



DIVERSIFIED GAS & OIL
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DIVERSIFIED GAS & OIL PLC

2016 ANNUAL REPORT & ACCOUNTS
FOR THE YEAR ENDED 31ST DECEMBER 2016



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DIVERSIFIED GAS & OIL PLC
Officers and Professional Advisors

DIRECTORS	Robert Marshall Post (Executive Chairman) Robert "Rusty" Russell Hutson, Jr. (Chief Executive Officer) Bradley Grafton Gray (Finance Director & Chief Operating Officer) David Edward Johnson (Senior Independent Non-Executive Director) Martin Keith Thomas (Independent Non-Executive Director)
REGISTERED NUMBER	09156132 (England and Wales)
REGISTERED OFFICE	27/28 Eastcastle Street London W1W 8DH (UK)
HEAD OFFICE	1100 Corporate Drive Birmingham, Alabama 35242 (US)
COMPANY SECRETARY	Cargill Management Services Limited 27/28 Eastcastle Street London W1W 8DH (UK)
INDEPENDENT AUDITOR	Crowe Clark Whitehill LLP St Bride's House, 10 Salisbury Square London EC4Y 8EH (UK)
LEGAL ADVISOR, UK	Watson Farley & Williams LLP 15 Appold Street London EC2A 2HB (UK)
LEGAL ADVISOR, US	Maynard Cooper & Gale 1901 Sixth Avenue North, Suite 2400 Birmingham, Alabama 35203 (US)
COMPETENT PERSON	Wright & Company, Inc. 12 Cadillac Drive, Suite 260 Brentwood, Tennessee 37027 (US)
SHARE REGISTRAR	Neville Registrars Limited Neville House, 18 Laurel Lane Halesowen B63 3DA (UK)
NOMINATED ADVISER AND JOINT BROKER	Smith & Williamson Corporate Finance Limited 25 Moorgate London EC2R 6AY (UK)
LEAD BROKER	Mirabaud Securities, LLP 10 Bressenden Place London SW1E 5DH

DIVERSIFIED GAS & OIL PLC
Chairman's Statement

Dear Shareholders:

I am delighted to be delivering my Chairman's statement on the back of a truly transformational year in 2016. Diversified Gas & Oil's (DGO) growth has accelerated rapidly in recent years, however the pace quickened through 2016, driven by several key events, and our evolution and realization of our vision has continued apace throughout 2017.

Our primary strategic objective in 2016 was obtaining a level of scale and materiality that would make us relevant and attractive to institutional investors as part of a flotation on the AIM Market of the London Stock Exchange. To that end, we successfully completed two acquisitions in April and June 2016 that increased our cash flow and profitability, two elements that are the bedrock of our business model. These acquisitions provided us with a stable platform from which we could consider, and subsequently deliver, the more ambitious growth plans that have occurred in 2017.

DGO has a simple and robust strategy; acquire low-risk, profitable producing assets within our geographical focus in the Appalachian Basin, North East US, and then maximize production, and profitability, from these wells through the implementation of operational efficiencies and recovery techniques. The third element to our strategy focuses on the organic growth opportunity within our existing portfolio as we initiate infill drilling in areas with upside potential. In the current industry environment, we are achieving considerably higher rates of return through M&A than we could deliver with the drill-bit, which is why our primary focus has been on consolidating M&A opportunities whilst the market window continues to offer attractive valuation metrics. Should the oil and gas prices firm up, or the M&A opportunities cease to present themselves, then we will be ready to switch our focus to the organic growth within the diverse portfolio that we have assembled.

Since inception in 2001, DGO has always focused on the Appalachian Basin, the oldest and most established hydrocarbon basin in the US, because of the low risk geology and easy access to market provided by an abundance of infrastructure. The industry dynamics in the region have shifted considerably in recent years driven by the increased focus on shale and this has presented a unique and compelling opportunity for DGO that we have leveraged to our advantage. The focus of large independents is increasingly on the unconventional shale reservoirs of Marcellus and Utica, meaning the overlaying conventional producing reservoirs are non-core to their businesses. Retention of the licenses to the shale reservoirs are however held by production (HBP) from the conventional reservoirs and therefore the large independents are keen to offload the conventional assets to a capable operator who can maintain production and in doing so, retain the rights to the unconventional assets on behalf of the vendors. Such is the importance of the selected acquirer's operating capabilities that the consideration price of the assets is not the deciding factor, thereby presenting favourable valuation metrics on acquiring proven developed producing reserves.

As a result of all these factors, DGO has uniquely positioned itself as a capable and proven acquirer in the region, leveraging our local network, our assets and access to capital, and the reputation that we have steadily built over 15 years as a credible operator. Our market position has enabled us to execute on the acquisitions throughout 2016 and 2017 year to date, and we continue to screen exciting and complementary opportunities within our steady pipeline.

Having successfully acquired the Eclipse and Seneca assets in 2016, using the capital raised through our bond offering in London, we set our sights on obtaining a listing on the AIM Market. We chose the AIM market as it is an international growth market, it has an established and sophisticated understanding of our industry, and our unique and proven business model would enable us to differentiate our story from other E&Ps listed on AIM. Despite the challenging market conditions and generally negative sentiment towards investing in E&Ps, DGO was able to raise \$50 million with high quality blue-chip institutional investors, making it the largest oil and gas IPO to have taken place in the London market since April 2014. We believe that the success of this process can be assigned to the simplicity of our strategy, the low-cost nature of our operations that generate profitability in a low commodity price environment, and finally our commitment to a dividend policy that sets us apart from most of our peers.

The principal purpose of the AIM listing was to strengthen our balance sheet and give us better access to capital, both of which would enable us to capitalize on future M&A opportunities. We are pleased to report that the listing has been a resounding success, and we began executing our plans in the weeks following our IPO, with the acquisition of

DIVERSIFIED GAS & OIL PLC
Chairman's Statement

additional wells in April 2017. We have also announced an agreement for a transformational \$84.2 million acquisition which once completed, will significantly increase our acreage position, proven reserves, daily production and cash flow. This ambitious acquisition will instantly enhance our operational and financial profile, and takes us to another level.

In summary, 2016 was about growth, but more importantly, it was about laying the foundations to enable more aggressive growth, and we have successfully built on those foundations during an extremely exciting and busy start to 2017. I would personally like to thank the executive team for their dedication and commitment to the entrepreneurial values that underpin DGO. I would also like to thank the Board for their pragmatic guidance through what has been an exciting and intense period of growth for the Company. Finally, I would like to thank our shareholders for the faith and support that they have shown in the Company. Our primary objective is to create value on behalf of our shareholders and we are confident that we have the right strategy, assets and management in place to deliver on our ambitious objectives.



Robert M. Post
Chairman of the Board

DIVERSIFIED GAS & OIL PLC
Strategic Report

I am pleased to report that 2016 was undoubtedly a transformational year for DGO. Utilizing our successful capital raising efforts from our listed bond offering, DGO closed two acquisitions that significantly increased our production and cash flows and advanced the company to the size and scale to position ourselves for the AIM IPO completed in February 2017. This important balance sheet recapitalization provides a platform to execute our business strategy of acquiring and developing conventional oil and gas assets in Appalachia.

Our strategy remains consistent:

- 1) Acquire producing assets at compelling valuations. The assets typically are mature production with predictable flow rates and low declines.
- 2) Maximize production by enhancing operational techniques and deploying capital in an efficient manner.
- 3) Execute low risk, low cost drilling when economics are favourable.

We are firmly committed to our growth strategy as evidenced by the two acquisitions we closed in 2016, and have accelerated the rollout of this strategy in 2017, as detailed in this report.

Acquisition - Eclipse Resources

On 13 April 2016, DGO completed the acquisition of all the conventional assets of Eclipse Resources in Ohio (US). The assets acquired included approximately 1,300 conventional oil and gas wells producing approximately 235 barrels of oil per day (“BOPD”) and 3,200 MCF per day of natural gas production.

Acquisition - Seneca Resources Corporation

In June 2016, DGO completed the acquisition of 2,200 conventional oil and gas wells in Pennsylvania (US) from Seneca Resources Corporation. These assets were producing approximately 10,700 MCF of natural gas per day and 35 BOPD. This was the largest acquisition for DGO to date.

Financial Highlights

Both the Eclipse and Seneca acquisitions added significant production and were accretive to DGO’s EBITDA. We ended 2016 with gross production of 26,500 mcf/day, an 120% increase from the 2015 year end. This growth was driven primarily by our acquisition-focus throughout 2016. We also enhanced our operating metrics by becoming more efficient in our operations. Total lease operating expense per MCFE dropped from \$1.72 in 2015 to an average of \$1.39 in the fourth quarter of 2016, which included all of our acquisitions for the period. On a per flowing barrels of oil equivalent (BOE), 2016 ended at \$8.26, positioning us firmly at the low end of the industry operating cost curve. Our strict commitment to capital discipline ensures we are prudent in how we spend our capital to ensure the highest returns for the money spent.

Revenues for the year ended 31 December 2016 were \$18.3 million, up \$12.0 million from the prior year 2015. The increase was attributable to a full year of revenues from the three acquisitions closed in 2015, the impact of the two 2016 acquisitions, and the increase in production associated with the assets. Operating profit was \$22.4 million (2015: \$4.6 million) credited to obtaining natural gas and crude oil production at compelling valuations over its fair market value of \$24.2 million. Net Income was \$32.5 million (2015: \$413 thousand loss) which was favourably impacted by the settlement of mezzanine debt which resulted in a gain on debt cancellation of \$14.1 million. Excluding the impact of one-time costs and gains along with other non-cash transactions, the adjusted EBITDA of DGO was \$4.3 million (2015: \$2.6 million).

Total assets of DGO increased to \$85.9 million representing an increase of 85.0%. This increase in assets resulted from the recognition of the fair market value of the two successful acquisitions of the conventional assets of Eclipse Resources and Seneca Resources. These acquisitions added significant scale to our operations and increased our oil and gas reserves. As a result of recording the increase in the fair market value of the acquired assets, we recorded a gain on bargain purchase of \$24.3 million which favourably impacted our shareholders’ equity. Our total equity balance at 31 December 2016 is \$9.2 million compared to a deficit balance of \$8.8 million at 31 December 2015.

Prior to 1 January 2016, DGO’s results of operations and financial position consisted of the consolidation of individually owned “pass through” corporate entities incorporated in the United States. As a result of the successful

DIVERSIFIED GAS & OIL PLC

Strategic Report

contribution of the capital stock of the historical pass through entities to our US parent entity, Diversified Gas & Oil Corporation, DGO established an initial recognition of deferred income taxes in 2016. DGO's Statement of Financial Position at 31 December 2016 includes a deferred tax liability of \$15.1 million. Further discussion of our deferred income taxes is provided for in the notes to our Consolidated Financial Statements.

DGO's total borrowings at 31 December 2016 were \$41.3 million (\$44.4 million in 2015). DGO has historically funded its acquisition strategy through debt, including the acquisitions of Eclipse Resources and Seneca Resources. The majority of the total borrowings were fully satisfied in the first quarter of 2017 as a result of DGO's IPO on the AIM Market of the London Stock Exchange.

Future Developments

2017 promises to be another extremely active year for the company and we have already delivered a number of transformational milestones in the year. In February we completed our public offering raising \$50 million in the largest oil and gas IPO in the London market since 2014. Later that month, we announced the acquisition of 1,300 oil and gas wells in Ohio and Pennsylvania (US), increasing our total production to approximately 33,300 mcf per day. These assets complemented our existing portfolio in both states and increased our daily natural gas production by 14% and daily oil production by 23%.

At the time of this writing, DGO has signed a conditional Purchase and Sale Agreement for a transformational acquisition that will have a significant impact on our production and operations. This acquisition will give us a platform to significantly increase our operations within the Appalachian Basin and establish the Company as one of the largest conventional oil and gas operators in the region. The purchase price is \$84.2 million and this transaction will add approximately 6,800 BOE to our daily production, an increase of 161%. Combined, the Company will produce approximately 11,000 BOE of net daily production, making us a material producer amongst our small-mid cap peer group. This acquisition is scheduled to close in late June 2017.

Dividend

DGO stated in the Company's Admission Document, published on 30 January 2017, that the Directors intend to adopt a progressive dividend policy to reflect the expectation of future cash flow generation and long-term earnings potential for the Group. The Board intends that not less than 40 per cent of operating free cash flow will be paid to Shareholders by way of a dividend.

The Board intends to recommend a final dividend in line with the stated dividend policy, for approval by shareholders at the Company's Annual General Meeting to be held on 28 July 2017 and, if approved, to be paid not later than 31 July 2017. Details of the recommended final dividend will be notified to shareholders shortly.

Responsibility for risk management

Risk management is integral to all of DGO's activities. Each member of executive management is responsible for continuously monitoring and managing risk within the relevant business areas. Every material decision is preceded by an evaluation of applicable business risks. Reports on DGO's risk exposure and reviews of its risk management are regularly undertaken and presented to the Board of Directors.

Principal risks and uncertainties

DGO may not successfully manage its growth

Expansion of the business of DGO may place additional demands on the management, administrative and technological resources, and may require additional capital expenditure. If DGO is unable to manage any such expansion effectively, then this may adversely impact the business, development, financial condition, results of operations, prospects, profits, cash flow and reputation of DGO. DGO's growth and future success will be dependent to some extent on the successful completion of such expansion strategies proposed to be undertaken. The execution of DGO's expansion strategies may also place a strain on its managerial, operational and financial reserves. Should DGO fail to implement such expansion strategies, DGO's business operations, financial performance and prospects may be adversely affected.

DIVERSIFIED GAS & OIL PLC
Strategic Report

Changes in natural gas and crude oil commodity pricing environment

Changes in commodity pricing may affect the value of DGO's natural gas and oil fair market valuation, operating cash flow and adjusted EBITDA regardless of operating performance. DGO could be affected by unforeseen events outside of its control including economic and political events and trends, inflation and deflation, terrorist attacks or currency exchange fluctuation. The combined effect of these factors is difficult to predict and DGO could be affected adversely by changes in economic, political, administrative, taxation or other regulatory factors in any jurisdiction in which DGO may operate. Deterioration in the economic climate could result in a delay or cancellation of DGO's plans and strategies. DGO's management can mitigate several of these risks and streamline cash flows with adequate derivatives in place.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of foreign currency risk, interest rate risk and other price risk, for example, commodity price risk. The objective of market risk management is to manage and control market price exposures within acceptable limits, while maximizing returns.

Liquidity risk

Liquidity risk arises from DGO's ability to generate cash flows from operations to fund its business requirements or to create access to non-operational sources of funding. This risk can result in DGO's difficulty in meeting its financial obligations as they become due. The Directors continually review the cash available to the Company and seek to manage financial risk by ensuring sufficient liquidity is available to meet foreseeable needs.

Environmental risk

DGO's operations are subject to environmental regulation in all the jurisdictions in which it operates. DGO is unable to predict the effect of additional environmental laws and regulations which may be adopted in the future, including whether any such laws or regulations would adversely affect DGO's operations. There can be no assurance that such new environmental legislation once implemented will not oblige DGO to incur significant expenses and undertake significant investments.

Closing Remarks

As reported, it has been an exciting time for DGO and we have accelerated the growth of the Company in a relatively short time frame. We are particularly proud that we have been able to make such strides in the face of challenging industry headwinds. We are continuing to see strong acquisition deal flow and we assess each opportunity with value creation as our primary goal. We will continue to be aggressive in our approach, but disciplined in our valuations, placing emphasis on efficiencies and cash flow. We truly believe that we have now created a solid platform from which we can grow and that our best days are ahead.

Finally, I would like to thank our Board of Directors for their ongoing support, and all of our staff for their dedication and commitment in this truly ever-changing landscape. I would also reiterate our Chairman's gratitude to our shareholders for their trust in our strategy and management team. We will continue to work hard to maintain and repay that faith by developing a strong track record for delivery.



Robert "Rusty" Hutson, Jr.
Chief Executive Officer

DIVERSIFIED GAS & OIL PLC
Directors' Report

The Directors present their report on DGO, together with the audited Consolidated Financial Statements for the year ended 31 December 2016.

Review of business, outlook and dividends

Details of DGO's progress during the year and its future prospects, including its intended dividend strategy, are provided in the Chairman's Statement and Strategic Report on pages 4 to 8.

Financial instruments

Details of DGO's principal risks and uncertainties relating to financial instruments are detailed in the Strategic Report and note 26 to the financial statements.

Directors

The directors who served during the year are set out on page 3. The directors' beneficial interests in the share capital of DGO were as follows at 31 December 2016:

	Ordinary shares of 1p	% of issued share capital	% of issued share capital following admission to AIM
Robert M. Post (appointed 31/07/2014)	20,000,000	45.24%	18.90%
Robert R. Hutson, Jr. (appointed 31/07/2014)	20,000,000	45.24%	18.90%
Martin K. Thomas (appointed 01/01/2015)	2,000,000	4.52%	1.9%
Bradley G. Gray (appointed 24/10/2016)	2,210,481	5.00%	2.1%

On admission to AIM on 3 February 2017, DGO appointed David E. Johnson as a Senior Independent non-executive Director. Mr. Johnson holds 50,000 ordinary shares in the Company.

Directors' remuneration

The remuneration paid to the directors (who are the key management personnel) is shown below:

For the year ended 31 December 2016:

	Note	Salaries and benefits \$'000	Director remuneration pay \$'000	Total \$'000
Robert M. Post		67	-	67
Robert R. Hutson, Jr.		122	-	122
Martin K. Thomas	(a)	-	70	70
Bradley G. Gray	(b)	405	-	405
		<u>594</u>	<u>70</u>	<u>664</u>

(a) Martin K. Thomas is a Partner at Watson Farley & Williams LLP, UK legal advisor for DGO. The total billings for 2016 totaled £418 thousand (Approx \$588 thousand).

(b) Effective 24 October 2016, DGO PLC issued 2,210,481 ordinary shares of £0.01 each to Bradley G. Gray as non-cash salary compensation. The total non-cash salary expensed related to the issuance totaled \$351 thousand.

DIVERSIFIED GAS & OIL PLC
Directors' Report

Directors' remuneration (Continued)

For the year ended 31 December 2015:

	Note	Salaries and benefits \$'000	Director remuneration pay \$'000	Total \$'000
Robert M. Post		26	-	26
Robert R. Hutson, Jr.		31	-	31
Martin K. Thomas	(a)	-	48	48
		<u>57</u>	<u>48</u>	<u>105</u>

(a) Martin K. Thomas is a Partner at Watson Farley & Williams LLP, UK legal advisor for DGO. The total billings for 2015 totaled £184 thousand (approximately \$281 thousand).

Subsequent events

Details of subsequent events can be found in note 29 to the financial statements and the future developments section of the Strategic report.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare DGO Financial Statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of DGO at the end of the financial year and of the profit or loss of DGO for that year. In preparing these Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether the applicable IFRS's as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on a going concern basis unless it is inappropriate to presume that DGO will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain DGO's transactions and disclose with reasonable accuracy the financial position of DGO and enable them to ensure that the Financial Statements comply with the Companies Act of 2006. They are also responsible for safeguarding the assets of DGO and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the website is the responsibility of the Directors. DGO is compliant with AIM Rule 26 regarding DGO's website.

The work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the information contained in the Financial Statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of the Financial Statements and other information included in annual reports may differ from legislation in other jurisdictions.

DIVERSIFIED GAS & OIL PLC
Directors' Report

Provision of information to auditors

Each of the persons who are directors at the time when this Directors' Report is approved has confirmed that:

- so far as that director is aware, there is no relevant audit information of which DGO's auditors are unaware; and
- he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information

This report was approved by the board and signed on its behalf.



Robert M. Post
Chairman of the Board

DIVERSIFIED GAS & OIL PLC
Corporate Governance Statement

Corporate governance statement

DGO's success is directly linked to sound and effective governance and we remain committed to achieving high standards in all we do. The Directors recognise the importance of sound corporate governance and have developed governance policies appropriate for the size of the group, with reference to the main provisions of the Corporate Governance Guidelines for Smaller Quoted Companies published by the Quoted Companies Alliance.

As DGO grows, the Directors and Executive Management continue to review and adjust our approach and make ongoing improvements to the Company's policies and procedures as part of building a successful and sustainable company. Good governance creates the opportunity for appropriate decisions to be made by the right people at the right time.

The Board is responsible for the direction and overall performance of DGO with emphasis on policy and strategy, financial results and major operational issues. During the year, the matters reserved for the Board's decision have been reviewed and formally documented. Specific matters for the Board's consideration include:

- Approval of DGO's strategic plan
- Review of performance of DGO's strategy, objectives, business plans and budgets
- Approval of DGO's operating and capital expenditure budgets and any material changes to them
- Material changes to DGO's corporate structure and management and control structure
- Changes to governance and business policies
- Ensuring an effective system of internal control and risk management
- Approval of half yearly and annual report and accounts and preliminary announcements of final year results
- Any changes to DGO's listing
- Reviewing the effectiveness of the Board and its Committees

The Board delegates matters not reserved for the Board to the executive management team.

Board Effectiveness, Composition and Independence of the Board

The QCA Guidelines recommend that at least one-third of Board members should be non-executive Directors. During the year ended 31 December 2016, the Board comprised an Executive Chairman, Chief Executive Officer, Finance Director and one Non-Executive Director. Subsequent to the year ended 31 December 2016 and related to DGO's IPO, DGO appointed one additional Non-Executive Director to the Board. The skills and experience of the Non-Executive Directors are wide and varied and they provide constructive challenge in the boardroom.

The Board has undertaken a formal assessment of the auditor's independence and will continue to do so at least annually. This assessment includes:

- a review of non-audit services provided to DGO and the related fees;
- a review of the auditor's own procedures for ensuring the independence of the audit firm and parties and staff involved in the audit; and
- obtaining confirmation from the auditor that, in their professional judgement, they are independent.

The Audit Committee

DGO has established an audit committee, which comprises Bradley Gray (Chairman), David Johnson and Martin Thomas. The audit committee's main functions include, inter alia, reviewing and monitoring internal financial control systems and risk management systems on which DGO is reliant, considering annual and interim accounts and audit reports, making recommendations to the Board in relation to the appointment and remuneration of DGO's auditors and monitoring and reviewing annually their independence, objectivity, effectiveness and qualifications.

DIVERSIFIED GAS & OIL PLC
Corporate Governance Statement

The Remuneration Committee

DGO has established a remuneration committee, which comprises David Johnson (Chairman), Robert Post and Martin Thomas, and meets as often as required to enable the remuneration committee to fulfill its obligations to DGO. The remuneration committee will be responsible for reviewing the performance of the Chairman and the executive directors and for setting the scale and structure of their remuneration, paying due regard to the interests of shareholders as a whole and the performance of DGO. The remuneration committee will also approve the design of and determine targets for any performance-related pay schemes operated by DGO.

Internal controls

The Board is responsible for DGO's system of internal controls and for reviewing their effectiveness. The internal controls are designed to ensure the reliability of financial information for both internal and external purposes. The Directors are satisfied that the current controls are effective with regard to the size of DGO. Any internal control system can only provide reasonable, but not absolute assurance against material misstatement or loss.

Given the size of DGO, there is currently no need for an internal audit function.

DIVERSIFIED GAS & OIL PLC
Independent Auditor's Report

Independent Auditor's Report to the Members of Diversified Gas & Oil PLC

We have audited the financial statements of Diversified Gas & Oil Plc for the year ended 31 December 2016 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Cash Flows and the related notes numbered 1 to 29.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditors

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

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- give a true and fair view of the state of the group's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion based on the work undertaken in the course of our audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Directors' Report and Strategic Report have been prepared in accordance with applicable legal requirements

Matters on which we are required to report by exception

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

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

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

DIVERSIFIED GAS & OIL PLC
Independent Auditor's Report

Other matter

We have reported separately on the parent company financial statements of Diversified Gas & Oil PLC for the year ended 31 December 2016.



Stephen Bullock
Senior Statutory Auditor
For and on behalf of

Crowe Clark Whitehill LLP

Statutory Auditor
St Bride's House
10 Salisbury Square
London EC4Y 8EH, UK

6 June 2017

DIVERSIFIED GAS & OIL PLC
Consolidated Statements of Comprehensive Income
For the year ended 31 December 2016

	Note	Year ended 31 December 2016 \$'000	Year ended 31 December 2015 \$'000
Revenue	7	18,279	6,304
Cost of sales	8	(12,767)	(4,251)
Depreciation and depletion	8	(4,039)	(3,388)
Gross profit/(loss)		1,473	(1,335)
Administrative expenses	8	(2,540)	(1,016)
Gain/(Loss) on disposal of property and equipment		34	(2)
(Loss)/Gain on derivative financial instruments		(810)	402
Gain on bargain purchase	13	24,293	6,582
Operating profit		22,450	4,631
Finance costs		(3,291)	(3,177)
Finance costs, accrued	22	-	(925)
Accretion of decommissioning provision	21	(797)	(366)
Potential initial public offering charges	10	-	(576)
Gain on debt cancellation	22	14,149	-
Income/(Loss) before taxation		32,511	(413)
Taxation on income/(loss)	9	(14,829)	-
Income/(Loss) after taxation		17,682	(413)
Other comprehensive income - Gain on foreign currency conversion		901	17
Total comprehensive income/(loss) for the year		18,583	(396)
Earnings per share – basic and diluted (US\$)	17	\$ 0.42	\$ (0.01)

DIVERSIFIED GAS & OIL PLC
Consolidated Statements of Financial Position
As at 31 December 2016

	Note	2016	2015
		\$'000	\$'000
ASSETS			
Non-current assets			
Oil and gas properties	11	76,793	42,353
Property and equipment	12	3,348	2,110
Other assets		998	414
Restricted cash	14	117	115
		<u>81,256</u>	<u>44,992</u>
Current assets			
Trade receivables	15	3,084	1,345
Derivative financial instruments	16	-	17
Other current assets	10	1,311	43
Cash and cash equivalents		224	90
		<u>4,619</u>	<u>1,495</u>
Total Assets		<u>85,875</u>	<u>46,487</u>
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	19	669	630
Share based payment reserve		313	-
Merger reserve		(478)	(478)
Retained earnings/(deficit)		8,658	(8,969)
Total Equity		<u>9,162</u>	<u>(8,817)</u>
Non-current liabilities			
Decommissioning liability	21	12,265	8,869
Capital lease	23	274	58
Borrowings	22	10,113	20,115
Deferred tax liability	9	15,148	-
Other liabilities		414	277
		<u>38,214</u>	<u>29,319</u>
Current liabilities			
Trade and other payables	24	4,627	1,749
Borrowings	22	27,181	22,821
Capital lease	23	169	115
Derivative financial instruments	16	939	-
Other liabilities		5,583	1,300
		<u>38,499</u>	<u>25,985</u>
Total Liabilities		<u>76,713</u>	<u>55,304</u>
Total Liabilities and Equity		<u>85,875</u>	<u>46,487</u>

The Notes form an integral part of these Consolidated Financial Statements.

The Financial Statements were approved by the Board of Directors on 6 June 2017 and signed on its behalf by



Robert M. Post
Chairman of the Board

DIVERSIFIED GAS & OIL PLC
Consolidated Statements of Changes in Equity
For the year ended 31 December 2016

	Note	Share capital \$'000	Share based payment reserve \$'000	Merger reserve \$'000	Retained earnings \$'000	Total equity \$'000
Balance as of 1 January 2015		611	-	(478)	(7,470)	(7,337)
Loss after taxation		-	-	-	(413)	(413)
Gain on foreign currency conversion		-	-	-	17	17
<i>Total comprehensive loss for the year</i>		-	-	-	(396)	(396)
Stockholder contributions pre-group reconstruction	20	-	-	-	1,296	1,296
Stockholder distributions pre-group reconstruction	20	-	-	-	(2,399)	(2,399)
Issuance of share capital	19	19	-	-	-	19
<i>Transactions with owners</i>		19	-	-	(1,103)	(1,084)
Balance as of 31 December 2015		630	-	(478)	(8,969)	(8,817)
Income after taxation		-	-	-	17,682	17,682
Gain on foreign currency conversion		-	-	-	901	901
<i>Total comprehensive income for the year</i>		-	-	-	18,583	18,583
Stockholder distributions pre-group reconstruction	20	-	-	-	(956)	(956)
Issuance of share capital	19	39	313	-	-	352
<i>Transactions with owners</i>		39	313	-	(956)	(604)
Balance as of 31 December 2016		669	313	(478)	8,658	9,162

DIVERSIFIED GAS & OIL PLC
Consolidated Statements of Cash Flows
For the year ended 31 December 2016

	2016	2015
	\$'000	\$'000
Cash flows from operating activities		
Income/(Loss) after taxation	17,682	(413)
<i>Cash flow from operations reconciliation:</i>		
Depreciation and depletion	4,039	3,388
Finance costs	3,291	3,177
Accretion of decommissioning provision	797	366
Loss on derivative financial instruments	957	859
Gain on oil and gas program	(84)	(344)
Deferred income taxes	14,829	-
Gain on bargain purchase	(24,293)	(6,582)
Gain on debt cancellation	(14,149)	-
(Gain)/Loss on disposal of property and equipment	(34)	2
Noncash equity grant	340	-
<i>Working capital adjustments:</i>		
Change in trade receivables	(907)	(158)
Change in other current assets	(269)	(26)
Change in other assets	(652)	(414)
Change in trade and other payables	2,662	(1,547)
Change in other liabilities	920	938
Net cash provided by/(used in) operating activities	5,129	(754)
Cash flows from investing activities		
Expenditures on oil and gas properties	(7,838)	(2,513)
Expenditures on property and equipment	(1,462)	(1,216)
Increase in restricted cash	(2)	(25)
Proceeds on disposal of oil and gas properties	93	105
Net cash used in investing activities	(9,209)	(3,649)
Cash flows from financing activities		
Proceeds from borrowings	14,915	9,311
Repayment of borrowings	(6,794)	(844)
Financing expense	(3,222)	(3,078)
Proceeds from capital lease	435	192
Repayment of capital lease	(164)	(19)
Contributions from stockholders pre-group reconstruction	-	1,296
Dividends to stockholders pre-group reconstruction	(956)	(2,399)
Net cash provided by financing activities	4,214	4,459
Net increase in cash and cash equivalents	134	56
Cash and cash equivalents - beginning of year	90	34
Cash and cash equivalents - end of year	224	90

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

1. GENERAL INFORMATION

Diversified Gas & Oil PLC (DGO) is an Appalachian Basin focused natural gas and crude oil operations company with headquarters in Birmingham, Alabama, USA. DGO was incorporated on 31 July 2014 in England and Wales as a private limited company under company number 09156132. DGO's registered office is located at 27/28 Eastcastle Street, London W1W 8DH, United Kingdom.

2. BUSINESS CONSOLIDATION

The Consolidated Financial Statements reflect the following corporate structure of DGO:

- i. Diversified Gas & Oil PLC (PLC), and its wholly owned subsidiary,
 - a. Diversified Gas & Oil Corporation (DGOC), as well as its wholly owned subsidiaries,
 - i. Diversified Resources, Inc.
 - ii. M & R Investments, LLC;
 - iii. M & R Investments Ohio, LLC;
 - iv. Marshall Gas and Oil Corporation;
 - v. R&K Oil and Gas, Inc.;
 - vi. Fund 1 DR, LLC
 - vii. Diversified Oil & Gas, LLC;
 - viii. Diversified Appalachian Group, LLC

In 2015, Robert R. Hutson, Jr. and Robert M. Post collectively transferred their common stock in DGOC to DGO. In exchange for their common stock of DGOC, Hutson and Post were collectively issued an additional 35,000,000 shares of par value £0.01 common stock in DGO, resulting in a total of 40,000,000 ordinary shares held, collectively.

3. BASIS OF PREPARATION AND ACCOUNTING POLICY

(a) Basis of Preparation and Measurement

The Consolidated Financial Statements of DGO have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), issued by the International Accounting Standards Board (IASB), including interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), and the Companies Act 2006 applicable to companies reporting under IFRS as adopted by the EU. The Consolidated Financial Statements have been prepared under the historical cost convention, as modified for any financial assets which are stated at fair value through profit or loss.

As a result of the transaction between DGO and stockholders Hutson and Post in the prior year and in accordance with IFRS 3 – Business Combinations (Revised 2008), the financial statements represent consolidated financial information of the Group (DGO Group). Therefore, although the DGO Group reconstruction did not become unconditional until 2015, the comparatives to these consolidated financial statements are presented as if the DGO Group structure has always been in place, including the activity from incorporation of DGO Group's subsidiary companies. All entities had the same management as well as majority shareholders.

In accordance with IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, in developing an appropriate accounting policy, the Directors have considered the pronouncements of other standard setting bodies and specifically looked to accounting principles generally accepted in the United Kingdom (“UK GAAP”) for guidance (Section 19 of FRS102) which does not conflict with IFRS and reflects the economic substance of the transaction.

Under UK GAAP, the assets and liabilities of all entities are recorded at book value, not fair value. Intangible assets and contingent liabilities are recognized only to the extent that they were recognized by the legal acquirer in accordance within applicable IFRS, no goodwill is recognized, any expenses of the combination are written off immediately to the income statement and comparative amounts, if applicable, are restated as if the combination had taken place at the beginning of the earliest accounting year presented.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

3. BASIS OF PREPARATION AND ACCOUNTING POLICY (continued)

(a) Basis of Preparation and Measurement (continued)

Unless otherwise stated, the financial statements are presented in US Dollars, which is the currency of the primary economic environment in which DGO operates. All values are rounded to the nearest thousand dollars except where otherwise indicated. The financial statements have been prepared under the historical cost convention, except for acquisitions and derivative financial instruments that have been measured at fair value through profit and loss.

The financial statements have been prepared on the going concern basis, which assumes that DGO will be able to meet its liabilities as they fall due for the foreseeable future.

(b) New Standards and Interpretations Not Yet Adopted

There are no new IFRSs or IFRIC interpretations that are effective for the first time for the financial year. A number of new standards and amendments to standards and interpretations have been issued but are not yet effective and in some cases have not yet been adopted by the EU. The Directors do not expect that the adoption of these standards will have a material impact on the financial statements of DGO in future years, except that IFRS 9 will impact both the measurement and disclosures of financial instruments, IFRS 15 may have an impact on revenue recognition and related disclosures and IFRS 16 will have an impact on the recognition of operating leases. At this point the Directors have yet to conclude on their assessment to provide a reasonable estimate of the effect of these standards.

4. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

DGO has made the following judgments which may have a significant effect on the amounts recognized in the consolidated audited financial information:

(a) Valuation of intangible oil and gas assets on acquisition

Proved reserves are estimated by reference to available geological and engineering data and only include volumes for which access to market is assured with reasonable certainty. Estimates of proved reserves are inherently imprecise, require the application of judgement and are subject to regular revision, either upward or downward, based on new information such as from the drilling of additional wells, observation of long-term reservoir performance under producing conditions and changes in economic factors, including product prices, contract terms or development plans. An assessment of the value of these proved reserves on acquisition is produced, considering the discounted cash flows of production to a present value ("PV"). DGO uses a discount ranging between 10% and 35% for such an acquisition, depending on the market conditions at the time of the transaction as well any additional risk factors arising in the specific transaction, to best obtain a fair value estimate of oil and gas properties.

(b) Impairment indicators for oil and gas properties

Following a review by the Directors of ongoing operational performance of DGO's natural gas and crude oil properties for the year ending 31 December 2016, the Directors are of the opinion that no impairment indicators are apparent for these assets.

(c) Reserve estimates

Reserves are estimates of the amount of natural gas and crude oil product that can be economically and legally extracted from DGO's properties. To calculate the reserves, estimates and assumptions are required about a range of geological, technical and economic factors, including quantities, production techniques, recovery rates, production costs, transport costs, commodity demand, commodity prices and exchange rates.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

4. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)

(c) Reserve estimates (continued)

Estimating the quantity and/or grade of reserves requires the size, shape and depth of fields to be determined by analyzing geological data, such as drilling samples. This process may require complex and difficult geological judgments and calculations to interpret the data. The Directors have engaged third-party engineers who are considered experts and have extensive experience in oil and gas engineering, with focus in the Appalachian Basin of the US.

Given the economic assumptions used to estimate reserves change from year to year and, because additional geological data is generated during the course of operations, estimates of reserves may change from time to time.

Changes in reported reserves may affect DGO's financial results and financial position in the following ways:

- asset carrying values may be affected by possible impairment due to adverse changes in estimates future cash flows; and
- depreciation, depletion and amortization charged in the statement of comprehensive income may change where such charges are determined by the units of production basis, or where the useful economic lives of assets change.

(d) Decommissioning costs

These costs will be incurred by DGO at the end of the operating life of some of DGO's properties. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established which would affect future financial results.

(e) Income taxes

As a result of multiple stock share contributions (see note 2 regarding share contributions) and effective tax year 2016, all wholly owned subsidiaries lost their pass-through tax status and are subject to U.S. federal and state income tax. DGO began filing a consolidated U.S. federal income tax return and separate company state tax returns for years beginning after 31 December 2015. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related to differences between the cost basis of assets and liabilities for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be deductible or taxable when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future federal income taxes. DGO accounts for any interest and penalties related to IRS assessments as income tax expenses.

(f) Going Concern

The financial statements have been prepared on the going concern basis, which contemplates the continuity of normal business activity and the realization of assets and the settlement of liabilities in the normal course of business.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

4. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)

(f) Going Concern (continued)

Subsequent to the year end, DGO completed a recapitalization process through an initial public offering, which the Directors consider is a substantial event in the going concern outlook (see Note 29 regarding events after the reporting period). The Directors have reviewed DGO's overall position and outlook and are of the opinion that DGO is sufficiently well funded to be able to operate as a going concern for at least the next twelve months from the date of approval of these financial statements. The Directors believe that the use of the going concern basis is appropriate. Accordingly, the Directors have prepared the financial statements on a going concern basis.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of the Consolidated Financial Statements in compliance with IFRS as adopted by the EU requires the Directors to exercise judgment in applying DGO's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the Consolidated Financial Statements are disclosed in Notes 4 and 5 to these Consolidated Financial Statements.

(a) Cash

Cash on the balance sheet comprises cash at banks. Balances held at banks, at times, exceed federally insured amounts. DGO has not experienced any losses in such accounts and the Directors believe DGO is not exposed to any significant credit risk on its cash.

For the purpose of the Consolidated Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

(b) Trade receivables

Trade receivables are stated at the historical carrying amount, net of any provisions required. Trade receivables are due from customers throughout the oil and natural gas industry. Although diversified among several companies, collectability is dependent on the financial condition of each individual company as well as the general economic conditions of the industry. The Directors review the financial condition of customers prior to extending credit and generally do not require collateral to support of DGO's trade receivables. Any changes in the Directors' provision for un-collectability of trade receivables during the year is recognized in the Statement of Comprehensive Income.

(c) Derivative financial instruments

Derivatives are used as part of the Directors' overall strategy to mitigate risk associated with the unpredictability of cash flows due to volatility in commodity prices. Further details of DGO's exposure to these risks are detailed in note 26. DGO has entered into financial instruments which are considered derivative contracts, such as swaps and collars which result in net cash settlement each month and do not result in physical deliveries. The derivative contracts are initially recognized at fair value at the date contract is entered into and remeasured to fair value every balance sheet date. The resulting gain or loss is recognized in the Statement of Comprehensive Income in the year incurred.

(d) Restricted cash

Cash held for bonding purposes is classified as restricted cash and recorded within non-current assets.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Pre-license costs

Pre-license costs are expensed in the year in which they are incurred.

(f) Exploration and evaluation costs

DGO follows IFRS 6 in accounting for oil and gas assets. Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the Statement of Comprehensive Income. Only material expenditures incurred after the acquisition of a license interest are capitalized. Historically, the expenditures have not been deemed material, as DGO drills in active areas where there are minimal and immaterial exploration and evaluation costs and therefore the cost has been expensed.

(g) Development costs

Expenditures on the construction, installation or completion of infrastructure facilities, such as platforms and pipelines, and the drilling of development wells, including delineation wells, are capitalized within oil and gas properties.

(h) Oil and gas properties and property and equipment

Oil and gas properties and property and equipment are stated at cost, less accumulated depletion/depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning obligation, for qualifying assets, and borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalized value of a finance lease is also included within property and equipment.

(i) Depreciation and depletion

Oil and gas properties are depleted on a unit-of-production basis over the proved reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proven reserves of the relevant area. The unit-of-production rate for the depreciation of field development costs considers expenditures incurred to date, together with sanctioned future development expenditure. Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses, if any. The cost of an item of property, plant and equipment initially recognized includes its purchase price and any cost that is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Property, plant and equipment are generally depreciated on a straight-line basis over their estimated useful lives:

Drilling costs and equipment:	7 - 15 years
Buildings and leasehold improvements:	10 - 39 years
Motor vehicles:	5 - 7 years
Other property and equipment:	3 - 5 years

Property and equipment held under finance leases are depreciated over the shorter of lease term and estimated useful life.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Major maintenance and repairs

Expenditures on major maintenance refits or repairs comprise the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated and is now written off is replaced, and it is probable that future economic benefits associated with the item will be generated, the expenditure is capitalized. Where part of the asset was not separately considered as a component, the replacement value is used to estimate the carrying amount of the replaced assets which are immediately written off. Inspection costs associated with major maintenance programs are capitalized and amortized over the year to the next inspection. All other maintenance costs are expensed as incurred.

(k) Impairment of non-financial assets

The Directors assess at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Directors estimate the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value-in-use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, recent market transactions are considered, if available. If no such transactions can be identified, an appropriate valuation model is used.

The Directors base impairment calculations on detailed forecast calculations which are prepared separately for each of DGO's cash-generating units to which the individual assets are allocated. These forecast calculations are generally covering a period of three to five years.

Impairment losses of continuing operations are recognized in the Statement of Comprehensive Income in those expense categories consistent with the function of the impaired asset.

(l) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date: whether fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

(m) Decommission liability

Where a material liability for the removal of production equipment and site restoration at the end of the production life of a well exists, a liability for decommissioning is recognized. The amount recognized is the present value of estimated future net expenditures determined in accordance with local conditions and requirements. The unwinding of the discount on the decommissioning liability is included as accretion of the decommissioning provision. The cost of the relevant property, plant and equipment asset is increased with an amount equivalent to the liability and depreciated on a unit of production basis. Changes in estimates are recognized prospectively, with corresponding adjustments to the liability and the associated non-current asset.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Deferred taxation and Income taxes

Deferred taxation

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and expected to apply when the related deferred tax is realized or the deferred liability is settled.

Deferred tax assets are recognized to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilized.

Income taxes

Current income tax assets and liabilities for the year ended 31 December 2016 are measured at the amount to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date in the jurisdictions where DGO operates and generates taxable income.

In the year ended 31 December 2015, DGO consisted of pass-through taxable entities for all federal and state jurisdictions, thus no current income tax asset or liability existed.

(o) Revenue recognition

Natural gas and crude oil

Revenue from sales of natural gas and crude oil products is recognized when the significant risks and rewards of ownership have been transferred, which is when title transfers to the customer. This transfer generally occurs when product is physically transferred into a vessel, pipe, sales meter or other delivery mechanism.

Revenue from the production of oil in which DGO has an interest with other producers is recognized based on DGO's working interest and the terms of the relevant production sharing contracts.

Operator revenue

Revenue from the operation of third-party wells is recognized as earned in the month work is performed and consistent with DGO's contractual obligations.

Oil & gas program revenue

Revenue from sales of working interest ownership in DGO's operated wells is recognized as earned in the month the ownership transfers to or from the third-party working interest investors.

Water disposal revenue

Revenue from the sale of water disposal services to third-parties into DGO's disposal well is recognized as earned in the month the water was physically disposed.

Revenue is stated after deducting sales taxes, production taxes, excise duties and similar levies.

(p) Functional currency and foreign currency translation

The financial statements are presented in United States Dollars ("USD"), which is the functional currency of DGO. Items included in DGO's standalone parent company financial statements are measured using Pounds Sterling ("£"), which is the currency of the primary economic environment in which it operates.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Functional currency and foreign currency translation (continued)

The results and financial position of all DGO entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each Statement of Financial Position presented are translated at the closing rate at the date of that Statement of Financial Position;
- income and expenses for each Statement of Comprehensive Income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognized in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of monetary items receivable from foreign subsidiaries for which settlement is neither planned nor likely to occur in the foreseeable future are recognized in other comprehensive income.

(q) Segmental reporting

DGO operates as one reportable segment that produces natural gas and crude oil in the Appalachian Basin of the United States of America. An operating segment is a component of DGO that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of DGO's other components. An operating segment's operating results are reviewed regularly by the executive managers to make decisions about resources to be allocated to the segment and assess its performance.

6. CHANGE TO SIGNIFICANT ACCOUNTING ESTIMATES

In accordance with IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, the Directors of DGO have made the following change in estimate, which created an adjustment in the carrying amounts of the applicable accounts.

(a) Decommissioning costs

These costs will be incurred by DGO at the end of the operating life of some of DGO's properties. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Thus, there could be significant adjustments to the provisions established which would affect future financial results.

For the year ended 31 December 2016, DGO's reserve report reflected a longer operating life for all oil and gas properties than what the original decommissioning provision calculated. As a result of a longer operating life, the decommissioning provision will be depreciated and accreted over a 30-year period, rather than a shorter period that was estimated through 2015.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

6. CHANGE TO SIGNIFICANT ACCOUNTING ESTIMATES (continued)

(a) Decommissioning costs (continued)

The impact of the change in estimate on the consolidated and future years' comprehensive income is as follows:

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>Later</u>
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Increase (Decrease) in depreciation, depletion and amortization	(316)	(273)	(249)	(224)	(201)	(1,667)
Increase (Decrease) in accretion expense	(234)	(253)	(273)	(295)	(319)	9,961

As a result of the estimate change, the asset retirement obligation asset, included in oil and gas properties and the decommissioning liability were reduced by \$2.9 million, respectively.

7. REVENUE

	<u>2016</u>	<u>2015</u>
	\$'000	\$'000
Natural gas and crude oil revenue	14,878	4,738
Operator revenue	1,209	825
Oil and gas program revenue	1,573	344
Water disposal revenue	619	397
Total revenue	<u>18,279</u>	<u>6,304</u>

DGO extracts and sells natural gas and crude oil to various customers. DGO also operates oil and natural gas wells for customers and other working interest owners. A significant portion of DGO's trade receivables represent receivables related to either sales of oil and natural gas or operational services. Oil and natural gas trade receivables are generally uncollateralized. There was no provision for uncollectability of trade receivables at 31 December 2016 (2015: \$5 hundred). No other debts were past due or impaired as at each of these dates.

During the year ended 31 December 2016, three customers individually totaled more than 10% of total revenues, totaling 21%, 18% and 10% (2015: two customers, 23% and 17%). All revenues were generated in the United States of America.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

8. EXPENSES BY NATURE

	2016	2015
	\$'000	\$'000
Automobile	776	389
Employees and benefits	4,496	2,047
Insurance	162	240
Well operating expenses	7,333	1,575
Total cost of sales	12,767	4,251
Depreciation	756	309
Depletion	3,283	3,079
Total depreciation and depletion	4,039	3,388
Acquisition costs	838	293
Employees and benefits	713	169
Other administrative	301	190
Professional fees	272	205
Auditors' remuneration		
Audit of parent	34	31
Audit of group	247	38
Total Auditors' remuneration	281	69
Other fees payable to auditors	42	9
Rent	93	81
Total administrative expenses	2,540	1,016
Total expenses	19,346	8,655
	2016	2015
	\$'000	\$'000
Aggregate remuneration (including Directors):		
Wages and salaries	3,871	1,723
Payroll taxes	278	150
Benefits	1,060	343
Total employees and benefits expense	5,209	2,216
The average monthly number of employees was as follows:	74	39

Wages and salaries in 2016 reflect an equity grant of \$340 thousand, the addition of DGO's two principal shareholders' salaries in the fourth quarter of 2016 and the inclusion of one-time retention salaries related to the Eclipse acquisition transition.

Details of the Directors' remunerations can be found in the Directors' Report.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

9. TAXATION

For taxable year ending 31 December 2016, all DGO subsidiaries lost their pass-through tax status, are subject to U.S. federal and state income tax and began filing a consolidated U.S. federal income state tax return and separate company state tax returns due to the 2015 share contribution. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related to differences between the basis of assets and liabilities for financial and income tax reporting.

The provision for income taxes for the years ended 31 December 2016 and 2015 in the Statements of Comprehensive Income are summarized below:

	<u>2016</u>	<u>2015</u>
	<u>\$'000</u>	<u>\$'000</u>
Current income tax expense		
Federal	-	-
State	-	-
Total current income tax expense	-	-
Deferred income tax expense		
Federal	13,168	-
State	1,661	-
Total deferred income tax expense	14,829	-
Total income tax expense	<u>14,829</u>	<u>-</u>

The components of the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	<u>2016</u>	
	<u>\$'000</u>	<u>%</u>
Expected tax at statutory US Federal income tax rate	11,054	34.0%
Increase (decrease) in tax resulting from:		
State income taxes, net of federal tax benefit	258	0.8%
Book income of acquisitions prior to acquisition date	(7,968)	(24.5%)
Prior year effect of change in tax status for tax year 2016	11,342	34.9%
Other - net	144	0.4%
	<u>14,829</u>	<u>45.6%</u>

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9. TAXATION (Continued)

As a result of DGO's primary two shareholders contributing their capital stock to DGOC, the DGO subsidiaries lost their pass-through status (see Note 2). The deferred tax liability related to temporary differences at the date of the share transfer was established through a charge of \$11.3 million to the income tax provision for the year.

At 31 December 2016, DGO has available \$4.4 million in estimated unused federal and state net operating loss carryforwards that may be applied against future taxable income and that expire through 2036.

The components of the net deferred income tax liability included in noncurrent liabilities are as follows:

	2016	2015
	\$'000	\$'000
Deferred tax assets		
Decommissioning provision, asset	4,696	-
Derivative adjustment	360	-
Net operating loss carryforward	1,677	-
Total deferred tax assets	6,733	-
Deferred tax liabilities		
Depreciation	(21,562)	-
Foreign currency translation adjustment	(319)	-
Total deferred tax liabilities	(21,881)	-
Net deferred tax liability	(15,148)	-

For U.S. federal tax purposes, DGO is taxed as one consolidated entity, which includes its parent company, PLC. PLC is subject to additional taxes in its home jurisdiction of the United Kingdom. For the years ended 31 December 2016 and 2015, PLC did not incur any income tax liability in the United Kingdom.

10. POTENTIAL INITIAL PUBLIC OFFERING CHARGES

Beginning in 2014, DGO explored the potential of an initial public offering (IPO). Costs associated with the potential IPO included professional fees paid to legal counsel, accountants, and financial advisers, totaling \$576 thousand. During the year ended 31 December 2015, Directors concluded that due to a low commodity pricing environment it was more favourable to pursue debt financing through a bond market which resulted in all accumulated costs being expensed.

For the year ended 31 December 2016, included in other current assets is \$755 thousand related to costs incurred for DGO's AIM IPO that completed on 3 February 2017. This amount was charged to Share Based Payment Reserve in February 2017.

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11. OIL AND GAS PROPERTIES

	\$'000
Cost at 31 December 2014	42,527
Additions	14,472
Disposals	<u>(340)</u>
Cost at 31 December 2015	56,659
Additions	41,077
Disposals	<u>(3,128)</u>
Cost at 31 December 2016	<u><u>94,608</u></u>
Accumulated depletion and impairment at 31 December 2014	(11,471)
Charge for the year	(3,079)
Disposals	<u>244</u>
Accumulated depletion and impairment at 31 December 2015	(14,306)
Charge for the year	(3,553)
Disposals	<u>44</u>
Accumulated depletion and impairment at 31 December 2016	<u><u>(17,815)</u></u>
Net book value at 31 December 2015	<u><u>42,353</u></u>
Net book value at 31 December 2016	<u><u>76,793</u></u>

Producing property depletion, drilling cost depreciation and the amortization of intangible drilling costs have been charged to depreciation for the year ended 31 December 2016 in the amount of \$3.6 million (2015: \$3.1 million).

At 31 December 2015, the net book value of oil and gas properties includes immaterial amounts of development assets under construction which are not being depleted.

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12. PROPERTY AND EQUIPMENT

	Land, buildings, leasehold improvements	Automobiles	Other property and equipment	Total
	\$'000	\$'000	\$'000	\$'000
Cost at 31 December 2014	384	958	964	2,306
Additions	428	347	441	1,216
Disposals	-	(10)	(7)	(17)
Cost at 31 December 2015	812	1,295	1,398	3,505
Additions	291	986	515	1,792
Disposals	-	-	(74)	(74)
Cost at 31 December 2016	1,103	2,281	1,839	5,223
Accumulated depreciation at 31 December 2014	(29)	(489)	(577)	(1,095)
Charge for the year	(10)	(170)	(129)	(309)
Disposals	-	8	1	9
Accumulated depreciation at 31 December 2015	(39)	(651)	(705)	(1,395)
Charge for the year	(19)	(286)	(181)	(486)
Disposals	-	-	6	6
Accumulated depreciation at 31 December 2016	(58)	(937)	(880)	(1,875)
Net book value at 31 December 2015	773	644	693	2,110
Net book value at 31 December 2016	1,045	1,344	959	3,348

13. BUSINESS ACQUISITIONS

The assets acquired in all acquisitions include the necessary permits, rights to production, royalties, contracts and agreements that support the production from the wells. The acquisitions have been accounted for as a business acquisition under IFRS 3. See note 4(a) detailing the valuation of intangible oil and gas assets on acquisition.

The acquisitions gave rise to bargain purchases due to the prevailing market conditions in the Appalachian basin, the context of global oil and gas prices and a change in the operational focus of the sellers compelling these sellers to divest of their conventional oil and gas assets.

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13. BUSINESS ACQUISITIONS (continued)

Eclipse Resources Acquisition

In April 2016, DGO acquired 1,300 conventional natural gas and oil wells in Ohio and equipment from Eclipse Resources. The purchase consideration totaling \$4.8 million, comprised of cash of \$1.3 million and a short-term note payable of \$3.5 million. Management considered the fair value of the reserves held in the assets acquired to be \$11.8 million, which was the 30% cumulative cash flow discount reserve valuation derived from a third-party engineer at the time of purchase. The estimated fair values of the assets and liabilities assumed were as follows:

	\$'000
Oil and gas properties	11,774
Oil and gas properties (Decommissioning provision, asset portion)	2,443
Equipment	757
Decommissioning liability	(2,443)
Other liabilities, long term (suspended royalties and customer deposits)	(89)
Gain on bargain purchase	(7,642)
Purchase price	4,800

Since acquisition the assets acquired have generated \$5.4 million to DGO's revenues.

Seneca Resources Corporation Acquisition

In June 2016, DGO acquired 2,200 conventional natural gas and oil wells in Pennsylvania from Seneca Resources Corporation. The purchase consideration comprised of cash financed by a short-term note payable of \$3.6 million and an interest free obligation to the seller of \$3.5 million. Management considered the value of the reserves held in the assets acquired was \$23.6 million which approximated the 35% cumulative cash flow discount reserve valuation derived from a third-party engineer at the time of purchase. The estimated fair values of the assets and liabilities assumed were as follows:

	\$'000
Oil and gas properties	23,620
Oil and gas properties (Decommissioning provision, asset portion)	4,249
Decommissioning liability	(4,249)
Gain on bargain purchase	(16,570)
Purchase price	7,050

Since acquisition the assets acquired have generated \$3.2 million to DGO's revenues.

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13. BUSINESS ACQUISITIONS (Continued)

Broadstreet Energy Acquisition

In July 2015, DGO acquired 732 conventional natural gas and oil wells in Ohio from Broadstreet Energy. The purchase consideration totaling \$2.6 million, comprised of cash of \$600 thousand and a short-term note payable of \$2.0 million. Management considered the fair value of the reserves held in the assets acquired to be \$3.3 million, which was the 10% cumulative cash flow discount reserve valuation derived from a third-party engineer at the time of purchase. The estimated fair values of the assets and liabilities assumed were as follows:

	\$'000
Oil and gas properties	3,253
Oil and gas properties (Decommissioning provision, asset portion)	2,919
Decommissioning liability	(2,919)
Gain on bargain purchase	(653)
Purchase price	2,600

Subsequent to the initial recording, the decommissioning provision and liability have both been reduced by \$1.3 million (see Note 6 – Change to Significant Accounting Estimates).

Since acquisition the assets acquired have generated \$1.8 million and \$749 thousand to DGO's revenues in years ending 2016 and 2015, respectively.

Texas Keystone, Inc. Acquisition

In November 2015, DGO acquired 1,709 conventional natural gas and oil wells and two buildings in Pennsylvania and West Virginia, equipment and automobiles from Texas Keystone, Inc. The purchase consideration comprised of a short-term payable of \$725 thousand. Management considered the value of the reserves held in the assets acquired to be \$5.7 million which was the 30% cumulative cash flow discount reserve valuation derived from a third-party engineer at the time of purchase. The estimated fair values of the assets and liabilities assumed were as follows:

	\$'000
Oil and gas properties	5,728
Oil and gas properties (Decommissioning provision, asset portion)	2,178
Buildings	428
Equipment	380
Automobiles	282
Capital lease obligation	(164)
Decommissioning liability	(2,178)
Gain on bargain purchase	(5,929)
Purchase price	725

Subsequent to the initial recording, the decommissioning provision and liability have both been reduced by \$657 thousand (see Note 6 – Change to Significant Accounting Estimates).

Since acquisition the assets acquired have generated \$4.0 million and \$1.1 million to DGO's revenues in years ending 2016 and 2015, respectively.

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14. RESTRICTED CASH

Restricted cash is cash held on deposit and restricted in use by state governmental agencies to be utilized and drawn upon by those state agencies if the operator should abandon any wells. These deposit requirements are different by state.

	2016	2015
	\$'000	\$'000
Restricted cash	117	115
Total	117	115

15. TRADE RECEIVABLES

	2016	2015
	\$'000	\$'000
Trade receivables	3,084	1,345
Total	3,084	1,345

All trade receivables are currently due and DGO believes these receivables to be collectible.

16. DERIVATIVE FINANCIAL INSTRUMENTS

The following table summarizes DGO's derivative agreements and calculated fair value of such agreements:

Contract Type	Remaining Volumes	Ending Month	Swap Price	Floor Price	Short Put Price	Ceiling Price	Mark to Market	
							2016	2015
							\$'000	\$'000
Natural Gas Derivatives								
Swap	-	June 2016	\$2.39	-	-	-	-	(88)
Swap	535,000 MMBTUs	October 2017	\$3.38	-	-	-	(99)	-
Two-Way Collar	270,000 MMBTUs	March 2017	-	\$3.35	-	\$3.87	(15)	-
Two-Way Collar	225,000 MMBTUs	March 2017	-	\$3.25	-	\$3.81	(20)	-
Two-Way Collar	152,500 MMBTUs	December 2017	-	\$3.25	-	\$3.75	(24)	-
Three-Way Collar	1,642,500 MMBTUs	December 2017	-	\$2.50	\$3.00	\$3.48	(470)	-
Three-Way Collar	1,237,000 MMBTUs	December 2017	-	\$2.80	\$3.30	\$3.37	(156)	-
Crude Oil Derivatives								
Swap	-	December 2015	\$90.07	-	-	-	-	105
Two-Way Collar	7,600 BBLs	December 2016	-	\$43.00	-	\$52.00	(1)	-
Two-Way Collar	60,955 BBLs	December 2017	-	\$50.00	-	\$58.70	(68)	-
Three-Way Collar	45,600 BBLs	December 2017	-	\$37.00	\$47.00	\$59.00	(86)	-
Total derivative financial instrument							(939)	17

The fair values of the natural gas derivative contracts are valued at the NYMEX Henry Hub Final Settlement index at the last trading day of each month.

The fair values of the crude oil derivative contracts are valued at the monthly average of the NYMEX – WTI Futures index.

The closed monthly settlements and the change in the fair value of all derivative agreements from period to period are recorded together in the Statement of Comprehensive Income.

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17. EARNINGS PER SHARE

The calculation for earnings per share (basic and diluted) for the relevant year is based on the comprehensive income/(loss) after income tax attributable to equity holders for the years ended on 31 December 2016 and 2015 as follows:

	2016	2015
Income/(Loss) after taxation (\$)	17,682,000	(413,000)
Weighted average number of Ordinary Shares	42,010,690	40,100,000
Earnings per ordinary share	\$ 0.42	\$ (0.01)

Diluted loss per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of other equity instruments. There were no potentially dilutive ordinary shares in issue as of 31 December 2016 and 2015.

18. ADJUSTED EBITDA

Adjusted EBITDA is a non-IFRS financial measure, which is of particular interest to the industry and Directors, as it is essentially the cash generated from operations that DGO has free for interest payments and capital investment. Adjusted EBITDA should not be considered as an alternative to operating profit (loss), comprehensive income, cash flow from operating activities or any other financial performance or liquidity measure presented in accordance with IFRS. Adjusted EBITDA is a non-IFRS financial measure that is defined as comprehensive income (loss) plus or minus:

- finance costs, including accrued finance costs and deferred financing costs;
- depreciation and depletion
- gain on bargain purchase;
- net gains or losses on the valuation of commodity derivative contracts;
- net gains or losses on foreign currency translation;
- net gains or losses on disposal of property and equipment;
- acquisition related costs
- other material non-cash costs

	2016	2015
	\$'000	\$'000
Operating profit	22,450	4,631
Gain on bargain purchase	(24,293)	(6,582)
(Gain)/Loss on disposal of property and equipment	(34)	2
Fair value movement on open derivatives	957	859
Depreciation and depletion	4,039	3,388
Non-cash equity grant included in administrative expenses	340	-
Acquisition costs	838	293
Adjusted EBITDA	4,297	2,591

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19. SHARE CAPITAL

	Note	Number of shares	Total Share capital \$'000
Balance as of 31 December 2014		40,000,000	611
Issuance – Martin Thomas	(a)	1,200,000	19
Balance as of 31 December 2015		41,200,000	630
Issuance – Martin Thomas	(b)	800,000	12
Issuance – Bradley Gray	(c)	2,210,481	27
Balance as of 31 December 2016		44,210,481	669

- (a) Effective 2 December 2015, DGO PLC issued 1,200,000 ordinary shares of £0.01 each to Martin K. Thomas.
- (b) Effective 1 July 2016, DGO PLC issued 800,000 ordinary shares of £0.01 each to Martin K. Thomas.
- (c) Effective 24 October 2016, DGO PLC issued 2,210,481 ordinary shares £0.01 each to Bradley G. Gray as non-cash salary compensation. These shares are subject to a vesting schedule over three years.

20. STOCKHOLDER CONTRIBUTIONS AND DISTRIBUTIONS PRE-GROUP RECONSTRUCTION

	Note	2016 \$'000	2015 \$'000
Stockholder contributions			
Cash from Robert R. Hutson, Jr. and Robert M. Post	(a)	-	1,296
Stockholder distributions			
Cash to Robert R. Hutson, Jr. and Robert M. Post		956	2,399

- (a) Stockholder contributions are injections of working capital provided by stockholders. These contributions have no conditions and are distributable, therefore they have been recognized directly to retained earnings.

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21. DECOMMISSIONING LIABILITY

DGO's decommissioning liability represents the present value of decommissioning costs relating to oil and gas properties, which are expected to be incurred up to 2046, which is when the producing oil and gas properties, on average, are expected to cease operations. These provisions have been created based on the Directors' estimates. Assumptions are based on the current economic environment and the Directors believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to consider any material changes to the assumptions (see Note 6 regarding change of decommissioning estimate). Actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning works required. The timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates.

The discount rate used in the calculation of the decommissioning liability at each of 31 December 2016 and 2015 was 8.0%.

The cost of inflation rate used in the calculation of the decommissioning liability at each of 31 December 2016 and 2015 was 3.0%.

	\$'000
Liability at 31 December 2014	3,466
Additions	5,377
Accretion	366
Disposals	(340)
	8,869
Liability at 31 December 2015	8,869
Additions	5,457
Accretion	797
Disposals	(4)
Change of estimate effect (See Note 6 regarding change of decommissioning estimate)	(2,854)
	12,265
Liability at 31 December 2016	12,265

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22. BORROWINGS

Borrowings as of 31 December 2016 and 2015 consist of the following amounts:

	2016	2015
	\$'000	\$'000
Financing companies and institutions, with interest rates ranging from 4.19% to 9.29%, maturing June 2017 through to October 2020, secured by automobiles.	277	305
Financial institution, with interest rate of 3.25%, matured December 2016, secured by oil and gas assets. In Q1 2017, paid in full with IPO proceeds.	15,768	16,218
Note payable – unsecured revolving line of credit of up to \$50,000, with a rate of 9.99%, with an annual renewal term.	11	33
Note payable, mezzanine lender, with interest rate of 12.00%, maturing January 2018, secured by a lien on oil and gas assets.	-	14,771
Financial institution, with interest rates ranging from 5.00%-6.90%, maturing July 2017 through to December 2020, secured by buildings.	88	113
Note payable – financial institution, with interest rate of 4.00%, matured August 2016, secured by oil and gas properties. In Q1 2017, paid in full with IPO proceeds.	3,165	3,285
Note payable - individual, with interest of 6.00%, maturing March 2016, unsecured.	220	420
Notes payable - individuals, with interest of 8.00%, maturing September 2017, unsecured.	98	116
Note payable – unsecured revolving line of credit of up to \$1,000,000, with a rate of Wall Street Journal Prime Rate plus 2.00% rounded to the nearest 0.125%, having a floor of 6.00% and a ceiling of 18.00%, with an annual renewal term.	659	17
Note payable - business institution, no interest rate, matured, remaining balance owed on building properties acquired, unsecured	-	725
Note payable – financial institution, with interest rate of Wall Street Journal Prime Rate plus 0.50%, maturing July 2017, secured by oil and gas properties.	2,000	2,000
Bonds payable - individuals and institutional investors, with interest of 8.5%, maturing June 2020, unsecured. In Q1 2017, 99% of bonds were repaid with IPO proceeds.	13,928	6,375

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22. BORROWINGS (Continued)	2016	2015
	\$'000	\$'000
Bonds payable - individuals and institutional investors, with interest of 8.5%, maturing June 2020, unsecured. In Q1 2017, 99% of bonds were repaid with IPO proceeds.	13,928	6,375
Notes payable – financing companies, with interest rates ranging from 10%-12%, maturing September 2016 through to November 2016, secured by oil and gas properties. In Q1 2017, paid in full with IPO proceeds.	4,750	-
Notes payable - individuals, with interest of 8.5%, maturing September 2016, unsecured	236	-
Note payable - business institution, no interest rate, matured, remaining balance owed on acquisition post-closing settlements, unsecured	139	-
Total Borrowings	41,339	44,378

For all borrowings with maturities prior to 31 December 2016, DGO received waivers or consents from the respective lenders.

Borrowings payable as at each of 31 December 2016 and 2015 consist of the following:

	2016	2015
	\$'000	\$'000
Total borrowings	41,339	44,378
Less current portion of long-term debt	(27,181)	(22,821)
Less deferred financing costs (see below)	(4,045)	(2,367)
Plus accrued finance costs (see below)	-	925
Total non-current borrowings, net	10,113	20,115

During the year ended 2015, the mezzanine lender had introduced settlement terms which were finalized in March 2016. Outstanding borrowings of \$14.8 million and accrued finance charges of \$925 thousand were settled in exchange for an immediate payment of \$950 thousand. The remaining balance, net of expenses, is recognized as a gain on debt settlement totaling \$14.1 million.

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22. BORROWINGS (Continued)

Deferred financing costs as of 31 December 2016 and 2015 consist of the following amounts:

	\$'000
Deferred financing costs at 31 December 2014	1,713
Additions	1,439
Charge	(402)
Potential initial public offering cost expensed (see note 10)	(392)
Foreign currency translation adjustment	9
Deferred financing costs at 31 December 2015	2,367
Additions	3,165
Acceleration of charge at debt payoff	(336)
Charge	(825)
Foreign currency translation adjustment	(326)
Deferred financing costs at 31 December 2016	4,045

Subsequent to 31 December 2016, all deferred financing costs were expensed when applicable borrowings were paid in full with IPO proceeds.

Future maturities of the long-term notes payable as of 31 December 2016 and 2015 are as follows:

	2016	2015
	\$'000	\$'000
Not later than one year	27,181	22,821
Later than one year and not later than five years	14,158	21,557
Later than five years	-	-
	41,339	44,378

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23. LEASES

DGO leased automobiles, equipment and real estate under both operating and capital leases as of 31 December 2016 and 2015. A summary of this activity is as follows:

(a) Capital leases

Through an acquisition in 2015, DGO has acquired existing finance lease obligations for automobiles. The net book value of these assets financed with these leases as of 31 December 2016 was \$556 thousand (2015: \$254 thousand). The interest rate is 5.50%, maturing 2017 January through to 2020 November.

Future minimum lease payments associated with capital leases at 31 December 2016 were as follows:

	\$'000
Not later than one year	169
Later than one year and not later than five years	274
Later than five years	-
Total minimum lease payments	443
Less amount representing interest	(39)
Present value of minimum lease payments	404

Future minimum lease payments associated with capital leases at 31 December 2015 were as follows:

	\$'000
Not later than one year	115
Later than one year and not later than five years	58
Later than five years	-
Total minimum lease payments	173
Less amount representing interest	(15)
Present value of minimum lease payments	158

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23. LEASES (Continued)

(b) Operating leases

DGO leases both equipment and real estate under leases classified as operating, under multi-year agreements. During the year ended 31 December 2016, total expense under operating leases was \$126 thousand (2015: \$85 thousand).

Future minimum lease payments associated with operating leases with original terms of greater than one year at 31 December 2016 were as follows:

	\$'000
Not later than one year	123
Later than one year and not later than five years	410
Later than five years	1,466
Total future minimum lease payments	1,999

Future minimum lease payments associated with operating leases with original terms of greater than one year at 31 December 2015 were as follows:

	\$'000
Not later than one year	91
Later than one year and not later than five years	24
Later than five years	-
Total future minimum lease payments	115

Operating leases between related parties are detailed at Note 28.

24. TRADE AND OTHER PAYABLES

	2016	2015
	\$'000	\$'000
Trade payables	3,439	1,610
Other payables and accruals	1,188	139
	4,627	1,749

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25. FAIR VALUE

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal marked (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, DGO utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. IFRS 13 "Fair Value Measurement" establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is defined as follows:

Level 1: Inputs are unadjusted, quoted prices in active markets for identical assets at the measurement date.

Level 2: Inputs (other than quoted prices included in Level 1) can include the following:

- (a) observable prices in active markets for similar assets;
- (b) prices for identical assets in markets that are not active;
- (c) directly observable market inputs for substantially the full term of the asset; and
- (d) market inputs that are not directly observable but are derived from or corroborated by observable market data.

Level 3: Unobservable inputs which reflect the Director's best estimates of what market participants would use in pricing the asset at the measurement date.

DGO does not hold derivatives for speculative or trading purposes and the derivative contracts held by DGO do not contain any credit-risk related contingent features. The Directors have not elected to apply hedge accounting to derivative contracts.

Netting the fair values of derivative assets and liabilities for financial reporting purposes is permitted if such assets and liabilities are with the same counterparty and a legal right of set-off exists, subject to a master netting arrangement. The Directors have elected to present derivative assets and liabilities net when these conditions are met. When derivative assets and liabilities are presented net, the fair value of the right to reclaim collateral assets (receivable) or the obligation to return cash collateral (payable) is also offset against the net fair value of the corresponding derivative. As at each of 31 December 2016 and 2015, there were no collateral assets or liabilities associated with derivative assets and liabilities.

Derivatives expose DGO to counterparty credit risk. The derivative contracts have been executed under master netting arrangements which allow DGO, in the event of default by its counterparties, to elect early termination. The Directors monitor the creditworthiness of DGO's counterparties but are not able to predict sudden changes and hence may be limited in their ability to mitigate an increase in credit risk.

Possible actions would be to transfer DGO's positions to another counterparty or request a voluntary termination of the derivative contracts, resulting in a cash settlement in the event of non-performance by the counterparty. For each of the fiscal years ended 31 December 2016 and 2015, the counterparties for all DGO's derivative financial instruments were lenders under formal credit agreements.

The derivative instruments consist of non-financial instruments considered normal purchases and normal sales. As such, significant fair values inputs can generally be verified and do not typically involve significant judgments of the Directors (Level 2 inputs).

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25. FAIR VALUE (Continued)

For recurring and non-recurring fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (ex: changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it.

All financial instruments measured at fair value use Level 2 valuation techniques for the each of the years ended 31 December 2016 and 2015.

Level 2 fair value measurements are those including inputs other than quoted prices included within Level 1 that are observable for the asset or liability directly or indirectly. The fair value of the swap commodity derivatives is calculated using a discounted cashflow model and the fair value of the option commodity derivatives are calculated using a relevant option pricing model, which are calculated from relevant market prices and yield curves at the balance sheet date and are therefore based solely on observable price information. These instruments are not directly quoted in active markets and are accordingly classified as Level 2 in the fair value hierarchy.

There have been no transfers between fair value levels during the reporting year.

Classification of financial instruments	2016	2015
	\$'000	\$'000
Financial assets		
Loans and receivable financial assets	3,084	1,345
Fair value through profit or loss	-	17
	3,084	1,362
Financial liabilities		
Borrowings, net of deferred financing costs	37,294	42,936
Trade and other payables	4,627	1,749
Fair value through profit or loss	939	-
	42,860	44,685

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For the year ended 31 December 2016

26. FINANCIAL RISK MANAGEMENT

DGO's principal financial liabilities, other than derivatives, comprise of borrowings and trade and other payables. The main purpose of these financial liabilities is to finance DGO's operations and to provide guarantees to support its operations. DGO's principal financial assets include trade and other receivables and cash and cash equivalents that derive directly from its operations. DGO also enters into derivative transactions.

DGO is exposed to market risk, credit risk and liquidity risk. DGO's management oversees these risks. All derivative activities for risk management purposes are carried out by a contracted specialist company that has the appropriate skills and experience for complex financial contracts and risk management techniques.

(a) Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises of two types of risk: interest rate risk and commodity price risk. Financial instruments affected by market risk include borrowings and derivative financial instruments.

(b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. DGO's exposure to the risk of changes in market interest rates relates primarily to DGO's borrowings with a senior credit facility, which has floating interest rates. All other material borrowings have fixed rates of interest.

An interest rate swap, which is designed to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount is a way to mitigate interest rate risk. At 31 December 2016, the Directors have elected not to enter an interest rate swap.

(c) Commodity price risk

DGO is affected by the price volatility of the natural gas and oil commodities. A material part of DGO's revenue is derived from the sale of natural gas and crude oil. The impact of DGO's hedge portfolio is recognized on a monthly basis in the Statement of Comprehensive Income. Due to the volatility of the price of natural gas and oil, DGO has entered into various direct purchase contracts with gas purchasers and has entered into various gas and oil financial contracts with BP Energy Company.

DGO's normal policy is to sell its products under contract at prices determined by reference to prevailing market prices on petroleum exchanges and keep options and swaps in place for 12-24 months in advance to minimize commodity risk and create stabilized and predictable cash flow.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

26. FINANCIAL RISK MANAGEMENT (Continued)

(d) Credit risk

Credit risk is the risk that a counter party will not meet its obligations under a contract, leading to a financial loss. The credit risk from its liquid funds is limited because the counter parties are banks with high credit ratings and have not experienced any losses in such accounts. DGO's credit risk is primarily attributable to its operating activities and its trade receivables.

(e) Trade receivables

The amount of trade receivables presented in the Statement of Financial Position is net of allowance for doubtful receivables. Trade receivables are due from customers throughout the oil and natural gas industry. Although diversified among many companies, collectability is dependent on the financial condition of each individual company as well as the general economic conditions of the industry. DGO reviews the financial condition of customers prior to extending credit and generally does not require collateral in support of their trade receivables.

Receivables from joint interest owners, classified in other non-current assets, are generally with other oil and natural gas companies that own a working interest in the properties operated by DGO. DGO has the ability to withhold future revenue payments to recover any non-payment of joint interest receivables.

The aging analysis of trade receivables is as follows:

	Total, neither past due nor impaired
	\$'000
Trade receivables less than one month old at 31 December:	
2015	1,345
2016	3,084

There were four customers that individually accounted for more than 10% of total receivables, totaling 63% of total trade receivables at 31 December 2016 (2015: 8 customers, 83%).

(f) Liquidity risk

Liquidity risk arises from DGO's management of working capital and the finance charges and principal repayments on its borrowings. It is the risk that DGO will encounter difficulty in meeting its financial obligations as they become due.

DGO's objective is to maintain a balance between continuity of funding and flexibility through the use of operational receivables and bank borrowings. DGO manages liquidity risk by continuously monitoring 90-day forecasts and actual cash flows. DGO assesses debt maturing within 12 months and is typically able to access sources of funding with existing lenders.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

26. FINANCIAL RISK MANAGEMENT (Continued)

(f) Liquidity risk (Continued)

For the year ended 31 December 2016:

	Less than 3 months \$'000	3 to 12 months \$'000	1 to 5 years \$'000	> 5 years \$'000	Total \$'000
Trade and other payables	3,719	908	-	-	4,627
Borrowings	24,982	2,199	10,113	-	37,294
Capital Lease	36	112	295	-	443
Other liabilities	967	4,616	414	-	5,997
	29,704	7,835	10,822	-	48,361

For the year ended 31 December 2015:

	Less than 3 months \$'000	3 to 12 months \$'000	1 to 5 years \$'000	> 5 years \$'000	Total \$'000
Trade and other payables	948	801	-	-	1,749
Borrowings	1,226	21,595	20,115	-	42,936
Capital Lease	29	86	58	-	173
Other liabilities	1,120	180	-	277	1,577
	3,323	22,662	20,173	277	46,435

(g) Capital risk

DGO's objectives when managing capital are to safeguard the ability to continue as a going concern while pursuing opportunities for growth through identifying and evaluating potential acquisitions and constructing new infrastructure on existing proved leaseholds. DGO defines capital as DGO's shareholders' equity excluding share capital and merger reserve, totaling \$8.7 million at 31 December 2016 (2015: \$(9.0 million)). DGO is not subject to any externally imposed capital requirements. DGO's management does not establish a quantitative return on capital criteria, but rather promotes year over year growth.

(h) Collateral risk

DGO has pledged its oil and gas properties to fulfill the collateral requirements for borrowing credit facilities with its senior secured lenders. The collective fair value of the oil and gas properties pledged was \$125 million at 31 December 2016. The fair value is based on a third-party engineering reserve calculation using a 10% cumulative discount cash flow and a commodities futures price schedule.

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

27. CONTINGENCIES AND PROVISIONS

DGO is involved in various pending legal issues that have arisen in the normal course of business, none which are expected to have any material impact on DGO's financial position or results of operations.

DGO's operations are subject to environmental regulation in all the jurisdictions in which it operates. The Directors are unable to predict the effect of additional environmental laws and regulations which may be adopted in the future, including whether any such laws or regulations would adversely affect DGO's operations. There can be no assurance that such new environmental legislation, once implemented, will not oblige DGO to incur significant expenses and undertake significant investments.

28. RELATED PARTY TRANSACTIONS

(a) UK Legal Counsel

Martin K. Thomas is a partner at Watson Farley & Williams LLP, the UK legal advisor for DGO. The total billings from Watson Farley & Williams LLP to DGO totaled £418 thousand (approximately \$588 thousand) for the year ended 31 December 2016 (2015: £184 thousand or approximately \$281 thousand).

(b) Office Space Lease

In 2016, DGO entered into a twenty year lease for its corporate headquarters facility, commencing in 2017 with Diversified Real Estate Holdings, LLC, a company owned by Rusty Hutson, Jr. and Robert Post. The Directors believe the terms of this lease are reasonable and reflect market rates for a facility of this type.

The future lease payments under this lease are as follows:

<u>Lease Year</u>	<u>Total Annual Rent</u> <u>\$'000</u>
Years 1-5	465
Years 6-10	475
Years 11-15	490
Years 16-20	500
	<u>1,930</u>

DIVERSIFIED GAS & OIL PLC
Notes to the Consolidated Financial Statements
For the year ended 31 December 2016

29. EVENTS AFTER THE REPORTING YEAR

The Directors have performed an analysis of the activities and transactions subsequent to 31 December 2016 to determine the need for any adjustments to and/or disclosure of, within the Consolidated Financial Information.

(a) Initial Public Offering (“IPO”)

In February 2017, DGO issued share capital was admitted to trading on the AIM Market of the London Stock Exchange. DGO placed 61,000,000 new ordinary shares at 65 pence per share to raise \$50.0 million (£39.7 million) (before expenses and admission costs). The funds raised were used for the repurchase of bonds, repayment of existing debt facilities, costs of admission and working capital requirements. As a result of the repayment of the numerous borrowings with proceeds from the IPO, the \$4.0 million charge of deferred financing cost was accelerated and fully expensed in February 2017.

(b) Acquisitions

In April 2017, DGO acquired 1,300 conventional natural gas and crude oil wells in Ohio and Pennsylvania, equipment and automobiles from a larger Appalachian based producing company. The purchase consideration comprised of cash of \$1.8 million met from DGO's existing resources. A provisional assessment of the value of these proved reserves on acquisition is produced, considering the discounted cash flows of production to a present value (“PV”). DGO uses a discount ranging between 10% and 35% for such acquisition, depending on the market conditions at the time of the transaction as well any additional risk factors arising in the particular transaction, in order to obtain a fair value estimate of oil and gas properties. DGO plans to record the fair value of oil and gas assets based on a present value discount factor of 35% with a resulting fair value of approximately \$6.0 million. The assets acquired in the acquisition included the necessary permits, rights to production, royalties, contracts and agreements that support the production from the wells.

(c) Proposed Acquisitions and AIM Reverse Takeover

In May 2017, DGO entered a conditional sale and purchase agreement to acquire certain gas and oil assets of Titan Energy, LLC in the Appalachian Basin, principally in the states of Ohio, Pennsylvania, southern New York and northeast Tennessee. The acquisition would add 7,300 producing wells for purchase consideration of \$84.2 million, funded through a new term debt facility, and a proposed placing of new ordinary shares.

The acquisition will constitute a reverse takeover under the AIM Rules and accordingly trading in the Company's ordinary shares was suspended on 5 May 2017. An admission document, setting out full details of DGO and the proposed acquisition, is required to be published prior to trading being restored.

DIVERSIFIED GAS & OIL PLC
Independent Auditor's Report
For the year ended 31 December 2016

We have audited the financial statements of Diversified Gas & Oil PLC for the year ended 31 December 2016, which comprises the Statement of Financial Position and Statement of Changes in Equity, set out on pages 58 to 66.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' ("FRS 102") (United Kingdom Generally Accepted Accounting Practice).

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprive.

OPINION ON THE FINANCIAL STATEMENTS

In our opinion, the financial statements:

- give a true and fair view of the state of the affairs of the Company's as at 31 December 2016;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion, based on the work undertaken in the course of our audit:

- The information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements, and
- The Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

DIVERSIFIED GAS & OIL PLC
Independent Auditor's Report
For the year ended 31 December 2016

Matters on which we are required to report by exception

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

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

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

Other matter

We have reported separately on the consolidated financial statements of Diversified Gas & Oil PLC for the year ended 31 December 2016.



Stephen Bullock
for and on behalf of
Crowe Clark Whitehill LLP
Statutory Auditor
St Bride's House
10 Salisbury Square
London
EC4Y 8EH

6 June 2017

DIVERSIFIED GAS & OIL PLC
Statement of Financial Position
For the year ended 31 December 2016

	Note	2016	2015
		£'000	£'000
ASSETS			
Non-current assets			
Investments	9	350	350
Other assets		20	62
		370	412
Current assets			
Other current assets	8	780	1
Receivables from subsidiaries	9	10,055	2,658
Cash and cash equivalents		-	24
		10,835	2,683
Total Assets		11,205	3,095
EQUITY AND LIABILITIES			
Equity			
Share capital	4	442	412
Share based payment reserve		256	-
Retained earnings/(deficit)		2,039	(595)
Total Equity		2,737	(183)
Non-current liabilities			
Borrowings	6	7,785	3,143
		7,785	3,143
Current liabilities			
Trade and other payables	11	426	135
Borrowings	6	257	-
		683	135
Total Liabilities		8,468	3,278
Total Liabilities and Equity		11,205	3,095

The Company's retained earnings for the period includes a profit for the year of £2.6 million (2015 period: loss of £171 thousand).

The Notes form an integral part of these Consolidated Financial Statements.

The Financial Statements were approved by the Board of Directors on 6 June 2017 and signed on its behalf by



Robert M. Post
Chairman of the Board

DIVERSIFIED GAS & OIL PLC
Statement of Changes in Equity
For the year ended 31 December 2016

	Share capital	Share based payment reserve	Retained earnings	Total equity
	£'000	£'000	£'000	£'000
At 31 July 2015	400	-	(424)	(24)
Issuance of share capital	12	-	-	12
Comprehensive loss for the period	-	-	(171)	(171)
At 31 December 2015	412	-	(595)	(183)
Issuance of share capital	30	256	-	286
Comprehensive income for the year	-	-	2,634	2,634
At 31 December 2016	442	256	2,039	2,737

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

1. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

(a) Basis of Preparation of Financial Statements

Diversified Gas & Oil PLC (the Company) is a public limited company incorporated in England on 1 July 2014. The registered office is 15 Appold Street, London, EC2A 2HB. The financial statements have been prepared in accordance with Financial Reporting Standard 102 and the Companies Act 2006 under the historical cost basis.

The comparative financial statements for the period ended 31 December 2015 represent the UK legal statutory period of 1 August 2015 to 31 December 2015.

The preparation of financial statements in compliance with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies (see note 3).

The financial information of the Company is presented in Pound Sterling ("£") and rounded to the nearest thousand, unless otherwise stated.

The Company has taken advantage of Section 408 of the Companies Act 2006 and has not included a Profit and Loss account in these Financial Statements.

The Company has taken advantage of the following disclosure exemptions in preparing these Financial Statements, as permitted by FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland": the requirements of Section 7 – Statement of Cash Flows and the requirements of Section 11 – Financial Instruments.

(b) New Standards and Interpretations Not Yet Adopted

At the date of authorisation of this Financial Information, the Directors have reviewed the standards in issue by the International Accounting Standards Board ("IASB") and IFRIC, which are effective for annual accounting years ending on or after the stated effective date. In their view, none of these standards would have a material impact on the financial reporting of the Company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Cash and cash equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are highly liquid investments that mature in no more than three months from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

(b) Borrowings

Borrowings which are basic financial instruments are initially recorded at the present value of future payments discounted at a market rate of interest for a similar loan. Subsequently, they are measured at amortised cost using the effective interest method.

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Finance costs

Finance costs are charged to the profit and loss account over the term of the debt using the effective interest method so that the amount charged is at a constant rate on the carrying amount. Issue costs are initially recognised as a reduction in the proceeds of the associated capital instrument.

(d) Investments

Investment in a subsidiary company is held at cost less accumulated impairment losses.

(e) Going concern

The Directors have considered financial resources together with their consolidated forecast financial information. Consequently, the Directors believe that the Company is well placed to manage its business risks successfully despite the current downturn in global oil and gas prices. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Subsequent to year end, the Company completed a recapitalization process through an initial public offering which Directors consider is a substantial event in the going concern outlook (see Note 29 regarding events after the reporting period). The Directors have reviewed the Company's overall position and outlook and are of the opinion that the Company is sufficiently well funded to be able to operate as a going concern for at least the next twelve months from the date of approval of these financial statements. The Directors believe that the use of the going concern basis is appropriate. Accordingly, the Directors have prepared the Financial Statements on a going concern basis.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

In preparing these financial statements the Directors consider that the key judgment is the allocation of costs between the loan balance and the profit or loss account relating to expenses of the bond listing on the NEX Exchange growth market (formerly ISDX). See note 6 for details.

4. SHARE CAPITAL

On 1 July 2016, PLC issued additional share capital of 800,000 Ordinary Shares of £0.01 each. The total number of Ordinary Shares of £0.01 allotted issued and fully paid at 1 July 2016 was 42,000,000 with an aggregate nominal value of £420,000.

On 24 October 2016, PLC issued additional share capital of 2,210,481 Ordinary Shares of £0.01 each. The total number of Ordinary Shares of £0.01 allotted issued and fully paid at 24 October 2016 was 44,210,481.

5. OPERATING EXPENSES

Details of the Directors' remuneration is included in the Directors' Report on pages 8 and 9.

Details of Auditors' remuneration is included in Note 8 to the Consolidated Financial Statements.

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

6. BORROWINGS

Borrowings payable at each of 31 December 2016 and 2015 consist of the following:

	2016	2015
	£'000	£'000
Note payable – individual and institutional investors, with an interest rate of 8.00%, maturing July 2017 through September 2017, unsecured.	75	75
Bonds payable - individual and institutional investors, with an interest rate of 8.50%, maturing June 2020, unsecured. In Q1 2017, 99% of bonds were repaid with IPO proceeds.	10,650	4,166
Notes payable - individuals, with interest of 8.5%, maturing September 2016, unsecured	270	-
Total borrowings	10,995	4,241
Less current portion of long-term debt	(257)	-
Less deferred financing costs (see below)	(2,953)	(1,098)
Total non-current borrowings, net	7,785	3,143

All borrowings with maturities prior to 31 December 2016 have received waivers from the respective lenders.

Deferred financing costs at each of 31 December 2016 and 2015 consist of the following:

	£'000
Deferred financing costs at 31 July 2015	462
Additions	688
Charge	(52)
Deferred financing costs at 31 December 2015	1,098
Additions	2,316
Charge	(461)
Deferred financing costs at 31 December 2016	2,953

Subsequent to year end, all deferred financing costs were expensed when borrowings were paid in full with IPO proceeds.

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

6. BORROWINGS (Continued)

Future maturities of the long-term notes payable at 31 December 2016 and 2015 are as follows:

	2016	2015
	£'000	£'000
Not later than one year	257	-
Later than one year and not later than five years	10,738	4,241
Later than five years	-	-
	10,995	4,241

The above borrowings are recognized as a financial liability measured at amortized cost and the carrying value approximates to their fair value.

7. RELATED PARTY TRANSACTIONS

(a) Subsidiary Receivables

For the year ended 31 December 2016, the Company provided working capital to its subsidiaries and a receivable balance of £10.1 million was owed from Diversified Gas & Oil Corporation and its subsidiary entities (2015: £2.7 million), this balance is interest free and repayable on demand. There is no ultimate controlling party.

(b) UK Legal Counsel

Martin K. Thomas is a partner at Watson Farley & Williams LLP, the UK legal advisor for DGO. The total billings from Watson Farley & Williams LLP to PLC totaled £418 thousand for the year ended 31 December 2016 (2015: £184 thousand).

8. EVENTS AFTER THE REPORTING YEAR

In February 2017, the Company admitted share capital to trading on the London AIM Exchange and placed 61,000,000 new Ordinary Shares at 65 pence per share to raise £39.7 million (before expenses and admission costs). The funds raised were used for the repurchase of bonds, repayment of existing subsidiary debt facilities, costs of admission and working capital requirements of the subsidiary group.

For 2016, included in other current assets is £582 thousand related to costs incurred for DGO's IPO that occurred 3 February 2017. This amount was charged to Share Based Payment Reserve in February 2017.

As a result of the repayment of numerous borrowings with proceeds from the IPO, the £3.0 million charge of deferred financing cost was accelerated and fully expensed in February 2017.

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

9. INVESTMENTS

The Company owns in its entirety the issued share capital of Diversified Gas & Oil Corporation, a company incorporated in Delaware, United States of America. The carrying value at both 31 December 2016 and 2015 of investments held was £350 thousand.

Diversified Gas & Oil Corporation (DGOC) owns in its entirety the issued share capital of the following entities:

- i. Diversified Resources, Inc
- ii. M & R Investments LLC
- iii. M & R Investments Ohio LLC
- iv. Marshall Gas & Oil Corporation
- v. R & K Oil and Gas Corporation
- vi. Fund 1 DR LLC
- vii. Diversified Oil & Gas, LLC
- viii. Diversified Appalachian Group, LLC

The country of incorporation for the above entities is the United States of America.

10. TAXATION

	Year ended 31 December 2016	Period ended 31 December 2015
	£'000	£'000
Corporation tax	-	-
Current tax on profits for the year	-	-
Total current tax	-	-
Taxation on profit of ordinary activities	-	-

The tax assessed for the year is the same as the standard rate of corporation tax in the UK of 20.0%.

DIVERSIFIED GAS & OIL PLC
Notes to the Financial Statements
For the year ended 31 December 2016

10. TAXATION (continued)

	Year ended 31 December 2016 £'000	Period ended 31 December 2015 £'000
Profit/(Loss) on ordinary activities before tax	2,634	(170)
Corporate tax in the UK of 20.0% on profits for the period	527	(35)
Non-taxable income	(543)	-
Effects of tax losses carried forward	16	35
Total tax charge for the year	-	-

Non-taxable income of PLC for 2016 relates to dividend income received from US subsidiaries in the amount of £2.7 million.

A deferred tax asset of approximately £51 thousand (2015: £35 thousand) has not been recognized on the losses due to the uncertainty of the availability of future profits.

11. CREDITORS

	2016 £'000	2015 £'000
Amounts falling due within one year:		
Trade and other creditors	426	120
Accruals and deferred income	-	15
	426	135

The carrying amounts of the above financial liabilities measured at amortized cost approximate to their fair values.

