontracting parties in oil and gas production sharing agreements ("PSAs"). While tax regimes applicable under PSAs differ individually, generally they provide for lower withholding income tax rates, exemption from VAT, and simplified reporting and accounting procedures.

In addition, beneficial tax regimes, which were introduced in 2008, may exist in special economic zones and since 2013, technological and chemical industrial parks have been subject to such beneficial tax regimes. Under the Tax Code, all companies operating in Azerbaijan are required to be registered. As a part of ongoing business law reforms introduced from January 2008, company registration procedures involving multiple governmental bodies were eliminated and companies are now only required to register with the Ministry of Taxes. Without formal registration, a company may not do business in Azerbaijan.

The President signed a decree on the approval of "Directions for Tax Reforms to be implemented in 2016" and improvement of tax administration on 4 August 2016. The decree, in conjunction with its attached directions, is aimed at boosting mutual trust and transparency between taxpayers and tax authorities, creating advantageous conditions for the business community, determining accurate taxation potential in light of the continuous development pace of the national economy and sets forth the roadmap for further reforms to the aforementioned purposes. As a result of the aforementioned presidential decree, amendments to the Tax Code were introduced, which became effective as of 1 January 2017. These amendments included, amongst other things, the following:

- Introduction of an advance tax ruling which entails binding advance agreement between the taxpayer and tax authority on certain tax obligations;
- Taxation of the digital economy;
- Introduction of a legislative basis for transfer pricing;
- Application of VAT mark-up on agricultural products sold in retail trading;
- Refund of VAT paid on goods purchased by individuals for consumption purposes during "shopping festivals";
- Mitigation of tax burden through voluntary tax disclosure; and
- Bringing tax anti-avoidance rules into conformity with international practice.

### *Banking*

Banking in Azerbaijan is regulated by the Law "On Banks", the Law "On the Central Bank", and normative acts of the CBA, and, since 2016, the FIMSA. Both banks and non-bank credit organisations are classified as credit organisations. However, while banks are allowed to conduct all types of banking operations, under the Law "On Non-Bank Credit Organisations", non-bank credit organisations may conduct only certain types of banking operations, such as extending loans, selling and purchasing debt obligations (factoring, forfeiting), leasing, issuing guarantees, etc., and are expressly prohibited from accepting deposits.

The Law on Cashless Payments was adopted on 16 December 2016. The main purpose of the law is to ensure the transparency of operations conducted among the participants of civil turnover and the protection of consumer rights, stimulate the substitution of cash payments with cashless payments and expedite the development of the banking system.

### *Insolvency Regimes*

Azerbaijan has two separate insolvency regimes: one for non-bank companies and private entrepreneurs and another for banks. The insolvency of non-bank companies and private entrepreneurs is regulated by the Law "On Insolvency and Bankruptcy" dated 13 June 1997. The insolvency of banks is regulated by the Law "On Banks" dated 16 January 2004. In accordance with the recent amendments to the abovementioned Law "On Insolvency and Bankruptcy", additional rules on insolvency of joint stock investment funds and insurance companies are reflected in the Law "On Investment Funds" dated 22 October 2010 and the Law "On Insurance Activity" dated 25 December 2007. These laws set forth the

rules for declaring an individual or enterprise bankrupt, for managing and liquidating an enterprise after it has been declared bankrupt, for satisfying creditors' claims and for the bankruptcy process generally.

#### *Licenses and Permits*

Pursuant to the Decree of the President of the Republic of Azerbaijan "On Some Measures Related to Licensing" dated 21 December 2015, the number of licensable activities in the Republic has been significantly reduced and the requirement to obtain licence to engage in production, sale and import of alcoholic beverages and tobacco products, passenger and cargo transportation, commercial shipping, etc. has been removed.

A new Law on Licenses and Permits entered into force on 1 June 2016. It sets out criteria for determining activities requiring licenses and permits (except in financial markets), an exhaustive list of licenses and permits, provisions for issuance, re-registration, suspension, resumption and cancellation of a license or permit and provisions regulating the relationship between the authorities granting licenses and license holders. Additionally, pursuant to a Presidential decree dated 21 January 2017, an electronic portal will enable electronic submission, acceptance, processing of and responding to applications for issuance, reissuance, cessation, resumption and revocation of licenses and permits.

#### *Investments*

Azerbaijani law is evolving in accordance with the Government's strategic goal of creating a welcoming environment for foreign businesses. Under the Law "On Protection of Foreign Investments" dated January 15, 1992, foreign investors are afforded equal treatment with domestic investors (a "**national treatment**" regime) and are afforded various guarantees, such as guarantee against deterioration of legislation, guarantee against nationalisation and requisition, guarantee of compensation of damages and to repatriate profits. Azerbaijan has concluded numerous bilateral treaties on the mutual protection of investments with several more treaties currently under negotiation. Foreign investments are thus protected by guarantees provided under law. Foreign investment in Azerbaijan is regulated by a number of international treaties and agreements, and by domestic legal acts, including the Law "On Protection of Foreign Investment" dated January 15, 1992, the Law "On Investment Activity" dated January 13, 1995, the "Privatisation Law" and the Second Privatisation Program, as well as laws regulating specific sectors of the Azerbaijani economy.

The Law "On International Private Law" provides that where transactions have a foreign element (e.g., where one of the parties is a foreign person), parties to an agreement may choose a foreign law as the governing law of the transaction contracts. When a contract governed by foreign law is enforced in a local court, a local court is under a duty to take all necessary measures to determine the content of the applicable foreign law based upon official interpretation and practice. In the event that such measures: (a) do not yield a result or (b) require excessive costs and neither party presented documentary evidence confirming the content of the foreign law, a court applies local law. See "*Risk Factors – Risk Factors Relating to the Notes – There is a risk that the choice of English law as the governing law of the Notes and the Guarantee might not be applied by the courts of Azerbaijan.*".

On 18 January 2016, the President of the Republic of Azerbaijan signed the Decree "On additional measures in connection with the promotion of investments". Pursuant to this Decree, "Investment promotion documents" will be issued to eligible persons, which will serve as a basis for granting tax and customs benefits. Considerations when issuing investment promotion documents include the areas of industry where investments will be made, a minimum amount in relation to the scope of an investment project and the territories where investment projects will be performed.

Subsequent changes were made to the Tax Code and the Law on Customs Duties to reflect benefits for persons holding investment promotion documents, as stipulated under the Decree. Persons who hold an investment promotion document are exempt from income tax of 50% of taxable income, value added tax on imported hardware, technological equipment and installations, assets tax and land tax. They are also exempt from customs duties on imported hardware, technological equipment and installations. All of the tax and customs exemptions are valid for seven years from the date of the issuance of an investment promotion document.

On 15 March 2016, the President approved the Law on the Implementation of Special Financing for Investment Projects in Connection with Construction and Infrastructure Facilities. This new law

introduces options for the potential financing of projects following the Build-Operate-Transfer ("**BOT**") model. The BOT model will apply to the construction, operation and transfer of, *inter alia*, bridges, tunnels, main gas pipelines, underground gas storage facilities, commercial buildings and factories, amongst others.

On 13 July 2016, the President signed a decree on "Improvement of, the Efficiency of the Business Environment and Azerbaijan's Position in International Ratings". A special commission and a secretariat of the commission have been established to improve the business and investment environment, increase its attractiveness for local and foreign investors, ensure the sustainability of the recently achieved entrepreneurship development, strengthen the business environment's competitiveness as well as improve Azerbaijan's position in international ratings.

#### *Trade and Customs*

The Customs Code of the Republic of Azerbaijan was adopted on 24 June 2011 and provides the regulations, rules and procedures applicable to import to and export from the territory of the Azerbaijan. In February 2011, the President signed a decree intended to simplify customs procedures, strengthen transparency in the customs administration and to shorten customs clearance times, reflecting a shift towards the Government's aim for development of foreign economic activity. A key element of those aims was the implementation of the "single-window" principle on import of goods and vehicles into the territory of Azerbaijan and authorizing the State Customs Committee to fulfil the functions of the single inspection body in relation to goods and vehicles imported.

On 1 March 2016, the President of the Republic of Azerbaijan signed a Decree on "Additional Measures Related to Promotion of Export of Non-Oil Products". According to this Decree, persons exporting non-oil products from Azerbaijan will be paid an export promotion allowance out of the proceeds of the State Budget, taking into account the local components produced and used in the production process in Azerbaijan, as well as the value of non-oil products made in Azerbaijan and the type of the exported goods. The base export promotion allowance shall be 3% of the customs value of exported goods, as set forth in the customs declaration. The Decree will be in force until 31 December 2020.

The Law on Anti-dumping, Compensation and Protection Measures was adopted on 31 May 2016. The main purpose of the law is to protect the interests of local producers from dumping, subsidised imports and import surpluses by applying anti-dumping and compensatory measures. The new law sets out rules for determining whether an import is classified as dumping or not, calculating the costs and profits incurred or generated by the import, calculating dumping profit margins and specific subsidies by a foreign state and damages suffered by local producers resulting from dumping and subsidised imports. The law also establishes the grounds for, the types of and the procedure for application of the protection measures.

A Presidential decree on the terms of use of the green corridor and other gating systems for the transportation of goods and vehicles across the customs border entered force on 1 August 2016. The decree is aimed at simplification of rules for goods transported across the customs border. Four types of corridors were introduced in the decree. Under "green corridor" principles, entrepreneurs are able to fill out an electronic declaration, which is then subject to a risk assessment. Registration procedures may vary depending on the entrepreneur submitted declaration, and goods will be imported into the country without additional physical examination provided all of the relevant requirements are complied with. Goods satisfying the requirements of the blue corridor and yellow corridors will undergo limited examination at the customs border. Goods passing through the red corridor will be subject to mandatory inspection.

In an effort to further promote the development of the non-hydrocarbon sector, the President adopted a decree on 5 October 2016 on payment mechanisms for the costs incurred in organizing export missions to foreign countries, promotion of the "Made in Azerbaijan" brand in foreign markets, obtaining export certificates and patents in foreign countries and export-related research programs and projects. The decree only applies to exporters of Azerbaijani non-oil products that are registered as taxpayers in Azerbaijan, and sets out rules for calculation of support grants to be paid out of the state budget in relation to the promotion of non-oil export as described above.

In October 2016, the Cabinet of Ministers adopted a Resolution on "Regulation on payment of promotion allowance to persons exporting non-oil products", "List of non-oil products according to foreign economic activity commodity nomenclature that the promotion allowance will be applicable to" and

“Multiples applicable to the base promotion allowance based on types of goods”. The resolution sets forth the application procedure for a grant of allowance, lists qualifying goods with a corresponding foreign economic activity commodity nomenclature code (e.g. natural honey, pomegranate) and applicable multiples to calculate the promotion allowance for such qualifying goods.

### ***Municipalities***

Members of municipalities are elected in direct elections through elections held every five years. The last municipal elections were held in December 2014. Municipalities are authorised to collect local taxes and payments, approve a local budget, and implement local programmes of social security and economic development.

### **Bilateral Relations**

#### ***Georgia***

Diplomatic relations were established between Azerbaijan and Georgia on 18 November 1992. The main areas of economic cooperation with Georgia are energy, transport, the banking sector, construction, information communication technology, trade and tourism.

Besides significant direct investments into the Georgian economy, Azerbaijan actively cooperates with Georgia in the BTC oil pipeline, the SCP gas pipeline and the Baku-Tbilisi-Kars railway line projects. As such, good relationships between Azerbaijan and Georgia are of major importance to both countries. See *"The Economy – Principal Sectors of the Economy – Energy – Oil and Gas Export Pathways"*.

#### ***Armenia***

A major conflict broke out between Armenia and Azerbaijan in 1988 when Armenian nationalists established a separatist movement in the western Azerbaijani region of Nagorno-Karabakh. Full-scale hostilities between the countries broke out in 1991-1992. The conflict in and around the Nagorno-Karabakh region has resulted in the occupation of almost one fifth of the territory of Azerbaijan, and has resulted in approximately one out of every nine persons in Azerbaijan becoming an internally displaced person or refugee. Although a cease-fire was achieved in 1994, and both sides agreed to a dialogue and negotiations over the peaceful settlement of the conflict, no major breakthrough has been achieved in resolving the conflict. The cease-fire is regularly violated, including an escalation of tensions at the line of contact in early April 2016, which is considered to be the worst escalation of the conflict in the last 20 years and resulted in the death of hundreds of people, including civilians. On 5 April 2016, a ceasefire was agreed between Armenia and Azerbaijan under the mediation of the Russian Federation. Nevertheless, smaller scale skirmishes continue on a frequent basis, the last one occurring on 25 February 2017.

The international community has condemned the use of military force against Azerbaijan and the resulting occupation of its territories. Four United Nations ("UN") Security Council Resolutions (822, 853, 874 and 884) were adopted in 1993 calling for the withdrawal of Armenian forces from occupied Azerbaijani territories. The resolutions have not been complied with by Armenia. Other international organisations have called for Armenia to withdraw its forces from the occupied territories of Azerbaijan and ongoing settlement negotiations have been mediated by OSCE's Minsk Group, which meets on an ad hoc basis. The Minsk Group, co-chaired by United States, Russia and France, consists of Belarus, Germany, Italy, Sweden, Finland, Turkey, Armenia and Azerbaijan. The Minsk Group has made proposals for the peaceful settlement of the conflict, but these proposals have not been accepted by Armenia. The most recent summits of the Azerbaijani and Armenian Presidents with the mediation of the OSCE Minsk Group took place on 16 May 2016 in Vienna and 20 June 2016 in Saint Petersburg. The high-level discussions were substantive and productive and the Presidents confirmed agreements on stabilising the situation in the conflict zone and creating an atmosphere to advance the peace process. For that purpose, the sides agreed to increase the number of international observers in the conflict zone. See *"Risk Factors – Risk Factors Relating to the Guarantor – Azerbaijan is involved in a conflict with Armenia and there may be an outbreak of armed conflict"*. The separatist regime established in the occupied Nagorno-Karabakh region is not recognised by any country.

## **Iran**

The Islamic Republic of Iran recognised the independence of Azerbaijan in December 1991. Diplomatic relations were established between the two countries in March 1992. Officials of the two countries pay regular visits and the countries continue to cooperate on bilateral and multilateral platforms, including within the Economic Cooperation Organization ("ECO") and other institutions. See "*Risk Factors – Risks relating to Azerbaijan – Relations with neighbours*".

Economic cooperation between Azerbaijan and Iran is multifaceted and covers areas such as trade, transport, energy, communications, agriculture and information and communication technologies. Azerbaijan and Iran have signed a number of comprehensive contracts and agreements in the economic, scientific and technological sectors, the most important of which include cooperation agreements on the mutual promotion and protection of investments, trade, energy, transportation, tourism, customs and the elimination of double taxation for income and property. SOCAR has a natural gas swapping agreement with Iran, whereby Iran supplies natural gas to Nakhchivan Autonomous Republic in exchange for Azerbaijan providing natural gas to Iran through the Baku-Astara line.

Another example of economic cooperation between Azerbaijan and Iran is the International North South Transport Corridor ("INSTC"). The INSTC is a multi-modal transportation route established on the basis of an agreement made on 12 September 2000 in St. Petersburg, between Iran, Russia and India for the purpose of promoting transportation cooperation among the member states. This corridor will connect the Indian Ocean and Persian Gulf to the Caspian Sea via Iran, and is then connected to St. Petersburg and Northern Europe via Russia. Currently, the INSTC includes eleven members, including Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkey, Ukraine, Belarus, Oman, Syria and Bulgaria (as an observer). The President of Azerbaijan's official visit to Iran on 23 February 2016 resulted in the signing of a package of bilateral documents, including a framework agreement to advance the INSTC project through increased coordination among the railways of Azerbaijan and Iran, and a related agreement between Azerbaijan Railways CJSC and the Islamic Republic of Iran Railways on the construction of a railway bridge on the Azerbaijan-Iran border.

Other bilateral documents arising from the President's visit to Iran are expected to be a milestone in the development of relations between Azerbaijan and Iran. The package included cooperation memoranda between SOCAR and NIOC, and SOCAR and Ghadir Investment Company in the fields of oil, gas and petrochemical products. Additionally, certain other documents, including agreements on cooperation in the fields of elimination, control and mitigation of the consequences of emergency situations, mutual administrative assistance with customs issues and framework agreements on the sale of electricity were signed between the parties.

## **Russia**

Diplomatic relations were established between Azerbaijan and the Russian Federation in April 1992. Meetings of the Azerbaijan-Russian Federation Intergovernmental Joint Commission on economic, scientific technical and cultural cooperation have been held 15 times since 1996. The countries' Foreign Ministries consult on political matters on a regular basis.

Russia is also one of three co-chairs of the OSCE Minsk Group. The two countries also cooperate closely on humanitarian issues at a central and regional level, and their respective Presidents formed the International Humanitarian Forum, which has met in Baku since 2011. The most recent International Humanitarian Forum took place on 29 – 30 September 2016.

## **Turkey**

Turkey was the first state to recognise Azerbaijan's independence in November 1991 and diplomatic relations were established between the two countries in January 1992. The countries cooperate closely on economic, infrastructure, energy security, education, culture, environment, youth and sport issues.

The countries also collaborate on the BTC oil pipeline, the SCP gas pipeline, the Baku-Tbilisi-Kars railway line and TANAP projects. See "*The Economy – Principal Sectors of the Economy – Energy – Oil and Gas Export Pathways*".



## *United States*

The United States established diplomatic relations with Azerbaijan in 1992 and has expressed its commitment to strengthening democracy and the formation of an open market economy in Azerbaijan. Both countries seek new ways together to promote regional security and stability, enhance energy security, and strengthen economic and political reforms. The United States is one of three countries which co-chairs the OSCE's Minsk Group.

Azerbaijan and the United States cooperate in many international organisations, including the UN, Euro-Atlantic Partnership Council ("**EAPC**"), OSCE, IMF and World Bank. Azerbaijan has an observer status at the Organization of American States and the World Trade Organization ("**WTO**") and is a participant in the North Atlantic Treaty Organization's ("**NATO**") Partnership for Peace programme.

The United States and Azerbaijan have a bilateral trade agreement and a bilateral investment treaty. US companies are involved in offshore oil development projects with Azerbaijan and have been exploring emerging investment opportunities in Azerbaijan in the telecommunications and other sectors. Azerbaijan has been designated as a beneficiary country under the Generalised System of Preferences ("**GSP**") programme, under which a range of products that Azerbaijan might seek to export are eligible for duty-free entry to the United States. The GSP programme provides an incentive for investors to produce in Azerbaijan and export selected products duty-free to the US market.

## **International Relations**

Azerbaijan is a member of the UN (which it joined in March 1992) and belongs to many other international organisations. It maintains diplomatic relations with 177 countries. It has 68 diplomatic missions and nine general consulates abroad, some of which are in countries subject to sanctions.

## *Regional Groupings*

Azerbaijan is a member of several regional groupings. It is a founding member of GUAM (Georgia, Ukraine, Azerbaijan and Moldova), founded in October 1997 as a political, economic and strategic alliance.

It is also a founding member of the Organization of Black Sea Economic Cooperation ("**BSEC**") established in June 1992 by Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey and Ukraine. BSEC works to foster relations among member states. Azerbaijan also continues to be a member of the CIS, alongside Russia, Belarus, Ukraine, Kazakhstan, Kyrgyzstan, Moldova, Turkmenistan, Tajikistan, Uzbekistan and Armenia. The CIS works to promote coordination in areas of trade, finance, law-making and security, and to support cooperation on democratisation and cross-border crime prevention across the former Soviet republics.

Azerbaijan is also a member of the Organization of the Islamic Conference since December 1991 and the Economic Cooperation Organization ("**ECO**") since 1992.

## *UN*

A relationship between Azerbaijan and the UN was established soon after the collapse of the Soviet Union and the restoration of Azerbaijan's independence and Azerbaijan was admitted to the UN in March 1992 and the Permanent Mission of the Republic of Azerbaijan to the UN was opened in New York in May 1992.

Azerbaijan has used the platform of the UN to draw the international community's attention to the Armenian-Azerbaijan conflict and harness its potential for a peaceful settlement. In 1993, following the occupation of the Nagorno-Karabakh region and other territories in Azerbaijan, the UN Security Council adopted four resolutions (822, 853, 874 and 884) reaffirming the territorial integrity of Azerbaijan and demanding an immediate cease-fire, suspension of hostilities and withdrawal of all occupying forces from Azerbaijan. These resolutions have not been complied with by Armenia.

Azerbaijan maintains active and effective cooperation with the UN specialised agencies, and relevant regional commissions and programmes.

Azerbaijan was elected as a non-permanent member of the UN Security Council for 2012-2013 in October 2011 and during this two year period Azerbaijan played an active and constructive role in the functioning of the UN Security Council. Azerbaijan was elected in June 2016 as a member of the UN Economic and Social Council for 2017 to 2019. In July 2016, Azerbaijan and the UN signed the UN-Azerbaijan Partnership Framework for 2016 to 2020.

### ***NATO and military relationships***

Azerbaijan-NATO cooperation started in March 1992 when Azerbaijan, together with 37 countries, joined the North Atlantic Cooperation Council ("**NACC**") that brought together 16 Alliance members, 15 states of the former USSR and the other countries of the former Warsaw Pact. NACC was transformed into the Euro-Atlantic Partnership Council ("**EAPC**") in May 1997. EAPC provides an important forum for discussions and consultations on political and security related issues.

The Partnership for Peace ("**PfP**") was introduced in January 1994 as a major initiative by NATO aimed at enhancing stability and security throughout Euro-Atlantic area. Azerbaijan was in the first wave of countries that responded to the invitation to join the Programme by signing the Framework Agreement on 4 May 1994.

PfP has proved to be very successful in developing and promoting mechanisms for defence cooperation and military interoperability between NATO and Azerbaijan. Most notably PfP has developed practical tools allowing NATO and partner nations to engage in joint crisis management and peacekeeping operations. Azerbaijan, building on enhanced representation of the partner nations at NATO, has established a diplomatic mission to the organisation and sends diplomatic staff and a Military Representative to NATO.

The developing practical cooperation between Azerbaijan and NATO goes beyond the immediate responsibilities of Ministries of Defense and Foreign Affairs, covering broad areas such as border control, civil emergency planning, environmental and scientific issues and public diplomacy.

Azerbaijan has also undertaken a number of 'Partnership Goals' on defence planning and preparation of forces for peace support operations. The Individual Partnership Action Plan ("**IPAP**"), which Azerbaijan joined in 2004, enables it to hold regular political dialogues, systematise bilateral cooperation as an overarching tool and agree on new cooperation activities of mutual interest in a more flexible manner. Azerbaijan successfully completed the first (2005-2007), second (2008-2010) and third (2012-2013) and fourth (2015-2016) cycles of its IPAP and is currently working on the fifth (2017-2018) cycle.

As a key component in NATO's Northern Distribution Network, Azerbaijan provides a secure route for 40% of the NATO-led International Security Assistance Force's ("**ISAF**") multi-modal transit into Afghanistan. Working closely with the US Transportation Command and the US Air Mobility Command, Azerbaijan has aided important over-flight clearances and medical evacuation flights as well as landing and refuelling operations for US and NATO efforts supporting the ISAF. Currently, Azerbaijan maintains a significant troop contribution to the Resolute Support Mission in Afghanistan, the ongoing NATO led advisory and support mission in that country, as well as provision of multi-modal transit, training and financial assistance.

During the Resolute Support Mission, Azerbaijani servicemen served together with other NATO soldiers in Afghanistan and provided specialised training for Afghani police, border guard officers and civilian and military doctors. President Aliyev stated Azerbaijan's intention to expand its partnership with Afghanistan's national institutions, highlighting the long-standing friendship between the Afghan and the Azerbaijani people. Upon conclusion of the Resolute Support Mission, Azerbaijan expects to contribute through the long-term NATO-Afghanistan support and engagement framework referred to as "The Enduring Partnership."

Azerbaijan has also joined the Interoperability Platform (the "**IP**"), an outcome mechanism of the Partnership Interoperability Initiative launched at the Wales Summit 2014, bringing together 25 selected NATO partners. The IP allows such NATO partners to cooperate more deeply on interoperability issues related to crisis management, including command and control systems, education and training, exercises and logistics.

### ***Relationship with the European Union***

Since regaining its independence in 1991, the Republic of Azerbaijan has developed a partnership with the European Union based on mutual respect, equal rights and shared interests. Over the last two decades the EU-Azerbaijan relationship has gone through different phases, resulting in closer and mutually beneficial interactions in many areas of common interest.

The Partnership and Cooperation Agreement (signed on 22 April 1996 and entered into force on 1 July 1999) ("**PCA**") between the EU and Azerbaijan established an appropriate framework and mechanisms for political dialogue and development of relations between the EU and Azerbaijan.

Another important milestone in promoting the EU-Azerbaijan relationship was the adoption of the five-year EU-Azerbaijan European Neighbourhood Policy Action Plan on 14 November 2006, which laid out the strategic objectives of bilateral cooperation and aimed to help implementation of the provisions of the PCA. Since 2009, Azerbaijan has participated in the EU Eastern Partnership Programme, a common endeavour of the EU member-states and six partner countries of Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, launched during a summit held on 7 May 2009. Within the Eastern Partnership, Azerbaijan is focused on enhancing its relations with the EU on the bilateral track.

Azerbaijan and the EU enjoy close trade and economic ties. Azerbaijan is the EU's largest trading partner in the South Caucasus and the EU member-states are among Azerbaijan's major partners in external trade, as well as foreign investments in Azerbaijan's economy.

Strategic partnership in the field of energy remains the cornerstone of the EU-Azerbaijan relationship, enhanced by a Memorandum of Understanding on a Strategic Partnership between the European Union and the Republic of Azerbaijan in the Field of Energy signed on 7 November 2006, envisioning gradual expansion of the strategic partnership to other relevant sectors, namely, education, agriculture and transport. Azerbaijan has actively contributed to ensure the EU's energy security by exporting substantial volumes of crude oil to the European markets. Currently, EU-Azerbaijan energy cooperation also envisages the export of natural gas from Azerbaijan to be considered as a crucial element ensuring pan-European energy security and diversification of supply. The Joint Declaration between the Republic of Azerbaijan and the EU on the Southern Gas Corridor was signed on 13 January 2011.

Azerbaijan participates in the Transport Corridor Europe-Caucasus-Asia ("**TRACECA**"), which is supported by the EU. Azerbaijan also participates in the EU4Energy Programme, an EU-funded energy programme launched on 1 July 2016, which assists certain countries of the Eastern Partnership and Central Asia with the improvement of energy data capabilities, including the ability to collect and monitor such data. Additionally, the programme assists beneficiary countries in formulating energy policy specific to such beneficiary country.

The EU and Azerbaijan signed the Visa Facilitation Agreement (on 29 November 2013), Joint Declaration on Mobility Partnership (on 5 December 2013), Readmission Agreement (on 28 February 2014) and Framework Agreement on the General Principles of participation of Azerbaijan in the EU programs (on 14 June 2014).

Azerbaijan aims to develop an equal and mutually beneficial partnership with the EU, and considers a strategic partnership to be the most appropriate format for enhancing bilateral cooperation. Moreover, Azerbaijan has entered into strategic partnership agreements with several EU member states which serve as a solid ground for establishing a strategic partnership framework within the EU. Azerbaijan submitted a draft "Agreement between the Republic of Azerbaijan and the European Union on the Strategic Partnership" to the EU in May 2015, in the context of the Eastern Partnership Summit in Riga, Latvia. Both sides have agreed to continue the discussions of this document.

On 14 November 2016, the EU Foreign Affairs Council adopted a mandate for negotiations on a new agreement between EU and Azerbaijan and authorised the European Commission and the High Representative of the Union for Foreign Affairs and Security Policy to negotiate the provisions that fall within the competence of the Union of a Comprehensive Agreement between the European Union and its Member States and Azerbaijan.

At the invitation of President of the EU Council, Donald Tusk, President Ilham Aliyev visited Brussels on 6 February 2017 and met with the High Representative of the EU for Foreign Affairs and Security Policy,

Federica Mogherini as well as with the President of the European Commission, Jean-Claude Juncker, and the Commission's vice-president responsible for the Energy Union, Maros Sefcovic.

The negotiation process on a new EU-Azerbaijan strategic partnership agreement officially began on 7 February 2017.

### ***Council of Europe***

Since becoming a member of Council of Europe ("CE") in January 2001, Azerbaijan has been actively cooperating with all institutions of the CE, including the Parliamentary Assembly of the CE ("**PACE**"). Azerbaijan is represented in the PACE by a delegation of twelve parliament members.

Azerbaijan took Chairmanship of the Council of Europe's Committee of Ministers from May to November 2014, taking over from the previous chair, Austria. The Committee of Ministers is the Council of Europe's decision-making body. It comprises the Foreign Affairs Ministers of all EU Member States, or their permanent diplomatic representatives in Strasbourg. It is both a governmental body, where national approaches to problems facing European society can be discussed on an equal footing, and a collective forum, where Europe-wide responses to such challenges are formulated. In collaboration with the Parliamentary Assembly, it is the guardian of the Council's fundamental values, and monitors member states' compliance with their undertakings.

Azerbaijan has also sought to enhance its laws and regulations relating to corruption by following European regimes. Azerbaijan has ratified the Council of Europe's Civil and Criminal Law Conventions on Corruption. During 2004, it also joined the Council of Europe's Group of States against Corruption and signed up to the UN Convention against Corruption in February 2004. As part of the ASAN reforms (see "*The Economy – Overview*"), Azerbaijan has also established the State Agency for Public Service and Social Innovations. In addition to its objectives of expediting and elevating the level of professionalism in public services, the agency is tasked with increasing transparency and strengthening the fight against corruption. See "*Risk Factors – Risks relating to Azerbaijan – Corruption*".

### ***Organisation for Security and Co-operation in Europe***

Azerbaijan joined the Conference on Security and Co-operation in Europe ("**CSCE**") in January 1992 and in July 1992, Azerbaijan signed the CSCE Helsinki Final Act of 1975 at the CSCE Helsinki Summit. In December 1993, Azerbaijan joined the CSCE Charter of Paris and in November 1999 signed the Charter for European Security at the OSCE Istanbul Summit.

The CSCE was renamed the Organization for Security and Co-operation in Europe ("**OSCE**") in 1994. Azerbaijan considers the OSCE to be a unique pan-European security organisation, and with this in mind places special importance on expanding its activities within the organisation in all fields. The OSCE plays a key role in peace negotiations between Armenia and Azerbaijan in respect of the Nagorno-Karabakh conflict, with the OSCE Minsk Group responsible for arranging settlement talks.

A delegation from Milli Majlis participates in the Annual Sessions of the OSCE Parliamentary Assembly.

### ***CICA (Conference on Interaction and Confidence Building Measures in Asia)***

CICA is a multilateral platform for discussion of the issues essential to international and regional security and development of mutually beneficial economic and social cooperation through the implementation of joint initiatives and projects. CICA comprises 26 Asian countries as its member states. CICA is an encompassing regional forum based on sovereign equality dealing with security issues related to the peace and security, and Azerbaijan continues its efforts to enhance cooperation among CICA member states. Broad geographic scope and significant human potential of the CICA region creates favourable opportunities for advancing cooperation on a wide spectrum of issues of mutual concern.

### ***WTO Accession***

Azerbaijan's working party with the WTO (the "**Working Party**") was established in July 1997 and the first meeting of the Working Party was held in June 2002. Bilateral negotiations on market access are underway on the basis of revised offers in goods and services. Multilateral work is proceeding on the basis of a draft Working Party report, which was last revised in February 2015 (the "**Working Party Report**"). The 13th meeting of the Working Party took place on 22 July 2016, attended by a delegation

headed by the Chief Negotiator and deputy Minister of Foreign Affairs of the Republic of Azerbaijan, and covered topics including intellectual property, domestic support to agriculture, banking regulations, competition and trade.

## **IMF**

### *Mission in February 2016*

A staff team from the IMF visited Baku during 28 January 2016 until 3 February 2016 on a fact-finding visit and to discuss areas of technical assistance cooperation. On 3 February 2016, the IMF issued a press release stating that economic growth and balance of payments pressures are likely to remain major challenges for Azerbaijan in the near term. The report also added that the Azerbaijan authorities were well placed to overcome these challenges because of Azerbaijan's substantial buffers in place to combat these challenges, provided that they further strengthen their policy response. In addition, policy priorities include formulating and pre-announcing a multi-year fiscal consolidation plan, bolstering the monetary policy framework to support the move to exchange rate flexibility, strengthening the financial sector and supervision and undertaking structural reforms to make the economy more diverse.

In the 3 February press release, the IMF also expressed their support of the Government's intention to further reduce public investment to more sustainable levels in 2016, with a greater focus on project efficiency. The Government and IMF staff have agreed to maintain a close policy dialogue and to increase technical assistance support.

### *2016 Article IV Consultation*

In May 2016, an IMF team visited Baku to hold discussions in the context of the 2016 Article IV Consultation. At the conclusion of the visit, the IMF team predicted that growth was expected to rise between 2.5 and 2.75 percent over the medium term as gas production and exports rise coupled with the expected effects from implemented reforms beginning to manifest over the period. On 9 September 2016, the IMF concluded the Article IV consultation with Azerbaijan. In their press release dated 14 September 2016, the IMF stated that Azerbaijan's near-term economic prospects remain weak and that the difficult external environment could hamper macroeconomic outcomes in the near future. Against this background, the IMF supported the authorities' adjustment efforts against the decline in oil prices and weaker growth in trading partners. In particular, moving towards a managed floating exchange rate regime and reforms for diversification of the economy were initiatives supported by the Executive Directors. The IMF recommended reforms to secure macroeconomic and financial stability and promote a diversified and private sector-led economy. In addition, the IMF suggested reducing tax exemptions and strengthening tax administration, implementing pension reform plans, improving monetary transmission and the functioning of the foreign exchange market and closely monitoring the banking system.

### *Mission in March 2017*

A staff team from the IMF visited Baku between 27 February 2017 until 3 March 2017 on a fact-finding mission, which included meetings with the Ministry of Finance, the CBA, the FIMSA and others. The aim of the visit was to assess the macroeconomic policy outlook for 2017, as well as to focus on the new monetary and exchange rate policy framework.

## THE ECONOMY

### Overview

Following the restoration of independence in 1991, Azerbaijan went through a period of sharp economic decline which lasted until 1995 and during which GDP declined by approximately 58%. The long-lasting military conflict with Armenia over the Nagorno-Karabakh region, a succession of weak and short-lived governments and loss of traditional markets with the collapse of the Soviet Union all contributed to the severity of this economic crisis.

Economic recovery was initiated by the signing of the PSA for the developments of ACG oil field, in 1994. Signed by then President Heydar Aliyev and a consortium of international oil companies, this contract paved the way for redevelopment of the oil industry and with it the economy of Azerbaijan. Substantial foreign direct investment to the oil industry followed, ensuring rapid knowhow transfer and providing the conditions for the acceleration of economic development. This was followed by the establishment of key state institutions that formed the backbone of the new, independent state. Trade and price controls were liberalised and the state began reforms to support growth of the market-based economy.

In the period following the initial oil boom, one of the main tasks has been the efficient use and reallocation of revenue derived from the country's oil and gas reserves. SOFAZ was established to channel revenues from oil exports to the priority sectors of the economy and key social and economic projects. This, along with other areas of economic policy and reform, has enabled Azerbaijan to improve its fiscal stability and to achieve sustainable growth which, in turn, has enabled the country to reform other priority areas of the economy, upgrade critical infrastructure and improve social welfare.

During the last 10 years, almost US\$190 billion has been invested in the economy and the country's strategic foreign exchange reserves stand at approximately US\$37.6 billion as of 31 December 2016 (with the CBA holding approximately US\$4.6 billion (including government deposits) and SOFAZ holding approximately US\$33 billion of foreign reserves). Economic growth since 2000 has transformed the country from a low income category to an upper middle income country according to the World Bank's classification. The country's poverty rate has also been reduced from above 50% during the early 2000s to 5.0% in 2015, based on internal classifications. The quality of life has also improved considerably, which is reflected in increased life expectancy, access to better healthcare, education and other social services.

Azerbaijan's development performance has been positively noted by the international community. The economy is ranked 37th in the 2016-2017 Global Competitiveness Report of the World Economic Forum, the highest ranking among the CIS economies. Azerbaijan has also improved its position in the UN's 2014 Human Development Index, which considers the potential human development of the population (taking into account factors such as life expectancy, education and income), rising to a rank of 78th overall (an improvement of 4 places from 2013).

Improvements in transparency and accountability have also been made. In July 2013, the President signed an order establishing the State Agency for Public Service and Social Innovations, with the objective of making Government services more easily accessible to citizens using modern technology, reducing corruption and increasing transparency.

As part of this initiative, the agency established and managed the Azerbaijan service and assessment network ("ASAN") – a network of centres where government services are delivered by highly trained public servants – as well as carrying out information technology projects to better organise and manage electronic services provided by the state and to improve the integration of databases across all state agencies. All of the services in the centre are processed online. Currently, eleven ASAN centres are functioning. They may also include translation services, a laboratory, a medical service, internet cafes, post offices and photo studios in the centres.

Furthermore, in December 2015, the President of the Republic of Azerbaijan signed a decree on certain measures in the area of licensing. In accordance with the new regulations, all licences will now be issued for an unlimited period. With effect from 23 December 2015, all existing licences have an unlimited term of validity. The Ministry of Economy was designated as the state authority responsible for the issuance, suspension, resumption and cancellation of licences through ASAN centres or an electronic licence portal.

On 1 June 2016, a new Law on Licences and Permits entered into force. It sets out criteria for determining activities requiring licences and permits (except in financial markets), an exhaustive list of licences and permits, provisions for issuance, re-registration, suspension, resumption and cancellation of a licence or permit and provisions regulating the relationship between the authorities granting licences and licence holders. The law requires that a licence shall be obtained for 65 types of activities, and in addition, 15 licenses are required for the provision of various financial markets activities. The number of activities requiring a permit is at 86.

On 23 September 2016, the President signed a decree “On establishment of ABAD (Easy Support to Family Business), which is a public legal entity under the State Agency for Public Service and Social Innovations (ASAN)” to support the development of small and medium entrepreneurship. According to the decree, ABAD will carry out the following functions:

- implementation of support projects for family owned businesses and small and medium entrepreneurs;
- creation of a fund to finance the above mentioned support projects;
- selection of the family businesses and small and medium entrepreneurs for ABAD projects;
- provision of business planning, marketing, branding, design, accounting and legal services to family businesses and small and medium entrepreneurs;
- organising the certification of produced goods based on the simplified one stop shop principle;
- organising the transportation and sale of produced goods; and
- organising training for the usage of production facilities.

Under the decree, AZN 1.0 million from the President's reserve fund was to be allocated to the State Agency for Public Service and Social Innovations to fund the ABAD project.

In addition, the Law "On suspension of inspections in the sphere of entrepreneurship" dated 20 October 2015 prohibits inspections of business enterprises for two years starting from 1 November 2015. This prohibition is subject to certain exceptions, such as tax audits, inspections related to ensure safety of life and health, state and economy safety.

In December 2015, the CBA announced that it had abandoned the dollar-euro basket peg of the Manat and had switched to a floating exchange rate regime, as a result of intensifying external economic shocks.

#### **Azerbaijan – 2020: Outlook for the future**

In December 2012, Azerbaijan adopted a long-term social and economic development plan (the "**2020 Project**"), the main goals of which are to stimulate economic development through diversification of the economy and the building of competitive non-hydrocarbons sectors to counter the potential impact of falling oil production on growth. The 2020 Project sets out the strategic target of doubling GDP per capita to US\$13,000 by 2020 and the Government plans to achieve this through diversification of the economy beyond the hydrocarbons sector, supporting innovation and scientific research, increasing the skills of the labour force and reforms to improve state institution efficiencies.

The 2020 Project also aims to achieve higher standards of living and lower poverty levels through Government investment in education, healthcare and cultural and social institutions. To this end the Government has also approved education funding increases year-on-year through to 2020, intended to increase participation in pre-school education, build and refurbish schools and colleges, modernise secondary education, improve teacher training and provide further support to Azerbaijani students studying abroad.

As part of the 2020 Project, the Government has proposed the development of special industrial and economic zones across Azerbaijan, the development of petrochemical complexes in Sumgayit, the processing of domestic waste in Balakhani and the development of an aluminium industry in Ganja. There are also proposals for the development of new steelworks, fertiliser factories, shipyards and cement plants. The 2020 Project also includes proposals to develop and modernise the farming industry and to

establish a State Fund for the Development of Information Technologies to improve information skills in the labour force and develop entrepreneurship. See *"Risk Factors – Risks relating to Azerbaijan – The development of Azerbaijan's physical infrastructure may require further investment"*.

The Government will also be supporting and investing in the development of transport infrastructure. As well as the ongoing development of the International Sea Trade Port in Alat, Azerbaijan's rail networks are also being upgraded under a World Bank financed "Railway Modernization Project", which-upon completion-aims to cut transit times on the transport corridor to Georgia by 50% and transform Azerbaijan Railways into a financially self-sustainable operation in freight transportation by providing proper infrastructure, reducing costs and improving locomotive capacity and operational reliability. These improvements will also see updates to rolling stock and electrification of the rail network. In addition, the Baku Metro coverage will also be extended, with plans to build new stations and extend the current network. Following the completion of upgrades to a significant proportion of the road network, there are plans for new highway roads linking the regions and there will be an extensive programme of widening and reconstruction of existing roads. To support growth in tourism and business travel, works on the construction of a new terminal at Heydar Aliyev International Airport in Baku have been completed and the new terminal is operational, and updates to regional airports within Azerbaijan are ongoing.

The early results of the 2020 Project were positive. The targeted GDP per capita requires an annual growth rate for non-oil and gas GDP of 7.0% and the average per annum growth rate from 2010 to 2015 was 7.5%. However, the economy's growth slowed in 2015 with a real GDP growth rate of 1.1%, which was followed by a decline in GDP of 3.1% in 2016. Most of the contraction was seen in the construction sector as infrastructure and other construction projects were stopped or delayed due to the lack of financing resulting from falling oil prices. The growth rate in 2015 was 1.1% in non-oil and gas GDP (increasing to 69.3% of GDP). In 2016 non-oil and gas GDP decreased by 4.5%. Exports from the non-hydrocarbons sectors saw significant and consistent growth since 2006 until 2014 but have been declining since then. See *"Risk Factors – Risks relating to Azerbaijan – Azerbaijan may not be able to sufficiently expand the non-hydrocarbon sector of its economy"*.

On 18 January 2016, the President of the Republic of Azerbaijan announced new policy initiatives for the modernisation of Azerbaijan's economy. The main topics of the President's announcement was the need for further efforts to deepen economic reforms, adoption of good practices of developed nations, making the economic and financial system more transparent, improving banking sector and business environment, creating better conditions for businessmen, eliminating all bureaucratic impediments. The main points of the President's announcement can be summarised as follows:

- structural reforms should continue and repetitive and inessential governmental institutions should be eliminated or merged.
- there is a need for strengthening legislative basis for currency market regulation and the relevant proposals are being prepared;
- large-scale privatisation program should be developed, with participation of international experts and business environment shall be further improved to attract local and foreign investors and vitalise business environment;
- restoration of trust in Manat through regulation of banking sector, consolidation of problem banks, insurance of deposits etc. shall be achieved;
- opportunities of raising foreign debt in international markets, including issuance of sovereign bonds, given the low level of foreign indebtedness shall be further considered;
- development of non-hydrocarbon sector should be prioritised to reduce the dependence on exports. A particular emphasis was placed on construction sector and was announced that all ungrounded requirements and demands from entrepreneurs should be stopped so that they could undertake large-scale construction projects. Efficiency of mortgage financing shall be increased.



## GDP

The following table sets forth certain information regarding Azerbaijan's GDP for the periods indicated:

<b>Nominal GDP 2005 – 2016</b>						
<b>For the year ended 31 December</b>	<b>GDP</b>		<b>Real Growth rate</b>	<b>GDP per capita</b>		<b>GDP per capita Real Growth rate</b>
	<i>AZN millions</i>	<i>US\$ million</i>	<i>% change year over year</i>	<i>AZN</i>	<i>US\$</i>	<i>% change year over year</i>
2005 .....	12,522.5	13,238.7	26.4	1,494.3	1,579.8	24.9
2006 .....	18,746.2	20,983.0	34.5	2,208.2	2,471.6	32.7
2007 .....	28,360.5	33,050.3	25.0	3,296.6	3,841.7	23.4
2008 .....	40,137.2	48,852.5	10.8	4,603.7	5,603.3	9.3
2009 .....	35,601.5	44,297.0	9.3	4,033.2	5,018.2	7.9
2010 .....	42,465.0	52,909.3	5.0	4,753.0	5,922.0	3.7
2011 .....	52,082.0	65,951.6	0.1	5,752.9	7,285.0	(1.2)
2012 .....	54,743.7	69,683.9	2.2	5,966.1	7,594.3	0.8
2013 .....	58,182.0	74,164.4	5.8	6,258.3	7,977.4	4.4
2014 .....	59,014.1	75,234.6	2.8	6,268.0	7,990.8	1.5
2015 .....	54,380.0	52,996.8	1.1	5,706.6	5,561.5	(0.1)
2016 <sup>(1)</sup> .....	60,393.6	37,843.0	(3.1)	6,266.3	3,926.5	(4.2)

Source: Ministry of Finance, State Statistical Committee

<sup>(1)</sup> Preliminary data

During the early years of newly-independent Azerbaijan, there was a near total collapse of trading and economic mechanisms and relationships that were highly geared towards a centralised economy. Many sectors of the country's economy were paralysed and economic collapse, which began in 1989, became severe in the first three years after independence. However, as a result of Azerbaijan initiating a privatisation strategy, implementing an "open door" policy (based on mutually-beneficial cooperation in the country), restoring relations with other countries, attracting foreign investment, establishing a healthy investment environment and conditions suitable for entrepreneurship activity and other measures, economic degradation was stemmed by the late 1990s and Azerbaijan began to benefit from a new stage of economic development.

Between 2005 and 2008, GDP grew by 2.4 times, making Azerbaijan one of the most rapidly developing economies in the world. The fastest year on year rate of growth was recorded in 2006, when GDP increased by 34.5%. The economy of Azerbaijan has continued on a solid growth path, with growth of 28.1% in the period 2010 to 2015. The impact of the global financial crisis on the economy was limited and, while GDP from the non-hydrocarbon industrial sector declined by approximately 10% in 2009, positive growth quickly returned in 2010 and by the end of that year GDP exceeded pre-2009 levels. In 2011, 2012, 2013 and 2014, growth across non-oil and gas GDP was robust, increasing by 9.4%, 9.7%, 10.0%, 7.0%, respectively, with a decline in non-oil and gas GDP growth in 2015. In 2016, non-oil and gas GDP decreased by 4.5%.

## GDP by Sector

The following table illustrates the proportion of Azerbaijan's Nominal GDP by economic sector for the periods indicated:

Nominal GDP by Economic Sector	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
	(% of GDP)					
Industry .....	53.8	49.4	45.5	40.4	32.9	37.2
Oil and gas industry.....	49.6	44.7	40.9	36.3	28.3	32.5
Non-oil industry.....	4.2	4.7	4.6	4.1	4.6	4.7
Services.....	27.2	29.2	30.8	34.2	40.0	39.0
Construction.....	8.0	10.1	11.6	12.6	12.0	10.6
Agriculture, hunting, forestry and fishing .....	5.1	5.1	5.4	5.3	6.2	5.6
Net taxes on products .....	5.9	6.2	6.7	7.5	8.9	7.6

Source: Ministry of Finance, State Statistical Committee

<sup>(1)</sup> Preliminary data.

The following table sets forth the contribution of private and public sectors to GDP for the periods indicated:

Public and Private Sector contribution to GDP	1995	2000	2005	2010	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
Public .....	69.7	29.2	22.2	18.3	17.5	18.5	17.7	18.1	18.8	16.4
Private .....	30.3	70.8	77.8	81.7	82.5	81.5	82.5	81.9	81.2	83.6

Source: State Statistical Committee

<sup>(1)</sup> Preliminary data.

Implementation of reforms related to the transition to a market economy has played an important role in year-on-year development of the private sector. This has helped the private sector secure a key position in the economy. The share of gross value added ("GVA") in GDP contributed by non-state enterprises and organisations was 30.3% in 1995, but by 2010, 2011, 2012, 2013, 2014, 2015 and 2016 had increased to 81.7%, 82.5%, 81.5%, 82.5%, 81.9%, 81.2% and 83.6% respectively.

The following table illustrates Azerbaijan's nominal GDP by economic sector for the periods indicated:

Nominal GDP by Economic Sector	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
	(AZN millions)					
Mining and quarrying (including extraction of oil and gas) .....	24,980.0	23,570.1	22,790.2	20,222.3	14,370.2	18,519.8
Construction.....	4,141.0	5,507.9	6,753.7	7,454.4	6,499.5	6,394.2
Wholesale and retail trade; repairs .....	3,283.7	3,654.0	4,148.9	4,652.0	5,387.8	6,152.2
Agriculture, forestry and fishing .....	2,643.5	2,813.7	3,122.2	3,139.2	3,359.3	3,369.6
Transport and storage .....	2,658.8	2,693.6	2,568.9	2,984.3	3,241.9	4,102.5
Manufacturing (including processing of oil and gas).....	2,077.2	2,321.8	2,452.8	2,777.7	2,713.9	3,120.3
Electricity, gas, and water supply.....	953.5	1,148.5	1,198.6	840.8	828.2	806.9
Accommodation and food service activities .....	757.2	897.4	1,069.2	1,269.1	1,312.8	1,436.3
Communications.....	828.9	945.1	1,011.9	1,070.9	1,087.7	1,060.2
Social and other services .....	6,702.2	7,799.6	9,187.6	10,190.4	10,719.7	10,840.4
<b>Total .....</b>	<b>49,026.0</b>	<b>51,351.7</b>	<b>54,304.0</b>	<b>54,601.1</b>	<b>49,521.0</b>	<b>55,802.4</b>
Net taxes on products .....	3,056.0	3,392.0	3,878.0	4,413.0	4,859.0	4,591.2

<b>Total GDP (in Market Prices)</b> .....	<b>52,082.0</b>	<b>54,743.7</b>	<b>58,182.0</b>	<b>59,014.1</b>	<b>54,380.0</b>	<b>60,393.6</b>
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Source: State Statistical Committee

(<sup>1</sup>) Preliminary data.

The following table illustrates Azerbaijan's real GDP by economic sector for the periods indicated:

Real GDP <sup>(1)</sup> by Economic Sector	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(2)</sup>
	(AZN millions)					
Mining and quarrying (including extraction of oil and gas) .....	13,597.0	12,903.6	12,993.9	12,643.1	12,756.8	12,846.1
Construction .....	2,704.0	3 196.2	3,876.9	4,218.1	3,652.9	2,816.4
Wholesale and retail trade; repairs .....	1,568.6	1,719.2	1,889.4	2,078.3	2,304.8	2,339.4
Transport and storage .....	1,304.5	1,369.7	1,456.0	1,524.4	1,509.2	1,501.6
Agriculture, forestry and fishing .....	1,280.8	1,365.3	1,432.3	1,395.0	1,487.1	1,525.7
Manufacturing (including processing of oil and gas) .....	1,044.8	1,093.9	1,116.9	1,158.2	1,191.8	1,172.7
Accommodation and food service activities .....	279.3	331.8	384.9	455.0	518.7	519.2
Electricity, gas, and water supply	106.7	118.3	122.7	130.2	129.9	129.3
Communications .....	910.0	1,054.6	1,167.4	1,343.8	1,435.2	1,499.8
Social and other services .....	2,044.6	2,155.0	2,310.2	2,430.3	2,500.8	2,438.2
<b>Total</b> .....	<b>24,840.3</b>	<b>25,307.7</b>	<b>26,750.6</b>	<b>27,376.4</b>	<b>27,487.2</b>	<b>26,788.5</b>
Net Taxes .....	1,612.5	1,725.4	1,872.1	1,963.8	2,036.5	1,946.9
<b>GDP</b> .....	<b>26,452.8</b>	<b>27,033.1</b>	<b>28,622.7</b>	<b>29,340.2</b>	<b>29,523.6</b>	<b>28,735.4</b>

Source: State Statistical Committee

(<sup>1</sup>) Based on 2005 prices.

(<sup>2</sup>) Preliminary data.

The mining and quarrying sector (which is predominantly made up of oil and gas extraction) was the largest contributor to the economy in the period from 2010 to 2016. The sector accounted for AZN 19.5 billion of nominal GDP in 2010 (45.9%) and this decreased to AZN 14.4 billion of nominal GDP in 2015 (26.4%) and AZN 18.5 billion of nominal GDP in 2016 (30.7%).

Over the same period, non-hydrocarbons sectors saw significant increases in their contribution to nominal GDP. This trend was seen across the largest of these sectors, which all saw increases in their contribution to GDP. Construction, including both public construction works and the development of private residential and commercial buildings, increased from AZN 3.4 billion in 2010 (8.1% of GDP) to AZN 6.5 billion in 2015 (12.0%) and was AZN 6.4 billion in the 2016 (10.6%). Despite the global financial crisis, the wholesale and retail trade sector of the economy increased from AZN 2.7 billion in 2010 (6.4%) to AZN 5.4 billion in 2015 (9.9%) and was AZN 6.2 billion in 2016 (10.2%). The transport sector increased from AZN 2.4 billion (5.6%) in 2010 to AZN 3.2 billion (6.0%) in 2015 and was AZN 4.1 billion (6.8%) in the 2016, agriculture increased from AZN 2.3 billion (5.5%) in 2010 to AZN 3.4 billion (6.2%) in 2015 and was AZN 3.4 billion (5.6%) in the 2016 and manufacturing increased from AZN 2.0 billion (4.7%) in 2010 to AZN 2.7 billion (5.0%) in 2015 and was AZN 3.1 billion (5.2%) in 2016.

The following table illustrates real GDP growth by economic sector for the periods indicated:

Real GDP growth by Economic Sector	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
	(% change year over year)					
Mining and quarrying (including extraction of oil and gas) .....	(10.2)	(5.1)	0.7	(2.7)	0.9	0.7
Construction.....	20.0	18.2	21.3	8.8	(13.4)	(22.9)
Wholesale and retail trade; repairs .....	10.2	9.6	9.9	10.0	10.9	1.5
Transport and storage .....	(0.8)	5.0	6.3	4.7	(1.0)	(0.5)
Agriculture, forestry and fishing .....	5.8	6.6	4.9	(2.6)	6.6	2.6
Manufacturing (including processing of oil and gas).....	6.8	4.7	2.1	3.7	2.9	(1.6)
Accommodation and food service activities.....	22.6	18.8	16.0	18.2	14.0	0.1
Electricity, gas and water supply.....	11.2	10.9	3.7	6.1	(0.2)	(0.5)
Communication.....	11.8	15.9	10.7	15.1	6.8	4.5
Social and other services .....	5.7	5.4	7.2	5.2	2.9	(2.5)

Source: State Statistical Committee

<sup>(1)</sup> Preliminary data.

In the period between 2010 and 2014 there has been a noticeable shift in the economy as Azerbaijan's non-hydrocarbons sectors have seen significant growth. With oil extraction from the major ACG field reaching its plateau, the contribution of the hydrocarbons sector to country's GDP declined by 10.2%, 5.1% and 2.7% in 2011, 2012 and 2014, respectively, with very limited growth in 2013 and 2015. By comparison, growth across non-oil and gas GDP was very robust in 2010, 2011, 2012, 2013 and 2014 increasing by 7.8%, 9.4%, 9.7%, 10.0% and 7.0% respectively, which significantly contributed to the overall growth in the economy during this period, with a decline in GDP growth in 2015, when GDP grew by 1.1%. In 2016, non-oil and gas GDP decreased by 4.5%.

In 2011, 2012 and 2013, nearly all sectors of the economy (excluding hydrocarbons) demonstrated consistent and real growth in terms of GDP contribution. The highest levels of consistent growth over that period were seen in accommodation and food services, which saw annual growth in 2011, 2012, 2013, 2014 and 2015 of 22.6%, 18.8%, 16.0%, 18.2% and 14.0%, respectively. In the same periods, growth rates of construction were 20%, 18.2%, 21.3% and 8.8%, respectively, with a decline of 13.4% in 2015. Growth in communications in 2011, 2012, 2013, 2014 and 2015 was 11.8%, 15.9%, 10.7%, 15.1% and 6.8%, respectively. See "*Risk Factors – Risks relating to Azerbaijan – GDP and inflation*".

In 2015, preliminary estimates indicate contraction in a handful of sectors of the economy, including construction, transport and storage and electricity, gas and water supply.

### Informal Economy

As has typically been the case with other transition economies, a small portion of Azerbaijan's non-hydrocarbon economy is comprised of an informal, or shadow, economy. By its nature, it is not possible to clearly measure but official estimates put it at approximately 9.0% of GDP and approximately 12.9% of non-oil and gas GDP as of 31 December 2015. The informal economy is also taken into account in the above GDP data and is only partially taxed, resulting in reduced state revenue. The Government is taking steps to address the informal economy by streamlining various regulations on non-cash transactions, amending tax laws to improve compliance, developing a mandatory life insurance programme to encourage formal sector employment as well as increasing penalties for unregistered and undeclared economic activity.

### Principal Sectors of the Economy

#### *Mining and Quarrying*

The mining and quarrying sector (which is predominantly made up of oil and gas extraction) in Azerbaijan has a long history and continues to play a substantial role in the economy. In 2015, the mining and quarrying sector accounted for 26.4% of nominal GDP and 43.2% of real GDP. In the year ended 31 December 2016, the mining and quarrying sector accounted for 30.7% of nominal GDP, based on the preliminary data. Oil and gas extraction accounted for 87.9% of the overall exports of the country in 2015

and 87.0% of the overall exports of the country in the year ended 31 December 2016. As of 31 December 2016, Azerbaijan's proved reserves were estimated at 2.55 trillion cubic metres of natural gas and 7 billion barrels of oil.

SOCAR is the state-owned company responsible for producing oil and natural gas in Azerbaijan. SOCAR also operates the country's refineries, runs the pipeline systems and manages the import and export of oil and gas. The members of SOCAR's senior management team are appointed by the President of Azerbaijan. Operating decisions are taken by the company's President.

### **Oil**

Industrial oil production in Azerbaijan began in 1848 and grew rapidly, with half of the world's oil coming from Azerbaijan by 1901. Following independence, Azerbaijan successfully encouraged foreign investment into its hydrocarbons industry to replace aging infrastructure and increase production, allowing Azerbaijan to once again become a significant supplier of hydrocarbons to international markets. Since 1994, Azerbaijan has been producing oil based on 35 PSAs with leading oil companies and, at present, companies from 15 countries are operating in the hydrocarbons sector of Azerbaijan under 17 PSAs.

Total oil output was 50.8 million tonnes in 2010, 45.6 million tonnes in 2011, 43.4 million tonnes in 2012, 43.5 million tonnes in 2013 and 42 million tonnes in 2014. In 2015, output was 41.6 million tonnes and average daily oil production exceeded 843,000 barrels. In the year ended 31 December 2016, output was 41.0 million tonnes and average daily oil production exceeded 829,000 barrels. In 2011, 2012, 2013 and 2014, oil exports were 39.0 million tonnes, 36.8 million tonnes, 36.7 million tonnes and 35.2 million tonnes, respectively. In 2015 and 2016, oil exports remained stable at 35.0 million tonnes per annum.

ACG is the largest oil field discovered up to date in the Azerbaijan sector of the Caspian Sea, with initial oil in place of almost 17 billion barrels. Up to 10 billion barrels of this oil can be recovered over the life of the field, which may extend beyond 2050. The field is now fully operational, and oil is being produced from Chirag, Central Azeri, West Azeri, East Azeri, Deep-Water Gunashli and West Chirag platforms. By the end of the current PSA in 2024, it is estimated that output from the field will have been 4.7 billion barrels. Significant further investment will be required at that stage to improve recovery factors and recover the remaining reserves.

The PSA for the development of the ACG field, the then so called "Contract of the Century", which was promulgated into law by then President Heydar Aliyev, was entered into by SOCAR and the participating international companies (BP (UK), Amoco (US), LUKoil (Russia), Pennzoil, (now Devon of US), UNOCAL (US), Statoil (Norway), McDermott (US), Ramco (US), TPAO (Turkey), Delta Nimir (now Amerada Hess of US), and SOCAR (Azerbaijan)) and came into effect in 1994 with a term of 30 years. BP operates the ACG field and SOCAR holds 11.6461% of the joint venture. The current shareholding structure in the ACG PSA is as follows: BP (35.7828%), SOCAR (11.6461%), Chevron (11.2729%), INPEX (10.9644%), Statoil (8.5633%), ExxonMobil (8.0006%), TPAO (6.7500%), ITOCHU (4.2986%), ONGC (2.7213%). During the contract period, total revenues for Azerbaijan are estimated to be US\$200 billion through taxes, bonuses and SOCAR's ownership share. See "*Risk Factors – Risks relating to Azerbaijan – Azerbaijan's economy is dependent on oil production and global prices for oil*".

### **Natural Gas**

In the period from 2003 to 2009, gas output increased from 5.5 billion cubic metres per year to 23.7 billion cubic metres. Gas output for the period from 2010 to 31 December 2016 increased as well (from 26.3 billion cubic meters to 29.4 billion cubic meters). Over the longer term, it is projected that gas output will increase following further development of current assets and the development of new projects.

The following table sets forth gas output and gas exports for the periods indicated:

For the year ended 31 December					
2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
<i>(billion cubic metres)</i>					

Gas output.....	25.8	26.9	29.5	29.6	29.0	29.4
Gas exports.....	6.8	6.6	7.3	8.1	8.2	8.5

<sup>(1)</sup> Preliminary data for the year ended 31 December 2016.

The largest gas field in Azerbaijan is the Shah Deniz field, which is one of the world's largest gas condensate fields with over 1 trillion cubic metres of natural gas and approximately 2 billion barrels of condensate in place, according to BP, with the potential for further hydrocarbons at deeper geological horizons and following further exploration and assessment. See "*Business—The Projects—Shah Deniz*".

#### ***Future developments – Umid and Absheron fields***

Azerbaijan continues to encourage further exploration of its oil and gas reserves. Prospective development opportunities for gas have been identified at the Umid and Absheron fields. Commercially viable reserves were discovered at the Umid field in 2010 and there are estimated reserves of 200 billion cubic metres of gas and 40 million tonnes of condensate. The Umid development project is a joint venture between SOCAR (holding an interest of 80%) and Nobel Oil Exploration and Production (holding an interest of 20%). A permanent offshore platform has been constructed and three wells have been drilled at a depth of 6,248, 6,236 and 6,240 metres, respectively. Production from one of the wells commenced in 2012. The third well was completed in December 2016. The Umid field produced 94,000 barrels of condensate and 76.6 million cubic metres of gas in 2012, increasing to 220,000 barrels of condensate and 183.1 million cubic metres of gas in 2013, 406,000 barrels of condensate and 357.2 million cubic metres of gas in 2014, 407,000 barrels of condensate and 337.8 million cubic metres of gas in 2015 and 377,182 barrels of condensate and 285.5 million cubic metres of gas in 2016. Production for January 2017 amounted to 39,660 barrels of condensate and 36.9 million cubic metres of gas.

Commercially viable reserves were discovered at the Absheron field in 2011. The field has estimated reserves of 250 – 300 billion cubic metres of gas and 38 million tonnes of condensate. The PSA for the Absheron field was signed in February 2009 between SOCAR (currently holding 40%) and Total (currently holding 40%), with Engie (the company previously known as GDF Suez) subsequently joining the consortium (holding 20% interest, which was purchased from Total). In addition to an existing well, a second well was drilled in 2011 to a depth of 6,874 metres for exploratory purposes. Another well is planned to be drilled beginning in 2017. Production from this well is expected to commence in 2020.

#### ***Oil and Gas Transportation***

Direct oil exports from Azerbaijan to its major European trade partners were made possible by the construction of the BTC, which transports crude oil via a 1,768 km (1,094 miles) pipeline expanding from the ACG field through Azerbaijan, Georgia and on to Ceyhan, a port on the south-eastern Mediterranean coast of Turkey. The majority of the funding for the construction of the BTC came from third parties, including the European Bank for Reconstruction and Development ("**EBRD**"), the International Finance Corporation ("**IFC**") and a syndicate of commercial banks. During 2012, 2013 and 2014, approximately 247 million, 249 million and 261 million barrels of oil and condensate from ACG (approximately 77%), SD (approximately 6%) fields and third-party shippers (approximately 17%) were exported via the BTC, respectively. During 2015, slightly over 262 million barrels were exported via the pipeline (an increase of 0.6% from 2014). During the year ended 31 December 2016, approximately 254 million barrels of oil and condensate were exported via the pipeline (a decrease of 3.1% from the same period in 2015). See "*Risk Factors – Risks relating to Azerbaijan – Azerbaijan's oil and gas exports are dependent on the BTC and SCP pipelines*".

Gas from the Shah Deniz field is exported by the SCP, a gas pipeline that transports gas to Turkey via the same route as the BTC. See "*Business—The Projects—South Caucasus Pipeline Expansion*".

#### ***Construction***

In 2016, the construction sector accounted for 10.6% of Azerbaijan's nominal GDP, compared to 12.1% in 2015, 12.6% in 2014, 11.6% in 2013, 10% in 2012 and 8% in 2011. The construction sector has experienced significant growth in recent years with output rising from AZN 3.4 billion in 2010 to AZN 6.5 billion in 2015 and was AZN 6.4 billion in 2016. The construction sector grew by 22.4% in 2010, 20.0% in 2011, 18.2% in 2012, 21.3% in 2013, 8.8% in 2014, decreased by 13.4% in 2015 and further decreased by 22.9% in 2016 compared to 2015. The decline in 2015 and 2016 was as a result of

infrastructure and other construction projects being stopped or delayed due to the lack of financing resulting from falling oil prices.

A number of large public construction projects have been undertaken in recent years, including the building of a number of new luxury hotels in Baku (including the Four Seasons, JW Marriott, Hilton and Fairmont), the construction of the Baku Crystal Hall, a concert hall built to host the 2012 Eurovision Song Contest and with capacity of more than 23,000 spectators, the construction of the Heydar Aliyev Center, which houses a conference hall, a gallery hall and a museum, and the Congress Hall of the Heydar Aliyev Center, the venue of the 2015 ADB annual meeting. The Government has also constructed new sporting facilities, including the Olympic stadium in Baku. Public construction projects are also being carried out to support the development of Azerbaijan's transport infrastructure, such as the construction of new airports in regions for tourist development and improvements to a substantial proportion of Azerbaijan's road network. The construction of a new terminal at Heydar Aliyev International Airport in Baku was completed in 2015. In addition, there have been a large number of construction projects to improve social services infrastructure through the building of new kindergartens, schools, hospitals and care facilities.

The State Housing Construction Agency was established under the President by a President's decree signed on 11 April 2016. The agency's objective is to meet the citizens' housing needs, improve their living conditions, ensure construction according modern architectural standards and ensure compliance with environmental and energy efficiency. The agency was also established in an effort to promote the construction of multi-storey residential buildings, create preferential conditions for citizens to own apartments (affordable housing) and organise the effective use of funds allocated for multi-storey housing construction.

In November 2016, the President signed a decree on "Certain Matters related to the Activity of State Housing Construction Agency", which establishes an electronic platform for the sale of apartments on preferential terms and sets conditions for obtaining housing on such terms. The decree approves the "Rules for Acquiring of Apartments at 'MIDA' LLC's Disposal by Citizens on Preferential Terms" that determines the preferential terms, provides a list of persons entitled to such preferential terms and sets the procedures for the sale of apartments on such preferential terms. Additionally, this decree establishes standards for the applications for sales on preferential terms, the review of such applications, the ability to receive mortgage financing and the management of the buildings.

Significant reforms have been carried out in recent years to simplify the system of issuing permits in the construction sector. The share of people employed in the construction industry has also grown substantially from 6.6% in 2010 to 7.2% in 2016.

### ***Wholesale and retail trade; repair***

According to the State Statistical Committee, the wholesale and retail trade sector increased its contribution to real GDP from AZN 2.7 billion in 2010 to AZN 5.4 billion in 2015 and from 5.3% of real GDP in 2010 to 7.8% of real GDP in 2015. The wholesale and retail trade sector's contribution to real GDP was AZN 2.3 billion (8.1% of real GDP) in 2016. The wholesale trade sector consists mainly of local operators who deal in a wide range of local and imported goods, whilst the retail trade sector is dominated by local participants. Recently, some regional and international brands have opened retail outlets in Azerbaijan, including many international luxury retail brands in Baku.

### ***Transport***

The volume of freight transported by both companies and individual operators reached 222.1 million tonnes for the year ended 31 December 2016. Contribution of transport and storage to GDP was 6.8% in 2016, 6.0% in 2015, 5.1% in 2014, 4.4% in 2013, 4.9% in 2012 and 5.1% in 2011.

For the year ended 31 December 2016, 6.9% of freight was transported by railway, 2.6% by sea, 0.1% by air, 26.8% by pipelines and 63.6% by road; passenger transport was 11.3% by metro and 88.5% by road.

The development of the Europe-Caucasus-Asia transport corridor, part of the TRACECA programme, was one of the country's early post-independence achievements. This vital logistic link has had a very positive impact on Azerbaijan's transport sector. In 2016, 50.3 million tonnes of freight were transported

along Azerbaijan's section of the corridor (27.4% by railway, 62.6% by road, and 10.0% by sea), down 3.7% in 2016 compared with 2015.

Currently under construction, the Baku-Tbilisi-Kars railway line will provide connections between the Trans-Europe and Trans-Asia railway networks, and carry freight and passengers directly through Azerbaijan, Georgia and Turkey. It will also enhance the economic potential of the countries in this region. By transporting freight to and from European and Asian countries, this railway line will increase the volume of intermodal and container transportation.

The current Baku International Sea Port is being moved to a new location near the town of Alat, 70 kilometres south of Baku. The new site is located at the crossroads of two major transportation corridors, the East-West and the North-South – an area where Azerbaijan's main railway and highway networks meet. The New Baku International Sea Port at Alat is being built over an area of 400 hectares in three phases. The first phase of construction of the new Baku International Sea Port in Alat was completed in 2015, with construction ongoing and expected completion of the project to occur in 2017. The maritime fleet will be updated and expanded and the Baku-Boyuk Kasik and Baku-Yalama railways will be restored and modernised.

A rail project, named the Baku-Tbilisi-Kars railway, is undergoing construction. The Baku-Tbilisi-Kars railway project consists of two sites. The first site is the Marabda-Akhalkalaki railway and the second site is the Akhalkalaki-Kartsakhi railway. Construction, rehabilitation and reconstruction works are in progress for the Marabda-Akhalkalaki site and are currently being carried out in three stages, with the first stage's progress being 98.96%, the second stage's progress being 84.54% and the third stage's progress being 79.23%, all as of 31 October 2016. The cumulative progress for Akhalkalaki-Kartsakhi site was 66.1% as of 31 October 2016.

A new air terminal, runway and hangars at Heydar Aliyev International Airport in Baku have been operating since 2015. The new Baku International Sea Port is expected to be the largest industrial/logistics zone in the Caspian region, fed by growing petrochemical feedstock and offering comprehensive logistics services to zone residents and international clients, serving as a major regional intermodal distribution hub. The Baku International Sea Port's envisions an integrated development model that links the port, airport, logistics centres, petrochemical industry and other strategic transport and non-transport projects under the umbrella of a special legal regime.

On 17 March 2016, the President signed a decree to create a special economic area consisting of a free trade zone in the Alat area, including the territory of the Baku International Sea Port. In furtherance of this decree, on 7 September 2016, DP World has entered into an advisory agreement with the Azerbaijan Ministry of Economy and the Port of Baku to develop a framework for the Alat Free Trade Zone in Azerbaijan. The future business hub is expected to become part of a network of economic zones in the country to develop the economy and to form part of the Eurasian trade corridor.

### ***Agriculture, forestry and fishing***

Implementation of agrarian reforms has created opportunities for the development of the agricultural sector. From 1992 to 1995, agricultural output decreased on average by 12% annually, but in the period 1996 to 2006 it increased on average by 7.1% per annum. This development and reform has continued under Azerbaijan's 2020 Project and in 2016, agriculture accounted for 5.6% of GDP.

Azerbaijan traditionally has been an agricultural products exporter to the Soviet republics. Agriculture is one of the main industries in the non-hydrocarbons sector that has significant export potential (particularly to long-standing trade partners such as Russia and Turkey) and the Government has undertaken a series of reforms to improve the production and processing capacity of the farmers. These include lump sum subsidies to the agricultural sector, exempting farming from tax and providing easier access to financing through subsidised loans farmers for seeds, fertilisers, livestock and lease of agricultural equipment and machinery. The Government has also supported building of a network of high capacity refrigerated units and warehouses in farming areas and has supported programmes to import more productive breeds of livestock for farmers.

These reforms have largely led to growth across the highly-diversified agricultural sector, which is not focused on any specific cash crop or one food product. For the year ended 31 December 2016, production was 3,065.1 thousand tonnes of cereals and dried pulses; 902.4 thousand tonnes of potatoes and 1,270.6



thousand tonnes of vegetables. Compared to 2015 figures, production of cereals increased 2.2%, production of potatoes increased 7.5% and production of vegetables decreased 0.4%. Production of fruit and berries has decreased. For the year ended 31 December 2016, 882.8 thousand tonnes of fruit and berries were produced in the country, a decrease of 0.6% over 2015.

Cotton production, once an important part of the agricultural sector, was 89.4 thousand tonnes for the year ended 31 December 2016, an increase of 2.5 times over 2015. Similar developments took place in tobacco production, where production increased to 3.6 thousand tonnes for the year ended 31 December 2016, an increase of 3.4% over 2015. Production of green tea leaves was 1,015.7 tonnes for the year ended 31 December 2016, 75.4% higher than in 2015.

Livestock farming has also increased. Since 1996 there has been an annual increase in meat and egg production. Production totals for the year ended 31 December 2016 were 523.8 thousand tonnes of meat, 2,009.9 thousand tonnes of milk, 1,609.8 million eggs and 16.7 thousand tonnes of wool. Compared to 2015, production in 2016 represented an increase of 1.6%, 4.4%, 3.7% in each of meat, milk and egg production, respectively, and a decrease of 2.1% in wool production. For 2016, the country's farms held 2.7 million head of cattle, including 1.3 million cows and buffaloes, and 8.6 million sheep and goats, representing decreases, compared to 2015 figures, of 0.3%, 0.4% and 0.7%, respectively.

In 2015, 12.0% of the total land area of Azerbaijan was covered by forests. Output of wood products was valued at AZN 11.2 million in 2015.

Fish caught commercially in 2010, 2011, 2012, 2013, 2014, 2015 and 2016 amounted to 45.3, 47.0, 57.7, 51.0, 50.1, 51.2 and 63.1 thousand tonnes, respectively.

### ***Manufacturing***

One of the Government's principal aims is to expand Azerbaijan's industrial production with a strong focus on developing the country's manufacturing sector. For the year ended 31 December 2015 and for the year ended 31 December 2014, manufacturing accounted for 5.3% and 4.7%, respectively, of Azerbaijan's nominal GDP, compared to 4.2% in 2013 and 2012. For 2016, manufacturing accounted for 5.2% of nominal GDP.

A wide variety of goods is currently manufactured in Azerbaijan, the main areas including food, beverages, tobacco, light industry, metallurgy, machinery, construction and petrochemicals. As part of the 2020 Project development plans, the Government is planning to build a very large oil, gas and petrochemical complex for extraction, production and refining of oil, gas and petrochemical products. The Government also plans to boost manufacturing in the non-hydrocarbons sectors by the construction of fertiliser plants, shipyards, cement works and steelwork factories to increase manufacturing export capacity, as part of its long-term aims to diversify the economy and grow the non-hydrocarbons sector. The work is on-going to establish special economic zones and industrial estates to provide further platform for greater non-oil production and exports. See "*The Economy – Overview – Azerbaijan 2020: Outlook for the future*".

### ***Accommodation and food service activities***

The accommodation and food services sector of the economy remains small accounting for only 2.4% of nominal GDP in 2016, although there has been some major investment in Azerbaijan's tourism infrastructure over the last few years. The annual number of visitors to Azerbaijan has increased significantly in the past six years from 1.3 million in 2010 to 2.0 million in 2016. The number of people employed in the accommodation and food service catering sector has also increased substantially from 46,900 in 2010 to 68,400 in 2016 (1.4% of the employed population).

The Government is committed to increasing tourism in Azerbaijan and is actively encouraging investment in the sector, conducting an aggressive advertising and marketing campaign aimed at increasing Azerbaijan's worldwide exposure. Due to the steadily increasing tourist visitor numbers, the hotel industry is also developing. Six international airports are operating in Azerbaijan and several five-star and four- star hotels have been built in these regions by private investors to service the growing number of visitors.

Tourist development includes operation of a ski resort at Shahdag and Gabala. The number of hotel beds available in Azerbaijan was 37,278 in 2015 and 37,820 in 2016.

Citizens of Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine or Uzbekistan do not require a visa to visit Azerbaijan. Citizens of Turkey and Israel, and citizens of Kuwait, Bahrain, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Indonesia, Japan, the Republic of Korea, China, Malaysia and Singapore are able to obtain a visa on arrival in Azerbaijan. Azerbaijan is a party to a visa facilitation agreement with the EU, which came into force on 1 September 2014. Effective from January 2017, Azerbaijan introduced a new electronic visa system (the ASAN Viza system) for citizens of 81 designated countries. Under this system, visas are issued for single-entry visits up to 30 days and the application processing time has been reduced to three days.

On 27 December 2016, the President signed a decree on “Certain Measures related to Improvement of Tourism in the Republic of Azerbaijan”. This decree promulgates the “Regulations for the Tourism Council of the Republic of Azerbaijan”, which was established by the President’s earlier order on “Additional Measures related to Improvement of Tourism in the Republic of Azerbaijan” signed in September 2016. Additionally, the decree lays the foundation for the establishment of the National Bureau for Promotion of Tourism, whose mission is to increase and promote international tourism.

### **Electricity, Generation and Consumption**

In 2016, Azerbaijan's electricity output was 24,969.8 GWh, an increase of 1.1% compared to 2015. Of the 2016 output, 20,699.0 GWh (82.9%) was attributable to thermal power plants, 1,954.7 GWh (7.8%) to hydro power plants and 2,316.1 GWh (9.3%) from other forms of generation. In 2016, electricity, gas, steam and air conditioning supply accounted for 1.2% of Azerbaijan's nominal GDP, compared to 1.4% in 2015, 1.8% in 2014 and 1.9% in 2013. In 2015, approximately 36.0% of the electricity generated in Azerbaijan is consumed by industrial and commercial customers.

Over the last decade, the Azerbaijani electricity industry has undergone a significant restructuring. When privatisation of the distribution companies in 2002 did not bring the expected performance improvements for the power supply, the distribution sector was re-nationalised in 2006. At that time, the distribution grid was found to be in a poor condition with high network losses and frequent blackouts and brownouts. Until 2007, peak demand could also not be fully met by domestic generation and electricity had to be imported. Following the re-nationalisation and subsequent investment, Azerenerji OJSC and the Baku Electric Grid JSC (now Azerishiq OJSC) have been able to improve the quality of the power supply considerably, with distribution losses at only 10-11% and few, if any, interruptions in supply.

The following table sets forth details of electricity generation and consumption in Azerbaijan for the periods indicated:

<b>Electricity generation and consumption in Azerbaijan</b>	<b>For the year ended 31 December</b>						
	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016<sup>(3)</sup></b>
	<i>(GWh unless otherwise stated)</i>						
Electricity generation.....	18,709.5	20,293.8	22,988.1	23,354.4	24,727.7	24,688.4	24969.8
Thermal Power Plants.....	15,003.0	17,316.8	19,536.7	20,065.6	21,401.2	20,904.6	20699.0
Hydro Power Plant.....	3,446.3	2,675.8	1,821.0	1,489.0	1,300	1,637.5	1954.7
Other <sup>(1)</sup> .....	260.2	301.2	1,630.4	1,799.6	2,027.2	2,146.2	2316.1
Export-import balance.....	362.6	676.8	539.4	368.3	365.2	157.5	981.1
Export.....	462.4	804.8	680.3	495.6	489.3	265.0	1095.5
Import.....	99.8	128.0	140.9	127.3	124.1	107.5	114.4
<b>Total supply to grid.....</b>	<b>18,346.6</b>	<b>19,617.0</b>	<b>22,448.6</b>	<b>22,986.1</b>	<b>24,362.5</b>	<b>24,530.9</b>	<b>23988.7</b>
<b>Consumption per capita (kWh)<sup>(2)</sup>.....</b>	<b>2,053.5</b>	<b>2,166.9</b>	<b>2,446.5</b>	<b>2,472.5</b>	<b>2,587.6</b>	<b>2,574.3</b>	<b>2489.0</b>

Source: State Statistical Committee

<sup>(1)</sup> Includes auto producers and wind and solar power plants.

<sup>(2)</sup> Includes losses.

<sup>(3)</sup> Preliminary data.

As part of its ongoing development plans, Azerbaijan is adding to its domestic generation capacity. The 780MW "Janub" Combined Cycle Power Plant was completed in 2013, the construction of the 400MW "Shimal-2" power plant is ongoing, and there are several other power plants under development, including (i) the 920 MW “Yashma” gas combined cycle power plant in Yashma territory, for which a

feasibility study is currently being prepared; (ii) the 600 MW “Hovsan” gas combined cycle power plant to be constructed as part of proposed large-scale energy projects in the Hovsan settlement of Absheron peninsula; feasibility studies are currently being prepared for the "Hovsan" plant and the proposed energy projects; (iii) the 385 MW “Sangachal” modular power plant. There are currently plans to increase electric generation capacity by approximately 50% by 2025. Azerbaijan, with support from the World Bank, is also upgrading its systems for monitoring electricity generation and distribution networks. The Supervisory Control and Data Acquisition ("SCADA") project consists of two phases, the first of which has already been completed and saw the installation of monitoring and communications equipment at 45 power plants and high voltage substations, along with the installation of a 1,000km fibre optic network between such facilities. The second phase of SCADA is expected to be implemented in the period from 2014 to 2018. The implementation of the second phase of SCADA is currently ongoing and consists of updates to the monitoring and communications equipment of the first phase, as well as the extension of the system across the remaining facilities in the network.

Electricity is exported primarily to Russia, Iran and Georgia. Net exports in 2016 amounted to 981.1 GWh. Azerbaijan is an important participant in Azerbaijan-Georgia-Turkey Power Bridge Project, a regional energy project aimed at the export of electricity from Azerbaijan and Georgia to Turkey. The Azerbaijan–Georgia–Turkey Power Bridge, completed in June 2015, increased the capacities of electricity transit to Turkey, and 416.7 MW were exported from Azerbaijan to Turkey in the nine months ended 30 September 2016.

Azerenerji OJSC and Baku Electric Grid JSC (now, Azerishiq OJSC) have been the two key companies in the Azerbaijani electricity market. Both companies are wholly state-owned. Azerenerji owns all of the generation capacity, save for some small private generators and the power plants in Nakhchivan Autonomous Republic. Azerenerji OJSC also operates most of the electricity transmission systems in Azerbaijan. With its seven subsidiary grid companies Sumgayit, Ganja, Mingachevir, Shirvan, Imishli, Shaki and Khachmaz Regional Electricity Networks, Azerenerji OJSC is also responsible for electricity distribution and sales in the whole country except for the Baku region and Nakhchivan Autonomous Republic. Azerishiq OJSC operates the distribution grid in Baku region and is involved in retail electricity sales to its customers. The Nakhchivan State Energy Agency is responsible for electricity generation, transmission and distribution in Nakhchivan Autonomous Republic.

Pursuant to the Order of the President of the Republic of Azerbaijan "On "Azerishiq" Open Joint Stock Company dated 10 February 2015, Baku Electric Grid JSC was renamed Azerishiq OJSC. All shares of Azerishiq OJSC are owned by the Republic. Upon establishment, Azerishiq OJSC was authorised to sell electric energy, which was previously entrusted with Azerenerji OJSC. Azerishiq OJSC is engaged in the sale of electric energy in the territory of the Republic, with the exception of Nakhchivan Autonomous Republic.

The Ministry of Energy is the central executive body in the energy sector in Azerbaijan, responsible for the implementation of national energy policy regulations and licensing of generation and supply. The Tariff Council, chaired by the Minister of Economy, is the responsible authority for price regulation and tariff methodology in the electricity markets, as well as prices (tariffs), service fees and collections to which state price regulation applies. The Tariff Council is funded by the State Budget and is chaired by the Minister of Economy and has representatives from other ministries.

Although Azerbaijan has had policies supporting the development of renewable energy production since 2004, other than hydroelectric generation (which constituted 7.8% of generation in 2016) renewable sources do not currently contribute a material amount of generation capacity.

In 2007, construction of the Takhtakerpu water reservoir in Shabran commenced. This reservoir is part of the Samur-Absheron irrigation system. The official ceremony to mark the start of the provision of water into the reservoir Takhtakerpu was held on 19 July 2013. The area of the reservoir is 8.71 square kilometres, its capacity is 270 million cubic metres of water. Water from the Samur river flows through the Velvelechay-Takhtakerpu channel to the reservoir.

### ***Communications***

Communication is one of Azerbaijan's most rapidly expanding sectors of the economy and is playing a vital role in the country's socio-economic development. There has been steady year-on-year growth of the communications sector since 1995. In 2010, communication sector revenue was AZN 791.6 million and

in 2015 this figure reached AZN 1,083.6 million (2.0% of GDP). In 2016, the revenues of the sector stood at AZN 1,060.2 million (1.8% of GDP).

Mobile networks, high speed data links and internet, as well as other communication channels, have seen significant development to keep up with market demands, with wireless telecommunications being one of the most quickly expanding services. Demand for internet and data services has been rising with internet penetration rates of 77.0% at the end of 2015. By 2015, market penetration for the mobile networks was 112.0%, with the largest network operator being Azercell. Bakcell and Azerfon are also significant network operators, with more than 20% of the market each. The number of digital telephone exchanges was 16 in 1995, but by the beginning of 2007, substitution of older stations had given rise to 811 digital exchanges and in 2015 the number of telephone exchanges reached 1,790.

Azerbaijan's first satellite, built by Orbital Sciences Corporation, was launched into orbit on 7 February 2013 from Kourou in French Guiana. The satellite will cover Europe and large parts of Asia and Africa and will transmit television, radio and the internet. The satellite has an anticipated service life of 15 years. Commercial and financial arrangements have been put in place with respect to a second communications satellite, which is planned to launch in 2017.

### ***Environment***

Azerbaijan has experienced environmental issues with current and past sites of oil and gas extraction and processing, resulting from land contamination, gas flaring, the disposal of waste water and oil spills. Although the level of pollution and potential clean up is difficult to assess, Azerbaijan, like most other resource-rich regions of the CIS, is burdened with a Soviet-era legacy of environmental mismanagement. There are particular problems at past production oil fields, some of which have been exploited for more than 150 years. Poor environmental awareness in the past allowed a number of incidents of oil leaks due to pipeline failures. Temporary reservoirs for the storage of drilling mud, liquid waste and oil were not repaired or disposed of properly causing severe pollution of several regions, including in Baku, Absheron, Salyan, Shirvan, Muradkhanli and Neftchala. In total, an area of 100 km<sup>2</sup> is polluted by hydrocarbon waste products in these six regions. In September 2006, SOCAR prepared and approved an action plan with respect to the damage caused to the Absheron area. This action plan was subsequently revised in 2009 and 2011. As of 30 June 2015 (the most recently available data), the carrying amount of the provision for future costs to be incurred for environmental remediation was AZN 114 million.

To address these challenges, Azerbaijan has developed a national environmental policy which aims to implement sustainable development principles, namely the preservation of natural resources at national, regional and international levels; the informed use and application of scientific technology; and the efficient exploitation of economic and human resources.

Established in 2001, the Ministry of Ecology and Natural Resources is the main body responsible for implementing the national environmental policy, as well as enforcing environmental legislation, education, research, and ecological audits. To achieve the aims of the policy, legislation aimed at adopting European standards of environmental protection has recently been introduced and the government has implemented reforms to the environmental management system.

Special emphasis is also being placed on managing the environmental profile of Azerbaijan's oil and gas exploration and exploitation projects. The Shah Deniz project, operated by BP, will be carried out to meet the requirements of local and international standards and in full compliance with ISO 14001 environmental management system certification. Under the various PSAs in force, oil and gas companies are required to work in accordance with environmental standards developed with SOCAR and the Ministry of Ecology and Natural Resources. These standards draw both on existing Azerbaijani law and international oil and gas industry standards and experience with their implementation in exploration and production in other parts of the world.

The Ministry has in recent years broadened ties with international organisations in order to resolve current environmental problems. Azerbaijan has co-operated with organisations such as the UNDP, IAED, UNEP, NATO, OSCE, the Global Foundation for the Environment, the Organization for Economic Cooperation and Development, ECO, the World Bank, the Asian Bank and the World Wildlife Foundation. An international environmental conference on the Caspian Sea was held in 2014. Azerbaijan is also party to 20 international conventions and protocols in the area of environmental protection and has ratified the UN Framework Convention on Climate Change in 1995, as well as the Kyoto Protocol in

2000. Azerbaijan supported the adoption of a new global agreement on climate change to be applied to all parties in the 21<sup>st</sup> Conference of Parties to the UN Framework Convention on Climate Change held in Paris in 2015. In its Intended Nationally Determined Contribution, Azerbaijan set a target of 35% reduction in the level of greenhouse gas emissions compared to 1990 as a base year. See "*Risk Factors – Risk Factors Relating to the Guarantor – Azerbaijan's long history of oil and gas production has left significant environmental issue.*"

## Inflation

A consumer price index ("CPI") is used as a broad measure of inflation in Azerbaijan. CPI statistics are collected and calculated on a monthly basis by the State Statistical Committee and published on its website during first ten days of every month. The State Statistical Committee uses the CPI data to monitor both headline inflation and core inflation. Core inflation is headline inflation net of supply-side shocks, such as abrupt or short-term price fluctuations resulting, for example, from one-off increases in public utility fees or adverse weather conditions of a temporary nature.

The following table sets forth the movement in consumer and industrial producer prices for the periods indicated:

Consumer Price Index and Producer Price Index	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016
CPI .....	7.9	1.1	2.4	1.4	4.0	12.4
annual average (% to previous year) .....	7.9	1.1	2.4	1.4	4.0	12.4
Producer Price Inflation .....	33.5	4.5	(3.9)	(5.1)	(30.6)	27.5
annual average (% to previous year) .....	33.5	4.5	(3.9)	(5.1)	(30.6)	27.5

Source: State Statistical Committee

Average annual CPI inflation was 12.4% in 2016, 4.0% in 2015, compared to 1.4% in 2014, 2.4% in 2013, 1.1% in 2012, 7.9% in 2011 and 5.7% in 2010. High increases in Producer Price Inflation during 2010 and 2011 were primarily due to significant increases in oil prices in world markets compared to 2009 prices. In 2016, inflation was 12.4%, primarily as a result of the devaluation of the Manat. Inflation for 2017 is forecasted to be 7.3%.

The following table sets forth CPI for the periods indicated across specific sectors:

Consumer Price Index	For the year ended 31 December							
	2009	2010	2011	2012	2013	2014	2015	2016
	(%)							
<b>CPI</b>								
(period average) .....	1.5	5.7	7.9	1.1	2.4	1.4	4.0	12.4
Food .....	(1.5)	7.2	10.4	0.8	2.2	1.0	6.1	14.7
Non-Food .....	3.4	2.3	2.6	1.0	0.8	3.2	3.8	16.7
Services .....	7.1	4.3	4.7	1.2	3.5	0.3	1.2	5.8
<b>CPI</b>								
(period ended 31 December) .....	0.7	7.9	5.6	(0.3)	3.5	(0.1)	7.6	15.7
Food .....	(2.6)	12.7	7.1	(1.0)	2.9	(0.5)	9.2	21.0
Non-Food .....	0.6	3.4	1.2	0.4	3.5	0.2	11.0	16.2
Services .....	9.1	(0.1)	5.1	0.4	4.2	(0.1)	2.5	8.1

Source: State Statistical Committee

Food price increases accounted for 0.42% of the average annual inflation rate, non-food products accounted for 0.27% and services for 0.31% in 2016. The average annual inflation rate for non-food products and services was 3.8% and 1.2%, respectively, in 2015. In 2016, the average inflation rate for non-food products and services was 16.7% and 5.8%, respectively.

The reduction in CPI inflation in 2012, 2013 and 2014 was mainly due to relatively low world food prices, a reasonable growth rate of the money supply and a stable exchange rate. Higher levels of domestic food production over the period have also had a stabilising effect on prices.

In 2015, the CBA's target for CPI inflation was 5-6%. The CBA has sought to keep inflation within these target ranges, while also ensuring a stable exchange rate, by managing the money supply and purchasing foreign currency reserves in 2015. In 2016, the CPI inflation was 12.4% due to devaluation of the Manat.

The forecasted CPI inflation for 2017 and 2018 is 7.3% and 4.9%, respectively. See "*Risk Factors – Risks relating to Azerbaijan – GDP and inflation*".

## Wages

The following table presents data on nominal and real growth of wages, in comparison to the previous year, during the periods indicated:

Annual Wage Growth	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
Nominal growth of wage rate (%).....	9.9	9.4	6.7	4.6	5.0	6.8

Source: State Statistical Committee

<sup>(1)</sup> Preliminary data for 2016.

The following table presents data on wage levels during the periods indicated:

Average Wage Levels	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
Average monthly nominal wage (AZN).....	364.2	398.4	425.1	444.5	466.9	498.6
Average monthly nominal wage (US\$).....	461.2	507.1	541.9	566.7	455.0	312.4
Average monthly nominal wage by sector (AZN)..						
Private sector .....	466.7	500.3	542.1	571.1	617.4	674.2
Public sector.....	303.3	332.9	346.9	355.7	360.4	375.4
Agriculture, forestry and fishing .....	196.4	201.1	217.9	241.3	245.8	256.6
Industry .....	526.1	599.6	646.3	714.3	822.5	900.3
Construction.....	519.4	587.5	625.5	626.9	677.7	813.7
Services.....	333.9	356.7	379.1	393.3	405.9	419.8

Source: State Statistical Committee

<sup>(1)</sup> Preliminary data for 2016.

The average monthly wage in Azerbaijan has grown significantly in recent years. Average monthly nominal wages in dollar terms increased in each year between 2010 and 2014. While the average monthly nominal wage in Manat increased in 2015, it was significantly affected by the recent devaluation of the Manat and decreased in dollar terms. The average monthly nominal wages in dollar terms further decreased as of 31 December 2016 due to the devaluation of the Manat in December 2015.

Both private and public sector wages have grown significantly during the past several years. Robust growth recorded in the non-hydrocarbons sector for the same period was associated with a rise in labour productivity, which reflected itself in a 44.5% increase in the private sector average wage rate between 2011 and 2016. Public sector wages increased by 23.8% over the same period.

The Government pursues a consistent public sector wage setting policy, which aims at sufficiently compensating increased labour productivity in the sector, while at the same time taking into account the changes in the inflation rate. In line with this policy, the Government periodically issues decrees on the increase of wages of public sector employees. Due to the recent higher levels of inflation, the Government anticipates facing greater pressure to keep public sector wages in line with this growth.

The minimum monthly wage remains low in Azerbaijan compared to the level of average monthly wages. Effective from 1 January 2017, the minimum monthly wage rate was increased to AZN 116 or 21.1% of average nominal wages. The minimum wage level is being increased by the Government every year in order to improve the welfare of citizens and strengthen the social protection of the poor. As of 1 March 2016, the monthly salary of persons working in certain entities financed by the State Budget (e.g., the fields of education, culture, youth, tourism, sports and health) was increased by 10%.

## Employment

Economic growth over the last decade has resulted in improving levels of employment and the creation of new jobs. Between 2010 and 2016, the number of people employed increased from 4.33 million to 4.76 million whilst the unemployment rate fell from 5.6% to 5.0% according to official statistics.

The Government is committed to strengthening existing employment laws so as to meet international standards. The "Employment Strategy in Azerbaijan Republic (2006-2015)" was approved by the President on 26 October 2005 and aims to ensure the efficient use of the nation's labour resources. Two state programmes have been developed to implement the first and second stages of this employment strategy. The aims of the strategy include increasing the quality and competitiveness of the employment market and strengthening the social protection of job seekers and the unemployed. The Government provides an education program for the unemployed persons. The employment strategy for 2016 – 2030 is currently being developed and is expected to be adopted by the end of 2016. See "*Social Insurance System—Unemployment*".

The following table sets out selected average employment statistics for the periods indicated:

Employment	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
Total Population ('000s) .....	9,111.1	9,235.1	9,356.5	9,477.1	9,593.0	9,810.0
Labour resources ('000s).....	6,101.2	6,166.9	6,230.7	6,284.8	6,335.9	–
Economically active population ('000s).....	4,626.1	4,688.4	4,757.8	4,840.7	4,915.3	5,012.7
Employed ('000s).....	4,375.2	4,445.3	4,521.2	4,602.9	4,671.6	4,759.9
Unemployed ('000s).....	250.9	243.1	236.6	237.8	243.7	252.8
Activity rate (%).....	64.4	64.5	64.7	65.1	65.4	66.0
Unemployment rate (%).....	5.4	5.2	5.0	4.9	5.0	5.0
Employed persons by sector (%).....						
Private sector .....	73.9	74.0	74.1	74.4	74.8	75.4
Public sector.....	26.1	26.0	25.9	25.6	25.2	24.6
Agriculture, forestry and fishing .....	37.9	37.7	37.1	36.7	36.4	36.3
Industry.....	7.0	7.0	7.1	7.0	6.9	7.1
Construction.....	7.1	7.2	7.2	7.3	7.2	7.2
Services.....	48.0	48.1	48.6	49.0	49.5	49.3

Source: State Statistical Committee

<sup>(1)</sup> Preliminary data for 2016.

The following table shows the average number of people employed in various economic sectors for the periods indicated:

Employment by Economic Sector	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
	('000s)					
Agriculture, forestry and fishing .....	1,657.4	1,673.8	1,677.4	1,691.7	1,698.4	1,729.6
Wholesale and retail trade; repairs .....	635.4	646.8	664.0	681.9	693.7	699.5
Education .....	349.9	349.0	366.2	367.3	373.5	374.8
Construction.....	308.9	321.8	325.5	334.1	336.4	343.8
Manufacturing (including processing of oil and gas).....	210.3	215.6	224.1	227.1	229.8	242.2
Transportation and storage .....	181.8	182.7	183.8	185.1	197.1	198.4
Human health and social work activities.....	165.2	165.4	171.8	176.5	180.8	185.6
Other service activities .....	130.7	136.6	138.0	143.6	154.1	163.9
Real estate activities .....	71.2	74.8	79.4	85.6	89.7	88.0
Arts, entertainment and recreation .....	60.3	61.1	61.8	67.8	69.6	77.4
Information and communication .....	58.0	58.7	58.1	59.2	60.3	61.2
Professional, scientific and technical activities.....	46.7	54.6	56.3	58.5	59.6	61.4
Administrative and support service activities.....	47.4	49.2	52.4	53.7	55.2	57.1
Accommodation and food service activities.....	48.1	48.9	49.2	55.7	61.5	68.4
Mining and quarrying (including extracts of oil and gas).....	41.2	41.8	42.3	41.5	39.1	38.1
Electricity, gas, steam and air conditioning supply.....	30.8	31.2	32.3	29.8	27.1	27.6
Financial and insurance activities.....	26.3	26.9	30.6	32.8	33.0	27.1
Water collection, treatment and supply .....	24.6	24.7	25.7	25.8	25.4	30.4

<b>Total employed population</b> .....	<u>4,375.2</u>	<u>4,445.3</u>	<u>4,521.2</u>	<u>4,602.9</u>	<u>4,671.6</u>	<u>4,759.9</u>
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Source: State Statistical Committee

(<sup>1</sup>) Preliminary data for 2016.

While agriculture has remained the largest employer compared with other sectors of the economy, there have been significant increases in employment in construction (from 6.6% of the employed population in 2010 to 7.2% in 2016). Although the hydrocarbons sector is very important for the economy, it provides relatively little employment with fewer than 34,430 employed in that sector in 2015, and in 2016 this figure was 34,127.

## Social Insurance System

### Poverty Assessment

Azerbaijan relies on both an income and consumption approach for assessing poverty levels. A consumption aggregate comprised of both food and non-food baskets as well as an estimated rental value of durables is an important tool for measuring poverty because the Government believes consumption is more likely to be accurately declared and less sensitive to changes than income.

Based on the consumption approach, Azerbaijan has established a poverty line at approximately 60% of the average monthly consumption per capita of all households in Azerbaijan.

The following table sets forth information about levels of poverty in Azerbaijan for the years specified:

Poverty	For the year ended 31 December				
	2011	2012	2013	2014	2015
Average monthly consumption per capita of all households in Azerbaijan (AZN) .....	173.0	202.0	221.4	234.9	245.55
Poverty line1(AZN per month) .....	107.2	119.3	125.2	129.6	135.6
Poverty level (% of population) .....	7.6	6.0	5.3	5.0	4.9

Source: State Statistical Committee, Central Bank of Azerbaijan

The Government is committed to reducing the number of poor households. The Government's efforts to reduce poverty levels have been successful. In 2015, poor households as a share of total households was 4.9% which fell from 5.0% in 2014 and 5.3% in 2013.

Households classified as poor are entitled to receive a poverty family benefit or lump-sum financial assistance. Such payments are paid regardless of income and are currently paid to approximately 558,133 people. Poverty benefits are paid out of the State Budget and are classified as part of the "Social Protection" expenditures within the expenditure ledger of the State Budget. For the year ended 31 December 2016, Social Protection expenditures as a whole amounted to AZN 2,645.2 million or 14.9% of the overall State Budget expenditures according to preliminary data.

### Refugees and internally displaced persons

Financial support is provided to refugees and displaced persons from the Nagorno-Karabakh conflict (in 2015, approximately 800,000 people). A wide range of support is provided from both the State Budget and direct funding by SOFAZ, including housing and utility services. As this support comes from a variety of Governmental agencies it is not possible to determine accurately the overall cost of it.

### Unemployment

Unemployment benefits are limited and regulated by the 2001 Law "On Employment" and the 1997 Law "On Social Insurance", which regulate the arrangements and financing of unemployment payments and benefits, as well as setting out the criteria for such entitlements. In 2016, unemployment benefits amounted to AZN 17.0 million paid to 11,552 unemployed people from the State Social Protection Fund budget.

The Government provides an education program for the unemployed persons. The program offers training on skills such as interview etiquette, person-to-person networking and job-seeking methods. Unemployed



persons registered in the State Employment Service of the Republic of Azerbaijan are directed to training centres, where they can develop their professional skills and choose among available fields of study such as marketing, human resources and IT.

### ***Pensions***

Azerbaijan's pension system is in balance and consists of two elements: the basic state pension and the funded pension. The basic pension is a minimum guaranteed by the state, while the funded pension consists of a further contribution from the State Social Protection Fund based on the duration of pension payments. The basic eligibility criteria for state pensions are as follows: (i) reaching the retirement age (63 for men and 60 for women) provided the person has the required "insurance experience" (which is defined as the sum of (a) work or other activity periods (provided mandatory state social insurance fees have been paid to the relevant state authority in relation to such periods) taken into account in determining a pension right and (2) other periods included under social experience under relevant legislation under the Law "On Pensions" dated 7 February 2006); (ii) disability; or (iii) the death of a household's primary provider. There are currently plans to increase pension contribution payments and reduce the unfunded elements of the pension.

As of 31 December 2016, 1.3 million people were receiving the basic state pension which is AZN 110 per month. Approximately 0.8 million people were receiving the pension based on age, 0.4 million people based on disability and 0.1 million people based on the loss of the household's primary provider. The average monthly pension (including both basic and funded elements) was AZN 192.2 as of 31 December 2016.

On 16 January 2016, the President of the Republic of Azerbaijan approved a 10% raise to the basic pension provided by the state, as a result of the devaluation of the Manat.

A pension reform law which has been submitted to the Parliament and is expected to be discussed during the spring 2017 session of the Parliament. The revised pension plan, if adopted, will increase retirement ages and pension contribution periods. The current base pension, which accounts for more than half of pension spending, is expected to be eliminated by the pension reform law and be replaced by an increase to the defined pension contribution benefit, while putting in place a minimum pension to soften the impact of the pension reform on low income individuals.

### **Privatisation Process**

Following independence from the Soviet Union, Azerbaijan has sought to transition from a fully state-owned economy to an economy where 81.3% of GDP (in 2015) is generated by the private sector. In 2015, 70.1% of the non-hydrocarbons sector was privately owned. In 2013, 75.3% of the non-hydrocarbons sector was privately owned, up from 73.5% in 2012. On 18 January 2016, the President of the Republic of Azerbaijan ordered the Government to draw up a programme for large-scale privatisation. The goal of the programme will be to attract foreign investment and encourage privatisation and investment in Azerbaijan on an intensive and global scale. The main sectors expected to be targeted for privatisation are utilities, such as gas and electricity, transportation facilities and cultural enterprises.

In 2016, the President issued several decrees aimed at improving and accelerating the privatisation of state owned property. Pursuant to these decrees, the President instructed relevant state authorities to prepare a new bill of the Law "On Privatisation of State Property", and the acceleration of the state property privatisation process has been identified as an important economic policy of Azerbaijan. Pursuant to the Presidential decree "On Certain Measures related to Acceleration of Privatisation and Increasing Efficiency of Management of State Property" dated 19 July 2016, the President instructed the Cabinet of Ministers of the Azerbaijan to collect from the State Committee on Property Issues and other related bodies proposals for (i) the list of enterprises to be retained in state ownership for the medium term; (ii) the rehabilitation of enterprises to be privatised before their privatisation and the settlement of their debts; and (iii) the resolution of social problems related to privatisation. The State Committee on Property Issues was instructed to inform the public and foreign investors about state entities and state owned facilities open for privatisation and to accelerate the process of privatisation of state property slated for privatisation prior to the entry into force of this decree. More than 490 state owned properties were privatised in 2016.

Privatisation of state property began in 1995, following the adoption of the First State Privatisation Programme. This first phase (from 1996 to 1998) took a mass-privatisation approach, mainly focusing on small-scale enterprises. The Second State Privatisation Programme began in 2000, focusing on medium- and large-scale enterprises and enabling wider participation of labour collectives.

There are several legally adopted privatisation methods in Azerbaijan, including direct sale to a strategic investor; sale by tender; sale at voucher and cash auctions; sale at general auctions; sale through bankruptcy and insolvency proceedings and sales to employees on preferential terms.

Voucher privatisation was introduced on 1 January 1997 when 32 million privatisation vouchers were issued so as to distribute 65% of all state property identified for privatisation. During specialised voucher auctions, citizens were able to bid for shares in medium- and large-scale enterprises which had been converted into joint stock companies and other state-owned assets. Individuals were also able to buy, sell, transfer or assign their vouchers through the securities market.

A state privatisation option programme was also introduced, which enabled foreign parties to take part in voucher auctions by purchasing options. Those who reinvested their net profits in Azerbaijan were able to participate in voucher auctions without being required to submit options. In total, 1,437 enterprises were privatised at voucher auctions between 1997 and 2010.

Both state privatisation vouchers and options expired on 31 December 2010. Since then, citizens and foreign investors have had equal access to the privatisation process. Individual and corporate foreign investors have the same rights as Azerbaijani citizens in respect of purchasing state-owned property.

There are no restrictions on subsequent sales of enterprises acquired by foreign purchasers or on taking long-term leases of land and foreign investors' rights are equally protected under the law of Azerbaijan.

Investment tenders have proven to be another successful method of privatising medium- and large- scale enterprises, by which the prospective buyer proposes an investment programme, which will introduce reforms and measures to maintain improved productivity at the state enterprise and solve pre-existing management problems. The ownership rights of the enterprise are only transferred to the buyer following the successful implementation of the investment programme. Between 1998 and 2016, 105 enterprises have been privatised through investment tenders, resulting in a total of US\$1.1 billion of private investment. Foreign participation in investment tenders has included sovereign investors such as the United States, Switzerland, France and the United Kingdom. Approximately 17,000 jobs have been created or restored as part of these investment programmes. Examples of successful investment tenders include investments into Garadagh-Cement, Baku Tobacco, Moscow Hotel (now known as the Baku Flame Towers), Azerbaijan Hotel (now the Baku Hilton Hotel) and Ganja-Wine.

Since 2009, the privatisation process has been managed and overseen by the State Committee on Property Issues ("SCPI"). The key functions of the SCPI with respect to privatisation include attracting private investment in state-owned property, management and maintenance of state property prior to privatisation, supporting privatised enterprises, co-ordinating real estate and land registration matters and maintenance of the local real estate and address registers.

Between 1995 2016, approximately 47,680 small state enterprises were privatised; approximately 1,603 medium-and large-scale state enterprises were transformed into joint stock companies and approximately 7,155 plots of land have been sold.

It estimated that around 1.2 million people have directly benefited from privatisation, and the generation of approximately AZN 676 million in revenue between 1998 and 2015.

The following table sets forth the cumulative number of privatised enterprises between 2010 and 2016:

Number of Privatised Enterprises and Plants	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016
	<i>(cumulative at end of the year)</i>					
Small enterprises and plants .....	43,808	44,696	45,669	46,275	46,791	47,680
Joint Stock Companies established under large and medium size state enterprises .....	1,587	1,594	1,599	1,603	1,604	1,603

Source: State Property Committee

## Foreign Investment

By the second half of the 1990s, Azerbaijan became a target for foreign investors. Capital inflow increased year on year from 1994 and, in 2006, foreign investment had reached US\$5.1 billion.

Of the total foreign investment of US\$60.2 billion directed to the country's economy during the period from 2010 until 2015, 57.8% (US\$34.8 billion) was direct investment. The remaining 42.2% (US\$25.4 billion) was made up of portfolio investments, foreign credits not identified in direct investments and similar other financial inflows.

The focus for foreign investors has been the hydrocarbon sector, which constituted 83.0% (US\$28.9 billion) of the total direct investment between 2010 and 2015. The second highest area of investment was in loans to the private and public sectors of the economy, which accounted for 41.3%, 42.6%, 30.4%, 25.2%, 16.1% and 20.6% of total foreign investment in 2010, 2011, 2012, 2013, 2014 and 2015, respectively.

The following table shows a breakdown of foreign investment for the periods indicated below:

Foreign Investment	For the year ended 31 December				
	2011	2012	2013	2014	2015
	<i>(US\$ million)</i>				
Total foreign investment.....	8,673.9	10,314.0	10,540.9	11,697.7	10,719.1
Oil industry .....	3,407.8	4,287.8	4,935.2	6,730.7	6,622.7
Oil bonus(1) .....	19.9	2.0	2.4	17	2.0
Financial credits.....	3,692.5	3,135.5	2,655.8	1,880.6	2,210.2
Foreign companies and joint ventures.....	886.0	1,094.5	1041.0	1318.5	860.4
Turkey .....	89.1	185.9	401.3	481.4	220.4
US .....	73.8	92.5	24.4	89.3	18.9
United Kingdom .....	148.8	149.3	136.0	153.5	173.1
Germany.....	32.5	45.6	15.1	51.0	60.1
France.....	14.3	14.4	6.1	7.2	4.5
UAE .....	75.3	92.4	109.3	90.2	103.9
Russia.....	35.0	21.8	36.1	13.6	15.9
Other countries.....	417.2	492.6	312.7	432.3	263.6
Other investments .....	667.7	1,794.2	1,906.5	1,750.9	1,023.8

Source: State Statistical Committee

(1) Oil Bonus consists of the fees payable by foreign oil companies to SOCAR, SOFAZ or other relevant authorities in connection with the signing and implementation of oil and gas contracts.

Where stated in the table above, "**Other Investments**" comprise portfolio investments (purchases of shares that are less than 10% of the equity and do not provide direct management *authority* over enterprises, bonds and other debt instruments by foreign investors), other foreign credits not identified in direct investments and similar other financial inflows.

## BALANCE OF PAYMENTS AND FOREIGN TRADE

### Balance of Payments

The following table sets out Azerbaijan's balance of payments and related statistics for the periods indicated:

Balance of Payments	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
	<i>(US\$ million)</i>					
<b>Current Account.....</b>	<b>17,155</b>	<b>14,881</b>	<b>13,079</b>	<b>10,430</b>	<b>(222)</b>	<b>(1,113)</b>
<b>Foreign Trade Balance.....</b>	<b>24,337</b>	<b>22,181</b>	<b>21,382</b>	<b>18,928</b>	<b>5,812</b>	<b>2,915</b>
Export of goods.....	34,393	32,374	31,703	28,259	15,586	9,535
Oil and gas sector.....	32,871	30,701	30,003	26,627	14,088	8,751
Other sectors.....	1,522	1,673	1,700	1,632	1,498	784
Import of goods.....	(10,056)	(10,193)	(10,321)	(9,332)	(9,774)	(6,620)
Oil and gas sector.....	(1,135)	(1,043)	(1,167)	(1,438)	(2,403)	(1,820)
Other sectors.....	(8,921)	(9,150)	(9,154)	(7,894)	(7,371)	(4,800)
<b>Balance of services.....</b>	<b>(2,996)</b>	<b>(2,924)</b>	<b>(4,189)</b>	<b>(6,090)</b>	<b>(4,229)</b>	<b>(2,270)</b>
Oil and gas sector.....	(1,594)	(2,097)	(2,565)	(4,058)	(3,065)	(1,958)
Other sectors.....	(1,402)	(826)	(1,624)	(2,032)	(1,164)	(312)
<i>Out of total services</i>						
Transport.....	(191)	(228)	(167)	130	509	183
Construction.....	(401)	(240)	(1,505)	(3,863)	(3,497)	(2,168)
<b>Primary income.....</b>	<b>(4,860)</b>	<b>(4,327)</b>	<b>(4,121)</b>	<b>(2,582)</b>	<b>(2,028)</b>	<b>(1,798)</b>
Oil and gas sector.....	(4,622)	(4,128)	(4,127)	(3,085)	(2,072)	(1,940)
Other sectors.....	(238)	(198)	6	503	44	142
– Receipts.....	1,019	1,092	1,029	1,674	1,258	745
– Payments.....	(5,879)	(5,418)	(5,150)	(4,256)	(3,286)	(2,543)
<b>Secondary income.....</b>	<b>673</b>	<b>(50)</b>	<b>7</b>	<b>174</b>	<b>222</b>	<b>40</b>
Remittances of individuals.....	633	(40)	0	186	240	65
– Receipts.....	1,771	1,852	1,579	1,709	1,183	433
– Payments.....	(1,138)	(1,892)	(1,579)	(1,523)	(943)	(368)
<b>Capital account.....</b>	<b>1</b>	<b>(7)</b>	<b>(12)</b>	<b>(7)</b>	<b>(44)</b>	<b>(40)</b>
<b>Financial account.....</b>	<b>4,039</b>	<b>8,094</b>	<b>6,489</b>	<b>3,419</b>	<b>9,025</b>	<b>1,974</b>
Net acquisition of financial assets						
("+" increase; "-" decrease)						
of which:.....	6,838	11,865	11,771	11,692	13,721	4,573
– direct investment abroad	533	1,192	1,490	2,209	3,260	2,087
– portfolio and other investments.....	6,305	10,673	10,281	9,483	10,461	2,486
Net incurrence of liabilities						
("+" increase; "-" decrease)						
of which:.....	2,799	3,771	5,282	8,273	4,696	2,599
– Direct investment in Azerbaijan.....	4,444	5,289	6,290	8,049	7,483	5,430
– Repatriation of investments.....	(2,999)	(3,287)	(3,661)	(3,636)	(3,437)	(2,088)
– Oil bonus.....	20	2	2	17	2	0
– Portfolio and other investments.....	1,334	1,767	2,651	3,843	648	(743)
<b>Net errors and omissions.....</b>	<b>(761)</b>	<b>(1,824)</b>	<b>(2,737)</b>	<b>(2,810)</b>	<b>(2,038)</b>	<b>1,937</b>
<b>Changes in reserve assets</b>						
("+" increase; "-" decrease)	<b>12,356</b>	<b>4,956</b>	<b>3,841</b>	<b>4,194</b>	<b>(11,329)</b>	<b>(1,190)</b>
<b>Balance.....</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

Source: Central Bank of Azerbaijan

<sup>(1)</sup> For the nine months ended 30 September 2016.

Owing to increases in oil exports, Azerbaijan's current account was in surplus from 2005 to 2014. In 2012, there was a surplus of US\$14.9 billion and this continued into 2013 with a surplus of US\$13.1 billion. In 2014, there was a surplus of US\$10.4 billion. In 2015 and the nine months ended 30 September 2016, there was a deficit of US\$0.2 billion and US\$1.1 billion, respectively. A significant proportion of the surplus in the previous periods was attributable to the hydrocarbons sector, which saw a US\$18.0 billion current account surplus in 2014 and a US\$6.6 billion current account surplus in 2015. The non-hydrocarbon sector showed an US\$7.6 billion deficit in 2014, however that was fully covered by the

surplus on the hydrocarbons current account. The non-hydrocarbon sector showed a US\$6.8 billion deficit in 2015, which was not fully covered by the surplus on the hydrocarbons current account, and resulted in a US\$200.0 million deficit in the current account. Revenues in the hydrocarbons sector can be attributed primarily to oil and natural gas exports and large foreign direct investments.

The capital and finance account deficit was US\$3.4 billion in 2014, US\$9.0 billion in 2015 and US\$2 billion in the nine months ended 30 September 2016, resulting in overall balances of 4.5%, 17.0% and 7.2% of GDP in 2014, 2015 and the nine months ended 30 September 2016. The capital and finance account deficit was US\$8.1 billion in 2012 and US\$6.5 billion in 2013 but it was fully covered by the surpluses on the current account resulting in overall balances of 21.4% and 8.8% of GDP in 2012 and 2013, respectively.

Foreign trade turnover amounted to US\$16.2 billion for the nine months ended 30 September 2016, US\$25.4 billion in 2015 and US\$37.6 billion in 2014, generating a positive balance of US\$2.9 billion for the nine months ended 30 September, US\$5.8 billion in 2015 and US\$18.9 billion in 2014. Foreign trade turnover amounted to US\$42.6 billion in 2012 and US\$42.0 billion in 2013, generating a positive balance of US\$22.2 billion in 2012 and US\$21.4 billion in 2013. Total exports were 1.44 times greater than imports during the nine months ended 30 September 2016. Exports of goods totalled US\$9.5 billion in the nine months ended 30 September 2016, US\$15.6 billion in 2015 and US\$28.3 billion in 2014. Exports of goods totalled US\$32.4 billion in 2012 and US\$31.7 billion for 2013. Of this, hydrocarbon products accounted for 91.8% of total exports of goods in the nine months ended 30 September 2016. US\$8.8 billion worth of hydrocarbon products was exported to foreign countries in the nine months ended 30 September 2016, US\$14.09 billion in 2015, US\$26.6 billion in 2014, US\$30.0 billion in 2013 and US\$30.7 billion in 2012.

Imports of goods amounted to US\$6.6 billion in the nine months ended 30 September 2016, US\$9.8 billion in 2015, US\$9.3 billion in 2014, US\$10.3 billion in 2013 and US\$10.2 billion in 2012. In the nine months ended 30 September 2016, imports related to the hydrocarbons sector were US\$1.8 billion, while other sectors generated US\$4.8 billion of imports. In 2015 and 2014, imports related to the hydrocarbons sector were US\$2.4 billion and US\$1.4 billion, respectively, while other sectors generated US\$7.4 billion and US\$7.9 billion, respectively, of imports. In 2013, the breakdown was US\$1.2 billion of imports by the hydrocarbons sector and US\$9.2 billion by other sectors. In 2012, imports related to the hydrocarbons sector were US\$1.0 billion, while other sectors generated US\$9.2 billion of imports.

The balance of services yielded deficits of US\$2.3 billion, US\$4.2 billion, US\$6.1 billion, US\$4.2 billion and US\$2.9 billion in the nine months ended 30 September 2016, and the years ended 31 December 2015, 2014, 2013 and 2012, respectively. In the nine months ended 30 September 2016, the hydrocarbons sector accounted for US\$1.9 billion of the deficit and it accounted for US\$3.1 billion, US\$4.1 billion, US\$2.6 billion and US\$2.1 billion in 2015, 2014, 2013 and 2012, respectively.

Primary income, which comprises payments of employee compensation to non-resident workers and investment income, recorded a negative balance of US\$1.8 billion in the nine months ended 30 September 2016, US\$2.0 billion in 2015, US\$2.6 billion in 2014, US\$4.1 billion in 2013 and US\$4.3 billion in 2012, largely due to deficits in the hydrocarbons sector of US\$1.9 billion, US\$2.1 billion, US\$3.1 billion, US\$4.1 billion, and US\$4.1 billion, respectively, in the nine months ended 30 September 2016, and the years ended 31 December 2015, 2014, 2013 and in 2012. The balance of secondary income, which includes individual remittances, has in recent years been almost negligible, yielding a surplus of US\$40 million in the nine months ended 30 September 2016, US\$222 million in 2015, US\$174 million in 2014, a surplus of US\$7 million in 2013 and a negative balance of US\$50 million in 2012.

### ***Foreign Trade***

Azerbaijani foreign trade statistics are generated by the State Statistics Committee and are based on customs statistics from cargo declaration records, in accordance with international standards. Because such statistics are based on customs statistics from cargo declaration records, official data on volumes of exported crude oil and natural gas based on customs statistics may differ from the trade figures compiled by the CBA in this section.

Exports are an important source of foreign exchange earnings for Azerbaijan. Crude oil, oil products and natural gas are the principal Azerbaijani exports. The share of these commodities in exports was 94.1% in 2010, 94.4% in 2011, 93.1% in 2012, 92.7% in 2013, 92.4% in 2014, 87.8% in 2015 and 87.0% in 2016.

In 2016, overall exports decreased by 28.2% while non-hydrocarbons exports decreased by 21.8%. In 2015, overall exports decreased by 41.7%, while non-hydrocarbons exports decreased by 7.5%. In 2014, overall exports decreased by 9.0%, while non-hydrocarbons exports decreased by 3.6%.

Machinery and transportation equipment, followed by industrial equipment, have consistently represented largest component of Azerbaijan's imports. A lack of local production facilities and quality manufacturers created import dependence for these products, which have been imported to satisfy local demand in connection with large infrastructure projects and manufacturing. Machinery accounted for 48.4% in 2011, 41.7% in 2012, 39.0% in 2013, 37.6% in 2014, 39.9% in 2015, 33.0% in 2016, whereas industrial goods accounted for 19.7% in 2011, 21.5% in 2012, 18.1% in 2013, 19.4% in 2014, 25.6% in 2015, 22.3% in 2016.

The following table shows the composition of imports for 2012 through 2016, using the International Standard Trade Classification ("ISTC"):

Principal Imports	For the year ended 31 December									
	2012		2013		2014		2015		2016	
	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total
Foodstuff and live animals .....	958.5	9.9	1064.1	9.9	982.3	10.7	910.5	9.9	1189.8	13.9
Beverage and tobacco .....	353.2	3.7	400.2	3.7	469.3	5.1	360.0	3.9	209.9	2.5
Non-food raw materials (other than fuel) .....	333.9	3.5	324.0	3.0	146.3	1.6	211.9	2.3	187.3	2.2
Mineral fuel, lubricants, similar materials .....	84.7	0.9	141.6	1.3	297.0	3.2	150.1	1.6	272.2	3.2
Oils and fats obtained from animals and plants .....	96.7	1.0	69.1	0.6	73.1	0.8	71.6	0.8	127.8	1.5
Chemical goods and similar products not included in other categories .....	969.6	10.0	933.9	8.7	875.0	9.5	838.3	9.1	896.4	10.5
Industrial goods usually classified based on material type <sup>(1)</sup> .....	2073.3	21.5	1933.7	18.1	1778.5	19.4	2362.3	25.6	1901.5	22.3
Machinery and transportation equipment .....	4023.6	41.7	4173.3	39.0	3454.9	37.6	3677.6	39.9	2820.1	33.0
Various industrial products	748.1	7.7	749.1	7.0	692.1	7.5	631.3	6.9	910.6	10.7
Goods not included in other ISTC categories .....	11.3	0.1	923.5	8.7	419.2	4.6	3.1	0.0	16.8	0.2
<b>Total.....</b>	<b>9652.9</b>	<b>100.0</b>	<b>10712.5</b>	<b>100.0</b>	<b>9187.7</b>	<b>100.0</b>	<b>9 216.7</b>	<b>100.0</b>	<b>8532.4</b>	<b>100.0</b>

Source: State Statistical Committee

<sup>(1)</sup> This category includes leather, leather goods, and dressed furs; rubber goods, cork and wood manufactures (excluding furniture); paper, paperboard and articles made from paper pulp, paper or paperboard; textile yarn, fabrics, made-up articles, and related products; non-metallic mineral manufactures; iron and steel; non-ferrous metals and items manufactured from metal.

The following table shows the composition of exports from 2012 through 2016, using the ISTC:

Principal Exports	For the year ended 31 December									
	2012		2013		2014		2015		2016	
	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total	US\$ million	% of total
Foodstuff and live animals .....	617.6	2.6	647.8	2.7	648.2	3.0	625.1	4.9	478.2	5.2
Beverage and tobacco .....	29.7	0.1	41.7	0.2	44.6	0.2	35.2	0.3	27.6	0.3
Non-food raw materials (other than fuel) .....	83.1	0.3	47.0	0.2	33.9	0.2	25.7	0.2	45.2	0.5
Mineral fuel, lubricants, similar materials .....	22259.2	93.1	22229.8	92.7	20177.2	92.4	11187.1	87.9	7955.8	87.0
Oils and fats obtained from animals and plants .....	180.8	0.8	182.8	0.8	138.5	0.6	105.5	0.8	14.2	0.2
Chemical goods and similar products not included in other categories .....	239.6	1.0	175.5	0.7	231.1	1.1	190.2	1.5	153.2	1.7
Industrial goods usually classified based on material type <sup>(1)</sup> .....	284.4	1.2	265.1	1.1	200.9	0.9	180.0	1.4	273.7	3.0
Machinery and transportation equipment .....	92.5	0.4	163.5	0.7	87.2	0.4	208.6	1.6	103.3	1.1
Various industrial products .....	40.2	0.2	149.3	0.6	190.1	0.9	88.9	0.7	15.3	0.2
Goods not included in other ISTC categories .....	80.9	0.3	72.9	0.3	76.9	0.3	82.8	0.7	76.8	0.8
<b>Total .....</b>	<b>23908.0</b>	<b>100.0</b>	<b>23975.4</b>	<b>100.0</b>	<b>21828.6</b>	<b>100.0</b>	<b>12729.1</b>	<b>100.0</b>	<b>9143.3</b>	<b>100.0</b>

Source: State Statistical Committee

<sup>(1)</sup> This category includes leather, leather goods, and dressed furs; rubber goods, cork and wood manufactures (excluding furniture); paper, paperboard and articles made from paper pulp, paper or paperboard; textile yarn, fabrics, made-up articles, and related products; non-metallic mineral manufactures; iron and steel; non-ferrous metals and items manufactured from metal.

### Direction of foreign trade

The following table shows the geographical spread of Azerbaijani foreign trade turnover from 2012 through 2016:

Foreign Trade Turnover By Region	For the year ended 31 December									
	2012		2013		2014		2015		2016	
	Import	Export	Import	Export	Import	Export	Import	Export	Import	Export
	(share of total, %)									
Europe .....	49.7	52.9	57.0	54.0	55.0	57.2	54.5	58.0	53.7	49.8
Asia .....	39.3	38.5	34.3	39.9	35.0	35.7	33.5	35.3	37.1	46.1
America .....	10.4	6.7	7.7	4.1	9.6	4.6	11.6	4.4	8.4	1.6
Africa .....	0.4	1.8	0.8	2.0	0.1	2.5	0.1	2.3	0.2	2.5
Oceania .....	0.2	0.1	0.2	0.0	0.3	0.0	0.3	0.0	0.6	0.0

Source: State Statistical Committee

The following table sets out Azerbaijan's foreign trade by country groups for the years indicated:

Foreign Trade Turnover By Country	For the year ended 31 December									
	2012		2013		2014		2015		2016	
	Import	Export	Import	Export	Import	Export	Import	Export	Import	Export
	<i>(share of total, %)</i>									
<b>EU .....</b>	<b>27.7</b>	<b>46.8</b>	<b>35.1</b>	<b>48.0</b>	<b>33.8</b>	<b>53.0</b>	<b>31.9</b>	<b>53.0</b>	<b>26.0</b>	<b>43.2</b>
from this:										
Italy .....	2.7	23.2	2.3	25.0	3.0	22.0	6.4	17.7	3.9	17.1
Germany .....	8.1	4.0	7.7	5.7	7.7	8.8	7.5	9.6	4.7	6.7
France .....	1.9	7.4	4.0	4.7	1.7	7.0	2.3	6.8	1.8	5.4
United Kingdom .....	5.1	1.4	12.5	2.0	10.6	0.6	6.0	0.1	5.8	0.6
Netherlands .....	1.6	0.1	1.7	0.1	2.1	0.1	1.1	0.8	0.9	0.4
Others .....	8.3	10.7	6.9	10.5	8.7	14.5	8.6	18.0	8.9	13.0
<b>BSEC .....</b>	<b>37.7</b>	<b>15.5</b>	<b>35.0</b>	<b>14.3</b>	<b>36.0</b>	<b>9.7</b>	<b>33.5</b>	<b>20.8</b>	<b>38.8</b>	<b>22.0</b>
<b>CIS Countries .....</b>	<b>24.6</b>	<b>5.2</b>	<b>23.8</b>	<b>6.3</b>	<b>22.7</b>	<b>3.8</b>	<b>21.3</b>	<b>4.1</b>	<b>25.3</b>	<b>7.3</b>
from this:										
Russia .....	14.3	4.0	14.1	4.5	14.3	2.9	15.6	3.3	19.2	4.5
Ukraine .....	5.6	0.4	5.5	1.1	4.6	0.2	3.4	0.2	3.4	0.5
Kazakhstan .....	3.5	0.2	2.9	0.3	2.4	0.1	1.1	0.1	1.1	0.3
Others .....	1.2	0.6	1.3	0.4	1.4	0.6	1.2	0.5	1.6	2.0
<b>ECO .....</b>	<b>21.6</b>	<b>4.2</b>	<b>19.0</b>	<b>3.9</b>	<b>18.5</b>	<b>4.4</b>	<b>15.1</b>	<b>14.1</b>	<b>17.6</b>	<b>15.2</b>
<b>GUAM .....</b>	<b>7.0</b>	<b>2.7</b>	<b>6.8</b>	<b>3.3</b>	<b>5.6</b>	<b>2.6</b>	<b>4.1</b>	<b>4.1</b>	<b>4.0</b>	<b>4.2</b>

Source: State Statistical Committee

In 2016, Azerbaijan had established trading relationships with 186 countries. The main trade partner regions were the EU and the CIS, which collectively accounted for 50.5% of exports and 51.3% of imports. The main individual destinations for imports were Russia (19.2%), Turkey (13.8%), China (8.2%), Great Britain (5.8%), United States (5.5%), Germany (4.7%), Italy (3.9%) and Ukraine (3.4%). The principal partners for exports in 2016 were Italy (17.1%), Turkey (12.4%), Taiwan, Province of China (8.7%), Israel (7.3%), Germany (6.7%) and France (5.4%).

Azerbaijani exports are predominantly resource intensive (such as crude oil, oil products and natural gas) and destined for European markets (such as Italy and Greece) and other high income countries. The non-oil exports of Azerbaijan are primarily destined for countries with Free Trade Agreements (such as the CIS countries and Georgia) and Turkey, Switzerland and Iran. The main imported commodities are from the neighbouring countries and countries with Free Trade Agreements with Azerbaijan. Middle and higher technology products are more common imports from Europe and developed countries.

### **Foreign Reserves**

Azerbaijan's strategic foreign reserves are held by two main state bodies: the CBA and SOFAZ, a future generation fund established to collect the share of the Government's receipts from oil and gas exploration.

The following table sets out Azerbaijan's official reserve assets at the end of each of the years indicated:



<b>Official Reserve Assets</b>	<b>Central Bank</b>	<b>State Oil Fund</b>	<b>Total</b>
	<i>(at year end, US\$ billions)</i>		
1995 .....	0.25	—	0.25
1996 .....	0.27	—	0.27
1997 .....	0.55	—	0.55
1998 .....	0.47	—	0.47
1999 .....	0.66	—	0.66
2000 .....	0.68	0.27	0.95
2001 .....	0.73	0.49	1.22
2002 .....	0.72	0.69	1.41
2003 .....	0.80	0.82	1.62
2004 .....	1.1	0.96	2.06
2005 .....	1.2	1.4	2.6
2006 .....	2.9*	1.5	4.4
2007 .....	4.9*	2.5	7.4
2008 .....	6.4*	11.2	17.6
2009 .....	5.4*	14.9	20.3
2010 .....	7.1*	22.8	29.9
2011 .....	11.0*	29.8	40.8
2012 .....	12.2*	34.1	46.3
2013 .....	14.2*	35.9	50.1
2014 .....	14.6*	36.8	51.4
2015 .....	5.5*	33.4	38.9
2016 .....	4.6*	33	37.6

\* including government deposits

Source: Central Bank of Azerbaijan Republic; SOFAZ

SOFAZ holds the majority of Azerbaijan's official reserves. Since 2010, SOFAZ's share has remained stable, at 76.2% in 2010, 72.9% in 2011, 73.5% in 2012, 71.7% in 2013, 71.6% in 2014, and increased to 85.9% in 2015 and 87.8% in 2016.

As of 28 February 2017, the CBA's foreign reserves stood at US\$4.4 billion, equivalent to five months of 2015 import cover. The CBA's foreign reserves are mostly held in highly liquid, secure investments and SOFAZ's foreign reserves are kept in liquid assets such as fixed income and public equities as well as less liquid assets such as real estate and private equities. See "*Public Finance – State Oil Fund of the Republic of Azerbaijan*".

## MONETARY AND FINANCIAL SYSTEM

### **The Central Bank**

Until 1989, the banking system of Azerbaijan was controlled by the state, with business decisions being subordinated to the political priorities of the state. The legal basis for the current banking system was established under Article 14 of the Constitutional Act "On basis of the current economic independence of the Republic of Azerbaijan" dated 25 May 1991. This law, as well as stipulating the independence of the banking system and circulation of the national monetary unit of Azerbaijan, also established the status and authority of the National Bank of Azerbaijan.

On 7 August 1992, the Law "On Banks and Banking Activity in the Republic of Azerbaijan" and the Law "On the National Bank of the Republic of Azerbaijan" were both adopted. On 15 August of the same year, the Manat (the national currency of Azerbaijan) was issued as legal tender alongside the rouble. As of 1 January 1994, the Manat was declared the only legal tender in Azerbaijan.

Following the Referendum Act of the Republic of Azerbaijan of 18 March 2009 on "Additions and Amendments to the Constitution of the Republic of Azerbaijan", The National Bank of the Republic of Azerbaijan was renamed the Central Bank of the Republic of Azerbaijan.

The CBA is independent from the state, and its Governor is nominated by the President and is appointed for a five-year term. Dr. Elman Rustamov has been the Governor of the CBA since January 1995. Mr. Alim Guliyev has been holding the position of the First Deputy Governor of the CBA since September 1996. His term expired in February 2017 and it is yet to be confirmed whether Mr. Alim Guliyev or someone else will be the First Deputy Governor of the CBA going forward. There are three further Deputy Governors of the CBA, nominated by the Governor and appointed by the President. In addition, the management of the CBA includes three Executive Directors appointed by the Governor, responsible for Risk Management, Strategic Management, Cash Management, the Treasury Department and the regional offices of the CBA.

On 3 February 2016, the public legal entity FIMSA was created by Presidential decree. Pursuant to the amendments to the Law "On the Central Bank of the Republic of Azerbaijan" of 4 March 2016, banking supervision authorities were transferred to the FIMSA.

### **Monetary policy framework of the CBA and goals**

According to Article 4 of the Law "On the Central Bank of the Republic of Azerbaijan", the ultimate goal of the CBA is to ensure price stability. In recent years, the CBA achieved its primary objective under its exchange rate targeting regime. Monetary policy was successful in reducing inflation to single digit levels. Due to the higher levels of inflation in recent years, however, the CBA has worked to maintain a tight monetary policy by limiting the money supply and reducing credit available to banks.

The main policy issue in 2015 was the choice of a new exchange rate regime. In 2015, the CBA adopted a more flexible exchange rate regime and in February 2015, the CBA moved away from a peg to the US Dollar in favour of a peg to a currency basket (US Dollar and Euros), which caused the Manat to devalue by 34% to 1.05 Manat per US dollar. On 21 December 2015, the CBA moved to a managed floating exchange rate regime under which the CBA is better able to prevent extreme fluctuations in the exchange rate without having a specific exchange rate target, which caused the Manat to fall by 47% to the US Dollar in one day. The devaluation was the result of the CBA's decision to stop protecting the value of the Manat in the face of falling oil prices, as the CBA's actions in protecting the value of the Manat were depleting existing foreign reserves.

In order to make the exchange rate more responsive to macroeconomic fundamentals, the CBA announced a new exchange rate regime in December 2015 which took effect in 2016. The CBA's ability to intervene in the foreign exchange market became more limited and, as a result, the Manat to US Dollar exchange rate became more volatile.

Depreciation pressures continued in 2016 as a result of weak balance of payments indicators. For the year ended 31 December 2016, the US Dollar gained around 13% against the Manat.

A more flexible exchange rate regime necessitated a new monetary policy anchor. The CBA used a monetary base as a monetary policy target since the interbank money market is underdeveloped. The

CBA coordinated the target on the monetary base with relevant authorities. The restricted monetary base growth contributed to rebalancing the foreign exchange market during 2016.

In 2016, the annual inflation rate was 12.4%. Reduced demand and a depreciated Manat counterbalanced the inflation rate, which was also affected by global and administrative prices.

In 2016, demand prevailed over supply in the foreign exchange market. While lower levels of foreign currency inflows into country and foreign exchange sales by the SOFAZ impacted the market, dollarisation decreased compared to the previous year. Since sales by the SOFAZ did not suffice, the CBA had to intervene in the foreign exchange market. Unlike previous years, these interventions were made through auctions. In total, the CBA and the SOFAZ held 114 currency sale auctions in 2016. In 2016, monetary policy decisions rested upon the evaluation of inflationary risks.

The CBA continued to use the interest rate corridor to manage the aggregate level of liquidity of banks during 2016. The interest rate corridor consists of one to seven day REPO (floor of the corridor), one to seven day reverse-REPO (ceiling of the corridor) and the discount (refinancing) rate. In 2016, the CBA made critical corrections to the parameters of the interest rate corridor to reduce inflation, restore confidence in the national currency and promote the rise in local currency deposits. The refinancing rate adjusted for inflation was raised to 15% from 3% - the floor to 12% from 0.1% and the ceiling to 18% from 5% in steps. Decisions related to interest rate corridor were taken in light of the macroeconomic situation, the conjuncture in the money market and the yield on government securities.

The CBA has launched deposit auctions to promote the liquidity of the Manat and has restored the issue of short-term notes. The term of deposit is two weeks while the maturity of the short-term notes is 28 days. The amount attracted through deposit auctions and short-term notes has totalled over AZN 538 million as of 28 February 2017. These operations were also aimed to develop the money market and improve the operational framework of monetary policy.

The reserve requirement has shifted to 1% from 0.5% for foreign currency denominated liabilities to decrease dollarisation and increase financial stability in the banking sector. The requirement for Manat denominated liability remains unchanged. While the Government expects that the rate of dollarization will be reduced in the future, a high degree of dollarisation may negatively influence the design and implementation of monetary policy. See "*Risk Factors – Risk Factors Relating to the Guarantor – Devaluation of the Manat could have a material adverse effect on Azerbaijan's economy*".

#### ***Exchange rate and international competitiveness***

The change in the exchange rate regime was followed by sharp depreciation of the Manat (approximately 98%) against the US Dollar in 2015. Since the beginning of the 2016, the official Manat exchange rate was set based on the average exchange rate used in interbank transactions. The CBA's practice has been to announce the official exchange rate for a particular business day on the preceding business day. For recent rates of exchange between the US Dollar and the Manat, see "*Exchange Rates*".

In 2016, the real effective exchange rate of the Manat (non-oil trade weighted) depreciated by 19.8%, mainly as a result of the depreciation of the nominal effective exchange rate by 27.5%. The depreciated real effective exchange rate positively affects the competitiveness of the non-hydrocarbon sector, offsets imports and stimulates the development of export oriented sectors. Depreciation of the Manat did not significantly increase prices due to the devaluation of the currencies of main trading partners and a decline in money supply. The average inflation in 2016 was 12.4%, comparable to those of Azerbaijan's main trading partners.

#### ***Money demand and monetary aggregates***

The developments in the foreign exchange market affected the money supply in Manat in 2015 and 2016. As a result of the exchange rate regime change, the monetary base in Manat declined by approximately 40% in 2015. In 2016, the Manat monetary base increased approximately 13.9%.

The following table sets forth selected data on monetary aggregates for the periods indicated:

Monetary Aggregates	For the year ended 31 December							
	2009	2010	2011	2012	2013	2014	2015	2016
Currency in (M0) Circulation (AZN millions).....	4,512.7	5,793.2	7,658.5	9,777.5	10,458.7	10,152.5	4,775.9	6,376.9
Broad Money (M2) (AZN millions).....	6,169.2	8,297.5	10,997.2	13,806.4	16,434.8	17,435.8	8,678.3	11,546.4
Broad Money (M3) (AZN millions).....	8,469.2	10,527.5	13,903.2	16,775.3	19,289.4	21,566.5	21,286.9	20,889.6
Broad Money (M3) (growth year on year, %).....	(0.3)	24.3	32.1	20.7	9.0	11.8	(1.3)	(1.9)
Broad Money (M3) (share of GDP, %).....	24.5	25.3	27.8	31.1	33.2	36.6	39.2	34.8
Manat Reserve Money (AZN millions).....	4,907.7	6,520.9	8,489.4	10,660.3	11,642.9	11,541.9	6,901.8	7,860.5
Growth rate (%).....	(1.1)	32.9	30.2	25.6	9.2	(0.9)	(40.2)	13.9
Deposits in Manats (M2-M0) (AZN millions).....	2,353.3	3,205.3	4,280.7	5,062.5	5,976.1	7,283.4	3,902.4	5,169.5
Deposits in foreign currencies (M3-M0) (AZN millions).....	4,025.8	4,420.4	5,166.3	5,636.7	2,854.7	4,130.5	12,608.5	14,512.7
Loans in Manats (AZN millions).....	4,886.2	5,865.3	6,326.5	8,422.8	11,076.7	13,505.7	10,994.5	8,663.1
Loans in foreign currencies (AZN millions).....	3,521.3	3,298.1	3,523.8	3,820.9	4,346.3	5,037.0	10,735.9	7,781.4

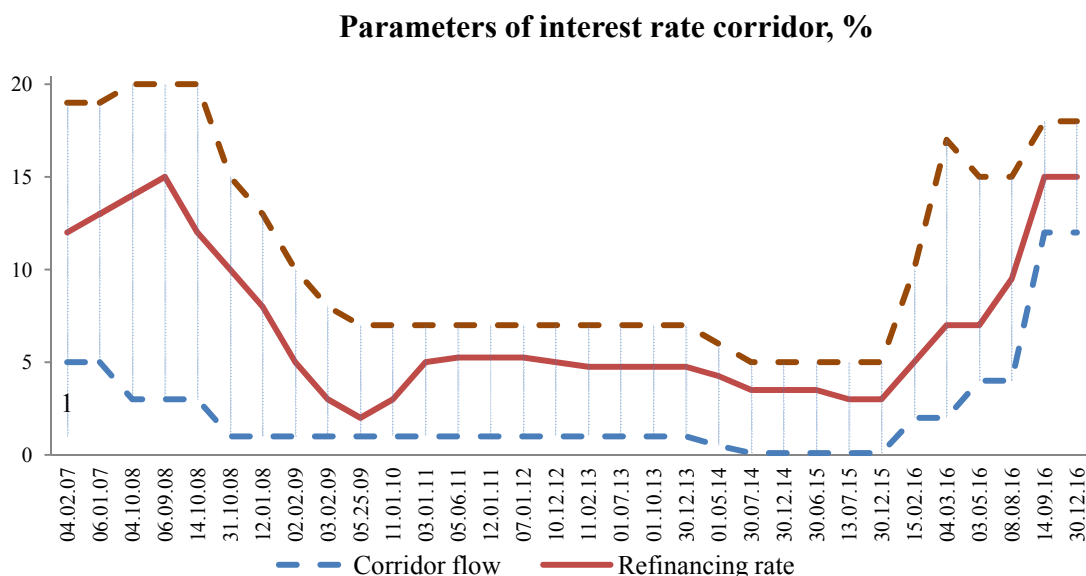
\* Where M0 = Physical cash and coins; M1= M0 + demand savings and deposits; M2 = M1 + time savings and deposits and M3 = M2 + savings and deposits in freely convertible currency

\* Reserve money (also called monetary base) is: Currency issued + Bank Reserves at CBA

Source: Central Bank of Azerbaijan

### Monetary operations and instruments

The CBA uses an interest rate corridor to manage the aggregate level of liquidity of Azerbaijan banks. The interest rate corridor consists of one to seven day REPO (floor of the corridor), one to seven day reverse-REPO (ceiling of the corridor) and a discount (refinancing) rate. The following chart sets forth the parameters of the interest rate corridor:



In 2016, the CBA made corrections to the parameters of the interest rate corridor in an effort to boost confidence in the Manat, promote savings in Manat, and work towards improved monetary policy tools over the period.

The CBA uses monetary policy instruments depending on the economic situation, especially with respect to the financial sector. The commonly used instruments of the CBA are:

- To provide liquidity: credits (current credits, short-term credits, medium-term credits), operations with securities (direct purchases of CBA notes and Reverse-REPOs of CBA notes, direct purchases of government securities and Reverse-REPO operations with government securities).
- To absorb liquidity: deposits (direct and indirect auctions), operations with securities (direct sales of CBA notes and REPOs with CBA notes, direct sales of government securities and REPO operations with government securities) and reserve requirements.

In June 2016, as a result of the current macroeconomic environment, monetary policy targets and the liquidity of the banking sector, the CBA has bolstered liquidity sterilisations and launched deposit operations in an effort to attract funds in Manat, which targets the development of the money base thereby promoting the improvement of the monetary policy framework. The purposes of liquidity sterilisation are continuation of the contractionary monetary policy, to provide alternative investment opportunities for domestic banks and to assist in decreasing pressure on the CBA's foreign exchange assets.

The CBA also utilised reserve requirements to regulate money supply and banking system liquidity. For the purposes of decreasing dollarisation and strengthening financial stability in the banking sector, on 3 March 2016, the Management Board of the CBA decided to increase the reserve requirement on banks' foreign currency denominated liabilities from 0.5% to 1%, and decrease the reserve requirement on liabilities to non-resident financial sectors and settlements with international financial institutions from 0.5% to 0%.

#### **Monetary policy implementation tools**

The CBA has used a variety of instruments to achieve established targets, such as open market operations. With the increase in the liquidity of the economy, the CBA began to liberalise capital outflows from June 2007. This initiative has helped to preserve the macroeconomic balance, by sterilising the money supply that bears an inflationary potential. From 2010, capital flows were fully liberalised.

The following table sets out liquid assets and loans for the periods specified:

Liquid assets and loans	As of 31 December							
	2009	2010	2011	2012	2013	2014	2015	2016
	<i>(as of 31 December, AZN millions)</i>							
Liquid Assets .....	1,502.6	2,330.4	2,426.2	2,625.5	2,287.5	3,223.4	3,950.1	5,420.8
Short-term liabilities .....	1,828.1	2,532.0	3,080.8	3,414.3	3,577.9	4,477.1	5,316.8	7,679.4
Total loans .....	8,407.5	9,163.4	9,850.3	12,243.7	15,422.9	18,542.6	21,718.0	15,938.3
Loans to public sector .....	1,591.7	1,467.9	838.3	1,353.4	589.6	744.1	1,352.0	1,597.5
Loans to private sector .....	6,815.8	7,695.5	9,012.0	10,890.3	14,833.3	17,798.5	20,366.0	14,340.7

Source: Central Bank of Azerbaijan, FIMSA

Given the development level of the financial markets, by April 2007 the CBA started to apply the "interest rate corridor" approach, improving monetary policy in conformity with international standards. Application of the interest rate corridor, which is an advanced form of implementation mechanism of current monetary policy, can improve the CBA's ability to affect the volume of money in the economy by providing a new operational structure. At the end of 2015, the ceiling of the interest rate corridor was 5.0% and the floor was 1.0%.

Given the inflation target and the plans to support economic growth in the non-hydrocarbon sector, at the beginning of 2013 the CBA decided to reduce interest rates from 5.0% to 3.0%, and leave other parameters of the interest rate corridor unaltered. To sterilise the part of the money supply that has inflationary potential, the CBA continued to use its short-term notes during 2013. The average yield on notes in the latest auction on 24 December 2014 was 0.91%, while the average yield from an auction in early 2014 was 0.99%.

On 15 July 2016, the President signed a decree on the establishment of the Financial Stability Council of the Republic of Azerbaijan. The main purposes for the establishment of the Council are to strengthen macroeconomic stability and financial sustainability, carry out coordinated policy in this field and achieve

effective regulation and application of laws. The Financial Stability Council is tasked with analysing the financial sector, conducting examinations of the legislative framework and developing, in accordance with international best practices and standards, proposals to prevent possible threats to macroeconomic stability and financial sustainability.

In 2016, consistent measures have been taken to ensure sustainable macroeconomic stability, stimulate wider use of the national currency as a means of saving, and develop financial markets. Investment of government securities with high yields, while setting a higher corridor ceiling for the guaranteed national currency deposits aims at strengthening the confidence in Manat. Given the targets of ensuring macroeconomic stability and new trends in financial markets, the CBA has revised the parameters of the interest rate corridor. The refinancing rate was increased to 5.0% as of 15 February 2016 and then to 7.0% percent as of 4 March 2016. On 15 February 2016 the floor and ceiling of the corridor were set at 2% and 10%, respectively. The corridor ceiling was further revised and set at 17.0% on 4 March 2016, while the corridor floor remained unchanged at 2.0%. Continuing a tight monetary policy in an effort to ease pressure on the Manat, the CBA increased the interest rate corridor stepwise. As of 31 December 2016, the ceiling of the interest rate corridor was 18.0%, the floor was 12.0% and refinancing rate was 15.0%.

### **Interest Rates**

The CBA's refinancing interest rate, which is the interest rate which banks have to pay when they borrow money from the CBA, influences most domestic interest rates in Azerbaijan. The following table sets forth the CBA refinancing interest rate for the periods specified:

<b>CBA Refinancing Interest Rate</b>	<b>03.2011 – 05.2011</b>	<b>06.2011 – 11.2012</b>	<b>12.2012 – 01.2013</b>	<b>02.2013 – 04.2014</b>	<b>05.2014 – 07.2014</b>	<b>07.2014 – 07.2015</b>	<b>07.2015 – 02.2016</b>	<b>02.2016 – 03.2016</b>	<b>03.2016 – 08.2016</b>	<b>08.2016 – 09.2016</b>	<b>09.2016 – present</b>
	5.0	5.25	5.0	4.75	4.25	3.5	3.0	5.0	7.0	9.5	15.0

*Source: Central Bank of Azerbaijan*

A strong financial base has continued to develop in recent years, aided by a higher value of assets of financial institutions and the development of the insurance and leasing sectors. Interest rates are fully liberated and determined by markets. With more competition, lending rates have decreased. In the last five years, average lending rates by commercial banks have decreased from 16.7% to 13.8%. The spread between lending and deposit rates is approximately 4.0%.

### **Banking Sector**

At independence in 1991, there were 23 corporate and commercial banks operating in Azerbaijan. In the first few years following independence, more than 200 banks were opened but many were under capitalised and had limited branch coverage. Regulatory requirements were increased as a result and the banking sector began to consolidate and restructure, becoming more highly capitalised. By 2016, the minimum capital requirements were AZN 50 million, an increase from AZN 10 million from June 2012. As of 31 December 2016, 32 banks were licenced to operate in Azerbaijan. From 31 December 2015, the licences of the Bank of Azerbaijan OJSC, Gencebank OJSC, United Credit Bank OJSC, Texnika Bank OJSC, Qafqaz Inkishaf Bankı OJSC, Atrabank OJSC were revoked by the CBA and the licences of Para Bank, Zamin Bank, Kredo Bank, Deka Bank and Bank Standard were revoked by the FIMSA. The main reasons for revocation were failure to comply with the requirements on minimum amount of total capital and total capital adequacy ratio, failure to fulfil their obligations to creditors and to conduct its activities in a prudential and in a trustworthy manner.

In recent years, the banking system has seen increased competition among market participants, restructuring of the banking system to place greater focus on the quality and reliability of services provided to customers and the formation of a group of leading banks. Integration of banks with international financial markets has grown and foreign capital and investments have increased rapidly. As the use of modern information and banking technologies has accelerated, customers have been provided with electronic and automated banking services. Azerbaijan also established the first mortgage system in

the Caucasus region in 2005, under which approximately AZN 704 million of mortgage loans (approximately 18,162 loans) have been granted as of 31 December 2016.

In June 2016, a new Presidential decree “On Certain Matters of Mortgage Financing in the Republic of Azerbaijan” was adopted. Pursuant to this decree, the “e-mortgage system” was created and launched and is operational as of the date of this Prospectus. Prior to that, an application for a mortgage loan could only be filed through the official website of the Azerbaijan Mortgage Fund, or through local banks participating in the mortgage lending programme of the Azerbaijan Mortgage Fund. A new charter of the Azerbaijan Mortgage Fund, a fully state-owned open-joint stock-company, was approved. In addition, new rules on “Extending Mortgage Loans, and Preferential Mortgage Loans at the Account of Azerbaijan Mortgage Fund Open Joint Stock Company” were approved by this decree. The Supervisory Board of the Fund has been vested with the authority to determine interest rates for mortgage lending as well as the maximum amount of such mortgage loans. In addition, the list of young families entitled to receive preferential mortgage loans has been significantly expanded to include school teachers and civil servants meeting certain requirements.

In November 2016, the President signed a Decree on “Approval of Regulations for 'Electronic mortgage' system.” The relevant regulations provide the legal, organizational and technical foundations of an electronic platform for mortgage financing using the proceeds of the Azerbaijan Mortgage Fund, as well as the provision of mortgage loans on preferential terms. The electronic mortgage platform will permit centralised and real-time electronic mortgage financing and will allow the users to access services electronically, including mortgage application and processing.

The banking sector has also seen an increase in the market share of private banks, the shares of which have increased from 57.0% in 2008 to 63.0% in 2015. This trend was reversed in 2016 when the market share of private banks decreased to 59.6% as of 31 December 2016. Notwithstanding that, the market share of the country's largest and state-owned bank, the International Bank of Azerbaijan (“IBA”), also decreased from 43.0% in 2008 to 39.0% in 2016.

The following table sets out certain data on the net income and profitability of Azerbaijan's banking sector in the periods stated:

Aggregate Profit and Loss Statement and Profitability Ratios	As of 31 December							
	2009	2010	2011	2012	2013	2014	2015	2016
	<i>(AZN millions)</i>							
<b>INCOME</b>								
Interest Income .....	1,034.6	1,055.3	1,099.8	1,257.8	1,646.9	2,255.7	2,381.5	1,994.2
Interest Expense .....	465.7	551.6	586.3	661.0	817.6	986.4	1,053.8	1,079.7
<b>Net Interest Income</b> .....	<b>568.9</b>	<b>503.7</b>	<b>513.4</b>	<b>596.9</b>	<b>829.2</b>	<b>1,269.3</b>	<b>1,327.7</b>	<b>914.6</b>
Non-Interest Income .....	258.7	271.6	321.0	367.3	442.6	476.5	321.6	(338.3)
Non-Interest Expense .....	413.18	451.3	538.4	635.8	759.4	909.1	867.3	998.7
<b>Net Non-Interest Income</b> .....	<b>(154.4)</b>	<b>(179.7)</b>	<b>(217.4)</b>	<b>(268.5)</b>	<b>(316.8)</b>	<b>(432.7)</b>	<b>(545.7)</b>	<b>(1,337.0)</b>
Loan loss provisions .....	132.9	184.0	447.3	159.7	171.3	373.7	589.7	1,212.0
<b>Net Income before tax</b> .....	<b>281.1</b>	<b>140.1</b>	<b>(152.3)</b>	<b>169.9</b>	<b>341.3</b>	<b>458.8</b>	<b>191.8</b>	<b>(1,625.1)</b>
<b>PROFITABILITY RATIOS</b>								
(%) .....								
Return on Average Assets .....	2.5	1.0	(1.2)	0.9	1.5	1.7	0.7	(4.8)
Return on Average Equity <sup>(1)</sup> .....	17.5	7.4	(8.9)	7.1	11.7	11.6	5.1	(60.6)

Source: Central Bank of Azerbaijan, FIMSA

<sup>(1)</sup> Return on average equity is calculated as net income divided by average equity.

Savings (individual savings) have exceeded AZN 7.4 billion over the five-year period ended 31 December 2016. Devaluation of the Manat in 2015 led to a significant raise in dollarisation, with the share of savings in the foreign currency increasing from 38% to around 85% (as of 31 December 2015) during the year, and standing at 80% as of 31 December 2016. As of 31 December 2016, the assets, credit portfolio and total capital of the banking sector exceeded AZN 31.4 billion, AZN 15.9 billion and AZN 1.9 billion, respectively.

The following table sets out details of the non-performing loans in the Azerbaijani banking sector for the periods stated:

Non-performing Loans	As of 31 December							
	2009	2010	2011	2012	2013	2014	2015	2016 <sup>(1)</sup>
Overdue loans (AZN millions).....	303.5	492.9	633.8	748.8	792.8	976.3	1,508.5	3,821.3
Total outstanding loans (AZN millions).....	8,407.5	9,163.4	9,850.3	12,243.7	15,422.9	18,542.6	21,930.4	15,938.3
Overdue loans (% of total loans).....	3.6	5.4	6.4	6.1	5.1	5.3	6.9	24.0

Source: Central Bank of Azerbaijan, FIMSA

<sup>(1)</sup> Since it became operational in March 2016, the FIMSA calculates the percentage of NPLs.

From 2010 to 2016, the loan portfolio of the Azerbaijan banking sector has increased from AZN 9.2 billion to AZN 15.9 billion, primarily as a result of the devaluation of the Manat in February 2015 and December 2015. Over the same period, the proportion of non-performing loans to the total loan portfolio (calculated using the CBA methodology) increased from 5.4% as of 31 December 2010 to 6.9% as of 31 December 2015. Since it became operational in March 2016, the FIMSA (rather than the CBA) has calculated the percentage of NPLs using a different methodology from that utilised by the CBA and the non-performing loans stood at 24.0% as of 31 December 2016. Provisioning covers 55% of non-performing loans.

Overall capitalisation of the banking system has increased significantly since 2003, with total regulatory capital up from AZN 116 million to AZN 1,009 million in 2007 and AZN 1,694.2 million as of 31 December 2016. Over the same period, capital adequacy ratios increased from 10.9% in 2003 to 19.9% in 2007 and have decreased to 7.6% as of 31 December 2016, principally due to the significant unhedged short open currency position of IBA and the Manat devaluation (see "*Risk Factors—Risk Factors Relating to the Guarantor—The banking sector remains highly concentrated and underdeveloped*"). As of 31 December 2016, the capital ratio of IBA (a majority state-owned bank) constituted 11.8%. The ongoing recovery process is expected to strengthen the capital position of IBA. In January 2017, the Ministry of Finance injected additional capital to IBA in the amount of AZN 600 million.

In July 2015, the President of the Republic of Azerbaijan issued Decree N° 507 which provides for the transfer of certain problem assets of the IBA to Agrarkredit. The Ministry of Finance of the Republic of Azerbaijan and the Central Bank of the Republic of Azerbaijan, working together with the IBA, have determined and will continue to determine lists of problem assets to be transferred to Agrarkredit in accordance with the Decree. The Affected Assets include primarily loans and advances to customers, which are generally non-performing and high risk. Pursuant to the Decree, the transfer of the Affected Assets is to take place in stages. The transfers are effected against the payment to the IBA of cash consideration equal to the principal of the loans and other assets being transferred plus accrued interest. As of 31 December 2016, Affected Assets with a gross book value of approximately AZN 10 billion have been transferred, and the IBA has received payment of AZN 9.93 billion in cash. Further transfers of the Affected Assets are expected in 2017.

There are five major banks in Azerbaijan, with a capitalisation of more than AZN 100 million: Pasha Bank, Xalq Bank, Kapital Bank, Express Bank and Bank Silkway as of 31 December 2016.

Fifteen banks have foreign shareholders, and total foreign equity investments in banks reached AZN 330 million by the end of 2012 and increased to AZN 365 million by 31 December 2016. The EBRD, the IFC, the Black Sea Trade and Development Bank, VTB Bank (Russia) and Ziraat Bankası (Turkey) are among the foreign shareholders of Azerbaijani banks. Foreign banks such as Commerzbank (Germany), Société Générale (France), Citibank (U.S.) and Rosselxozbank (Russia) also have representative offices in Azerbaijan. See "*Risk Factors – Risks relating to Azerbaijan – The banking sector remains highly concentrated and underdeveloped*".



## **Banking Regulation and Prudential Standards**

The third generation of banking legislation was adopted in 2004 in accordance with European regulations and introducing corporate governance standards. Prudential regulations are oriented at maintaining the sustainability of the banking sector, and relevant preventative measures are taken by monitoring domestic and external factors that may affect activities of Azerbaijan banks.

In 2015, the CBA took measures to enhance the flexibility of the banking supervision and prudential regulation system while also allowing the CBA to keep risks to the banking sector at an appropriate level. The CBA eased its provisioning requirements on bank assets in order to minimise the impact of exchange rate corrections on debt burden of borrowers and took additional actions to maintain the financial sustainability of the banking sector. Quantitative regulation requirements were eased, the capital adequacy ratio reduced to 10%, and the leverage ratio to 5%. Consequently, the banking sector was provided with additional capital and lending opportunities. See "*Risk Factors – Risks relating to Azerbaijan – The banking sector remains highly concentrated and underdeveloped*".

In 2015, significant actions were taken within the framework of banking system restructuring. As part of the implementation of the decree of the President of the Republic of Azerbaijan dated 15 July 2015, which envisaged the privatisation of the state-owned shares of the IBA, problem assets of IBA were transferred to Agrarkredit. Since 31 December 2015, the licences of Bank of Azerbaijan OJSC, Gencebank OJSC, Yunayted Kredit Bank OJSC, Qafqaz Inkishaf Bankı OJSC, Atrabank OJSC and Texnikabank OJSC were revoked by the CBA. By decision of the FIMSA on 21 July 2016, the licences of Dekabank, Kredobank, Parabank and Zaminbank were revoked. The licence of Bank Standard was revoked in accordance with a decision taken by the FIMSA on 1 October 2016. The main reasons for licence revocation were failure to comply with the requirements on minimum amount of total capital and total capital adequacy ratio, failure to fulfil their obligations to creditors and to conduct its activities in a prudential and in a trustworthy manner.

Throughout 2016, significant reforms have been made in the banking sector. In carrying out its evaluation of the real banking sector, the FIMSA conducted on-site diagnostics and identified banks with insufficient capital. Additionally, stress tests were performed to determine potential risks and exposures. As a result, a capitalisation program was designed for each bank, and implementation at each bank is currently being monitored. Under the program, the licence of any bank whose capital position has not been restored will be revoked (a zero tolerance principle is applied), with a view towards providing a stable and competitive banking sector resilient to unexpected shocks.

In 2015, the CBA continued adapting the regulative framework to Basel recommendations and the European Directive. The "counter-cyclic" management framework was developed, and the early warning capacity strengthened. Measures on stage-by-stage adaptation of capitalisation requirements to Basel standards continued in order to strengthen the capacity of the banking capital to absorb unexpected losses. In 2015, prudential supervision measures ensured the maintenance of key financial stability indicators at an acceptable level. In 2016, the FIMSA has identified several principles called "Sound Lending and Responsible Borrowing for Credit Institutions", to which banks have already adapted their business strategy. Under these principles, banks assess a borrower based on certain ratios such as debt to income and loan to value before granting credit. For consumer loans in either local and foreign currencies, if the income of the borrower is lower than three times the minimum living expense, the borrower's debt-to-income ratio should not exceed 40% and if the income of the borrower is greater than three times the minimum living expense, the borrower's debt-to-income ratio should not exceed 50%. In addition, the loan-to-value ratio should not exceed 90% for consumer loans, and 70% for mortgage loans. The purpose of these principles is to decrease the public sector debt burden, which will lead to reduced credit risk in the future. At the same time, FIMSA continues to work on the resolution framework for the management of troubled banks and strengthening of prudential regulations. The FIMSA has put together a supervisory action plan and the Financial Stability Board has also been created.

The CBA developed Corporate Governance Standards in Banks with effect from 11 June 2013 which establish the prerequisites for sustainable banking services by increasing the quality of management in banks. These reforms have taken into consideration the corporate governance recommendations put forward by the Basel Committee on Banking Supervision in the "Principles for Enhancing Corporate Governance" published in October 2010. In case of violation of any of the banking regulations, the CBA has the power to impose (including financial penalties) on non-compliant banks, according to the Administrative Offences Code. In 2015, new initiatives on development of corporate governance in

banks, particularly on regulation of compensation and remuneration policy were put forward. A methodological base was established for promoting responsible lending in banks and non-banking credit organisations. Further initiatives are being developed by the FIMSA.

The Regulations on Risk Management in Banks were updated and entered into force on 17 December 2013 in order to strengthen the requirements for establishing a more effective risk management system, setting an operational risk management strategy and developing risk management methods and tools in banks. Meanwhile, the Regulations on Assets Classification and Loan Loss Provisioning have been tailored to the banking risk regulation.

### ***Impact of the Global Banking Crisis***

The CBA took preventive regulatory actions in order to minimise potential risks inherent to rapid growth during the 2008 financial crisis which enabled Azerbaijan to face the financial crisis with minimal impact. Preventive measures allowed Azerbaijan to neutralise the risks encountered by the banking sector and, as a result, no bank defaulted during the crisis. The following protection measures were adopted by the CBA:

- mandatory reserve norms (5.0%) for external borrowing were applied before the crisis to prevent excessive foreign borrowing;
- the maximum amount of insured deposits was increased from AZN 6,000 to AZN 30,000;
- regulations on risk management and corporate governance were amended;
- a stricter classification of risk-weighted assets was adopted;
- regulations for management of exposures to a single borrower or a group of connected borrowers were tightened;
- minimum requirements for the Loan to Value ratio of some loans were increased;
- earnings directed to bank capitalisation were exempted from tax;
- the Organised Interbank Credit Market guarantee system was established;
- the required reserve norms were decreased from 12.0% to 0.5%, thereby providing additional liquidity to the banking sector;
- the refinancing rate was decreased from 15.0% to 2.0%; and
- the period for which the CBA is able to lend to banks as a lender of last resort was increased.

### ***Impact of the recent Manat devaluation and regulative measures taken by the CBA in 2015 and 2016***

In December 2015, the CBA announced that it had abandoned the dollar-euro basket peg of the Manat and had switched to a floating exchange rate regime, as a result of intensifying external economic shocks. In response to the latest situation in the financial sector, the following protection measures were adopted by the CBA:

- In order to prevent the deterioration of the loan portfolio, as well as to maintain solvency of borrowers, the provisioning requirements to loan restructuring have been softened (the requirement for restructured loans has been decreased from 30% to 5%). Since 1 October 2015, the provisioning requirement for recently restructured loans has been reduced to 2%, while the requirement for non-restructured loans under monitoring has been cut from 5% to 1%. Moreover, the requirements for special provisions related to non-performing loans have been softened (the requirement for non-satisfactory loans has been decreased from 30% to 25%, for doubtful loans from 60% to 50%). This amendment came into force on 1 January 2016;
- To ensure Manat liquidity of the sector: the reserve requirements for banks have been reduced from 2% to 0.5%. Consequently, the liquidity of the banks has been strengthened, their lending

capacity has risen and (ii) in order to maintain stable Manat-denominated lending to the real sector, more than AZN 1 billion of financial support has been provided to the banks;

- In order to meet the Manat demand of the real sector, the CBA has implemented a new tool of a "swap" to support AZN lending by the banks;
- The CBA has implemented real time, transparent foreign currency exchange auctions, which are held several times a week. Market participants are informed of their parameters in advance via Bloomberg. SOFAZ sells foreign exchange reserves through these auctions, and auction results are regularly disclosed to the public. The interbank foreign exchange market operates on a regular basis on non-auction days.
- Ratio for the aggregate capital and Tier 1 capital were reduced from 12% to 10% and 6% to 5%, respectively, and the leverage ratio requirement has been softened gradually from 8% to 5%;
- In order to protect the savings of the population and to reinforce confidence in the banking sector, the maximum interest rate for insured savings in Manat has been increased 12%;
- The implementation of a new deposit scheme from 1 March 2016, currently in effect, which will guarantee bank deposits without any caps on the amount guaranteed for the next three years, but with an interest rate cap; whereby the maximum interest rate for insured savings in foreign currency was set at 3%, while the 12% maximum rate was retained for Manat deposits; and
- The CBA proposed that the total amount of open currency positions shall not exceed 10% of a bank's total capital for any one foreign currency and that the greater of the sum of all long currency positions and sum of all short currency positions shall not exceed 20% of a bank's total statutory capital, the CBA postponed the application of the short currency position limits until 1 January 2016. Banks are required to report their foreign exchange positions to the CBA on a daily basis.

See "*Risk Factors – Risks relating to Azerbaijan – The banking sector remains highly concentrated and underdeveloped*".

### **Deposit Insurance Fund**

Deposit insurance was introduced to boost confidence in the banking sector and the Deposit Insurance Fund was established. The fund provides compensation for each deposit covered by deposit insurance. Effective from 1 March 2016, the previous cap of AZN 30,000 was removed, so that all individuals' deposits meeting an interest rate cap are insured by the Deposit Insurance Fund for the full amount of the deposit for the next 3 years. As of December 2015, the proportion of bank deposits covered temporarily by the Deposit Insurance Fund was 68.4%. The annual interest rate ceiling on insured deposits was decreased from 12.0% to 10.0% from 1 August 2013 and has been further increased to 12.0% in 2015. From 1 March 2016 the maximum interest rate for insured savings in foreign currency was set at 3.0%, while the 12.0% maximum rate was retained for Manat deposits,

As of 31 December 2015, the Deposit Insurance Fund has only had to provide compensation to protected depositors of Royal Bank OJSC. The fund notified deposit holders in Royal Bank OJSC in July 2012 of the revocation of the bank's licences and liquidation. Compensations were paid from 1 August 2012 for the first AZN 30,000 of deposits. The amount of the compensation payments subsequently made by the Deposit Insurance Fund totalled AZN 15 million at the end of 2015. The banking licences of 11 banks have been revoked by the CBA and the FIMSA in 2016. Compensation payments have been made by the Deposit Insurance Fund to the depositors of three of such banks. The amount of the compensation payments made totalled AZN 713 million as of 30 November 2016.

According to the "Law on Deposit Insurance", the Deposit Insurance Fund has the right to require the amount of compensation payments to depositors from the respective insolvent banks. According to the "Law on Banks", assets of the insolvent bank shall be distributed, in the first place, to meet the claims of the Deposits Insurance Fund on a recourse basis.

In accordance with the recent amendments made to the "Law on Deposit Insurance", in the event the liquid assets necessary to compensate the depositors are not sufficient, the Fund may request the Central

Bank to provide funds. The Central Bank may provide to the Deposit Insurance Fund a credit secured by a government guarantee.

## **Financial Markets**

The first securities in Azerbaijan's history appeared in the beginning of the 20th century. These were the shares of domestic joint-stock companies, dealing primarily with oil extraction and processing. In 1913, the newly established Baku Merchant Bank registered its first equity issue prospectus, and became the first bank in Azerbaijan to operate as a joint-stock company.

The main laws regulating the market are the Civil Code and the recently adopted Law "On the Securities Market". In addition, market activities are also regulated under acts and rules issued by the state regulator. Created in 1998, the State Committee for Securities ("SCS") is the main securities market regulator in Azerbaijan.

The State Committee for Securities, the State Insurance Supervision Service of the Ministry of Finance and the Financial Monitoring Service under the Central Bank of the Republic of Azerbaijan were abolished pursuant to the Decree of the President of the Republic of Azerbaijan dated 3 February 2016. The decree also established the FIMSA in the form of a public legal entity, and provided for all supervisory authorities for banking, insurance, securities and AML to be transferred to the FIMSA. Upon adoption of the FIMSA charter by Presidential decree dated 10 March 2016, the State Committee for Securities, the State Insurance Supervision Service of the Ministry of Finance and the Financial Monitoring Service under the Central Bank of the Republic of Azerbaijan were abolished. The FIMSA became fully operational on 1 April 2016.

The FIMSA is established with the purpose of licensing, regulating and supervising the securities market, investment funds, insurance brokers, credit organisations such as banks, non-bank credit organisations and postal services operators, and payment systems activities, as well as improving transparency and flexibility of the supervision system over money laundering and financing of terrorism.

The FIMSA is governed by a board of five directors, all of whom will be appointed by the President of the Republic of Azerbaijan. Relevant changes have been incorporated into the laws "On the Securities Market", "On Central Bank of the Republic of Azerbaijan", "On non-banking credit organizations", "On insurance activity" and other relevant acts envisaged by the decree.

Special attention has been given to institutional development and expansion of financial markets, and expanding legal, regulatory and institutional frameworks for new financial instruments, along with further improvement of existing financial market tools. In addition to developing financial markets, the objective has been to enhance the capability to implement monetary policy using market transactions. The CBA started issuing its notes from 2004. There has been rapid growth of the state securities market, which consists of the CBA's notes and securities of the Ministry of Finance. This growth required closer coordination between the CBA and the Ministry of Finance and, in 2005, a Coordination Board was established, composed of representatives of both bodies. At meetings of the Board, the scope and terms of state security issues are discussed and coordinated.

In 2006, the IMF, with financial assistance from SECO, started implementing a 3-year regional project to develop the state securities market and domestic debt management. In June 2009, the State Mortgage Fund issued mortgage bonds, which was the first-ever issuance of such an instrument in the history of Azerbaijan securities market. In 2009, for the first time, the Ministry of Finance issued treasury notes with 2, 3 and 5 year maturity and callable treasury bills with 1 year maturity. In 2012, the Capital Market Modernisation Project was launched, funded by the Government, the World Bank and SECO and managed by the SCS/ FIMSA. The main objective of this 5-year project is to increase the use of equity and corporate debt as financing and/or investment instruments through the adoption of an effective capital markets regulatory framework and infrastructure.

### ***"Baku Stock Exchange" CJSC ("BSE")***

The BSE was established in 2000 by 18 shareholders, including leading Azerbaijani banks, investment and brokerage companies and the Istanbul Stock Exchange. As of 31 December 2016, the BSE had 20 shareholders.

The BSE's activities are controlled and regulated by the SCS, as well as the BSE's own internal regulations. The BSE trading floor can be accessed only by exchange members having respective investment company licences. Exchange members are shareholders of the exchange and any legal entity that has purchased a seat on the exchange; both are subject to holding the investment company licence and complying with other membership requirements of the BSE. The cost of one seat on the BSE is AZN 60,000. As of 31 December 2016, the BSE had six members.

Trading on the BSE is conducted electronically. Trading is carried out in real-time by means of the Electronic Trading System of the BSE. To improve the efficiency and automation of the trading and depository system, the BSE and the National Depository Center ("**NDC**") provided remote access capabilities to the broker-dealer community in 2009. Clearing and settlement services are provided by the NDC. Clearing is performed in DVP form. Currently, all settlements are either on a T+0 or T+1 basis. The NDC has recently adopted new clearing regulations, which may establish a different settlement period. The new regulations have not yet been published.

Both state and corporate securities may be traded on the BSE. State securities are notes of the Central Bank and T-bills and T-notes issued by the Ministry of Finance. Notes of the Central Bank are discount short-term securities entitling their holders to receive back face value (AZN 100) after 28 days. Only resident banks can purchase these securities. T-bills are discount short-term bonds entitling holders to receive back face value (AZN 100) from the issuer at the end of a specified term. The maturities of T-bills range from 35 days to 12 months. There are also callable treasury bills with 1 year maturity. T-notes are up to 1, up to 5 and over 5 year maturity coupon bonds. T-bills can be purchased by both resident and non-resident entities and individuals.

Ownership records for notes of the Central Bank and T-bills are stored in the depository of the NDC by means of individual custody accounts. Investors can obtain information about their custody accounts through an investment company or directly from NDC. At the maturity date, the issuer transfers money to the investors' accounts through the NDC clearing system. Both notes of the Central Bank and T-bills are traded on the secondary market on the BSE during their turnover period. On the BSE, notes of the Central Bank are also traded within repo and reverse repo transactions. Since 24 May 2006, interbank repo transactions have been carried out.

In 2015, the following equity issuances occurred on the BSE: IBA (AZN 100 million), Turanbank OJSC (AZN 47 million), Azərkosmos OJSC (AZN 23.6 million), Aqrolizinq OJSC (AZN 119.1 million), Bakı Sığorta OJSC (AZN 1 million), Bank of Baku OJSC (AZN 52.9 million), Muğanbank OJSC (AZN 4.7 million), Meqa Sığorta OJSC (AZN 2.5 million), Bank BTB OJSC (AZN 7.2 million), FINOKO OJSC (AZN 0.7 million) and AXA MBASK Sığorta Şirkəti OJSC (AZN 3 million). In 2016, the following equity issuances occurred on the BSE: Muganbank OJSC (AZN 5 million), Finex Credit (AZN 100 thousand), Dekabank (AZN 4.6 million), Parabank (AZN 15 million), Nikoil Bank (AZN 90 million).

Corporate securities trading turnover has greatly increased in the past few years. There are three markets for equity trading: 1st tier listing, 2nd tier listing and Alternative Trading Market ("**ATM**"). Currently 923 companies' shares are traded on the BSE, but only two companies have a first tier listing (DamirBank and IBA). As of 31 December 2016, ten equity issuances have utilised a market maker to increase liquidity in the market.

The ATM was created to let shares of unlisted companies be traded on the BSE. There are different requirements for first and second tier listings. The first tier listings are more suitable for large Azerbaijani and international companies and the second tier listing requirements are more suitable for growing small and medium sized Azerbaijani enterprises.

About 562 of the companies whose shares are traded on the BSE have more than 50 shareholders. The largest companies on the BSE are International Bank of Azerbaijan, Unibank OJSC, Bank of Baku OJSC, Azerishiq OJSC, Xalqbank OJSC, European Tobacco-Baku ASC, Turanbank ASC, Atabank OJSC, AtaHolding OJSC, Bank BTB OJSC, Azərbaycan Sənaye Bankı OJSC and KapitalBank OJSC.

There are 60 bond issuances traded on the BSE, of which 22 are government bonds and 8 are bonds issued by the Azerbaijan Mortgage Fund. Like equities, the BSE has three markets for bonds trading: 1st tier listing, 2nd tier listing and the Alternative Trading Market. In 2013, market maker institutions were introduced to the market. As of 31 December 2016, three bond issuances have utilised a money market to increase liquidity in the market. Maturities for corporate bonds range from one to ten years.

There are no restrictions for foreign investors in accessing the local corporate securities market. Foreign investors can participate in the transactions on BSE under the same conditions as local investors. Foreign investors can also repatriate receipts from transactions in foreign currency with corporate bonds without any restrictions, except for investors in certain jurisdictions. The list of such jurisdictions was prepared based on those countries/territories determined to be participating in legalisation of proceeds of crime, financing of terrorism and similar activities. Presently, the list includes 16 countries.

The following table highlights some volume figures of the BSE for the indicated periods:

Trade Volumes on the Baku Stock Exchange	For the year ended 31 December					
	2011	2012	2013	2014	2015	2016
Turnover of BSE						
(AZN millions) .....	8,429.6	9,001.8	8,475.9	12,933.5	8,304.4	5,696.1
(US\$ million) .....	10,717.9	11,467.3	10,804.2	16,488.4	8,078.2	3,216.8 <sup>(1)</sup>
(weight in GDP, %) .....	16.84	16.67	14.56	21.92	15.3	9.49
Turnover of BSE on the market segments (AZN millions) .....						
T-bills (placement) .....	239.08	141.74	98.05	80.21	0	421.5
T-bills (secondary market) .....	41.57	25.71	36.56	27.60	20.79	145.9
Notes (placement) .....	642.52	859.03	299.82	158.05	0	268.75
Notes (secondary market) .....	12.55	210.73	43.95	349.81	0	0
Repo transactions .....	5,781.97	6,856.47	6,609.11	3,540.81	119.76	2.06
Corporate bonds (placement) .....	198.87	60.71	152.79	2,165.19	71	169.09
Corporate bonds (secondary market) .....	530.33	343.41	790.97	1,283.3	1,766.12	130.7
Equities (placement) .....	974.39	488.03	423.16	1,009.47	268.7	114.7
Equities (secondary market) .....	8.35	15.96	21.44	19.61	10.75	3.26
Derivatives (commodity) .....	—	—	—	204.69	93.5	272
Derivatives (currency) .....	—	—	—	4,094.73	5,953.8	4,168.5
Average interest rate on T-bills (%) .....	3.09	3.90	2.91	2.78	n/a	13.07
Average interest rate on Notes (%) .....	2.19	1.84	1.20	1.01	n/a	14.86
Average interest rate on Corporate Bonds (%) .....	6.04	8.48	11.05	10.08	12.51	10.09

Sources: BSE, State Statistical Committee, Central Bank of Azerbaijan and FIMSA

<sup>(1)</sup> The Central Bank's AZN/US\$ rate as of 31 December 2016 was 1.7707:1.

### Law on Capital Markets

The Law on Capital Markets came into force on 15 July 2015, based on a decree signed by the President of the Republic of Azerbaijan.

This law includes updates and changes in the issuance and registration of securities, IPO procedures, depository and post trade systems, establishment of the central depository, its management and its cancellation rules and procedures, investment companies, investors' rights, and other rules and regulations.

According to this law:

- Issuance of the securities can be either through an IPO or through a private placement;
- For the first time in Azerbaijan, IPOs will be performed through subscriptions;
- Issuance of the securities to more than 50 persons can be made only through public offers;
- Trading of securities in documentary form will not be allowed;
- Broker and dealer firms will operate as investment companies which will need a licence (without term) to operate. Investment companies will provide main and supporting investment services. According to the new law, they can be established only in form of a joint stock company;

- The market will be divided into three categories: government securities' market, corporate securities' market, and derivatives' market. They all will be operated by the stock exchange.

The implementation of the new law will help to modernise and improve the governance of the National Depository Center, the BSE and investment companies.

#### *New derivative trading (margin trading) platform*

Derivates have been traded at the BSE since April 2014. Instruments traded are currency futures and contracts for differences ("CFDs"). Derivatives are being traded on a separate trading platform acquired by the BSE, which is called Metatrader 4. The BSE supervises derivatives trading via special web interface connected to the database.

The market architecture involves the BSE, NDC, liquidity provider and customer banks, which joined a collective agreement. According to the collective agreement, the BSE must undertake the role of market organiser, "Invest -AZ" must provide liquidity to the market, and NDC must assume the role of managing the accounts of the liquidity provider. As stated in the collective agreement, clearing and settlement of trading must be performed by NDC.

Legal matters between parties (namely the BSE, NDC, the liquidity provider and customer banks) with regards to the derivatives trading are being settled according to the collective agreement signed on 1 March 2014. Entities that wish to participate in the derivatives market can join the trading by signing the collective agreement. In this process, "Invest-AZ" undertakes the role of broker for those who applied for derivatives trading (banks) and for those that are client of the joined banks. Currently, Commercial Bank Unibank OJSC is the only bank which benefits from the service of "Invest-AZ".

#### *The State Program of the Securities Market Development in the Republic of Azerbaijan in 2011-2020*

In May 2011, the President of the Republic of Azerbaijan enacted "The State Program of the Securities Market Development in the Republic of Azerbaijan in 2011-2020" (the "**State Program**"). The State Program's main goal is to streamline reforms in capital markets' infrastructure, legal and regulatory regime, and to stimulate demand and supply of capital market instruments as well as to increase the level of public awareness and financial literacy in the area. The Government, the World Bank and the Swiss State Secretariat for Economic Affairs ("**SECO**") have jointly approved financing of the five-year long Capital Market Modernisation Project ("**CMMP**") to support the implementation of the State Program.

The CMMP was designed to coordinate activities under its four main goals: (i) Streamlining and Automating the Capital Market Infrastructure, (ii) Updating and Strengthening the Legal and Regulatory Framework of the Sector, (iii) Stimulating Supply of the Capital Market Instruments and (iv) Capacity Building of the Sector's Main Stakeholders.

Within the boundaries of the CMMP, a team of European and local legal experts prepared a draft harmonised with the European Directives and IOSCO Principles. In 2015, the new "Law on Capital Markets" was adopted by the Parliament, which led to implementation of more than 30 regulations by the Cabinet of Ministers, Ministry of Justice and the SCS covering various aspects of the capital markets. The rules of the Baku Stock Exchange and the National Depository Centre (acting as the country's CSD) have been fully reformed in accordance with the implementing regulations.

Another sub-project financed by the CMMP is a capital market information system (the "**Capital Market Information System**"). Together with international experts, the teams of the SCS, the BSE and the NDC organised an international tender on providing the integrated electronic trading, post-trading and surveillance platform solution for the country's capital market participants. 22 international vendors participated in the tender organised in 2014, at which the Korea Exchange (KRX) was selected as winner and it began the implementation of the Capital Market Information System in early 2015. The CETA (Centralised Exchange Trading System of Azerbaijan) was successfully launched in February 2016 and includes new trading, post-trading and surveillance modules.

#### *Listing Advisory Program*

The Listing Advisory Program ("**LAP**") is being supported and implemented by the BSE and the FIMSA as part of the State Programme. The LAP aims to build on success in making a "highly effective securities market" in order to regulate the economy, attract financial resources to the real sector, move capital

between sectors and increase effectiveness of the economic system, creating better corporate governance and more transparency about economic activities and increasing popular participation.

The LAP is also aimed at increasing the demand for investment capital and supply of investment opportunities and securities on the BSE, as part of processes to build and deepen the capital markets in Azerbaijan. It aims to introduce companies and other potential issuers to the BSE and to the process and advantages of listing and using the stock exchange to raise long-term risk capital in either equity or debt. It focuses on those companies that have the best potential to use the BSE to raise equity or debt capital. The objective is to increase the supply of securities and investment opportunities on the BSE and to build sales and marketing momentum around approaching companies and other potential listing targets.

The basic purpose of the LAP is to implement an effective and ongoing program aimed principally at potential issuers and listings that provides education and awareness about the market, identifies ways to improve market use, selects potential companies for listing and guides and supports them through capital raising including debt and equity issues, such as IPOs. The support and guidance available through LAP includes:

- Education and awareness workshops, presentations and consultations;
- Direct advisory services and support to select and guide companies through listing;
- Provision of trainings and workshops;
- Literature and educational materials.

As the result of the LAP, training has been provided to more than 100 companies, listing requirements have been eased and the number of listed companies have increased.

## **Securities Market**

### ***CBA notes***

The first auction held by the CBA for issuing and placement of notes was on 14 September 2004. The CBA held 51 auctions to sell notes during 2010, with an issuance volume of AZN 311 million, of which about AZN 261 million were put-up in auction. Total placement volume was AZN 223.8 million. The average weighted yield rose from 1.00% at the first auction to 2.08% at the last auction. The volume of outstanding notes at year-end totaled AZN 24.2 million.

The volume of issued CBA notes significantly increased in 2011. The CBA held 51 auctions on placement of issued notes in 2011. Total volume auctioned was approximately AZN 777 million, against demand of AZN 642.5 million. The volume of outstanding notes at year end was of AZN 50.2 million. The average weighted yield increased from 2.20% at the first auction to 2.77% at the end of year.

The volume of issued CBA notes also increased in 2012. The CBA held 52 auctions, totalling AZN 860.2 million. Outstanding notes at year end totaled AZN 47.4 million. The average weighted yield was 2.84% at the first action and had fallen to 1.87% at the end of the period. The secondary market turnover for notes totaled AZN 210.7 million.

In 2013, the CBA issued notes for the amount of AZN 1.5 billion. The volume placed at the auctions was about AZN 340 million. By the end of period, the volume of outstanding notes totaled AZN 20.0 million. The average weighted yield during the period decreased from 1.76% at the first auction to 1.06% at the last.

In 2014, the CBA issued notes for the amount of AZN 1.56 billion. The volume placed at the auctions was approximately AZN 158.18 million. By the end of period, the volume of outstanding notes totaled AZN 27.02 million. The average weighted yield during the period decreased from 1.07% at the first auction to 0.91% at the last.

In 2015, the CBA issued notes for the amount of AZN 0.42 billion. The volume placed at the auctions was nil. By the end of period, the volume of outstanding notes was nil.



In 2016, the CBA held nine auctions to sell notes with an issuance volume of AZN 269 million. As of 31 December 2016, the volume of outstanding notes was AZN 108.4 million.

### ***Government Short-Term Securities Market***

The Ministry of Finance started issuing Government short-term securities ("**GSTS**") from 1996. As the GSTS market developed, the Ministry of Finance decided to increase domestic borrowing. At the 2010 auctions, the volume of GSTS issued was AZN 1.3 billion, of which AZN 360 million was placed. The average weighted yield of GSTS ranged from 0.68% at the first auction to 5.00% during the year.

The volume of GSTS issued by Ministry of Finance decreased in 2011 and number of auctions held was 112 (against 157 held during the corresponding period in 2010). Total GSTS volume issued during the year amounted to AZN 500 million and the volume placed at auctions was AZN 239 million. During the period, average weighted yield ranged from 0.73% to 5.00%.

The issue volume of GSTS in 2012 remained the same as 2011. Over the year, the total issue of GSTS amounted to AZN 500 million. The volume placed during the 75 auctions was AZN 141.7 million. Average weighted yield ranged between 1.46% and 5.00% during the year.

In 2013, 119 auctions were held by the Ministry of Finance, and issued volume of GSTS was AZN 556 million, of which AZN 98 million was placed. Average weighted yield for GSTS ranged from 1.46% to 4.25% during the year.

In 2014, 110 auctions were held by the Ministry of Finance, and issued volume of GSTS was AZN 609 million, of which AZN 80 million was placed. Average weighted yield for GSTS ranged from 1.46% to 4.25% during the year.

In 2015, no auctions were held by the Ministry of Finance, and issued volume of GSTS was nil.

In 2016, 40 auctions were held by the Ministry of Finance, and the issued volume of GSTS was AZN 524.8 million of which AZN 421 million was placed. Average weighted yield for GSTS ranged from 7.7% to 18.1% during the period.

### ***REPO and Reverse REPO Auctions***

For the purpose of absorbing surplus liquidity, the CBA uses tools such as REPO and reverse-REPO auctions. An Interbank REPO market was formed in late 2006. Following that, commercial banks could implement REPO transactions between themselves. The volume of REPO auctions decreased in 2010 (against the volume in 2009) with the volume of transactions totalling AZN 837.7 million. The yield for REPO transactions ranged from 1.0% rose to 1.5% during the year. The maturity of REPO transactions varied from one-day to 30 days.

The volume of REPO transactions significantly increased during 2011. Total volume of REPO and Reverse-REPO transactions was AZN 5.8 billion. The volume of Interbank REPO during 2011 totaled AZN 29.3 million. The rate of one-day REPO transactions in the market was 1.0%.

The volume of REPO transactions continued to increase during 2012, amounting to AZN 6.8 billion. The volume of Interbank REPO during the year totaled AZN 12.7 million. The yield for one-day REPO transactions ranged from 1.0% to 1.7% during 2012.

The volume of REPO transactions amounted to AZN 6.60 billion during 2013. Maturity of transactions was 1 day. No Reverse-REPO transactions were made during the period. In 2013, the volume of the Interbank REPO market was nearly AZN 11 million. The yield on REPO transactions was 1.0% during 2013.

The volume of REPO transactions amounted to AZN 3.32 billion during 2014. Maturity of transactions was 1 day. No Reverse-REPO transactions were made during the period. In 2014, the volume of the Interbank REPO market was nearly AZN 4 million. The yield on REPO transactions varied from 0.1% to 1% during 2014.

The volume of REPO transactions amounted to AZN 124 million in 2015. The volume of Reverse-REPO transactions amounted to AZN 32 million during this period. Maturity of reverse-repo transactions was 1 day. In 2015, the volume of the Interbank REPO market was AZN 81.6 million.

The volume of REPO transactions significantly diminished in 2016. The volume of REPO transactions amounted to AZN 2 million during the period. No Reverse-REPO transactions were made during the period, and the volume of the Interbank REPO market was nil.

### ***Corporate Bond Market***

The corporate bond market has been rapidly growing in the last few years. The total turnover of the market more than doubled in 2010. The total volume of placed bonds was AZN 101.4 million, and the secondary market volume amounted to AZN 164.6 million. More than AZN 82 million of placed bonds were Azerbaijan Mortgage Fund bonds. Maturity for AMF bonds was 7 and 9 years. The yield for AMF bonds ranged from 3.00 to 3.25%. The bonds issued by other companies had a maturity of between 1-2 years and the yield ranged from 12.5 to 15.0%. There have been 98 new corporate bond issues since 2008, amounting to AZN 3,352 million. Of this amount, AZN 390 million were AMF bonds.

In 2011, the total volume of placed bonds increased to AZN 198.9 million (of which AMF bonds was AZN 77.4 million). The volume of secondary market had also increased to AZN 530.3 million. Issued bonds had a maturity between 1 and 5 years (AMF bonds 6-7 years) and the yield of 8.00 to 15.00%.

The placement volume of corporate bonds sharply decreased in 2012, amounting to AZN 60.7 million. AMF bonds placement volume was AZN 36.2 million. The secondary market volume also decreased to AZN 343.4 million. Maturity for corporate bonds excluding AMF bonds ranged from 1 to 5 years. During the period, issued bonds had a yield between 9.5% and 15.0%.

In 2013, the total volume of placed bonds amounted to AZN 152.8 million (of which AZN 57.3 million are AMF bonds). With the market makers actively participating in the corporate bonds market, the volume of secondary market increased to AZN 790.9 million. The yields for bonds ranged from 7.0 to 15.0%. Maturities were between one and ten years.

In 2014, the total volume of placed bonds amounted to AZN 2,176 million (of which AZN 40 million are AMF bonds). With the market makers actively participating in the corporate bonds market, the volume of secondary market increased to AZN 1,283 million. The yields for bonds ranged from 3.00 to 15.00%. Maturities were between one and ten years.

In 2015, the total volume of placed bonds amounted to AZN 71 million (of which AZN 45 million are AMF bonds). With the market makers actively participating in the corporate bonds market, the volume of secondary market increased to AZN 1,766 million. The yields for bonds ranged from 3.00 to 15.00%. Maturities were between one and ten years.

In 2016, the total volume of placed bonds amounted to AZN 169 million (no AMF bonds were issued in 2016). During this period, no market maker transactions took place, and the volume of the secondary market contracted to AZN 130.7 million. In the same period, bond yields ranged from 9.0% to 14.0%, and maturities were between one and ten years.

### ***Equities Market***

The primary market volume of shares had greatly increased in 2010, reaching AZN 426 million. The largest issue of the year was done by Baku Electric Grid OJSC (now, Azerishiq OJSC), amounting to AZN 180 million. There were 43 new share issues during the year. The secondary market volume for shares was AZN 15.6 million.

The issued volume of shares totaled AZN 981.6 million (27 new issues) in 2011. The total volume of placed shares was AZN 974.4 million. Azerenerji OJSC issued shares with an amount of AZN 824.6 million. The secondary market volume decreased to AZN 8.4 million.

The primary market volume of shares decreased to AZN 488.0 million in 2012. Azerenerji OJSC performed another large stock issue of AZN 200.0 million. There were 37 new share issues during the year. The secondary market volume had doubled since the last year, amounting to AZN 16.0 million.

In August 2012, the CBA increased the minimum capital requirement for banks from AZN 10.0 million to AZN 50.0 million, effective 1 January 2014. Later in the year, the CBA extended the deadline to 1 January 2015. To reach to the minimum capital requirement, banks increased their equity capital by issuing new shares. In 2013, there were 29 new share issues totalling AZN 423.1 million. The secondary market volume amounted to AZN 21.4 million during the same period.

In 2014, there were 29 new share issues totalling AZN 1,009 million. The secondary market volume amounted to AZN 19 million during the same period. In 2015, there were 18 new share issues totalling AZN 268 million. The secondary market volume amounted to AZN 10 million during the same period.

In 2016, there were five new share issues totalling nearly AZN 115 million. The secondary market volume amounted to AZN 3.26 million during the same period.

## PUBLIC FINANCE

### The Budgetary Process

The 2002 Law "On Budget System" (the "**Budgetary System Law**") sets out the procedures governing Azerbaijan's budgetary system and regulates the preparation, adoption, execution and monitoring of the State Budget. Azerbaijan aims to follow international best practice in its budgetary procedures.

The Budgetary System Law calls for preparation of a medium-term socio-economic development strategy, as well as medium-term budget indicators. A draft budget is now prepared not only for the upcoming year, but also contains economic and budgetary projections for the next three years.

Azerbaijan's fiscal year is from 1 January to 31 December. A draft State Budget is prepared twice a year, which allows forecast adjustments based on socio-economic changes. The initial draft budget is prepared in March-April and in July-August, the draft State Budget is adjusted to reflect real events and expected developments.

The Budgetary System Law also contains a framework for co-ordinating the relationship between the State Budgets, local government budgets and the budgets of other state funds such as SOFAZ and the State Social Protection Fund.

The Budgetary System Law also ensures transparency at all stages of the budgetary process. The draft budgets together with all assumptions are published. Quarterly updates showing the actual implementation of the State Budget are also disclosed.

The Ministry of Finance prepares the draft State and consolidated Budget and submits it to the Cabinet of Ministers, which, in turn, submits it to the President. The Ministry of Finance is also responsible for supervision over the implementation of the State Budget.

The draft budget is prepared using information and spending requests gathered from other ministries and agencies. Input on the budget process is received from the Ministry of Finance, the Ministry of Economy, Ministry of Taxes, State Customs Committee, the CBA, State Statistical Committee, State Social Protection Fund, SOFAZ, all central executive bodies, local executive bodies and all local financial bodies.

In accordance with the Budgetary System Law, preparation of a draft budget begins 11 months prior to the next budget year and is initiated by a decision of the Cabinet of Ministers published towards the end of January each year.

During March, the Ministry of Finance develops its medium-term budget forecast (revenue, expenditure, deficit and financing) and the Ministry of Economy prepares the state investment programme. The initial draft State Budget and state investment programme are presented to the Cabinet of Ministers before 15 April. Following any necessary corrections and adjustments, the final draft of the State and consolidated budget and consolidated budget indicators for the next three years are submitted to the Cabinet of Ministers by the Ministry of Finance and the Ministry of Economy before 15 September and, after discussions in the Cabinet of Ministers, these are submitted to the President before 25 September of each respective year.

The President then submits the draft budget to Milli Majlis for discussion by 15 October. Milli Majlis publishes the main budget indicators in the press within 10 days and approves the budget no later than 20 December. Within one month of approval, monthly and quarterly breakdown of budget revenues and expenditures and budget indicators are presented by the Ministry of Finance to the various budget organisations.

In February 2016, the Parliament approved amendments to the original State Budget for 2016, which was previously approved in November 2015. The amendments to the 2016 State Budget were proposed to take into account the falling price of oil and the devaluation of the Manat. The original 2016 State Budget was created based on fixed crude oil (Brent) prices of US\$50 per barrel, but has been amended to reflect a new fixed crude oil (Brent) price of US\$25 per barrel. The amended 2016 State Budget was promulgated into law by the President on 2 March 2016. According to the 2016 State Budget, actual budget revenues were AZN 17.5 billion and actual budget expenditures were AZN 17.7 billion. Transfers from SOFAZ to the state budget in 2016 were AZN 7.6 billion as forecasted.

Azerbaijan's State Budget for 2017 was presented to the Parliament in October 2016, and adopted in December 2016.

### ***Treasury***

The State Treasury Agency of the Ministry of Finance was given the task of increasing the fiscal efficiency of Azerbaijan in Decree 48 of 9 February 2009 of the President "On measures to improve activity of the Ministry of Finance of the Republic of Azerbaijan".

The State Treasury Agency is the executive body responsible for the implementation of state budget cash and the accounting of the financial operations, assuming obligations for budget expenses on behalf of the state before budget organisations, controlling management, entry and use of public funds.

The Treasury Management Information System ("TMIS") plays a leading role in enhancing transparency, automating accountability of the state budget funds, widening the scope of treasury implementation services, management and control improvements. Currently, around 90% of the state budget operations are linked to TMIS. TMIS offers a clear advantage over previous systems by ensuring that all types of banking transactions are concluded in real-time via a single treasury account of the State Treasury Agency in the CBA. The system also enables direct transfer of budget and extra budget receipts to the central treasury and their automatic registration.

### **2016 Budget**

#### ***2016 Actual State Budget Revenues***

State Budget revenues in 2016 were AZN 17.499 billion compared with AZN 17.498 billion in 2015, an increase of 0.01%.

In 2016, revenues from the Ministry of Taxes were AZN 7.02 billion compared with AZN 7.1 billion in 2015, a decrease of 1.1%.

The Government's objective is to increase revenue generation from the non-oil sector and gradually decrease the reliance on transfers from SOFAZ for budget purposes. Transfers from SOFAZ in 2016 were AZN 7.6 billion, which was AZN 0.5 billion (6.3%) less than in 2015.

#### ***2016 Actual State Budget Expenditures***

In 2016, the State Budget expenditures were AZN 17.7 billion compared with AZN 17.8 billion in 2015, reflecting a 0.23 % decrease. The State Budget aims to balance a social development target with the need to upgrade the country's public infrastructure. A significant share of the expenditures is directed towards raising economic potential, ensuring energy, food, environmental and transport security, further promoting entrepreneurship and agricultural activity, particularly following the Manat devaluation and expected inflation growth caused thereby.

Social orientated expenses in the 2016 State Budget increased by 36.8% to AZN 6 billion, which include education (AZN 1.8 billion), social protection expenditures (AZN 2.7 billion) and public health (AZN 830.8 million) and culture, art, information and sport expenditures (AZN 738.6 million).

The State Budget deficit in 2016 was AZN 0.2 billion, primarily due to devaluation of the Manat in December 2015 and falling oil prices. As planned, the State Budget deficit was covered through issuances of securities, revenues from privatisation, foreign grants and foreign loans.

### **2017 Budget**

#### ***2017 Approved State Budget Revenues***

The forecasted State Budget revenues and expenditures for 2017 are AZN 16.3 billion and AZN 16.9 billion, respectively.

Revenues from the Ministry of Taxes in 2017 are forecasted at AZN 7.5 billion, which is 0.5 billion higher than in 2016.

Transfers from SOFAZ in 2017 are forecasted to be AZN 6.1 billion, which is AZN 1.5 billion (19.9%) less than in 2016.

### **2017 Approved State Budget Expenditures**

In 2017, State Budget expenditures are forecasted to be AZN 16.9 billion, a 4.5% decrease compared to 2016 actual expenditures.

In 2017, social orientated expenses, including education (forecasted AZN 1.7 billion), social protection expenditures (forecasted AZN 2.3 billion), public health (forecasted AZN 745.4 million) and culture, art, information and sport expenditures (forecasted AZN 282.6 million) are budgeted to decrease by 17.6%.

The Government expects a budget deficit of AZN 645 million in 2017. The deficit is expected to be covered through issuances of securities, revenues from privatisation, foreign grants and foreign loans.

### **Public Accounts**

The following table sets forth a summary of the actual and proposed revenues and expenditures, and the overall balance of the state budget, for the periods indicated:

<b>Public Accounts</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017 <sup>(1)</sup></b>
	<i>(AZN millions)</i>						
<b>Revenues of consolidated budget .....</b>	<b>23,225.7</b>	<b>22,338.4</b>	<b>23,223.0</b>	<b>23,082.2</b>	<b>18,416.0</b>	<b>21,566.4</b>	<b>20,020.7</b>
State budget revenues <sup>(2)</sup> .....	15,700.7	17,281.5	19,496.3	18,400.6	17,498.0	17,499.1	16,255.0
Revenues of Nakhchivan AR .....	49.2	56.0	342.7	357.9	371.5	358.3	348.4
Revenues of State Social Protection Fund .....	718.4	877.3	2,674.8	2,894.3	2,912.4	3,175.7	3,400.0
Revenues of State Oil Fund .....	15,757.4	13,673.2	13,886.5	12,731.0	7,721.1	9,410.2	8,370.0
<b>Expenses of consolidated budget .....</b>	<b>17,540.7</b>	<b>20,072.7</b>	<b>22,218.4</b>	<b>21,417.7</b>	<b>21,014.7</b>	<b>21,418.0</b>	<b>28,767.2</b>
State budget expenditure <sup>(3)</sup> .....	15,397.5	17,416.5	19,143.5	18,709.0	17,784.5	17,743.6	16,900.0
Expenditures of Nakhchivan AR .....	303.5	318.8	331.0	368.3	374.8	354.5	348.4
Expenditures of State Social Protection Fund .....	2,125.1	2,457.0	2,588.3	2,868.8	2,934.2	3,194.8	3,400.0
Expenditures of State Oil Fund <sup>(4)</sup> .....	9,549.5	10,544.0	12,498.4	10,071.3	9,159.9	9,002.0	14,451.3
Expenditures on projects financed from external loans .....	730.7	1,000.0	834.5	701.9	848.3	881.0	2,020.8
<b>Consolidated budget surplus (deficit) .....</b>	<b>5,685.0</b>	<b>2,265.7</b>	<b>1,004.6</b>	<b>1,664.5</b>	<b>(2,598.7)</b>	<b>148.4</b>	<b>(8,746.5)</b>

Source: Ministry of Finance

<sup>(1)</sup> Approved 2017 budget.

<sup>(2)</sup> Includes transfer from SOFAZ.

<sup>(3)</sup> Includes transfers from state budget to Nakhchivan AR, transfers from state budget to State Social Protection Fund and transfers from State Budget financed organisations to State Social Protection Fund.

<sup>(4)</sup> Includes transfers to State Budget.

The following table sets forth the transfers to or from the state budget which transfers, if not eliminated, would overstate the "Revenue of consolidated budget" and "Expenses of consolidated budget" line items above.

The table sets forth the amounts of transfers from or to the state budget which transfers (a) if subtracted from the applicable individual revenue line items set forth in the Public Accounts table above will cause the sum of such individual revenue line items to equal the amount set forth as "Revenues of consolidated budget" and (b) if subtracted from the applicable individual expenditure line items in the Public Accounts table, will cause the sum of such individual expenditure line items to equal the amount set forth as "Expenses of consolidated budget".

<b>Public Accounts</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017<sup>(1)</sup></b>
<i>(AZN millions)</i>							
Transfers from State Oil Fund to state budget.....	9,000.0	9,905.0	11,350.0	9,337.0	8,130.0	7,615.0	6,100.0
Transfer from state budget to State Social Protection Fund.....	886.0	1,044.3	1,077.0	1,142.0	1,100.0	1,246.0	1,270.0
Transfer from state budget financed organisations to State Social Protection Fund.....	426.9	456.2	472.6	538.9	559.3	614.5	704.4
Transfer to Nakhchivan AR.....	252.7	258.1	277.7	283.7	297.7	282.4	278.9

Source: Ministry of Finance

<sup>(1)</sup> Approved 2017 budget.

## Revenues

The following table sets out information about the state budget revenues for the periods indicated:

<b>State Budget Revenues</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017<sup>(1)</sup></b>
<i>(AZN millions)</i>							
<b>From Tax Ministry</b> .....	<b>5,471.9</b>	<b>6,025.5</b>	<b>6,664.0</b>	<b>7,113.4</b>	<b>7,118.2</b>	<b>7,015.6</b>	<b>7,510.0</b>
Tax Revenues.....	5,052.3	5,404.7	5,894.0	6,540.3	6,652.3	6,174.7	7,118.0
<i>Direct Taxes</i> .....	3,117.4	3,340.7	3,536.6	3,635.2	3,618.5	3,423.9	3,991.0
Personal Income Tax.....	715.7	813.0	859.7	980.3	982.5	1,145.7	1,168.0
Corporate Profit Tax.....	2,134.0	2,252.0	2,374.8	2,302.5	2,211.1	1,983.2	2,179.0
Corporate Property Tax.....	103.9	105.1	125.1	141.3	148.2	174.7	178.0
Corporate Land Tax.....	35.3	30.6	33.1	35.4	48.7	50.3	50.0
Road Tax (for local persons).....	28.1	28.6	24.4	22.3	60.0	70.0	72.0
Simplified Tax (uniform tax for small business).....	100.4	111.4	119.5	153.4	168.0	303.8	344.0
<i>Indirect Taxes</i> .....	1,934.9	2,064.0	2,357.4	2,905.1	3,033.8	2,750.8	3,127.0
VAT.....	1,387.7	1,483.6	1,723.9	2,048.6	2,353.5	2,108.3	2,498.0
Excise (for domestic goods).....	417.4	454.6	512.0	740.3	564.2	532.2	518.0
Mining Tax.....	129.8	125.8	121.5	116.2	116.1	110.3	111.0
Non-Tax Revenues.....	419.6	620.8	770.0	573.1	465.9	537.2	392.0
Administrative Fees.....	106.8	103.4	123.6	111.1	94.7	105.7	105.0
Others.....	312.8	517.4	646.4	462.0	371.2	431.5	287.0
<b>From Customs Committee</b> .....	<b>1,141.5</b>	<b>1,208.3</b>	<b>1,383.2</b>	<b>1,510.8</b>	<b>1,592.0</b>	<b>2,291.6</b>	<b>2,200.0</b>
Tax Revenues.....	909.1	977.8	1,085.0	1,144.9	1,204.6	1,691.4	1,746.0
VAT.....	834.7	883.4	986.1	1,071.0	1,101.2	1,515.3	1,639.0
Excise.....	62.2	76.9	81.3	57.0	83.6	92.9	90.0
Road Tax (for foreign).....	12.2	17.5	17.6	16.9	19.8	83.2	17.0
Non-Tax Revenues: Customs Duty.....	232.5	230.6	298.2	365.9	387.4	600.2	454.0
<b>Other Revenues of State Budget</b> .....	<b>9,087.3</b>	<b>10,047.7</b>	<b>11,449.1</b>	<b>9,776.4</b>	<b>8,787.8</b>	<b>8,192.0</b>	<b>6,545.0</b>
Official Transfers principally from SOFAZ.....	9,000.0	9,905.0	11,350.0	9,337.0	8,130.0	7,615.0	6,100.0
State Property Incomes.....	5.1	5.2	6.5	7.3	7.6	7.6	8.0
Budget financed.....	0	0.0	0	207.3	202.2	239.1	353.0
Others.....	82.2	137.5	92.6	224.8	448.0	330.3	84.0
<b>Total Revenues of State Budget</b> .....	<b>15,700.7</b>	<b>17,281.5</b>	<b>19,496.3</b>	<b>18,400.6</b>	<b>17,498.0</b>	<b>17,499.1</b>	<b>16,255.0</b>

Source: Ministry of Finance

<sup>(1)</sup> Approved 2017 budget.

The Government's principal sources of revenues are taxes, in particular corporate profit tax and VAT, and transfers from state entities such as SOFAZ.

Total revenues have grown from AZN 11.4 billion in 2010 to AZN 17.5 billion in 2016. Revenues experienced year on year growth in each year from 2010 to 2014 and declined in 2015. Transfers to the state budget, principally from SOFAZ, increased from AZN 5.9 billion in 2010 to AZN 17.7 billion in 2016. An Action Plan on coordination of preparation, execution and control of state budget and extra budgetary state funds adopted by the Cabinet of Ministers in 12 July 2004 regulates the transfers from extra budgetary funds to and from the State Budget.

## Expenditure

The following table sets out information about state budget expenditure for the periods indicated:

State Budget Expenditure	2011	2012	2013	2014	2015	2016	2017 <sup>(1)</sup>
<b>Total Budget Expenditure (AZN millions)</b> .....	<b>15,397.5</b>	<b>17,416.5</b>	<b>19,143.5</b>	<b>18,708.9</b>	<b>17,784.5</b>	<b>17,743.6</b>	<b>16,900.0</b>
Share in GDP (%).....	29.56	31.81	32.9	31.71	32.7	29.4	27.5
Budget Expenditure per capita (AZN millions).....	2,111.1	2,369.4	2,574.9	2,484.4	1,832.4	1,840.9	1,737.5
<b>Budget Expenditure in functional classification (AZN millions)</b>							
General Public Services.....	1,071.9	1,027.0	1,635.3	1,425.5	1,773.1	2,904.4	2,846.9
Defence.....	1,345.3	1,400.7	1,485.0	1,516.1	1,700.8	2,192.7	2,642.1
Law-enforcement <sup>(2)</sup> .....	710.3	929.2	1,049.3	1,103.6	1,105.7	1,117.1	1,211.6
Education.....	1,268.5	1,453.2	1,437.7	1,553.9	1,605.1	1,754.4	1,736.1
Health.....	493.4	609.4	618.9	665.3	708.2	702.5	745.4
Social Protection.....	1,495.4	1,769.6	1,750.3	1,971.2	1,857.2	2,645.3	2,253.0
Culture and Sport <sup>(3)</sup> .....	189.8	240.8	274.9	294.0	272.4	687.4	282.6
Housing and Community Amenities.....	312.3	437.9	398.3	417.1	395.9	416.9	304.2
Fuel and Energy Complex.....	0.0	0.0	2.4	2.1	4.0	5.8	3.5
Agriculture, Forestry and Fishing.....	444.7	468.2	487.9	504.8	547.6	585.4	517.4
Industry and Construction <sup>(4)</sup> .....	5,866.3	5,783.7	6,932.7	6,278.5	5,002.5	2,707.1	2,521.1
Transport and Communication.....	61.6	85.4	110.5	88.2	119.4	89.1	101.8
Other Economic Activity.....	118.3	185.5	275.8	308.0	339.4	319.8	191.5
Other.....	2,019.7	3,025.9	2,684.5	2,580.7	2,353.2	1,615.7	1,542.8
<b>Surplus/(deficit) in AZN million</b> .....	<b>303.2</b>	<b>(135.0)</b>	<b>352.8</b>	<b>308.4</b>	<b>(286.5)</b>	<b>(244.5)</b>	<b>(645.0)</b>
Share in GDP (%).....	0.58	(0.25)	0.61	0.52	(0.53)	(0.40)	(1.05)
<b>Financing of Deficit (AZN million)</b> .....	<b>83.1</b>	<b>210.4</b>	<b>165.4</b>	<b>1,992.8</b>	<b>286.5</b>	<b>1,111.5</b>	<b>645.0</b>
External and domestic issuance.....	(109.2)	45.3	(43.0)	1000.2	(37.6)	186.8	0.0
grants.....	0.0	12.0	0.0	0.0	14.6	12.3	20.0
Non-budget revenues of state budget financed organisations.....	135.9	118.0	173.1	0.0	0.0	0.0	0.0
Privatisation.....	56.4	35.1	35.3	32.2	24.1	31.2	200.0
Others.....	0.0	0.0	0.0	960.4	285.4	881.1	425.0

Source: Ministry of Finance

<sup>(1)</sup> Approved 2017 budget.

<sup>(2)</sup> Court, security, law-enforcement, prosecutor expenditures.

<sup>(3)</sup> Culture, art, information and sport expenditures.

<sup>(4)</sup> Includes public capital investment.

In 2016, the Government's largest areas of spending were (i) general public services, which accounted for 16.4% of expenditures; (ii) industry and construction expenditures, which accounted for 15.3% of expenditures; (iii) social protection which accounted for 15.0% of expenditures; (iv) defence which accounted for 12.4% of expenditures. Social protection includes retirement, survivor and disability pensions, unemployment payments and the costs associated with the social costs of the Nargorno-Karabakh refugees and internally displaced persons from the conflict.

## Taxation

The Azerbaijan taxation system is governed by the Tax Code (see "*The Republic of Azerbaijan – Constitution and Political System – Legislation and regulatory development*"). The tax system consists of state taxes, taxes of the autonomous republic and local (municipal) taxes. The principal taxes forming the state budget revenues are personal income tax, corporate profit tax, value added tax, simplified tax and excise tax.



The Government is methodically introducing measures aimed at the increase of non-oil revenues as a proportion of state budget revenues, which can be seen from the forecasts of the 2016 State Budget.

### ***Personal Income Tax***

Since 2001, personal income tax rates have been changed from a five tiered progressive tax rate system (12.0, 20.0, 25.0, 30.0 and 35.0%) to a system with only two levels: 14.0% for individuals with taxable monthly income below AZN 2,500 and 25.0% of the portion of taxable income above AZN 2,500 plus AZN 350 for individuals with taxable monthly income above AZN 2,500.

### ***Corporate Income Tax***

Over the last 20 years, the rate of corporate income tax has been decreased significantly. After Azerbaijan gained its independence, Milli Majlis has made a number of amendments to Azerbaijan's tax laws with the aim of increasing tax compliance and establishing an internationally competitive investment environment. The rate of corporate profit tax currently stands at 20.0%, down from 35% in 1992.

Dividends paid by resident enterprises are subject to tax at the source of payment, at a rate of 10.0%. If dividends have been taxed at 10.0% prior to being received by beneficial owners, then that dividend income is not be subject to additional income tax.

### ***Value Added Tax (VAT)***

In general, except for some specific exclusions (such as agricultural production), all business activity in Azerbaijan is subject to VAT. VAT is currently set at 18.0% and has been at this level since 2000. From 1992 to 2000, VAT was set at the rate of 20.0%.

VAT is levied on most goods sold in, or imported into, Azerbaijan, as well as on services rendered and works undertaken in Azerbaijan. The Government intends to further reform regulations related to the VAT taxable base.

### ***Simplified Tax***

Legal and physical persons whose annual turnover does not exceed AZN 200,000 can benefit from the simplified tax payment regime and not pay VAT. The taxable base for the simplified tax is the gross revenue obtained for goods (works, services etc.) and property provided by the taxpayer, as well as non-sales related incomes within the reporting period. The simplified tax is payable at the rate of 4.0% in Baku and 2.0% in other cities and regions of Azerbaijan, generally. Certain activities (e.g. baby-sitting, photography and gardening) are subject to a fixed simplified tax ranging from 5 AZN to 30 AZN per month or ranging from 0.5 AZN to 45 AZN per transaction multiplied by a rate specified by geographical location. Different simplified tax rates are applied to the carriage of passengers and cargo depending on various factors (e.g. destinations, number of seats).

### ***Excise duties***

Excise rates vary depending on the good produced or imported. Currently, excise tax is levied on all types of alcoholic beverages, tobacco products, oil products, imported fur and leather products, imported platinum, gold, jewellery and other items made thereof, processed, sorted, framed and fixed diamonds, light vehicles (excluding specially appointed motor vehicles with special signs and equipment), leisure and sports yachts and other luxury transport vehicles at varying rates (according to the size of the engine, year etc.). Excise tax for cars, recreational or sport yachts and other floating facilities has been increased pursuant to the recent amendments to the Tax Code.

### **State Oil Fund of the Republic of Azerbaijan**

SOFAZ was established in 1999 and has the following two main objectives:

- Ensuring intergenerational equality with regard to the country's oil wealth;
- Preservation of macroeconomic stability

SOFAZ is a legal entity separate from the Government or the CBA. SOFAZ's operation is guided by the Constitution and laws of Azerbaijan, Presidential Decrees and Resolutions and the SOFAZ Regulations. SOFAZ has a three-tier governance structure, with the President as its supreme governing and reporting authority. Its activities are overseen by a supervisory board and operational management is vested in the Executive Director. The supervisory board consists of representatives of both executive and legislative powers, including the Prime Minister and vice-speaker of the Parliament.

The major sources of income for SOFAZ include:

- Net revenues generated from the sale of the share of the Republic in hydrocarbons (excluding expenditures on transportation of hydrocarbons, customs clearance and banking costs, marketing, insurance and independent surveyor fees, as well as shareholder revenues of SOCAR from the investments in the projects where it is an investor, participant or a contracting party);
- bonuses paid by investors to SOCAR or the other authorised state bodies for signing or executing the oil and gas agreements;
- acreage payments to SOCAR or an authorised state body of the Republic for the use of the area contracted for oil and gas exploration and development;
- the share of the Republic from the dividends generated from the implementation of the oil and gas agreements; and revenues from profit sharing (excluding shareholder revenues of SOCAR from its investments in the projects where it is an investor, participant or a contracting party);
- revenues generated from oil and gas transported over the territory of the Republic by means of the Baku-Supsa pipeline, BTCP and SCP (excluding shareholder revenues of SOCAR from its investments in the projects where it is an investor, participant or a contracting party);
- revenues generated from the transfer of assets from investors to an authorised state body within the framework of oil and gas agreements;
- revenues generated from the placement, management, sale or other utilisation of the SOFAZ's assets (including financial assets and assets handed over by investors within the frames of oil and gas contracts) and asset revaluation;
- grant and other aid; and
- other revenues and inflows in accordance with legislation.

According to the Decree of the President No 287, dated 25 February 2014, SOFAZ is required to finance the 51% of shares held directly by the Republic in SGC. In addition to that, as per the decree, SOFAZ should ensure the financing of the shares that SGC acquired in the Projects via long-term investment in SGC. A resolution of State Commission dated 9 July 2014 established the mechanism of financing SGC through equity injections corresponding to SGC's forecasted obligations in the Projects. Subsequent resolutions of the State Commission further developed the existing mechanism by establishing that debt raising could be an alternative method of funding.

Until mid-2016, a certain portion of SOCAR's equity in SGC was financed through the revenues deriving from 10% shares owned by SOCAR's affiliates in Shah Deniz PSA and SCP, while the remaining portion was provided by the Ministry of Finance to SOCAR from the State Budget. SOCAR then injected funds via share capital in SGC. Starting from mid-2016, the revenues deriving from 10% shares owned by SOCAR's affiliates in Shah Deniz PSA and SCP have been used by these affiliates to cover a certain portion of capital expenditures and SOCAR has been funding its obligations to the Issuer solely using the proceeds provided by the Ministry of Finance to SOCAR from the State Budget. State shares in the Issuer are held by the Ministry of Economy.

In 2014, SOFAZ allocated US\$51 million for financing the state shares in the Issuer and transferred these funds to the Ministry of Economy, allowing the Ministry to make equity contributions. In 2015, SOFAZ provided US\$686 million to the Ministry of Economy designated for equity contributions to the Issuer. In accordance with the decree, SOFAZ has invested US\$2.517 billion as of 31 December 2015 for financing

the state's participation in the Projects. As of 31 December 2016, SOFAZ transferred to the Ministry of Economy US\$495.2 million designated for equity contributions to the Issuer.

For 2016, SOFAZ allocated AZN 2,355.3 million (and paid AZN 797.4 million) for financing the state shares in the Issuer and the Ministry of Finance has allocated AZN 1,995.8 million. For 2017, SOFAZ has allocated AZN 496.2 million for financing the state shares in the Issuer and the Ministry of Finance has allocated AZN 560 million.

### ***Financial Activities***

SOFAZ's assets stood at AZN 57.0 billion (US\$33 billion) as of 31 December 2016 having grown from AZN 18.2 billion (US\$22.8 billion) in 2010. From 2001 to 31 December 2016, AZN 110.9 billion (US\$130.8 billion) was received by SOFAZ and approximately AZN 3.95 billion of this amount was derived from investment income.

As of 31 December 2016, 80.0% of SOFAZ's assets comprised fixed income securities and money market instruments, 12.2% comprised equities, 4.4% comprised real estate, 3.4% comprised gold. Of the fixed income securities and money market instruments, 58.1% were corporate bonds (including 23.2% of fixed income investments in financial bonds), 16.0% were bonds of agencies and supranationals, 6.6% were short-term commercial papers, 6.5% were sovereign bonds and 8.0% were deposits and 4.7% were cash.

### ***Expenditure Directions***

Pursuant to the underlying objectives of SOFAZ, part of its assets are transferred to the State Budget and part are used to fund investment and social projects. In the period from 2001 to 31 December 2016, AZN 71.52 billion was transferred to the State Budget and AZN 7.76 billion was used to finance various investment and social projects. In the medium term, the Government plans that SOFAZ transfers will reduce year on year.

SOFAZ has been involved in financing of the following projects:

- Southern Gas Corridor project
- BTCP
- Improvement of social condition of refugees and displaced persons from the Nagorno-Karabakh conflict
- Baku-Tbilisi-Kars railway
- Oguz-Qabala-Baku water pipeline
- Samur-Absheron irrigation system
- "STAR" Oil Refinery Complex
- Education of Azeri youth abroad
- Statutory capital of AIC
- SOCAR participation shares in Azeri-Chirag-Guneshli project

### ***Investment Policy***

SOFAZ's investment and risk management policies are approved annually by the President and are overseen by the Supervisory Board. The major underlying principle of SOFAZ's investment strategy is to implement a conservative policy aimed at maximising returns while minimising the probability of substantial losses.

SOFAZ invests only in overseas assets. According to its current investment policy, approximately 70% of its assets should be held in debt obligations and money market instruments (with maximum lower deviation of 5%) with the remainder in equities (up to 15% according to its current investment policy),

real estate (up to 10% according to its current investment policy with maximum upper deviation of 2%) and gold (up to 5% according to its current investment policy with maximum upper deviation of 3%).

SOFAZ has invested approximately US\$6.5 billion in the US, including in the US Treasury as well as in US corporate debt and equities. As of 31 December 2016, approximately 8.5% of SOFAZ's total assets were managed by four external managers: Deutsche Asset & Wealth Management, International Bank for Reconstruction and Development, UBS Global Asset Management and State Street Global Advisors.

As of 31 December 2016, 52.5% of SOFAZ's assets have been invested in assets denominated in US dollars; 34.3% in assets denominated in Euros; 4.8% in assets denominated in GBP and 8.4% in assets denominated in currencies of Russia, Turkey and countries with the long-term country ratings of not less than the credit ratings A (S&P, Fitch) or A2 (Moody's).

### ***Reporting System***

SOFAZ's financial activities are regularly audited by a reputable international firm of auditors and may also be examined by the Chamber of Accounts, established by Milli Majlis. Information and press releases, as well as quarterly and annual statements on SOFAZ's revenues and expenditures are regularly published in the local press and posted on SOFAZ's web-site both in Azerbaijani and English.

### ***Extractive Industries Transparency Initiative ("EITI")***

EITI is a global standard ensuring transparency and accountability of payments/allocations made by extractive industry companies to government and payments/allocations received by the governments of resource-rich countries. EITI was launched at the World Summit for Sustainable Development in 2002 in Johannesburg.

SOFAZ is closely involved in the EITI implementation in the country. The Government declared its willingness to join EITI and support the international efforts for higher transparency in the extractive industries at the EITI Lancaster House Conference on 17 June 2003.

On 15 March 2005, Azerbaijan published its first EITI report, thus initiating the practical implementation of EITI principles. Since then, the Government has published 20 EITI reports. The reports have been disclosed on the EITI Azerbaijan's website and the Fund's website.

SOFAZ was a winner of the 2007 UN Public Service Award in the category of "Improving transparency, accountability and responsiveness in the Public Service" for the successful implementation of the EITI. SOFAZ is the first governmental agency in Eastern Europe and CIS to win this award.

Azerbaijan participates actively in the EITI and has shown its support by initiating and tabling a UN General Assembly Resolution on EITI, which was unanimously adopted in 2008.

Azerbaijan is the first ever country to complete Validation, the EITI's quality assurance process which verifies compliance with EITI principles and criteria. The EITI Board designated Azerbaijan as the first EITI Compliant country at the 4th EITI International Conference in 2009 in Doha.

Azerbaijan was also awarded the "EITI Award 2009" for its commitment to EITI principles and criteria and its achievements in EITI implementation.

Azerbaijan was elected as an EITI International Board member in 2006, 2009, 2011 and 2013 at the International EITI Conferences. The Executive Director of SOFAZ represented Azerbaijan in the EITI Board from its establishment in 2006 until the last Board election in 2016, which took place at the recent EITI Global Conference on 24 and 25 February 2016 in Lima, Peru.

In accordance with the Validation held in January 2015, the EITI International Board decided to downgrade Azerbaijan from "compliant" to "candidate" status at the EITI International Board meeting held in Brazzaville, Congo in April 2015 and assigned certain corrective actions that needed to be fulfilled by Azerbaijan. The implementation of the plan of corrective actions assigned to Azerbaijan was assessed at the following Validation, which was held in July 2016. As a result of the actions that were undertaken by the Government during the period following the first Validation, Azerbaijan achieved noticeable progress in solving the issues flagged by the EITI International Board.

The EITI International Board decided to maintain Azerbaijan's "candidate" status at its meeting in October 2016 in Astana, Kazakhstan. The EITI International Board agreed that Azerbaijan had made meaningful progress in implementing the 2016 EITI Standard, with considerable improvements across several individual requirements compared to the first Validation in 2015. The EITI International Board proposed a number of new corrective actions which were evaluated in accordance with the EITI Standard at the EITI International Board meeting in Bogota, Colombia in March 2017. These corrective actions require the government to take further steps to ensure satisfactory progress with the requirements related to civil society engagement. This includes legal and regulatory amendments eliminating the need for civil society institutions to obtain an extract every two years confirming their registration, requirement to register grants with the Ministry of Justice and the need for foreign donors to register individual grants with the authorities and obtain an opinion on the purposefulness of the grant.

The EITI International Board also set out other corrective actions to be assessed in the next Validation process, which is scheduled to commence in July 2017.

The Government has taken several important steps to ensure that the legal and operational environment exists for civil society institutions to be substantively involved in the EITI process. The decree signed by the President dated 21 October 2016 (ahead of the EITI International Board's 2016 meeting in Astana) on the Application of the "one-stop-shop" Principle in the Procedure of Provision of Grants by Foreign Donors on the Territory of Azerbaijan Republic (the "**Decree**") was a starting point of important steps in this regard. For the purposes of supporting the activities of civil society institutions in Azerbaijan, facilitating the issuance of grants by foreign donors in Azerbaijan and ensuring transparency in this field and the effectual direction of allocated funds, it was decided by the Decree that starting from 1 January 2017, the "one-stop shop" principle will apply to the procedure for the issuance of grants by foreign donors to NGOs in Azerbaijan.

The Decree was followed by important measures by the Cabinet of Ministers of the Republic of Azerbaijan to ease grant registration process, including an amendment dated 11 January 2017 ("On amendments of the Procedure for registry of grant agreements (decisions) approved by the decision number 216 of the Cabinet of Ministers of the Republic of Azerbaijan dated 5 June 2015") and an amendment dated 24 January 2017 ("On amendments of the Procedure for Foreign Donors to Obtain the Right for Provision of Grants in the Territory of the Republic of Azerbaijan approved by the decision number 339 of the Cabinet of Ministers of the Republic of Azerbaijan dated 22 October 2015.").

These amendments have noticeably eased the registration process of grants by foreign donors. The main changes to the process are as follows:

- The elimination of the requirement on the involvement of foreign donors in the registration processes;
- The elimination of the requirement to obtain a permit to provide grants prior to signing an agreement with a donor to have a grant registered;
- The elimination of the requirement of foreign donors obtaining an opinion on purposefulness of the grant from the Ministry of Finance. According to the new "one-stop shop" principle, either the donor or the recipient must contact the Ministry of Justice and submit all necessary documents to this Ministry;
- The elimination of many bureaucratic requirements which could create artificial obstacles and delay the registration process. There is no longer a requirement to either notarise the translation (into Azerbaijani) of documents written in a foreign language or submit additional papers on a project's program or budget;
- The deadline for submission of the documents for registration of agreement from signing day has been extended from 15 to 30 days and the documents that prove the legal status of the entities are not required to be submitted;
- Branches of NGOs do not have to submit financial reports to the Ministry of Finance, which will instead be submitted to the Ministry of Justice; and
- The volume of information required in the registration documents has been reduced.

On 9 March 2017, the EITI Board decided that whilst Azerbaijan had taken further steps to meet the EITI Standard, it has not fully met the corrective actions related to civil society matters prescribed by the Board in October 2016. As a result, Azerbaijan's membership in EITI was suspended.

## PUBLIC DEBT

### Overview

The Ministry of Finance classifies public debt as "domestic" or "external" according to two criteria: place of issue and residency. In relation to the former, all instruments issued for the domestic market, regardless of the status of their holder (domestic or foreign) are classified as "domestic debt". In relation to the latter, all instruments, regardless of the market they are issued for are classified as either "external" or "domestic" according to the residency status of the holder.

As 31 December 2016, total public debt amounted to US\$7,607.8 million, of which 90.9% or US\$6,913.2 million was external debt, and US\$694.6 million was the domestic debt.

Most of the recent increase in public debt can be attributed to increases in domestic debt in the form of an increased number of state guarantees. These were temporary measures to provide assistance to some key public enterprises that faced liquidity problems following the global financial crisis.

Public debt does not include the debt of state owned enterprises. However, public debt does include a portion of sovereign guaranteed debt of state owned enterprises (including the Notes offered hereby), determined on a risk weighted basis.

The following table sets forth certain key statistics with regard to Public Debt for the periods 2011-2016:

Public Debt	As of and for the year ended 31 December					
	2011	2012	2013	2014	2015	2016
Public debt (US\$ million).....	7,431.8	9,589.0	9,378.7	8,402.0	9,869.3	7,607.8
Domestic Public Debt.....	2,615.1	3,880.6	3,319.8	1,923.8	2,975.0	694.6
External Public Debt.....	4,816.7	5,708.4	6,058.9	6,478.2	6,894.3	6,913.2
Principal Payments (US\$ million).....	918.8	620.4	1,569.6	472.5	433.4	664.6
Domestic Public Debt.....	612.0	290.1	855.3	113.6	51.6	95.3
External Public Debt.....	306.8	330.3	714.3	358.9	381.9	569.3
Interest Payments (US\$ million).....	187.5	171.5	165.3	131.8	144.7	165.1
Domestic Public Debt.....	114.4	74.1	70.6	33.0	19.7	15.2
External Public Debt.....	73.1	97.4	94.7	98.8	125.0	149.9
Total Public Debt Service (US\$ million).....	1,106.3	791.9	1,734.9	604.3	578.1	829.7
Domestic Public Debt Service..	726.4	364.2	925.9	146.6	71.2	110.5
External Public Debt Service...	379.9	427.7	809.0	457.7	506.9	719.2
Total Public Debt/GDP <sup>(1)</sup> (%)..	11.3	13.8	12.7	11.2	28.3 <sup>(2)</sup>	22.3 <sup>(3)</sup>
Domestic Public Debt /GDP....	4.0	5.6	4.5	2.6	8.5	2.0
External Public Debt/GDP .....	7.3	8.2	8.2	8.6	19.8	20.3
Total Public Debt/Budget Revenue (%) .....	37.4	43.6	37.7	35.8	58.1	77.0
Total Public Debt Service/Budget Revenue (%) ..	5.6	3.6	7.0	2.6	3.4	8.4
External Public Debt Service/Exports (%).....	1.1	1.4	2.7	1.4	3.1	5.5

Source: Ministry of Finance

<sup>(1)</sup> Public debt to GDP ratios were calculated using GDP in Manat.

<sup>(2)</sup> Public debt denominated in US dollars was converted to Manat at a rate of AZN 1.55 per US\$1.00.

<sup>(3)</sup> Public debt denominated in US dollars was converted to Manat at a rate of AZN 1.77 per US\$1.00.

The following table sets forth the contracted total public debt service for Azerbaijan for 2017 to 2024 as of 31 December 2016.

	2017	2018	2019	2020	2021	2022	2023	2024
	(US\$ million)							
Total public debt service .....	1,032.1	1,056.6	1,195.5	993.8	971.6	869.5	805.9	1,998.5
Principal .....	793.8	831.3	986.0	799.5	771.3	682.4	633.3	1,842.9
Interest .....	238.3	225.3	209.5	194.3	200.2	187.1	172.6	155.6

Source: Ministry of Finance

## Debt management

The Law "On the Public Debt", which was adopted and approved by Milli Majlis, has been improved and expanded in accordance with recommendations and proposals from various ministries and IMF experts. This law expands the authority of the Ministry of Finance in determining Azerbaijan's public debt policy, provides for measures to reduce the risks associated with increased public debt, establishes a debt repayment reserve fund as well as debt limits and changes the definitions of certain terminology related to public debt to conform to international standards.

The Public Debt Management Agency of the Ministry of Finance was established by the Order of the President dated 9 February 2009 (N<sup>o</sup> 48) and mandated to secure the implementation of any borrowing on behalf of the sovereign in accordance with the legislation, to implement issuance of public debt securities, to administer registry of public debt, state guarantees and debt of foreign countries to Azerbaijan, as well as manage assets of the state treasury.

## Domestic debt

The domestic debt of Azerbaijan comprises securities issued by Azerbaijan (T-bills and other obligations), rescheduled Government debt owed to the CBA, and state guaranteed debt. The State Budget Law contains a specific line item setting forth the ceiling for State domestic debt to be issued for each year.

The main components of public domestic debt are as followings:

- state bonds;
- state securities issued in the amount of written off principal debt of the CBA for centralised credit resources;
- securities issued for repayment of the amount of centralised credit resources borrowed from the CBA to cover the budget deficit in the period of 1992-1996; and
- state guaranteed loans.

The Ministry of Finance issues T-bills and T-notes with maturity from 35 days to one year with yields ranging from 7.0 to 20.0%.

The following table sets forth outstanding domestic public debt as of the dates indicated.

Domestic Public Debt	As of 31 December					
	2011	2012	2013	2014	2015	2016
	(AZN millions)					
Obligations to the CBA .....	123.8	117.7	104.7	91.7	78.7	65.7
Obligations under Promissory notes to the CBA .....	255.4	255.4	255.4	255.4	255.4	255.4
Obligations under Government T-Bills and Bonds .....	159.4	204.6	156.1	200.3	122.7	336.7
Obligations under Government Guarantee .....	1,518.2	2,468.6	2,088.2	961.6	4,182.4	572.3
<b>Total Domestic Public Debt ..</b>	<b>2,056.8</b>	<b>3,046.3</b>	<b>2,604.4</b>	<b>1,509.0</b>	<b>4,639.2</b>	<b>1,230.1</b>

Source: Ministry of Finance



<sup>(1)</sup> Includes highly risk weighted debt of state owned enterprises backed by a Government guarantee.

The following table sets forth the marketable Internal Public Debt securities (T-bills, T-notes and Government Bonds) outstanding for the periods indicated:

Marketable Domestic Public Debt Securities Outstanding by Maturity	As of 31 December					
	2011	2012	2013	2014	2015	2016
	(AZN millions)					
T-bills (1 month maturity) .....	0.0	0.0	0.00	0.65	0.0	0.0
T-bills (3 month maturity) .....	7.0	6.9	0.00	0.0	0.0	14.8
T-bills (6 month maturity) .....	8.7	1.0	0.00	0.0	0.0	90.0
Government bonds (1 year maturity).....	62.0	104.4	4.05	13.09	0.0	101.0
Government bonds (2 years maturity).....	4.8	9.3	13.10	14.40	2.0	0.0
Government bonds (3 years maturity).....	36.9	43.0	98.95	132.14	120.7	43.2
Government bonds (5 years maturity).....	40.0	40.0	40.00	40.0	0.0	0.0
<b>Total .....</b>	<b>159.4</b>	<b>204.6</b>	<b>156.10</b>	<b>200.28</b>	<b>122.7</b>	<b>249.0</b>

Source: Ministry of Finance

With the objective of mitigating the adverse impact of the 2008 financial crisis on Azerbaijan's economy, amendments were made to the Law "On the Central Bank of Azerbaijan Republic" adopted on 19 June 2009 authorising the CBA to finance economically important projects as well as to grant targeted sovereign guaranteed loans to banks and enterprises. As a result, some state enterprises were provided with targeted sovereign guaranteed loans by the CBA in the years between 2009 and 2012.

#### External state and state guaranteed debt

As of 31 December 2016, Azerbaijan had US\$6.9 billion of outstanding external state debt ("DESD"), which corresponds to approximately 20.4% of the country's GDP. These loans are primarily for the purpose of financing investment projects of Azerbaijan for the following sectors: infrastructure (60.8% of total DESD), industry (1.2% of total DESD), economy and finance (3.1% of total DESD), agriculture and amelioration (3.5% of total DESD), socio-cultural (1.9% of total DESD), deficit financing (25.3% of total DESD) and other sectors (4.1% of total DESD).

The following table sets out certain data regarding external state and state guaranteed debt as of the dates stated.

Outstanding External State and State Guaranteed Debt	As of 31 December					
	2011	2012	2013	2014	2015	2016
	(US\$ million)					
Medium and long-term debt ...	4,816.7	5,708.4	6,058.9	6,478.2	6,894.3	6,913.2
World Bank .....	1,271.7	1,638.5	1,647.2	1,825.9	2,014.1	2,130.9
Asian Development Bank ...	251.1	415.5	553.9	567.6	743.1	1,455.2
European Bank of Reconstruction and Development .....	270.5	239.5	212.2	69.8	59.9	86.0
Islamic Bank of Development .....	463.9	519.9	538.7	261.0	292.9	331.0
Japan International Cooperation Agency .....	575.0	659.8	575.5	57.9	94.9	151.3
Commercial banks.....	1,730.5	1,934.0	2,223.6	1,423.3	1,239.6	1,001.2
Eurobonds .....	0	0	0	1,250.0	1,250.0	1,250.0
Other.....	254.0	301.2	307.8	1,023.0	1,199.8	507.6
Short-term debt .....	0.0	0.0	0.0	0.0	0.0	0.0
<b>TOTAL .....</b>	<b>4,816.7</b>	<b>5,708.4</b>	<b>6,058.9</b>	<b>6,478.2</b>	<b>6,894.3</b>	<b>6,913.2</b>

Source: Ministry of Finance

The following table sets out the external state and state guaranteed debt by currency composition for the years stated:

External State and State Guaranteed Debt by Currency	As of 31 December											
	2011		2012		2013		2014		2015		2016	
	US\$ millions	% of total	US\$ millions	% of total	US\$ millions	% of total	US\$ millions	% of total	US\$ millions	% of total	US\$ millions	% of total
US\$.....	1,728.3	35.9	2,437.0	42.7	2,855.9	46.9	4,200.2	64.8	4,575.5	66.4	5,263.2	76.1
EUR.....	1,457.8	30.3	1,495.0	26.2	1,746.6	28.2	1,384.0	21.4	1,405.2	20.4	860.9	12.5
JPY.....	575.0	11.9	659.8	11.6	575.5	10.5	133.5	2.1	170.5	2.5	155.6	2.3
SDR.....	914.9	19.0	935.5	16.4	708.0	11.4	640.6	9.9	607.7	8.8	525.3	7.6
CHF.....	10.8	0.2	9.4	0.2	3.2	0.1	0	0	0	0	0.0	0
Other.....	129.9	2.7	171.7	3.0	169.7	2.9	119.9	1.8	135.4	1.9	108.2	1.5
<b>TOTAL.....</b>	<b>4,816.7</b>	<b>100.0</b>	<b>5,708.4</b>	<b>100.0</b>	<b>6,058.9</b>	<b>100.0</b>	<b>6,478.2</b>	<b>100.0</b>	<b>6,894.3</b>	<b>100.0</b>	<b>6,913.2</b>	<b>100</b>

Source: Ministry of Finance

The following table shows debt service for the external state and state guaranteed debt by type of creditor for the years stated:

External State and State Guaranteed Debt Service	As of 31 December					
	2011	2012	2013	2014	2015	2016
	(US\$ million)					
<b>World Bank</b>						
Principal (PR).....	11.6	26.3	341.3	104.5	121.5	149.8
Interest (IN).....	9.7	12.1	12.0	11.4	12.7	22.4
Total.....	21.3	38.4	353.3	115.9	134.2	172.2
<b>JIBC</b>						
PR.....	21.5	17.2	13.2	12.4	18.3	20.7
IN.....	3.4	3.3	2.6	3.2	3.8	4.1
Total.....	24.9	20.5	15.8	15.6	22.2	24.8
<b>IMF</b>						
PR.....	19.1	13.0	9.7	4.0	1.8	0.0
IN.....	0.2	0.0	0.0	0.0	0.0	0.0
Total.....	19.4	13.0	9.7	4.0	1.8	0.0
<b>EBRD</b>						
PR.....	30.9	30.06	30.0	30.4	30.7	32.5
IN.....	4.2	5.6	4.8	4.6	4.3	4.8
Total.....	35.1	35.6	34.8	35.0	35.0	37.3
<b>Others</b>						
PR.....	223.6	243.7	320.1	423.3	408.3	499.9
IN.....	55.6	76.4	75.3	107.8	132.0	171.0
<b>Total.....</b>	<b>279.2</b>	<b>320.1</b>	<b>395.4</b>	<b>531.1</b>	<b>540.3</b>	<b>670.9</b>
<b>Total PR.....</b>	<b>306.8</b>	<b>330.3</b>	<b>714.3</b>	<b>574.5</b>	<b>580.7</b>	<b>702.9</b>
<b>Total IN.....</b>	<b>73.1</b>	<b>97.4</b>	<b>94.7</b>	<b>127.1</b>	<b>152.8</b>	<b>202.3</b>
<b>GRAND TOTAL.....</b>	<b>379.9</b>	<b>427.7</b>	<b>809.0</b>	<b>701.6</b>	<b>733.5</b>	<b>905.2</b>

Source: Ministry of Finance

Increased debt servicing in 2013 was the result of a one-off principal repayment on the outstanding World Bank loans in the amount of US\$300 million, which was a condition to the Republic's qualification to an upper-middle income category and associated decision by the World Bank.

## **Cooperation with International Financial Institutions**

### ***World Bank Group***

Azerbaijan has been a member of the World Bank Group ("**WBG**") since 1992. The country is an active member of all five WBG institutions: the IBRD, the International Development Association ("**IDA**"), Multilateral Investment Guarantee Agency ("**MIGA**"), the International Financial Corporation ("**IFC**") and the International Centre for Settlement of Investment Disputes ("**ICSID**").

Since the beginning of the engagement, the WBG has provided financing for 50 projects in different sectors totalling over US\$3.78 billion of IDA credits, grants and IBRD loans. The WBG's portfolio currently consists of 9 active projects with total net commitment amount of approximately US\$1.9 billion. The disbursement ratio as of 31 December 2016 was 10.2%.

In addition to IDA/IBRD operations, the portfolio consists of two active trust fund projects for a total of US\$2.4 million, which support ongoing project preparation and implementation. These funds support Azerbaijan: Establishment of a Meta-Information System and the Swiss State Secretariat for Economic Affairs Trust Fund for Azerbaijan-Financial Sector Modernization.

The new Country Partnership Framework 2015-2020 ("**CPF**") for Azerbaijan was endorsed by the WBG's Board of Executive Directors on 21 July 2015. The CPF is a joint strategy aimed at supporting Azerbaijan on its path toward sustainable, inclusive and private sector-led growth. The CPF is underpinned by the Systematic Country diagnostics ("**SCD**") for Azerbaijan, the WBG's comprehensive analysis of the country's economic conditions, challenges and constraints in the short and longer term. The CPF will help address a selected set of those constraints. The CPF is also aligned with Azerbaijan's own development priorities and the WBG's global goals of reducing poverty and boosting shared prosperity. Focusing on two areas of public sector management and service delivery and economic competitiveness, the WBG will assist Azerbaijan strengthen public resource management, facilitate selected infrastructure networks, increase Azerbaijan's financial inclusion, reduce the regulatory burden on the private sector and support economic activities in rural areas. The Analytical and Advisory program will focus on the potential for shared prosperity and equitable growth in resource-rich Azerbaijan.

### ***International Finance Corporation***

As the private sector arm of the WBG, the IFC plays a critical role in supporting the diversification agenda in Azerbaijan. Azerbaijan became a member of the IFC in 1995. IFC's initial engagement started during early stages of oil and gas development projects in early 2000s, where it provided significant financing for development ACG oilfield in Caspian. IFC also provided US\$125 million direct funding and an additional US\$125 million mobilisation from other lenders in supporting the BTCP that runs more than 1700 km from the shore of the Caspian Sea to the port of Ceyhan in the Mediterranean Sea in Turkey.

Over time IFC's strategic focus has shifted towards supporting development of the non-oil private sector. This strategy involves (i) promoting competition in the banking sector, establishing joint ventures in the non-banking financial sector, technical assistance to private local banks for institutional capacity building; (ii) improving access to finance; (iii) supporting SME financing by providing credit lines to local private banks for onward lending; (iv) enhancing the business climate and reducing impediments to foreign investments; (v) supporting agri-business and food-processing; and (vi) creating conditions for public private partnerships. IFC's current focus is on supporting the economic competitiveness agenda of the WBG's CPF.

In addition to investment programs, IFC's advisory services are equally important for the development of the private sector. IFC implements advisory programs to increase resource efficiency, improve the business climate and strengthen financial markets. In recent years advisory services have focused on building a strong financial markets infrastructure to support private sector and SME growth. Other program highlights include a leasing development project, an SME linkages program, corporate governance projects, as well as planned programs aimed at developing the housing finance market and improving the business enabling environment.

Approximately half of IFC's total investments in Azerbaijan have been channelled through financial intermediaries, including banks and microfinance organisations. IFC has prioritised increased access to finance for SMEs and women entrepreneurs.

As of 31 December 2016, IFC had invested more than US\$473 million in 56 long-term projects in the financial services, infrastructure and manufacturing sectors, of which US\$73 million was mobilised from other lenders. IFC has also supported trade worth approximately US\$80 million through its trade finance program and implemented advisory projects aimed at encouraging private sector growth.

SOFAZ is the second largest investor in the IFC Asset Management Company. SOFAZ has committed US\$350 million to three funds managed by the IFC Asset Management Company: (i) the IFC Global Infrastructure Fund, which invests alongside IFC in equity and equity-related investments in the infrastructure sector in emerging markets; (ii) the IFC Catalyst Fund, which invests in funds that provide growth capital to companies developing innovative ways to address climate change in emerging markets; (iii) and the IFC African, Latin American and Caribbean Fund, which invests alongside IFC in equity and equity-related investments across a range of sectors in Sub-Saharan Africa, Latin America and the Caribbean. While the arrangement allows Azerbaijan to support fellow nations in the developing world, it also enables SOFAZ to further diversify its portfolio.

### *IMF*

Azerbaijan became an IMF member in September 1992. Its first use of IMF financing started with a SDR 58.5 million program under the Systemic Transformation Facility. Early programs in the mid-1990s focused on macroeconomic stabilisation and first generation structural reforms. Over the years up to 2005, IMF provided an additional SDR 290.0 million in financing, mostly through the Enhanced Structural Adjustment Facility and Extended Credit Facility to support economic programmes aimed at moving toward a stable and sustainable macroeconomic position. Azerbaijan has since repaid all its IMF loans and has no outstanding financial obligations to the IMF. The current quota is SDR 391.7 million.

The IMF has been active in providing technical assistance to the Government in building national institutions and developing technical capacity. The IMF has provided technical assistance in wide range of fields, including public debt and expenditure management, fiscal and tax policy and management, banking, monetary policy and statistics.

The consultation on Article IV of the IMF's Articles of Agreement was concluded in May 2014. The IMF Board of Directors welcomed the Government's new gas sector agreements, which will transform Azerbaijan into a strategic gas supplier for the European market, and the successful Eurobond debut, issued amid market turbulence in the region and reflects investor confidence in the prudent management of the oil revenues as reflected in the large buffers and macroeconomic stability. The most recent press release following the IMF staff visit in June 2015 supported the Government's plan to adjust fiscal spending to the new reality of substantially lower oil prices.

A staff team from the IMF visited Baku during 28 January 2016 until 3 February 2016 on a fact-finding visit and to discuss areas of technical assistance cooperation. On 3 February 2016, the IMF issued a press release supporting the Government's intention to further reduce public investment to more sustainable levels in 2016, with a greater focus on project efficiency. The Government and IMF staff have agreed to maintain a close policy dialogue and to increase technical assistance support.

In May 2016, an IMF team visited Baku to hold discussions in the context of the 2016 Article IV Consultation. On 9 September 2016, the IMF concluded the Article IV Consultation with Azerbaijan. In their press release dated 14 September 2016, the IMF stated that Azerbaijan's near-term economic prospects remain weak and that the difficult external environment could hamper macroeconomic outcomes in the near future. The IMF also stressed the need to institute reforms to secure macroeconomic and financial stability and promote a diversified and private sector-led economy. In addition, the IMF recommended reducing tax exemptions and strengthening tax administration, implementing pension reform plans, improving monetary transmission and the functioning of the foreign exchange market and closely monitoring the banking system.

A staff team from the IMF visited Baku between 27 February 2017 until 3 March 2017 on a fact-finding mission, which included meetings with the Ministry of Finance, the CBA, the FIMSA and others. The

aim of the visit was to assess the macroeconomic policy outlook for 2017, as well as to focus on the new monetary and exchange rate policy framework.

The next Article IV discussions are scheduled for the end of 2017.

### ***EBRD***

Azerbaijan joined the EBRD in September 1992. As of 31 December 2016, the EBRD had 56 active investments in Azerbaijan, totalling €939 million, of which 68% of EBRD investments are in the private sector.

Azerbaijan's cooperation with EBRD is focused on the following strategic priorities: non-oil private sector development, financial sector, infrastructure, natural resources and support for small and medium size enterprises.

### ***Asian Development Bank***

Azerbaijan joined the Asian Development Bank ("**ADB**") in December 1999 and a liaison office was established in Baku in early 2002. In 2004, a full Representative Office was set up and an active programme was initiated. ADB's operations in Azerbaijan are undertaken in line with the Government's own development strategies to reduce poverty and promote sustainable and inclusive economic growth.

ADB financing is primarily focused on infrastructure projects that are implemented jointly with the Government. These projects are predominantly in the areas of water and sanitation, energy and transport.

ADB also provides significant support to private sector activity, predominantly in the development of the financial sector.

Azerbaijan has received 28 loans and one grant project totalling US\$3.1 billion, 35 technical assistance projects valued at approximately US\$22.6 million and nine private sector transactions worth approximately US\$738 million to support its development programmes.

### ***Islamic Development Bank***

Azerbaijan joined the Islamic Development Bank ("**IDB**") in 1992. IDB's activities in Azerbaijan have been targeted at improving agriculture development, power generation, road construction, environmental protection and projects aimed at improving living conditions of refugees and internally displaced persons. The IDB also participates in the development of the private sector in Azerbaijan.

Since 1992, a total of 70 projects were approved by the IDB Group amounting to US\$1.39 billion. These include 36 projects from IDB ordinary funds totalling US\$1.17 billion, 16 projects from Islamic Corporation for Development of Private Sector totalling US\$123.8 million, 13 projects from Islamic Trade Finance Corporation totalling US\$82 million and 4 projects from Special Assistance resources totalling US\$2 million.

## REGULATION OF THE HYDROCARBONS SECTOR IN AZERBAIJAN

### General

Regulation of the hydrocarbons sector in Azerbaijan, in particular in respect of the Issuer and its Operating Companies is developing. See "*Risk Factors—Risk Factors Relating to the Issuer's Business—The regulatory regime in Azerbaijan is underdeveloped*" and "*Relationship with the Government*".

### Licensing Requirements in the Hydrocarbons Sector

#### *Special Permits and Consents*

The Law on Energy of 24 November 1998 (the "**Energy Law**") requires that an individual or legal entity wishing to engage in the exploration, exploitation, production, processing, storage, transportation, distribution or use of energy raw materials and products, including, *inter alia*, oil and natural gas, must obtain a permit and enter into an energy contract with the Ministry of Energy of the Republic. Pursuant to the Subsoil Law, local and foreign legal entities and individuals are allowed to use subsoil resources only in accordance with the terms and conditions of a special permit or consent issued to such entities by Government authorities.

Pursuant to Presidential Decree N° 713 "On Some Measures in the Area of Licensing" dated 21 December 2015, certain activities are subject to Government licensing including the installation and operation of facilities for liquid and natural gas, mining and drilling works and the transportation of dangerous goods.

Presidential Decree N° 310 "On Measures for Improving Issuance of Special Consents (Licences) for Certain Business Activities in Republic of Azerbaijan" of 28 March 2000 purports to exempt entities established by a Presidential Decree and financed from the state budget and other entities as may be specified by law from certain licensing requirements. Certain activities, such as gas production and processing, are reserved to state enterprises or joint-stock companies with the controlling stake belonging to the Republic.

The Law "On the List of Goods with Limited Circulation" of 23 December 2003 limits ownership of certain equipment principally used in and for the production and processing of oil, oil products and natural gas to certain persons who have obtained a special permit from the Ministry of Energy. Pursuant to Presidential Decree N° 292 "On Additional Measures for Regulation of Circulation of Goods with Limited Circulation" of 12 September 2005 ("**Decree 292**"), a special permit for the circulation of goods may also be issued to state-owned enterprises and joint-stock companies in which the state is a controlling shareholder, in certain circumstances which are not specified in either the aforementioned law or Decree 292. As a result, these provisions are subject to interpretation and a practice in respect thereof has not yet been established. There is also doubt as to whether such permits are required for state-owned enterprises and joint-stock companies controlled by the Government.

#### *Other Consents*

The Law on Natural Monopolies of 15 December 1998 (the "**Monopolies Law**") governs relations among natural monopolies, consumers and Government authorities in relevant commodity markets. The Monopolies Law applies, *inter alia*, to entities, such as the Issuer and its Operating Companies, to the extent they are engaged in pipeline transportation of oil and natural gas, as well as to entities engaged in the storage and distribution of natural gas. The Monopolies Law grants the regulator, the State Service for Antimonopoly Policy and Protection of Consumers' Rights of the Ministry of Economy, the powers to limit the power of monopolies by controlling prices, requiring mandatory service to customers, setting minimum volumes and limiting the volumes of production or sales. In addition, the regulator can limit the extension of monopolies into other industries by requiring companies subject to the Monopolies Law to request a consent prior to engaging in certain classes of transactions, including the acquisition of certain property rights over fixed assets exceeding certain value and intended for the production of goods not otherwise regulated by the Monopolies Law and investments in other activities and industries.

### PSAs

The exploration and production of oil and gas in Azerbaijan by entities other than SOCAR is conducted almost exclusively under PSAs concluded between private entities and SOCAR. Azerbaijani law does not regulate the procedure for entering into PSAs or set any requirements for the content of PSAs. However,

in practice, all PSAs follow in general the same form, including provisions on the minimum obligatory work programme of contractors, project management, the duties of the operating company, personnel and training, use of land and facilities, taxation, production and sharing of petroleum, valuation of petroleum and natural gas and environmental protection, among other things. Upon conclusion, PSAs are ratified by the Parliament of the Republic and given the force of law prevailing over any conflicting provisions of current and future Azerbaijani law. In general, PSAs provide a favourable regime for contractors and sub-contractors allowing exemption from certain taxes and customs duties.

### ***Allocation of Costs and Profits***

Parties to a PSA are responsible for funding their participating interest share of costs related to operations in the contract area. The parties to a PSA agree to recover costs and participate in profits on a conventional production sharing basis.

Production is divided into "cost recovery" production and "profit" production. The general formula is that the parties recover Operating Costs and part of Capital Costs (each, as defined below) out of a portion of production based on price, net of transportation costs, which is the cost recovery portion, and the remaining portion of production, the profit portion, is shared between the parties. The allocation of the profit portion amongst the various parties to a PSA, including the Issuer and the Republic, varies according to, among other things, transportation costs and the parties' cumulative, after-tax real rate of return.

The amount of the cost recovery portion attributable to the parties' direct and indirect operating costs ("**Operating Costs**") and capital costs ("**Capital Costs**") is determined on a quarterly basis.

For purposes of determining how profit production will be shared, the parties' cumulative rate of return is calculated on the basis of net cash flow, which is defined as total income from sales (adjusted for transportation costs) less the sum of all Operating Costs and part of Capital Costs, and profit taxes paid under the PSA.

### ***Governance***

All the parties to a PSA, except for SOCAR, are referred to as "**Contractor Parties**". Pursuant to the relevant PSA, the Contractor Parties and SOCAR form a Steering Committee ("**Steering Committee**") comprised of representatives of the Contractor Parties and an equal number of representatives of SOCAR. Each Steering Committee is charged with, among other things, oversight of operations and approval of annual work programmes and budgets. The Contractor Parties, as a group, for the relevant PSA and SOCAR are each entitled to one vote for decisions taken by the Steering Committee. All decisions of the Steering Committee require a unanimous vote. Deadlocked decisions, if not mutually resolved, are referred to arbitration. Each Steering Committee meets at least twice each year.

Operations are managed through annual work programmes and approved budgets, which must be submitted to a Steering Committee by the Contractor Parties at least three months prior to the beginning of each calendar year. The Annual Work Programmes and Budgets are subject to approval by the Steering Committee, failing which they are submitted to arbitration.

The Contractor Parties can be required under the PSA to make certain bonus payments to SOCAR, as agent for the Republic.

### ***Joint Operating Agreements***

Each PSA requires that the Contractor Parties form a joint operating entity to act as operator for the contract area under a joint operating agreement (a "**JOA**"). Each JOA also governs the relationship among the Contractor Parties for the development of the contract area. Under the terms of each JOA, the Contractor Parties form a jointly-managed operating entity and may appoint an operator to assume responsibility for operations and management, which, in the case of the Shah Deniz PSA, is BP.

## **Other regulatory requirements**

### ***Pre-emptive Right***

Under the Energy Law, the Republic has a pre-emptive right to purchase energy products (as set out in the Energy Law) under energy contracts in order to satisfy domestic demand. When exercising this pre-emptive right, the Republic is required to purchase the energy products at international market prices.

### ***Price Regulation***

Price regulation in Azerbaijan is conducted by the Tariff Council, which is chaired by the Minister of Economy and composed of various deputy ministers and deputy heads of various state authorities. The Tariff Council has the authority to regulate, among other things, domestic wholesale and retail prices of oil, oil products and gas and tariffs for services relating to the transportation of oil and natural gas through pipelines as well as storage and distribution of natural gas. The prices and tariffs for these goods and services have been prescribed by the Tariff Council.

### ***Special Regimes and Exemptions***

To promote and strengthen domestic oil and gas infrastructure, expertise, manpower and capacity, a special economic regime, to be in force for at least 15 years with effect from 2009, has been set up in Azerbaijan concerning the export-orientated oil and gas services, which, however, specifically excludes any operations undertaken under PSAs, pipeline agreements and other similar agreements or operations carried on relating to domestic oilfields. On obtaining a permit from the Ministry of Energy, concerned entities (acting as contractors and subcontractors in the relevant operations and including, without limitation, joint ventures set-up with the participation of foreign investors) are entitled to a favourable tax regime with the right to apply either a 5% withholding tax or statutory profit tax to its profits and also to certain exemptions from VAT and customs duties. Additionally, such exporters are required to meet certain currency requirements (such as notification to the Central Bank of the offshore bank accounts) and local content obligations when staffing their operations.

### ***Mandatory Insurance***

The Issuer and its Operating Companies operating in Azerbaijan (the "**Azerbaijan Companies**") are required to obtain and maintain insurance under applicable law, including: (i) occupational health and safety insurance; (ii) social insurance (social security) for its employees; (iii) immovable property insurance; (iv) liability insurance for owners and/or operators of immovable property; and (v) liability insurance for owners and/or operators of motor vehicles. See "*Business—Insurance*".

### ***The Ministry of Energy***

The Ministry of Energy is the chief regulator in the hydrocarbons sector. If instructed by the President of Azerbaijan, the Ministry has the authority to: (i) prepare draft agreements on production of hydrocarbon resources, such as PSA; (ii) conduct negotiations in respect of such agreements; (iii) sign such agreements on behalf of the Government; and (iv) supervise the implementation thereof.

Under the Law on Energy and implementing decree of the President, the Ministry of Energy, supervises and issues special permits to entities and individuals wishing to engage in exploration, exploitation, production, processing, storage, transportation, distribution and use of energy materials and products, including, *inter alia*, oil and natural gas.

The Law on Licences and Permits in force from 1 June 2016, sets out the lists of permits related to hydrocarbon activities: (i) production of gas and processing of natural gas; (ii) transportation of gas; (iii) distribution of gas; (iv) design, construction and exploitation of underground gas storage facilities; (v) exploitation of gas processing installations; (vi) exploration of oil and gas fields; (vii) exploitation and production of oil and gas fields; (viii) processing of oil and oil products; (ix) transportation of oil and oil products through pipelines. It is not clear whether the permits under the Law on Energy are replaced by the permits under the Law on Licences and Permits. The issuing authority for these permits has not been determined in connection with the adoption of the Law on Licences and Permits.



The State Agency for Alternative and Renewable Energy Sources was established under the Ministry of Energy on 16 July 2009 and, after a number of transformations (including liquidation in June 2012), the agency was revived as a central executive authority. The agency is vested with the authority to promote the development of alternative and renewable energy in Azerbaijan. The exploration, production, transportation, distribution of alternative and renewable energy and setting up of necessary infrastructure all have been assigned to Azalternativenerji, a state-owned limited liability company controlled by the agency.

### ***Environmental Compliance and Ecological Permits***

The Azerbaijan Companies are subject to a variety of environmental laws in Azerbaijan, including, *inter alia*, regulations and requirements that govern air emissions, water use and disposal, waste management and impact on wildlife, as well as land use restrictions. A number of laws and codes regulate these areas of environmental protection. In addition, certain standards adopted in the Soviet era are still in force in Azerbaijan. The penalties for failing to comply with these obligations can be substantial, including fines or even suspension of permission to operate facilities that are not compliant with applicable environmental regulations.

The Law on Protection of Ambient Air of 2001 (the "**PAA Law**") provides that the emission of harmful substances into the air from stationary sources is permitted only if a special permit issued by the MENR has been obtained. Under the PAA Law, the special permit establishes the level of permissible emissions and required mitigating measures that the permit holder must take. The PAA Law further provides that any emissions (or other impact on ambient air) conducted without a special permit and violation of the conditions of a special permit may result in restriction, suspension or termination of the violating activities. The PAA Law also prohibits flaring without the use of purification equipment.

The MENR also has an authority to prescribe maximum amount of waste water that can be drained by enterprises into water basins. The requirement to obtain permits to water use is repeated in the new Law on Licences and Permits.

Azerbaijani law and various industry standards applicable in Azerbaijan also contain a number of requirements on the placement of drilling wells relative to various locations and objects such as water basins, roads, settlements, nature reserves, historical monuments and telecommunication lines and equipment.

### ***Health and Safety Compliance***

The Issuer's and the Azerbaijan Companies' activities are subject to laws and regulations in Azerbaijan relating to health and safety matters, including industry specific health and safety requirements, and are regulated by various state bodies, including the Ministry of Emergency Situations, the Ministry of Labour and Social Protection and the Ministry of Health.

The laws and regulations of Azerbaijan require an employer to provide its employees with safe and healthy working conditions, to train its employees on health and safety requirements, to provide special clothing, shoes and food, to obtain periodic third-party attestations in respect of equipment and worksites, to perform examinations, certifications and registrations of certain equipment, to follow technical safety rules during operations, to maintain third party liability insurance and to comply with fire safety, sanitary and hygiene regulations.

## FORM OF THE NOTES AND TRANSFER RESTRICTIONS

*The following information relates to the form, transfer and delivery of the Notes.*

### 1. **Form of the Notes**

All Notes will be in definitive fully registered form, without interest coupons attached. Notes offered and sold outside the United States in reliance on Regulation S will be represented by interests in the Unrestricted Global Note, in definitive fully registered form, without interest coupons attached, which will be deposited on or about the Closing Date with a common depository for Euroclear and Clearstream, Luxembourg, and registered in the nominee name of the common depository in respect of interests held through Euroclear and Clearstream, Luxembourg.

Notes offered and sold in reliance on Rule 144A to QIBs that are also QPs will be represented by interests in a Restricted Global Note, in definitive fully registered form, without interest coupons attached, which will be registered in the name of Cede & Co., as nominee for, and which will be deposited on or about the Closing Date with a custodian (the "**Custodian**") for, DTC. The Restricted Global Note (and any Note Certificates (as defined below) issued in exchange therefor) will be subject to certain restrictions on transfer contained in a legend appearing on the face of such Note as set forth under paragraph 3 below.

*The Unrestricted Global Note will have an ISIN number and a Common Code and the Restricted Global Note will have a separate CUSIP number.*

For the purposes of the Restricted Global Note and the Unrestricted Global Note, any reference in the Conditions to "**Note Certificate**" or "**Note Certificates**" shall, except where the context otherwise requires, be construed so as to include the Restricted Global Note or, as the case may be, the Unrestricted Global Note and interests therein.

### 2. **Notices**

So long as the Notes are represented by a Global Note and the Global Note is held on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled accountholders except that so long as the Notes are listed on the Irish Stock Exchange and the rules of that Exchange so require, notices shall also be published in a leading newspaper having general circulation in the Republic of Ireland (which is expected to be the Irish Times)

### 3. **Transfer Restrictions**

A beneficial interest in the Unrestricted Global Note may be transferred to a person who wishes to take delivery of such beneficial interest through the Restricted Global Note, if such transfer is being made to a person whom the transferor reasonably believes is a QIB within the meaning of Rule 144A that is also a QP as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act and the rules and regulations thereunder, in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States or any other jurisdiction, and such transfers will be subject to the transfer restrictions contained in the legend appearing on the face of such Note, as set out below.

A beneficial interest in the Restricted Global Note may also be transferred to a person who wishes to take delivery of such beneficial interest through the Unrestricted Global Note only upon receipt by the Registrar of a written certification from the transferor (in the form set out in the schedule to the Fiscal Agency Agreement) to the effect that such transfer is being made in accordance with Regulation S or Rule 144 (if available) under the U.S. Securities Act to QIBs that are also QPs.

Any beneficial interest in either the Restricted Global Note or the Unrestricted Global Note that is transferred to a person who takes delivery in the form of a beneficial interest in the other Global Note will, upon transfer, cease to be a beneficial interest in such Global Note and become a beneficial interest in the other Global Note and, accordingly, will thereafter be subject to all

transfer restrictions and other procedures applicable to a beneficial interest in such other Global Note for so long as such person retains such an interest.

The Notes are being offered and sold in the United States only to qualified institutional buyers within the meaning of and in reliance on Rule 144A who are also qualified purchasers as defined in the Investment Company Act of 1940. Because of the following restrictions, purchasers of Notes offered in the United States in reliance on Rule 144A are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of such Notes.

Each purchaser of Notes offered hereby pursuant to Rule 144A will be deemed to have represented and agreed as follows (terms used herein that are defined in Rule 144A are used herein as defined therein):

- (i) the purchaser (a) is a qualified institutional buyer within the meaning of Rule 144A that is also a QP as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act and the rules and regulations thereunder, (b) is acquiring the Notes for its own account or for the account of such a QIB that is also a QP and (c) such person is aware that the sale of the Notes to it is being made in reliance on Rule 144A;
- (ii) the Notes are being offered only in a transaction not involving any public offering in the United States within the meaning of the U.S. Securities Act, and the Notes offered hereby have not been and will not be registered under the U.S. Securities Act and may not be reoffered, resold, pledged, or otherwise transferred except in accordance with the legend set out below; and
- (iii) the Restricted Global Note and any Restricted Note Certificates (as defined below) issued in exchange for an interest in the Restricted Global Note will bear a legend to the following effect, unless the Issuer and the Guarantor determine otherwise in accordance with applicable law:

"NEITHER THIS NOTE NOR THE GUARANTEE HAS BEEN AND WILL NOT BE REGISTERED UNDER, AND EACH WAS ORIGINALLY ISSUED OR MADE IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER, THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "**U.S. SECURITIES ACT**"), AND THE NOTES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. THE HOLDER OF THIS NOTE BY ITS ACCEPTANCE HEREOF REPRESENTS AND AGREES, FOR THE BENEFIT OF THE ISSUER AND THE GUARANTOR, THAT (A) THIS NOTE (AND ANY INTEREST HEREIN) MAY BE RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (1) TO THE ISSUER OR THE GUARANTOR, (2) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE U.S. SECURITIES ACT) (A "**QIB**") THAT IS ALSO A QUALIFIED PURCHASER (AS DEFINED IN SECTION 2(A)(51)(A) OF THE U.S. INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "**U.S. INVESTMENT COMPANY ACT**") AND THE RULES AND REGULATIONS THEREUNDER (A "**QP**") PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QIBS EACH OF WHICH IS A QP WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT SUCH OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A UNDER THE U.S. SECURITIES ACT, AND IN AN AMOUNT FOR EACH ACCOUNT OF NOT LESS THAN US\$200,000 PRINCIPAL AMOUNT OF NOTES, (3) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF RULE 903 OR RULE 904 OF REGULATION S ("**REGULATION S**") UNDER THE U.S. SECURITIES ACT OR (4) PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE U.S. SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER, IF AVAILABLE, AND IN EACH OF SUCH CASES IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION, AND THAT (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS NOTE (OR INTEREST HEREIN) FROM IT OF THE TRANSFER RESTRICTIONS REFERRED TO IN (A) ABOVE.

IF THE HOLDER OF THIS NOTE HEREOF IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S, SUCH HOLDER REPRESENTS THAT (1) IT IS A QIB THAT IS ALSO A QP; (2) IT IS NOT A BROKER-DEALER WHICH OWNS AND INVESTS ON A DISCRETIONARY BASIS LESS THAN US\$25,000,000 IN SECURITIES OF UNAFFILIATED BANKS; (3) IT IS NOT A PARTICIPANT-DIRECTED EMPLOYEE PLAN, SUCH AS A 401(K) PLAN; (4) IT IS HOLDING THIS NOTE FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QIBS, EACH OF WHICH IS A QP; (5) IT WAS NOT FORMED FOR THE PURPOSE OF INVESTING IN THE ISSUER OR THIS NOTE; (6) IT UNDERSTANDS THAT THE ISSUER MAY RECEIVE A LIST OF PARTICIPANTS HOLDING POSITIONS IN ITS SECURITIES FROM ONE OR MORE BOOK-ENTRY DEPOSITARIES AND (7) IT WILL PROVIDE NOTICE OF THE FOREGOING TRANSFER RESTRICTIONS TO ITS SUBSEQUENT TRANSFEREES.

THE HOLDER HEREOF HEREBY ACKNOWLEDGES THAT IF AT ANY TIME WHILE IT HOLDS AN INTEREST IN THIS NOTE IT IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S THAT IS NOT A QIB AND A QP, THE ISSUER MAY (A) COMPEL IT TO SELL ITS INTEREST IN THIS NOTE TO A PERSON WHO IS (I) A U.S. PERSON WHO IS A QIB AND A QP THAT IS, IN EACH CASE, OTHERWISE QUALIFIED TO PURCHASE THIS NOTE IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE U.S. SECURITIES ACT OR (II) NOT A U.S. PERSON WITHIN THE MEANING OF REGULATION S WHO IS LOCATED OUTSIDE THE UNITED STATES AND IS PURCHASING SUCH NOTE IN AN OFFSHORE TRANSACTION OR (B) COMPEL THE HOLDER TO SELL ITS INTEREST IN THIS NOTE TO THE ISSUER OR AN AFFILIATE OF THE ISSUER OR TRANSFER ITS INTEREST IN THIS NOTE TO A PERSON DESIGNATED BY OR ACCEPTABLE TO THE ISSUER. THE ISSUER HAS THE RIGHT TO REFUSE TO PERMIT A TRANSFER OF AN INTEREST IN THIS NOTE TO A PERSON WHO IS NOT BOTH A QIB AND A QP. THE ISSUER HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. INVESTMENT COMPANY ACT, BUT RATHER INTENDS TO RELY ON SECTION 3(C)(7) THEREUNDER.

THE ISSUER MAY COMPEL EACH HOLDER OF THIS NOTE THAT IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S TO CERTIFY PERIODICALLY THAT SUCH HOLDER IS A QIB AND A QP.

THIS NOTE AND ALL RELATED DOCUMENTATION MAY BE AMENDED OR SUPPLEMENTED FROM TIME TO TIME TO MODIFY THE RESTRICTIONS ON AND PROCEDURES FOR REALES AND OTHER TRANSFERS OF THIS NOTE TO REFLECT ANY CHANGE IN APPLICABLE LAW OR REGULATION (OR THE INTERPRETATION THEREOF) OR IN PRACTICES RELATING TO THE RESALE OR TRANSFERS OF RESTRICTED SECURITIES GENERALLY. BY THE ACCEPTANCE OF THIS NOTE, THE HOLDER HEREOF SHALL BE DEEMED TO HAVE AGREED TO ANY SUCH AMENDMENT OR SUPPLEMENT."

- (iv) that if it is a U.S. person within the meaning of Regulation S, it is (a) not a broker-dealer which owns and invests on a discretionary basis less than US\$25 million in securities of unaffiliated Banks, (b) not a participant-directed employee plan, such as a 401(k) plan, (c) not formed for the purpose of investing in the Notes or the Issuer, and (d) aware, and each beneficial owner of such Notes has been advised, that the seller of such Notes may be relying on the exemption from the provisions of Section 5 of the U.S. Securities Act provided by Rule 144A;
- (v) that it will, (a) along with each account for which it is purchasing, hold and transfer beneficial interests in the Rule 144A Notes in a principal amount that is not less than US\$200,000 and (b) provide notice of these transfer restrictions to any subsequent transferees. In addition, it understands that the Issuer may receive a list of participants holding positions in the Issuer's securities from one or more book-entry depositories; and
- (vi) that it understands that the Issuer has the power to compel any holder of Rule 144A Notes that is a U.S. person and is not a QIB and a QP to sell or transfer its interest in the Rule 144A Notes. The Issuer has the right to refuse to permit the transfer of an interest in the Rule 144A Notes to a person who is not both a QIB and a QP.

Each purchaser of Notes outside the United States pursuant to Regulation S, will be deemed to have represented, agreed and acknowledged as follows:

- (i) it is, or at the time Notes are purchased will be, the beneficial owner of such Notes and it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S);
- (ii) it understands that such Notes have not been and will not be registered under the U.S. Securities Act and that it will not offer, sell pledge or otherwise transfer such Notes except in an offshore transactions in accordance with Rule 903 or Rule 904 of Regulation S, and in accordance with any applicable securities laws of any State of the United States; and
- (iii) the Issuer, the Guarantor, the Registrar, the Joint Lead Managers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

#### 4. **Exchange of Interests in Global Notes for Note Certificates**

The Restricted Global Note will become exchangeable, free of charge to the holder, in whole but not in part, for Note certificates in definitive form ("**Restricted Note Certificates**") if DTC (a) notifies the Issuer or the Guarantor that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Restricted Global Note or ceases to be a "**clearing agency**" registered under the Exchange Act, or is at any time no longer eligible to act as such, and the Issuer or the Guarantor are unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of DTC or (b) an Event of Default (as defined and set out in Condition 12 (*Events of Default*) of the Notes) occurs. In such circumstances, such Restricted Note Certificates shall be registered in such names as DTC shall direct in writing and the Issuer will procure that the Registrar notify the holders as soon as practicable after the occurrence of the events specified in (a) and (b).

The Unrestricted Global Note will become exchangeable, free of charge to the holder, in whole but not in part, for Note certificates in definitive form ("**Unrestricted Note Certificates**") if (a) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or does in fact do so or (b) an Event of Default (as defined and set out in Condition 12 (*Events of Default*) of the Notes) occurs. In such circumstances, such Unrestricted Note Certificates will be registered in such names as Euroclear and Clearstream, Luxembourg shall direct in writing and the Issuer or the Guarantor will procure that the Registrar notify the holders as soon as practicable after the occurrence of the events specified in (a) and (b).

In the event that the Restricted Global Note is to be exchanged for Restricted Note Certificates or the Unrestricted Global Note is to be exchanged for Unrestricted Note Certificates (together "**Note Certificates**") the relevant Global Note shall be exchanged in full for the relevant Note Certificates and the Issuer or the Guarantor will, without charge to the holder or holders thereof, but against such indemnity as the Registrar may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange, cause sufficient Note Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Noteholders.

On exchange, a person having an interest in a Global Note must provide the Registrar with (i) a written order containing instructions and such other information as the Issuer, the Guarantor and the Registrar may require to complete, execute and deliver such Note Certificates and (ii) in the case of the Restricted Global Note only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a person whom the transferor reasonably believes is a QIB that is also a QP. Note Certificates issued in exchange for a beneficial interest in the Restricted Global Note shall bear the legends applicable to transfers pursuant to Rule 144A, as set out under "Transfer Restrictions" above. Restricted Note Certificates issued as described above will not be exchangeable for beneficial interests in the

Unrestricted Global Note and Unrestricted Note Certificates issued as described above will not be exchangeable for beneficial interests in the Restricted Global Note.

In addition to the requirements described under "*Transfer Restrictions*" above, the holder of a Note may transfer such Note only in accordance with the provisions of Condition 3 (*Transfer of Notes*) of the Notes.

Upon the transfer, exchange or replacement of a Restricted Note Certificate bearing the legend referred to under "*Transfer Restrictions*" above, or upon specific request for removal of the legend on a Restricted Note Certificate, the Issuer will deliver only Restricted Note Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer, the Guarantor and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer or the Guarantor that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the U.S. Securities Act and the U.S. Investment Company Act of 1940.

The Registrar will not register the transfer of any Notes or exchange of interests in a Global Note for Note Certificates for a period of 15 calendar days ending on the due date of any payment of principal or interest in respect of such Notes.

#### 5. **Euroclear, Clearstream, Luxembourg and DTC Arrangements**

So long as DTC or its nominee or Euroclear, Clearstream, Luxembourg or the nominee of their common depository is the registered holder of a Global Note, DTC, Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, will be considered the sole owner or holder of the Notes represented by such Global Note for all purposes under the Fiscal Agency Agreement, the Deed of Covenant and the Notes. Payments of principal, interest and Additional Amounts, if any, in respect of Global Notes will be made to DTC, Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, as the registered holder thereof. None of the Issuer, the Guarantor, the Fiscal Agent, any Paying and Transfer Agent or the Joint Lead Managers or any affiliate of any of the above or any person by whom any of the above is controlled for the purposes of the U.S. Securities Act will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the Global Notes or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Distributions of principal and interest with respect to book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by Euroclear or Clearstream, Luxembourg from the Paying and Transfer Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg customers in accordance with the relevant system's rules and procedures.

Holders of book-entry interests in the Notes through DTC will receive, to the extent received by DTC from the Paying and Transfer Agent, all distributions of principal and interest with respect to book-entry interests in the Notes from the Paying and Transfer Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

Interest on the Notes (other than interest on redemption) will be paid to the person shown as the Noteholder in the Register at close of business on the Clearing System Business Day before the due date for payment (the "**Record Date**"), where "**Clearing System Business Day**" means a day on which each clearing system for which the Restricted Global Note and Unrestricted Global Note are being held is open for business. Principal and interest with respect to the Restricted Note Certificates and the Unrestricted Note Certificates on redemption will be paid to the holder shown on the Register on the Record Date upon delivery and surrender of the relevant Note Certificate. Trading between the Restricted Global Note and the Unrestricted Global Note will therefore be net of accrued interest from the relevant Record Date to the relevant Interest Payment Date.

The laws of some states of the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer interests in a Global Note to

such persons will be limited. Because DTC, Euroclear and Clearstream, Luxembourg can only act on behalf of participants, who in turn act on behalf of indirect participants, the ability of a person having an interest in a Global Note to pledge such interest to persons or entities which do not participate in the relevant clearing system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

The holdings of book-entry interests in the Notes in Euroclear, Clearstream, Luxembourg and DTC will be reflected in the book-entry accounts of each such institution. As necessary, the Registrar will adjust the amounts of Notes on the Register for the accounts of the common depository (or its nominee) and Cede & Co. to reflect the amounts of Notes held through Euroclear and Clearstream, Luxembourg on the one hand and DTC, on the other. Beneficial ownership in Notes will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream, Luxembourg and DTC.

Interests in the Unrestricted Global Note and the Restricted Global Note will be in uncertificated book-entry form.

***Trading between Euroclear and/or Clearstream, Luxembourg Account Holders.*** Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

***Trading between DTC Participants.*** Secondary market sales of book-entry interests in the Notes between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to United States corporate debt obligations in DTC's Same Day Funds Settlement System.

***Trading between DTC Seller and Euroclear/Clearstream, Luxembourg Purchaser.*** When book- entry interests in Notes are to be transferred from the account of a DTC participant holding a beneficial interest in the Restricted Global Note to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the Unrestricted Global Note (subject to such certification procedures as are provided in the Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12 noon, New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg accountholder. On the settlement date, the Custodian will instruct the Registrar to (a) decrease the amount of Notes registered in the name of Cede & Co. and evidenced by the Restricted Global Note and (b) increase the amount of Notes registered in the name of the nominee of the common depository for Euroclear and Clearstream, Luxembourg and evidenced by the Unrestricted Global Note. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first Business Day following the settlement date. See above concerning the Record Date for payment of interest.

***Trading between Euroclear/Clearstream, Luxembourg Seller and DTC Purchaser.*** When book- entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC participant wishing to purchase a beneficial interest in the Restricted Global Note (subject to such certification procedures as are provided in the Agency Agreement), the Euroclear or Clearstream, Luxembourg participant must send to Euroclear or Clearstream, Luxembourg delivery free of payment instructions by 5:00 p.m. Brussels or Luxembourg time, one Business Day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depository for Euroclear and Clearstream, Luxembourg and the Registrar to arrange delivery to the DTC participant on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg account holder, as the case may be. On the settlement date, the common depository for Euroclear and Clearstream, Luxembourg will (a) transmit appropriate instructions to the Custodian who will in turn deliver such book- entry interest in the Notes free of payment to the relevant account of the DTC participant and (b) instruct the Registrar to (i) decrease the amount

of Notes registered in the name of the nominee of the common depository for Euroclear and Clearstream, Luxembourg and evidenced by the Unrestricted Global Note and (ii) increase the amount of Notes registered in the name of Cede & Co. and evidenced by the Restricted Global Note. See above concerning the Record Date for payment of interest.

Although the foregoing sets out the procedures of Euroclear, Clearstream, Luxembourg and DTC in order to facilitate the transfers of interests in the Notes among participants of DTC, Clearstream, Luxembourg and Euroclear, none of Euroclear, Clearstream, Luxembourg or DTC is under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, the Guarantor, the Trustee, any Paying and Transfer Agent or any of the Joint Lead Managers or any affiliate of any of the above, or any person by whom any of the above is controlled for the purposes of the U.S. Securities Act, will have any responsibility for the performance by DTC, Euroclear and Clearstream, Luxembourg or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or for the sufficiency for any purpose of the arrangements described above.

6. **Prescription**

Claims against the Issuer in respect of principal and interest on the Notes while represented by a Global Note will become void unless it is presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 10 (*Taxation*) of the Notes).

7. **Meetings**

The holder of a Global Note will be treated as being two persons for the purposes of any quorum requirements of, or the right to demand a poll at, a meeting of Noteholders and, at any such meeting, as having one vote in respect of each US\$1,000 in principal amount of Notes for which the Global Note may be exchanged.

8. **Purchase and Cancellation**

Cancellation of any Note surrendered for cancellation following its purchase will be effected by reduction in the principal amount of the relevant Global Note.



## TAXATION

*The following is a general summary of the Republic of Azerbaijan and tax consequences as of the date hereof in relation to payments made under the Notes in relation to holding, sale or transfer of Notes. It is not exhaustive and purchasers are urged to consult their professional advisors as to the tax consequences to them of holding or transferring Notes.*

### **Azerbaijan Taxation**

*The following is a summary of certain Azerbaijani tax considerations relevant to the purchase, ownership and disposition of Notes by non-resident and resident holders and does not purport to be a comprehensive discussion of the tax treatment of the Notes. The summary is based on the laws of Azerbaijan currently in effect. The summary does not seek to address the availability of double tax treaty relief in respect of the Notes, or practical difficulties involved in obtaining such double tax treaty relief.*

Prospective investors should consult their own tax advisers regarding the tax consequences of investing in the Notes in their own particular circumstances. No representation with respect to the Azerbaijani tax consequences to any particular holder is made hereby.

Many aspects of Azerbaijani tax law are subject to significant uncertainty. Further, the substantive provisions of Azerbaijani tax law applicable to financial instruments may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed capital markets and taxation systems. In this regard, the interpretation and application of such provisions will in practice rest substantially with the Azerbaijani tax authorities.

For the purposes of this summary, a "non-resident" means (a) an individual actually present in Azerbaijan for an aggregate period of not more than 182 days in a given calendar year and not treated as an Azerbaijani tax resident for other reasons such as having citizenship, habitual abode, centre of vital interests or a permanent residence in Azerbaijan or (b) a legal person which is not (i) organised and carrying on entrepreneurial activity under Azerbaijani law or (ii) managed from Azerbaijan, which purchases, holds and disposes of the Notes.

### ***Non-resident Holders***

#### ***Payments under the Notes***

Payments under the Notes, which constitute Azerbaijani source income (such as, for example, interest payments), made by an Azerbaijani entity (such as the Issuer) to non-resident individuals or legal persons are subject to Azerbaijani withholding tax at the rate of up to 10%, unless such withholding tax is reduced or eliminated pursuant to the terms of an applicable double tax treaty. Given that payment of interest will be made through the Paying Agents and Euroclear, Clearstream, Luxembourg and that there are very few international capital markets transactions by Azerbaijani issuers, it may be difficult for holders of Notes to prove to the local tax authorities that a withholding tax has been applied to interest payments and, therefore, to obtain the benefit of any applicable double tax treaty relief.

Additionally, pursuant to the Amendment Law, the direct or indirect payments by Azerbaijani tax residents to persons established (registered) in low tax jurisdictions are treated as Azerbaijani source income and are subject to a 10% withholding tax. The list of such jurisdictions is yet to be determined by the President of the Republic of Azerbaijan. In the event any holders of the Notes are established (registered) in such jurisdictions, payments indirectly made by the Issuer to such holders of the Notes, which are not otherwise subject to the withholding tax (e.g. the principal amount of the Notes), could be potentially subject to a 10% withholding tax. In the absence of any established practice, it is difficult to predict the approach that the tax authorities will take in relation to the payments to low tax jurisdictions.

The issuer has agreed that payments under the Notes will be grossed-up in accordance with the provisions of Condition 10 (*Taxation*).

With regard to payments to non-resident individuals, starting from 1 February 2016, payments of interest on deposits and payments of discounts, dividends and interest in relation to investment securities (*i.e.* shares and corporate bonds) made by an Azerbaijani entity to non-resident individuals were first exempt from the 10% withholding tax for the period of 3 years (*i.e.* until 1 February 2019). Under the

Amendment Law, this exemption was further prolonged for a 7 year period taking effect 1 February 2016 (i.e., until 1 February 2023).

### ***Payments under the Guarantee***

Any payments under the Guarantee to non-resident Noteholders are not subject to Azerbaijani withholding or other taxes unless such non-resident Noteholders are otherwise subject to Azerbaijani tax and files Azerbaijani tax returns. Non-resident Noteholders who are not otherwise subject to Azerbaijani tax will not become liable to pay Azerbaijani tax on income received under the Guarantee merely as a result of holding the Notes.

Non-resident Noteholders that are already subject to Azerbaijani tax should be aware that they potentially could become liable to pay tax on payments received under the Guarantee and should consult their tax advisers accordingly.

While the Guarantor has agreed to gross up any taxes it may withhold in connection with payments under the Guarantee pursuant to Clause 4 (*Taxes and Withholdings*) of the Deed of Guarantee, there is no legal requirement for the Guarantor to deduct withholding taxes on its payments under the Guarantee.

### ***Redemption, Sale or other Disposition of the Notes***

A non-resident holder generally should not be subject to any Azerbaijani taxes in respect of redemption, sale or other disposition of the Notes outside of Azerbaijan, **provided that** (i) the proceeds of such disposition are not received from a source within Azerbaijan or (ii) income in relation to the Notes is not received through the activities of a permanent establishment of a non-resident holder in Azerbaijan.

In the event that the proceeds of the disposition of the Notes are received from a source within Azerbaijan, a non-resident holder should not be subject to Azerbaijani tax in respect of the proceeds to the extent such disposition is not deemed a sale of goods in the territory of Azerbaijan (with respect to such classification of the disposition of the Notes we generally note that Azerbaijani tax authorities can adopt a view that Azerbaijani withholding tax shall apply to the payment of any disposition proceeds from a source within Azerbaijan), **provided that** no portion thereof is attributable to accrued interest. If any portion of such proceeds can be shown to be attributable to accrued interest, Azerbaijani withholding tax will be applied at a rate of 10% to such portion. Non-resident holders should consult their own tax advisers with respect to the possibility of such apportionment.

### ***Resident Holders***

Payments of interest made by an Azerbaijani entity to resident individuals or legal persons are subject to the Azerbaijani withholding tax at the rate of up to 10%. Tax so withheld can be credited against tax liability of resident legal entities; and in respect of individual residents shall fully discharge their tax liability. Given that payment of interest will be made through the Paying and Transfer Agents and Euroclear and Clearstream, Luxembourg and that there are very few international capital markets transactions of Azerbaijani issuers, it could, in practice, be difficult to prove to the local tax authorities that taxes in relation to interest have been withheld.

Although not clearly stated in law, the Guarantor is not obliged to deduct the withholding tax from payments made by it under the Guarantee. If the tax has not been withheld at the source of payment, such income shall be reported by a receiving Noteholder legal entity and/or individual entrepreneur and be subject to the Azerbaijani profits/income tax (based on a positive difference between income and deductible expenses). As regards individual non-entrepreneurial Noteholders, although a resident individual is obliged to report and pay the Azerbaijani tax on his/ her income, which cannot be taxed at the source of payment, from the practical stand point, the tax authorities currently do not enforce the requirement to have income of such individuals declared. This approach taken by tax authorities may change in the future.

With regard to payments to resident individuals, starting from 1 February 2016 payments of interest on deposits and payments of discounts, dividends and interest in relation to investment securities (*i.e.* shares and corporate bonds) made by an Azerbaijani entity to resident individuals are exempt from a 10% withholding tax for the period of 3 years (*i.e.* until 1 February 2019). Under the Amendment Law this exemption was further prolonged for a 7 year period starting from 1 February 2016 (*i.e.*, until 1 February 2023).

A Noteholder, who is an individual resident in Azerbaijan for tax purposes, or a resident legal entity, is subject to applicable Azerbaijani taxes in respect of gains from disposition of the Notes.

#### **VAT**

No VAT will be payable in Azerbaijan on any payment of interest or principal in respect of the Notes.

#### ***Inheritance Taxes***

Azerbaijani personal income tax should not apply to an inheritance of Notes by non-resident individuals but would apply to any inheritance of the Notes by resident individuals (as such inheritance will be included into the worldwide income of the resident). Azerbaijani law, however, exempts the first AZN 20,000 of any inheritance from personal income tax and fully exempts inheritances from family members.

#### **U.S. Federal Income Taxation**

The following summary describes certain U.S. federal income tax consequences of the acquisition, ownership and disposition of a Note by an investor that acquires the Note in this offering from the Issuer of the Notes at the issue price appearing on the cover of this Prospectus and holds it as a capital asset (generally, property held for investment). This summary does not address all aspects of U.S. federal income taxation that may be applicable to a particular investor's decision to acquire, own or dispose of a Note. In particular, this summary does not address U.S. federal income tax consequences that apply to prospective investors subject to special tax rules, including, among others, tax-exempt organisations, financial institutions, dealers and traders in securities or currencies, U.S. Holders (as defined below) that will hold a Note as part of a "straddle", hedging transaction or "conversion transaction" for U.S. federal income tax purposes, U.S. Holders that enter into "constructive sale" transactions with respect to the Notes, U.S. Holders that own (directly or through attribution) 10% or more of the stock, by vote or value, of the issuer of the Notes, U.S. Holders that have a "functional currency" other than the U.S. dollar and certain U.S. expatriates. Further, this discussion does not address the U.S. federal estate and gift tax, alternative minimum tax consequences, the Medicare tax on net investment income, or any state, local and non-U.S. tax consequences of acquiring, owning and disposing of the Notes.

The discussion below is based on the Internal Revenue Code of 1986, as amended (the "**Code**"), U.S. Treasury regulations thereunder, and judicial and administrative interpretations thereof, all as of the date of this Offering Memorandum and any of which may at any time be repealed, revoked or modified or subject to differing interpretations, potentially retroactively, so as to result in U.S. federal income tax consequences different from those discussed below. No ruling has been or will be sought or obtained from the U.S. Internal Revenue Service (the "**IRS**") with respect to any of the United States federal income tax consequences discussed herein. In addition, there can be no assurances that the IRS would not assert, or that a U.S. court would not uphold, positions concerning the U.S. federal income tax consequences of a U.S. Holder's acquisition, ownership or disposition of a Note that are contrary to the discussion below.

If a partnership (including any entity treated as a partnership for U.S. federal income tax purposes) holds a Note, the U.S. federal income tax consequences to the partners of such partnership will depend on the activities of the partnership and the status of the partners. A partnership considering an investment in Notes should consult its own tax advisers about the consequences to its partners of the acquisition, ownership or other disposition of Notes by the partnership.

Prospective purchasers should consult their own tax advisers as to the particular tax considerations for them relating to the purchase, ownership and disposition of a Note, including the applicability of any U.S. federal, state, or local tax laws, or non-U.S. tax laws, any changes in applicable tax laws, and any pending or proposed legislation or regulations.

As used herein, the term "**U.S. Holder**" means a beneficial owner of a Note that is for U.S. federal income tax purposes: (i) an individual who is a citizen or resident of the United States; (ii) a corporation created or organised in or under the laws of the United States, any state therein or the District of Columbia; (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or (iv) a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more U.S. persons have authority to control all substantial decisions of the trust.

### **Pre-issuance Accrued Interest**

A portion of the price paid for the additional Notes will be allocable to interest that accrued prior to the date the Note is purchased (the "**pre-issuance accrued interest**"). The Issuer intends to take the position that, on the first interest payment date, a portion of the interest received in an amount equal to the pre-issuance accrued interest will be treated as a return of the pre-issuance accrued interest and not as a payment of interest on the additional Note. A U.S. Holder's basis in an additional Note will not include the portion of purchase price allocable to the pre-issuance accrued interest. Amounts treated as a return of pre-issuance accrued interest should not be taxable when received. U.S. holders should consult their tax advisors with regard to the tax treatment of the pre-issuance accrued interest on an additional Note.

### **Payments of stated interest**

Subject to the discussion above under "Pre-Issuance Accrued Interest" In general, a payment of stated interest on a Note, including any amount withheld in respect of any taxes and any additional amounts, will be taxable to a U.S. Holder as ordinary interest income at the time it is accrued or is paid in accordance with the U.S. Holder's method of accounting for U.S. federal income tax purposes. In addition, interest on the Notes will be treated as foreign source income for U.S. federal income tax purposes and generally will constitute "passive category" income for most U.S. Holders. A U.S. Holder may, subject to certain limitations, be eligible to claim a credit or deduction in respect of taxes that are withheld from the payments on the Notes. The rules relating to foreign tax credits are complex and U.S. Holders are urged to consult their own tax advisers regarding the application of the foreign tax credit rules to their particular situation.

### **Amortisable Bond Premium**

If a U.S. holder purchases an additional Note for an amount that is greater than the amount payable at maturity, the U.S. holder will be considered to have purchased the Note with amortisable bond premium equal in amount to the excess of the purchase price (excluding an amount equal to the pre-issuance accrued interest) over the amount payable at maturity. The U.S. holder may elect to amortise this premium, using a constant yield method, over the remaining term of the Note. A U.S. holder may generally use the amortisable bond premium allocable to an accrual period to offset qualified stated interest required to be included in the U.S. holder's income with respect to the Note in that accrual period. However, because the additional Notes may be redeemed prior to maturity at a premium, special rules apply that may reduce or eliminate the amount of bond premium that a U.S. holder may amortise with respect to an additional Note. A U.S. holder who elects to amortise bond premium must reduce the U.S. holder's tax basis in the Note by the amount of the premium amortised in any year. An election to amortise bond premium applies to all taxable debt obligations then owned and thereafter acquired by the U.S. holder and may be revoked only with the consent of the IRS. If a U.S. holder does not elect to amortise bond premium, that premium will decrease the gain or increase the loss such U.S. holder would otherwise recognise on the disposition of the additional Note.

### **Sale, exchange, redemption, retirement or other taxable disposition of the Notes**

Upon the sale, exchange, redemption, retirement or other taxable disposition of a Note, a U.S. Holder generally will recognise taxable gain or loss equal to the difference between the amount of cash and the fair market value of any property received on the disposition (except to the extent such cash or property is attributable to accrued and unpaid stated interest, which will be treated like a payment of interest, as described above) and the U.S. Holder's adjusted tax basis in the Note. A U.S. Holder's adjusted tax basis in a Note generally will equal the amount paid for the Note decreased by the amount of any amortised bond premium on the Note and the amount attributable to pre-issuance accrued interest.

Any gain or loss that a U.S. Holder recognises upon the sale, exchange, redemption, retirement or other disposition of a Note generally will be capital gain or loss and will be long-term capital gain or loss if, at the time of the disposition, the U.S. Holder's holding period for the Note is more than one year. The ability of U.S. Holders to deduct capital losses is subject to limitations.

Any gain or loss realised on the sale, exchange or other taxable disposition of a Note generally will be treated as U.S. source gain or loss, as the case may be. A U.S. Holder may, subject to certain limitations, be eligible to claim a credit or deduction in respect of taxes that are withheld from the payments made upon sale, exchange or other taxable disposition of the Notes. However, because any such gain or loss

will be U.S. source gain or loss, as the case may be, a U.S. Holder may not be able to fully utilise its U.S. foreign tax credits in respect of such tax unless such U.S. Holder has other foreign source income. The rules relating to foreign tax credits are complex and U.S. Holders are urged to consult their own tax advisers with regard to the application of the foreign tax credit rules to their particular situation.

### **Information reporting and backup withholding requirements**

U.S. Holders may be subject to information reporting on the amounts paid to them (, unless they provide proof of an applicable exemption. If a U.S. Holder does not provide this proof of exemption, it may be subject to backup withholding on such amounts unless the U.S. Holder provides its taxpayer identification number and otherwise complies with the requirements of the backup withholding rules. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder's U.S. federal income tax liability and may entitle the U.S. Holder to a refund, **provided that** the required information is timely furnished to the IRS.

U.S. Holders should consult their own tax advisers regarding any reporting obligations they may have as a result of their acquisition, ownership or disposition of Notes. Failure to comply with certain reporting obligations could result in the imposition of substantial penalties.

**U.S. Holders should consult their tax advisers with respect to the tax consequences to them of the ownership and disposition of the Notes, including the tax consequences under state, local, foreign and other tax laws and the possible effects of changes in U.S. federal or other tax laws.**

### **The proposed financial transactions tax ("FTT")**

On 14 February 2013, the European Commission published a proposal (the "**Commission's proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**"). However, Estonia has since stated that it will not participate.

The Commission's proposal has very broad scope and could, if introduced, apply to certain dealings in the Notes (including secondary' market transactions) in certain circumstances.

Under the Commission's proposal, FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between the participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate.

Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

## SUBSCRIPTION AND SALE

Citigroup Global Markets Limited, J.P. Morgan Securities plc, and UniCredit Bank AG (the "**Joint Lead Managers**") have, pursuant to an amended and restated Subscription Agreement dated 10 March 2017, severally and not jointly agreed with the Issuer and the Guarantor, subject to the satisfaction of certain conditions, to subscribe or procure subscribers for the Further Notes at the issue price of 107.469% of the principal amount of the Further Notes. In addition, the Issuer has agreed to reimburse the Joint Lead Managers for certain of their expenses in connection with the issue of the Further Notes. The Subscription Agreement entitles the Joint Lead Managers to terminate it in certain circumstances prior to payment being made to the Issuer.

To the extent permitted by local law, the Joint Lead Managers and the Issuer have agreed that commissions may be offered to certain brokers, financial advisors and other intermediaries based upon the amount of investment in the Further Notes purchased by such intermediary and/or its customers. Each such intermediary is required by law to comply with any disclosure and other obligations related thereto, and each customer of any such intermediary is responsible for determining for itself whether an investment in the Further Notes is consistent with its investment objectives.

### **United Kingdom**

Each Manager has represented, warranted and agreed that:

- (a) (i) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (ii) it has not offered or sold and will not offer or sell the Further Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Further Notes would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;
- (b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Further Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or the Guarantor; and
- (c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Further Notes in, from or otherwise involving the United Kingdom.

### **United States**

The Further Notes have not been and will not be registered under the Securities Act and the Further Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from, or in a transaction not subject to the registration requirements of, the Securities Act.

Each Joint Lead Manager has agreed that:

- (a) except as permitted by the Subscription Agreement, it will not offer or sell the Further Notes as part of their distribution at any time within the United States or to, or for the account or benefit of, U.S. persons (other than the Further Notes sold pursuant to Rule 144A);
- (b) it has not solicited and will not solicit offers for, or offer or sell, Further Notes by means of any general solicitation or advertising in the United States or otherwise in any manner involving a public offering within the meaning of Section 4(a)(2) of the Securities Act;
- (c) none of it, its affiliates or any person acting on its or their behalf, has engaged or will engage in any directed selling efforts (within the meaning of Regulation S) with respect to the Further Notes; and

- (d) such Joint Lead Manager, or any person acting on its behalf, will offer or sell or solicit offers for the Further Notes as part of their initial distribution only (1) to persons whom it reasonably believes to be “**qualified institutional buyers**” as defined in Rule 144A under the Securities Act (“**QIBs**”) that are also “**qualified purchasers**” as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act and the rules and regulations thereunder purchasing for their own account or for one or more institutional accounts of which such person is acting as a fiduciary or agent, only when such Joint Lead Manager reasonably believes that each such account is a QIB that is also a QP or (2) in offshore transactions outside the United States within the meaning and meeting the requirements of Rule 903 under the Securities Act.

In addition, until 40 days after the commencement of the offering, an offer or sale of Further Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

Terms used in this section have the meanings given to them by Regulation S under the Securities Act.

### **Italy**

The offering of the Further Notes has not been cleared by the *Commissione Nazionale per la Società e la Borsa* (“**CONSOB**”) pursuant to Italian securities legislation. Accordingly, each Manager has represented and agreed that it has not offered, sold or delivered, directly or indirectly, any Further Notes to the public in the Republic of Italy.

For the purposes of this provision, the expression “offer of Notes to the public” in Italy means the communication in any form and by any means of sufficient information on the terms of the offer and the Further Notes to be offered so as to enable an investor to decide to purchase or subscribe the Further Notes, including the placement through authorised intermediaries.

Each Manager has represented and agreed that it will not offer, sell or deliver, directly or indirectly, any Note or distribute copies of this Prospectus or of any other document relating to the Further Notes in the Republic of Italy except:

- (i) to qualified investors (*investitori qualificati*), as defined under Article 100 of the Legislative Decree No. 58 of February 24, 1998, as amended (the “**Italian Financial Act**”), as implemented by Article 26, paragraph 1(d) of CONSOB Regulation No. 16190 of October 29, 2007, as amended (“**Regulation No. 16190**”), pursuant to Article 34-ter, first paragraph, letter b), of CONSOB Regulation No. 11971 of May 14, 1999, as amended (“**Regulation No. 11971**”); or
- (ii) in other circumstances which are exempted from the rules on public offerings pursuant to Article 100 of the Italian Financial Act and its implementing CONSOB regulations including Regulation No. 11971.

Any such offer, sale or delivery of the Further Notes or distribution of copies of the Prospectus or any other document relating to the Further Notes in the Republic of Italy must be in compliance with the selling restriction under (i) and (ii) above and:

- (a) made by investment firms, banks or financial intermediaries permitted to conduct such activities in the Republic of Italy in accordance with the relevant provisions of the Italian Financial Act, Regulation No. 16190, Legislative Decree No. 385 of September 1, 1993 as amended (the “**Banking Act**”) and any other applicable laws or regulation;
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, as amended, pursuant to which the Bank of Italy may request information on the offering or issue of securities in Italy or by Italian persons outside of Italy; and
- (c) in compliance with any other applicable laws and regulations or requirement imposed by CONSOB or the Bank of Italy or any other Italian authority.

Any investor purchasing the Further Notes is solely responsible for ensuring that any offer, sale, delivery or resale of the Further Notes by such investor occurs in compliance with applicable Italian laws and regulations.”

### **Certain Relationships**

Certain of the Joint Lead Managers and their affiliates from time to time have performed, and in the future will perform, banking, investment banking, advisory, consulting and other financial services for the Republic of Azerbaijan, the Issuer and SOCAR and their respective affiliates, for which they may receive customary advisory and transaction fees and expenses reimbursement.

In addition, in the ordinary course of their business activities, the Joint Lead Managers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Republic of Azerbaijan, the Issuer, SOCAR or any of their respective affiliates (including the Further Notes). Certain of the Joint Lead Managers or their affiliates that have a lending relationship with the Republic of Azerbaijan, the Issuer or SOCAR may hedge their credit exposure to the Republic of Azerbaijan consistent with their customary risk management policies. Such Joint Lead Managers and their affiliates may hedge such exposure by entering into transactions that consist of either the purchase of credit default swaps or the creation of short positions in securities (potentially including the Further Notes). Any such short positions could adversely affect future trading prices of Further Notes. The Joint Lead Managers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

### **Covered Fund**

The Issuer may be classified as a "covered fund" as defined in Section 13 of the Bank Holding Company Act (the "**Volcker Rule**"). The definition of "covered fund" in the Volcker Rule includes (generally) any entity that would be an investment company under the U.S. Investment Company Act of 1940, as amended (the "**1940 Act**"), but for the exemption provided under Section 3(c)(1) or 3(c)(7) thereunder. Because the Issuer relies on Section 3(c)(7) of the 1940 Act for its exemption from registration thereunder (which exemption limits sales of the Further Notes to "qualified purchasers" as such term is defined in the 1940 Act) it may be considered to be a covered fund, which may limit the ability of U.S. "banking entities" and non-U.S. affiliates of U.S. banking entities to hold an ownership interest in the Issuer or enter into financial transactions with the Issuer.

If the Issuer is deemed to be a "covered fund", the marketability and liquidity of the Further Notes could be significantly impaired. Some investors may choose not to purchase any securities of a covered fund — whether or not the securities constitute an ownership interest in a covered fund under the Volcker Rule. In addition, limited regulatory guidance is available to interpret the Volcker Rule, and implementation of the regulatory framework for the Volcker Rule is still evolving. Thus, the uncertainty caused by the breadth of the Volcker Rule's prohibitions and the lack of interpretive guidance could further negatively impact the liquidity and value of the Further Notes. Any purchaser, and in particular any entity that is a "banking entity" as defined under the Volcker Rule, should consider the potential impact of the Volcker Rule in respect of such investment. Each purchaser must determine for itself whether it is a banking entity subject to regulation under the Volcker Rule.

Under the Volcker Rule, "**ownership interest**" is defined broadly to include any participation or other interest that entitles the holder of such interest to, amongst other things: (a) vote to remove management or otherwise other than as a creditor exercising remedies upon an event of default, (b) share in the income, gains, profits or excess spread of the covered fund or (c) receive underlying assets of the covered fund. The Issuer does not believe that an investment in the Further Notes issued would constitute acquiring or retaining an ownership interest in a covered fund.

Notwithstanding the forgoing, neither the Issuer nor the Joint Lead Managers, their respective Affiliates or any other person makes any representation as to any investor's ability to acquire or hold the Further Notes now or at any time in the future.



**Republic of Azerbaijan**

Each of the Joint Lead Managers has represented, warranted and undertaken that it has not offered or sold and will not offer or sell the Further Notes to any person in Azerbaijan, other than as permitted under the laws of Azerbaijan.

**General**

No action has been or will be taken in any jurisdiction by the Issuer, Guarantor or the Joint Lead Managers that would, or is intended to, permit a public offering of the Further Notes, or possession or distribution of this Prospectus or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Prospectus comes are required by the Issuer, the Guarantor and the Joint Lead Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Further Notes or have in their possession, distribute or publish this Prospectus or any other offering material relating to the Further Notes, in all cases at their own expense.

## GENERAL INFORMATION

### 1. Clearing Systems

The Further Notes have been accepted for clearance through the DTC, Clearstream, Luxembourg and Euroclear systems. The Further Notes will be consolidated and form a single series with the Original Notes on 24 March 2017. The Common Code and ISIN for the Unrestricted Notes and Common Code, ISIN and CUSIP the Restricted Notes are as follows:

#### *Unrestricted Notes*

Temporary ISIN:	XS1533917008
ISIN:	XS1319820897

Temporary Common Code:	153391700
Common Code:	131982089

#### *Restricted Notes*

Temporary ISIN:	US84302LAB80
ISIN:	US84302LAA08

Temporary Common Code:	111731144
Common Code:	098266950

Temporary CUSIP:	84302LAB8
CUSIP:	84302LAA0

### 2. Admissions to Trading

It is expected that admission of the Further Notes to trading will be granted on or before 15 March 2017.

### 3. Authorisations

The Issuer and the Guarantor will, on or prior to the Issue Date, have obtained all necessary consents, approvals and authorisations in Azerbaijan in connection with the issue and performance of the Notes and the Guarantee, including the issuance of the Further Notes. The issue of the Further Notes was authorised by resolutions of the General Meeting of Shareholders and the Supervisory Board of the Issuer each passed on 18 January 2016 and the giving of the Guarantee by the Guarantor was authorised by the instructive order of the Cabinet of Ministers of the Guarantor dated 7 March 2016.

### 4. Material Adverse Change relating to the Issuer

There has been no significant change in the financial or trading position of the Issuer since 30 November 2016 and no material adverse change in the financial position or prospects of the Issuer since 31 December 2015.

### 5. Litigation relating to the Issuer

Neither the Issuer nor any of its respective subsidiaries are involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened) which may have, or have had during the 12 months preceding the date of this Prospectus, a significant effect on the financial position or profitability of the Issuer.

6. **Documents on Display relating to the Issuer**

For so long as any of the Notes is outstanding, copies of the following documents may be inspected in electronic format at the specified offices of each of the Paying and Transfer Agents during normal business hours:

- (a) the constitutional documents of the Issuer: instructive order of the President of the Republic ordering the establishment of the Issuer, the Issuer's charter, certificate of state registration and extract from the state register of commercial legal entities;
- (b) the annual report and consolidated accounts of the Issuer for the year ended 31 December 2015 including the audit report relating to such accounts;
- (c) the interim condensed consolidated accounts of the Issuer for the eleven months ended 30 November 2016;
- (d) the budget of the Republic of Azerbaijan for the last fiscal year;
- (e) the Fiscal Agency Agreement;
- (f) the prospectus issued in respect of the Original Notes dated 18 March 2016, this Prospectus and any supplements thereto;
- (g) the Deed of Covenant; and
- (h) the Deed of Guarantee.

English translations of any of the documents listed above which are not in English are also available for inspection as described above.

7. **Material Adverse Change relating to the Guarantor**

There has been no significant change in relation to the Republic of Azerbaijan's (i) tax and budgetary systems, (ii) gross public debt, (iii) foreign trade and balance of payment figures, (iv) foreign exchange reserves, (v) financial position and resources and (vi) income and expenditure figures of the Republic since the fiscal year ended 31 December 2015.

8. **Litigation relating to the Guarantor**

The Republic of Azerbaijan is not and has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Republic of Azerbaijan is aware) during the previous 12 months which may have, or have had in the recent past, a significant effect on the Republic of Azerbaijan's financial position.

9. **Documents on Display relating to the Guarantor**

For so long as any of the Notes is outstanding, copies of the following documents may be inspected in electronic format at the specified offices of the Fiscal Agent:

- (a) this Prospectus;
- (b) the Fiscal Agency Agreement;
- (c) the Deed of Covenant;
- (d) the Deed of Guarantee; and
- (e) the Budgets for the year ending 31 December 2016 and 31 December 2017.

English translations of any of the documents listed above which are not in English are also available for inspection as described above.

10. **Auditors**

The Audited Financial Statements contained in this Prospectus have been audited by Ernst & Young Holdings (CIS) B.V. in accordance with International Standards on Auditing and E&Y rendered an unqualified audit report on such accounts. The Interim Financial Statements have been reviewed but not audited by Ernst & Young Holdings (CIS) B.V. in accordance with International Standards on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, who have expressed an unqualified conclusion on those financial statements, as stated in their report appearing herein. Ernst & Young Holdings (CIS) B.V. is regulated in the Republic of Azerbaijan by the Chamber of Auditors of the Azerbaijan Republic which has issued Ernst & Young with a licence to practise as auditors. There is no other professional institute of auditors in the Republic of Azerbaijan.

11. **Conflicts of Interest**

Several members of the management and supervisory board of the Issuer hold significant positions within the Government (or are Members of Parliament) of the Republic of Azerbaijan, and/or other entities that are owned or controlled by the Republic of Azerbaijan (which include significant commercial counterparties of the Issuer). Aside from the foregoing, there are no potential conflicts of interest between any duties of the members of the administrative, management or supervisory bodies of the Issuer towards the Issuer and their private interests and/or other duties.

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**REVIEWED UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS FOR THE ELEVEN MONTHS ENDED 30 NOVEMBER 2016 WITH  
INDEPENDENT AUDITORS' REPORT**



**Southern Gas Corridor  
Closed Joint-Stock Company**

**Interim condensed consolidated financial statements**

*30 November 2016*

# Southern Gas Corridor CJSC

## Interim condensed consolidated financial statements

30 November 2016

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## Report on review of the interim condensed consolidated financial statements

To Management of the Southern Gas Corridor CJSC

### **Introduction**

We have reviewed the accompanying interim condensed consolidated statement of financial position of the Southern Gas Corridor Closed Joint Stock Company (the "Company") and its subsidiaries (the "Group") as of 30 November 2016 and the related interim condensed consolidated statements of profit or loss, comprehensive income, changes in equity and cash flows for the eleven months period then ended, and explanatory notes. Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with IAS 34 *Interim Financial Reporting* (IAS 34). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

### **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

*Ernst & Young Holdings (CIS) B.V.*

16 February 2017

## Southern Gas Corridor CJSC

### Interim condensed consolidated statement of financial position

(Amounts presented are in thousands of US dollars)

	Note	30 November 2016 Unaudited reviewed	31 December 2015 Audited
<b>Assets</b>			
<b>Non-current assets</b>			
Oil and gas properties	4	453,769	490,333
Construction in progress and development costs	5	4,779,809	2,564,393
Advance payments	6	1,837,928	1,636,491
Investments in associate	7	89,414	60,740
Loans receivable	8	321,612	137,497
Deferred tax assets		2,884	-
Other non-current assets		2,003	2,003
<b>Total non-current assets</b>		<b>7,487,419</b>	<b>4,891,457</b>
<b>Current assets</b>			
Cash and cash equivalents	9	438,663	254,560
Accounts receivable		11,476	19,004
Inventories		10,338	9,335
Accrued revenue		2,293	3,119
Other current assets		33,450	37,924
<b>Total current assets</b>		<b>496,220</b>	<b>323,942</b>
<b>Total assets</b>		<b>7,983,639</b>	<b>5,215,399</b>
<b>Equity and liabilities</b>			
<b>Equity</b>			
Share capital	10	1,740,800	1,444,900
Additional paid in capital	10	631,768	-
Other reserves		(45,176)	(45,176)
Cumulative translation differences		(34,382)	(23,516)
Retained earnings		(22,148)	31,703
<b>Equity attributable to the Group's equity holders</b>		<b>2,270,862</b>	<b>1,407,911</b>
Non-controlling interest		646,064	339,995
<b>Total equity</b>		<b>2,916,926</b>	<b>1,747,906</b>
<b>Non-current liabilities</b>			
Long-term borrowings	11	3,721,658	2,191,873
Government grant	11	669,350	683,281
Decommissioning liabilities	12	71,094	52,066
Deferred revenue		2,863	5,283
Deferred tax liability		11,332	8,060
Other non-current liabilities		12,098	10,001
<b>Total non-current liabilities</b>		<b>4,488,395</b>	<b>2,950,564</b>
<b>Current liabilities</b>			
Trade and other payables	13	205,720	197,025
Accrued liabilities	13	358,576	318,759
Current portion of long-term borrowings	11	13,273	-
Income tax payable		749	1,145
<b>Total current liabilities</b>		<b>578,318</b>	<b>516,929</b>
<b>Total equity and liabilities</b>		<b>7,983,639</b>	<b>5,215,399</b>

**Signed and authorized on behalf of the Group**

Afgan Isayev, General Director

  
 16 February 2017

Adil Pashayev, Finance Director

  
 16 February 2017

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Interim condensed consolidated statement of comprehensive income

*(Amounts presented are in thousands of US dollars)*

	Note	Eleven months ended 30 November 2016 Unaudited reviewed	Eleven months ended 30 November 2015 Unaudited reviewed
Revenue	14	103,391	136,170
Cost of sales	15	(62,001)	(63,086)
<b>Gross profit</b>		<b>41,390</b>	<b>73,084</b>
Transportation tariffs		(3,576)	(4,587)
General and administrative expenses		(11,320)	(11,475)
Other income		14,958	14,467
<b>Operating profit</b>		<b>41,452</b>	<b>71,489</b>
Interest income		6,815	4,864
Finance costs	8, 11, 12	(73,985)	(48,449)
Share of result of associates	7	(4,977)	(7,547)
Foreign exchange loss, net		(20,719)	(567)
<b>(Loss)/profit before income tax</b>		<b>(51,414)</b>	<b>19,790</b>
Income tax expenses		(1,529)	(3,412)
<b>(Loss)/profit for the period</b>		<b>(52,943)</b>	<b>16,378</b>
<b>Other comprehensive gain/(loss)</b>			
<i>Other comprehensive gain/(loss) to be reclassified to profit or loss in subsequent period</i>			
Exchange differences on translation of foreign operations		(8,188)	(8,713)
Exchange differences on translation of foreign associate		(2,678)	(2,034)
<b>Other comprehensive gain/(loss) for the period</b>		<b>(10,866)</b>	<b>(10,747)</b>
<b>Total comprehensive (loss)/income for the period</b>		<b>(63,809)</b>	<b>5,631</b>
<b>(Loss)/profit attributable to:</b>			
Equity holders of the Group		(53,851)	15,287
Non-controlling interest		908	1,091
		<b>(52,943)</b>	<b>16,378</b>
<b>Total comprehensive (loss)/income attributable to:</b>			
Equity holders of the Group		(64,717)	4,540
Non-controlling interest		908	1,091
		<b>(63,809)</b>	<b>5,631</b>

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Interim condensed consolidated statement of cash flows

*(Amounts presented are in thousands of US dollars)*

	Note	Eleven months ended 30 November 2016 Unaudited reviewed	Eleven months ended 30 November 2015 Unaudited reviewed
<b>Operating activities</b>			
(Loss)/profit before income tax		(51,414)	19,790
<i>Non-cash adjustments to reconcile profit before tax to net cash flows</i>			
Finance costs	8, 11, 12	73,985	48,449
Depreciation and depletion	15	53,474	48,679
Share of result of associate	7	4,977	7,547
Other income		(14,958)	(14,467)
Interest income		(6,815)	(4,864)
Exchange loss		21,031	633
<i>Working capital adjustments</i>			
Accounts receivable		7,528	(202)
Inventories		(1,003)	124
Accrued revenue		826	9,479
Other assets		4,474	(3,034)
Deferred revenue		(2,420)	(1,382)
Trade and other payables		10,375	498
Accrued liabilities		(1,555)	7,752
<b>Cash generated from operations</b>		<b>98,505</b>	<b>119,002</b>
Income tax paid		(1,525)	(1,376)
Interest received		3,023	4,807
<b>Net cash flows from operating activities</b>		<b>100,003</b>	<b>122,433</b>
<b>Investing activities</b>			
Placement of deposits		-	(350,000)
Proceeds from withdrawal of deposits		-	383,246
Financing provided to third party	8	(85,000)	(19,300)
Financing provided to associate		(118,500)	(45,556)
Advance payments for acquisition of shares	6	(264,101)	(492,191)
Investments in oil and gas properties		(15,791)	(19,042)
Investment in associates	7	(38,900)	(17,500)
Additions to construction in progress and development costs		(1,969,332)	(1,102,324)
<b>Net cash used in investing activities</b>		<b>(2,491,624)</b>	<b>(1,662,667)</b>
<b>Financing activities</b>			
Contribution from shareholders to the charter capital	10	295,900	965,200
Increase in additional paid-in capital	10	631,768	-
Contribution in subsidiary by non-controlling shareholder		305,161	-
Proceeds from borrowings	11	1,397,596	182,880
Proceeds from sale of shares in subsidiary		-	265,649
Interest paid		(34,375)	-
<b>Net cash from financing activities</b>		<b>2,596,050</b>	<b>1,413,729</b>
Net foreign exchange translation differences		(20,326)	-
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>184,103</b>	<b>(126,505)</b>
Cash and cash equivalents at the beginning of the period	9	254,560	212,198
<b>Cash and cash equivalents at the end of the period</b>	9	<b>438,663</b>	<b>85,693</b>

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Interim condensed consolidated statement of changes in equity

*(Amounts presented are in thousands of US dollars)*

	Attributable to the equity holders of the parent					Total	Non-controlling interest	Total equity
	Share capital	Additional paid-in capital	Other reserves	Cumulative translation differences	Retained earnings			
<b>At 31 December 2014</b>	<b>100,000</b>	-	-	(11,104)	13,208	<b>102,104</b>	-	<b>102,104</b>
Profit for the period	-	-	-	-	15,287	<b>15,287</b>	1,091	<b>16,378</b>
Other comprehensive loss	-	-	-	(10,747)	-	<b>(10,747)</b>	-	<b>(10,747)</b>
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(10,747)</b>	<b>15,287</b>	<b>4,540</b>	<b>1,091</b>	<b>5,631</b>
Contribution from shareholders to the charter capital (Note 10)	965,200	-	-	-	-	<b>965,200</b>	-	<b>965,200</b>
Sale of share in subsidiary	-	-	(45,176)	-	-	<b>(45,176)</b>	338,831	<b>293,655</b>
<b>At 30 November 2015 Unaudited reviewed</b>	<b>1,065,200</b>	<b>-</b>	<b>(45,176)</b>	<b>(21,851)</b>	<b>28,495</b>	<b>1,026,668</b>	<b>339,922</b>	<b>1,366,590</b>
<b>At 31 December 2015</b>	<b>1,444,900</b>	<b>-</b>	<b>(45,176)</b>	<b>(23,516)</b>	<b>31,703</b>	<b>1,407,911</b>	<b>339,995</b>	<b>1,747,906</b>
(Loss)/profit for the period	-	-	-	-	(53,851)	<b>(53,851)</b>	908	<b>(52,943)</b>
Other comprehensive loss	-	-	-	(10,866)	-	<b>(10,866)</b>	-	<b>(10,866)</b>
<b>Total comprehensive (loss)/income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(10,866)</b>	<b>(53,851)</b>	<b>(64,717)</b>	<b>908</b>	<b>(63,809)</b>
Contribution from shareholders to the charter capital (Note 10)	295,900	-	-	-	-	<b>295,900</b>	-	<b>295,900</b>
Increase in additional paid-in capital (Note 10)	-	631,768	-	-	-	<b>631,768</b>	-	<b>631,768</b>
Contribution by non-controlling shareholders	-	-	-	-	-	-	305,161	<b>305,161</b>
<b>At 30 November 2016 Unaudited reviewed</b>	<b>1,740,800</b>	<b>631,768</b>	<b>(45,176)</b>	<b>(34,382)</b>	<b>(22,148)</b>	<b>2,270,862</b>	<b>646,064</b>	<b>2,916,926</b>

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 1. Corporate information

Southern Gas Corridor Closed Joint-Stock Company (the "Company" or "SGC CJSC") was established by the Presidential Decree No. 287 dated 25 February 2014. It was incorporated on 31 March 2014 in accordance with Azerbaijani legislation. 51% of the Company is owned by the Republic of Azerbaijan (the "State"), which is represented by the Ministry of Economy of the Republic of Azerbaijan ("ME"), whereas 49% belongs to the State Oil Company of Azerbaijan Republic ("SOCAR"). The Company is domiciled in the Republic of Azerbaijan. The registered address is located at 73 Neftchilar Avenue, Baku, AZ 1000, the Republic of Azerbaijan.

The Company was established for consolidating, managing and financing the State's interests in the full-field development of the Shah Deniz gas-condensate field, the expansion of the South Caucasus Pipeline ("SCP"), implementation of Trans-Anatolian Natural Gas Pipeline ("TANAP") and Trans Adriatic Pipeline ("TAP") projects (together the "Projects").

The Company has the following subsidiaries:

Name		Country of incorporation	% equity interest	
			30 November 2016	31 December 2015
SGC Upstream LLC	Subsidiary	Azerbaijan	100%	100%
SGC Midstream LLC	Subsidiary	Azerbaijan	100%	100%
TANAP Doğalgaz İletim A.Ş.	Subsidiary	Turkey	58%	58%
AzTAP GmbH	Subsidiary	Switzerland	100%	100%

The Company holds 20% share in Trans Adriatic Pipeline AG ("TAP AG"), through AzTAP GmbH.

On 13 April 2015 the Company sold its 30% share in TANAP Doğalgaz İletim A.Ş. ("TANAP A.Ş.") to Boru Hatları ile Petrol Taşıma A.Ş. ("BOTAS"). On 16 April 2015 the Company sold further 12% share in TANAP A.Ş. to BP Pipelines (TANAP) Limited (BP). Further details are disclosed in Note 8.

On 28 October 2015, management of SOCAR Turkey Enerji A.Ş. ("STEAS") has sent official letter expressing its intention for acquiring 7% shares in TANAP A.Ş. from the Company. No acquisition has taken place as of issuance of these interim condensed consolidated financial statements.

#### 2. Significant accounting policies, judgments, estimates and assumptions

##### Basis of preparation

These interim condensed consolidated financial statements of the Company and its subsidiaries (collectively referred to as "the Group") for the eleven months period ended 30 November 2016 have been prepared in accordance with International Accounting Standards ("IAS") 34 *Interim Financial Reporting*. These interim financial statements should be read in conjunction with the Group's annual consolidated financial statements for the year ended 31 December 2015, which have been prepared in accordance with International Financial Reporting Standards ("IFRS").

##### Going concern

The going concern basis assumes that the Group will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. As at 30 November 2016 the Group had net current liabilities in the amount of US dollars 82,098. In addition, as at 30 November 2016 the Group had certain commitments which will require significant cash outflows in the foreseeable future (see Note 18).

The Group's ability to continue as a going concern depends on the ability to generate sufficient cash inflows from financing provided by third parties and its shareholders.



## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies, judgments, estimates and assumptions (continued)

##### Going concern (continued)

The Group's management expects to receive sufficient amount of proceeds from hydrocarbons sales under current Shah Deniz Production Sharing Agreement, contributions from State Oil Fund of the Republic of Azerbaijan ("SOFAZ") and capital injections by the shareholders as well as through funds raised by external debt. The Group management believes that the funds obtained from the above sources will be sufficient for meeting its financial commitments and the Group will be able to continue as a going concern for the foreseeable future.

##### Accounting policies

The accounting policies are consistent with those of the annual consolidated financial statements for the year ended 31 December 2015, except for the adoption of new standards and interpretations effective as of 1 January 2016. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments apply for the first time in 2016, they do not have a material impact on the annual consolidated financial statements or the interim condensed consolidated financial statements of the Group. The nature and the impact of each new standard or amendment are described below:

##### *Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests*

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 *Business Combinations* principles for business combination accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation if joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments do not have any impact on the Group.

##### *Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation*

The amendments clarify the principle in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is a part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments do not have any impact to the Group given that the Group has not used a revenue-based method to depreciate its non-current assets.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies, judgments, estimates and assumptions (continued)

##### Accounting policies (continued)

###### *Amendments to IAS 27 Equity Method in Separate Financial Statements*

The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in their separate financial statements will have to apply that change retrospectively. First-time adopters of IFRS electing to use the equity method in their separate financial statements will be required to apply this method from the date of transition to IFRS. The amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments do not have any impact on the Group's consolidated financial statements.

###### *Annual improvements 2012-2014 cycle*

These improvements are effective for annual periods beginning on or after 1 January 2016. They include:

###### *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*

Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment must be applied prospectively.

###### *IFRS 7 Financial Instruments: Disclosures*

###### *(i) Servicing contracts*

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

###### *(ii) Applicability of the amendments to IFRS 7 to condensed interim financial statements*

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. This amendment must be applied retrospectively.

###### *IAS 19 Employee Benefits*

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment must be applied prospectively.

###### *IAS 34 Interim Financial Reporting*

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment must be applied retrospectively. These amendments do not have any impact on the Group.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies, judgments, estimates and assumptions (continued)

##### Accounting policies (continued)

###### *Amendments to IAS 1 Disclosure Initiative*

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- ▶ The materiality requirements in IAS 1.
- ▶ That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated.
- ▶ That entities have flexibility as to the order in which they present the notes to financial statements.
- ▶ That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments do not have any impact on the Group.

###### *Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception*

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. These amendments must be applied retrospectively and are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments do not have any impact on the Group as the Group does not apply the consolidation exception.

##### Presentation currency

The interim condensed consolidated financial statements are presented in US dollars ("USD") and all values are rounded to the nearest thousands, except when otherwise indicated.

The functional and the presentation currency of the Company and its subsidiaries and associate are the following:

SGC CJSC	USD
SGC Upstream LLC	USD
SGC Midstream LLC	USD
TANAP A.Ş.	USD
AzTAP GmbH	EUR
TAP AG	EUR

At 30 November 2016 the principal rate of exchange used for translating foreign currency balances was USD 1.0635 per EUR 1.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies, judgments, estimates and assumptions (continued)

##### Critical accounting estimates and judgements

The critical accounting estimates and judgements followed by the Group in the preparation of these interim financial statements are consistent with those disclosed in the audited consolidated financial statements for the year ended 31 December 2015. Estimates, assumptions and judgments have principally been made in respect of estimation of reserves, decommissioning liabilities, deferred and accrued revenue and recoverability of oil and gas assets.

Management reviews these estimates and judgements on a continuous basis, by reference to past experiences and other factors considered as reasonable which form the basis for assessing the book values of assets and liabilities. Adjustments to accounting estimates are recognized in the period in which the estimate is revised. Actual results may differ from such estimates if different assumptions or circumstances apply; however, management considers that the effect of any changes in these estimates would not be significant unless otherwise disclosed in the accompanying interim financial statements.

##### Recoverability of oil and gas assets

The Group assesses each asset or cash generating unit ("CGU") every reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made. Given the nature of the Group's activities, information on the fair value of an asset or CGU is not practicable to identify. Consequently, the recoverable amount used in performing the impairment test described below is value-in-use. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

##### Key assumptions used in value-in-use calculations

The calculation of value-in-use for oil fields is most sensitive to the following assumptions:

*Identification of CGU* – CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets of group of assets. Management assesses that SCP, TANAP and TAP projects are being constructed with the ultimate goal of the delivering Shah Deniz field natural gas to the Georgian, Turkish and European markets and in order to deliver non-Shah Deniz gas to the markets through SCP, TANAP and TAP pipelines additional infrastructures and facilities are required. Therefore, all these projects have been considered as one CGU and impairment test is performed on the level of the whole Group.

*Capital expenditures* – Capital expenditures necessary to maintain estimated production volumes are based on long-term development plans for particular field.

##### Commitments under DSPA

As disclosed in Note 18, the Group is committed to make progress payments under the terms of the DSPA. The parties to the DSPA have the intention to revise the mechanism of progress payments which will result in decrease of cash outflows by the Group. The Group expects that the respective amendment to DSPA will be signed in 2017. Accordingly, the Group used revised figures in relation to progress payments in calculation of undiscounted cash flows.

*Crude oil price* – Forecast commodity prices are publicly available. If the forecasted prices used in the calculation had been five dollars (US dollars 5.0) lower than management's estimate, this would not result with any impairment loss.

*Discount rate* – The post-tax discount rate applied to the cash flow projections of CGU was 6.0%. The discount rate calculation is based on the specific circumstances of the Group and derived from its incremental borrowing rate adjusted to the specific risks associated with the asset's estimated cash flows. If the estimated discount rate used in the calculation had been 0.5% higher than management's estimate, this would not result in impairment loss.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies, judgments, estimates and assumptions (continued)

##### Critical accounting estimates and judgements (continued)

The last impairment test was performed by the Group as of 30 June 2016 and did not result in any impairment loss. No indications of impairment were identified as of 30 November 2016.

#### 3. Segment information

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the management of the Group and for which discrete financial information is available.

The Group is organized into business units based on their products and services and has two reportable segments as follows:

- ▶ Oil and gas – representing extraction of natural gas and gas condensate.
- ▶ Distribution – representing transportation of natural gas and gas condensate.

No operating segments have been aggregated to form the above reportable operating segments.

The Group's segments are strategic business units that focus on different customers. Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Transfer prices between operating segments are either on an arm's length basis or non-arm's length basis.

The following table presents revenue and profit information regarding the Group's operating segments for the eleven months ended 30 November 2016 and 2015, respectively.

Eleven months period ended 30 November 2016	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
<b>Revenues</b>					
External customers	103,391	-	-	-	103,391
Inter-segment	-	20,378	-	(20,378)	-
<b>Total revenue</b>	<b>103,391</b>	<b>20,378</b>	<b>-</b>	<b>(20,378)</b>	<b>103,391</b>
<b>Segment (loss)/profit</b>	<b>(20,244)</b>	<b>(15,996)</b>	<b>10,185</b>	<b>(26,888)</b>	<b>(52,943)</b>

Eleven months period ended 30 November 2015	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
<b>Revenues</b>					
External customers	136,170	-	-	-	136,170
Inter-segment	-	19,409	-	(19,409)	-
<b>Total revenue</b>	<b>136,170</b>	<b>19,409</b>	<b>-</b>	<b>(19,409)</b>	<b>136,170</b>
<b>Segment profit/(loss)</b>	<b>30,029</b>	<b>(8,080)</b>	<b>(13,041)</b>	<b>7,470</b>	<b>16,378</b>

(\*) These numbers include unallocated transactions managed and recognized at the group level.

(\*\*) Inter-segment revenues and expenses are eliminated on consolidation. Amounts shown as eliminations include intercompany transactions.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 3. Segment information (continued)

The following table represents segment assets, liabilities as at 30 November 2016 and 31 December 2015 and capital expenditures of the Group's operating segments for the eleven months ended 30 November 2016 and 2015:

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
<b>Segment assets</b>					
At 30 November 2016	2,604,576	4,735,497	5,149,456	(4,505,890)	<b>7,983,639</b>
At 31 December 2015	2,241,496	2,645,608	3,537,638	(3,209,343)	<b>5,215,399</b>
<b>Segment liabilities</b>					
At 30 November 2016	(2,552,616)	(3,230,673)	(3,734,111)	4,450,687	<b>(5,066,713)</b>
At 31 December 2015	(2,169,421)	(1,852,488)	(2,638,603)	3,193,019	<b>(3,467,493)</b>
<b>Capital expenditures (***)</b>					
Eleven months period ended 30 November 2016	453,350	2,019,299	14	-	<b>2,472,663</b>
Eleven months period ended 30 November 2015	693,051	1,328,695	74	-	<b>2,021,820</b>

(\*) These numbers include unallocated assets and liabilities managed and recognized at the group level.

(\*\*) Inter-segment balances are eliminated on consolidation. Amounts shown as eliminations include intercompany balances.

(\*\*\*) Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

#### 4. Oil and gas properties

Movements in the carrying amount of oil and gas properties consisted of the following:

	Oil and gas production properties	Pipeline assets	Decommis- sioning costs	Total
<b>Cost</b>				
At 31 December 2014	442,698	74,473	16,366	533,537
Additions	29,858	845	1,084	31,787
At 31 December 2015	472,556	75,318	17,450	565,324
Additions	15,235	556	1,119	16,910
At 30 November 2016	487,791	75,874	18,569	582,234
<b>Accumulated depletion and depreciation</b>				
At 31 December 2014	(19,182)	(1,402)	(549)	(21,133)
Charge for the period	(49,226)	(3,398)	(1,234)	(53,858)
At 31 December 2015	(68,408)	(4,800)	(1,783)	(74,991)
Charge for the period	(48,476)	(3,158)	(1,840)	(53,474)
At 30 November 2016	(116,884)	(7,958)	(3,623)	(128,465)
<b>Net book value</b>				
At 30 November 2016	370,907	67,916	14,946	453,769
At 31 December 2015	404,148	70,518	15,667	490,333

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 4. Oil and gas properties (continued)

##### Oil and gas production properties

Oil and gas production properties are represented by the Group's 6.67% share in oil and gas production properties of Shah Deniz ("SD") project.

##### Pipeline assets

The pipeline cost represents the Group's 6.67% share in cost of construction and capitalized maintenance expenses on SCP pipeline.

##### Decommissioning costs

The capitalized decommissioning costs are represented by the Group's 6.67% share in costs related to decommissioning of assets employed for the purposes of SD and SCP projects. Refer to Note 12 for details.

#### 5. Construction in progress and development costs

Movements in the carrying amount of oil and gas properties consisted of the following:

	Development costs	Construction in progress	Decommis- sioning costs	Total
<b>At 31 December 2014</b>	<b>557,853</b>	<b>409,567</b>	<b>20,697</b>	<b>988,117</b>
Additions	309,783	1,254,682	11,811	1,576,276
<b>At 31 December 2015</b>	<b>867,636</b>	<b>1,664,249</b>	<b>32,508</b>	<b>2,564,393</b>
Additions	233,467	1,966,891	15,058	2,215,416
<b>At 30 November 2016</b>	<b>1,101,103</b>	<b>3,631,140</b>	<b>47,566</b>	<b>4,779,809</b>
<b>Net book value</b>				
<b>At 30 November 2016</b>	<b>1,101,103</b>	<b>3,631,140</b>	<b>47,566</b>	<b>4,779,809</b>
<b>At 31 December 2015</b>	<b>867,636</b>	<b>1,664,249</b>	<b>32,508</b>	<b>2,564,393</b>

##### Development costs

Development costs are represented by costs incurred in respect of Shah Deniz Stage 2 Development project.

##### Construction in progress

As at 30 November 2016 this amount includes cost directly related to the construction of TANAP and expansion of SCP pipeline system in the amount of US dollars 3,396,208 (31 December 2015: US dollars 1,501,908) and US dollars 234,932 (31 December 2015: US dollars 162,341), respectively. The amount related to construction of TANAP includes costs for project management services, early work expenses, land acquisition costs, personnel expenses and other costs directly attributable to the construction of pipeline.

##### Capitalized borrowing cost

Total cumulative borrowing costs capitalized as part of construction in progress and development costs equaled to US dollars 180,588 as at 30 November 2016 (31 December 2015: US dollars 54,003). Refer to Note 11 for further details.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 6. Advance payments

Advance payments consisted of the following:

	<b>30 November 2016</b>	<b>31 December 2015</b>
Advance payments for acquisition of shares	1,608,983	1,344,882
Other payments related to construction works	228,945	291,609
	<b>1,837,928</b>	<b>1,636,491</b>

#### Advance payments for acquisition of shares

Advance payments for acquisition of shares represents advances paid in the amount of US dollars 1,090 million (31 December 2015: US dollars 887 million) to Azerbaijan (Shah Deniz) Limited ("AzSD") and US dollars 519 million (31 December 2015: US dollars 458 million) to Azerbaijan (South Caucasus Pipeline) Limited ("AzSCP") for acquisition of their 10% interests in the SD PSA and SCP projects, respectively, and treated as non-financial assets. Refer to Note 16 for further details.

#### 7. Investments in associate

At 30 November 2016 the Group held twenty percent (20%) interest in TAP AG. The Group exercises significant influence over the entity by participating in its financial and operating decisions.

The table below summarizes the movements in the carrying amount of the Group's investment in TAP AG:

	<b>30 November 2016</b>	<b>31 December 2015</b>
<b>Opening carrying amount</b>	<b>60,740</b>	<b>56,432</b>
Additions to investment in associate	38,900	17,500
Share of after tax results of associate	(4,977)	(5,856)
Other	(2,571)	(1,335)
Exchange differences	(2,678)	(6,001)
<b>Closing carrying amount</b>	<b>89,414</b>	<b>60,740</b>

#### 8. Loans receivable

Loans receivable consisted of receivable from TAP AG (related associate) in the amount of US dollars 197,860 (31 December 2015: US dollars 84,977) and receivables from BOTAS in the amount of US dollars 123,752 (31 December 2015: US dollars 52,520). The loan to TAP AG bears interest equal to EUR rate for cross border shareholders loans as published by the Swiss federal tax authorities plus 1% margin and approximated 2% in 2016 (2015: 2%). The loan matures in July 2043. Interest income earned during the eleven months period ended 30 November 2016 was US dollars 2,571 (30 November 2015: US dollars 1,188).

Receivables from BOTAS represent deferred consideration in the amount of US dollars 29,917 (31 December 2015: US dollars 28,987) and loan receivable in the amount of US dollars 93,835 (31 December 2015: US dollars 23,533). In accordance with the sale and purchase agreement, the Group sold its 30% shares in TANAP A.Ş. to BOTAS for cash consideration of US dollars 168,226 and deferred consideration of US dollars 33,645. The deferred consideration does not bear interest and is expected to be repaid during 2020-2021. At initial recognition fair value of the deferred consideration was calculated as the present value using the market borrowing rate for similar financial instruments (3.5%) in the amount of US dollars 28,006. Income earned in respect of the deferred consideration from BOTAS during the eleven months period ended 30 November 2016 was US dollars 930 (30 November 2015: US dollars 898) and was recognized within interest income.



## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 8. Loans receivable (continued)

According to the funding agreement, following the sale of 30% shares of TANAP, the Group financed cash call requirements of BOTAS equivalent to 5% shares in TANAP A.Ş. in the amount of US dollars 85,000 during the eleven months period ended 30 November 2016 (31 December 2015: US dollars 27,950). The loan does not bear interest and is expected to be repaid in 2021-2023 fully. At initial recognition, the present value was calculated using the market borrowing rate for similar financial instruments (4%) in the amount of US dollars 67,118 and the difference between the fair value and carrying amount of loan in the amount of US dollars 17,882 was recognized in profit and loss (30 November 2015: US dollars 3,598). Income earned in respect of the loan receivable from BOTAS during the eleven months period ended 30 November 2016 was US dollars 3,184 (30 November 2015: US dollars 504) and was recognized within interest income.

#### 9. Cash and cash equivalents

Cash and cash equivalents consisted of the following:

	30 November 2016	31 December 2015
Cash at bank, USD	202,027	254,228
Cash at bank, AZN	236,257	–
Cash at bank, EUR	332	332
Cash at bank, other	47	–
<b>Total cash and cash equivalents</b>	<b>438,663</b>	<b>254,560</b>

Cash at bank includes time deposits in the amount of US dollars 17,497 (31 December 2015: US dollars 535) with maturity of up to one month and bearing effective interest rate between 2% and 2.4% (31 December 2015: 1.95%).

#### 10. Share capital and Additional paid-in capital

##### *Share capital*

During the eleven months period ended 30 November 2016 the Group received additional contribution in share capital in the amount of US dollars 295,900. As at 30 November 2016 and 31 December 2015 the Company had authorized, issued and fully paid 100 ordinary shares at par USD 17,408 and USD 14,449, respectively. Each share entitles one vote to the shareholder.

##### *Additional paid-in capital*

During the eleven months period ended 30 November 2016 SOCAR and ME have approved the decision to increase charter capital in the amount of US dollars 675,000 through cash contribution. The Group received additional contribution in the amount of US dollars 631,768. These contributions were not registered as of 30 November 2016 and recognized as additional paid-in capital.

#### 11. Borrowings and Government grant

##### **Bonds issued to SOFAZ**

In accordance with the Presidential Decree dated 25 February 2014 the State Oil Fund of Azerbaijan ("SOFAZ"), a governmental fund established for funding of important socio-economic projects, was assigned for financing of the Group's acquisitions of interests in the projects described in Note 1. Accordingly, in 2014 the Group issued bonds to SOFAZ in the aggregate amount of US dollars 2,516,996 with maturity period of 10 years. Interest rate implicit in bond prospectus is 1% + 6 months LIBOR. The repayment of interest shall be made in semiannual installments effective from 2021 till 2024.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 11. Borrowings and Government grant (continued)

At initial recognition, the Group calculated the fair value of the bond using market rate for similar financial instruments (4.5% + 6 months LIBOR) and recognized US dollars 704,270 of difference between fair value and carrying amount of the bond as government grant in its consolidated statements of financial position.

Total interest accrued during the eleven months period ended 30 November 2016 was US dollars 104,563 (30 November 2015: US dollars 87,635). The Group capitalized borrowing cost as part of construction in progress and development costs in the amount of US dollars 53,363 during the eleven months period ended 30 November 2016 (30 November 2015: US dollars 44,724).

During the eleven months period ended 30 November 2016 the Group recognized income from government grant in the amount of US dollars 13,931 which was recognized within other income (30 November 2015: US dollars 13,122).

#### Loan from BOTAS and BP

In accordance with Term Loan Facility Agreement signed in 2015, shareholders of TANAP A.Ş undertake to make available a loan facility for financing of their shares of the capital expenditures relating to the TANAP project. During the eleven months period ended 30 November 2016, the Group received principal amounts of loans from BOTAS and BP in the amount of US dollars 292,027 (31 December 2015: US dollars 170,101) and US dollars 116,811 (31 December 2015: US dollars 67,830), respectively. The loans bear interest at the rate of 5.5% + 1 month LIBOR. Total interest charges incurred during the eleven months period ended 30 November 2016 amounted US dollars 27,626 (30 November 2015: 1,926), which were capitalized as part of cost of asset.

#### Eurobond emission

In March 2016 the Company issued US dollars 1 billion senior unsecured notes guaranteed by the Republic of Azerbaijan ("Notes"). The Notes bear interest rate of 6.875 per cent per annum payable semi-annually in arrears on 24 March and 24 September in each year until maturity. The Notes mature on 24 March 2026 and are listed on the Irish Stock Exchange. The Notes were issued at discount and the Group received US dollars 991,120 from the issued Notes. Transaction costs incurred in respect of Notes equaled to US dollars 2,362.

Total interest accrued on bonds during the eleven months period ended 30 November 2016 was US dollars 47,648, including US dollars 45,596 capitalized as part of construction in progress and development costs.

As at 30 November 2016 current portion of long-term borrowings represents the accrued interest in the amount of US dollars 13,273.

#### 12. Decommissioning liabilities

The Group has a legal and constructive obligation with respect to decommissioning of oil and gas production and pipeline assets. Movements in provisions for the related asset retirement obligations are as follows:

	30 November 2016	31 December 2015
<b>Opening carrying amount</b>	<b>52,066</b>	<b>37,063</b>
Additional liability during the period	22,250	14,336
Unwinding of present value discount	2,851	2,108
Effect of discount rate revision	(6,073)	(1,441)
<b>Closing carrying amount</b>	<b>71,094</b>	<b>52,066</b>

Under the provisions of the SD PSA and SCP Host Government Agreements ("HGA") all Contractor Parties will have to make contributions to an abandonment fund, which will be used to finance the decommissioning and dismantling of constructed assets after the maturity of the SD PSA and SCP.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 12. Decommissioning liabilities (continued)

The maximum amount of decommissioning fund cannot exceed 10% of the capital costs in accordance with SD PSA. Decommissioning liability is estimated based on capital expenditures incurred in respect of assets already employed as at the end of each financial year. The Group share of the estimated undiscounted cost to abandon the production facilities employed in SD PSA was US dollar 155,855 as at 30 November 2016 (31 December 2015: US dollars 132,759).

The Group's share of expected undiscounted cost to decommission the SCP pipeline facilities at 30 November 2016 was US dollars 10,476 (31 December 2015: US dollars 10,301). The Group used a 2.5% (31 December 2015: 2.5%) inflation rate in its estimate of the retirement obligation upon termination of HGA and used a pre-tax rate that reflects current market assessments of the time value of money to discount the obligation.

Under the provisions of the HGA between TANAP A.Ş and Turkey, TANAP A.Ş is liable for decommissioning in damaged areas and shall provide a decommissioning plan to the government of Turkey no later than 10 years prior to expiration of the HGA. The Group management accounted for decommissioning liability since there have been progress, which requires an obligation about the rehabilitation of the construction area. The Group's share of expected undiscounted cost to decommission the TANAP pipeline facilities at 30 November 2016 was US dollars 35,525.

#### 13. Trade and other payables, accrued liabilities

Trade and other payables and accrued liabilities mainly consist of payables related to Shah Deniz Stage 2 development, expansion of SCP and construction of TANAP pipeline systems at 30 November 2016 and 31 December 2015.

#### 14. Revenue

The Group's revenue consisted of the following for the eleven months period ended 30 November:

	2016	2015
Revenue from sale of gas	59,437	84,627
Revenue from sale of crude oil	43,954	51,543
	<b>103,391</b>	<b>136,170</b>

According to the provisions of the SD PSA the profit oil and gas is shared between the Government and the Contractor Parties depending on cumulative after-tax real rate of return achieved as at the end of each calendar quarter by the Contractor Parties. During three quarters of 2016 the profit oil and gas was shared at a ratio of 55% to 45% in favor of the Contractor Parties and during three quarters of 2015 at a ratio of 55% to 45% in favor of the Government.

#### 15. Cost of sales

The Group's cost of sales consisted of the following for the eleven months period ended 30 November:

	Note	2016	2015
Depreciation and depletion	4	53,474	48,679
Other costs		8,527	14,407
		<b>62,001</b>	<b>63,086</b>

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 16. Transactions with related parties

Transactions with related parties consisted of the following:

Related party	As at 30 November 2016					For the eleven months period ended 30 November 2016	
	Long-term borrowings	Share capital	Additional paid-in capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 11)	2,058,505	-	-	-	-	-	-
SOCAR	-	852,992	287,518	-	-	432,509	-
ME	-	887,808	344,250	-	-	495,159	-
AzSD	-	-	-	1,090,394	-	-	203,122
AzSCP	-	-	-	518,589	-	-	60,979
SOCAR MO	-	-	-	-	3,467	-	185
AGSC	-	-	-	-	7,422	61,775	-
<b>Total</b>	<b>2,058,505</b>	<b>1,740,800</b>	<b>631,768</b>	<b>1,608,983</b>	<b>10,889</b>	<b>989,443</b>	<b>264,286</b>
<b>Total category</b>	<b>3,721,658</b>	<b>1,740,800</b>	<b>631,768</b>	<b>1,837,928</b>	<b>11,476</b>		

Related party	As at 31 December 2015					For the eleven months period ended 30 November 2015	
	Long-term borrowings	Share capital	Additional paid-in capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 11)	1,953,942	-	-	-	-	-	-
SOCAR	-	708,001	-	-	-	472,948	-
ME	-	736,899	-	-	-	492,252	-
AzSD	-	-	-	887,272	-	-	388,607
AzSCP	-	-	-	457,610	-	-	103,584
SOCAR MO	-	-	-	-	3,606	-	-
AGSC	-	-	-	-	9,760	64,525	-
<b>Total</b>	<b>1,953,942</b>	<b>1,444,900</b>	<b>-</b>	<b>1,344,882</b>	<b>13,366</b>	<b>1,029,725</b>	<b>492,191</b>
<b>Total category</b>	<b>2,191,873</b>	<b>1,444,900</b>	<b>-</b>	<b>1,636,491</b>	<b>19,004</b>		

#### AzSD

Settlements with AzSD (a subsidiary of SOCAR) during the eleven months period ended 30 November 2016 are represented by US dollars 203,122 advances paid for acquisition of 10% share in SD PSA and 8% share in AGSC under the DSPA (30 November 2015: US dollars 388,607). Refer to Note 18.

#### AzSCP

Settlements with AzSCP (a subsidiary of SOCAR) during the eleven months period ended 30 November 2016 are represented by US dollars 60,979 advances paid for acquisition of 10% shares in SCPC under the DSPA (30 November 2015: US dollars 103,584). Refer to Note 18.

#### AGSC

AGSC is a company established by the contractor parties of the SD PSA for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas. Receipts from AGSC represent cash received in the amount of US dollars 61,775 (30 November 2015: US dollars 64,525) from sale of gas to AGSC.

#### TAP AG

Transactions with TAP AG, associate of the Group are disclosed in Note 7 and Note 8.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 16. Transactions with related parties (continued)

##### Key management personnel

The senior management group consisted of the Group's General Director, Deputy General Director and three department directors as at 30 November 2016. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category was:

	2016	2015
Aggregate remuneration	136	149
Number of persons	5	5

The Group also incurred expenses for management services provided by SOCAR Upstream Management International LLC and SOCAR Midstream Operations LLC in the total amount of US dollars 1,381 during the eleven months period ended 30 November 2016 (30 November 2015: US dollars 4,193) under the Operator Services Agreement signed in December 2014.

#### 17. Financial risk management objectives and policies

##### Fair value of financial instruments

The fair value of the financial assets and liabilities is included in the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the interim condensed consolidated financial statements:

	30 November 2016	
	Carrying amounts	Fair values
Cash and cash equivalents (Note 9)	438,663	438,663
Accounts receivables	11,476	11,476
Loans receivable (Note 8)	321,612	311,936
<b>Total financial assets</b>	<b>771,751</b>	<b>762,075</b>
Trade and other payables	(205,720)	(205,720)
Accrued liabilities	(358,576)	(358,576)
Current portion of long-term borrowings (Note 11)	(13,273)	(13,273)
Long-term borrowings (Note 11)	(3,721,658)	(3,737,738)
<b>Total financial liabilities</b>	<b>(4,299,227)</b>	<b>(4,315,307)</b>

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 17. Financial risk management objectives and policies (continued)

##### Fair value of financial instruments (continued)

	31 December 2015	
	Carrying amounts	Fair values
Cash and cash equivalents (Note 9)	254,560	254,560
Accounts receivables	14,603	14,603
Loans receivable (Note 8)	137,497	137,497
<b>Total financial assets</b>	<b>406,660</b>	<b>406,660</b>
Trade and other payables	(197,025)	(197,025)
Accrued liabilities	(318,759)	(318,759)
Long-term borrowings (Note 11)	(2,191,873)	(2,197,326)
<b>Total financial liabilities</b>	<b>(2,707,657)</b>	<b>(2,713,110)</b>

The following methods and assumptions were used to estimate the fair values:

- (i) Current financial assets and liabilities approximate their carrying amounts largely due to the current maturities of these instruments.
- (ii) Long-term fixed-rate and variable-rate receivables/borrowings are evaluated by the Group using Level 3 inputs based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

##### Capital management

The Group considers total capital under management to be as follows:

	30 November 2016	31 December 2015
Long-term borrowings (Note 11)	3,721,658	2,191,873
Current portion of long-term borrowings (Note 11)	13,273	–
Less: cash and cash equivalents (Note 9)	(438,663)	(254,560)
<b>Net debt</b>	<b>3,296,268</b>	<b>1,937,313</b>
Equity attributable to equity holders of the Group	2,270,862	1,407,911
<b>Capital and net debt</b>	<b>5,567,130</b>	<b>3,345,224</b>
<b>Gearing ratio</b>	<b>59%</b>	<b>58%</b>

#### 18. Commitments and contingencies

##### Commitments related to participating interest in Shah Deniz PSA

On 17 December 2013 Shah Deniz consortium announced the final investment decision for Stage 2 development of Shah Deniz gas field in the Azerbaijan Sector of the Caspian Sea and signed Sixth, Seventh and Eighth Addendums to Shah Deniz PSA. The Group is committed to finance expenditures related to Shah Deniz project based on its share of interest.

As at 30 November 2016 the Shah Deniz PSA operator has number of capital commitments. The Group estimated its 6.67% share of these capital commitments in the amount of US dollars 745,523 (31 December 2015: US dollars 966,064).

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 18. Commitments and contingencies (continued)

##### Commitments related to participating interest in Shah Deniz PSA (continued)

Shah Deniz PSA Contractor Parties made the final investment decision on SCP Expansion project on 17 December 2013. SCP Expansion project objective is to expand the existing SCP pipeline system capacity. Due to SCP expansion additional facilities will be constructed in Georgia for the purposes of interconnection with TANAP. The Group has the commitment to fund the SCP Expansion project equivalent to its 6.67% shares throughout the construction and initial operational phase. As at 30 November 2016 the remaining budget for SCP Expansion is estimated in the amount of US dollars 1,633,786 with the Group's share of these commitments in the amount of US dollars 108,974 (31 December 2015: US dollars 2,799,000 and US dollars 186,693, respectively).

##### Commitment related to TANAP

###### *Construction of TANAP*

At the financial statement date, the Group has capital commitment to fund the construction of TANAP system. The remaining budget for construction of TANAP system is estimated in the amount of US dollars 5,229,151 (31 December 2015: US dollars 8,111,736).

##### Commitment related to TAP

###### *Construction of TAP*

The Group has the commitment to fund construction of TAP system. The remaining budget for construction of the TAP system is estimated in the amount of US dollars 3,460,753 (31 December 2015: US dollars 4,337,700). The Group's share of commitment at the financial statement date was US dollars 692,151 (31 December 2015: US dollars 867,540).

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC

###### *BOTAS gas contract*

AGSC is obliged under the gas contract signed with BOTAS to make available a maximum of approximately 6.6 bcm of gas annually from 2016 till 2021 at a price calculated based on the formula established by the gas contract.

###### *Stage 2 gas contract*

On 25 October 2011, SOCAR and BOTAS executed a gas sale and purchase agreement ("Stage 2 SPA") with respect to the sale by SOCAR to BOTAS of certain volumes of Shah Deniz Stage 2 gas (2 bcm first delivery year, 4 bcm second delivery year, 6 bcm plateau period). In December 2012 SOCAR transferred and assigned the rights and obligations under the Stage 2 SPA to AGSC. The anticipated commencement of first gas delivery under Stage 2 BOTAS SPA is July 2018.

###### *BOTAS contract for BTC fuel gas*

AGSC is obliged under the agreement with BOTAS to make available 0.15 bcm of gas annually at a price which is calculated based on the formula established in the contract.

###### *Azerbaijan gas obligation*

AGSC is obliged under the agreement signed with SOCAR to make available a minimum of approximately 1.5 bcm of gas annually in 2016 and onwards at a price calculated based on the formula established in the agreement.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 18. Commitments and contingencies (continued)

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

###### *Georgian gas obligation*

AGSC is obliged under the agreement signed with Georgian Oil and Gas Corporation ("GOGC") and the government of Georgia to make available 0.5 bcm of gas annually in 2016 and onwards, at a price which is calculated based on the formula established in the contract.

###### *Sale and purchase agreement with South Caucasus Pipeline Option Gas Company Limited ("OptionCo", a wholly owned subsidiary of SCPC)*

AGSC is obliged under the agreement signed with OptionCo to make available 0.29 bcm of gas during the contract year starting on 1 October 2015 and ending 1 September 2016. Thereafter, AGSC is obliged to deliver during the next contract year, which starts on 1 October 2016 and ends 30 September 2017, a maximum of five percent of the volumes transported by AGSC through Georgia via the SCP in the previous contract year, at a price which is calculated based on the formula established in the contract.

###### *Shah Deniz Stage 2 EU Long term Gas Sales Agreements ("GSAs")*

In September 2013 ten EU GSAs were signed by SOCAR with nine EU Buyers and in December 2013 the GSAs were assigned to AGSC until Shah Deniz PSA expiry with re-assignment to SOCAR as Shah Deniz Production declines. The commencement date will be firm up through funnelling mechanism within a 1-year window between 1 January 2020 and 1 January 2021 for DEPA, Shell, Axpo (PSV) and E.ON (now Uniper); 1 July 2020 and 1 July 2021 for Axpo (WTB), GDF Suez (now Engie), Gas Natural Fenosa, Enel, Hera and Bulgargaz. The GSAs assume 3 year build-up period, as defined in the contracts, with the following peak annual delivery obligations: AXPO (PSV) 0.48 bcm, GDF Suez (now Engie) 2.64 bcm, Gas Natural Fenosa 0.99 bcm, E.ON 1.45 bcm, Shell 0.95 bcm, Hera 0.3 bcm, Enel 0.48 bcm, AXPO (WTB) 0.96 bcm, Bulgargaz 0.94 bcm, DEPA 1 bcm.

###### *Trans Anatolian Pipeline Gas Transportation Agreement (TANAP GTA)*

AGSC is a party to TANAP GTA with annual reserved capacity during the build-up period, as defined in the contract, of 6.1 bcm, 6.2 bcm, 7.2 bcm and plateau of 10.5 bcm after 18 months with 100% ship or pay on the capacity reservation. The start date will be set through a funnelling mechanism inside the first window period between 1 July 2019 and 1 July 2021.

###### *Trans Adriatic Pipeline GTA (TAP GTA)*

AGSC is a party to TAP GTA with annual capacity of 9.08 bcm and additional annual regulated capacity of 0.46 bcm booked under TAP First Booking Phase ("FBP"). The planned commencement date is inside the second window period between 1 January 2020 and 31 December 2020.

###### *TAP Deferral Gas Sales Agreement*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 May 2019 – 31 December 2020 (with earlier termination or possible extension of the agreement in accordance with provisions of the agreement) in the volume of maximum 3.66 bcm in 2019 and 6.4 bcm in 2020, at a price which is stipulated in the contract.

###### *Sale and purchase agreement with Baku-Tbilisi-Ceyhan Pipeline Company ("BTC Co")*

AGSC is obliged under an agreement signed with BTC Co to make available 0.16 bcm during the following years until the termination of the contract subject to the right of BTC Co to reduce annual off-take, at a price which is calculated based on the formula established in the contract.



## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 18. Commitments and contingencies (continued)

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

###### *Debottlenecking SPA*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 January 2016 – 30 June 2018 as follows: 1.3 bcm per annum for the years 2016-2017 and 0.64 bcm in 2018, at a price which is stipulated in the contract.

###### *BOTAS Gas Transportation Agreement (BOTAS GTA)*

TANAP is a party to BOTAS GTA and with annual reserved capacity during the build-up period, as defined in the contract, of 1.9 bcm (12 month period commencing on start date), 3.8 bcm (next 12 month period) and plateau of 5.7 bcm 24 months after the start date. The start date will be within the period from and including 1 May 2018 to and including 30 June 2018.

###### *SOCAR Gas Transportation Agreement (SOCAR GTA)*

Based on this GTA, from and including the start date (6 March 2036) SOCAR shall pay to TAP AG the amount of actual monthly charge in relation of each booking of reserved capacity at each entry point and exit point at a price which is calculated based on the formula established in the contract. TAP AG shall make available to SOCAR for transportation of natural gas at the applicable entry point and exit point(s) as described below, a reserved capacity equal to the following maximum flow rates expressed in kilowatt-hours (kWh) per gas day: Entry point at Kipoi – 287,318,605 kWh per gas day; Exit point at SRG tie in – 242,999,147 kWh per gas day; Exit point at Komotini – 44,319,458 kWh per gas day.

###### *Framework agreement*

On 17 December 2013, AGSC executed a Term Sheet for GSA Novation and Capacity Transfer Framework Agreement with SOCAR ("Term Sheet"). A fully-termed Framework Agreement was negotiated with SOCAR to give effect to the Term Sheet. Framework Agreement relates to novation of long-term GSAs and transfer of GTA capacity from AGSC to SOCAR after 2036. The Framework Agreement was executed on 19 October 2015.

##### **Commitment under the Deferred Sale and Purchase Agreement ("DSPA")**

In July 2014 the Group signed the DSPA for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP. According to the terms of this agreement the Group shall make advance payments for these acquisitions to AzSD and AzSCP, while control will pass to the Group in March 2023, provided that certain conditions precedent are satisfied. As of 30 November 2016, the Group had commitments for payments in the amount of US dollars 535,032 (31 December 2015: US dollars 536,087) to AzSD and has to make progress payments equaled to Shah Deniz Stage 2 Development cash call requirements of AzSD till 31 December 2020. In addition, the Group has to make progress payments equaled to SCP Expansion project related cash calls requirements of AzSCP till 31 December 2020.

##### **Commitment under the Funding Agreement with BOTAS (The "Funding Agreement")**

On 26 May 2014 SOCAR and BOTAS signed Funding Agreement for financing BOTAS's 5% shares in TANAP A.Ş., upon acquisition of shares in TANAP A.Ş. by BOTAS. On 13 March 2015, the Group signed novation agreement with SOCAR and BOTAS, where all rights and obligations under the Funding Agreement were transferred from SOCAR to the Group. According to agreement with BOTAS, the Group has commitment for providing interest free loan to BOTAS for financing its 5% share in TANAP A.Ş.'s future cash call requirements till TANAP becomes operational.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 19. Current business environment

##### Azerbaijan economy

The Group's operations are mainly conducted in the Republic of Azerbaijan and the Republic of Turkey. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Republic of Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Republic of Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

As a result of significant drop in crude oil prices, on 21 February 2015, Azerbaijani Manat was devalued against US dollar and other major currencies by 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to US dollar 1, respectively. In addition, Azerbaijani manat was devalued against major currencies by approximately 47% on 21 December 2015. Following the second devaluation, the Central Bank of Republic of Azerbaijan announced the move to a floating exchange rate. During the eleven month period ended 30 November 2016 Azerbaijani Manat fluctuated between AZN 1.490 and AZN 1.7318 for US dollar 1.

There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Company's future results and financial position and business prospects in a manner not currently determinable.

Azerbaijani government announced plans to accelerate reforms and support to economic environment in response to current challenges. The Company's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Company's business in the foreseeable future.

##### Turkish economy

The strong performance of the Turkish economy, as clearly demonstrated in economic indicators of previous years, was impacted to some degree by the sluggish European markets that Turkey is most dependent on. The Turkish government began to implement new policies and measures to revive domestic demand in order to compensate for the slowdown in foreign markets.

While management believes it is taking appropriate measures to support the sustainability of Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

These consolidated financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the period when they become known and estimable.

#### 20. Events after the reporting date

##### Increase in share capital

During subsequent period SOCAR made equity contribution of USD 74,713 to the Group, which included a reimbursement of foreign exchange losses incurred by the Group in the amount of US dollars 31,481 in respect of portion of previous contribution made in Azerbaijani manat.

## Southern Gas Corridor CJSC

### Notes to the interim condensed consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 20. Events after the reporting date (continued)

##### Additional borrowings

On 30 December 2016 the Group borrowed a loan from the International Bank of Azerbaijan in the amount of US dollars 176,000 for financing of its projects. The loan is due on 28 February 2017.

On 16 January 2017, the Group signed loan agreement with the International Bank for Reconstruction and Development for the total amount of US dollars 400,000 for financing of TANAP project.

On 26 January 2017, the Group signed loan agreement with the Asian Infrastructure Investment Bank for the total amount of US dollars 600,000 for financing of TANAP project.

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31  
DECEMBER 2015**

**Southern Gas Corridor  
Closed Joint-Stock Company**

**Consolidated financial statements**

*31 December 2015*

**Southern Gas Corridor CJSC**  
**Consolidated financial statements**

31 December 2015

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## **Independent auditors' report**

To the Board of Directors and shareholders of  
the Southern Gas Corridor CJSC

We have audited the accompanying consolidated financial statements of the Southern Gas Corridor Closed Joint Stock Company (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2015 and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these 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.

### **Auditors' responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2015 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young Holdings (CIS) B.V.*

13 June 2016

## Southern Gas Corridor CJSC

### Consolidated statement of financial position

(Amounts presented are in thousands of US dollars)

	Note	31 December 2015 Audited	31 December 2014 Audited
<b>Assets</b>			
<b>Non-current assets</b>			
Oil and gas properties	6	490,333	512,404
Construction in progress and development costs	7	2,564,393	988,117
Advance payments	8	1,636,491	943,134
Investments in associate	9	60,740	56,432
Loan receivables	10	137,497	44,334
Other non-current assets		2,003	2,335
<b>Total non-current assets</b>		<b>4,891,457</b>	<b>2,546,756</b>
<b>Current assets</b>			
Cash and cash equivalents	11	254,560	212,198
Deposits	11	–	33,246
Accounts receivable	12	19,004	36,820
Inventories	13	9,335	13,152
Accrued revenue	19	3,119	13,118
Other current assets	14	37,924	38,214
<b>Total current assets</b>		<b>323,942</b>	<b>346,748</b>
<b>Total assets</b>		<b>5,215,399</b>	<b>2,893,504</b>
<b>Equity and liabilities</b>			
<b>Equity</b>			
Share capital	15	1,444,900	100,000
Other reserves	15	(45,176)	–
Cumulative translation differences		(23,516)	(11,104)
Retained earnings		31,703	13,208
<b>Equity attributable to the Group's equity holders</b>		<b>1,407,911</b>	<b>102,104</b>
Non-controlling interest	15	339,995	–
<b>Total equity</b>		<b>1,747,906</b>	<b>102,104</b>
<b>Non-current liabilities</b>			
Long-term borrowings	16	2,191,873	1,854,301
Government grant	16	683,281	697,699
Decommissioning liabilities	17	52,066	37,063
Deferred revenue	19	5,283	7,662
Deferred tax liability	21	8,060	6,458
Other non-current liabilities		10,001	–
<b>Total non-current liabilities</b>		<b>2,950,564</b>	<b>2,603,183</b>
<b>Current liabilities</b>			
Trade and other payables	18	197,025	54,896
Accrued liabilities	18	318,759	131,945
Income tax payable		1,145	1,376
<b>Total current liabilities</b>		<b>516,929</b>	<b>188,217</b>
<b>Total equity and liabilities</b>		<b>5,215,399</b>	<b>2,893,504</b>

Signed and authorized on behalf of the Group

Afgan Isayev, General Director



13 June 2016

Ramil Babayev, Finance Director



13 June 2016



The accompanying notes are an integral part of these consolidated financial statements.



**Southern Gas Corridor CJSC**  
**Consolidated statement of comprehensive income**

*(Amounts presented are in thousands of US dollars)*

	Note	Year ended 31 December 2015 Audited	From 31 March 2014 (inception) to 31 December 2014 Audited
Revenue	19	151,473	76,894
Cost of sales	20	(69,944)	(28,433)
<b>Gross profit</b>		<b>81,529</b>	<b>48,461</b>
General and administrative expenses		(12,510)	(1,489)
Transportation tariffs		(4,613)	(1,594)
Other income		16,190	13,122
<b>Operating profit</b>		<b>80,596</b>	<b>58,500</b>
Interest income		4,895	3,338
Finance costs	10, 16, 17	(56,110)	(42,715)
Share of result of associates	9	(5,856)	(2,749)
Foreign exchange loss, net		(85)	(1,955)
<b>Profit before income tax</b>		<b>23,440</b>	<b>14,419</b>
Income tax expenses	21	(3,781)	(1,211)
<b>Profit for the year/period</b>		<b>19,659</b>	<b>13,208</b>
<b>Other comprehensive loss</b>			
<i>Other comprehensive loss to be reclassified to profit or loss in subsequent period</i>			
Exchange differences on translation of foreign operations		(6,411)	(5,354)
Exchange differences on translation of foreign associate	9	(6,001)	(5,750)
<b>Other comprehensive loss for the year/period</b>		<b>(12,412)</b>	<b>(11,104)</b>
<b>Total comprehensive income for the year/period</b>		<b>7,247</b>	<b>2,104</b>
<b>Profit attributable to:</b>			
Equity holders of the Group		18,495	13,208
Non-controlling interest		1,164	-
		<b>19,659</b>	<b>13,208</b>
<b>Total comprehensive income attributable to:</b>			
Equity holders of the Group		6,083	2,104
Non-controlling interest		1,164	-
		<b>7,247</b>	<b>2,104</b>

*The accompanying notes are an integral part of these consolidated financial statements.*

**Southern Gas Corridor CJSC**  
**Consolidated statement of cash flows**

*(Amounts presented are in thousands of US dollars)*

	Note	Year ended 31 December 2015 Audited	From 31 March 2014 (inception) to 31 December 2014 Audited
<b>Operating activities</b>			
Profit before income tax		23,440	14,419
<i>Non-cash adjustments to reconcile profit before tax to net cash flows</i>			
Finance costs	10, 16,17	56,110	42,715
Depreciation and depletion	20	53,858	21,133
Share of result of associate	9	5,856	2,749
Other income		(16,190)	(13,122)
Interest income		(4,895)	(3,338)
Foreign exchange loss		(164)	817
<i>Working capital adjustments</i>			
Accounts receivable		12,638	(14,208)
Inventories		3,817	1,479
Accrued revenue		9,999	(8,844)
Other assets		622	(24,049)
Deferred revenue		(2,379)	(313)
Trade and other payables		(16,267)	(4,720)
Accrued liabilities		8,406	10,885
<b>Cash generated from operations</b>		<b>134,851</b>	<b>25,603</b>
Income tax paid		(2,497)	–
Interest received		4,895	2,823
<b>Net cash flows from operating activities</b>		<b>137,249</b>	<b>28,426</b>
<b>Investing activities</b>			
Acquisition of subsidiary, net of cash received		–	(165,219)
Acquisition of undivided interests in joint projects		–	(946,986)
Placement of deposits	11	(350,000)	(99,000)
Proceeds from withdrawal of deposits	11	383,246	65,754
Financing provided to third party	10	(27,950)	–
Financing provided to associate	10	(45,556)	–
Advance payments for acquisition of shares	8	(548,594)	(796,288)
Investments in oil and gas properties		(20,234)	(174,396)
Additions to construction in progress and development costs		(1,313,628)	(180,509)
Investment in associates	9	(17,500)	(8,260)
Other acquisitions		–	(2,003)
<b>Net cash used in investing activities</b>		<b>(1,940,216)</b>	<b>(2,306,907)</b>
<b>Financing activities</b>			
Contribution from shareholders	15	1,344,900	100,000
Proceeds from borrowings	16	234,780	2,522,996
Repayment of borrowings		–	(132,317)
Proceeds from sale of shares in subsidiary	15	265,649	–
<b>Net cash flows from financing activities</b>		<b>1,845,329</b>	<b>2,490,679</b>
<b>Net increase in cash and cash equivalents</b>		<b>42,362</b>	<b>212,198</b>
Cash and cash equivalents as at inception	11	212,198	–
<b>Cash and cash equivalents at the end of the year</b>	11	<b>254,560</b>	<b>212,198</b>
<b>Non-cash operating activity</b>			
Government grant on loan received for financing of projects	16	–	704,270

*The accompanying notes are an integral part of these consolidated financial statements.*

**Southern Gas Corridor CJSC**  
**Consolidated statement of changes in equity**

*(Amounts presented are in thousands of US dollars)*

	Attributable to the equity holders of the parent				Total	Non-controlling interest	Total equity
	Share capital	Other reserves	Cumulative translation differences	Retained earnings			
<b>At 31 March 2014 (inception)</b>	-	-	-	-	-	-	-
Profit for the period	-	-	-	13,208	13,208	-	13,208
Other comprehensive loss	-	-	(11,104)	-	(11,104)	-	(11,104)
<b>Total comprehensive income/(loss)</b>	-	-	(11,104)	13,208	2,104	-	2,104
Contribution from shareholders	100,000	-	-	-	100,000	-	100,000
<b>At 31 December 2014</b>	<b>100,000</b>	<b>-</b>	<b>(11,104)</b>	<b>13,208</b>	<b>102,104</b>	<b>-</b>	<b>102,104</b>
Profit for the year	-	-	-	18,495	18,495	1,164	19,659
Other comprehensive loss	-	-	(12,412)	-	(12,412)	-	(12,412)
<b>Total comprehensive income/(loss)</b>	<b>-</b>	<b>-</b>	<b>(12,412)</b>	<b>18,495</b>	<b>6,083</b>	<b>1,164</b>	<b>7,247</b>
Contribution from shareholders	1,344,900	-	-	-	1,344,900	-	1,344,900
Sale of share in subsidiary	-	(45,176)	-	-	(45,176)	338,831	293,655
<b>At 31 December 2015</b>	<b>1,444,900</b>	<b>(45,176)</b>	<b>(23,516)</b>	<b>31,703</b>	<b>1,407,911</b>	<b>339,995</b>	<b>1,747,906</b>

*The accompanying notes are an integral part of these consolidated financial statements.*

# Southern Gas Corridor CJSC

## Notes to the consolidated financial statements

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

### 1. Corporate information

Southern Gas Corridor Closed Joint-Stock Company (the “Company” or “SGC CJSC”) was established by the Presidential Decree No.287 dated 25 February 2014. It was incorporated on 31 March 2014 in accordance with Azerbaijani legislation. 51% of the Company is owned by the Republic of Azerbaijan (the “State”), which is represented by the Ministry of Economy of the Republic of Azerbaijan (“ME”), whereas 49% belongs to the State Oil Company of Azerbaijan Republic (“SOCAR”). The Company is domiciled in the Republic of Azerbaijan. The registered address is located at 73 Neftchilar Avenue, Baku, AZ 1000, the Republic of Azerbaijan.

The Company was established for consolidating, managing and financing the State’s interests in the full-field development of the Shah Deniz gas-condensate field, the expansion of the South Caucasus Pipeline (“SCP”), implementation of Trans-Anatolian Natural Gas Pipeline (“TANAP”) and Trans Adriatic Pipeline (“TAP”) projects (together the “Projects”).

On 24 April 2014 the Company incorporated its 100% owned subsidiary, SGC Upstream LLC, for participating in the exploration and development of the Shah Deniz gas-condensate field in accordance with the Agreement on the Exploration, Development and Production Sharing for the Shah Deniz Prospective Area in the Azerbaijan Sector of the Caspian Sea (“SD PSA”) dated 4 June 1996.

On 25 April 2014 the Company incorporated its 100% owned subsidiary, SGC Midstream LLC, to participate in the SCP project for the transportation of gas through gas export pipeline system from Azerbaijan through Georgia to the Georgian-Turkish border in accordance with, amongst other things, the Intergovernmental Agreement signed between the Government of Azerbaijan and the Government of Georgia.

On 31 July 2014 the Company, through its subsidiary, SGC Upstream LLC, acquired 6.67% participating interest in Shah Deniz project and 5.336% shares in Azerbaijan Gas Supply Company Limited (“AGSC”) as well as 6.67% shares in South Caucasus Pipeline Company Limited (“SCPC”), through its subsidiary, SGC Midstream LLC, based on the Sale and Purchase Agreement (“SPA”) signed on 29 April 2014 between the Company’s respective subsidiaries (acting as the purchasers) and Azerbaijan (Shah Deniz) Limited (“AzSD”) and Azerbaijan (South Caucasus Pipeline) Limited (“AzSCP”) (acting as the sellers).

On 23 July 2014 the Company, acting through SGC Upstream LLC and SGC Midstream LLC signed the Deferred Sale and Purchase Agreement (“DSPA”) for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP, respectively. The closing of the agreement is expected to happen in March 2023, subject to fulfillment of all the conditions precedent.

On 23 July 2014 the Company signed the agreement to get hold of 20% shares in Trans Adriatic Pipeline AG (“TAP AG”) (Project Company of TAP) through the acquisition of 100% shares of AzTAP GmbH from SOCAR Energy Holdings AG, a subsidiary of SOCAR. TAP AG was established for planning, developing, financing, and operating TAP project, including the construction of TAP, for the transportation of natural gas to the European markets.

On 23 July 2014 the Company signed the agreement to acquire from SOCAR 100% shares of TANAP Doğalgaz İletim A.Ş. (Project Company of TANAP), which was established for the implementation of TANAP project within the territory of the Republic of Turkey. The purpose of constructing TANAP is to distribute natural gas across the country and to transit gas through the territory of Turkey to European countries in accordance with the Intergovernmental Agreement signed between the Government of Azerbaijan and the Government of Turkey.

On 13 April 2015 the Company sold its 30% share in TANAP Doğalgaz İletim A.Ş. (“TANAP A.Ş.”) to Boru Hatları ile Petrol Taşıma A.Ş. (“BOTAS”). On 16 April 2015 the Company sold further 12% share in TANAP A.Ş. to BP Pipelines (TANAP) Limited (BP). Further details are disclosed in Note 15.

On 28 October 2015, management of SOCAR Turkey Enerji A.Ş. (“STEAS”) has sent official letter expressing its intention for acquiring 7% shares in TANAP A.Ş. from the Company. No acquisition has taken place as of issuance of these consolidated financial statements.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies

##### Basis of preparation

These consolidated financial statements of the Company and its subsidiaries (collectively referred to as “the Group”) for the year ended 31 December 2015 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by International Accounting Standards Board (“IASB”). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

##### Going concern

The going concern basis assumes that the Group will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. As at 31 December 2015 the Group had net current liabilities in the amount of US dollars 192,987. In addition, as at 31 December 2015, the Group had certain commitments which would require significant cash outflows in foreseeable future (see Note 25).

The Group’s ability to continue as a going concern depends on the ability to generate sufficient cash inflows from financing provided by third parties and its shareholders.

As noted in Note 27, during the period subsequent to 31 December 2015 the Group has received cash contribution from its shareholders in the amount of US dollars 295,900 and issued government guaranteed Eurobonds in the amount of US dollars 1,000,000. In addition, the Group’s management expects to receive sufficient amount of funds from proceeds from hydrocarbons sales under current Shah Deniz Production Sharing Agreement, contributions from State Oil Fund of the Republic of Azerbaijan (“SOFAZ”) and capital injections by the shareholders as well as through funds raised by external debt. The Group management believes that the funds obtained from the above sources will be sufficient for meeting its financial commitments and the Group will be able to continue as a going concern for the foreseeable future.

##### Basis for consolidation

The consolidated financial statements comprise the financial statements of the Group as at 31 December 2015.

Subsidiaries are all entities (including structured entities) over which the Group has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangement with the other vote holders of the investee;
- rights arising from other contractual arrangements;
- the Group’s voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Basis for consolidation (continued)

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but considered as an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Profit or loss and each component of other comprehensive income are attributed to the equity holders of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance.

##### Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

##### *Transactions with non-controlling interest*

Changes in the Group's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (i.e. transactions with owners in their capacity as owners). In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Group.

##### *Business combinations with entities under common control*

The Group applies pooling of interest method of accounting for business combinations with entities under the common control from the date when the combination took place.

The pooling of interests method includes the following:

The assets and liabilities of the combining entities are reflected at their carrying amounts. No adjustments are made to reflect fair values, or recognise any new assets or liabilities, at the date of the combination. The only adjustments that are made are to align accounting policies.

No "new" goodwill is recognised as a result of the combination. The only goodwill that is recognised is any existing goodwill relating to either of the combining entities. Any difference between the consideration paid/transferred and the net assets acquired is reflected within equity.

Total comprehensive income reflects the results of the combining entities from the period when the combination took place.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Business combinations (continued)

###### *Acquisition of an entity that is not a business*

When the Group acquires an entity that is not a business, it allocates the cost of acquisition between the individual identifiable assets and liabilities of the acquired entity on the basis of their relative fair values as following:

monetary assets and monetary liabilities are recognized at their fair value;

the cost of acquisition remained after deduction of the fair value of monetary assets and monetary liabilities is allocated to non-monetary assets and non-monetary liabilities on the basis of their fair value at the date of acquisition.

##### Investment in associates

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The Group's investment in its associate is accounted for using the equity method. Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of profit or loss reflects the Group's share of the results of operations of the associate. Any change in other comprehensive income ("OCI") of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The aggregate of the Group's share of profit or loss of an associate is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, and then recognises the loss as "Share of profit of an associate" in the statement of profit or loss.

Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Investments in SD PSA, SCP and AGSC

According to the terms of SD PSA, the Group owns the portion of project's assets and is liable for its portion of project's liabilities. At the same time the Group is entitled to its portion of expenses incurred and revenues earned by the whole project. Therefore, the Group accounts for its investment in SD PSA by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project.

Participating interest of the Group in the SCP Project is treated by the Group as undivided interest related to the investment in SCPC and accounted by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project.

The Group holds an interest in the AGSC, a company established together with other contractor parties of the Shah Deniz Project and Ministry of Energy of the Republic of Azerbaijan. AGSC is special structured entity established for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas and operates on no gain, no loss basis.

##### Foreign currency translation

The consolidated financial statements are presented in US dollars ("USD") and all values are rounded to the nearest thousands, except when otherwise indicated.

The functional currency of the Company, subsidiaries and associate are the following:

SGC CJSC	USD
SGC Upstream LLC	USD
SGC Midstream LLC	USD
TANAP A.Ş.	USD
AzTAP GmbH	EUR
TAP AG	EUR

The transactions executed in foreign currencies are initially recorded in the functional currencies of respective Group entities by applying the appropriate rates of exchanges prevailing at the date of transaction.

Monetary assets and liabilities not already measured in the functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the reporting date.

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's entities are recognized in profit or loss.

The results and financial position of the Group entities which functional currency differ from the presentation currency of the Group and not already measured in the Group's presentation currency are translated into the presentation currency of the Group as follows:

- (i) assets and liabilities for each statement of financial position are translated at the closing rate at the date of that statement of financial position;
- (ii) income and expenses for each statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognized as a separate component of equity – currency translation difference.

At 31 December 2015 the principal rate of exchange used for translating foreign currency balances was USD 1.0931 per EUR 1 (31 December 2014: 1.2139).



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial instruments – key measurement terms

Depending on their classification financial instruments are carried at fair value, cost or amortised cost as described below.

*Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible to by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;

Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

*Cost* is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest rate method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the consolidated statement of financial position.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial instruments – key measurement terms (continued)

*The effective interest rate method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

##### Financial assets

###### *Initial recognition and measurement*

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial assets are recognized initially at fair value.

The Group has not designated any financial assets upon initial recognition as at fair value through profit or loss, held-to-maturity investments, available-for-sale financial assets, or as derivatives.

###### *Subsequent measurement*

The subsequent measurement of financial assets depends on their classification:

###### *Loan and receivables*

This category is most relevant to the Group. Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method.

The effective interest rate method amortization is included in finance income in the consolidated statement of comprehensive income. The losses arising from impairment are recognized in the consolidated statement of comprehensive income.

###### *Cash and cash equivalents*

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

###### *Accounts receivable*

Accounts receivables which generally have 30-90 days' terms, are recognized and carried at original invoice amount less an allowance for any uncollectible amounts.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial assets (continued)

###### *Derecognition*

A financial asset (or, where applicable a part of a financial asset) is derecognized when:

the rights to receive cash flows from the asset have expired, or;

the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass through” arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

###### *Impairment of financial assets*

The Group assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

###### *Financial assets carried at amortized cost*

For financial assets carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate.

##### Financial liabilities

###### *Initial recognition and measurement*

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group has not designated any financial liabilities upon initial recognition as financial liabilities at fair value through profit or loss, or as derivatives designated as hedging instruments in an effective hedge.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial liabilities (continued)

###### *Subsequent measurement*

The measurement of financial liabilities depends on their classification as follows:

###### *Loans and borrowings*

This category is most relevant to the Group. After initial recognition, interest bearing loans and borrowings which have a fixed contractual repayment schedule are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the consolidated statement of comprehensive income when the liabilities are derecognized as well as through the effective interest rate method amortization process.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method. The effective interest rate method amortization is included in finance cost in the consolidated statement of comprehensive income.

Borrowings with no pre-defined contractual repayment schedules are measured in accordance with actual contractual terms.

###### *Trade and other payables*

Trade and other payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

###### *Derecognition*

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of comprehensive income.

##### **Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

##### **Oil and gas properties**

Oil and gas properties are stated at cost, less accumulated depreciation and provision for impairment, where required. Such cost includes the cost of replacing part of the oil and gas properties and borrowing costs for long-term construction projects if the recognition criteria are met.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of oil and gas properties items are capitalised and the replaced part is retired.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Oil and gas properties (continued)

At the end of each reporting period management assesses whether there is any indication of impairment of oil and gas properties. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed where appropriate if there are indicators that impairment loss may no longer exist or may have decreased.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are recognised in profit or loss for the year.

##### Construction in progress

All costs directly or indirectly attributable to the projects to construction and expansion the capacity of the pipeline systems are capitalized as a construction in progress. The construction in progress is stated at a cost and not depreciated. The construction in progress is transferred to the property, plant and equipment upon completion.

##### Depreciation, depletion and amortization

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the units-of-production method based on proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

The cost of an off-shore production platform, terminal and other development costs incurred in connection with a planned group of development wells is reduced for the portion of development costs related to wells which have not been drilled yet in determining the asset base subject to the unit-of-production amortization rate until the additional development wells are drilled. Similarly, in computing the depletion rate, those proved reserves that will be produced only after significant additional development costs are incurred are excluded from proved developed reserves.

Depreciation, depletion and amortization of capitalized costs of the pipeline systems are calculated using the straight line method for the period of useful life of pipelines. The estimated useful life of the SCP pipeline is thirty years from 25 November 2006 when the pipeline was officially put in use. The estimated useful life of the TANAP pipeline system will be the period from the date when the pipeline is officially put in use till the year 2061.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

##### Oil and natural gas development expenditure

The Group follows the successful efforts method of accounting for oil and natural gas development activities. Costs to acquire mineral interests, to determine the technical feasibility, assess commercial viability of an identified resource and to drill and equip exploratory wells that find proved reserves are capitalized within exploration and evaluation assets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed.

When proved reserves of oil and natural gas are identified and development is sanctioned by management, the relevant capitalized expenditure is first assessed for impairment and (if required) any impairment loss is recognized, then the remaining balance is transferred to oil and gas properties. No amortization is charged during the exploration and evaluation phase.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Oil and natural gas development expenditure (continued)

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, the drilling and equipment of development wells, including unsuccessful development or delineation wells, is capitalized within oil and gas properties. Oil and gas properties are stated at cost less accumulated depreciation and accumulated impairment losses.

##### Advance payments

Advance payments are recognized and carried at the original amount of payment less provision for any amount at risk of non-performance by the counterparty. Advance payments made for non-current assets as well as payments which will be settled during more than one-year period are non-current advance payments.

##### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the asset. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

##### Impairment of oil and gas properties, construction in progress, development costs and other non-financial assets

The Group assesses at each statement of financial position date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's ("CGU") fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Impairment losses of continuing operations, including impairment on inventories, are recognized in the consolidated statement of comprehensive income in expense categories consistent with the function of the impaired asset, except for a property previously revalued and the revaluation was taken to other comprehensive income. In this case, the impairment is also recognized in other comprehensive income up to the amount of any previous revaluation.

##### Inventories

Inventories are stated at the lower of cost and net realizable value. Cost of producing crude oil is accounted on weighted average basis. This cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition. The cost of crude oil is the production cost, the appropriate proportion of depletion and depreciation charges and overheads. Net realizable value of crude oil is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to completion and disposal.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Decommissioning liabilities

Under the provisions of the SD PSA, the Contractor Parties to the SD PSA are obligated to finance the ultimate abandonment of oil and gas production properties employed in petroleum operations within the contract area. The maximum amounts of abandonment funds cannot exceed 10% of the capital costs in accordance with the SD PSA. The Group estimates its share of total decommissioning liabilities based on SD PSA provisions by applying the 10% limit to all capital costs incurred in petroleum operations in the contract area as at the year-end. The present value of the decommissioning liabilities is recorded by the Group as a liability at the time the assets are installed or placed in service. The amount of liability equals the present value of the future decommissioning liabilities discounted at pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability rate, which equals 5.95% at 31 December 2015 (31 December 2014: 5.77%). A corresponding tangible fixed asset of an amount equivalent to the liability is also created and included in the cost of oil and gas production properties. This amount is subsequently depreciated as part of the oil and gas production properties and charged against income using the unit-of-production method based on proved reserves. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to oil and gas production properties. The unwinding of the discount on the decommissioning provision is included as a finance cost.

According to the Host Government Agreement (“HGA”) signed with the Georgian and Azerbaijan Governments, no later than 30 days after the termination of the HGA, SCPC must submit a decommissioning plan to these Governments addressing its obligations to retire the pipeline. The amount of asset retirement obligation is capitalized by shareholders of SCPC.

In accordance with HGA signed with the Government of Turkey, the Group shall comply with all its decommissioning obligations following the expiry of HGA (2061). The Group started construction works in March 2015. At the date of the consolidated financial statements, the Group had not performed works related to backfilling activities, placement of compressors and SCADAs, which would require decommissioning works.

##### Government grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant related to an asset, it is recognized as income in equal amounts over the expected useful life of the related asset.

The benefit of a governmental bond at a below market rate of interest is treated as a government grant. Such benefit is measured as the difference between the initial fair value of the issued bond and the proceeds received.

##### Income taxes

Income taxes have been provided for in the preliminary consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity.

The Group is liable for financing of its 6.67% share in the tax liabilities of SCPC, namely Azerbaijani income tax, Georgian income tax and Georgian minimum tax liabilities.

According to the provisions of SD PSA, contractor parties are liable for profit taxes. However, according to the SD PSA, respective government entity of the Republic of Azerbaijan is liable for payment of profit taxes of each contractor party from the proceeds from sales of crude oil and natural gas. Accordingly, the Group recognizes profit taxes and related revenue in the consolidated statement of profit and loss.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Income taxes (continued)

In accordance with HGA signed with the Government of Turkey and the Government of Azerbaijan, the Group will be subject to income tax in respect of TANAP project after the pipeline will be put in use. Accordingly, the Group is not subject to income tax during the construction phase.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income taxes are provided in full on temporary differences arising on recognition and subsequent measurement of provision for asset retirement obligation and related adjustments to cost of property, plant and equipment.

##### Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

##### Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, or receivable, taking into account contractually defined terms of payment net of discounts, returns, value added taxes and other taxes or duty.

Revenues associated with sales of crude oil (condensate) and gas are recorded at the point when the significant risks and rewards of ownership are transferred, which is when title to the extracted oil and gas passes to the customer based on the terms of the SD PSA and based on the proportion of its share in total crude oil and gas entitlement. The actual volume of oil received by the Group may differ from the entitled volume resulting in an over/under lifting. Underlift is recognized as a sale of crude oil at the point of lifting by the underlifter to the overlifter. Overlift is recognized as a purchase of oil by the overlifter from the underlifter. The extent of underlift is reflected by the Group as an asset in the statement of financial position, and the extent of overlift is reflected as a liability. The initial measurement of the overlift liability or underlift asset is at the market price of crude oil at the date of lifting. Subsequent measurement of overlift/underlift liabilities and assets depends on the settlement terms of the related operating agreements. If such terms allow for a cash settlement of the overlift/underlift balances between the parties, the balances are remeasured at fair value at reporting dates subsequent to initial recognition. The overlift/underlift balances that are settled through delivery of physical quantities of crude oil are measured at the lower of carrying amount and fair value at reporting dates subsequent to initial recognition.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Revenue recognition (continued)

BP Exploration Shah Deniz Limited, the Operator of the SD PSA (the "SD Operator"), provides the Contractor Parties of SD PSA on a quarterly basis with the Shah Deniz Petroleum Entitlement Report, that contains, inter alia, the final net back price figure which is applied when determining the final petroleum volume that each SD PSA party is entitled to receive. When the actual Shah Deniz Petroleum Entitlement Report is not available, the Group recognizes the revenue based on a provisional Shah Deniz Petroleum Entitlement Report issued by the SD Operator. The revenue recognized may be further revised in the event that actual net back price differs from the provisional net back price used for revenue calculation. The Group treats such revision of revenue, if any, as a change in estimate and reflects in the current year statement of comprehensive income.

##### Employee benefits

Wages, salaries, contributions to the Social Protection Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (e.g. health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group.

##### Transactions with related parties

For the purposes of these consolidated 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. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arm's length basis.

##### Contingencies

Contingent liabilities are not recognized in the consolidated financial statements unless it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made. A contingent asset is not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

##### New and amended standards and interpretations

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2015. Although these new standards and amendments applied for the first time in 2015, they did not have a material impact on the consolidated financial statements of the Group.

##### *Amendments to IAS 19 Defined Benefit Plans: Employee Contributions*

IAS 19 requires an entity to consider contributions from employees or third parties when accounting for defined benefit plans. Where the contributions are linked to service, they should be attributed to periods of service as a negative benefit. These amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. This amendment is effective for annual periods beginning on or after 1 July 2014. This amendment is not relevant to the Group, since none of the subsidiaries within the Group has defined benefit plans with contributions from employees or third parties.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### New and amended standards and interpretations (continued)

###### *Annual improvements 2010-2012 cycle*

These improvements are effective for accounting periods beginning on or after 1 July 2014 and the Group has applied these amendments for the first time in these consolidated financial statements. They include:

###### *IFRS 3 Business Combinations*

The amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IFRS 9 (or IAS 39, as applicable). This is consistent with the Group's current accounting policy, and thus this amendment does not impact the Group's accounting policy.

###### *IFRS 8 Operating Segments*

The amendments are applied retrospectively and clarify that:

an entity must disclose the judgements made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are 'similar';

the reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.

The Group has not applied the aggregation criteria in IFRS 8.12.

###### *IFRS 13 Fair Value Measurement*

The amendment clarifies in the basis for conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This is consistent with the Group's current accounting policy, and thus this amendment does not impact the Group's accounting policy.

###### *IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets*

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data by either adjusting the gross carrying amount of the asset to market value or by determining the market value of the carrying value and adjusting the gross carrying amount proportionately so that the resulting carrying amount equals the market value. In addition, the accumulated depreciation or amortization is the difference between the gross and carrying amounts of the asset. The Group did not record any revaluation adjustments during the current period.

###### *IAS 24 Related Party Disclosures*

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services. The Group has applied these amendments for the first time in these consolidated financial statements.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### New and amended standards and interpretations (continued)

###### *Annual improvements 2011-2013 cycle*

These improvements are effective for accounting periods beginning on or after 1 July 2014 and the Group has applied these amendments for the first time in these consolidated financial statements. They include:

###### *IFRS 3 Business Combinations*

The amendment is applied prospectively and clarifies for the scope exceptions within IFRS 3 that:

joint arrangements, not just joint ventures, are outside the scope of IFRS 3;

this scope exception applies only to the accounting in the financial statements of the joint arrangement itself.

The Group does not have investment in a joint arrangement, and thus this amendment is not relevant for the Group.

###### *IFRS 13 Fair Value Measurement*

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable). The Group does not apply the portfolio exception in IFRS 13.

#### 3. Significant accounting judgments, estimates and assumptions

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of commitments, guarantees and contingent liabilities, at the end of the reporting period. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

On an on-going basis, management evaluates their estimates, including those related to revenue recognition and contingencies. Management bases their estimates on various market-specific assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making assumptions about the carrying values of assets that are not readily apparent from other sources. Actual results may differ significantly from these estimates using different assumptions or conditions.

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

##### **Reserve estimates**

Estimates of recoverable quantities of proven and probable reserves reported include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex geological and geophysical models in order to make an assessment of the size, shape, depth and quantity of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period; changes in reported reserves can impact provision of decommissioning liabilities due to changes in expected future cash flows. Reserves are integral to the amount of depreciation, depletion and amortization charges to the consolidated statement of comprehensive income.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 3. Significant accounting judgments, estimates and assumptions (continued)

##### Reserve estimates (continued)

Natural gas and condensate reserves depend on price fluctuations as a result of change in production entitlement split between the State and contractor parties. Natural gas prices are calculated based on the long-term sales contracts provisions and depend on crude oil prices and other inputs. The current long-term Brent FOB oil price assumption used in the estimation of reserves is seventy two dollars thirty four cents per barrel (US dollars 72.34) as at the consolidated statement of financial position date.

The level of estimated commercial reserves is also a key determinant in assessing whether the carrying value of any of the Group's development and production assets has been impaired.

##### Decommissioning liabilities

As discussed in Note 2, under the terms of the SD PSA the Group will have to make contributions to the abandonment fund when seventy percent (70%) of petroleum reserves of the Shah Deniz field are recovered. Decommissioning liabilities are stated in the amount of expected contributions related to the currently employed assets discounted at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. This valuation requires the Group to make estimates about timing of expected future cash flows and adjustment to the discount rate, and hence they are subject to uncertainty. The estimation of the decommissioning liabilities is based on the assumption that contributions to the abandonment fund will start in 2029. Further details are disclosed in Note 17.

If the estimated discount rate used in the calculation had been 1% higher/lower than management's estimate, the carrying amount of the provision would have been US dollar 7,266 lower / US dollars 8,584 higher, respectively.

##### Deferred and accrued revenue

In the valuation of the Group's over-lift and under-lift position under the Shah Deniz PSA as at the year-end the Group uses thirty five dollars seventy four cents per barrel (US dollars 35.74) market price for crude oil as at 31 December 2015.

##### Recoverability of oil and gas assets

The Group assesses each asset or CGU every reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value in use. These assessments require the use of estimates and assumptions such as long-term oil prices, discount rates, operating costs, future capital requirements, decommissioning costs, exploration potential, reserves and operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risk and uncertainty. Therefore, there is a possibility that changes in circumstances will impact these projections, which may impact the recoverable amount of assets and/or CGUs.

Given the nature of the Group's activities, information on the fair value of an asset or CGU is not practicable to identify. Consequently, the recoverable amount used in performing the impairment test described below is value-in-use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 3. Significant accounting judgments, estimates and assumptions (continued)

##### Recoverability of oil and gas assets (continued)

##### *Key assumptions used in value-in-use calculations*

The calculation of value-in-use for oil fields is most sensitive to the following assumptions:

##### *Identification of CGU*

CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets of group of assets. The management assesses that SCP, TANAP and TAP projects are being constructed with the ultimate goal of the delivering Shah Deniz field natural gas to the Georgian, Turkish and European markets. Therefore, all these projects have been considered as one CGU and impairment test is performed on the level of the whole Group.

##### *Capital expenditures*

Capital expenditures necessary to maintain estimated production volumes are based on long-term development plans for particular field.

##### *Commitments under DSPA*

As disclosed in Note 25, the Group is committed to make progress payments under the terms of the DSPA. The parties to the DSPA have intention to revise progress payments which will result in decrease of cash outflows by the Group. The Group expects that the respective amendment to DSPA will be signed in 2016. Accordingly the Group used revised progress payments in calculation of undiscounted cash flows.

##### *Crude oil price*

Commodity prices used in the forecasts are publicly available.

If the forecasted prices used in the calculation had been five dollars (US dollars 5.0) lower than management's estimate, this would not result with any impairment loss.

##### *Discount rate*

The post-tax discount rate applied to the cash flow projections of CGU was 6%. The discount rate calculation is based on the specific circumstances of the Group and derived from its incremental borrowing rate adjusted to the specific risks associated with the asset's estimated cash flows. If the estimated discount rate used in the calculation had been 1% higher than management's estimate, this would not result in impairment loss.

##### **Contingencies**

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

#### 4. New standards and amendments issued, but not yet effective

Standards issued, but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing of standards and interpretations issued are those that the Group reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Group intends to adopt these standards when they become effective.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 4. New standards and amendments issued, but not yet effective (continued)

##### *IFRS 9 Financial Instruments*

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required, but comparative information is not compulsory. The Group plans to adopt the new standard on the required effective date. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

The Group's loan receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. The Group expects that these will continue to be measured at amortised cost under IFRS 9. However, the Group will analyse the contractual cash flow characteristics of those instruments in more detail before concluding whether all those instruments meet the criteria for amortised cost measurement under IFRS 9.

##### *Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. These amendments must be applied prospectively and are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Group.

##### *Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception*

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. These amendments must be applied retrospectively and are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Group.

##### *Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests*

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Group.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 4. New standards and amendments issued, but not yet effective (continued)

##### *IFRS 15 Revenue from Contracts with Customers*

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

##### *Amendments to IAS 1 Disclosure Initiative*

The amendments to IAS 1 *Presentation of Financial Statements* clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- the materiality requirements in IAS 1;

- that specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;

- that entities have flexibility as to the order in which they present the notes to financial statements;

- that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Group.

##### *IAS 7 (Statement of Cash Flows): amendments resulting from the disclosure initiative*

The amendments aim at clarifying IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The Group has not yet considered any changes or amendments to be made to the financial reports (effective for annual periods beginning on or after 1 January 2017).

##### *Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation*

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Group given that the Group has not used a revenue-based method to depreciate its non-current assets.

##### *IFRS 16 Leases*

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17 (effective for annual reporting periods beginning on or after 1 January 2019). These amendments are not expected to have any impact on the Group.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 4. New standards and amendments issued, but not yet effective (continued)

##### *Annual improvements 2012-2014 cycle*

In the 2012-2014 annual improvements cycle, the IASB issued five amendments to four standards, summaries of which are provided below. The changes are effective from 1 January 2016. The Group did not early adopt any of the amendments.

##### *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*

Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. The amendment must be applied prospectively.

##### *IFRS 7 Financial Instruments: Disclosures*

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required.

The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. The amendment must be applied retrospectively.

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

##### *IAS 19 Employee Benefits*

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment must be applied prospectively. These amendments are not expected to have any impact on the Group.

##### *IAS 34 Interim Financial Reporting*

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment must be applied retrospectively. These amendments are not expected to have any impact on the Group.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 5. Segment information

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the management of the Group and for which discrete financial information is available.

The Group is organised into business units based on their products and services and has two reportable segments as follows:

- oil and gas – representing extraction of natural gas and gas condensate;
- distribution – representing transportation of natural gas and gas condensate.

No operating segments have been aggregated to form the above reportable operating segments.

The Group's segments are strategic business units that focus on different customers. Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Transfer prices between operating segments are either on an arm's length basis or non-arm's length basis.

#### Information about reportable segment profit or loss, assets and liabilities

Segment information for the reportable segments for the year ended 31 December 2015 is set out below:

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
<b>Revenues</b>					
External customers	151,473	–	–	–	<b>151,473</b>
Inter-segment	–	20,046	–	(20,046)	–
<b>Total revenue</b>	<b>151,473</b>	<b>20,046</b>	<b>–</b>	<b>(20,046)</b>	<b>151,473</b>
Depreciation and depletion	(50,446)	(3,412)	–	–	<b>(53,858)</b>
Other costs	(12,932)	(3,968)	–	814	<b>(16,086)</b>
Transportation tariffs	(23,845)	–	–	19,232	<b>(4,613)</b>
General and administrative expenses	(7,976)	(2,796)	(1,738)	–	<b>(12,510)</b>
Other operating income	1,758	14	14,418	–	<b>16,190</b>
Interest income	–	2,241	38,577	(35,923)	<b>4,895</b>
Finance costs	(24,292)	(9,700)	(53,981)	31,863	<b>(56,110)</b>
Share of result of associates	–	(5,856)	–	–	<b>(5,856)</b>
Foreign exchange loss, net	(79)	(6,961)	(3,568)	10,523	<b>(85)</b>
Income tax expense	–	(3,781)	–	–	<b>(3,781)</b>
<b>Net profit/(loss) for the year</b>	<b>33,661</b>	<b>(14,173)</b>	<b>(6,292)</b>	<b>6,463</b>	<b>19,659</b>

(\*) These numbers include unallocated transactions managed and recognized at the group level.

(\*\*) Inter-segment revenues and expenses are eliminated on consolidation. Amounts shown as eliminations include intercompany transactions.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 5. Segment information (continued)

##### Information about reportable segment profit or loss, assets and liabilities (continued)

	<u>Oil and gas</u>	<u>Distribution</u>	<u>Unallocated (*)</u>	<u>Eliminations (**)</u>	<u>Total</u>
Investment in associates	–	60,740	–	–	60,740
Other reportable segment assets	2,241,496	2,584,868	3,537,638	(3,209,343)	5,154,659
<b>Total reportable segment assets</b>	<b>2,241,496</b>	<b>2,645,608</b>	<b>3,537,638</b>	<b>(3,209,343)</b>	<b>5,215,399</b>
Other reportable segment liabilities	(2,169,421)	(1,852,488)	(2,638,603)	3,193,019	(3,467,493)
<b>Total reportable segment liabilities</b>	<b>(2,169,421)</b>	<b>(1,852,488)</b>	<b>(2,638,603)</b>	<b>3,193,019</b>	<b>(3,467,493)</b>
<b>Capital expenditure (***)</b>					
Additions	352,157	1,255,842	64	–	1,608,063
Advance payments for acquisition of shares	432,610	115,984	–	–	548,594
Advance payments related to construction works	8,021	136,742	–	–	144,763
<b>Total capital expenditures</b>	<b>792,788</b>	<b>1,508,568</b>	<b>64</b>	<b>–</b>	<b>2,301,420</b>

(\*) These numbers include unallocated assets and liabilities managed and recognized at the group level.

(\*\*) Inter-segment balances are eliminated on consolidation. Amounts shown as eliminations include intercompany balances.

(\*\*\*) Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

Segment information for the reportable segments from 31 March 2014 (inception) to 31 December 2014 is set out below:

	<u>Oil and gas</u>	<u>Distribution</u>	<u>Unallocated (*)</u>	<u>Eliminations (**)</u>	<u>Total</u>
<b>Revenues</b>					
External customers	76,894	–	–	–	76,894
Inter-segment	–	9,561	–	(9,561)	–
<b>Total revenue</b>	<b>76,894</b>	<b>9,561</b>	<b>–</b>	<b>(9,561)</b>	<b>76,894</b>
Depreciation and depletion	(19,731)	(1,402)	–	–	(21,133)
Other costs	(5,501)	(2,464)	–	665	(7,300)
Transportation tariffs	(10,488)	(2)	–	8,896	(1,594)
General and administrative expenses	(766)	(391)	(332)	–	(1,489)
Other operating income	6,551	–	6,571	–	13,122
Interest income	25	2,184	21,342	(20,213)	3,338
Finance costs	(10,193)	(3,566)	(41,581)	12,625	(42,715)
Share of result of associates	–	(2,749)	–	–	(2,749)
Foreign exchange loss, net	–	–	(1,955)	–	(1,955)
Income tax expense	–	(1,211)	–	–	(1,211)
<b>Net profit/(loss) for the period</b>	<b>36,791</b>	<b>(40)</b>	<b>(15,955)</b>	<b>(7,588)</b>	<b>13,208</b>

(\*) These numbers include unallocated transactions managed and recognized at the group level.

(\*\*) Inter-segment revenues and expenses are eliminated on consolidation. Amounts shown as eliminations include intercompany transactions.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 5. Segment information (continued)

##### Information about reportable segment profit or loss, assets and liabilities (continued)

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
Investment in associates	–	56,432	–	–	56,432
Other reportable segment assets	1,553,889	1,256,612	2,025,999	(1,999,428)	2,837,072
<b>Total reportable segment assets</b>	<b>1,553,889</b>	<b>1,313,044</b>	<b>2,025,999</b>	<b>(1,999,428)</b>	<b>2,893,504</b>
Other reportable segment liabilities	(1,516,041)	(711,259)	(2,552,348)	1,988,248	(2,791,400)
<b>Total reportable segment liabilities</b>	<b>(1,516,041)</b>	<b>(711,259)</b>	<b>(2,552,348)</b>	<b>1,988,248</b>	<b>(2,791,400)</b>
<b>Capital expenditure (***)</b>					
Additions	125,323	148,595	60	–	273,978
Acquisitions of shares in projects	911,710	335,966	–	–	1,247,676
Advance payments for acquisition of shares	454,662	341,626	–	–	796,288
Advance payments related to construction works	–	146,846	–	–	146,846
<b>Total capital expenditures</b>	<b>1,491,695</b>	<b>973,033</b>	<b>60</b>	<b>–</b>	<b>2,464,788</b>

(\*) These numbers include unallocated assets and liabilities managed and recognized at the group level.

(\*\*) Inter-segment balances are eliminated on consolidation. Amounts shown as eliminations include intercompany balances.

(\*\*\*) Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

#### Geographical information

All revenue is generated from sales of natural gas and gas condensate produced in Azerbaijan.

Non-current assets other than financial instruments and deferred tax assets for each individual country for which it is material is reported separately as follows:

	2015	2014
Azerbaijan	2,594,078	1,704,621
Turkey	1,756,526	468,918
Georgia	342,616	272,451
Switzerland	60,740	56,432
<b>Total</b>	<b>4,753,960</b>	<b>2,502,422</b>

The analysis is based on location of assets.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 6. Oil and gas properties

Movements in the carrying amount of oil and gas properties consisted of the following:

	Oil and gas production properties	Pipeline assets	Decommis- sioning costs	Total
<b>Cost</b>				
<b>At 31 March 2014</b>	–	–	–	–
Acquisition of undivided interest in joint projects	430,079	74,207	14,273	<b>518,559</b>
Additions	12,619	266	2,093	<b>14,978</b>
<b>At 31 December 2014</b>	<b>442,698</b>	<b>74,473</b>	<b>16,366</b>	<b>533,537</b>
Additions	29,858	845	1,084	<b>31,787</b>
<b>At 31 December 2015</b>	<b>472,556</b>	<b>75,318</b>	<b>17,450</b>	<b>565,324</b>
<b>Accumulated depletion and depreciation</b>				
<b>At 31 March 2014</b>	–	–	–	–
Charge for the period	(19,182)	(1,402)	(549)	<b>(21,133)</b>
<b>At 31 December 2014</b>	<b>(19,182)</b>	<b>(1,402)</b>	<b>(549)</b>	<b>(21,133)</b>
Charge for the year	(49,226)	(3,398)	(1,234)	<b>(53,858)</b>
<b>At 31 December 2015</b>	<b>(68,408)</b>	<b>(4,800)</b>	<b>(1,783)</b>	<b>(74,991)</b>
<b>Net book value</b>				
<b>At 31 December 2015</b>	<b>404,148</b>	<b>70,518</b>	<b>15,667</b>	<b>490,333</b>
<b>At 31 December 2014</b>	<b>423,516</b>	<b>73,071</b>	<b>15,817</b>	<b>512,404</b>

#### Oil and gas production properties

Oil and gas production properties are represented by the Group's 6.67% share in oil and gas production properties of Shah Deniz ("SD") project.

#### Pipeline assets

The pipeline cost represents the Group's 6.67% share in cost of construction and capitalized maintenance expenses on SCP pipeline.

#### Decommissioning costs

The capitalized decommissioning costs are represented by the Group's 6.67% share in costs related to decommissioning of assets employed for the purposes of SD and SCP projects. Refer to Note 17 for details.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 7. Construction in progress and development costs

Movements in the carrying amount of oil and gas properties consisted of the following:

	Development costs	Construction in progress	Decommis- sioning costs	Total
<b>At 31 March 2014</b>	-	-	-	-
Acquisition of undivided interest in joint projects	449,630	54,534	18,125	<b>522,289</b>
Acquisition of subsidiary	-	206,828	-	<b>206,828</b>
Additions	108,223	148,205	2,572	<b>259,000</b>
<b>At 31 December 2014</b>	<b>557,853</b>	<b>409,567</b>	<b>20,697</b>	<b>988,117</b>
Additions	309,783	1,254,682	11,811	<b>1,576,276</b>
<b>At 31 December 2015</b>	<b>867,636</b>	<b>1,664,249</b>	<b>32,508</b>	<b>2,564,393</b>
<b>Net book value</b>				
<b>At 31 December 2015</b>	<b>867,636</b>	<b>1,664,249</b>	<b>32,508</b>	<b>2,564,393</b>
<b>At 31 December 2014</b>	<b>557,853</b>	<b>409,567</b>	<b>20,697</b>	<b>988,117</b>

#### Development costs

Development costs are represented by costs incurred in respect of Shah Deniz Stage 2 Development project.

#### Construction in progress

As at 31 December 2015 this amount includes cost directly related to the construction of TANAP and expansion of SCP pipeline system in the amount of US dollars 1,501,908 (31 December 2014: US dollars 322,080) and US dollars 162,341 (31 December 2014: US dollars 87,487), respectively. The amount related to construction of TANAP includes costs for project management services, early work expenses, land acquisition costs, personnel expenses and other costs directly attributable to the construction of pipeline.

#### Capitalized borrowing cost

As at 31 December 2015 the Group capitalized borrowing cost in the amount of US dollars 54,003 as part of construction in progress and development costs (2014: nil). Refer to Note 16 for further details.

#### 8. Advance payments

Advance payments consisted of the following at 31 December:

	2015	2014
Advance payments for acquisition of shares	1,344,882	796,288
Other payments related to construction works	291,609	146,846
	<b>1,636,491</b>	<b>943,134</b>

#### Advance payments for acquisition of shares

Advance payments for acquisition of shares represents advances paid in the amount of US dollars 887 million (31 December 2014: US dollars 454 million) to AzSD and US dollars 458 million (31 December 2014: US dollars 342 million) to AzSCP for acquisition of their 10% interests in the SD PSA and SCP projects, respectively, and treated as non-financial assets. Refer to Note 25 for further details.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 9. Investments in associate

At 31 December 2015 the Group held twenty percent (20%) interest in TAP AG. TAP AG is responsible for the development and operation of the gas transportation infrastructure from the Greece/Turkey border to Southern Italy in order to deliver Shah Deniz natural gas to European countries. The Group exercises significant influence over the entity by participating in its financial and operating decisions.

The Group acquired investment in TAP AG through acquisition of 100% shares of AzTAP GmbH in 2014 (Note 23).

The table below summarizes the movements in the carrying amount of the Group's investment in TAP AG:

	<b>2015</b>	<b>2014</b>
<b>Opening carrying amount</b>	<b>56,432</b>	<b>–</b>
Acquisition of investment in associate	–	56,671
Additions to investment in associate	17,500	8,260
Share of after tax results of associate	(5,856)	(2,749)
Other	(1,335)	–
Exchange differences	(6,001)	(5,750)
<b>Closing carrying amount</b>	<b>60,740</b>	<b>56,432</b>

The following table illustrates summarized financial information of the Group's investment in TAP AG at 31 December:

	<b>2015</b>	<b>2014</b>
Current assets	160,736	49,600
Non-current assets	604,796	390,633
Current liabilities	(109,262)	(23,033)
Non-current liabilities	(434,211)	(221,665)
<b>Net assets</b>	<b>222,059</b>	<b>195,535</b>
<b>Group's interest in net assets</b>	<b>44,412</b>	<b>39,107</b>
Goodwill recognized upon acquisition	18,872	18,872
Exchange differences on translation of goodwill	(1,209)	(1,547)
Other	(1,335)	–
<b>Carrying value</b>	<b>60,740</b>	<b>56,432</b>

Share of associate's results for the period ended 31 December:

	<b>2015</b>	<b>2014</b>
Revenue	–	–
Operating expenses	36,391	16,100
Other income	(592)	(829)
<b>Loss before tax</b>	<b>35,799</b>	<b>15,271</b>
Income tax benefit	(6,517)	(1,526)
<b>Net loss for the period since acquisition of associate</b>	<b>29,282</b>	<b>13,745</b>
<b>Group's share of net loss</b>	<b>5,856</b>	<b>2,749</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 10. Loan receivables

Loan receivables consisted of receivable from TAP AG in the amount of US dollars 84,977 (31 December 2014: US dollars 44,334) and receivables from BOTAS in the amount of US dollars 52,520. The loan to TAP bears interest at the rate of EUR rate for cross border shareholders loans as published by the Swiss federal tax authorities plus 1% margin and was equal to 2% in 2015 (2014: 3%). The loan matures in July 2043. Interest income earned during the year ended 31 December 2015 was US dollars 1,335 (31 December 2014: US dollars 580).

Receivables from BOTAS represent deferred consideration in the amount of US dollars 28,987 and loan receivable in the amount of US dollars 23,533. As discussed in Note 1, in accordance with the sale and purchase agreement, on 13 April 2015 the Group sold its 30% shares in TANAP A.Ş. to BOTAS for cash consideration of US dollars 168,226 and deferred consideration of US dollars 33,645. The deferred consideration does not bear interest and is expected to be repaid during 2020-2021. At initial recognition fair value of the deferred consideration was calculated as the present value using the market borrowing rate for similar financial instruments (3.5%) in the amount of US dollars 28,006. Income earned in respect of the deferred consideration from BOTAS during the year ended 31 December 2015 was US dollars 981 and was recognized within interest income.

As discussed in Note 25, according to the Funding Agreement, following the sale of 30% shares of TANAP A.Ş., the Group financed cash call requirements of BOTAS equivalent to 5% shares in TANAP A.Ş. in the amount of US dollars 27,950. The loan does not bear interest and is expected to be repaid in 2021. At initial recognition, the present value was calculated using the market borrowing rate for similar financial instruments (3.5%) in the amount of US dollars 22,737 and the difference between the fair value and carrying amount of loan in the amount of US dollars 5,213 was recognized in profit and loss. Interest income earned in respect of the loan receivable from BOTAS during the year ended 31 December 2015 was US dollars 796 (2014: nil).

#### 11. Cash and cash equivalents, deposits

Cash and cash equivalents consisted of the following at 31 December:

	<b>2015</b>	<b>2014</b>
Cash at bank, USD	254,228	202,472
Cash at bank, EUR	332	9,726
<b>Total cash and cash equivalents</b>	<b>254,560</b>	<b>212,198</b>

Cash at bank includes time deposits in the amount of US dollars 535 (31 December 2014: US dollars 194,832) with maturity of up to one month and bearing effective interest rate of 1.95% (31 December 2014: 1.6-2.5%).

#### Deposits

During 2015, the Group placed time deposit in the amount of US dollars 350 million with the maturity period of one year. The whole balance of deposit was fully utilized as at 31 December 2015.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 12. Accounts receivable

Accounts receivable consisted of the following at 31 December:

	2015	2014
Receivable from AzSD	–	21,554
Receivable from AGSC	9,760	5,178
Receivable from the SD Operator	4,401	5,127
Receivable from SOCAR MO	3,606	–
Other receivables	1,237	4,961
<b>Total accounts receivable</b>	<b>19,004</b>	<b>36,820</b>

Receivables from the SD Operator represent the inception-to-date excess of cash calls paid by the Group to the SD Operator over the actual expenditures reported by the SD Operator.

According to the crude oil sales agency agreement, the Group appointed SOCAR MO, a subsidiary of SOCAR, as its trading and marketing agent in respect of Shah Deniz PSA petroleum. SOCAR MO charges the Group commission fees for agency and marketing services at 0.5% (value added tax (“VAT”) inclusive) of the value of crude oil sold. Receivables from SOCAR MO represent a petroleum sold to a third party, for which no consideration was transferred to the Group as at 31 December 2015.

#### 13. Inventories

As at 31 December 2015 and 2014 inventories are represented by the Group’s share of inventories reported by the SD Operator.

#### 14. Other current assets

Other current assets represent the following at 31 December:

	2015	2014
VAT receivable	31,637	25,966
Other assets	6,287	12,248
<b>Total other current assets</b>	<b>37,924</b>	<b>38,214</b>

#### 15. Share capital and other reserves

##### Share capital

During the year ended 31 December 2015 the Group received additional contribution in share capital in the amount of US dollars 1,344,900. As at 31 December 2015 and 2014 the Company had authorized, issued and fully paid 100 ordinary shares at par USD 14,449 and USD 1,000, respectively. Each share entitles one vote to the shareholder.

##### Other reserves

As discussed in Note 1, on 13 April 2015 the Group sold its 30% shares in TANAP A.Ş. to BOTAS. Total consideration comprised of cash consideration paid by BOTAS in the amount of US dollars 168,226 and fair value of deferred consideration in the amount of US dollars 28,006 (Note 10). In addition, on 16 April 2015 the Group sold its 12% shares in TANAP A.Ş. to BP for cash consideration of US dollars 97,423. The difference between the net book value of shares sold (US dollars 338,831) and the fair value of considerations received from BOTAS and BP was recognized as loss on sale of share in subsidiary in other reserves in the amount of US dollars 45,176.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 16. Long-term borrowings and Government grant

##### Bonds issued to SOFAZ

In accordance with the Presidential Decree dated 25 February 2014 SOFAZ, a governmental fund established for funding of important socio-economic projects, was assigned to finance the Group's acquisitions of interests in the projects described in Note 1. Following this Decree, in 2014 the Group issued bonds to SOFAZ in the aggregate amount of US dollars 2,516,996 with maturity period of 10 years. Interest rate implicit in bond prospectus is 1% + 6 months LIBOR. The repayment of interest shall be made in semiannual installments effective from 2021 till 2024.

At initial recognition, the Group calculated the fair value of the bond using market rate for similar financial instruments (4.5% + 6 months LIBOR) and recognized US dollars 704,270 of difference between fair value and nominal amount of the bond as government grant in its consolidated statements of financial position.

Total interest accrued during the year ended 31 December 2015 was US dollars 99,641 (31 December 2014: US dollars 42,715). The Group capitalized US dollar 50,852 of borrowing cost as part of construction in progress and development costs during the year ended 31 December 2015 (2014: nil).

During the year ended 31 December 2015 the Group recognized income from government grant in the amount of US dollars 14,418 which was recognized within other income (31 December 2014: US dollars 6,571).

##### Loan from BOTAS and BP

In accordance with Term Loan Facility Agreement signed in 2015, shareholders of TANAP A.Ş undertake to make available a loan facility for financing of their shares of the capital expenditures relating to the TANAP project. During the year ended 31 December 2015, total amount of loans from BOTAS and BP were US dollars 167,700 and US dollars 67,080, respectively. The loans bear interest at the rate of 5.5% + 1 month LIBOR. Total interest charges incurred during the year ended 31 December 2015 amounted US dollars 3,151 which were capitalized as part of cost of asset.

#### 17. Decommissioning liabilities

The Group has a legal and constructive obligation with respect to decommissioning of oil and gas production and pipeline assets. Movements in provisions for the related asset retirement obligations are as follows:

	<b>31 December 2015</b>	<b>31 December 2014</b>
<b>Opening carrying amount</b>	<b>37,063</b>	–
Acquisition of undivided interest in joint projects	–	32,398
Additional liability during the period	14,336	4,665
Unwinding of present value discount	2,108	–
Effect of discount rate revision	(1,441)	–
<b>Closing carrying amount</b>	<b>52,066</b>	<b>37,063</b>

Under the provisions of the SD PSA and SCP Host Government Agreements (“HGA”) all Contractor Parties will have to make contributions to an abandonment fund, which will be used to finance the decommissioning and dismantling of constructed assets after the maturity of the SD PSA and SCP.

The maximum amount of decommissioning fund cannot exceed 10% of the capital costs in accordance with SD PSA. Decommissioning liability is estimated based on capital expenditures incurred in respect of assets already employed as at the end of each financial year. The Group share of the estimated undiscounted cost to abandon the production facilities employed in SD PSA was US dollar 132,759 as at 31 December 2015 (31 December 2014: US dollars 101,619).

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 17. Decommissioning liabilities (continued)

The Group's share of expected undiscounted cost to decommission the SCP pipeline facilities at 31 December 2015 was US dollars 10,301 (31 December 2014: US dollars 7,643). The Group used a 2.5% (31 December 2014: 2%) inflation rate in its estimate of the retirement obligation upon termination of HGA and used a pre-tax rate that reflects current market assessments of the time value of money to discount the obligation.

#### 18. Trade and other payables, accrued liabilities

Trade and other payables and accrued liabilities mainly consist of payables related to Shah Deniz Stage 2 development, expansion of SCP and construction of TANAP pipeline systems as at 31 December 2015 and 31 December 2014.

#### 19. Revenue, accrued revenue and deferred revenue

The Group's revenue consisted of the following for the year ended 31 December:

	2015	2014
Revenue from sale of gas	95,847	47,503
Revenue from sale of crude oil	55,626	29,391
	<b>151,473</b>	<b>76,894</b>

According to the provisions of the SD PSA the profit oil and gas is shared between the Government and the Contractor Parties depending on cumulative after-tax real rate of return achieved as at the end of each calendar quarter by the Contractor Parties. During 2014 and three quarters of 2015 the profit oil and gas was shared at a ratio of 55% to 45% in favor of the Government. In the fourth quarter of 2015 the split was 55% to 45% in favor of the Contractor Parties.

#### Accrued revenue

Accrued revenue balance of US dollars 3,119 at 31 December 2015 (31 December 2014: US dollars 13,118) represents the Group's underlift of crude oil resulted from a difference between the volumes lifted and entitled at Ceyhan terminal.

#### Deferred revenue

Deferred revenue balance of US dollars 5,283 at 31 December 2015 (31 December 2014: US dollars 7,662) represents the Group's overlift of crude oil resulted from a difference between the volumes lifted and entitled at Baku-Tbilisi-Ceyhan route ("BTC").

#### 20. Cost of sales

The Group's cost of sales consisted of the following for the year ended 31 December:

	Note	2015	2014
Depreciation and depletion	6	53,858	21,133
Other costs		16,086	7,300
		<b>69,944</b>	<b>28,433</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 21. Taxation

##### Taxation under the Shah Deniz Project

According to the provisions of SD PSA, the contractor parties are liable to pay income taxes related to the operations under the SD Project. According to the same provisions the respective state body of the Republic of Azerbaijan remits to the State Budget income taxes of each contractor party and reimburses the respective amount from condensate and natural gas attributable to the State. Accordingly, as a contractor party to SD PSA, the Group is liable for Azerbaijani income taxes and at the same time is entitled to additional profit petroleum. During the year ended 31 December 2015 and 2014 the Group had no income taxes from the activities in SD PSA.

The Group is exempt from certain ordinary operational taxes including Azerbaijani value added taxes in accordance with provision of SD PSA.

##### Taxation under the SCP project

SGC Midstream LLC elected SCPC to represent it in all tax issues before the tax authorities, so that the Group is a non-tax electing shareholder in accordance with the terms of Azerbaijani HGA. SCPC is liable for Azerbaijani income tax and Georgian minimum tax with respect to the income and deductions of, and natural gas transported by, SCPC, which are allocable to non-tax electing shareholders, including the Group.

The following taxes have been enacted:

Azerbaijani income tax at a fixed rate of 27%;

Georgian income tax at a fixed rate of 25%;

Georgian minimum tax (the "GMT") at a fixed rate of US dollars 2.50 per thousand of cubic meters of gas delivered to Georgian-Turkey border.

##### Georgian income tax and minimum tax

According to Georgian HGA, SCPC is liable for the income tax at a fixed rate of 25% for income generated from operations in Georgia. In case SCPC does not generate taxable income during a fiscal year, it shall be liable for GMT. The GMT for the preceding periods can be carried forward without limitation and credited against future income tax liability of SCPC in Georgia. The Group estimates that the GMT will exceed the income tax under Georgian HGA.

The provision for income taxes mainly comprised of the Group's share in Azerbaijan income tax expense, Georgian minimum tax expense and deferred tax expense of SCPC for the year ended 31 December 2015.

Deferred tax liabilities of SCPC are calculated on the temporary differences arising from the differences in accounting under IFRS and HGA (accrual versus cash basis).

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 22. Transactions with related parties

Transactions with related parties consisted of the following:

Related party	As at 31 December 2015				For the year ended 31 December 2015	
	Long-term borrowings	Share capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 16)	1,953,942	–	–	–	–	–
SOCAR	–	708,001	–	–	659,001	–
ME	–	736,899	–	–	685,899	–
AzSD	–	–	887,272	–	21,554	432,611
AzSCP	–	–	457,610	–	–	115,983
SOCAR MO	–	–	–	3,606	–	253
AGSC	–	–	–	9,760	69,851	–
<b>Total</b>	<b>1,953,942</b>	<b>1,444,900</b>	<b>1,344,882</b>	<b>13,366</b>	<b>1,436,305</b>	<b>548,847</b>
<b>Total category</b>	<b>2,191,873</b>	<b>1,444,900</b>	<b>1,636,491</b>	<b>19,004</b>		

Related party	As at 31 December 2014				From 31 March 2014 (inception) to 31 December 2014	
	Long-term borrowings	Share capital	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 16)	1,854,301	–	–	–	–	2,516,996
SOCAR	–	49,000	–	–	49,000	273,258
ME	–	51,000	–	–	51,000	–
AzSD	–	–	454,661	21,554	–	1,318,967
AzSCP	–	–	341,627	–	–	439,277
AGSC	–	–	–	5,178	40,249	–
<b>Total</b>	<b>1,854,301</b>	<b>100,000</b>	<b>796,288</b>	<b>26,732</b>	<b>140,249</b>	<b>4,548,498</b>
<b>Total category</b>	<b>1,854,301</b>	<b>100,000</b>	<b>943,134</b>	<b>36,820</b>		

#### AzSD

Settlements with AzSD (a subsidiary of SOCAR) for the year ended 31 December 2015 are represented by US dollars 432,611 advances paid for acquisition of 10% share in SD PSA and 8% share in AGSC under the DSPA. Settlements with AzSD during the period from 31 March 2014 (inception) to 31 December 2014 are represented by consideration paid for acquisition of 6.67% share in SD PSA and 5.336% share AGSC in the amount of US dollars 851,339, advances paid for acquisition of 10% share in SD PSA and 8% share in AGSC under DSPA in the amount of US dollars 454,661 and other advances. Refer to Note 25.

#### AzSCP

Settlements with AzSCP (a subsidiary of SOCAR) for the year ended 31 December 2015 are represented by US dollars 115,983 advances paid for acquisition of 10% shares in SCPC under the DSPA. Settlements with AzSCP during the period from 31 March 2014 (inception) to 31 December 2014 are represented by consideration paid for acquisition of 6.67% share in SCPC in the amount of US dollars 97,650 and advances paid for acquisition of 10% shares in SCPC under DSPA in the amount of US dollars 341,627. Refer to Note 25.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 22. Transactions with related parties (continued)

##### AGSC

AGSC is a company established by the contractor parties of the SD PSA for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas. Receipts from AGSC represent cash received in the amount of US dollars 69,851 (31 December 2014: US dollars 40,249) from sale of gas to AGSC.

##### Key management personnel

The senior management group consisted of the Group's General Director, Deputy General Director and three department directors as at 31 December 2015 (31 December 2014: General Director and Finance Director). The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category was:

	<b>31 December 2015</b>	<b>31 December 2014</b>
Aggregate remuneration	121	63
Number of persons	5	2

The Group also incurred expenses for management services provided by SOCAR Upstream Management International LLC and SOCAR Midstream Operations LLC in the total amount of US dollars 3,193 during the year ended 31 December 2015 under the Operator Services Agreement signed in December 2014.

#### 23. Business combination and acquisition of an entity that is not a business

##### Acquisition of TANAP

As discussed in the Note 1, in July 2014 the Group acquired 100% shares of TANAP A.Ş. from SOCAR. This transaction was accounted by the Group as acquisition of an entity under the common control and the assets and liabilities of the combining entity were recognized at their carrying amounts under pooling of interest method from the date when the combination took place.

Carrying values of identifiable assets and liabilities of TANAP at acquisition were as follows:

	<b>Carrying value on acquisition</b>
<b>Assets</b>	
Cash and cash equivalents	623
Accounts receivable	301
Other current assets	744
Oil and gas properties, net	206,828
Advance payments	11,604
	<b>220,100</b>
<b>Liabilities</b>	
Trade and other payables	(18,680)
Accrued liabilities	(16,501)
Short-term borrowings	(19,000)
	<b>(54,181)</b>
<b>Total identifiable net assets at carrying value</b>	<b>165,919</b>
Distribution to equity	-
<b>Consideration, settled in cash</b>	<b>165,919</b>

During 2015 TANAP contributed US dollars 1,465 net profit to the Group (31 December 2014: US dollars 1,412).

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 23. Business combination and acquisition of an entity that is not a business (continued)

##### Acquisition of AzTAP

As discussed in Note 1, in July 2014 the Group acquired 100% shares of AzTAP from SOCAR Energy Holdings AG for the amount US dollars 22 (CHF 20 thousand). AzTAP was established by SOCAR exclusively to exercise the option right to become shareholder of TAP AG. The Group recognized this purchase as acquisition of an entity that is not a business and allocated the cost of acquisition between the individual identifiable assets and liabilities of AzTAP on the basis of their relative fair values.

At the date of obtaining control over AzTAP, allocation of cost of acquisition to the identifiable assets and liabilities of AzTAP was as follows:

	<u>Allocated cost</u>
Cash and cash equivalents	99
Other current assets	65
Loan to associate	48,549
Investments in associates	56,671
Long-term borrowings	(105,362)
<b>Net assets of subsidiary</b>	<b><u>22</u></b>
<b>Consideration, settled in cash</b>	<b><u>22</u></b>

#### 24. Financial risk management objectives and policies

##### Financial risk factors

In the ordinary course of business, the Group is exposed to credit, liquidity and market risks. Market risks arise from fluctuating currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position. Although there are no structured formal risk management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

##### (i) Foreign exchange risk

Foreign exchange risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Foreign exchange risk arises primarily from future commercial transactions, recognised assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency. The Group does not have any formal procedures on managing foreign exchange risk, however, management is quite well informed on the tendencies in the economy and has undertaken steps to minimise its foreign exchange risks. Management does not hedge the Group's foreign exchange risk.

The major financial instruments in a foreign currency comprise loan receivable and certain cash and cash equivalents that are denominated in EUR.

The following table demonstrates the sensitivity to a reasonably possible change in EUR of the Group's profit before tax. A negative amount in the table reflects a potential net reduction in the profit before tax, while a positive amount reflects a net potential increase.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 24. Financial risk management objectives and policies (continued)

##### Financial risk factors (continued)

###### (i) Foreign exchange risk (continued)

The Group's exposure to change in EUR are the following:

	<b>Change in USD/EUR rate</b>	<b>Effect on profit before tax</b>
<b>2015</b>	12.50% (12.50%)	10,664 (10,664)
	<b>Change in USD/EUR rate</b>	<b>Effect on profit before tax</b>
<b>2014</b>	6.23% (6.23%)	3,368 (3,368)

###### (ii) Interest rate risk

The Group holds significant interest bearing assets and liabilities as described in Note 10 and Note 16. Interest rates on existing loan agreements are fixed in respective agreements and depend on fluctuations in LIBOR and EUR rate for cross border shareholders loans published by the Swiss federal tax authorities (ESTV).

The table below summarizes effect on profit before tax of the following shift in LIBOR and EUR rate per ESTV as at 31 December 2015 and 31 December 2014:

	<b>Change in floating variable</b>		<b>Effect on profit before tax</b>	
	<b>Increase</b>	<b>Decrease</b>	<b>After increase</b>	<b>After decrease</b>
<b>2015</b>				
LIBOR	+0.5	-0.12	(9,900)	2,400
EUR rate per ESTV	+0.5	-0.5	297	(297)
	<b>Change in floating variable</b>	<b>Decrease</b>	<b>After increase</b>	<b>After decrease</b>
<b>2014</b>				
LIBOR	+0.2	-0.2	(1,802)	1,802
EUR rate per ESTV	+0.5	-0.5	192	(192)

###### (iii) Credit risk

Financial instruments involve, to varying degrees, credit risks. The Group is subject to credit risk from its portfolio of loan receivable, cash and cash equivalents, deposits and accounts receivable and would be exposed to losses in the event of non-performance by counterparties.

The Group's exposure to credit risks arises from default of the counterparty, with a maximum exposure of US dollars 406,660 and 321,471 as at 31 December 2015 and 31 December 2014, respectively.

The Group places its cash with high credit quality financial institutions. The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade for condensate on credit terms are subject to credit verification procedures. Gas sales are made through AGSC to entities with strong financial position.

###### (iv) Liquidity risk

The Group monitors its risk to a shortage of funds by reviewing its net financial debt indicator on a regular basis. The net financial debt represents the difference between total financial liabilities and cash and cash equivalents. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of loans.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 24. Financial risk management objectives and policies (continued)

##### Financial risk factors (continued)

The tables below summarize the maturity profile of the Group's financial liabilities at 31 December 2015 and 31 December 2014 based on contractual undiscounted payments:

<b>2015</b>	<b>On demand</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>&gt;5 years</b>	<b>Total</b>
Trade and other payables	–	197,025	–	–	197,025
Accrued liabilities	–	318,759	–	–	318,759
Long-term borrowings	–	–	–	3,225,522	3,225,522
	<b>–</b>	<b>515,784</b>	<b>–</b>	<b>3,225,522</b>	<b>3,741,306</b>

<b>2014</b>	<b>On demand</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>&gt;5 years</b>	<b>Total</b>
Trade and other payables	–	54,896	–	–	54,896
Accrued liabilities	–	131,945	–	–	131,945
Long-term borrowings	–	–	–	2,860,020	2,860,020
	<b>–</b>	<b>186,841</b>	<b>–</b>	<b>2,860,020</b>	<b>3,046,861</b>

##### (v) Capital management

The primary objective of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain shareholders and creditor confidence to support its business activities.

The Group considers total capital under management to be as follows:

	<b>31 December 2015</b>	<b>31 December 2014</b>
Long-term borrowings (Note 16)	2,191,873	1,854,301
Less: cash and cash equivalents (Note 11)	(254,560)	(212,198)
<b>Net debt</b>	<b>1,937,313</b>	<b>1,642,103</b>
Equity	1,407,911	102,104
<b>Capital and net debt</b>	<b>3,345,224</b>	<b>1,744,207</b>
<b>Gearing ratio</b>	<b>58%</b>	<b>94%</b>

##### (vi) Fair value of financial instruments

The fair value of the financial assets and liabilities is included in the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 24. Financial risk management objectives and policies (continued)

##### Financial risk factors (continued)

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements:

	<b>31 December 2015</b>	
	<b>Carrying amounts</b>	<b>Fair values</b>
Cash and cash equivalents (Note 11)	254,560	254,560
Accounts receivables (Note 12)	14,603	14,603
Loan receivables (Note 10)	137,497	137,497
<b>Total financial assets</b>	<b>406,660</b>	<b>406,660</b>
Trade and other payables (Note 18)	(197,025)	(197,025)
Accrued liabilities (Note 18)	(318,759)	(318,759)
Long-term borrowings (Note 16)	(2,191,873)	(2,197,326)
<b>Total financial liabilities</b>	<b>(2,707,657)</b>	<b>(2,713,110)</b>

	<b>31 December 2014</b>	
	<b>Carrying amounts</b>	<b>Fair values</b>
Cash and cash equivalents (Note 11)	212,198	212,198
Deposits (Note 11)	33,246	33,246
Accounts receivables (Note 12)	31,693	31,693
Loan receivables (Note 10)	44,334	44,334
<b>Total financial assets</b>	<b>321,471</b>	<b>321,471</b>
Trade and other payables (Note 18)	(54,896)	(54,896)
Accrued liabilities (Note 18)	(131,945)	(131,945)
Long-term borrowings (Note 16)	(1,854,301)	(1,854,301)
<b>Total financial liabilities</b>	<b>(2,041,142)</b>	<b>(2,041,142)</b>

The following methods and assumptions were used to estimate the fair values:

- (i) Current financial assets and liabilities approximate their carrying amounts largely due to the current maturities of these instruments;
- (ii) Long-term fixed-rate and variable-rate receivables/borrowings are evaluated by the Group using Level 3 inputs based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

#### 25. Commitments and contingencies

##### Commitments related to participating interest in Shah Deniz PSA

On 17 December 2013 Shah Deniz consortium announced the final investment decision for Stage 2 development of Shah Deniz gas field in the Azerbaijan Sector of the Caspian Sea and signed Sixth, Seventh and Eighth Addendums to Shah Deniz PSA. The Group is committed to finance expenditures related to Shah Deniz project based on its share of interest.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 25. Commitments and contingencies (continued)

##### Commitments related to participating interest in Shah Deniz PSA (continued)

As of 31 December 2015 the Shah Deniz PSA operator has entered into a number of capital commitments and operating leases. The Group estimated its 6.67% share of these capital commitments and operating leases in the amount of US dollars 966,064 and US dollars 21,727, respectively (31 December 2014: US dollars 1,255,780 and US dollars 13,775, respectively). The total of future minimum lease payments under non-cancellable operating leases for each of the following periods is as follows:

<b>Operating leases</b>	<b>31 December 2015</b>	<b>31 December 2014</b>
Not later than one year	6,852	6,848
Later than one year and not later than five years	14,175	6,875
Later than five years	700	52
	<b>21,727</b>	<b>13,775</b>

##### Commitment related to SCP Expansion

Shah Deniz PSA Contractor Parties made the final investment decision on SCP Expansion project on 17 December 2013. SCP Expansion project objective is to expand the existing SCP pipeline system capacity. Due to SCP expansion additional facilities will be constructed in Georgia for the purposes of interconnection with TANAP. The Group has the commitment to fund the SCP Expansion project equivalent to its 6.67% shares throughout the construction and initial operational phase. The remaining budget for SCP Expansion is estimated in the amount of US dollars 2,799,000 (the Group's share: US dollars 186,693).

##### Commitment related to TANAP

###### *Construction of TANAP*

At the financial statement date, the Group has capital commitment to fund the construction of TANAP pipeline system. The remaining budget for construction of TANAP system is estimated in the amount of US dollars 8,111,736 (31 December 2014: US dollars 9,269,920).

##### Commitment related to TAP

###### *Construction of TAP*

The Group has the commitment to fund construction of TAP pipeline system. The remaining budget for construction of the TAP system is estimated in the amount of US dollars 4,337,700 (31 December 2014: US dollars 4,781,552). The Group's share of commitment at the financial statement date was US dollars 867,540 (31 December 2014: US dollars 956,310).

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC

###### *BOTAS gas contract*

AGSC is obliged under the gas contract signed with BOTAS to make available a maximum of approximately 6.6 bcm of gas annually from 2016 till 2019 at a price calculated based on a formula established by the gas contract.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 25. Commitments and contingencies (continued)

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

###### *Stage 2 gas contract*

On 25 October 2011, SOCAR and BOTAS executed a gas sale and purchase agreement (“Stage 2 SPA”) with respect to the sale by SOCAR to BOTAS of certain volumes of Shah Deniz Stage 2 gas (2 bcm first delivery year, 4 bcm second delivery year, 6 bcm plateau period). In December 2012 SOCAR transferred and assigned the rights and obligations under the Stage 2 SPA to AGSC. The anticipated commencement of first gas delivery under Stage 2 BOTAS SPA is July 2018.

###### *BOTAS contract for BTC fuel gas*

AGSC is obliged under the agreement with BOTAS to make available 0.15 bcm of gas annually from 2016 till 2019 at a price which is calculated based on formula established in the contract.

###### *Azerbaijan gas obligation*

AGSC is obliged under the agreement signed with SOCAR to make available a minimum of approximately 1.5 bcm of gas in 2016 and onwards at a price calculated based on the formula established in the agreement.

###### *Georgian gas obligation*

AGSC is obliged under the agreement signed with Georgian Oil and Gas Corporation (“GOGC”) and the government of Georgia to make available 0.5 bcm of gas in 2016 and onwards, at a price which is calculated based on a formula established in the contract.

###### *Sale and purchase agreement with OptionCo*

AGSC is obliged under the agreement signed with OptionCo to make available 0.29 bcm of gas during the contract year starting on 1 October 2015 and ending 1 September 2016. Thereafter, AGSC is obliged to deliver during the next contract year, which starts on 1 October 2016 and ends 30 September 2017, a maximum of five percent of the volumes transported by AGSC through Georgia via the SCP in the previous contract year, at a price which is calculated based on a formula established in the contract.

###### *Shah Deniz Stage 2 EU Long term Gas Sales Agreements (“GSAs”)*

In September 2013 ten EU GSAs were signed by SOCAR with nine EU Buyers and in December 2013 the GSAs were assigned to AGSC until Shah Deniz PSA expiry with re-assignment to SOCAR as Shah Deniz Production declines. The commencement date will be firmed up through funnelling mechanism within a 1-year window between 1 January 2020 and 1 January 2021 for DEPA, Shell, Axpo (PSV) and E.On; 1 July 2020 and 1 July 2021 for Axpo (WTB), GDF Suez, Gas Natural Fenosa, Enel, Hera and Bulgargaz. The GSAs assume 3 year build-up period, as defined in the contracts, with the following peak annual delivery obligations: AXPO (PSV) 0.48 bcm, GDF Suez 2.64 bcm, Gas Natural Fenosa 0.99 bcm, E.On 1.45 bcm, Shell 0.95 bcm, Hera 0.3 bcm, Enel 0.48 bcm, AXPO (WTB) 0.96 bcm, Bulgargaz 0.94 bcm, DEPA 1 bcm.

###### *Trans Anatolian Pipeline Gas Transportation Agreement (TANAP GTA)*

AGSC is a party to TANAP GTA with annual reserved capacity during the build-up period, as defined in the contract, of 6.1 bcm, 6.2 bcm, 7.2 bcm and plateau of 10.5 bcm after 18 months with 100% ship or pay on the capacity reservation. The start date will be set through a funnelling mechanism inside the first window period between 1 July 2019 and 1 July 2021.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 25. Commitments and contingencies (continued)

##### Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

###### *Trans Adriatic Pipeline GTA (TAP GTA)*

AGSC is a party to TAP GTA with annual capacity of 9.08 bcm and additional annual regulated capacity of 0.46 bcm booked under TAP First Booking Phase ("FBP"). The planned commencement date is inside the second window period between 1 January 2020 and 31 December 2020.

###### *TAP Deferral Gas Sales Agreement*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 May 2019 – 31 December 2020 (or until an earlier termination of the agreement in accordance with provisions of the agreement) in the volume of maximum 3.66 bcm in 2019 and 6.4 bcm in 2020, at a price which is stipulated in the contract.

###### *Sale and purchase agreement with Baku-Tbilisi-Ceyhan Pipeline Company ("BTC Co")*

AGSC is obliged under an agreement signed with BTC Co to make available 0.16 bcm during the following years until the termination of the contract subject to the right of BTC Co to reduce annual off-take, at a price which is calculated based on the formula established in the contract.

###### *Debottlenecking SPA*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 January 2016 – 30 June 2018 as follows: 1.3 bcm per annum for the years 2016-2017 and 0.64 bcm in 2018, at a price which is stipulated in the contract.

###### *BOTAS Gas Transportation Agreement (BOTAS GTA)*

TANAP is a party to BOTAS GTA and with annual reserved capacity during the build-up period, as defined in the contract, of 1.9 bcm (12 month period commencing on start date), 3.8 bcm (next 12 month period) and plateau of 5.7 bcm 24 months after the start date. The start date will be within the period from and including 1 May 2018 to and including 30 June 2018.

###### *SOCAR Gas Transportation Agreement (SOCAR GTA)*

Based on this GTA, from and including the start date (6 March 2036) SOCAR shall pay to TAP AG the amount of actual monthly charge in relation of each booking of reserved capacity at each entry point and exit point at a price which is calculated based on the formula established in the contract. TAP AG shall make available to SOCAR for transportation of natural gas at the applicable entry point and exit point(s) as described below, a reserved capacity equal to the following maximum flow rates expressed in kilowatt-hours (kWh) per gas day: Entry point at Kipoi – 287,318,605 kWh per gas day; Exit point at SRG – 242,999,147 kWh per gas day; Exit point at Komotini – 44,319,458 kWh per gas day.

###### *Framework agreement*

On 17 December 2013, AGSC executed a Term Sheet for GSA Novation and Capacity Transfer Framework Agreement with SOCAR ("Term Sheet"). A fully-termed Framework Agreement was negotiated with SOCAR to give effect to the Term Sheet. Framework Agreement relates to novation of long-term GSAs and transfer of GTA capacity from AGSC to SOCAR after 2036. The Framework Agreement was executed on 19 October 2015.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 25. Commitments and contingencies (continued)

##### Commitment under the Deferred Sale and Purchase Agreement (“DSPA”)

In July 2014 the Group signed the DSPA for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP. According to the terms of this agreement the Group shall make advance payments for these acquisitions to AzSD and AzSCP, while control will pass to the Group in March 2023, provided that certain conditions precedent are satisfied. As of 31 December 2015, the Group had commitments for payments in the amount of US dollars 536,087 (31 December 2014: US dollars 559,754) to AzSD and has to make progress payments equaled to Shah Deniz Stage 2 Development cash call requirements of AzSD till 31 December 2020. In addition, the Group has to make progress payments equaled to SCP Expansion project related cash calls requirements of AzSCP till 31 December 2020.

##### Commitment under the funding agreement with BOTAS (the “Funding Agreement”)

On 26 May 2014 SOCAR and BOTAS signed Funding Agreement for financing BOTAS’s 5% shares in TANAP A.Ş., upon acquisition of shares in TANAP A.Ş. by BOTAS. On 13 March 2015, the Group signed novation agreement with SOCAR and BOTAS, where all rights and obligations under the Funding Agreement were transferred from SOCAR to the Group. According to agreement with BOTAS, the Group has commitment for providing interest free loan to BOTAS for financing its 5% share in TANAP A.Ş.’s future cash call requirements till TANAP becomes operational.

##### Contingencies related to the SPA in respect of share in Shah Deniz PSA and AGSC

In July 2014 the Group acquired 6.67% participating interest in Shah Deniz project and 5.336% shares in AGSC and 6.67% shares in SCPC based on the sale and purchase agreement signed on 29 April 2014 with AzSD and AzSCP. These interest and shares were acquired by AzSD and AzSCP from Statoil Shah Deniz A.S. and Statoil Azerbaijan A.S., respectively based on the Sale and Purchase Agreement signed between the parties thereto. At 31 December 2015 AzSD had dispute with Statoil Shah Deniz A.S. (“Statoil”) in the amount of US dollars 29 million related to the purchase consideration determination. The parties agreed to involve an independent expert to resolve the dispute as required under the provisions of the sale and purchase agreement. On 17 February 2016 the independent expert concluded that the purchase consideration must be adjusted by approximately US dollars 15 million (out of total US dollars 29 million initially requested) in favor of Statoil. The expert’s decision is binding for AzSD and Statoil and the parties cannot challenge the expert’s opinion in relation to the consideration adjustment, unless (i) there has been a manifest error or fraud; (ii) there is a material interest or duty prejudicing his decision; or (iii) the expert decided a matter outside of the scope. However, AzSD and AzSCP has made a counter claim against Statoil in the amount of US dollars 19 million under the leakage and indemnity provision of the SPA, which, AzSD and AzSCP believe, did not fall within the jurisdiction of independent expert. If the dispute is ultimately resolved in favor of Statoil, AzSD will make payment of US dollars 15 million to Statoil and the Group will reimburse this amount to AzSD. Management believes that the resolution of the issue will not result in any additional liability to the Group, therefore, liability of approximately US dollars 15 million is not recognized in these consolidated financial statements.

#### 26. Current business environment

##### Azerbaijan economy

The Group’s operations are mainly conducted in the Republic of Azerbaijan and the Republic of Turkey. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Republic of Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Republic of Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 26. Current business environment (continued)

##### Azerbaijan economy (continued)

As a result of significant drop in crude oil prices, on 21 February 2015, Azerbaijani Manat was devalued against US dollar and other major currencies by 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to US dollar 1, respectively. On 21 December 2015 Azerbaijani Manat devalued against major currencies by a further 47%. Following the second devaluation, the Central Bank of Republic of Azerbaijan announced the move to a floating exchange rate.

There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Company's future results and financial position and business prospects in a manner not currently determinable. During subsequent period, crude oil prices were subject to significant volatility. Any further significant drop in crude oil prices could negatively affect the Company's future liquidity position, results of operations and might result in an impairment loss on oil and gas assets.

Azerbaijani government announced plans to accelerate reforms and support to economic environment in response to current challenges.

The Company's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Company's business in the foreseeable future.

##### Turkish economy

The strong performance of the Turkish economy, as clearly demonstrated in economic indicators of previous years, was impacted to some degree by the sluggish European markets that Turkey is most dependent on. The Turkish government began to implement new policies and measures to revive domestic demand in order to compensate for the slowdown in foreign markets.

While management believes it is taking appropriate measures to support the sustainability of Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

These consolidated financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the period when they become known and estimable.

#### 27. Events after the reporting date

##### Increase in share capital

ME and SOCAR have increased the Company's share capital in the total amount of US dollars 295,900 subsequent to year end.

##### Eurobond Emission

In March 2016 the Company issued US dollars 1 billion senior unsecured notes guaranteed by the Republic of Azerbaijan ("Notes"). The Notes bear interest rate of 6.875 per cent per annum payable semi-annually in arrears on 24 March and 24 September in each year until maturity. The Notes mature on 24 March 2026 and are listed on the Irish Stock Exchange.

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31  
DECEMBER 2014**

**Southern Gas Corridor  
Closed Joint-Stock Company**

**Consolidated financial statements**

*Period from 31 March 2014 (inception)  
to 31 December 2014  
with independent auditors' report*



# Southern Gas Corridor CJSC

## Consolidated financial statements

Period from 31 March 2014 to 31 December 2014

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## Independent auditors' report

To the Board of Directors and shareholders of Southern Gas Corridor CJSC

We have audited the accompanying consolidated financial statements of the Southern Gas Corridor Closed Joint Stock Company (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2014 and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and statement of cash flows for the period from 31 March 2014 (inception) to 31 December 2014, and a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these 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.

### **Auditors' responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2014 and its financial performance and its cash flows for the period from 31 March 2014 (inception) to 31 December 2014 in accordance with International Financial Reporting Standards.

*Ernst & Young Holdings (CIS) B.V.*

21 September 2015

## Southern Gas Corridor CJSC

### Consolidated statement of financial position

*(Amounts presented are in thousands of US dollars)*

	Note	2014
<b>Assets</b>		
<b>Non-current assets</b>		
Oil and gas properties	5	512,404
Construction in progress and development costs	6	988,117
Advance payments	7	943,134
Investments in associate	8	56,432
Loan to associate	9	44,334
Other non-current assets		2,335
<b>Total non-current assets</b>		<b>2,546,756</b>
<b>Current assets</b>		
Cash and cash equivalents	10	212,198
Deposits	10	33,246
Accounts receivable	11	36,820
Accrued revenue	18	13,118
Inventories	12	13,152
Other current assets	13	38,214
<b>Total current assets</b>		<b>346,748</b>
<b>Total assets</b>		<b>2,893,504</b>
<b>Equity and liabilities</b>		
<b>Equity</b>		
Share capital	14	100,000
Cumulative translation differences		(11,104)
Retained earnings		13,208
<b>Total equity</b>		<b>102,104</b>
<b>Non-current liabilities</b>		
Long-term borrowings	16	1,854,301
Government grant	16	697,699
Decommissioning liabilities	15	37,063
Deferred revenue	18	7,662
Deferred tax liability	20	6,458
<b>Total non-current liabilities</b>		<b>2,603,183</b>
<b>Current liabilities</b>		
Trade and other payables	17	54,896
Accrued liabilities	17	131,945
Income tax payable		1,376
<b>Total current liabilities</b>		<b>188,217</b>
<b>Total equity and liabilities</b>		<b>2,893,504</b>

Signed and authorized on behalf of the Board of Directors

Afgan Isayev, General Director



21 September 2015

Ramil Babayev, Finance Director

21 September 2015

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Consolidated statement of comprehensive income

*(Amounts presented are in thousands of US dollars)*

	<b>Note</b>	<b>From 31 March 2014 (inception) to 31 December 2014</b>
Revenue	18	76,894
Cost of sales	19	(28,433)
<b>Gross profit</b>		<b>48,461</b>
Transportation tariffs		(1,594)
General and administrative expenses		(1,489)
Other income	16, 18	13,122
<b>Operating profit</b>		<b>58,500</b>
Interest income		3,338
Finance costs	16	(42,715)
Share of result of associates	8	(2,749)
Foreign exchange loss, net		(1,955)
<b>Profit before income tax</b>		<b>14,419</b>
Income tax expenses	20	(1,211)
<b>Profit for the period</b>		<b>13,208</b>
<b>Other comprehensive loss</b>		
<i>Other comprehensive loss to be reclassified to profit or loss in subsequent period:</i>		
Exchange differences on translation of foreign operations		(5,354)
Exchange differences on translation of foreign associate		(5,750)
<b>Other comprehensive loss for the period</b>		<b>(11,104)</b>
<b>Total comprehensive income for the period</b>		<b>2,104</b>

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Consolidated statement of cash flows

*(Amounts presented are in thousands of US dollars)*

	Note	From 31 March 2014 (inception) to 31 December 2014
<b>Operating activities</b>		
Profit before income tax		14,419
<i>Non-cash adjustments to reconcile profit before tax to net cash flows:</i>		
Finance costs	16	42,715
Depreciation and depletion	19	21,133
Share of result of associate	8	2,749
Other income	16, 18	(13,122)
Interest income	12	(3,338)
Exchange loss		817
<i>Working capital adjustments:</i>		
Accounts receivable		(14,208)
Inventories		1,479
Accrued revenue		(8,844)
Other assets		(24,049)
Deferred revenue		(313)
Trade and other payables		(4,720)
Accrued liabilities		10,885
<b>Cash generated from operations</b>		<b>25,603</b>
Interest received		2,823
<b>Net cash flows from operating activities</b>		<b>28,426</b>
<b>Investing activities</b>		
Acquisition of subsidiary, net of cash received	22	(165,219)
Acquisition of undivided interests in joint projects		(946,986)
Placement of deposits		(99,000)
Proceeds from withdrawal of deposits		65,754
Advance payments for acquisition of shares	7	(796,288)
Investments in oil and gas properties		(174,396)
Additions to construction in progress and development costs		(180,509)
Investment in associates	8	(8,260)
Other acquisitions		(2,003)
<b>Net cash used in investing activities</b>		<b>(2,306,907)</b>
<b>Financing activities</b>		
Contribution from shareholders	14	100,000
Proceeds from borrowings	16	2,522,996
Repayment of borrowings	16	(132,317)
<b>Net cash from financing activities</b>		<b>2,490,679</b>
<b>Net increase in cash and cash equivalents</b>		<b>212,198</b>
<b>Cash and cash equivalents as at inception</b>	9	-
<b>Cash and cash equivalents at end of the year</b>	9	<b>212,198</b>
<b>Non-cash operating activity</b>		
Government grant on loan received for financing of projects	16	704,270

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Consolidated statement of changes in equity

*(Amounts presented are in thousands of US dollars)*

	Share capital	Cumulative translation differences	Retained earnings	Total
<b>At 31 March 2014 (inception)</b>	-	-	-	-
Contribution from shareholders	100,000	-	-	<b>100,000</b>
Profit for the period	-	-	13,208	<b>13,208</b>
Other comprehensive loss	-	(11,104)	-	<b>(11,104)</b>
<b>At 31 December 2014</b>	<b>100,000</b>	<b>(11,104)</b>	<b>13,208</b>	<b>102,104</b>

*The accompanying notes are an integral part of these financial statements.*

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 1. Corporate information

Southern Gas Corridor Closed Joint-Stock Company (the "Company") was established by the Presidential Decree No 287 dated 25 February 2014. It was incorporated on 31 March 2014 in accordance with Azerbaijani legislation. 51% of the Company is owned by the Government of Azerbaijan Republic (the "State"), which is represented by the Ministry of Economy and Industry of the Republic of Azerbaijan, whereas 49% belongs to the State Oil Company of the Azerbaijan Republic ("SOCAR"). The Company is domiciled in the Republic of Azerbaijan. The registered address is located at 73 Neftchilar Avenue, Baku, AZ 1000, the Republic of Azerbaijan.

The Company was established for consolidating, managing and financing the State's interests in the full-field development of the Shah Deniz gas-condensate field, the expansion of the South Caucasus Pipeline ("SCP"), implementation of Trans-Anatolian Natural Gas Pipeline ("TANAP") and Trans Adriatic Pipeline ("TAP") projects (together the "Projects").

On 24 April 2014 the Company incorporated its 100% owned subsidiary, SGC Upstream LLC ("SGC U"), for participating in the exploration and development of the Shah Deniz gas-condensate field in accordance with the Agreement on the Exploration, Development and Production Sharing for the Shah Deniz Prospective Area in the Azerbaijan Sector of the Caspian Sea ("SD PSA") dated 4 June 1996.

On 25 April 2014 the Company incorporated its 100% owned subsidiary, SGC Midstream LLC ("SGC M"), to participate in the SCP project for the transportation of gas through gas export pipeline system from Azerbaijan through Georgia to the Georgian-Turkish border in accordance with, amongst other things, the Intergovernmental Agreement signed between the Government of Azerbaijan and the Government of Georgia.

On 31 July 2014 the Company, through its subsidiary, SGC U, acquired 6.67% participating interest in Shah Deniz project and 5.336% shares in Azerbaijan Gas Supply Company Limited ("AGSC") as well as 6.67% shares in SCPC, through its subsidiary, SGC M, based on the Sale and Purchase Agreement ("SPA") signed on 29 April 2014 between the Company's respective subsidiaries (acting as the purchasers) and Azerbaijan (Shah Deniz) Limited ("AzSD") and Azerbaijan (South Caucasus Pipeline) Limited ("AzSCP") (acting as the sellers).

On 23 July 2014 the Company signed the agreement to acquire from SOCAR 100% shares of TANAP Doğalgaz İletim A.Ş. (Project Company of TANAP), which was established for the implementation of TANAP project within the territory of the Republic of Turkey. The purpose of constructing TANAP is to distribute natural gas across the country and to transit gas through the territory of Turkey to European countries in accordance with the Intergovernmental Agreement signed between the Government of Azerbaijan and the Government of Turkey.

On 23 July 2014 the Company signed the agreement to get hold of 20% shares in TAP AG (Project Company of TAP) through the acquisition of 100% shares of AzTAP GmbH from SOCAR Energy Holdings AG, a subsidiary of SOCAR. TAP AG was established for planning, developing, financing, and operating TAP project, including the construction of TAP, for the transportation of natural gas to the European markets.

On 23 July 2014 the Company, acting through SGC U and SGC M signed the Deferred Sale and Purchase Agreement ("DSPA") for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP, respectively. The closing of the agreement is expected to happen in March 2023, subject to fulfillment of all the conditions precedent. Further details are disclosed in Note 7 and Note 24.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies

##### Basis of preparation

These consolidated financial statements of the Company and its subsidiaries and associate (collectively referred to as "the Group") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

The consolidated financial statements are the Group's first financial statements for the period ended 31 December 2014 covering the accounting period from 31 March 2014 (inception) to 31 December 2014 ("the period ended 31 December 2014").

##### Basis for consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2014.

Subsidiaries are all entities (including special-purpose entities) over which the Group has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- ▶ Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- ▶ Exposure, or rights, to variable returns from its involvement with the investee; and
- ▶ The ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- ▶ The contractual arrangement with the other vote holders of the investee;
- ▶ Rights arising from other contractual arrangements;
- ▶ The Group's voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if that results in a deficit balance.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

##### *Transactions with non-controlling interest*

Changes in the Group's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (i.e. transactions with owners in their capacity as owners). In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Group.

##### *Business combinations with entities under common control*

The Group applies pooling of interest method of accounting for business combinations with entities under the common control from the date when the combination took place.

The pooling of interests method includes the following:

- ▶ The assets and liabilities of the combining entities are reflected at their carrying amounts. No adjustments are made to reflect fair values, or recognise any new assets or liabilities, at the date of the combination. The only adjustments that are made are to align accounting policies.
- ▶ No "new" goodwill is recognised as a result of the combination. The only goodwill that is recognised is any existing goodwill relating to either of the combining entities. Any difference between the consideration paid/transferred and the net assets acquired is reflected within equity.
- ▶ Total comprehensive income reflects the results of the combining entities from the period when the combination took place.

##### *Acquisition of an entity that is not a business*

When the Group acquires an entity that is not a business, it allocates the cost of acquisition between the individual identifiable assets and liabilities of the acquired entity on the basis of their relative fair values as following:

- ▶ monetary assets and monetary liabilities are recognized at their fair value;
- ▶ the cost of acquisition remained after deduction of the fair value of monetary assets and monetary liabilities is allocated to non-monetary assets and non-monetary liabilities on the basis of their fair value at the date of acquisition.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Investment in associates

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The Group's investment in its associate is accounted for using the equity method. Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of profit or loss reflects the Group's share of the results of operations of the associate. Any change in other comprehensive income ("OCI") of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The aggregate of the Group's share of profit or loss of an associate is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, then recognises the loss as "Share of profit of an associate in the statement of profit or loss".

Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

##### Investments in SD PSA, SCP and AGSC

According to the terms of SD PSA, the Group owns the portion of project's assets and is liable for its portion of project's liabilities. At the same time the Group is entitled to its portion of expenses incurred and revenues earned by the whole project. Therefore, the Group accounts for its investment in SD PSA by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project.

Participating interest of the Group in the SCP Project is treated by the Group as undivided interest related to the investment in SCPC and accounted by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project

At initial recognition the Group allocated the consideration amount to the individual identifiable assets and liabilities relevant to its share in SD PSA and SCP, on the basis of their relative fair values.

The Group holds an interest in the AGSC, a company established together with other contractor parties of the Shah Deniz Project and Ministry of Energy of the Republic of Azerbaijan. AGSC is special structured entity established for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas and operates on no gain, no loss basis.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Foreign currency translation

The consolidated financial statements are presented in US dollars ("USD") and all values are rounded to the nearest thousands, except when otherwise indicated.

The functional and the presentation currency of the Company and its subsidiaries are the following:

SGC Upstream LLC	USD
SGC Midstream LLC	USD
TANAP Doğalgaz İletim A.Ş.	USD
AzTAP GmbH	EUR

The transactions executed in foreign currencies are initially recorded in the functional currencies of respective Group entities by applying the appropriate rates of exchanges prevailing at the date of transaction.

Monetary assets and liabilities not already measured in the functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the reporting date.

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's entities are recognized in profit or loss.

The results and financial position of the Group entities which functional currency differ from the presentation currency of the Group and not already measured in the Group's presentation currency are translated into the presentation currency of the Group as follows:

- (i) assets and liabilities for each statement of financial position are translated at the closing rate at the date of that statement of financial position;
- (ii) income and expenses for each statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognized as a separate component of equity – currency translation difference.

At 31 December 2014 the principal rate of exchange used for translating foreign currency balances was USD 1.2139 per EUR 1.

##### Financial instruments – key measurement terms

Depending on their classification financial instruments are carried at fair value, cost or amortised cost as described below.

*Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible to by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial instruments – key measurement terms (continued)

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;

Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

*Cost* is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest rate method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the consolidated statement of financial position.

*The effective interest rate method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial assets

###### *Initial recognition and measurement*

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial assets are recognized initially at fair value.

The Group has not designated any financial assets upon initial recognition as at fair value through profit or loss, held-to-maturity investments, available-for-sale financial assets, or as derivatives.

###### *Subsequent measurement*

The subsequent measurement of financial assets depends on their classification:

###### *Loan and receivables*

This category is most relevant to the Group. Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method.

The effective interest rate method amortization is included in finance income in the consolidated statement of comprehensive income. The losses arising from impairment are recognized in the consolidated statement of comprehensive income.

###### *Cash and cash equivalents*

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

###### *Accounts receivable*

Accounts receivable, which generally have 30-90 days' terms, are recognized and carried at original invoice amount less an allowance for any uncollectible amounts.

###### *Derecognition*

A financial asset (or, where applicable a part of a financial asset) is derecognized when:

- ▶ The rights to receive cash flows from the asset have expired;
- ▶ The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass through" arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 2. Significant accounting policies (continued)

##### Financial assets (continued)

###### *Impairment of financial assets*

The Group assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

###### *Financial assets carried at amortized cost*

For financial assets carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate.

##### Financial liabilities

###### *Initial recognition and measurement*

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group has not designated any financial liabilities upon initial recognition as financial liabilities at fair value through profit or loss, or as derivatives designated as hedging instruments in an effective hedge.

###### *Subsequent measurement*

The measurement of financial liabilities depends on their classification as follows:

###### *Loans and borrowings*

This category is most relevant to the Group. After initial recognition, interest bearing loans and borrowings which have a fixed contractual repayment schedule are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the consolidated statement of comprehensive income when the liabilities are derecognized as well as through the effective interest rate method amortization process.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Financial liabilities (continued)

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method. The effective interest rate method amortization is included in finance cost in the consolidated statement of comprehensive income.

Borrowings with no pre-defined contractual repayment schedules are measured in accordance with actual contractual terms.

##### *Trade and other payables*

Trade and other payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

##### *Derecognition*

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of comprehensive income.

##### Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

##### Oil and gas properties

Oil and gas properties are stated at cost, less accumulated depreciation and provision for impairment, where required. Such cost includes the cost of replacing part of the oil and gas properties and borrowing costs for long-term construction projects if the recognition criteria are met.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of oil and gas properties items are capitalised and the replaced part is retired.

At the end of each reporting period management assesses whether there is any indication of impairment of oil and gas properties. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed where appropriate if there are indicators that impairment loss may no longer exist or may have decreased.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are recognised in profit or loss for the year.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Construction in progress

All costs directly or indirectly attributable to the projects to construction and expansion the capacity of the pipeline systems are capitalized as a construction in progress. The construction in progress is stated at a cost and not depreciated. The construction in progress is transferred to the property, plant and equipment upon completion.

##### Depreciation, depletion and amortization

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the units-of-production method based on proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

The cost of an off-shore production platform, terminal and other development costs incurred in connection with a planned group of development wells is reduced for the portion of development costs related to wells which have not been drilled yet in determining the asset base subject to the unit-of-production amortization rate until the additional development wells are drilled. Similarly, in computing the depletion rate, those proved reserves that will be produced only after significant additional development costs are incurred are excluded from proved developed reserves.

Depreciation, depletion and amortization of capitalized costs of the pipeline systems are calculated using the straight line method for the period of useful life of pipelines. The estimated useful life of the SCP pipeline is thirty years from 25 November 2006 when the pipeline was officially put in use. The estimated useful life of the TANAP pipeline system will be the period from the date when the pipeline is officially put in use till the year 2061.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

##### Oil and natural gas exploration, evaluation and development expenditure

The Group follows the successful efforts method of accounting for oil and natural gas exploration, evaluation and development activities. Costs to acquire mineral interests, to determinate the technical feasibility, assess commercial viability of an identified resource and to drill and equip exploratory wells that find proved reserves are capitalized within exploration and evaluation assets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed.

When proved reserves of oil and natural gas are identified and development is sanctioned by management, the relevant capitalized expenditure is first assessed for impairment and (if required) any impairment loss is recognized, then the remaining balance is transferred to oil and gas properties. No amortization is charged during the exploration and evaluation phase.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, the drilling and equipment of development wells, including unsuccessful development or delineation wells, is capitalized within oil and gas properties. Oil and gas properties are stated at cost less accumulated depreciation and accumulated impairment losses.

##### Advance payments

Advance payments are recognized and carried at the original amount of payment less provision for any amount at risk of non-performance by the counterparty. Advance payments made for non-current assets as well as payments which will be settled during more than one-year period are non-current advance payments.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### **Impairment of oil and gas properties, construction in progress, development costs and other non-financial assets**

The Group assesses at each statement of financial position date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's ("CGU") fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Impairment losses of continuing operations, including impairment on inventories, are recognized in the consolidated statement of comprehensive income in expense categories consistent with the function of the impaired asset, except for a property previously revalued and the revaluation was taken to other comprehensive income. In this case, the impairment is also recognized in other comprehensive income up to the amount of any previous revaluation.

##### **Inventories**

Inventories are stated at the lower of cost and net realizable value. Cost of producing crude oil is accounted on weighted average basis. This cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition. The cost of crude oil is the production cost, the appropriate proportion of DD&A and overheads. Net realizable value of crude oil is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to completion and disposal.

##### **Decommissioning liabilities**

Under the provisions of the SD PSA, the Contractor Parties to the SD PSA are obligated to finance the ultimate abandonment of oil and gas production properties employed in petroleum operations within the contract area. The maximum amounts of abandonment funds cannot exceed 10% of the capital costs in accordance with the SD PSA. The Group estimates its share of total decommissioning liabilities based on SD PSA provisions by applying the 10% limit to all capital costs incurred in petroleum operations in the contract area as at the year-end. The present value of the decommissioning liabilities is recorded by the Group as a liability at the time the assets are installed or placed in service. The amount of liability equals the present value of the future decommissioning liabilities discounted at pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability rate, which equals 5.77% at 31 December 2014. A corresponding tangible fixed asset of an amount equivalent to the liability is also created and included in the cost of oil and gas production properties. This amount is subsequently depreciated as part of the oil and gas production properties and charged against income using the unit-of-production method based on proved reserves. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to oil and gas production properties. The unwinding of the discount on the decommissioning provision is included as a finance cost.

According to the Host Government Agreement ("HGA") signed with the Georgian and Azerbaijan Governments, no later than 30 days after the termination of the HGA, SCPC must submit a decommissioning plan to these Governments addressing its obligations to retire the pipeline. The amount of asset retirement obligation is capitalized by shareholders of SCPC.

In accordance with HGA signed with the Government of Turkey, the Group shall comply with all its decommissioning obligations following the expiry of the agreement (2061). At the date of the consolidated financial statements, the Group did not perform construction works in TANAP system which would require decommissioning of the system.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Government grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant related to an expense item, it is recognized as deduction of the related expense. When the grant related to an asset, it is recognized as income in equal amounts over the expected useful life of the related asset.

The benefit of a governmental bond at a below market rate of interest is treated as a government grant. Such benefit is measured as the difference between the initial fair value of the issued bond and the proceeds received.

##### Income taxes

Income taxes have been provided for in the preliminary consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity.

The Group is liable for financing of its 6.67% share in the tax liabilities of SCPC, namely Azerbaijani income tax, Georgian income tax and Georgian minimum tax liabilities.

According to the provisions of SD PSA, contractor parties are liable for profit taxes. However, according to the SD PSA, respective government entity of the Republic of Azerbaijan is liable for payment of profit taxes of each contractor party from the proceeds from sales of crude oil and natural gas. Accordingly, the Group recognizes profit taxes and related revenue in the consolidated statement of profit and loss.

In accordance with HGA signed with the Government of Turkey and the Government of Azerbaijan, the Group will be subject to income tax in respect of TANAP project after the pipeline will be put in use. Accordingly, the Group is not subject to income tax during the construction phase.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income taxes are provided in full on temporary differences arising on recognition and subsequent measurement of provision for asset retirement obligation and related adjustments to cost of property, plant and equipment.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 2. Significant accounting policies (continued)

##### Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, or receivable, taking into account contractually defined terms of payment net of discounts, returns, value added taxes and other taxes or duty.

Revenues associated with sales of crude oil (condensate) and gas are recorded at the point when the significant risks and rewards of ownership are transferred, which is when title to the extracted oil and gas passes to the customer based on the terms of the SD PSA and based on the proportion of its share in total crude oil and gas entitlement. The actual volume of oil received by the Group may differ from the entitled volume resulting in an over/under lifting. Underlift is recognized as a sale of crude oil at the point of lifting by the underlifter to the overlifter. Overlift is recognized as a purchase of oil by the overlifter from the underlifter. The extent of underlift is reflected by the Group as an asset in the statement of financial position, and the extent of overlift is reflected as a liability. The initial measurement of the overlift liability or underlift asset is at the market price of crude oil at the date of lifting. Subsequent measurement of overlift/underlift liabilities and assets depends on the settlement terms of the related operating agreements. If such terms allow for a cash settlement of the overlift/underlift balances between the parties, the balances are remeasured at fair value at reporting dates subsequent to initial recognition. The overlift/underlift balances that are settled through delivery of physical quantities of crude oil are measured at the lower of carrying amount and fair value at reporting dates subsequent to initial recognition.

BP Exploration Shah Deniz Limited, the Operator of the SD PSA (the "SD Operator"), provides the Contractor Parties of SD PSA on a quarterly basis with the Shah Deniz Petroleum Entitlement Report, that contains, inter alia, the final net back price figure which is applied when determining the final petroleum volume that each SD PSA party is entitled to receive. When the actual Shah Deniz Petroleum Entitlement Report is not available, the Group recognizes the revenue based on a provisional Shah Deniz Petroleum Entitlement Report issued by the SD Operator. The revenue recognized may be further revised in the event that actual net back price differs from the provisional net back price used for revenue calculation. The Group treats such revision of revenue, if any, as a change in estimate and reflects in the current year statement of comprehensive income.

##### Employee benefits

Wages, salaries, contributions to the Social Protection Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (e.g. health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group.

##### Transactions with related parties

For the purposes of these consolidated 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. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arm's length basis.

##### Contingencies

Contingent liabilities are not recognized in the consolidated financial statements unless it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made. A contingent asset is not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 3. Significant accounting judgments, estimates and assumptions

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of commitments, guarantees and contingent liabilities, at the end of the reporting period. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

On an on-going basis, management evaluates their estimates, including those related to revenue recognition and contingencies. Management bases their estimates on various market-specific assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making assumptions about the carrying values of assets that are not readily apparent from other sources. Actual results may differ significantly from these estimates using different assumptions or conditions.

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

##### Reserve estimates

Estimates of recoverable quantities of proven and probable reserves reported include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex geological and geophysical models in order to make an assessment of the size, shape, depth and quantity of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period, changes in reported reserves can impact provision of decommissioning liabilities due to changes in expected future cash flows. Reserves are integral to the amount of depreciation, depletion and amortization charges to the consolidated statement of comprehensive income.

Natural gas and condensate reserves depend on price fluctuations as a result of change in production entitlement split between the State and contractor parties. Natural gas prices are calculated based on the long-term sales contracts provisions and depend on crude oil prices and other inputs. The current long-term Brent FOB oil price assumption used in the estimation of reserves is fifty seven dollars thirty three cents per barrel (US dollars 57.33) as at the consolidated statement of financial position date.

The level of estimated commercial reserves is also a key determinant in assessing whether the carrying value of any of the Group's development and production assets has been impaired.

##### Decommissioning liabilities

As discussed in Note 2, under the terms of the SD PSA the Group will have to make contributions to the abandonment fund when seventy percent (70%) of petroleum reserves of the Shah Deniz field are recovered. Decommissioning liabilities are stated in the amount of expected contributions related to the currently employed assets discounted at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. This valuation requires the Group to make estimates about timing of expected future cash flows and adjustment to the discount rate, and hence they are subject to uncertainty. The estimation of the decommissioning liabilities is based on the assumption that contributions to the abandonment fund will start in 2029. Further details are disclosed in Note 15.

If the estimated discount rate used in the calculation had been 1% higher/lower than management's estimate, the carrying amount of the provision would have been US dollar 5,694 lower / US dollars 6,842 higher, respectively.

##### Deferred and accrued revenue

In the valuation of the Group's over-lift and under-lift position under the Shah Deniz PSA as at the year-end the Group uses fifty seven dollars thirty three cents per barrel (US dollars 57.33) market price for crude oil as at 31 December 2014.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 3. Significant accounting judgments, estimates and assumptions (continued)

##### Recoverability of oil and gas assets

The Group assesses each asset or CGU every reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value in use. These assessments require the use of estimates and assumptions such as long-term oil prices, discount rates, operating costs, future capital requirements, decommissioning costs, exploration potential, reserves and operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risk and uncertainty. Therefore, there is a possibility that changes in circumstances will impact these projections, which may impact the recoverable amount of assets and/or CGUs.

Given the nature of the Group's activities, information on the fair value of an asset or CGU is not practicable to identify. Consequently, the recoverable amount used in performing the impairment test described below is value-in-use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

##### *Key assumptions used in value-in-use calculations*

The calculation of value-in-use for oil fields is most sensitive to the following assumptions:

##### *Identification of CGU*

CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets of group of assets. The management assesses that SCP, TANAP and TAP projects are being constructed with the ultimate goal of the delivering Shah Deniz field natural gas to the Georgian, Turkish and European markets. Therefore, all these projects have been considered as one CGU and impairment test is performed on the level of the whole Group.

##### *Capital expenditures*

Capital expenditures necessary to maintain estimated production volumes are based on long-term development plans for particular field.

##### *Crude oil price*

Forecast commodity prices are publicly available.

If the forecasted prices used in the calculation had been five dollars (US dollars 5.0) lower than management's estimate, this would not result any impairment loss.

##### *Discount rate*

The post-tax discount rate applied to the cash flow projections of CGU was 6%. The discount rate calculation is based on the specific circumstances of the Group and derived from its incremental borrowing rate adjusted to the specific risks associated with the asset's estimated cash flows. If the estimated discount rate used in the calculation had been 0.5% higher than management's estimate, this would not result in impairment loss.

##### Contingencies

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 4. New standards and amendments issued, but not yet effective

Standards issued, but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing of standards and interpretations issued are those that the Group reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Group intends to adopt these standards when they become effective.

##### *IFRS 9 Financial Instruments*

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

##### **Annual improvements 2010-2012 Cycle**

These improvements are effective for periods beginning on or after 1 July 2014 and are not expected to have an impact on the Group. They include:

##### *IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets*

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data on either the gross or the net carrying amount. In addition, the accumulated depreciation or amortization is the difference between the gross and carrying amounts of the asset.

##### *IAS 24 Related Party Disclosures*

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services.

##### **Annual improvements 2011-2013 Cycle**

These improvements are effective for annual periods beginning on or after 1 January 2014 and are not expected to have a material impact on the Group. They include:

##### *IFRS 13 Fair Value Measurement*

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable).

##### **Annual improvements 2012-2014 Cycle**

In the 2012-2014 annual improvements cycle, the IASB issued five amendments to four standards, summaries of which are provided below. The changes are effective 1 January 2016. The Group did not early adopt any of the amendments.

##### *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*

Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. The amendment must be applied prospectively.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 4. New standards and amendments issued, but not yet effective (continued)

##### *Annual improvements 2012-2014 Cycle (continued)*

##### *IFRS 7 Financial Instruments: Disclosures*

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required.

The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. The amendment must be applied retrospectively.

##### *IFRS 15 Revenue from Contracts with Customers*

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

#### 5. Oil and gas properties

At 31 December oil and gas properties consisted of the following:

	<b>Oil and gas production properties</b>	<b>Pipeline assets</b>	<b>Decommis- sioning costs</b>	<b>Total</b>
<b>Cost</b>				
<b>At 31 March 2014</b>	-	-	-	-
Acquisition of undivided interest in joint projects	430,079	47,938	14,273	<b>492,290</b>
Additions	12,619	26,535	2,093	<b>41,247</b>
<b>At 31 December 2014</b>	<b>442,698</b>	<b>74,473</b>	<b>16,366</b>	<b>533,537</b>
<b>Accumulated depletion and depreciation</b>				
<b>At 31 March 2014</b>	-	-	-	-
Charge for the year	(19,182)	(1,402)	(549)	<b>(21,133)</b>
<b>At 31 December 2014</b>	<b>(19,182)</b>	<b>(1,402)</b>	<b>(549)</b>	<b>(21,133)</b>
<b>Net book value</b>				
<b>At 31 December 2014</b>	<b>423,516</b>	<b>73,071</b>	<b>15,817</b>	<b>512,404</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 5. Oil and gas properties (continued)

##### *Oil and gas production properties*

Oil and gas production properties are represented by the Group's 6.67% share in oil and gas production properties of SD project.

##### *Pipeline assets*

The pipeline cost represents the Group's 6.67% share in cost of construction and capitalized maintenance expenses on SCP pipeline.

##### *Decommissioning costs*

The capitalized decommissioning costs are represented by the Group's 6.67% share in costs related to decommissioning of assets employed for the purposes of SD and SCP projects. Refer to Note 15 for details.

#### 6. Construction in progress and development costs

At 31 December construction in progress and development costs consisted of the following:

	<u>Development costs</u>	<u>Construction in progress</u>	<u>Decommissioning costs</u>	<u>Total</u>
<b>At 31 March 2014</b>	-	-	-	-
Acquisition of undivided interest in joint projects	449,630	81,200	18,125	548,955
Acquisition of subsidiary	-	206,828	-	206,828
Additions	108,223	121,539	2,572	232,334
<b>At 31 December 2014</b>	<u>557,853</u>	<u>409,567</u>	<u>20,697</u>	<u>988,117</u>
<b>Net book value</b>				
<b>At 31 December 2014</b>	<u>557,853</u>	<u>409,567</u>	<u>20,697</u>	<u>988,117</u>

##### *Development costs*

Development costs are represented by costs incurred in respect of Shah Deniz Stage 2 Development project.

##### *Construction in progress*

As at 31 December 2014 this amount includes cost directly related to the construction of TANAP and expansion of SCP pipeline system in the amount of US dollars 322,080 and US dollars 87,487, respectively. The amount related to construction of TANAP includes costs for project management services, early work expenses, land acquisition costs, personnel expenses and other costs directly attributable to the construction of pipeline.

#### 7. Advance payments

At 31 December advance payments consisted of the following:

	<u>2014</u>
Advance payments for acquisition of shares	796,288
Other payments related to construction works	146,846
	<u>943,134</u>

Advance payments for acquisition of shares represents advances paid in the amount of US dollars 454 million to AzSD and US dollars 342 million to AzSCP for acquisition of their 10% interests in the SD PSA and SCP projects, respectively, and treated as non-financial assets. Refer to Note 24 for further details.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 8. Investments in associate

At 31 December 2014 the Group held twenty percent (20%) interest in TAP AG. TAP AG is responsible for the development and operation of the gas transportation infrastructure from the Greece/Turkey border to Southern Italy in order to deliver Caspian natural gas to European countries. The Group exercises significant influence over the entity by participating in its financial and operating decisions.

The Group acquired investment in TAP AG through acquisition of 100% shares of AzTAP GmbH ("AzTAP").

The table below summarizes the movements in the carrying amount of the Group's investment in TAP AG:

	<b>2014</b>
<b>Carrying amount at 31 March</b>	-
Acquisition of investment in associate	56,671
Additions to investment in associate	8,260
Share of after tax results of associate	(2,749)
Exchange differences	(5,750)
	<b>56,432</b>

The following table illustrates summarized financial information of the Group's investment in TAP AG at 31 December:

	<b>2014</b>
Current assets	49,600
Non-current assets	390,633
Current liabilities	(23,033)
Non-current liabilities	(221,665)
<b>Net assets</b>	<b>195,535</b>
<b>Group's interest in net assets</b>	<b>39,107</b>
Goodwill recognized upon acquisition*	18,872
Exchange differences on translation of goodwill	(1,547)
<b>Carrying value</b>	<b>56,432</b>

\* Difference between the cost allocated to the acquisition of TAP AG and the fair value of its identifiable assets and liabilities is accounted as goodwill relating to TAP AG and is included in the carrying amount of the investment in associate. Refer to Note 22 for details.

Share of associate's results for the period ended 31 December:

	<b>2014</b>
Revenue	-
Operating expenses	16,100
Other income	(829)
<b>Loss before tax</b>	<b>15,271</b>
Income tax benefit	(1,526)
<b>Net loss for the period since acquisition of associate</b>	<b>13,745</b>
<b>Group's share of net loss</b>	<b>2,749</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 9. Loan to associate

Loan to associate represents receivable from TAP AG in accordance with Term Credit Facility Agreement ("TCFA") signed between TAP AG and its shareholders. The Group obtained control over the financial assets as a result of acquisition of AzTAP (Note 22).

The loan bears interest equal to EUR rate for cross border shareholders loans as published by the Swiss federal tax authorities plus 1% margin and approximates 3%. The loan matures in July 2043. Total interest income earned during 2014 was US dollars 580.

#### 10. Cash and cash equivalents, deposits

Cash and cash equivalents consisted of the following at 31 December:

	<b>2014</b>
Cash at bank, USD	202,472
Cash at bank, EUR	9,726
<b>Total cash and cash equivalents</b>	<b>212,198</b>

Cash at bank mainly includes time deposits in the amount of US dollars 194,832 with maturity of up to one month and bearing effective interest rates ranging between 1.6%-2.5%. Total interest income earned during 2014 was US dollars 1,575.

##### *Deposits*

At 31 December 2014 time deposits includes placements in the amount of US dollars 33,246 with maturity period of one year bearing the interest rates ranging between 1.5%-2.85% per annum. Total interest income earned during 2014 was US dollars 1,131.

#### 11. Accounts receivable

Accounts receivable consisted of the following at 31 December:

	<b>2014</b>
Receivable from AzSD	21,554
Receivable from AGSC	5,178
Receivable from the SD Operator	5,127
Other receivables	4,961
<b>Total accounts receivable</b>	<b>36,820</b>

Receivables from the SD Operator represent the inception-to-date excess of cash calls paid by the Group to the SD Operator over the actual expenditures reported by the SD Operator.

#### 12. Inventories

As at 31 December 2014 inventories are represented by the Group's share of inventories reported by the SD Operator.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 13. Other current assets

Other current assets represent the following as at 31 December:

	<b>2014</b>
VAT receivable	25,966
Other assets	12,248
<b>Total other current assets</b>	<b>38,214</b>

#### 14. Share capital

At 31 December 2014 the Group share capital amounted US dollars 100 million.

#### 15. Decommissioning liabilities

The Group has a legal and constructive obligation with respect to decommissioning of oil and gas production and pipeline assets. Movements in provisions for the related asset retirement obligations are as follows:

	<b>2014</b>
<b>At 31 March</b>	-
Acquisition of undivided interest in joint projects	32,398
Additional liability during the period	4,665
<b>At 31 December</b>	<b>37,063</b>

Under the provisions of the SD PSA and SCP HGAs all Contractor Parties will have to make contributions to an abandonment fund, which will be used to finance the decommissioning and dismantling of constructed assets after the maturity of the SD PSA and SCP.

The maximum amount of decommissioning fund cannot exceed 10% of the capital costs in accordance with SD PSA. Decommissioning liability is estimated based on capital expenditures incurred in respect of assets already employed as at the end of each financial year. The Group share of the estimated undiscounted cost to abandon the production facilities employed in SD PSA was US dollar 101,619 as at 31 December 2014.

The Group's share of expected undiscounted cost to decommission the SCP pipeline facilities at 31 December 2014 was US dollars 7,643. The Group used a 2% inflation rate in its estimate of the retirement obligation upon termination of HGA and used a pre-tax rate that reflects current market assessments of the time value of money to discount the obligation.

#### 16. Long-term borrowings and Government grant

##### *Bonds issued to SOFAZ*

In accordance with the Presidential Decree dated 31 March 2014 the State Oil Fund of Azerbaijan ("SOFAZ"), a governmental fund established for funding of important socio-economic projects, was assigned for financing of the Group's acquisitions of interests in the projects described in Note 1. Accordingly, in 2014 the Group issued bonds to SOFAZ in the aggregate amount of US dollars 2,516,996 with maturity period of 10 years. Interest rate implicit in bond prospectus is 1% + 6 months LIBOR. The repayment of interest shall be made in semiannual installments effective from 2021 till 2024.

At initial recognition, the Group calculated the fair value of the bond using market rate for similar financial instruments (4.5% + 6 months LIBOR) and recognized US dollars 704,270 of difference between fair value and carrying amount of the bond as government grant in its consolidated statements of financial position.

Total interest charges incurred during 2014 was US dollars 41,575 plus withholding tax of 1,140.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 16. Long-term borrowings and Government grant (continued)

##### *Bonds issued to SOFAZ (continued)*

During 2014 the Group recognized income from government grant over the expected useful life of the related assets. Total income recognized from government grant was US dollars 6,571 included in other income.

##### *Loan from Akbank T.A.Ş.*

On acquisition of TANAP, the Group recognized the loan at its carrying value in the amount of US dollars 19,000 due to Akbank T.A.Ş. under the loan agreement signed between the parties. On 23 July 2014, the Group received additional loan in the amount of US dollars 6,000 under the existing agreement. Within the reporting period the Group repaid all due amount of US dollars 25,000 loan due to Akbank T.A.Ş.

##### *Loan from SOCAR*

On acquisition of AzTAP, the Group recognized the loan at its fair value due to SOCAR Energy Holdings AG under the loan agreement between SOCAR and AzTAP. On 23 July 2014, the Group repaid all outstanding balance of US dollars 107,317 to SOCAR.

#### 17. Trade and other payables, Accrued liabilities

Trade and other payables and accrued liabilities mainly consist of payables related to Shah Deniz Stage 2 development, expansion of SCP and construction of TANAP pipeline systems at 31 December.

#### 18. Revenue, Accrued revenue and Deferred revenue

##### *Revenue*

The Group's revenue consisted of the following for the period ended 31 December:

	<u>2014</u>
Revenue from sale of gas	47,503
Revenue from sale of crude oil	29,391
	<u>76,894</u>

According to the provisions of SD PSA the profit oil and gas is shared between the State and the contractor parties of PSA depending on cumulative after-tax real rate of return achieved as at the end of each calendar quarter by contractor parties. During 2014 the profit oil and gas was shared at a ratio of 55% to 45% in favor of the State.

Revenue from sale of crude oil includes the amount of crude oil lifted by the AzSD in 2014. The parties agreed for cash settlement of the imbalance volume in the amount of US dollars 20,234. Accordingly, the Group recognized receivable from AzSD for the respective amount.

##### *Accrued revenue*

Accrued revenue balance of US dollar 13,118 at 31 December 2014 represents the Group's underlift of crude oil resulting from a difference between the volumes lifted and entitled at Ceyhan terminal.

##### *Deferred revenue*

Deferred revenue balance of US dollars 7,662 at 31 December 2014 represents the Group's over-lifting of crude oil resulting from a difference between the volumes lifted and entitled at Baku-Tbilisi-Ceyhan route ("BTC"). At initial recognition of share in SD PSA, the Group recognized deferred revenue in the amount of US dollars 14,526 for the overlift position as at acquisition date. The movement between the deferred revenue at acquisition date and 31 December 2014 is mainly due to price change and was recognized as other income in the consolidated statement of the comprehensive income in the amount of US dollars 6,551.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 19. Cost of sales

The Group's cost of sales consisted of the following for the period ended 31 December:

	Note	2014
Depreciation and depletion	5	21,133
Other costs		7,300
		<u>28,433</u>

#### 20. Taxation

##### *Taxation under the Shah Deniz Project*

According to the provisions of SD PSA, the contractor parties are liable to pay income taxes related to the operations under the SD Project. According to the same provisions the respective state body of the Republic of Azerbaijan remits to the State Budget income taxes of each contractor party and reimburses the respective amount from condensate and natural gas attributable to the State. Accordingly, as a contractor party to SD PSA, the Group is liable for Azerbaijani income taxes and at the same time is entitled to additional profit petroleum. During the period ended 31 December 2014 the Group had no income taxes from the activities in SD PSA.

The Group is exempt from certain ordinary operational taxes including Azerbaijani value added taxes in accordance with provision of SD PSA.

##### *Taxation under the SCP project*

SGC Midstream LLC elected SCPC to represent it in all tax issues before the tax authorities, so that the Group is a non-tax electing shareholder in accordance with the terms of Azerbaijani HGA. SCPC is liable for Azerbaijani income tax and Georgian minimum tax with respect to the income and deductions of, and natural gas transported by, SCPC, which are allocable to non-tax electing shareholders, including the Group.

The following taxes have been enacted for the period ended 31 December 2014:

- ▶ Azerbaijani income tax at a fixed rate of 27%;
- ▶ Georgian income tax at a fixed rate of 25%;
- ▶ Georgian minimum tax (the "GMT") at a fixed rate of US dollars 2.50 per thousand of cubic meters of gas delivered to Georgian-Turkey border.

##### *Georgian income tax and minimum tax*

According to Georgian HGA, SCPC is liable for the income tax at a fixed rate of 25% for income generated from operations in Georgia. In case SCPC does not generate taxable income during a fiscal year, it shall be liable for GMT. The GMT for the preceding periods can be carried forward without limitation and credited against future income tax liability of SCPC in Georgia. The Group estimates that the GMT will exceed the income tax under Georgian HGA.

The provision for income taxes mainly comprised of the Group's share in Azerbaijan income tax expense, Georgian minimum tax expense and deferred tax expense of SCPC for the period ended 31 December 2014.

Deferred tax liabilities of SCPC are calculated on the temporary differences arised from the differences in accounting under IFRS and HGA (accrual versus cash basis).

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 21. Transactions with related parties

Transactions with related parties consisted of the following at 31 December 2014:

Related party	Long-term borrowings	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 16)	1,854,301	-	-	-	2,516,996
SOCAR	-	-	-	-	273,258
AzSD	-	454,661	21,554	-	1,318,967
AzSCP	-	341,627	-	-	439,277
AGSC	-	-	5,178	40,249	-
<b>Total</b>	<b>1,854,301</b>	<b>796,288</b>	<b>26,732</b>	<b>40,249</b>	<b>4,548,498</b>
<b>Total category</b>	<b>1,854,301</b>	<b>943,134</b>	<b>36,820</b>		

#### SOCAR

Settlements with SOCAR are represented by consideration paid in the amount of US dollars 165,919 for acquisition of TANAP (Note 22) and US dollars 22 for acquisition of AzTAP (Note 22), and repayment of loan in the amount of 107,317 (Note 16) to SOCAR.

#### AzSD

Settlements with AzSD (a subsidiary of SOCAR) are represented by consideration paid for acquisition of 6.67% share in SD PSA and 5.336% share AGSC in the amount of 849,336, advances paid for acquisition of 10% share in SD PSA and 8% share in AGSC under DSPA and other advances. Refer to Note 24 for details.

#### AzSCP

Settlements with AzSCP (a subsidiary of SOCAR) are represented by consideration paid for acquisition of 6.67% share in SCPC in the amount of 97,650 and advances paid for acquisition of 10% shares in SCPC under DSPA. Refer to Note 24 for details.

#### AGSC

AGSC is a company established by the contractor parties of the Shah Deniz PSA for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas. Receipts from AGSC represent cash received in the amount of 40,249 from sale of gas to AGSC.

#### Key management personnel

The senior management group consists of the Group's General Director and Finance Director. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

	<u>2014</u>
Aggregate remuneration	63
Number of persons	2

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 22. Business combination and acquisition of an entity that is not a business

##### *Acquisition of TANAP*

As discussed in the Note 1, on 23 July 2014 the Group acquired 100% shares of TANAP from SOCAR. This transaction was accounted by the Group as acquisition of an entity under the common control and the assets and liabilities of the combining entity were recognized at their carrying amounts under pooling of interest method from the date when the combination took place.

Carrying values of identifiable assets and liabilities of TANAP at acquisition were as follows:

	<b>Carrying value on acquisition</b>
<b>Assets</b>	
Cash and cash equivalents	623
Accounts receivable	301
Other current assets	744
Oil and gas properties, net	206,828
Advance payments	11,604
	<b>220,100</b>
<b>Liabilities</b>	
Trade and other payables	(18,680)
Accrued liabilities	(16,501)
Short-term borrowings	(19,000)
	<b>(54,181)</b>
<b>Total identifiable net assets at carrying value</b>	<b>165,919</b>
Distribution to equity	-
<b>Consideration, settled in cash</b>	<b>165,919</b>

From the date of acquisition, TANAP contributed US dollars 1,412 net profit to the Group.

##### *Acquisition of AzTAP*

As discussed in Note 1, in July 2014 the Group acquired 100% shares of AzTAP from SOCAR Energy Holdings AG for the amount US dollars 22 (CHF 20 thousand). AzTAP was established by SOCAR exclusively to exercise the option right to become shareholder of TAP AG. The Group recognized this purchase as acquisition of an entity that is not a business and allocated the cost of acquisition between the individual identifiable assets and liabilities of AzTAP on the basis of their relative fair values.

At the date of obtaining control over AzTAP, allocation of cost of acquisition to the identifiable assets and liabilities of AzTAP was as following:

	<b>Allocated cost</b>
Cash and cash equivalents	99
Other current assets	65
Loan to associate	48,549
Investments in associates	56,671
Long-term borrowings	(105,362)
<b>Net assets of subsidiary</b>	<b>22</b>
<b>Consideration, settled in cash</b>	<b>22</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 23. Financial risk management objectives and policies

##### Financial risk factors

In the ordinary course of business, the Group is exposed to credit, liquidity and market risks. Market risks arise from fluctuating currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position. Although there are no structured formal risk management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

##### *(i) Foreign exchange risk*

Foreign exchange risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Foreign exchange risk arises primarily from future commercial transactions, recognised assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency. The Group does not have any formal procedures on managing foreign exchange risk, however, management is quite well informed on the tendencies in the economy and has undertaken steps to minimise its foreign exchange risks. Management does not hedge the Group's foreign exchange risk.

The major financial instruments in a foreign currency comprise loan receivable and certain cash and cash equivalents that are denominated in EUR.

The following table demonstrates the sensitivity to a reasonably possible change in EUR of the Group's profit before tax. A negative amount in the table reflects a potential net reduction in the profit before tax, while a positive amount reflects a net potential increase. The Group's exposure to change in EUR is not material.

	Change in USD/EUR rate	Effect on profit before tax
<b>2014</b>	6.23%	3,368
	(6.23%)	(3,368)

##### *(ii) Interest rate risk*

The Group hold significant interest bearing assets and liabilities as described in Note 9 and Note 16. Interest rates on existing loan agreements are fixed in respective agreements and depend on fluctuations in LIBOR and EUR rate for cross border shareholders loans published by the Swiss federal tax authorities (ESTV).

The table below summarizes effect on profit before tax of the following shift in LIBOR and EUR rate per ESTV as at 31 December 2014:

	Change in floating variable		Effect on profit before tax	
	Increase	Decrease	After increase	After decrease
<b>2014</b>				
LIBOR	+0.2	-0.2	(1,802)	1,802
EUR rate per ESTV	+0.5	-0.5	192	(192)

##### *(iii) Credit risk*

Financial instruments involve, to varying degrees, credit risks. The Group is subject to credit risk from its portfolio of loan receivable, cash and cash equivalents, deposits and accounts receivable and would be exposed to losses in the event of non-performance by counterparties.

The Group's exposure to credit risks arises from default of the counterparty, with a maximum exposure of US dollars 321,471 as at 31 December 2014.



## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 23. Financial risk management objectives and policies (continued)

##### Financial risk factors (continued)

The Group places its cash with high credit quality financial institutions. The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade for condensate on credit terms are subject to credit verification procedures. Gas sales are made through AGSC to entities with strong financial position.

##### *(iv) Liquidity risk*

The Group monitors its risk to a shortage of funds by reviewing its net financial debt indicator on a regular basis. The net financial debt represents the difference between total financial liabilities and cash and cash equivalents. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of loans.

The tables below summarize the maturity profile of the Group's financial liabilities at 31 December 2014 based on contractual undiscounted payments:

2014	On demand	3 to 12 months	1 to 5 years	>5 years	Total
Trade and other payables	-	54,896	-	-	54,896
Accrued liabilities	-	131,945	-	-	131,945
Long-term borrowings	-	-	-	2,860,020	2,860,020
	-	<b>186,841</b>	-	<b>2,860,020</b>	<b>3,046,861</b>

##### *(v) Capital management*

The primary objective of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain shareholders and creditor confidence to support its business activities.

The Group considers total capital under management to be as follows:

	31 December 2014
Long-term borrowings (Note 16)	1,854,301
Less: cash and cash equivalents (Note 10)	(212,198)
<b>Net debt</b>	<b>1,642,103</b>
Equity	102,104
<b>Capital and net debt</b>	<b>1,744,207</b>
<b>Gearing ratio</b>	<b>94%</b>

##### *(vi) Fair value of financial instruments*

The fair value of the financial assets and liabilities is included at the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

*(Amounts presented are in thousands of US dollars, unless otherwise stated)*

#### 23. Financial risk management objectives and policies (continued)

##### Financial risk factors (continued)

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements:

	31 December 2014	
	Carrying amounts	Fair values
Cash and cash equivalents (Note 10)	212,198	212,198
Deposits (Note 10)	33,246	33,246
Accounts receivables (Note 11)	31,693	31,693
Loan to associate (Note 9)	44,334	44,334
<b>Total financial assets</b>	<b>321,471</b>	<b>321,471</b>
Trade and other payables (Note 17)	(54,896)	(54,896)
Accrued liabilities (Note 17)	(131,945)	(131,945)
Long-term borrowings (Note 16)	(1,854,301)	(1,854,301)
<b>Total financial liabilities</b>	<b>(2,041,142)</b>	<b>(2,041,142)</b>

The following methods and assumptions were used to estimate the fair values:

- (i) Current financial assets and liabilities approximate their carrying amounts largely due to the current maturities of these instruments;
- (ii) Long-term fixed-rate and variable-rate receivables/borrowings are evaluated by the Group using Level 3 inputs based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

#### 24. Commitments and contingencies

##### *Commitments related to participating interest in Shah Deniz PSA*

On 17 December 2013 Shah Deniz consortium announced the final investment decision for Stage 2 development of Shah Deniz gas field in the Azerbaijan Sector of the Caspian Sea and signed Sixth, Seventh and Eighth Addendums to Shah Deniz PSA. The Group is committed to finance expenditures related to Stage 2 exploration and development based on its share of interest.

As of 31 December 2014 the SD operator has entered into a number of capital commitments and operating leases. The Group estimated its 6.67% share of these commitments and operating leases in the amount of US dollars 1,255,780 and US dollars 13,775, respectively. The total of future minimum lease payments under non-cancellable operating leases for each of the following periods is as follows:

##### **For the year ended 31 December 2014**

- Not later than one year	6,848
- Later than one year and not later than five years	6,875
- Later than five years	52
	<b>13,775</b>

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 24. Commitments and contingencies (continued)

##### **Commitment related to SCP Expansion**

SD PSA Contractor Parties made the final investment decision on SCP Expansion project on 17 December 2013. SCP Expansion project objective is to expand the existing SCP pipeline system capacity. Due to SCP expansion additional facilities will be constructed in Georgia for the purposes of interconnection with TANAP. The Group has the commitment to fund the SCP Expansion project throughout the construction and initial operational phase.

The SCP Expansion approved construction budget is estimated in the amount of US dollars 5,277,000 (the Group's share: US dollars 352,000).

##### **Commitment related to TANAP**

###### *Construction of TANAP*

At the financial statement date, the Group has commitment to fund construction of TANAP pipeline system. Approved budget for construction of TANAP system is estimated in the amount of US dollars 9,592,369. The project is expected to be completed by 2020.

###### *Sale and purchase agreement with BOTAS for the sale of shares in TANAP*

On 26 May 2014 SOCAR and BOTAS Petroleum Pipeline Corporation ("BOTAS") signed sale and purchase agreement for the sale of 30% shares in TANAP to BOTAS. On 23 July 2014, following the acquisition of TANAP, the Group signed novation agreement with SOCAR and BOTAS, where all rights and obligations under the sale and purchase agreement were transferred from SOCAR to the Group. At the financial statement date, the Group has a commitment to sell 30% share of TANAP to BOTAS. Refer to Note 26 for further information.

##### **Commitment related to TAP**

###### *Construction of TAP*

The Group has the commitment to fund construction of TAP pipeline system. The budget for construction of the TAP system is estimated in the amount of EUR 3,939,000 (US dollars 4,781,552). The Group share of commitment at the financial statement date was EUR 787,800 (US dollars 956,310).

##### **Commitments related to participating interest in AGSC, TANAP, TAP and SCPC**

###### *BOTAS gas contract*

AGSC is obliged under the gas contract signed with BOTAS to make available a maximum of approximately 6.3 bcm from 2015 and onwards at a price calculated based on the formula established by the gas contract.

###### *Stage 2 gas contract*

On 25 October 2011, SOCAR and BOTAS executed a gas sale and purchase agreement with respect to the sale by SOCAR to BOTAS of certain volumes of Shah Deniz Stage 2 Gas (2 bcm first delivery year, 4 bcm second delivery year, 6 bcm plateau period). In December 2012 SOCAR transferred and assigned the rights and obligations under the Stage 2 SPA to AGSC. The anticipated commencement of first gas delivery under Stage 2 BOTAS SPA is July 2018.

###### *BOTAS contract for BTC fuel gas*

AGSC is obliged under the agreement to make available 0.14 bcm in 2015 and onwards, at a price which is calculated based on the formula established in the contract.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 24. Commitments and contingencies (continued)

##### *Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)*

The performance of AGSC under the gas contract and BOTAS Stage 2 Contract is guaranteed under the Azerbaijan-Turkey IGA, by the government of the Republic of Azerbaijan. Commitments indicated above in respect of gas volumes to be delivered by AGSC are covered by the Upstream Purchase Agreements ("UPA") signed with the Shah Deniz PSA contractor parties and SOCAR (for and on behalf of the Republic of Azerbaijan).

##### *Azerbaijan gas obligation*

AGSC is obliged under an agreement signed with SOCAR to make available a minimum of approximately 1.5 bcm in 2015 and onwards at a price calculated based on the formula established in the agreement.

##### *Georgian gas obligation*

AGSC is obliged under an agreement signed with Georgian Oil and Gas Corporation and the government of Georgia to make available 0.5 bcm in 2015 and onwards, at a price which is calculated based on the formula established in the contract.

##### *Sale and purchase agreement with OptionCo*

AGSC is obliged under the agreement signed with OptionCo to make available 0.2 bcm during the contract year starting on 1 October 2014. Thereafter, the Group is obliged to deliver during a contract year, which starts on 1 October a maximum of five percent of the volumes transported by AGSC through Georgia via the SCP in the previous calendar year, at a price which is calculated based on the formula established in the contract.

##### *Shah Deniz Stage 2 EU Long term Gas Sales Agreements ("GSA")*

In September 2013 ten EU GSAs were signed by SOCAR with nine EU Buyers and in December 2013 the GSAs were assigned to AGSC until Shah Deniz PSA expiry with re-assignment to SOCAR as Shah Deniz Production declines. The commencement date will be firmed up through funnelling mechanism within a 1-year window between 1 January 2020 and 1 January 2021 for DEPA, Shell, Axpo (PSV) and E.On; 1 July 2020 and 1 July 2021 for Axpo (WTB), GDF Suez, Gas Natural Fenosa, Enel, Hera and Bulgargaz. The GSAs assume 3 year build-up period, as defined in the contract, with the following peak delivery obligations: AXPO (PSV) 0.48 bcm, GDF Suez 2.64 bcm, Gas Natural Fenosa 0.99 bcm, E.On 1.44 bcm, Shell 0.95 bcm, Hera 0.3 bcm, Enel 0.48 bcm, AXPO (WTB) 0.96 bcm, Bulgargaz 0.94 bcm, DEPA 1 bcm.

##### *Trans Anatolian Pipeline Gas Transportation Agreement (TANAP GTA)*

AGSC is a party to TANAP GTA with annual reserved capacity during the build-up period, as defined in the contract, of 6.1 bcm, 6.2 bcm, 7.2 bcm and plateau of 10.5 bcm after 18 months with 100% ship or pay on the capacity reservation. The start date will be set through a funnelling mechanism inside the first window period between 1 July 2019 and 1 July 2021.

##### *Trans Adriatic Pipeline GTA (TAP GTA)*

AGSC is a party to TAP GTA with initial capacity of 10 bcm and expansion capacity up to additional 10 bcm. The planned commencement date is inside the second window period between 1 January 2020 and 31 December 2020.

##### *TAP Deferral Gas Sales Agreement*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 May 2019 – 31 December 2020 (with possible extension of the contract period) in the volume equal to approximately 3.66 bcm in 2019 and 6.4 bcm in 2020, at a price which is stipulated in the contract.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 24. Commitments and contingencies (continued)

##### *Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)*

###### *Sale and purchase agreement with BTC Co*

AGSC is obliged under an agreement signed with BTC to make available 0.16 bcm in 2015 and during the following years until the termination of the contract subject to the right of BTC to reduce annual off-take, at a price which is calculated based on the formula established in the contract.

###### *DBV SPA*

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 January 2014 – 30 June 2018 as follows: 1.3 bcm in 2015-2017 and 0.64 bcm in 2018, at a price which is stipulated in the contract.

The Shah Deniz PSA contractor parties and SOCAR are obliged to deliver and sell to AGSC the necessary volumes of gas to fulfill AGSC's obligations listed above at a price resulting in neither a gain nor a loss to AGSC. In addition to the above, the Shah Deniz PSA contractor parties and SOCAR are obliged to pay to AGSC all transportation charges and third party liabilities as stipulated in the UPAs.

###### *BOTAS Gas Transportation Agreement (BOTAS GTA)*

TANAP is a party to BOTAS GTA and with annual reserved capacity during the build-up period, as defined in the contract, of 1.9 bcm (12 month period commencing on start date), 3.8 bcm (next 12 month period) and plateau of 5.7 bcm after 24 months of start date. The start date will be within the period from and including 1 May 2018 to and including 30 June 2018.

###### *AGSC and TANAP Gas Transportation Agreement*

The agreement was signed on 17 December 2013 with the start date occurring on 1 July 2019. Annual reserved capacity during the build-up period is 6.1 bcm (1 July 2019), 6.2 bcm (1 January 2020), 7.2 bcm (1 April 2020), 10.5 bcm (1 January 2021) and plateau of 10.5 bcm (after the date when annual reserve capacity in this GTA first becomes 10.5 bcm).

###### *SOCAR Gas Transportation Agreement (SOCAR GTA)*

Based on this GTA, from and including the start date (6 March 2036) SOCAR shall pay to TAP AG the amount of actual monthly charge in relation of each booking of reserved capacity at each entry point and exit point at a price which is calculated based on the formula established in the contract. TAP AG shall make available to SOCAR for transportation of natural gas, at the applicable entry point and exit point(s) as described below, a reserved capacity equal to the flow rates expressed in kWh per gas day: Entry point at Kipoi – 287,318,605 kWh per gas day; Exit point at SRG – 242,999,147 kWh per gas day; Exit point at Komotini – 44,319,458 kWh per gas day.

###### *Commitment under the Deferred Sale and Purchase Agreement*

As mentioned in Note 1, in July 2014 the Group signed the DSPA for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP in March 2023. According to the terms of this agreement the Group shall make advance payments for these acquisitions to AzSD and AzSCP, while control will pass to the Group in 2023, provided that certain conditions precedent are satisfied. As of 31 December 2014, the Group had commitments for payments in the amount of US dollars 559,754 to AzSD and has to make progress payments equaled to Shah Deniz Stage 2 Development cash call requirements of AzSD from 2015 to 2020 year. In addition, the Group had commitments in the amount of US dollars 9,369 to AzSCP and has to make progress payments equaled to SCP Expansion project related cash calls requirements of AzSCP from 2015 to 2020 year.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 24. Commitments and contingencies (continued)

##### *Contingencies related to the SPA in respect of share in Shah Deniz PSA and AGSC*

As mentioned in Note 1, in July 2014 the Group acquired 6.67% participating interest in Shah Deniz project and 5.336% shares in AGSC and 6.67% shares in SCPC based on the Sale and Purchase Agreement ("SPA") signed on 29 April 2014 with AzSD and AzSCP. These interest and shares were acquired by AzSD and AzSCP from Statoil Azerbaijan A.S. based on the sale and purchase agreement signed between the parties thereto. At 31 December 2014 AzSD had disagreement with Statoil Azerbaijan A.S. in respect of consideration determination in the amount US dollar 29,369 and was planning to involve the independent expert to resolve the disputed issues as required under the provisions of their sale and purchase agreement. In case the dispute is resolved in favour of Statoil A.S., AzSD will have to make additional payments determined by the expert and the Group, in turn, shall be liable to pay any corresponding adjustments to the consideration under the SPA, unless it disagrees with Final Completion Statement served by the seller, as per the terms of the SPA. Management believes that the resolution of the issue will not result in any additional liability to the Group.

##### *Dispute between AGSC and BOTAS*

AGSC and BOTAS have ongoing disputes on determination of the make-up gas deliveries start-up date which is 5 November 2014 based on AGSC position versus 18 October 2014 in accordance with BOTAS position. Make-up gas deliveries start-up date impacts the entitlement of BOTAS to receive make-up gas. Invoices were issued based on AGSC's interpretation of start-up of make-up gas deliveries and contested by BOTAS which made payments in accordance with its own position.

The disputes are based on the treatment of the volumes of deficient gas not taken by BOTAS due to the failures occurred at Hanak Compressor Station during the year 2014 and claimed as Force Majeure Events by BOTAS. The BOTAS SPA places the obligation on the party claiming Force Majeure Event to provide supporting documentation and information which is required to substantiate such claim. AGSC has rejected the claims of Force Majeure Events on a number of grounds concerning BOTAS's failure to demonstrate the sufficient evidence for validity of claims on Force Majeure Events. In accordance with BOTAS SPA if parties are not able to resolve a dispute relating to the claim of Force Majeure, the matter may be submitted to the Expert or arbitration. On 3 March 2015, AGSC has obtained Directors' approval for referral of the Force Majeure Disputes to an Expert determination. The disputed amount remains with BOTAS until the dispute is resolved. AGSC believes that the matter will be resolved in its favor and disputed amount is fully collectible.

#### 25. Current business environment

##### *Azerbaijan economy*

The Group's operations are mainly conducted in the Republic of Azerbaijan and the Republic of Turkey. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Republic of Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Republic of Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Considering significant drop in crude oil prices during second half of 2014, there continues to be uncertainty regarding economic growth, access to capital and cost of capital, which could negatively affect the Group's future financial position, results of operations and business prospects. In addition, as described in Note 26, Azerbaijani Manat has been devalued against major currencies by approximately 34% on 21 February 2015.

## Southern Gas Corridor CJSC

### Notes to the consolidated financial statements (continued)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

#### 25. Current business environment (continued)

##### *Turkish economy*

The strong performance of the Turkish economy, as clearly demonstrated in economic indicators of previous years, was impacted to some degree by the sluggish European markets that Turkey is most dependent on. The Turkish government began to implement new policies and measures to revive domestic demand in order to compensate for the slowdown in foreign markets. Subsequent to the year end, Turkish lira has been depreciated against major currencies by approximately 21%.

While management believes it is taking appropriate measures to support the sustainability of Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

These consolidated financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the period when they become known and estimable.

#### 26. Events after the reporting date

##### *Exchange rate loss*

On 21 February 2015, Azerbaijani Manat has been devalued against US dollar and other major currencies by 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to US dollar 1, respectively. In addition, Turkish lira has been depreciated against US dollar and other major currencies by average 21%. This event could adversely affect the Group's future results and financial position. Management believes it is taking all necessary measures to support the sustainability and development of the Group's business in the foreseeable future.

##### *Increase in share capital*

During February and March 2015 the Group's share capital has increased by US dollars 625,000.

##### *Sale of interest in subsidiary*

On 13 April 2015 the Group sold its 30% share in TANAP Doğalgaz İletim A.Ş. to BOTAS.

On 16 April 2015 the Group sold its 12% share in TANAP Doğalgaz İletim A.Ş. to BP Pipelines (TANAP) limited.

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