

Orazul Energy Peru S.A. and Subsidiaries

Consolidated Financial Statements

For the three-month period ended March 31,
2018 and 2017 and for the year ended
December 31, 2017

ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

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ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF MARCH 31, 2018 AND DECEMBER 31, 2017
(In thousands of dollars US\$000)

	Notes	2018 US\$000	2017 US\$000
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	6	22,103	23,429
Trade accounts receivable (net)	7	31,570	27,625
Other accounts receivable	8	2,763	3,187
Accounts receivable from related entities	9	5,470	85,258
Inventories (net)	10	6,586	6,260
Income tax asset	27 (e)	4,193	3,051
Other assets		<u>1,632</u>	<u>1,468</u>
Subtotal		<u>74,317</u>	<u>150,278</u>
Assets held for sale	11	<u>45,982</u>	<u>46,507</u>
Total current assets		<u>120,299</u>	<u>196,785</u>
NON-CURRENT ASSETS:			
Other accounts receivable	8	705	705
Property, plant and equipment (net) - Energy generation and transmission	12	353,514	362,849
Property, plant and equipment (net) - Gas investment	13	67,432	68,659
Intangibles assets	14	488,088	489,070
Deferred income tax assets	28	6,597	2,766
Other assets		<u>1,514</u>	<u>1,572</u>
Total non-current assets		<u>917,850</u>	<u>925,621</u>
TOTAL		<u>1,038,149</u>	<u>1,122,406</u>

	Notes	2018 US\$000	2017 US\$000
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Financial obligations	15	12,405	4,465
Trade accounts payable	16	7,991	9,106
Other accounts payable	17	2,694	2,230
Accounts payable to related entities	9	46,789	126,799
Liabilities for employee benefits	18	1,739	2,382
Deferred income		<u>504</u>	<u>640</u>
Total current liabilities		<u>72,122</u>	<u>145,622</u>
NON-CURRENT LIABILITIES:			
Financial obligations	15	540,472	540,472
Accounts payable to related entities	9	144,818	142,925
Deferred income tax liabilities	28	101,539	99,618
Provisions		<u>1,425</u>	<u>1,450</u>
Total non-current liabilities		<u>788,254</u>	<u>784,465</u>
Total liabilities		<u>860,376</u>	<u>930,087</u>
EQUITY:			
Issued capital stock	19 (a)	196,086	213,283
Retained earnings	19 (c)	<u>(18,317)</u>	<u>(20,967)</u>
Equity attributable to controlling equity holders		177,769	192,316
Non-controlling interests	19 (d)	<u>4</u>	<u>3</u>
Total equity		<u>177,773</u>	<u>192,319</u>
TOTAL		<u>1,038,149</u>	<u>1,122,406</u>

The accompanying notes are an integral part of these consolidated financial statements

ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE THREE-MONTH PERIOD ENDED ON MARCH 31, 2018 AND 2017 (In thousands of dollars US\$000)

	Notes	03/31/2018 US\$000	03/31/2017 US\$000
CONTINUOUS OPERATIONS			
Sale of energy and electrical energy transmission services		44,931	47,623
Sale of hydrocarbons		<u>5,919</u>	<u>4,998</u>
Total of sales	20	50,850	52,621
Costs of sale of energy and electrical energy transmission services		(25,659)	(28,145)
Cost of sales of hydrocarbons		<u>(5,880)</u>	<u>(3,366)</u>
Total of cost of sales	21	<u>(31,539)</u>	<u>(31,511)</u>
Gross profit		19,311	21,110
Administrative expenses	22	(5,099)	(7,417)
Selling expenses	23	(358)	(314)
Other income	25	689	491
Other expenses		(572)	(736)
Financial income		916	91
Financial expenses	26	(11,846)	(13,164)
Exchange difference (net)		<u>(89)</u>	<u>550</u>
Net profit before income tax		2,952	611
Income tax expense	27 (b)	<u>(825)</u>	<u>(4,033)</u>
Net profit (loss) for the year / period from continuous operations		2,127	(3,422)
DISCONTINUED OPERATIONS			
Net profit for the year from discontinued operations	11	<u>524</u>	<u>-</u>
Net profit (loss) for the year / period		2,651	(3,422)
Other comprehensive income for the period		<u>-</u>	<u>-</u>
Total other comprehensive income for the period		<u><u>2,651</u></u>	<u><u>(3,422)</u></u>
Loss for the year attributable to:			
Non-controlling interests		1	-
Owners of the Company		2,650	(3,422)

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ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE THREE-MONTH PERIOD ENDED ON MARCH 31, 2018 AND DECEMBER 31, 2017 (In thousands of dollars US\$000)

	Issued Capital Stock US\$000 (Note 19 (a))	Retained Earnings US\$000 (Note 19 (c))	Total Equity Attributable to owners of the Parent US\$000	Non- controlling Interests US\$000 (Note 19 (d))	Total Equity US\$000
TOTAL EQUITY AS OF DECEMBER 31, 2016	85,300	(3,207)	82,093	125,150	207,243
Reduction of non-controlled interest (Note 19 (d))	-	10,303	10,303	(10,303)	-
Capitalization of debt (Note 19(a))	127,950	-	127,950	-	127,950
Capital stock issued for the merger (note 19(a))	33	-	33	-	33
Foreign currency adjustment of subsidiary merged (note 1(c))	-	5,266	5,266	-	5,266
Acquisition of non-controlling interests (Note 19(d))	-	-	-	(114,843)	(114,843)
Excess of value paid in purchase of shares (Note 19(b))	-	(10,703)	(10,703)	-	(10,703)
Total comprehensive loss for the period	-	(22,626)	(22,626)	(1)	(22,627)
TOTAL EQUITY AS OF DECEMBER 31, 2017	<u>213,283</u>	<u>(20,967)</u>	<u>192,316</u>	<u>3</u>	<u>192,319</u>
Capital Reduction (Note 19 (d))	(17,197)		(17,197)		(17,197)
Total comprehensive profit for the period	<u>-</u>	<u>2,650</u>	<u>2,650</u>	<u>1</u>	<u>2,651</u>
TOTAL EQUITY AS OF MARCH 31, 2018	<u><u>196,086</u></u>	<u><u>(18,317)</u></u>	<u><u>177,769</u></u>	<u><u>4</u></u>	<u><u>177,773</u></u>

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ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE THREE-MONTH PERIOD ENDED ON MARCH 31, 2018 AND 2017 (In thousands of dollars US\$000)

	<u>03/31/2018</u> <u>US\$000</u>	<u>03/31/2017</u> <u>US\$000</u>
OPERATING ACTIVITIES:		
Collection from:		
Sale of energy and electrical energy transmission services	40,269	52,030
Sale of hydrocarbons	7,281	616
Interests and returns	14	18
Other operating activities	1,211	1,057
Payments for/to:		
Royalties	(3,428)	(2,717)
Suppliers of goods and services	(19,681)	(22,237)
Income tax	(3,832)	(5,884)
Employees and social benefits	(5,950)	(7,949)
Fuel prices stabilization fund	(188)	(406)
Other taxes	(209)	(424)
Other operating activities	<u>(234)</u>	<u>(2,134)</u>
Net cash and cash equivalents provided by operating activities	<u>15,253</u>	<u>11,970</u>
INVESTMENT ACTIVITIES:		
Collection from:		
Sale of property, plant and equipment	190	-
Dividends	1,049	-
Payments for:		
Purchase of property, plant and equipment	(244)	(319)
Purchase of intangibles assets	-	(17)
Purchase of gas investments	<u>(377)</u>	<u>(2,626)</u>
Net cash and cash equivalents provided by (used in) investment activities	<u>618</u>	<u>(2,962)</u>
FINANCING ACTIVITIES:		
Payments for:		
Capital reduction	(17,197)	-
Loans to related entities	-	(21,400)
Interests	<u>-</u>	<u>(1,140)</u>
Net cash and cash equivalents used in financing activities	<u>(17,197)</u>	<u>(22,540)</u>
NET (DECREASE) INCREASE OF CASH AND CASH EQUIVALENTS	(1,326)	(13,532)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	<u>23,429</u>	<u>85,213</u>
CASH AND CASH EQUIVALENT AT THE END OF THE PERIOD	<u><u>22,103</u></u>	<u><u>71,681</u></u>

The accompanying notes are an integral part of these consolidated financial statements

ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE-MONTH PERIOD ENDED MARCH 31, 2018 AND 2017 AND FOR THE YEAR ENDED DECEMBER 31, 2017

(In thousands of U.S. dollars (US\$000), unless otherwise indicated)

1. INCORPORATION, ECONOMIC ACTIVITY, MERGER BY ABSORPTION, SUBSIDIARIES AND OPERATING REGULATIONS

(a) Incorporation

Orazul Energy Peruer S.A. (hereinafter, the Company) is a Subsidiary of Orazul Energía (UK) Holdings Ltd. which owns 99.99% of voting shares which are representative of its issued capital stock.

The Company was incorporated on October 10, 2016 in Peru. On December 20, 2016, 87.23% of Orazul Energy Group S.A.C. (former legal name was Duke Energy International Group Sarl) was acquired by the Company from Duke Energy Corporation, which owned a group of companies in Peru, Chile, Guatemala and El Salvador, mainly engaged in the generation of electrical energy.

The significant businesses of Peru are related to hydro and thermal power generation, electricity transmission, natural gas production and processing assets.

Since the acquisition date of Orazul Energy Group S.A.C., the Company had the plan to sell the operating business located in Chile, Guatemala and El Salvador in the short term, so those assets have been classified as assets held for sale (Note 11).

As part of a reorganization plan within Orazul Group, the Company executed the following transactions:

- On August 2, 2017, the Company acquired an additional 12.76% of Orazul Energy Group S.A.C. (hereinafter OEG) from Orazul Energía (España) Holding S.L. (which previously acquired the interest of Duke Energy Corporation in 2016) for the total amount of US\$ 126,000, increasing its interest to 99.99%.
- On August 16, 2017, the Company merged by absorption with Orazul Energy Egenor S. en C. por A., which was one of its main subsidiaries in Peru.

(b) Economic activity

The Company is engaged in (directly or through or in association with third parties) investing in and holding securities, including, but not limited to, shares representing the capital of other companies, whether Peruvian or foreign under any form, and the generation of electrical energy through its hydroelectric power plants Cañon del Pato and Carhuaquero.

The Company's legal domicile, where its administrative offices are located, is street Dionisio Derteano 144, Floor 19, San Isidro, Lima, Peru.

(c) Merger by absorption

Based on the reorganization plan within Orazul Group, by public deed dated October 9, 2017 and Shareholders' Meeting held on August 16, 2017, the merger of the Company, as acquirer with **Orazul Energy Egenor S. en C. por A.**, was approved. The acquiree transferred all net assets and extinguished without dissolution or liquidation. The effective date for the merger was August 17, 2017. This merger was performed between two companies under common control and has not resulted in an effective change in the control of subsidiaries within the Group.

The economic activity of **Orazul Energy Egenor S. en C. por A.** was the generation of electrical energy within the area of its concessions and authorizations through its

hydroelectric power plants Cañon del Pato and Carhuaquero, and also the sale of electrical energy to regulated and free customers in the Peruvian territory that are part of the National Interconnected Electrical System (SEIN, for its acronym in Spanish) which the Company participates in.

(d) Subsidiaries

Subsidiaries are the entities in which the Company has the power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee, and has the ability to use its power to affect its returns. This situation is usually observed by controlling the equity interest of more than half of voting shares.

The Subsidiaries are entirely consolidated as from the date when their control was effectively transferred to the Company, and will cease to be so when the Company loses such control.

The Subsidiaries, as of March 31, 2018 and December 31, 2017, and the percentages of interest owned by the Company are detailed below:

OEG:

	Direct equity interest	
	2018	2017
	%	%
Holding:		
Orazul Energy Group S.A.C.	99.99	99.99

In addition OEG has the following operating subsidiaries:

OEG subsidiaries:

	Indirect equity interest	
	2018	2017
	%	%
Holding:		
Orazul Energy Hidrocarburos S.A. (a)	99.98	99.98
Orazul Energy Transmisión S.A. (a)	99.98	99.98
Operational:		
Orazul Energy Egenor S. en C. por A. (Note 1(c))	-	-
Etenorte S.R.L.	99.98	99.98
Aguaytia Energy del Peru S.R.L.	99.98	99.98
Termoselva S.R.L.	99.98	99.98
Eteselva S.R.L.	99.98	99.98

(a) These Companies were incorporated in August 2017, as a result of the reorganization process carried out by the group (Note 1 (c)).

Etenorte S.R.L.

This subsidiary provides electrical transmission services in accordance with Peruvian regulations, through the concession of certain transmission lines in northern Peru. The Company (Orazul Energy Peru S.A.) is its main client, which represents approximately 78% of its operating income in 2018 and 2017.

Aguaytia Energy del Peru S.R.L.

Aguaytia Energy del Peru S.R.L. (hereinafter Aguaytia) owns a natural gas field located in central rainforest of Peru (Block 31-C), from which it obtains dry natural gas and natural gas liquids; those gas liquids are then treated at the Fractionation Plant which produces liquefied petroleum gas (LPG) and natural gasoline. Dry natural gas is used by its Subsidiary, Termoselva S.R.L. (hereinafter Termoselva), for the generation of electrical energy. Natural gasoline was sold to Maple Gas Corporation del Peru S.R.L. (hereinafter Maple) until July 14, 2017. After the contract was terminated, the Company signed a contract with Petroleos del Peru S.A. (hereinafter Petroperu) to sell natural gasoline. LPG is sold to wholesalers and distributors, which perform their activities in the central rainforest and highlands of the country.

Termoselva S.R.L.

The economic activity of this subsidiary is the generation of electrical energy within its concession area. In order to perform its operations, Termoselva operates its thermoelectric power plant in Ucayali exclusively with dry natural gas provided by the Gas Plant of Aguaytia, and sell electrical energy to regulated and free customers in the Peruvian territory that are part of the National Interconnected Electrical System (SEIN, for its acronym in Spanish) which Termoselva participates in.

Eteselva S.R.L.

This subsidiary provides electrical transmission services, in accordance with Peruvian regulations, through the concession of certain transmission lines in eastern Peru. The companies (Termoselva S.R.L. and Orazul Energy Peru S.A.) are their main clients, which represents approximately 21% of its operating income (25% in 2017)

Amounts of the financial statements of consolidated Subsidiaries

Certain amounts of the financial statements of the subsidiaries for the three-month period ended March 31, 2018 and 2017 and for the year ended December 31, 2017, prepared under International Financial Reporting Standards, before elimination for consolidation purposes, are presented below:

Subsidiaries	2018 US\$000	2017 US\$000
Etenorte S.R.L.		
Total assets	13,679	13,276
Total liabilities	1,222	1,385
Equity	12,457	11,891
Net profit	565	530
Aguaytia del Peru S.R.L.		
Total assets	192,728	185,928
Total liabilities	9,645	8,654
Equity	183,083	177,274
Net profit	5,810	2,622
Termoselva S.R.L.		
Total Assets	66,842	72,983
Total Liabilities	9,057	10,830
Equity	57,875	62,153
Net profit	3,132	4,349
Eteselva S.R.L.		
Total Assets	32,572	35,834
Total Liabilities	479	1,134
Equity	32,093	34,700
Net profit	393	538

(e) Changes in the Company's ownership interests in existing subsidiaries

Changes in the Company's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries were recorded as equity transactions. The carrying amounts of the Company's interests and non-controlling interests were adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests were adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to owners of the Company.

When the Company loses control of a subsidiary, a gain or loss is recognized in profit or loss and is calculated as the difference between (i) the aggregate of fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill) and liabilities of the subsidiary and any non-controlling interests. All amounts previously recognized in other comprehensive income in relation to such subsidiary are accounted for as if the Company had directly disposed of the related assets or liabilities of the subsidiary. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as fair value on initial recognition for subsequent accounting, when applicable, and cost on initial recognition of an investment in an associate or a joint venture

(f) License Agreement for the production of hydrocarbons (Block 31-C)

This agreement allows Aguaytia to produce hydrocarbons in the area known as Block 31-C, where there are four producing wells and three gas reinjection wells. Other relevant aspects of the License Agreement are indicated as follows:

- (i) The term of the License Agreement is for 30 years counted from the subscription date of the agreement (March 30, 1994), which can be extended up to 40 years upon agreement of Aguaytia and Perupetro on behalf of the Peruvian government.
- (ii) Aguaytia agreed to comply with a minimum work schedule, which was entirely completed in 1998. This schedule included, among others, drilling and operation of wells, gas extraction and injection, construction of a gas processing plant and facilities for fractioning natural gas liquids and energy generation.
- (iii) Pursuant to the Organic Hydrocarbons Law and the Regulations for the Application of Royalties and Compensations, Aguaytia pays a royalty on a biweekly basis and applies a percentage on the valuation of production of supervised hydrocarbons (natural gas and natural gas liquids), as defined in the License Agreement.

The expense for royalties in 2017 was US\$8,550 (Note 21) and is presented as cost of sales of the consolidated statement of profit or loss and other comprehensive income, and US\$893 is part of the inventory balance.

In July 2013, Aguaytia initiated an arbitration process against Perupetro requesting a readjustment of the royalties that the Company paid for the exploitation of resources produced from Block 31-C.

On December 28, 2016, the Court issued a final decision where they accepted the request of Aguaytia to readjust the price of the natural gas royalty. The changes to these royalties are in force since January 1, 2017.

(iv) Taxes

On March 30, 1994, Aguaytia entered into a Legal Stability Agreement with the Peruvian government, under which the tax regime was guaranteed for gas operation and processing activities, as from the subscription date of the License Agreement until 2024, as well as according to specific standards established in this regard by the Organic Hydrocarbons Law and its amendments, during the term of the License Agreement.

As a benefit of this Legal Stability Agreement, the financial statements of Aguaytia have been prepared according to the accounting records, which are carried in U.S. dollars, pursuant to paragraph 5, article 87°, of the Peruvian Tax Code.

(v) Other rights

On behalf of the Peruvian government, the Central Reserve Bank of Peru guarantees Aguaytia the availability and convertibility of U.S. dollars.

(g) Operating regulations and legal standards that affect the hydrocarbons sector

Main operating regulations and legal standards of the hydrocarbons sector, where the Company develops its activities are as follows:

- Organic Hydrocarbons Law – Law No. 26221.
- Supervising Entity of Investment in Energy and Mining (OSINERGMIN, for its acronym in Spanish), by virtue of Law No. 26734, amended by Law No. 28964.
- Fund for the stabilization of fuel prices – Emergency Decree No. 010-2004 and its Regulation, Supreme Decree No. 142-2004-EF.
- Law that creates the Energy Security System in Hydrocarbons and the Energy Social Inclusion Fund (FISE, for its acronym in Spanish) - Law No. 29583.
- Law that guarantees energy security and promotes the development of the petrochemical pole southern Peru - Law No. 29970.

(h) Operating regulations and legal standards that affect the electrical sector

Main operating regulations and legal standards of the electrical sector, where the Company and Subsidiaries develop their activities are as follows:

- Electrical Concessions Law - Law 25844, and its Regulations, Supreme Decree No. 009-93-EM
- Law 28832 - Law to ensure the efficient development of electrical generation.
- Technical Quality Standard for Electrical Services - (Supreme Decree No. 020-97-EM)
- Law 26876 - Anti-monopoly Law in the Electrical Sector.
- Supervisory Entity of Investment in Energy and Mining (OSINERGMIN, for its acronym in Spanish), by virtue of Law No. 26734
- Law No. 29179: Law establishing mechanism to ensure the supply of electricity for the regulated market.
- Regulations for Environmental Protection during Electrical Activities (Supreme Decree No. 29-94-EM).
- Legislative Decree No. 1002 for the Promotion of Investments for Electricity Generation by using Renewable Energy.
- Energy Security System in Hydrocarbons and the Energy Social Inclusion Fund (Law No. 29852), and its regulation, Supreme Decree No. 021-2012-EM.
- Supreme Decree No. 026-2016-EM, which establishes the Regulation of the wholesale Electricity Market.
- Law that guarantees energy security and promotes the development of the petrochemical pole southern Peru (Law No. 29970) and its Regulations, Supreme Decree No. 038-2013-EM and Supreme Decree No. 005-2014-EM.
- Law for the Promotion of Investments for Economic Growth and Sustainable Development (Law No. 30327), which establishes the simplification and incorporation of permits and procedures, as well as investment promotion measures.

- The COES is a private entity, made up of all the System Agents (Generators, Transmitters, Distributors and Free Users). Its purpose is to coordinate the short, medium and long term operation of the Interconnected Electric Power System at minimum cost, preserving the security of the system, the best use of energy resources, as well as planning the development of the transmission of the SEIN and administer the Short Term Market
- Legislative Decree that improves the Regulation of Electricity Distribution in order to promote the access to electrical energy in Peru (Legislative Decree No. 1221), which establishes amendments to the Electrical Concessions Law. It also establishes guidance for the development of Distributed Generation.
- Legislative Decree of the private investment promotion framework through private and public associations and projects (Legislative Decree No. 1224) and its Regulations approved by Supreme Decree No. 410-2015-EF, which establish process and methods to promote private investments for the development of public infrastructure, public services, services related to them, applied research and/or technological innovation projects and execution of asset projects.

The Company and Subsidiaries' Management considers that they have complied with applicable standards and regulations and that no contingencies will arise from such compliance.

(i) Additional explanation for translation into English of the original consolidated financial statements issued in Spanish

These consolidated financial statements have been translated into English for convenience of English-speaking readers and have been derived from the financial statements originally issued in Spanish. In the event of discrepancy, the Spanish language version prevails.

2. SIGNIFICANT ACCOUNTING POLICIES

Main accounting policies used by the Company and Subsidiaries for the preparation and presentation of these consolidated financial statements are presented below:

(a) Statement of compliance and basis of preparation and presentation

The accompanying consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), effective as of March 31, 2018 and December 2017, including the International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC), adopted by the IASB. Historical cost basis was applied for these purposes. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

Fair value is the price that would be received when selling an asset, or paid when transferring a liability in an organized transaction between market participants at a measurement date, regardless of the fact that such price is directly observable or considerable through another valuation technique. When estimating the fair value of an asset or liability, the Company and Subsidiaries consider the characteristics of such asset or liability in the event that market participants would want to consider them when setting a price at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined over such basis, except for shared-based payments (within the scope of IFRS 2), lease transactions (within the scope of IAS 17), and measurements somehow similar to fair value, but not fair value, such as net realizable value in IAS 2, or value in use in IAS 36.

Additionally, for financial reporting purposes, fair value measurements are categorized in three levels: 1, 2 or 3; depending on the degree in which the information for fair value measurements are observable, and their significance to fair value measurement in its entirety, as described below:

Level 1: Input is quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company may access to at the measurement date.

Level 2: Input is different than quoted prices included in Level 1, which are observable for the asset or liability, whether directly or indirectly.

Level 3: Input is not observable for the asset or liability.

(b) Functional and presentation currency

The Company and its Subsidiaries prepare and present its consolidated financial statements in U.S dollars, their functional currency determined by Management. The functional currency is the currency of the main economic environment in which an entity operates, which influences the prices of provided services, among other factors.

(c) Foreign currency transactions

Operations performed in currencies other than the U.S dollar are considered as "foreign currency transactions", and are recognized by applying exchange rates effective at the date of transactions. At the end of each reporting period, balances of monetary items denominated in foreign currency are translated at exchange rates effective at that date. Balances of non-monetary items that are recognized in terms of historical cost in foreign currency are translated using exchange rates effective at the date of transactions.

Exchange differences derived from monetary items are recognized in net profit or loss for the period when arisen.

(d) Basis of consolidation

The accompanying consolidated financial statements include the accounts of the Company and of those entities controlled by the Company (Subsidiaries), as indicated in Note 1 (d). The Company considers that control of an entity is achieved when the Company has the power to govern their financial and operating policies in order to obtain benefits from their activities.

All intercompany transactions have been eliminated for consolidation. When necessary, adjustments are made to the financial statements of the Subsidiaries to bring their accounting policies into line with those used by the controlling Company.

Total comprehensive income of the Subsidiaries is attributed to the Company's shareholders and to the non-controlling interests of the Subsidiaries even in cases when these interests result in a deficit balance.

(e) Financial instruments

Financial instruments are defined as contracts that give rise simultaneously to a financial asset in a company and a financial liability or equity instrument in another company. Financial assets and liabilities are recognized when the Company and Subsidiaries become part of the contractual agreements of the corresponding instrument.

Financial assets and liabilities are initially recognized at fair value plus transaction costs directly attributable to the acquisition or issue of financial assets and financial liabilities, except for those classified at fair value through profit or loss, which are initially recognized at fair value and whose transaction costs, directly attributable to their acquisition or issue, are immediately recognized in profit or loss for the period.

Financial assets

Conventional purchases or sales of financial assets are recognized and derecognized using the accounting method at the contracting date, in which the following are recognized at such date: a) the asset to be received and the liability to be paid, and b) the derecognition of the asset being sold, the recognition of the possible output of the sale or disposal by other means, and the recognition of an account receivable from the buyer.

Financial assets held by the Company and Subsidiaries are classified as loans and accounts receivable. These assets are recorded at amortized cost using the effective interest rate less any recognized accumulated impairment loss. Income from interests is recognized using the

effective interest rate, except for those short-term accounts receivable whose recognition is not considered significant. The Company and Subsidiaries do not hold financial assets that require to be classified as financial assets at fair value through profit or loss, held-to-maturity investments or available-for-sale financial assets, nor has it carried out transactions during the period when those classifications have been required.

The carrying amount of the financial asset is reduced due to the impairment loss directly for all financial assets except for trade accounts receivable, where the carrying amount is reduced through a provision account. When a trade account receivable is considered as uncollectible, the provision account is deleted. Subsequent recovery of the amounts that were previously deleted will be converted into credits against the provision account. Changes in the carrying amounts of the provision account are recognized in the consolidated statement of profit or loss and other comprehensive income.

The Company and Subsidiaries will derecognize a financial asset only when the contractual rights on the cash flows of the financial asset expire or when the risks and benefits inherent to the ownership of the financial asset are transferred, substantially, to another entity. If the Company and Subsidiaries do not transfer nor retain substantially all the risks and benefits inherent to such ownership and continues retaining control of the transferred asset, the Company and Subsidiaries will recognize their interest in the asset and the obligation associated with the amount they would have to pay. If the Company and Subsidiaries retain substantially all the risks and benefits inherent to the ownership of the transferred financial asset, the Company and Subsidiaries will continue recognizing the financial asset and will recognize a collateral for the income received.

Financial liabilities

Financial liabilities and equity instruments are classified in accordance with the content of contractual arrangements entered into and considering the economic substance of the contract. An equity instrument is any contract that evidences a residual interest in the Company's equity once all its liabilities are deducted.

The financial liabilities held by the Company and Subsidiaries are classified as other financial liabilities, and are recorded at amortized cost after initial recognition using the effective interest rate method, recognizing the interest expense throughout the corresponding period.

The Company and Subsidiaries will derecognize a financial liability only if the Company and Subsidiaries' obligations expire, are cancelled or met. The difference between the carrying amount of the derecognized financial liability and the consideration paid or payable is recognized in profit or loss.

(f) Inventories

Inventories (supplies and spare parts) are stated at the lower of cost and net realizable value. Net realizable value represents the estimated selling price for inventories less all costs necessary to perform the sale. Cost is determined using the weighted-average method. The estimate obsolescence is recognized for those inventories in poor conditions and is charged to profit or loss in the year when obsolescence is identified.

(g) Property, plant and equipment – Energy generation and transmission

Property, plant and equipment are presented at cost, net of accumulated depreciation and any recognized impairment loss. Initial disbursements, as well as those subsequently incurred, related to goods whose cost can be estimated reliably, and it is probable that future economic benefits will be obtained from them, are recognized as property, plant and equipment.

Disbursements for maintenance and repairs are recognized as expenses in the year when incurred. Profits or losses arising from the sale or disposal of an item of property, plant and equipment are determined as the difference between the sales proceeds and the carrying amount of the asset, which are recognized in profit or loss for the period when the sale is considered performed.

Major components and spare parts that the Company and Subsidiaries expect to use for more than one period and that are related to an item of property, plant and equipment are recognized as such at the date of acquisition.

Works in progress are presented at cost. The cost of these assets in process includes professional fees and other costs, and for qualifying assets, borrowing costs. Those assets are subsequently reclassified to their category of property, plant and equipment once the construction or acquisition process is complete and they are ready for their intended use. These assets are depreciated from that moment, similarly to the rest of property, plant and equipment.

Depreciation of the Company

Depreciation is determined using the straight-line method on the estimated useful life of property, plant and equipment, represented by equivalent depreciation rates. Annual depreciation is recognized as expense or cost of other asset and is calculated considering the useful lives estimated for the following items:

	Years
Buildings and other constructions	12 – 80
Machinery and equipment	3 – 35
Vehicles	2 – 24
Furniture and fixtures	10 – 16
Sundry equipment	2 – 28

Depreciation of the Subsidiary Termoselva

In case of the subsidiary Termoselva, property, plant and equipment directly related to the electrical energy generation process, which exclusively uses dry natural gas from the field of Aguaytia and Aguaytia substation, are depreciated on the estimated useful life of the gas field of Aguaytia, under the units of production method.

Allocation factors of depreciation are determined by dividing the monthly production level by proven reserves of dry gas at the beginning of the period, provided by the Company. Such factor is determined for each asset involved in the electrical generation process.

As of March 31, 2018 and 2017, depreciation factors applied to property, plant and equipment related to the useful life of the gas field of Aguaytia ranged between 2.18% and 2.36%, and between 5.0% and 5.1%, respectively.

In case of the subsidiary Termoselva, property, plant and equipment that are not involved directly in the energy generation process are depreciated using the straight-line method based on the estimated useful life of assets, represented by equivalent depreciation rates.

	Years
Buildings and other constructions	22 – 33
Machinery and equipment	4 – 10
Furniture and fixtures	5
Sundry equipment	4 – 10

Depreciation of the Subsidiaries Eteselva and Etenorte

The substations and transmission lines Tingo Maria, Vizcarra and Paramonga for the case of Eteselva and the substations and transmission lines Huallanca, Chimbote 1, Chimbote 2, Carhuaquero and Chiclayo Oeste are depreciated by the straight-line method, based on the estimated useful life of 20 years, represented by equivalent depreciation rates.

Estimates on useful lives, residual values, if applicable, and depreciation method are reviewed regularly at the end of each reporting period in order to ensure that the depreciation method and period are consistent with the expected pattern of economic benefits of items of property, plant and equipment, prospectively incorporating the effects of any change in these estimates against net profit or loss in the period they are made.

(h) Property plant and equipment - Gas investments

Gas investments are presented at cost, net of accumulated depreciation and any recognized impairment loss. Initial disbursements, as well as those subsequently incurred, related to goods whose cost can be estimated reliably, and it is probable that future economic benefits will be obtained from them, are recognized as gas investments.

Disbursements for maintenance and repairs are recognized as expenses in the year when incurred. Profits or losses arising from the sale or disposal of an item of gas investments are determined as the differences between the sales proceed and the carrying amount of the asset, which are recognized in profit or loss for the period when the sale is considered performed.

Mayor components and spare parts that the Subsidiary Aguaytia expects to use for more than one period and that are related to an item of gas investments are recognized as such at the date of acquisition.

Work in progress is presented at cost. The cost of these assets in process includes professional fees and other costs, and for qualifying assets, borrowing costs. Those assets are subsequently reclassified to their category of gas investments once the construction or acquisition process is complete and they are ready for their intended use. These assets are depreciated from that moment, similarly to the rest of gas investments.

The depreciation of gas investments directly related to the gas extraction and production process and the transformation of gas liquids into natural gasoline and LPG is calculated using the units of production method. The Subsidiary Aguaytia determines the allocation factors of depreciation by dividing the monthly production level by proven reserves (until the termination of the concession of 30-year) of dry natural gas and natural gas liquids at the beginning of the period. Those factors are used for the determination of depreciation of each asset involved in the gas extraction and production process and the transformation of natural gas liquids into natural gasoline. The depreciation of gas investments indirectly related to the process is calculated using the straight-line method based on the estimated useful lives of assets, represented by equivalent depreciation rates.

Annual depreciation is recognized as expense and is calculated considering the following:

- For gas investments, using the units of production method, depreciation factors applied to plants were:

	2018	2017
	%	%
Gas and fractionation plant	0.99, 1.00 and 2.77	2.18, 2.36 and 9.83

- For gas investments, using the straight-line basis, useful lives estimated for certain items are:

	Years
Vehicles	5
Furniture and fixtures	10
Sundry equipment	4 – 10

Estimates on useful lives, residual values, if applicable, and depreciation method are reviewed regularly at the end of each reporting period in order to ensure that the depreciation method and period are consistent with the expected pattern of economic benefits of items of gas investments, prospectively incorporating the effects of any change in these estimates against net profit or loss in the period they are made.

(i) Assets held for sale

Current assets and the disposal group are classified as held for sale if its carrying amount is recovered mainly through a sale transaction rather than continuing use. This condition is valid when the sale is highly probable and the non-current asset (or disposal group) is eligible for immediate sale in its present condition. In addition, Management must be committed to a plan to sell the asset, which is expected to be performed within a year from the classification date.

At the time of recognition, the assets held for sale are measured at fair value; therefore, the difference between the amount paid and their fair value will be recorded in profit or loss as other gains or losses resulting from discontinued operations.

When the Company is committed to a sale plan involving loss of control of a subsidiary, all of the assets and liabilities of such subsidiary are classified as held for sale when the criteria described above are met, regardless of whether the Company will retain a non-controlling interest in its former subsidiary after the sale.

If a subsidiary is acquired as part of a business combination exclusively for resale, it will be measured at fair value less costs to sell.

(j) Impairment of tangible and intangible assets other than goodwill

The Company and Subsidiaries regularly review the carrying amounts of their tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). If it is not possible to estimate the recoverable amount of an individual asset, the Company and Subsidiaries estimate the recoverable amount of the cash-generating unit where the asset belongs. If a reasonable and consistent allocation basis is identified, corporate assets are also allocated to individual cash-generating units, or otherwise, to the smallest group of cash-generating units for which a reasonable and consistent allocation basis is identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

The recoverable amount is the higher of fair value less its cost to sell and value in use. Value in use is determined based on estimated future cash flows, which are discounted to their present value by using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks inherent to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is immediately recognized as expense.

An impairment loss can be subsequently reversed and recorded as income in profit for the period up to the amount in which the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized for the asset (or cash-generating unit) in previous years.

(k) Provisions

Provisions are recognized only when the Company and Subsidiaries have a present obligation (legal or constructive) as a result of a past event, it is probable that the Company and Subsidiaries will have to use resources which include economic benefits in order to settle such obligation and the amount of the obligation can be estimated reliably.

The amount recognized as provision reflects the best estimate of the disbursement necessary to settle the current obligation at the date of the consolidated statement of financial position, considering risks and uncertainties surrounding most of the events and circumstances concurrent to its valuation. If the amount of the provision is measured using estimated cash flows to settle the obligation, the carrying amount is the present value of corresponding disbursements.

In case it is expected that a part or the total disbursement necessary to settle the provision may be refunded by a third party, the portion receivable is recognized as an asset when its recovery is virtually certain, and the amount of such portion can be determined reliably.

(l) Contingent liabilities and assets

Contingent liabilities are not recognized in the consolidated financial statements, but are only disclosed in a note unless the possibility of an outflow of resources is remote. When the possibility of an outflow of resources to cover a contingent liability is remote, such disclosure is not required.

Contingent assets are not recognized in the consolidated financial statements, but are only disclosed in a note to the consolidated financial statements when it is probable that an inflow of resources will occur.

Items previously treated as contingent liabilities will be recognized in the consolidated financial statements in the period when a change in probabilities occurs, that is, when it is determined that an outflow of resources is probable to occur to cover such liability. Items previously treated as contingent assets will be recognized in the consolidated financial statements in the period when it is determined that an inflow of resources is virtually certain to occur.

(m) Employee benefits

Employee benefits include, among others, short-term benefits, such as wages, salaries and social security contributions, annual paid leaves, paid sick leaves, and profit-sharing and incentives, if paid within twelve months following the end of the period. These benefits are recognized against profit or loss for the period when the employee has provided services that entitle them to receive those benefits. These obligations are presented as part of liabilities for employee benefits in the consolidated statement of financial position.

(n) Recognition of revenue, costs and expenses

Revenue is measured using the fair value of the consideration, received or receivable, derived therefrom. Such revenue is reduced by estimates such as discounts and other similar concepts.

Sale of products, provision of services and others

- Revenue from energy and power generation and energy transmission delivered but not billed at the end of each month is billed the following month, but is recognized as revenue based on estimated consumption of customers in the corresponding month.
- Revenue from the sale of dry natural gas, LPG and natural gasoline is recognized in the period when the good is delivered, all risks and benefits inherent to ownership have been transferred to the buyer and it is probable that economic benefits related to the transaction will flow to the Company.
- Other revenue is recognized as realized and is recorded in the periods that it relates to.

Interests

Revenue from interests is recognized when it is probable that the Company and Subsidiaries will receive the economic benefits associated with the transaction and the revenue amount can be measured reliably. Such revenue is accumulated on a regular basis by taking the outstanding principal balance and applicable effective interest rate as a reference.

Costs and expenses

- The cost of generation of electrical energy and energy transmission are recorded in profit or loss of the year when service is provided, simultaneously with revenue recognition. Expenses are recorded in the periods they relate to and are recognized in profit or loss of the year when accrued, regardless of the payment date.

- The cost for sale of dry natural gas, LPG and natural gasoline is recorded in profit or loss of the year when goods are delivered, simultaneously with revenue recognition. Expenses are recorded in the periods they relate to and are recognized in profit or loss of the year when accrued, regardless of the payment date.
- Other costs and expenses are recognized when incurred.

(o) Income tax

Income tax expense comprises estimated current income tax payable plus deferred income tax.

Current income tax is determined by applying the tax rate established under effective tax laws on net taxable income of the year.

Deferred income tax corresponds to the tax amount expected to be recovered or paid on temporary differences between reported carrying amounts of assets and liabilities, and their corresponding tax bases. Deferred income tax liabilities are generally recognized for all taxable temporary differences. Deferred income tax assets are generally recognized for all deductible temporary differences and tax credits, discounts and unused tax losses, to the extent that it is probable that the Company and Subsidiaries will have sufficient future taxable profit to make them effective. Those assets and liabilities are not recognized if temporary differences proceed from goodwill or initial recognition (except in a business combination) of other assets and liabilities in an operation that does not affect tax or accounting profit or loss.

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is not probable that the Company and Subsidiaries hold sufficient future taxable profit to recover the entirety, or a part, of those assets.

Deferred income tax assets and liabilities are measured at tax rates expected to be applied when the asset is realized or the liability is settled, based on approved rates and tax laws, or whose approval process is virtually completed at the end of the reporting period. The measurement of such deferred taxes reflects tax consequences that could derive from the manner the Company and Subsidiaries expect to recover or settle the carrying amount of its assets and liabilities at the end of the reporting period.

Current and deferred income taxes are recognized as expense or income, and are included in the determination of net profit or loss for the period, except if those taxes relate to items recognized in other comprehensive income or directly in equity, in which case, current or deferred income taxes are also recognized in other comprehensive income or directly in equity, respectively.

(p) Cash and cash equivalents

Cash includes cash on bank and freely available deposits. Cash equivalents comprise short-term financial investments, maturing in less than 90 days as from the acquisition date, are readily convertible into a known cash amount and are not subject to a significant risk of changes in value.

(q) Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the accounting method of acquisition. The cost of the acquisition is measured at fair value, which is calculated as the sum of the acquisition date fair values of the assets transferred, liabilities incurred to the former owners of the acquiree and the equity interests issued in exchange for control of the acquiree.

Identifiable assets, liabilities and contingent liabilities ("identifiable net assets") are recognized at fair value at the date of acquisition. Acquisition related costs are recognized in the consolidated statement of profit or loss as incurred.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held equity interest in the acquire (if any) over the net acquisition-date amounts of

identifiable assets acquired and liabilities assumed. If, after reassessment, the net acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceed the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

(r) Impairment of goodwill

Goodwill is assessed for impairment on an annual basis, or more often if indicators of potential impairment exist. Determining whether goodwill and intangibles with indefinite lives are impaired requires an estimation of the value in use or fair value less costs to sell of the cash-generating unit and a suitable discount rate in order to calculate present value. Cash flows are derived from the budget for the next five years and a terminal growth rate is added, and do not include restructuring activities that the Orazul Group is not yet committed to or significant future investments that will enhance the performance of the cash-generating unit being tested. The recoverable amount is most sensitive to the discount rate used as well as the expected cash flows and the growth rate used for extrapolation purposes.

As time of disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of profit or loss on disposal.

3. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF UNCERTAINTY

Responsibility for information and estimations made

Management of the Company and Subsidiary is responsible for the information contained in these consolidated financial statements. For the preparation of these consolidated financial statements, certain estimates have been used to quantify some assets, liabilities, revenue, expenses and commitments recorded therein, based on experience and other relevant factors. Final results may differ from those estimates.

These estimates are reviewed on an ongoing basis. Changes in accounting estimates are prospectively recognized by recording the effects of changes in the corresponding profit or loss accounts for the period when corresponding reviews are conducted.

The most important estimates considered for the preparation of the consolidated financial statements of the Company and Subsidiaries refer to:

- Determination of functional currency and record of foreign currency transactions (Note 2 (b) and (c)).
- Estimate for energy and power revenues delivered and not billed (Note 2 (n)).
- Provision for energy and power purchases not billed (Note 2 (n)).
- Estimate for electric energy transmission revenues (Note 2 (n)).
- Useful life of property, plant and equipment - Gas investments (Note 2 (h)).
- Useful life of property, plant and equipment - Energy generation and transmission (Note 2 (g)).
- Impairment losses of specific assets (Note 2, (e), (f) and (J)).
- Fair value in business combination (Note (q)).
- Impairment of goodwill (Note 2 (r)).
- Current and deferred income tax determination (Note 2 (o)).
- Probability of contingencies (Note 2 (l)).

Key sources of uncertainty in estimates

We present the following basic assumptions regarding the future and other key sources of uncertainty in estimates, at the end of the reporting period, which may imply adjustments in the carrying amounts of assets and liabilities during the next financial period.

Impairment of non-current assets other than goodwill

In order to review if the assets is impaired, the Company and Subsidiaries compare the carrying amount of the assets with their recoverable value at least annually and whenever there are indications, they apply the accounting policy described in Note 2 (j).

The methodology used by the Company and Subsidiaries in estimating the recoverable amount of the assets is the value in use calculated from the present value of the expected future cash flows derived from the use of such assets.

The Company's Management has evaluated two cash-generating Unit (CGU) for the purpose of evaluating the Company's impairment:

- All of its generation plants; taking into account the business strategies that are defined based on the client portfolio and not on an individual basis of each plant.
- All of its gas investment, thermoelectric power plant and transmission line; taking into account the business strategies are interrelated and are mainly depend on Block 31-C.

Fair values in business combinations

The Company accounts for business combinations using the acquisition method of accounting. This method requires the application of fair values for both the consideration given and the assets and liabilities acquired. The calculation of fair values is often predicated on estimates and judgments including future cash flows, revenue streams and value-in-use calculations. The determination of fair values may remain provisional for up to 12 months from the date of acquisition due to the time required to obtain independent valuations of individual assets and to complete assessments of provisions. When the accounting for a business combination has not been completed at the reporting date, this is disclosed in the financial statements, including observations on the estimates and judgments made at the reporting date

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires Management to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value. Where the actual future cash flows are less than expected, a material impairment loss may arise. The cash flow is obtained from the budget approved by the Board of Directors. On this basis, as approved by Corporate Management, the Company's Management prepared the cash flow for the following five years and terminal growth rate. These cash flows do not include restructuring costs that the Company is not committed to perform or that imply future investments that will increase the capacity of assets that belong to the cash-generating unit under evaluation.

Useful life of property, plant and equipment

As described in Note 2(g) and Note 2(h), the Company and Subsidiaries review the estimated useful life of their property, plant and equipment. In 2017, Management determined with its internal specialist that there were no significant changes with regard to the useful life estimate of the assets related to the plants and transmission lines. The key sources of uncertainty considered for estimation of useful life are expected physical wear and tear and technical or commercial obsolescence arising from changes in use or changes in the demand for assets.

Proven reserves

Depreciation of certain assets is calculated using the units-of-production method on proved developed producing gas reserves. When determining the rates under the units-of-production method, the quantities of recoverable natural gas are established based on estimates prepared by our geologists and engineers. We regularly review our proved reserve estimates and makes changes to depreciation expenses as needed to account for new wells drilled and other events that may have caused significant changes in our estimated proved developed producing reserves.

Provisions for litigation and contingencies

The final cost of settlement of claims and litigation may vary due to estimates based on different interpretations of standards, opinions and final assessments of the amount of damages. Therefore, any variation in circumstances related to this type of contingencies could have a significant effect on the amount of the provision for contingencies recorded.

Income tax and deferred income tax liabilities

The correct valuation of income tax expense depends on several factors, including estimates of the realization of deferred tax assets and liabilities and the accrual of income tax payments. Current collections and payments may differ materially from these estimates as a result of changes in tax rules, as well as unforeseen future transactions impacting the Company's tax balances (Notes 27 and 28).

4. NEW STANDARDS, INTERPRETATIONS AND AMENDMENTS INTERNATIONALLY ISSUED

(a) Amendments to existent standards that did not significantly affect reported amounts and disclosures in current and previous years

The following amendments to existent standards were published with mandatory application for accounting periods beginning on or after January 1, 2017, but were not relevant to the operations of the Company and Subsidiaries:

- ***Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses.*** Effective for annual periods beginning on or after January 1, 2017.

The amendments to IAS 12 Income Taxes clarifies the following aspects:

- Unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use.
- The carrying amount of an asset does not limit the estimation of probable future taxable profits.
- Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences.
- An entity assesses a deferred tax asset in combination with other deferred tax assets. In circumstances in which local tax law restricts the utilization of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

- ***Amendments to IAS 7 Disclosure Initiative.*** Effective for annual periods beginning on or after January 1, 2017.

These amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

- ***Annual Improvements to IFRSs 2014 – 2016 Cycle***

The annual improvements to IFRSs 2014 – 2016 cycle include a number of amendments to various IFRSs, which are summarized below:

- IFRS 12 – Clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10–B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

(b) New IFRSs, interpretations and amendments issued applicable after the date of submission of the consolidated financial statements

The following standards and interpretations have been published for application to periods beginning after the date of presentation of these financial statements:

- **IFRS 9 Financial Instruments.** IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013, to include new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include: a) impairment requirements for financial assets, and b) limited changes to the classification and measurement requirements by introducing a "fair value through other comprehensive income" (FVTOCI) measurement category for certain simple debt instruments.

Key requirements of IFRS 9:

- IFRS 9 requires all recognized financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value. Specifically, debt instruments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interests on the principal outstanding, are generally measured at amortized cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms that give rise on specific dates to cash flows that are solely payments of principal and interests on the principal amount outstanding, are generally measured at fair value through other comprehensive income. All other debt and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, only with dividend income generally recognized in profit or loss.
- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of a financial liability that is attributable to changes in the credit risk of such liability is recognized in other comprehensive income, unless the recognition of the changes of credit risk of the liability in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated at fair value through profit or loss is recognized in profit and loss.
- In relation to the impairment of financial assets, IFRS 9 requires an expected credit impairment loss model, as opposed to an incurred credit impairment loss model under IAS 39. The credit impairment loss model requires an entity to account for expected credit losses and changes in those losses at each presentation date of the financial statements to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognized.
- The new general hedge accounting requirements retain three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an "economic relationship". Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

As of the date of these consolidated financial statements and after the analysis performed, the Company and Subsidiaries believe that the application of IFRS 9 will not have an impact on the consolidated financial statements.

- **IFRS 15 Revenue from Contracts with Customers.** Effective for periods beginning on or after January 1, 2018.

IFRS 15, issued in May 2014, establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Specifically, this standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when (or as) a performance obligation is satisfied, that is, when "control" of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

As of the date of these consolidated financial statements and after the analysis performed, the Company and Subsidiaries believe that the application of IFRS 15 will not have an impact on the consolidated financial statements, due to the revenue recognition policy in accordance with the guidelines of IAS 18 "Revenue from ordinary activities" that the Company continues to apply, which does not differ substantially with respect to the guidelines of IFRS 15 considering its business.

- **IFRS 16 Leases.** Effective for annual periods beginning on or after January 1, 2019.

IFRS 16 establishes how to recognize, measure, present and disclose leases. This standard introduces only one accounting model, and requires lessees to recognize one asset and one liability for all leases provided they are not hired for 12 months or less, or the underlying asset has a less significant value. Lessors will continue classifying leases as operating or finance, with no further changes as they have been doing so under IAS 17.

Management is now evaluating the impact of this standard on reported amounts and disclosures of the consolidated financial statements; therefore, it is not feasible to provide a reasonable estimate of the impact of IFRS 16 until a detailed review is completed.

- **IFRS 17 Insurance Contracts.** Effective for annual periods beginning on or after January 1, 2021.

IFRS 17 requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 will supersede IFRS 4 Insurance Contracts as of 1 January 2021.

Management believes that this standard is not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **IFRIC 22 Foreign Currency Transactions and Advance Consideration.** Effective for annual periods beginning on or after January 1, 2018.

The interpretation addresses foreign currency transactions or parts of transactions where:

- There is consideration that is denominated or priced in a foreign currency;
- The entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- The prepayment asset or deferred income liability is non-monetary.
- The Interpretations Committee came to the following conclusion:
- The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability.
- If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.

Management believes that this interpretation is not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **IFRIC 23 Uncertainty over Income Tax Treatments** Effective for annual periods beginning on or after January 1, 2019.

The interpretation addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- Whether tax treatments should be considered collectively
- Assumptions for taxation authorities' examinations
- The determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- The effect of changes in facts and circumstances

The Company's Management is evaluating the possible impact that this interpretation will have on the consolidated financial statements.

- **Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.** The date of effective application of these amendments has been determined to be indefinite.

These amendments deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, these amendments state that profits or losses resulting from the loss of control of a Subsidiaries that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method are recognized in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, profits and losses resulting from the remeasurement of investments retained in any former Subsidiaries (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions.** Effective for annual periods beginning on or after January 1, 2018.

These amendments clarify the standard in relation to the accounting for cash-settled share-based payment transactions that include a performance conditions, the classification of share-based payment transactions settled with net of tax withholdings and the accounting for the modification of share-based payment transactions from cash-settled to equity-settled.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **Amendments to IFRS 4. Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts.** The overlay approach should be applied when IFRS 9 is used for the first time. The deferral approach should be applicable for annual periods beginning on or after January 1, 2018 and can only be available for three years after such date.

These amendments provide two options for entities that issue insurance contracts within the scope of IFRS 4:

- An option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets (the "overlay approach").
- An optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the "deferral approach").

The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **Amendments to IAS 40 Transfers of Investment Property.** Effective for annual periods beginning on or after January 1, 2018.

The amendments in IAS 40 Investment Property are:

- Paragraph 57 has been amended to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use.
- The list of evidence in paragraph 57(a) – (d) was designated as non-exhaustive list of examples instead of the previous exhaustive list.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **Annual Improvements to IFRSs 2014 – 2016 Cycle**

The annual improvements to IFRSs 2014 – 2016 cycle include a number of amendments to various IFRSs, which are summarized below:

- IFRS 1 – Deleted the short-term exemptions in paragraphs E3–E7 of IFRS 1, because they have now served their intended purpose.
- IAS 28 – Clarified that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each

investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after January 1, 2018.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- ***Prepayment Features with Negative Compensation (Amendments to IFRS 9)***
Effective for annual periods beginning on or after January 1, 2019.

This standard amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortized cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments. Under the amendments, the sign of the prepayment amount is not relevant; i. e. depending on the interest rate prevailing at the time of termination, a payment may also be made in favor of the contracting party effecting the early repayment. The calculation of this compensation payment must be the same for both the case of an early repayment penalty and the case of an early repayment gain.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- ***Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)***
Effective for annual periods beginning on or after January 1, 2019.

These amendments clarify that an entity applies IFRS 9, including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- ***Annual improvements to the IFRS 2015-2017 Cycle.*** Effective for annual periods beginning on or after January 1, 2018.

The annual improvements to IFRSs 2015 – 2017 cycle include a number of amendments to various IFRSs, which are summarized below:

- IFRS 3 – The amendments clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business.
- IFRS 11 – The amendments clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
- IAS 12 – The amendments clarify that an entity should recognize the income tax consequences of dividends (e.g. distributable profits) in profit or loss, regardless of how such tax is generated.
- IAS 23 – Borrowing costs subject to capitalization; the amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

Management believes that these improvements are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

- **Amendments to IAS 19: Plan Amendment, Curtailment or Settlement.** Effective for annual periods beginning on or after January 1, 2019.

These amendments refer to the fact that if a plan amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement. In addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling.

Management believes that these amendments are not applicable to the Company and Subsidiaries since they do not perform this type of operations.

5. FINANCIAL INSTRUMENTS AND RISKS

Categories of financial instruments

The financial assets and liabilities of the Company and Subsidiaries comprise the following:

	2018 US\$000	2017 US\$000
Financial assets		
Cash and cash equivalents	22,103	23,429
Loans and accounts receivable at amortized cost:		
Trade accounts receivable (net)	31,570	27,625
Other accounts receivable	1,832	1,620
Accounts receivable from related entities	5,470	85,258
Total	<u>60,975</u>	<u>137,932</u>
Financial liabilities		
Other liabilities at amortized cost:		
Financial obligations	552,877	544,937
Trade accounts payable	7,991	9,106
Other accounts payable	55	169
Accounts payable to related entities	191,607	269,724
Total	<u>752,530</u>	<u>823,936</u>

Financial risks

The Company and Subsidiaries are constantly exposed to credit, liquidity and market risks, which arise from the variation of exchange, interest rates and prices. These risks are concentrated on electrical energy markets and are managed through specific policies and procedures established by the Financial Management. The Financial Management area is in charge of dealing with risks, and identifies, evaluates and covers financial risks.

(a) Market risk

(i) Exchange rate risk

The Company and Subsidiaries mainly bill in Peruvian soles. The exchange rate risk in the Company and Subsidiaries mainly arises from trade accounts receivable and payable held in foreign currency. The Company and Subsidiaries do not use derivative financial instruments to cover its exposure to exchange rate risk.

The carrying amount of financial assets and liabilities in foreign currency as of March 31, 2018 and december 2017, reflected according to the basis of accounting described in Note 2 (c) to the consolidated financial statements, is presented below:

	2018 S/000	2017 S/000
Assets:		
Cash and cash equivalents	13,894	7,765
Trade accounts receivable	<u>80,306</u>	<u>65,579</u>
 Total	 <u>94,200</u>	 <u>73,344</u>
Liabilities:		
Trade accounts payable	<u>29,471</u>	<u>24,373</u>
 Asset position (net)	 <u><u>64,729</u></u>	 <u><u>48,971</u></u>

The balances of financial assets and liabilities in foreign currency correspond to balances in Peruvian soles and are expressed in U.S. dollars at the offer and demand exchange rates published by Superintendencia de Banca, Seguros y AFP – SBS (Superintendence of Banking, Insurance and Private Pension Fund Administrators), effective at those dates, which were US\$0.3089 for selling and US\$0.3090 for buying (US\$0.3082 for selling and US\$0.3088 for buying as of December 31, 2017) per US\$1.00.

As of March 31, 2018, the Company and Subsidiaries recorded net exchange loss for US\$89 (net exchange profit for US\$550 in March 2017), whose net amount is included in item exchange difference, net in the consolidated statement of profit or loss and other comprehensive income.

Management considers a sensitivity rate of 10% as reasonable in the evaluation of exchange rate risk. A sensitivity analysis assuming the revaluation/devaluation of Peruvian soles (S/), equivalent at the aforementioned rates, exclusively on balances of monetary assets and liabilities reflected above, is detailed in the following table:

	Increase (decrease in): Exchange rate %	Effect of (loss) profit before income tax US\$000
2018:		
US\$ / Soles	+10%	(2,008)
US\$ / Soles	-10%	2,005
2017:		
US\$ / Soles	+10%	(1,526)
US\$ / Soles	-10%	1,510

(ii) Price risk

The Company is not exposed to commercial risks arising from changes in energy sale prices since they are not expected to fluctuate significantly because main revenues come from purchase price agreement with clients (Energy distribution companies). Regarding the free market, ratios are managed that allow having predictability in prices.

Management of the Subsidiary Aguaytia analyzes price risks related to the sale of LPG and natural gasoline.

Regarding the sale of LPG, Management believes that the price risk is mitigated considering the mechanism established by the Fund for the Stabilization of Fuel Prices for the domestic market, which seeks to compensate the high volatility of crude oil prices, so there are no significant risks as a result of variations of international prices of LPG.

Regarding the selling price of natural gasoline, the Company is exposed to commercial risks arising from changes in selling prices since they are determined in international markets. A sensitivity analysis of the Company is presented below, assuming an increase and decrease of 6% of average selling prices of natural gas and the impact on its gross income.

	Increase (decrease) in international price	Effect on gross profit before income tax
	%	US\$000
2018:		
Selling price of natural gasoline	+6%	239
Selling price of natural gasoline	-6%	(239)
2017:		
Selling price of natural gasoline	+6%	620
Selling price of natural gasoline	-6%	(620)

(iii) Interest rate risk

The Company and Subsidiaries have financial assets related to loans granted to related entities that accrue interests at fixed rate. Sales and operating cash flows of the Company and Subsidiaries are independent of changes in market interest rates.

The policy of the Company and Subsidiaries as of 2018 is maintain borrowings at fixed interest rates. In this regard, short and long-term debts at fixed rates represent all total financial debt as of March 31, 2018; therefore, any change in interest rates would not adversely affect profit or loss of the Company and Subsidiaries..

(b) Credit risk

Credit risk refers to the event that the other party fails to meet their contractual obligations, which causes a financial loss for the Company and Subsidiaries. Financial instruments that partially expose the Company and Subsidiaries to credit risk concentrations mainly comprise cash and cash equivalents and trade accounts receivable.

Management considers that this risk is mitigated since trade accounts receivable are concentrated on highly renowned entities and the policy of the Company and Subsidiaries to continuously assess the credit records of customers as well as their financial conditions to meet their obligations.

In Subsidiary Aguaytia, the higher credit risk that faced the Subsidiary is the non-collectability of invoices issued to Maple for natural gasoline sales, which during 2017 represented the 2% of revenue for the year. Management is assessing strategies in order to collect the outstanding amounts and to overcome this situation.

In this regard, the Subsidiary adopted actions to avoid the increase in the exposure on the aforementioned accounts receivable. These actions consisted in the construction and set up of a dispatch plant that allowed the sale of natural gasoline to other clients. The dispatch plant's operations started in August 2017 and the Company signed a contract with Petroleos del Peru S.A. to sell the product.

Regarding deposits in banks, the Company and Subsidiaries place their liquidity excess in renowned financial institutions, establish conservative credit policies and constantly evaluate existing conditions in the market they operate. As a result, the Company and Subsidiaries do not estimate significant losses arising from this risk.

(c) Liquidity risk

Management is mainly responsible for dealing with liquidity risk for which it has established policies and procedures regarding short, medium and long-term debts. The Company and Subsidiaries manage liquidity risk by monitoring their cash flows and the maturities of their financial assets and liabilities.

The contractual maturity of non-derivative financial assets is current as of March 31, 2018 and December 31, 2017.

The analysis of financial liabilities, including interest payable of the Company and Subsidiaries, classified per maturity, considering the remaining period to reach such maturity at the date of the consolidated statement of financial position, is presented below:

	Less than 1 month US\$000	Between 1 and 3 months US\$000	Between 3 months and 1 years US\$000	Between 1 and 5 years US\$000	More than 5 years	Total US\$000	Carrying amount US\$000
2018:							
Financial obligations	13,063	-	17,875	123,750	689,219	843,907	552,877
Trade accounts payable	7,991	-	-	-	-	7,991	7,991
Other accounts payable	55	-	-	-	-	55	55
Accounts payable to related entities	-	-	2,520	-	144,818	147,338	191,607
Total	21,109	-	20,395	123,750	834,037	999,291	752,530
	Less than 1 month US\$000	Between 1 and 3 months US\$000	Between 3 months and 1 years US\$000	Between 1 and 5 years US\$000	More than 5 years US\$000	Total US\$000	Total US\$000
2017:							
Financial obligations	-	-	30,938	123,750	689,219	843,907	544,937
Trade accounts payable	9,106	-	-	-	-	9,106	9,106
Other accounts payable	169	-	-	-	-	169	169
Accounts payable to related entities	-	-	128,520	-	209,846	338,366	269,724
Total	9,275	-	159,458	123,750	899,065	1,191,548	823,936

Management addresses the risk associated with the amounts included in each one of the categories mentioned above, which include maintaining good credit history with local banks in order to ensure sufficient credit lines and pay its working capital with cash flows provided by its operations.

March 31, 2018 and December 31, 2017, the Company and Subsidiaries have access to financial facilities for US\$25,000. As of March 31, 2018, the Company has not used these credit lines.

(d) Fair value of financial instrument

Fair value is defined as the amount for which a financial instrument could be exchanged in a transaction between two willing parties, which should not be a forced sale or settlement, and the best evidence of its value is its price, if any.

As of March 31, 2018 and December 31, 2017, Management of the Company and Subsidiaries considers that the accounting values of their financial instruments are similar to their fair values estimated in the market, based on methodologies and assumptions indicated below:

- The item cash and cash equivalents does not represent a significant credit or interest rate risk, so it has been assumed that the carrying amount is similar to fair value.
- Accounts receivable and payable mature, except for the non-current account payable to related entity, in less than one year, so it has been considered that their fair value is not significantly different than their carrying amount. The Company's Management considers that the carrying amount of the non-current account payable to related entity is similar to its fair value, since the account receivable accrued an interest rate that is similar to market interest.
- In case of long-term financial obligations of the Company, as of March 31, 2018, the fair value of long-term financial obligations is US\$524,563 (US\$541,200 in December 2017). For the calculation of such fair value, Management has obtained quotations according to the terms and conditions established at the contracting date from credit-

rating agencies. This fair value is classified as Level 2 since the measurement corresponds to variables that are based on observable market data, either directly or indirectly, other than quoted prices included in Level 1.

- Management considers that the fair values of other financial liabilities are similar to their carrying amount due to their short-term maturity, except for financial obligations (Note 15).

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise the following:

	2018 US\$000	2017 US\$000
Cash on hands and banks (a)	6,721	23,429
Term deposits (b)	15,382	-
Total	<u>22,103</u>	<u>23,429</u>

- (a) Cash on hands and banks mainly comprise checking accounts and correspond to balances held in local and foreign banks, in Peruvian soles and U.S. dollars, and are freely available.
- (b) As of March 31, 2018, term deposits corresponded to funds held by the Company and Subsidiaries in local banks, in U.S. dollars, which matured in 11 days and accrued interests at an annual rate of 1.46%.

7. TRADE ACCOUNTS RECEIVABLE (NET)

Trade accounts receivable (net) comprise the following:

	2018 US\$000	2017 US\$000
Energy and power delivered but not billed	14,723	15,641
Invoices	37,237	30,229
Sub total	49,960	45,870
Impairment estimate	(18,390)	(18,245)
Total	<u>31,570</u>	<u>27,625</u>

The average credit period granted to customers of the Company and Subsidiaries ranges between 7 and 60 days.

Once the terms indicated above expire, overdue balances accrue interests. The interest is determined by the annual average of the lending and borrowing rates of the dollar and sol currency. As of March 31, 2018, the annual average rate for the Company and Subsidiaries are 8.96% and 3.78% for local and foreign currency, respectively (9.13% and 3.62% as of December 31, 2017 for local and foreign currency, respectively).

As of March 31, 2018, the Company and Subsidiaries hold accounts receivable within their maturity terms for US\$28,631 (US\$19,524 as of December 31, 2017).

As of March 31, 2018, the Company and Subsidiaries hold trade accounts receivable overdue but not impaired for US\$2,939 (US\$8,101 as of December 31, 2017), for which no impairment estimate of accounts receivable has been determined since their credit quality

has not varied significantly, and Management of the Company and Subsidiaries considers that those amounts are still recoverable.

The aging of these balances is summarized as follows:

	2018 US\$000	2017 US\$000
Overdue for up to 30 days	817	5,844
Overdue between 31 and 90 days	260	503
Overdue between 91 and 180 days	236	63
Overdue between 181 and 360 days	1,626	1,691
	<u>2,939</u>	<u>8,101</u>
Total	<u>2,939</u>	<u>8,101</u>

Energy and power delivered but not billed

Energy and power delivered but not billed corresponds to the consideration for power and energy that the Economic Operation Committee of the National Interconnected System (COES-SINAC) monthly allocates to each generator and communicates to be billed to other generators or distributors, members of SINAC. Such energy and power basically corresponds to sales performed in December.

Energy and power delivered but not billed as of March 31, 2018 and December 2017 were billed and collected substantially in April 2018 and January 2018 respectively, except the impaired estimate amount, with no significant changes.

Impairment estimate of accounts receivable

The movement of the impairment estimate of accounts receivable was as follows:

	2018 US\$000	2017 US\$000
Opening balance	18,245	12,211
Additions (Note 22)	145	6,549
Collections (Note 22)	-	(554)
Exchange difference	-	39
	<u>18,390</u>	<u>18,245</u>
Closing balance	<u>18,390</u>	<u>18,245</u>

The impairment estimate of accounts receivable is determined according to policies established by Management. This estimate is recognized considering, among other factors, uncollected balances for more than 90 days, the possibilities to be collected, and the evidence of financial difficulties of the debtor that will increase, beyond normal, the uncollectible risk of uncollected balances, so that its amount has a level that Management estimates appropriate to cover possible losses in accounts receivable at the date of the consolidated statement of financial position. The estimate amount is recognized against profit or loss of the year. Subsequent collections are recognized against profit or loss of the year. Basic criteria to derecognize impaired financial assets against such valuation account are: (i) depletion of the collection process, including enforcement of guarantees, and (ii) the debtor's financial difficulties that evidence the inability to enforce the collection of accounts receivable.

The aging of accounts receivable and the status of customers are constantly monitored to ensure the appropriateness of the estimate in the consolidated financial statements. As a result, Management considers that the impairment estimate of accounts receivable covers sufficiently the risk of loss of doubtful accounts as of March 31, 2018 and December 2017.

Since 2016, the higher credit risk that Aguaytia addressed is the non-collectability of the invoices issued to Maple for natural gasoline sales. The impairment estimate for this customer accumulated as of March 31, 2018 is was US\$17,196.

8. OTHER ACCOUNTS RECEIVABLE

Other accounts receivable comprise the following:

	Current		Non-current	
	2018 US\$000	2017 US\$000	2018 US\$000	2017 US\$000
Financial assets:				
Claims to COES	120	139	-	-
Fund for the stabilization of fuel prices (a)	1,358	1,170	-	-
Sundry items	354	311	-	-
Sub total	1,832	1,620	-	-
Non-financial assets:				
Credits on Value-Added tax (b)	931	1,567	-	-
Credit on Temporary Taxes on net assets - ITAN	-	-	442	442
Income tax asset	-	-	-	-
Claims to SUNAT	-	-	263	263
Sub total	931	1,567	705	705
Total	2,763	3,187	705	705

- (a) This item corresponds to an account receivable from the Peruvian government in relation to the Fund for the stabilization of fuel prices (Note 1(g)). The collection term of such fund unilaterally depends on the Peruvian government; however, Management considers that there is no impairment risk of accounts receivable since there is a fund held by the government that is intended exclusively for the pertinent payment.
- (b) As of March 31, 2018 and December 2017, the balance corresponds to credit on value-added tax (VAT) which will be offset in future periods.

9. BALANCES AND TRANSACTIONS WITH RELATED ENTITIES

The parent of the Company and Subsidiaries is Orazul Energía (UK) Holdings Ltd.

During 2018, the Company and Subsidiaries performed the following significant transactions with related entities in the normal course of operations:

2018	Financial interest		Others	
	Income US\$000	Expenses US\$000 (Note 26)	Selling investments US\$000 (Note 11)	Other service US\$000
Goldwat BD, S.L. -Spain (2)	872	-	-	-
Orazul Energía (España) Holding S.L. (2)	-	568	-	-
Orazul Energía (UK) Holding Ltd.(1)	-	-	-	-
Orazul Energía Management LLC -Delaware (2)	-	-	-	241
Orazul Energía Partners LLC (2)	-	1,893	-	-
Total	872	2,461	-	241

2017	Financial interest		Others	
	Income US\$000	Expenses US\$000	Selling investments US\$000 (Note 11)	Buying investments US\$000 (Note 11) Other service US\$000
Goldwat BD, S.L. -Spain (2)	-	-	80,684	-
Orazul Energía Partners LLC (2)	-	5,856	-	-
Total	-	5,856	80,684	-

1. Parent Company
2. Other related entity

These transactions, and other less relevant, resulted in the following balances receivable from and payable to the related entity:

	Relationship	2018 US\$000	2017 US\$000
Non-trade accounts receivable (a):			
Goldwat BD, S.L. -Spain (b)	(1)	4,849	84,651
Orazul Energy Duquenco SPA (a)	(1)	452	532
Orazul Energía Management LLC -Delaware (a)	(1)	101	34
Other related entities (a)	(1)	68	41
Total		5,470	85,258
Non-trade payable accounts:			
Orazul Energía (España) Holding S.L. (c)	(1)	46,432	126,718
Orazul Energía Management LLC - Delaware (a)	(1)	276	-
Orazul Energy Duquenco SPA	(1)	81	81
Total		46,789	126,799
Loans - non-current portion (d)			
Orazul Energía Partners LLC	(1)	144,818	142,925
Total		144,818	142,925

1. Other related entity

- (a) This items corresponds to accounts receivable, that are expected to be collected in the short term, and do not accrue interests.
- (b) On January 4, 2017, the subsidiary Orazul Energy Group S.A.C. transferred in favor of Goldwat BD, S.L.-Spain its investment in Duke Energy Guatemala Ltd. and Duke Energy International El Salvador Investements N°.1 S.á r.l. for US\$80,684, with an unsecured promissory note. The note matures in January 2027 and accrues interests at a rate of 5% per year.
- (c) On August 2, 2017, the Company acquired from Orazul Energía (España) Holding S.L. 12.76% of its interest in Orazul Energy Group S.A.C. The parties agreed a price of US\$126,000 to be paid by an unsecure promissory note. Such note accrues interests at a rate of 2% per year.

On March 20, 2018, through the document "Assignment of account receivable", Orazul Energy Peru S.A. assigns and transfers to Orazul Energía (España) Holding S.L. the right and title on the account receivable held with Goldwat BD, S.L. as of that date for a total amount of US\$80,684. As a result, the parties agree that the account receivable transferred to Orazul Energía (España) Holding S.L. partially compensates the debt of US\$126,000 (only capital) held by Orazul Energy Peru S.A. with Orazul Energía (España) Holding S.L.. Therefore, as of that date, the debt held by Orazul Energy Peru S.A. with Orazul Energía (España) Holding S.L. amounts to US\$45,316.

- (d) On December 20, 2016, Orazul Energía Partners LLC, granted a loan in favor of the Company for US\$255,900. The initial rate was 12% per year with maturity in 2026, which changed to 6% in March 2017.

On July 4, 2017, Orazul Energía Partners LLC, transferred to Orazul Energia (UK) Holdings Ltd 50% of the rights of debt equivalent to US\$127,950. On the same date, Orazul Energia (UK) Holdings Ltd. approved the capitalization of said debt and increase the capital stock issued by the Company (Note 19).

Remunerations to key personnel

Remunerations paid to key personnel who have the authority and responsibility of planning, managing and controlling the activities of the Company, whether directly or indirectly, amounted to US\$422 in March 2018 (US\$1,777 in December 2017)

10. INVENTORIES (NET)

Inventories (net) comprise the following:

	2018 US\$000	2017 US\$000
Supplies and spare parts	6,238	6,871
Fuel and lubricants	<u>1,122</u>	<u>138</u>
Sub total	7,360	7,009
Obsolescence estimate	<u>(774)</u>	<u>(749)</u>
Total	<u><u>6,586</u></u>	<u><u>6,260</u></u>

The movement of the obsolescence estimate of inventories was as follows:

	2018 US\$000	2017 US\$000
Opening balance	749	1,318
Increase (Note 21)	25	110
Recovery (Note 21)	<u>-</u>	<u>(679)</u>
Closing balance	<u><u>774</u></u>	<u><u>749</u></u>

The obsolescence estimate of inventories was determined based on external technical reports. Management believes that this estimate covers the obsolescence risk appropriately as of March 31, 2018 and December 31, 2017.

11. ASSETS HELD FOR SALE

As of March 31, 2018, assets held for sale correspond to the net investment held in Chile.

	Group Cooperatie U.A. (Chile)	Orazul Energy Guatemala and El Salvador (Central America)	Total
	US\$000	US\$000	US\$000
As of December 31, 2016	44,918	80,684	125,602
Profit of the year	1,589	-	1,589
Disposal	-	(80,684)	(80,684)
As of December 31, 2017	46,507	-	46,507
Profit of the year	524	-	524
Dividends	(1,049)	-	(1,049)
As of March 31, 2018	45,982	-	45,982

In December 2016, Management announced a plan to dispose the operation in Guatemala, El Salvador and Chile. The disposal plan is consistent with the Company's perspective to focus its activities on operations in Peru.

On January 4, 2017, OEG (Company's subsidiary) transferred in favor of Goldwat BD, S.L. - Spain (related party) its operating business in Guatemala and El Salvador with a carrying amount of US\$80,684 and a price value of US\$80,684 (Note 9(b)).

OEG expects to transfer Chilean-operating business during 2018 to a related party.

12. PROPERTY, PLANT AND EQUIPMENT (NET) – ENERGY GENERATION AND TRANSMISSION

The movement in the cost, accumulated depreciation and impairment loss of property, plant and equipment (net) – Energy generation and transmission during March 31, 2018 and December 31, 2017 was as follows:

	Land US\$000	Buildings and other constructions US\$000	Machinery and equipment US\$000	Vehicles US\$000	Furniture and fixtures US\$000	Sundry equipment US\$000	Cost for disposal of assets US\$000	Constructions in process US\$000	Total US\$000
COST:									
As of January 1, 2017	8,907	348,752	463,580	4,040	1,789	21,172	40	2,777	851,057
Additions	-	-	-	-	-	-	-	2,779	2,779
Sales	(184)	(3,581)	(13)	(120)	(321)	(866)	-	-	(5,085)
Transfers	-	108	1,879	119	1	640	-	(2,772)	(25)
Exchange difference	100	12,101	8,019	115	38	618	2	68	21,061
As of December 31, 2017	8,823	357,380	473,465	4,154	1,507	21,564	42	2,852	869,787
Additions	-	-	-	-	-	-	-	244	244
As of March 31, 2018	8,823	357,380	473,465	4,154	1,507	21,564	42	3,096	870,031
ACCUMULATED DEPRECIATION:									
As of January 1, 2017	-	172,554	267,578	2,401	1,226	13,183	40	-	456,982
Additions	-	9,041	21,722	849	261	2,792	-	-	34,665
Sales and disposals	-	(1,859)	(5)	(108)	(296)	(844)	-	-	(3,112)
Exchange difference	-	6,063	5,930	84	28	446	2	-	12,553
As of December 31, 2017	-	185,799	295,225	3,226	1,219	15,577	42	-	501,088
Additions	-	2,207	6,250	227	78	842	-	-	9,604
As of March 31, 2018	-	188,006	301,475	3,453	1,297	16,419	42	-	510,692
IMPAIRMENT LOSS:									
As of January 1, 2017	-	829	4,884	1	1	34	-	-	5,749
Sales and disposals	-	(22)	(75)	-	-	-	-	-	(97)
Exchange difference	-	30	166	-	1	1	-	-	198
As of December 31, 2017	-	837	4,975	1	2	35	-	-	5,850
Sales and disposals	-	-	(25)	-	-	-	-	-	(25)
As of March 31, 2018	-	837	4,950	1	2	35	-	-	5,825
NET COST:									
Total As of March 31, 2018	8,823	168,537	167,040	700	208	5,110	-	3,096	353,514
Total as of December 31, 2017	8,823	170,744	173,265	927	286	5,952	-	2,852	362,849

- (a) The expense for depreciation of property, plant and equipment for the period ended March 31, 2018 and December 31, 2017 has been recorded in the following items in the consolidated statement of profit or loss and other comprehensive income:

	<u>2018</u> <u>US\$000</u>	<u>2017</u> <u>US\$000</u>
Costs of sale of electrical energy (Note 21)	9,367	33,800
Administrative expenses (Note 22)	237	865
Total	<u>9,604</u>	<u>34,665</u>

- (b) Significant sales of property, plant and equipment correspond to the following:
- In 2017, the Company entered into a purchase agreement for US\$4,000 with Protecta S.A. Compañía de Seguros for the sale of buildings and equipment related to offices located in Pardo & Aliaga (San Isidro – Lima), whose carrying amount was US\$1,813 and gave rise to a net profit of US\$2,188.
- (c) Accumulated impairment loss as of March 31, 2018 and December 2017 mainly corresponds to the impairment of thermoelectric power plants for US\$5,850 and US\$5,825 respectively, since their carrying amounts exceeded their recoverable values. Management of the Company and Subsidiaries considers that, as of March 31, 2018 and December 2017, additional provisions are no required, other than the estimate previously recognized in the records for the impairment of property, plant and equipment.
- (d) As of March 31, 2018 and December 2017, the Company and Subsidiaries do not have commitments for the acquisition of property, plant and equipment.
- (e) According to the policies established by Management, as of March 31, 2018 and December 2017, the Company and Subsidiaries have hired insurance policies to cover the potential risks to which certain items of their property, plant and equipment are subject, as well as possible claims that may be filed due to the performance of their operations. The Company and Subsidiaries understand that those insurance policies sufficiently cover the risks they are exposed to.

13. PROPERTY, PLANT AND EQUIPMENT (NET) - GAS INVESTMENTS

The movement in the cost and accumulated depreciation of property, plant and equipment – gas investments during March 31, 2018 and December 31, 2017 was as follows:

	Gas and fractionation plant US\$000	Vehicles US\$000	Furniture and fixture US\$000	Sundry equipment US\$000	Works in progress US\$000	Total US\$000
COST:						
As of January 1, 2017	133,179	231	411	979	8,013	142,813
Additions	-	-	-	-	9,379	9,379
Disposals	(3)	(20)	-	(2)	-	(25)
Transfers and others	11,049	144	11	4,488	(15,692)	-
As of December 31, 2017	144,225	355	422	5,465	1,700	152,167
Additions	-	-	-	-	377	377
Transfers and others	-	-	-	124	(124)	-
As of March 31, 2018	144,225	355	422	5,589	1,953	152,544
ACCUMULATED DEPRECIATION:						
As of January 1, 2017	77,528	151	276	515	-	78,470
Additions	4,605	9	32	415	-	5,061
Disposals	-	(21)	-	(2)	-	(23)
As of December 31, 2017	82,133	139	308	928	-	83,508
Additions	1,436	12	11	145	-	1,604
As of March 31, 2018	83,569	151	319	1,073	-	85,112
NET COST:						
As of March 31, 2018	60,656	204	103	4,516	1,953	67,432
As of December 31, 2017	62,092	216	114	4,537	1,700	68,659

- (a) The expense for depreciation of property, plant and equipment - gas investments in March 2018 is US\$1,604 (US\$5,061 in December 31, 2017). This expense is presented in item cost of sales in the consolidated statement of profit or loss and other comprehensive income (Note 21).
- (b) As of March 31, 2018 and December 2017, the Company's Management considers that there are situations that could indicate that the value of property, plant and equipment - gas investments may be impaired such as the impairment of the accounts receivable from Maple and the reduction of the hydrocarbons sales; however the Company's Management concluded that there is not an impairment that should be recorded in the financial statements, based on the impairment test performed.
- (c) As of March 31, 2018 and December 2017, the Company and Subsidiaries do not have commitments for the acquisition of property, plant and equipment – Gas Investment.
- (d) According to the policies established by Management, as of March 31, 2018 and December 2017, the Company and Subsidiaries have hired insurance policies to cover the potential risks to which certain items of their property, plant and equipment are subject, as well as possible claims that may be filed due to the performance of their operations. The Company and Subsidiaries understand that those insurance policies sufficiently cover the risks they are exposed to.

14. INTANGIBLE ASSETS

	Goodwill	Electric and hydrocarbon concessions	Total
	US\$000	US\$000	US\$000
COST:			
As of December 31, 2017	395,456	93,614	489,070
Amortization (Note 21)	-	(982)	(982)
As of March 31, 2018	<u>395,456</u>	<u>92,632</u>	<u>488,088</u>

Goodwill:

As of March 31, 2018 and December 2017, goodwill corresponds to the excess of the consideration given on the net fair value of assets and liabilities identified during the acquisition of the Peruvian operating business on December 20, 2016 for US\$344,924 (Note 29), deferred income tax liabilities arising from intangible assets acquired and the adjustment of fair value of fixed assets for US\$50,532 (Note 28).

Impairment test for goodwill is based on the value in use of the cash-generating unit to which is related, by using a discounted cash flow model using a discount tax of 7.85%. Cash flow is obtained from the budget approved by the Board of Directors. On this basis, as approved by Corporate Management, the Company's Management prepared the cash flow for the following five years and terminal growth rate. These cash flows do not include restructuring costs that the Company is not committed to perform or that imply future investments that will increase the capacity of assets that belong to the cash-generating unit under evaluation. As a result of such estimate, the recoverable value of goodwill exceeds its carrying amount, and for that reason, it was not necessary to recognize an impairment loss as of March 31, 2018.

Electric and hydrocarbon concessions

As of March 31, 2018 and December 31, 2017, electric and hydrocarbon concessions correspond to intangible assets identified at the acquisition date on December 20, 2016 (Note 29). The useful life of electric concessions is indefinite and a useful life of 18 years has been determined for hydrocarbons concessions, which are aligned with the end of the concession. As of March 31, 2018 and December 31, 2017, the Company's Management estimates that it will not be required to establish reserves for the possible impairment of its intangible assets with an indefinite life.

The expense for amortization of electric and hydrocarbon concessions in March 2018 is US\$984. This expense is presented in item cost of sales in the consolidated statement of profit or loss and other comprehensive income (Note 21).

15. FINANCIAL OBLIGATIONS

Financial obligations comprise the following:

Creditors	Maturity	Authorized and used amount US\$000	Total	
			2018 US\$000	2017 US\$000
Bonds - Orazul Energy Peru (a)	April 2027	550,000	552,877	544,937
Current			12,405	4,465
Non current			540,472	540,472
Total			552,877	544,937

(a) Bonds - Orazul Energy Peru:

On April 25, 2017, the Company (originally Orazul Energy Egenor S. en C. por A., later merged with the Company on August 16, 2017) priced its first bond offering in the international capital market for the amount of US\$550,000 under Rule 144A and Regulation S of the Securities Market Law of the United States of America. It obtained the risk classification "BB", assigned by the international risk-rating agencies Fitch Ratings and Standard & Poor's. Those bonds will be redeemed upon maturity in April 2027, accrue interests at a nominal annual rate of 5.625% and coupon interest is paid semi-annually.

As of March 31, 2018, the amount for the bonds issued for US\$552,517 (US\$544,937 in December 2017), consists of the principal of US\$550,000, accrued interest pending payment for US\$13,063 (US\$5,328 in December 2017), these amounts are offset by the amortized cost of US\$10,186 (US\$10,391 in December 2017).

During the effective term of bonds, the Company will be subject to restrictions and responsibilities, the most relevant are as follows:

- The Company agrees to some restrictions for the payments outside its usual operations, new investments and in the sale of assets.
- The Company and its guarantors agree to keep their accounting records under IFRS, and report their financial statements within the periods established in the agreement.
- The Company agrees to comply with certain restrictions for new indebtedness.
- The Company agrees to maintain effective insurance policies that cover its generation and transmission assets and that have coverage, deductibles and insured amounts that are reasonable and usual for private companies engaged in the generation and distribution of electrical energy.

Management considers that these restrictions and responsibilities required for the Company were complied appropriately as of March 31, 2018 and December 31, 2017.

16. TRADE ACCOUNTS PAYABLE

Trade accounts payable comprise the following:

	2018	2017
	US\$000	US\$000
Invoices	1,378	2,869
Goods and services received but not billed	6,613	6,237
Total	<u>7,991</u>	<u>9,106</u>

Trade accounts payable are mainly denominated in U.S. dollars, have current maturities, do not accrue interests and do not have specific guarantees.

17. OTHER ACCOUNTS PAYABLE

Other accounts payable comprise the following:

	2018	2017
	US\$000	US\$000
Financial liabilities:		
Guarantee deposits	44	99
Sundry items	11	70
Sub-total	<u>55</u>	<u>169</u>
Non-financial liabilities:		
Value-Added Tax	1,399	1,247
Rural electricity contribution	79	121
Other	1,161	693
Sub-total	<u>2,639</u>	<u>2,061</u>
Total	<u>2,694</u>	<u>2,230</u>

18. LIABILITIES FOR EMPLOYEE BENEFITS

The liabilities for employee benefits comprise the following:

	2018	2017
	US\$000	US\$000
Bonuses to employees	386	1,054
Employee profit-sharing	413	574
Employee severance indemnities	106	330
Vacations	652	241
Pension Fund Administration	101	102
ESSALUD	81	81
Total	<u>1,739</u>	<u>2,382</u>

The liabilities for employee benefits are mainly denominated in Peruvian soles and have current maturity.

19. EQUITY

(a) Issued capital stock

As of March 31, 2018, issued capital stock is represented by 651,224,289 (706,436,289 as of December 31, 2017) common shares with a face value of S/1.00 per share, duly authorized, issued and paid.

The General Shareholders' Meeting held on January 26, 2018, agreed to reduce the Company's capital stock by S/55,212 (US\$17,200), this reduction was made, without modifying the interest structure.

The General Shareholders' Meeting held on July 4, 2017, agreed to capitalize a loan with Orazul Energía (UK) Holding Ltd. (Note 9(d)), which amounted to S/416,221 (equivalent to US\$127,950), and issued 416,221,350 common shares with a value of S/1.00 per share.

As a result of the Company's reorganization plan, the General Shareholders' Meeting held on August 16, 2017 agreed to issue 109,139 common shares, equivalent to S/109 (US\$33), to reflect the interest of minority shareholders in the Company, as a result of the merger of Egenor.

The movement of outstanding common shares was as follows:

	Outstanding common shares
As of January 01, 2017	290,105,800
Issued for:	
Capitalization of debt (Note 9(d))	<u>416,221,350</u>
Capital stock issued for the merger (Note 1 (c))	<u>109,139</u>
As of December 31, 2017	<u>706,436,289</u>
Issued for:	
Reduce Capital stock	<u>(55,212,000)</u>
As of March 31, 2018	<u>651,224,289</u>

As of March 31, 2018, the equity interest structure of the Company was as follows:

Shareholders	Shares N°	Interest %
Orazul Energía (UK) Holdings Ltd.	651,166,963	99.99
Others	<u>65,123</u>	<u>0.01</u>
Total	<u>651,232,086</u>	<u>100.00</u>

(b) Excess of value paid in purchase of shares

As part of the reorganization within Orazul Group, on August 2, 2017, the Company acquired from Orazul Energía (España) Holding S.L. (hereinafter Orazul Spain), a related party, 12.76% of its interest in OEG, and as a result, the interest of the Company in OEG increased to 99.99%. The related party agreed to set a price of US\$126,000 by an unsecured promissory note (Note 9(c)), however, the nominal value of this 12.76% interest was US\$115,297, so the Company recognized the excess of the value paid as a decrease in its equity for US\$10,703.

(c) Retained earnings

According to Legislative Law 945 dated December 23, 2003, which amended the Income Tax Law, domiciled legal entities that agree to distribute dividends or any other form of profit distribution will retain the rate applicable described in Note 27 on the amount to be distributed, except when such distribution is made in favor of legal entities domiciled in Peru.

There are no restrictions for dividend remittance or capital repatriation to foreign investors.

(d) Non-controlling Interest

As result of determination of purchase price allocation from the acquisition of the investment in OEG at December 20, 2016, the Company has recognized a non-controlling interest for amount for amount of US\$125,150.

On January 4, 2017, OEG (Company's subsidiary) transferred in favor of Goldwat BD, S.L. - Spain (related party) its controlling interest of operating business in Guatemala and El Salvador. As a result, the Company reduced in its consolidated financial statements the non-controlling interest for those operating business for an amount of US\$10,303 (equivalent to 12.76% of interest).

As a result of the acquisition of 12.76% of interest in OEG on August 2, 2017 (Paragraph (b)), the Company has reduced the non-controlling interest balance for amount of US\$114,843.

20. SALE OF ENERGY AND ELECTRICAL ENERGY TRANSMISSION SERVICES AND HYDROCARBONS

For the three-month period ended March 31, 2018 and 2017, the sale of energy, electrical energy transmission services and sale of hydrocarbons include the following credit balances:

	2018 US\$000	2017 US\$000
Sale of electrical energy:		
Sale of electrical energy and power		
Energy	19,730	26,611
Power	13,913	14,057
COES compensations		
Energy	6,363	3,746
Power	2,754	1,910
Other	409	33
Sale of hydrocarbons:		
Natural gasolina	1,928	2,470
LPG	3,991	2,528
Electrical energy transmission	<u>1,762</u>	<u>1,266</u>
Total of sales	<u><u>50,850</u></u>	<u><u>52,621</u></u>

21. COSTS OF SALE OF ENERGY AND ELECTRICAL ENERGY TRANSMISSION SERVICES AND HYDROCARBONS

For the three-month period ended March 31, 2018 and 2017, the cost of sale of energy and electrical energy transmission services include the following:

	2018 US\$000	2017 US\$000
Royalties from electrical energy sales (Note 1)	1,323	844
Royalties from sales of hydrocarbons (Note 1)	2,105	1,872
Transport, storage and other costs of natural gas	1,020	-
Supplies, spare parts and fuel	222	189
Purchase of transmission charges	9,526	9,049
Purchase of:		
Energy	509	1,831
Power	-	2,584
Other cost	411	680
Personnel expenses	2,494	2,502
Services provided by third parties	1,199	1,484
Taxes	417	430
Sundry management charges	207	350
Estimates of the period:		
Depreciation (Notes 12 and 13)	11,955	9,559
Recovery of obsolescence estimate (Note 10)	25	-
Employee severance indemnities	126	137
Total	<u>31,539</u>	<u>31,511</u>

22. ADMINISTRATIVE EXPENSES

For the three-month period ended March 31, 2018 and 2017, administrative expenses include the following:

	2018 US\$000	2017 US\$000
Personnel expenses	1,853	1,861
Services provided by third parties	1,474	946
Taxes	705	719
Sundry management charges	545	545
Estimates of the period:		
Depreciation (Note 12)	237	216
Amortization	42	37
Employee severance indemnities	98	110
Impairment estimate of accounts receivable, net (Note 7)	<u>145</u>	<u>2,983</u>
Total	<u>5,099</u>	<u>7,417</u>

23. SELLING EXPENSES

For the three-month period ended March 31, 2018 and 2017, selling expenses include the following:

	2018 US\$000	2017 US\$000
Personnel expenses	307	290
Services provided by third parties	33	6
Sundry management charges	2	1
Estimates of the period:		
Employee severance indemnities	16	17
Total	<u>358</u>	<u>314</u>

24. PERSONNEL EXPENSES

For the three-month period ended March 31, 2018 and 2017, personnel expenses include the following:

	2018 US\$000	2017 US\$000
Salary	2,858	1,730
Bonuses	842	1,820
Gratifications	426	173
Profit sharing	230	718
Vacations	225	105
Others	358	371
Total (Notes 21, 22 and 23)	<u>4,939</u>	<u>4,917</u>

25. OTHER INCOME

For the three-month period ended March 31, 2018 and 2017, other income includes the following:

	2018 US\$000	2017 US\$000
Equipment lease	215	332
Net profit from the sale of fixed assets	191	-
Others	283	159
Total	<u>689</u>	<u>491</u>

26. FINANCIAL EXPENSES

For the three-month period ended March 31, 2018 and 2017, financial expenses include the following:

	2018 US\$000	2017 US\$000
Interests - bonds (Note 15(b))	7,734	1,124
Interests - related parties	2,461	5,856
Withholding tax on interests - related parties	1,401	673
Financial cost - Corporate bonds (Note 15(c))	211	-
Interests - Syndicate loan (Note 15(a))	-	5,434
Other financial expenses	39	77
Total	<u>11,846</u>	<u>13,164</u>

27. INCOME TAX

(a) Income tax regime

(i) Tax rates

The income tax rate for legal entities domiciled in Peru shall be determined by applying the following rates on their net income:

Taxable periods	Rates
2017 and subsequent years	29.5%

Legal entities domiciled in Peru are subject to an additional rate, as shown below, on any amount that may be considered as indirect income provision, including amounts charged to expenses and unreported income; that is, expenses which may have benefited shareholders, interest holders, among others; other expenses not related to the business; expenses of shareholders, interest holders, among others, which are assumed by the legal entity.

Taxable periods	Rates
2017 and subsequent years	5%

(ii) Transfer pricing

In order to determine income tax, transfer pricing of transactions performed with related entities or entities resident in territories with low or no taxation shall be supported with their pertinent supporting documentation and the compliance with formal obligations.

Services:

- The "benefit test" should be performed for its deduction as cost or expense.
- The benefit test will be considered as performed when the service provides economic or commercial value for the recipient to enhance or maintain its commercial position, and if independent entities would have satisfied the need for the service and provided it themselves or by a third party.
- The actual provision of the service, nature, actual need for the service and costs and expenses incurred by the service supplier, as well as allocation criteria, should be evidenced (changes should be justified).

- The deductible cost or expense for received services will be equal to the sum of: (i) costs and expenses incurred by the supplier, plus (ii) mark-up (which cannot be higher than 5% for "low value-adding services").

Formal obligations:

Operations performed between related entities and through tax havens that correspond to 2016 and subsequent years should no longer be supported by a Technical Transfer Pricing Report, but by a local report, whose due dates are in April 2018 (operations performed in 2016) and June every year (operations performed in 2017 and subsequent years).

On the other hand, the master report and report per country should be submitted for operations performed in 2017 and subsequent years. The forms, due dates and conditions for these reports have not been approved by the Tax Administration yet.

Based on the analysis conducted on the Company's operations, Management and its legal advisors believe that no significant liabilities will arise for the financial statements as of March 31, 2018 and December 31, 2017, with regard to transfer pricing.

(iii) Significant changes to Income Tax regime in Peru

After March 31, 2018, no significant changes have been made to the income tax regime in Peru that may impact these consolidated financial statements. The standards and interpretations effective as of March 31, 2018 and December 31, 2017 have been considered by Management when preparing these consolidated financial statements.

(iv) Tax situation

Orazul Energy Peru S.A.

Income tax returns from the period from October 10, 2016 to December 31, 2016 and for the year 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Orazul Energy Egenor S. en C. por A.

The review of income tax return from 2011 gave rise to the issuance of determination and fine resolutions for US\$575. In February 2015, the Company filed a claim against the Tax Administration and in August 2015, the Tax Administration declared the claim filed by the Company as groundless, so in September 2015, the Company filed an appeal against such resolutions before the Tax Court, which has not been resolved to date. In December 2017, the Tax Court resolve partially in favour of the Company. The updated contingency is US\$312.

Income tax return from 2013 was reviewed by the Tax Administration. As a result of this review, it does not result in significant liabilities for the Company.

Income tax returns from 2014 to 2016 and for the period from January 1, 2017 to August 16, 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Temporary tax on net assets return from 2013 was reviewed by the Tax Administration in 2014, which issued determination and fine resolutions for US\$264 plus interests in May 2015. In July 2015, the Company filed a claim against the Tax Administration; and in April 2016, the Tax Administration declared the claim filed by the Company as groundless. In May 2016, the Company filed an appeal against the SUNAT decision before the Tax Court, which has not been resolved to date. The updated contingency is US\$426.

Etenorte S.R.L.

Income tax returns from 2013 to 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Aguaytia Energy del Peru S.R.L.

Income tax returns from 2013 to 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Termoselva S.R.L.

Income tax returns from 2014 to 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Income tax return from 2013 was reviewed by the Tax Administration. As a result of this review, it does not result in significant liabilities for the Company.

Eteselva S.R.L.

Income tax returns from 2013 to 2017 have not been reviewed by the Tax Administration yet, which is empowered to conduct those reviews within four years immediately after the submission date of pertinent tax returns.

Due to possible interpretations that tax authorities may have on current applicable regulations every year, it is not possible to determine to date whether liabilities for the Company and Subsidiaries will arise or not from the reviews to be conducted. Therefore, any income tax or charge that may result from those tax reviews would be applied to profit or loss for the year when determined. Management of the Company and Subsidiaries believes that any additional tax payment would not be significant for the consolidated financial statements as of March 31, 2018 and 2016.

Temporary Tax on Net Assets

This tax is applicable to third category recipients subject to the general income tax regime. Since 2009, the tax rate of 0.4% is applicable to the amount of net assets exceeding S/1 million.

The actually paid amount can be used as credit against payments on account of the general income tax regime or against the regularization payment of income tax of the corresponding taxable period. As of March 31, 2018 and 2017, the Company and Subsidiaries do not have an ITAN balance to recover and Aguaytia is exempted from paying this tax.

(b) Income tax expense of the Company and Subsidiaries comprises the following:

	2018 US\$000	2017 US\$000
Current income tax	2,694	6,010
Deferred income tax (Note 28)	(1,869)	(2,044)
Adjustment of income tax from previous periods	-	67
Total	<u>825</u>	<u>4,033</u>

The expense for current income tax corresponds to the tax to be paid, calculated by applying a 29.5% rate for the Company and Subsidiaries and 30% for Aguaytia on taxable income, after deducting 5% of profit-sharing of employees.

- (c) During the three-month period ended March 31, 2018 and 2017, the effective rate of income tax expense is different from the tax rate applicable to profit before taxes. The nature of this difference is due to certain items related to the determination of taxable income, whose effects on applicable tax rate are presented below (in percentages on profit before taxes):

	2018		2017	
	Amount US\$000	Percentage %	Amount US\$000	Percentage %
(Loss) Profit before income tax	2,952	100	611	100
Income tax calculated as per tax rate	871	29.50	180	29.50
Tax effect on additions and deductions:				
Non-deductible expenses (net)	(46)	(1.56)	(66)	(10.80)
Adjustments recognized in the present year	-	-	3,742	612.44
Exchange difference	-	-	110	17.96
Related to income tax of previous years	-	-	67	10.97
Current and deferred income tax as per effective income tax rate	825	27.94	4,033	660.07

- (d) Offsetting tax loss carryforward - Aguaytia

According to Legislative Decree No. 774 (applicable for Aguaytia's hydrocarbon operations), it will be possible to offset the tax loss from Peruvian source determined and recorded in a taxable period, assigning this amount every year until its depletion, to net third category income to be obtained in the four immediately subsequent years, calculated as from the following year of its generation. The amount that is not offset once this period of time has passed will not be offset in subsequent years.

As of March 31, 2018, Aguaytia has a tax loss carryforward of US\$13,953, which was generated in 2018, 2017 and 2016 for the amounts of US\$402, US\$7,743 and US\$5,808 respectively.

- (e) The Company and Subsidiaries hold income tax credit balances from the Tax Administration for US\$4,193 as of March 31, 2018 (US\$3,051 in December 2017).

28. DEFERRED INCOME TAX LIABILITY

The movement of net deferred income tax liability during March 31, 2018 and December 31, 2017 and the description of temporary differences that generated them are shown below:

	Balance as of 31.12.2016 US\$000	Profit/loss for the year US\$000	Exchange Difference US\$000	Balance as of 31.12.2017 US\$000	Profit/loss for the year US\$000 (Note 25)	Balance as of 31.03.2018 US\$000
Liability:						
Fair value adjustment of long term assets	50,532	(5,219)	-	45,313	(1,821)	43,492
Difference in depreciation basis and rates of property, plant and equipment	57,813	(2,757)	1,683	56,739	(35)	56,704
Financing cost	-	3,065	-	3,065	(60)	3,005
Total	108,345	(4,911)	1,683	105,117	(1,916)	103,201
Asset:						
Tax loss	(1,742)	(2,323)	-	(4,065)	243	(3,822)
Impairment loss of property, plant and equipment	(3,149)	1,483	(60)	(1,726)	7	(1,719)
Provision for vacations	(530)	478	(19)	(71)	(42)	(113)
Impairment estimate of accounts receivable	(2,553)	504	(6)	(2,055)	(20)	(2,075)
Provision for dismantling of assets	(204)	(33)	(7)	(244)	-	(244)
Obsolescence estimate of inventory	(351)	126	(7)	(232)	1	(231)
Effect originated by difference between functional currency and currency for tax purposes in Non-monetary assets	(503)	758	-	255	(255)	-
Other provisions	(320)	202	(9)	(127)	72	(55)
Total	(9,352)	1,195	(108)	(8,265)	6	(8,259)
Total deferred (net)	98,993	(3,716)	1,575	96,852	(1,910)	94,942
Total deferred income tax asset	(2,067)			(2,766)		6,597
Total deferred income tax liability	101,060			99,618		101,539

29. BUSINESS COMBINATION

On December 20, 2016, the Company and Orazul Energía (España) Holding S.L. (hereinafter "Orazul España") acquired the investment in OEG, which held operating business in Peru, Chile, and Central America (Guatemala and El Salvador), for a total purchase price of US\$983,195. The Company paid in cash a total amount of US\$857,592, equivalent to its interest of 87.23%, and Orazul España paid in cash a total amount of US\$125,603 equivalent to its interest of 12.76%.

The acquisition was consistent with the strategy of investing in select high-growth economies through companies that have a long record of accomplishment of adhering to the highest excellence standards and expand its global portfolio of clean power generation.

Assets and liabilities at fair value determined as of acquisition date, were as follows:

	2016 US\$000
Cash and cash equivalents	37,477
Trade accounts receivable	22,719
Other accounts receivable	3,595
Accounts receivable from related entities	47,258
Inventories	6,023
Income tax assets	3,580
Other assets	1,041
Property, plant and equipment	452,669
Intangibles assets	93,614
Assets held for sale	125,602
Financial obligations	(76,233)
Trade accounts payable	(16,654)
Other account payable	(4,720)
Accounts payable to related entities	(12)
Liabilities for employee benefits	(7,443)
Deferred income tax liabilities	(50,528)
Deferred income tax assets	2,067
Provisions	(1,784)
Fair value of net assets	638,271
Purchase price	983,195
Goodwill	344,924

As required by IFRS 3, the Company identified assets and liabilities acquired at fair value at the acquisition date. This assessment resulted in an additional recognition of intangibles assets related to electric and hydrocarbon concessions for an amount of US\$93,614 and adjustment of fair value of fixed assets for an amount of US\$77,683.

Those adjustments of intangible assets and fixed assets are subject to temporary differences for income taxes and therefore the Company has recorded a deferred income tax liability of US\$50,532 as of 2016 and the counterparty allocated to goodwill. In March 31, 2017 the balance is US\$43,492 (Note 28).

In addition, since the acquisition date of OEG, the Company had the plan to sell the operating business in Chile and Central America in the short term and those assets have been classified as assets held for sale for US\$125,602 (Note 11)

The goodwill of US\$344,924 was recognized as part of intangible assets. Goodwill on this acquisition is not expected to be deductible for income tax purposes.

30. CONTINGENCIES

The Company and Subsidiaries have the following contingencies that are individually significant claims that, in the opinion of Management of the Company and Subsidiaries and its legal advisors, have a possible perspective of loss. In this regard and based on the information available to the Company and Subsidiaries, including the estimated remaining time until the completion of these contingencies, the results of the evidence presented in the cases and the evaluation of internal and external advisors, the Company and Subsidiaries are not able to estimate a reasonably possible loss or range of loss with respect to the issues described below:

ORAZUL

- (a) The Company is involved in several court proceedings on labor matters, mostly related to job reinstatement, vacations and profit sharing, for which, after being evaluated individually, it has been estimated that the Company could be sanctioned up for an amount of S/4,436 (equivalent to US\$1,367).
- (b) Finally, in November 2017, OEFA initiated an administrative proceeding against the Company regarding an alleged infraction of the regulation consisting in not providing access to OEFA's supervisors to our reservoirs located in San Diego. In connection to this proceeding, the Company could be fined up to 100 UIT (tax unit) (equivalent to US\$124).

AGUAYTIA

- (a) Aguaytia is party of a court proceeding initiated in 2016 by the company Maderas de Exportacion y Comercializacion S.A.C. The plaintiff claims an area affected by the passage of one of our pipelines, as well as damages for up to S/5,716 (equivalent to US\$1,761).
- (b) In addition, Aguaytia is party to an administrative proceeding initiated by OSINERGMIN for not having a Supervisory Control and Data Acquisition ("SCADA") system in place at Block 31-C in connection with which OSINERGMIN has imposed a fine of 5,674 UIT (equivalent to US\$7,082). Aguaytia has initiated one proceeding in local court to determine whether Aguaytia committed the infraction or not, and another to dispute the amount of the fine.
- (c) Finally, Aguaytia is party of one more administrative proceedings initiated by OSINERGMIN in September 2017, is related to an alleged infraction of the regulation consisting in filing seven statements with inaccurate information, for which OSINERGMIN sanctioned Aguaytia with a fine for each issued statement at issue. In this proceeding, Aguaytia acknowledged responsibility for two of them and contested the remaining five statements, for which Aguaytia could be fined with 7.1 UIT (equivalent to US\$9) if they are confirmed by the higher instance.

ETESSELVA

- (a) In the opinion of Eteselva's Management and its legal advisors, there are no significant claims that have a possible perspective of loss or any other contingencies for Eteselva as of March 31, 2018.

TERMOSELVA

- (a) In the opinion of Termoselva's Management and its legal advisors, there are no significant claims that have a possible perspective of loss or any other contingencies for Termoselva as of March 31, 2018.

ETENORTE

- (a) In the opinion of Etenorte's Management and its legal advisors, there are no significant claims that have a possible perspective of loss or any other contingencies for Etenorte as of March 31, 2018.

31. COMMITMENTS AND GUARANTEES

Sale of energy

As of March 31, 2018 and December 31, 2017, main commitments of sale of energy of the Company are as follows:

<u>Type of customers</u>	<u>Contracted power Kw</u>	<u>Start date – agreement</u>	<u>Termination date - agreement</u>
Regulated customers	From 74 to 103,233	Between 2013 and 2014	Between 2019 and 2023
Free customers	From 1,000 to 60,000	Between 2013 and 2016	Between 2017 and 2019

In June 2017, the Company requested the issuance of a Stand By Letter of credit (US\$545), which has as beneficiary Orazul Energia Management LLC in favor of Masaveu Post Oak Houston, Delaware LLC., for the rental of the offices of these entities.

32. LEASES

AS LESSEE

On July 1, 2014, the Company and Inmuebles Limatambo S.A. entered into an operating lease agreement for the administrative offices of the Company. The effective term of the agreement is for 5 years, with price increases at 3% every year.

As of March 31, 2018 and 2017, future minimum lease installments are as follows:

	<u>2018 US\$000</u>	<u>2017 US\$000</u>
Less than one year	891	884
Between one (1) and five (2) years	224	449
Total	<u>1,115</u>	<u>1,333</u>

33. NON-MONETARY TRANSACTIONS IN THE CONSOLIDATED STATEMENT OF CASH FLOWS

Investment activities that did not result in disbursements of cash and cash equivalents in the year of acquisition and affected assets and liabilities for the three-month period ended March 31, 2018 and 2017 are summarized below:

	<u>2018 US\$000</u>	<u>2017 US\$000</u>
Debt compensation	80,684	-
Disposal of assets held for sale (Note 11)	-	80,684

34. ENVIRONMENT

Pursuant to the provisions set forth in Supreme Decree No. 029-94-EM, Regulations for Environmental Protection in Electrical Activities, the Company implemented in previous years its Environmental Management and Adaptation Program (PAMA), which was previously approved by competent authorities. On July 11, 2005, the Company received Official Letter No. 3042-2005-OSINERG-GFE, under which the Safety and Environmental Area of OSINERGMIN concludes that the Company does not have any pending commitment in its PAMA.

The Subsidiaries Aguaytia del Peru S.R.L., Eteselva S.R.L. and Termoselva S.R.L have an Environmental Impact Assessment for Block 31-C, which was approved by Official Letter No. 248-95-EM/DGH in August 1995. Pursuant to the provisions set forth in Supreme Decree No. 039-2014-EM, Regulations for Environmental Protection in Hydrocarbons Activities and Supreme Decree No. 029-94-EM, Regulations for Environmental Protection in Electrical Activities, the Company and Subsidiaries submit a report from the previous period every year, signed by an environmental auditor, in which they report their compliance with the current environmental law and include recommendations of the EIA, if any. The Company and Subsidiaries also submit a consolidated report on controls performed on waste emissions and/or disposals.

35. SUBSEQUENT EVENTS

We are not aware of any subsequent event that has occurred between the closing date and issue date of these consolidate financial statements, which may significantly affect them.
