

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion and analysis of our financial condition and results of operations as of 31 December 2013 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2013 and 2012. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial and operating information contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" comprises information of OAO NOVATEK and its consolidated subsidiaries (hereinafter jointly referred to as "we" or the "Group").

### **OVERVIEW**

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom, in each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for both reporting periods. In terms of proved natural gas reserves, we are also the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

Our exploration, development, production and processing of natural gas, gas condensate and crude oil have been conducted within the Russian Federation, and, in accordance with Russian law, we sell our produced natural gas volumes exclusively in the Russian domestic market.

Prior to July 2013, the majority of our stable gas condensate was shipped to international markets via the Port of Vitino located on the White Sea. From the third quarter of 2013, most of our stable gas condensate is sent as a raw material feedstock for processing to the Gas Condensate Fractionation and Transshipment Complex launched in June 2013 (see "Recent Developments" below). Refined products (namely, naphtha, jet fuel, gasoil, fuel oil) from the fractionation of our stable gas condensate are sold directly to the international markets, with the remaining stable gas condensate volumes sold to both international and domestic markets.

Our crude oil and liquefied petroleum gas ("LPG") are generally delivered to both international and domestic markets.

### **RECENT DEVELOPMENTS**

#### **Increasing our resource base**

In November 2013, the Group discovered the Dorogovskoye oil and gas condensate field, located in the Yamal Nenets Autonomous Region ("YNAO") as a result of the geological and geophysical research works performed at the North-Russskiy license area. As of 31 December 2013, the Dorogovskoye field's recoverable reserves according to the Russian reserve classification C1+C2 totaled to 35.1 billion cubic meters ("bcm") of natural gas and 2.5 million tons of liquid hydrocarbons.

In October 2013, the Group launched production at the Urengoyevskoye field located within the Group's Olimpiyskiy license area, with an annual natural gas production capacity estimated at approximately one billion cubic meters.

In March 2013, the Group won the right to purchase an oil and gas exploration and production license for the East-Tazovskoye field located in the YNAO, based on auction results held by the Federal Agency for the Use of Natural Resources of the Russian Federation. As of 31 December 2013, the estimated proved reserves appraised under the PRMS reserve methodology totaled to 17.1 bcm of natural gas and 2.5 million tons of liquid hydrocarbons. We paid RR 3.2 billion for the mineral license.

## **Production growth**

In October 2013, our joint venture ZAO Nortgas (“Nortgas”) launched the Eastern dome of the North-Urengoykoye field allowing Nortgas to increase the production capacity in 2014 by approximately five bcm of natural gas and by 0.5 million tons of gas condensate to achieve peak production capacity of more than 10 bcm of natural gas and 1.4 million tons of gas condensate.

In October 2012, we launched the fourth stage of the second phase development at our Yurkharovskoye field, which allowed us to achieve the design production capacity of the field and reach the field’s natural gas production plateau of 37.2 bcm per annum. The fourth stage complex included two gas treatment trains with total annual capacity of seven billion cubic meters.

In April and December 2012, our joint venture OOO SeverEnergiya (“SeverEnergiya”) launched the first and second phases of the Samburgskoye field, respectively, with combined annual natural gas production capacity of approximately 4.6 bcm and 650 thousand tons of gas condensate.

## **Increasing refining capacity**

In January 2014, we completed our Purovsky Gas Condensate Plant (“Purovsky Plant”) expansion project increasing the plant capacity from five to 11 million tons per annum. Four gas condensate stabilization trains were launched (with an annual capacity of one and a half million tons each). The completion of this strategic project allows us to achieve a balance between our gas condensate production potential and processing capacity.

In June and October 2013, the Group launched the first and the second stage, respectively, of a stable gas condensate fractionation unit located at the Port of Ust-Luga on the Baltic Sea (“the Ust-Luga Complex”). The Ust-Luga Complex includes two gas condensate fractionation units with a total nameplate capacity of six million tons per annum (three million tons each), 520 thousand cubic meters of storage facilities for feedstock and products, two deep-water berths and other infrastructure facilities.

The Ust-Luga Complex enables us to process stable gas condensate into light and heavy naphtha, jet fuel, gasoil and fuel oil (“gas condensate refined products”), which are subsequently shipped to international markets via tankers on the Baltic Sea. The commissioning of the Ust-Luga Complex increases the added value of our liquid hydrocarbons sales and allows us to diversify our sales market. Currently the Ust-Luga Complex refines almost all of the stable gas condensate produced at the Purovsky Plant into gas condensate refined products, with the remaining volumes of stable gas condensate sold directly to the international or domestic markets.

## **Purchases and acquisitions**

In December 2013, our 50% participation interest joint venture OOO Yamal Development (“Yamal Development”), acquired a 60% equity stake in Artic Russia B.V. for the amount of USD 2,939 million from Eni, the Italian energy company. Artic Russia B.V. owns a 49% participation interest in SeverEnergiya. The Group also swapped its 51% stake in OAO Sibneftegas (“Sibneftegas”) for a 40% stake in Artic Russia B.V. Following the completion of these two transactions, the Group’s effective share in SeverEnergiya increased from 25.5% to 59.8%. SeverEnergiya has significant potential for increasing natural gas, gas condensate and crude oil production. The Group treats SeverEnergiya as a joint venture of Yamal Development and accounts for SeverEnergiya under the equity method. Our joint venture Yamal Development is also accounted by the Group under the equity method.

In December 2012, the Group acquired an 82% equity interest in OOO Gazprom mezhregiongas Kostroma, a regional natural gas trader in the Kostroma region of the Russian Federation, to support and expand the Groups’ natural gas sales opportunities in the region. At the date of acquisition, the company held three percent of its participation interest in the form of treasury shares, and accordingly, the Group’s effective participation interest in Gazprom mezhregiongas Kostroma was 84.5%. In February 2013, OOO Gazprom mezhregiongas Kostroma was renamed to OOO NOVATEK-Kostroma (“NOVATEK-Kostroma”). In February 2014, the Group acquired an additional 15% equity stake in NOVATEK-Kostroma thus increasing the Group’s effective participation interest to 100 percent.

In December 2012, the Group established OOO NOVATEK Moscow region (“NOVATEK Moscow region”), a wholly owned subsidiary, to support the Group’s current natural gas deliveries to the Moscow region, as well as to expand potential sales opportunities in the region.

In November 2012, the Group acquired a 49% ownership interest in Nortgas for total consideration of USD 1,375 million. In June 2013, the Group increased its ownership interest in Nortgas to 50% by subscribing to the entity's additional share emission for a cash consideration of USD 52 million. Nortgas is a Russian oil and gas production company that holds the production license for the North-Urengoykoye field located in YNAO, which is located in a close proximity to our transport and processing infrastructure. The estimated proved reserves appraised under the PRMS reserve methodology totaled 229 bcm of natural gas and 29 million tons of liquid hydrocarbons as of 31 December 2013, for a combined total of 1.7 billion barrels of oil equivalent.

### **Yamal LNG project**

In December 2013, under the framework agreement with China National Petroleum Corporation ("CNPC") on Yamal LNG project signed in September 2013, NOVATEK sold a 20% equity stake in OAO Yamal LNG ("Yamal LNG") to CNPC after the receipt of necessary regulatory approvals from the Russian Federation, the People's Republic of China and the European Union. As a result, the Group's share of Yamal LNG decreased to 60%. As part of the agreement, in September 2013, NOVATEK, CNPC and a consortium of Chinese financial institutions concluded a memorandum on project financing whereby the Chinese commercial banks will consider actively participating in the external project financing. In October 2013, Yamal LNG and CNPC entered into the heads of agreement for the supply of liquefied natural gas ("LNG") no less than three million tons per annum at DES terms for a period of 15 years with possible supply extension.

The Yamal LNG project envisages the construction of a LNG plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula. The project also requires the construction of transportation infrastructure including an airport and the seaport at Sabetta. In December 2013, the Board of Directors of Yamal LNG approved a final investment decision based on an estimated capital cost of USD 26.9 billion. The commercial launch of the first LNG train is planned in 2017.

Effective 1 December 2013, the State Duma of the Russian Federation approved a law (Federal Law 318-FZ) to liberalize the export of liquefied natural gas provided that mineral licenses as of 1 January 2013 stipulate LNG plant construction or shipment of gas produced to a LNG plant for liquefaction. As a result of the changes in law, Yamal LNG has the right to sell its LNG to export markets.

In July 2013, Yamal LNG entered into a Slot Reservation Agreement with Daewoo Shipbuilding & Marine Engineering for the construction of LNG carriers with an ice classification of ARC7. The Slot Reservation Agreement provides for the option to build, launch and equip up to 16 vessels and sets the preliminary contract price of vessels, the schedule of their production and expected delivery dates. The Slot Reservation Agreement also provides for the cession of rights to finance and purchase of ice class vessels to third party carriers approved by Yamal LNG.

### **Expanding presence in the gas market**

In 2013, we increased our proportion of natural gas volumes sold to end-customers to 88.9% due to the conclusion during 2012 of a range of long-term contracts for periods of 10 to 15 years. The long-term contracts were concluded with OAO MMK (10.5 years), E.ON's and Fortum's Russian subsidiaries (15 years), as well as with Mechel Group (10 years and more). In addition, we concluded a five-year contract with OAO Severstal and a three-year contract with OAO Mosenergo. The share of natural gas volumes sold under the aforementioned contracts in 2013 aggregated 42.0% of our total natural gas sales volumes.

In 2012, the Group signed long-term natural gas purchase and sales contracts with third parties on the European market. The gas purchase and sales contracts have been signed for a delivery period of ten years starting from 1 October 2012. The total volume of natural gas supplied over this period is estimated to be approximately 210 terawatt-hours (or approximately 20 bcm). In addition, the Group periodically concludes short-term natural gas purchase and sales agreements on the European market to optimize its trading activities. The financial result from natural gas trading activities, including the effect from changes in fair value of gas contracts, was recorded in the consolidated statement of income within other operating profit (loss).

### **Eurobonds**

In February 2013, the Group issued four-year Russian rouble denominated Eurobonds in the amount of RR 14 billion with the annual coupon rate of 7.75%.

In December 2012, the Group issued ten-year USD denominated Eurobonds in the amount of USD one billion with a coupon rate of 4.422% per annum.

## SELECTED DATA

| <i>millions of Russian roubles except as stated</i>                             | Year ended 31 December: |           | Change<br>% |
|---------------------------------------------------------------------------------|-------------------------|-----------|-------------|
|                                                                                 | 2013                    | 2012      |             |
| <b>Financial results</b>                                                        |                         |           |             |
| Total revenues (net of VAT, export duties, excise and fuel taxes)               | 298,158                 | 210,973   | 41.3%       |
| Operating expenses                                                              | (192,761)               | (125,775) | 53.3%       |
| Profit attributable to shareholders of OAO NOVATEK                              | 110,006                 | 69,458    | 58.4%       |
| Normalized profit attributable to shareholders of<br>OAO NOVATEK <sup>(1)</sup> | 79,825                  | 69,518    | 14.8%       |
| EBITDA <sup>(2)</sup>                                                           | 159,440                 | 95,106    | 67.6%       |
| Normalized EBITDA <sup>(1)</sup>                                                | 121,791                 | 95,166    | 28.0%       |
| Normalized EBITDAX <sup>(3)</sup>                                               | 122,218                 | 97,188    | 25.8%       |
| Earnings per share (in Russian roubles)                                         | 36.31                   | 22.89     | 58.6%       |
| Normalized Earnings per share (in Russian roubles) <sup>(1)</sup>               | 26.35                   | 22.91     | 15.0%       |
| Net debt <sup>(4)</sup>                                                         | 157,732                 | 114,067   | 38.3%       |
| Production costs (USD per barrel of oil equivalent)                             | 10.63                   | 8.06      | 31.9%       |
| <b>Production volumes <sup>(5)</sup></b>                                        |                         |           |             |
| Total hydrocarbons production (million barrels of oil equivalent)               | 439.0                   | 405.1     | 8.4%        |
| Total daily production (thousand barrels of oil equivalent per day)             | 1,203                   | 1,107     | 8.4%        |
| <b>Operating results</b>                                                        |                         |           |             |
| Natural gas sales volumes (million cubic meters)                                | 64,152                  | 58,880    | 9.0%        |
| Stable gas condensate sales volumes (thousand tons)                             | 2,117                   | 2,847     | (25.6%)     |
| Naphtha sales volumes (thousand tons)                                           | 1,328                   | -         | n/a         |
| Liquefied petroleum gas sales volumes (thousand tons)                           | 1,078                   | 905       | 19.1%       |
| Crude oil sales volumes (thousand tons)                                         | 627                     | 442       | 41.9%       |
| Other gas condensate refined products (thousand tons) <sup>(6)</sup>            | 278                     | -         | n/a         |
| <b>Oil and gas reserves <sup>(7)</sup></b>                                      |                         |           |             |
| Total proved reserves SEC (million barrels of oil equivalent)                   | 12,537                  | 12,394    | 1.2%        |
| Total natural gas proved reserves SEC (billion cubic meters)                    | 1,740                   | 1,758     | (1.0%)      |
| Total natural gas proved reserves PRMS (billion cubic meters)                   | 2,141                   | 2,195     | (2.5%)      |
| Total liquids proved reserves SEC (million tons)                                | 134                     | 106       | 26.4%       |
| Total liquids proved reserves PRMS (million tons)                               | 187                     | 149       | 25.5%       |
| <b>Cash flow results</b>                                                        |                         |           |             |
| Net cash provided by operating activities                                       | 88,525                  | 75,825    | 16.7%       |
| Capital expenditures <sup>(8)</sup>                                             | 59,254                  | 43,554    | 36.0%       |
| Free cash flow <sup>(9)</sup>                                                   | 29,271                  | 32,271    | (9.3%)      |

Reconciliation of normalized EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO NOVATEK is as follows:

| <i>millions of Russian roubles</i>                                              | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|---------------------------------------------------------------------------------|--------------------------------|---------------|---------------------|
|                                                                                 | <b>2013</b>                    | <b>2012</b>   |                     |
| <b>Profit attributable to shareholders of OAO NOVATEK</b>                       | <b>110,006</b>                 | <b>69,458</b> | <b>58.4%</b>        |
| Depreciation, depletion and amortization                                        | 13,503                         | 11,499        | 17.4%               |
| Net impairment expenses                                                         | 2,611                          | 325           | n/a                 |
| Loss (income) from changes in fair value<br>of derivative financial instruments | (549)                          | 36            | n/a                 |
| Total finance expense (income)                                                  | 6,684                          | (2,986)       | n/a                 |
| Total income tax expense                                                        | 27,185                         | 16,774        | 62.1%               |
| <b>EBITDA <sup>(2)</sup></b>                                                    | <b>159,440</b>                 | <b>95,106</b> | <b>67.6%</b>        |
| Net loss (gain) on disposal of interest<br>in subsidiaries and joint ventures   | (37,649)                       | 60            | n/a                 |
| <b>Normalized EBITDA <sup>(1)</sup></b>                                         | <b>121,791</b>                 | <b>95,166</b> | <b>28.0%</b>        |
| Exploration expenses                                                            | 427                            | 2,022         | (78.9%)             |
| <b>Normalized EBITDAX <sup>(3)</sup></b>                                        | <b>122,218</b>                 | <b>97,188</b> | <b>25.8%</b>        |

<sup>(1)</sup> Excluding the effect from the disposal of interest in joint ventures and subsidiaries.

<sup>(2)</sup> EBITDA represents profit (loss) attributable to shareholders of OAO NOVATEK adjusted for the add-back of net impairment expenses (reversals), depreciation, depletion and amortization, income tax expense and finance income (expense) from the Consolidated Statement of Income, income (loss) from changes in fair value of derivative financial instruments.

<sup>(3)</sup> Normalized EBITDAX represents EBITDA as adjusted for the add-back of exploration expenses and excludes the effect from the disposal of interest in joint ventures and subsidiaries.

<sup>(4)</sup> Net Debt represents our total debt net of cash and cash equivalents.

<sup>(5)</sup> Total hydrocarbons production and total daily production are calculated based on net production, including our proportionate share in the production of our joint ventures.

<sup>(6)</sup> Other gas condensate refined products include jet fuel, gasoil and fuel oil.

<sup>(7)</sup> Oil and gas reserves are attributable to all consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in the respective fields.

<sup>(8)</sup> Capital expenditures represent additions to property, plant and equipment excluding payments for mineral licenses.

<sup>(9)</sup> Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

## SELECTED MACRO-ECONOMIC DATA

| <i>Exchange rate, Russian<br/>roubles for one US dollar<sup>(1)</sup></i> | 1Q    |        | 2Q    |       | 3Q     |        | 4Q    |        | Year  |        | Change<br>Y-o-Y, % |
|---------------------------------------------------------------------------|-------|--------|-------|-------|--------|--------|-------|--------|-------|--------|--------------------|
|                                                                           | 2013  | 2012   | 2013  | 2012  | 2013   | 2012   | 2013  | 2012   | 2013  | 2012   |                    |
| At the beginning of the period                                            | 30.37 | 32.20  | 31.08 | 29.33 | 32.71  | 32.82  | 32.35 | 30.92  | 30.37 | 32.20  | (5.7%)             |
| At the end of the period                                                  | 31.08 | 29.33  | 32.71 | 32.82 | 32.35  | 30.92  | 32.73 | 30.37  | 32.73 | 30.37  | 7.8%               |
| Average for the period                                                    | 30.41 | 30.26  | 31.61 | 31.01 | 32.80  | 32.01  | 32.53 | 31.08  | 31.85 | 31.09  | 2.4%               |
| Depreciation (appreciation)<br>of Russian rouble to US<br>dollar          | 2.3%  | (8.9%) | 5.2%  | 11.9% | (1.1%) | (5.8%) | 1.2%  | (1.8%) | 7.8%  | (5.7%) | n/a                |

<sup>(1)</sup> According to the Central Bank of Russian Federation (CBR). The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

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| <i>Crude oil prices,<br/>USD per bbl</i> | 1Q    |       | 2Q    |       | 3Q    |       | 4Q    |       | Year  |       | Change<br>Y-o-Y, % |
|------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------------|
|                                          | 2013  | 2012  | 2013  | 2012  | 2013  | 2012  | 2013  | 2012  | 2013  | 2012  |                    |
| <b>WTI<sup>(2)</sup></b>                 |       |       |       |       |       |       |       |       |       |       |                    |
| At the end of the period                 | 97.2  | 103.0 | 96.6  | 85.0  | 102.3 | 92.1  | 98.4  | 91.8  | 98.4  | 91.8  | 7.2%               |
| Average for the period                   | 94.4  | 103.0 | 94.2  | 93.5  | 105.8 | 92.2  | 97.6  | 88.2  | 98.0  | 94.2  | 4.0%               |
| <b>Brent<sup>(3)</sup></b>               |       |       |       |       |       |       |       |       |       |       |                    |
| At the end of the period                 | 107.4 | 123.5 | 102.5 | 94.5  | 108.1 | 111.0 | 110.3 | 110.0 | 110.3 | 110.0 | 0.3%               |
| Average for the period                   | 112.6 | 118.6 | 102.4 | 108.3 | 110.3 | 109.5 | 109.2 | 110.1 | 108.7 | 111.7 | (2.7%)             |
| <b>Dubai<sup>(3)</sup></b>               |       |       |       |       |       |       |       |       |       |       |                    |
| At the end of the period                 | 107.1 | 120.4 | 100.4 | 92.9  | 104.8 | 110.6 | 108.1 | 107.8 | 108.1 | 107.8 | 0.3%               |
| Average for the period                   | 108.1 | 116.5 | 100.8 | 106.2 | 106.2 | 106.1 | 106.8 | 107.5 | 105.5 | 109.0 | (3.2%)             |
| <b>Urals<sup>(3)</sup></b>               |       |       |       |       |       |       |       |       |       |       |                    |
| At the end of the period                 | 106.5 | 120.0 | 102.5 | 94.2  | 106.4 | 109.9 | 109.1 | 108.1 | 109.1 | 108.1 | 0.9%               |
| Average for the period                   | 110.8 | 116.9 | 102.1 | 106.6 | 109.7 | 108.9 | 108.2 | 108.8 | 107.7 | 110.4 | (2.4%)             |

<sup>(2)</sup> Based on New York Mercantile Exchange Light Sweet prices provided by Reuters to Platts.

<sup>(3)</sup> Based on Brent (Dtd) prices, Dubai prices and Russian Urals/ESPO spot assessments prices as provided by Reuters to Platts. ESPO stands for East Siberian Pipeline Ocean crude oil.

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| <i>Oil products prices,<br/>USD per ton</i> | 1Q    |       | 2Q   |      | 3Q   |       | 4Q    |       | Year  |       | Change<br>Y-o-Y, % |
|---------------------------------------------|-------|-------|------|------|------|-------|-------|-------|-------|-------|--------------------|
|                                             | 2013  | 2012  | 2013 | 2012 | 2013 | 2012  | 2013  | 2012  | 2013  | 2012  |                    |
| <b>Naphtha Japan<sup>(4)</sup></b>          |       |       |      |      |      |       |       |       |       |       |                    |
| At the end of the period                    | 922   | 1,057 | 856  | 750  | 900  | 967   | 984   | 950   | 984   | 950   | 3.6%               |
| Average for the period                      | 960   | 1,024 | 858  | 888  | 919  | 913   | 946   | 944   | 920   | 942   | (2.3%)             |
| <b>Jet fuel<sup>(4)</sup></b>               |       |       |      |      |      |       |       |       |       |       |                    |
| At the end of the period                    | 984   | 1,092 | 938  | 905  | 977  | 1,055 | 1,023 | 1,010 | 1,023 | 1,010 | 1.3%               |
| Average for the period                      | 1,038 | 1,061 | 930  | 994  | 993  | 1,025 | 997   | 1,027 | 990   | 1,027 | (3.6%)             |
| <b>Gasoil<sup>(4)</sup></b>                 |       |       |      |      |      |       |       |       |       |       |                    |
| At the end of the period                    | 918   | 1,015 | 886  | 847  | 918  | 982   | 950   | 932   | 950   | 932   | 1.9%               |
| Average for the period                      | 961   | 995   | 872  | 927  | 932  | 946   | 932   | 956   | 924   | 957   | (3.4%)             |
| <b>Fuel oil<sup>(4)</sup></b>               |       |       |      |      |      |       |       |       |       |       |                    |
| At the end of the period                    | 628   | 765   | 607  | 603  | 608  | 700   | 607   | 613   | 607   | 613   | (1.0%)             |
| Average for the period                      | 654   | 732   | 609  | 675  | 615  | 684   | 609   | 628   | 622   | 680   | (8.5%)             |

<sup>(4)</sup> Based on Naphtha C+F (cost plus freight) Japan, Jet CIF NWE, Gasoil 0.1% CIF NWE, Fuel Oil 1.0% CIF NWE prices provided by Platts.

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| <i>Liquefied petroleum gas<br/>prices, USD per ton<sup>(5)</sup></i> | 1Q   |      | 2Q   |      | 3Q   |      | 4Q   |      | Year |      | Change<br>Y-o-Y, % |
|----------------------------------------------------------------------|------|------|------|------|------|------|------|------|------|------|--------------------|
|                                                                      | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |                    |
| At the end of the period                                             | 633  | 838  | 570  | 613  | 762  | 813  | 838  | 840  | 838  | 840  | (0.2%)             |
| Average for the period                                               | 699  | 783  | 605  | 786  | 674  | 721  | 828  | 830  | 702  | 780  | (10.0%)            |

<sup>(5)</sup> Based on spot prices for propane-butane mix at the Belarusian-Polish border (DAF, Brest) as provided by Argus.

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| <i>Export duties,<br/>USD per ton</i> <sup>(6)</sup> | <b>1Q</b>   |             | <b>2Q</b>   |             | <b>3Q</b>   |             | <b>4Q</b>   |             | <b>Year</b> |             | <b>Change<br/>Y-o-Y, %</b> |
|------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------------|
|                                                      | <b>2013</b> | <b>2012</b> | <b>2013</b> | <b>2012</b> | <b>2013</b> | <b>2012</b> | <b>2013</b> | <b>2012</b> | <b>2013</b> | <b>2012</b> |                            |
| <b>Crude oil, stable gas condensate</b>              |             |             |             |             |             |             |             |             |             |             |                            |
| At the end of the period                             | 420.6       | 411.2       | 359.3       | 419.8       | 400.7       | 393.8       | 385.7       | 396.5       | 385.7       | 396.5       | (2.7%)                     |
| Average for the period                               | 406.5       | 400.8       | 379.7       | 443.0       | 383.2       | 366.6       | 399.3       | 406.6       | 392.2       | 404.3       | (3.0%)                     |
| <b>LPG</b>                                           |             |             |             |             |             |             |             |             |             |             |                            |
| At the end of the period                             | 131.4       | 157.3       | 72.2        | 237.1       | 75.5        | 76.2        | 203.5       | 197.4       | 203.5       | 197.4       | 3.1%                       |
| Average for the period                               | 176.8       | 180.0       | 71.4        | 197.4       | 53.7        | 92.7        | 159.7       | 187.4       | 115.4       | 164.4       | (29.8%)                    |
| <b>Naphtha</b>                                       |             |             |             |             |             |             |             |             |             |             |                            |
| At the end of the period                             | 378.6       | 370.1       | 323.3       | 377.8       | 360.6       | 354.4       | 347.1       | 356.8       | 347.1       | 356.8       | (2.7%)                     |
| Average for the period                               | 365.9       | 360.7       | 341.8       | 398.7       | 344.9       | 329.9       | 359.4       | 366.0       | 353.0       | 363.8       | (3.0%)                     |
| <b>Jet fuel, gasoil, fuel oil</b>                    |             |             |             |             |             |             |             |             |             |             |                            |
| At the end of the period                             | 277.6       | 271.4       | 237.1       | 277.0       | 264.4       | 259.9       | 254.5       | 261.7       | 254.5       | 261.7       | (2.8%)                     |
| Average for the period                               | 268.3       | 264.5       | 250.6       | 292.3       | 252.9       | 241.9       | 263.5       | 268.4       | 258.8       | 266.8       | (3.0%)                     |

<sup>(6)</sup> Export duties are determined by the Russian Federation government in US dollars and are paid in Russian roubles.

## **CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS**

### **Current financial market conditions**

The economic instability in the Euro-Zone has appeared to subside with the various measures taken by the respective governments, Central Banks and other quasi-governmental financial institutions. Although the main financial and economic issues plaguing the Euro-Zone over the last few years remain in the forefront of present discussions, we will continue to monitor the credit situation very closely and take various measures, we deem necessary, to ensure the integrity of our financial condition and mitigate counter-party credit exposure from our natural gas and liquid hydrocarbon sales. In addition, we continue to take proactive steps to ensure the safety of our excess funds deposited with both domestic and international banks, as well as limit our risk exposure from prepayments to various service providers. Presently, our cash and deposits are diversified and maintained in banks that we believe are well capitalized in accordance with international capital adequacy rules.

We have reviewed our capital expenditure program for the upcoming year and have concluded that we have sufficient liquidity, through current internal cash flows and short-term borrowing facilities, to adequately fund our core natural gas business operations and planned capital expenditure program.

Management will continue to closely monitor the economic environment in Russia, as well as the domestic and international capital markets to determine if any further corrective and/or preventive measures are required to sustain and grow our business. In addition, we will continue to assess the trends in the capital markets for opportunities to access long-term funding at a reasonable cost to the Group commensurate with our investment grade credit ratings and our capital requirements.

### **Natural gas prices**

The Group's natural gas prices on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service ("FTS"), a Russian Federation governmental agency, and present market conditions.

According to the Russian Federation government Directive No.1205 on "Improvement of State Gas Price Regulation" as of 31 December 2010, starting from 2013 natural gas prices for sales to end-customers on the domestic market (excluding residential customers) are set for each region of the Russian Federation on a quarterly basis using a price formula within the maximum and minimum price range. The maximum and minimum wholesale gas prices may be revised semiannually – as of 1 January and 1 July. In addition, the wholesale gas prices may be recalculated twice a year – as of 1 April and 1 October, based on changes in oil products prices in the European markets within a range of +/-3% from the prices set previously.

In May 2013, the FTS made changes to the Statement of Gas Price Formula Definition that provides for the possibility of adjusting the minimum and maximum wholesale gas prices for the next quarter of the calendar year in case there was a significant deviation (more than 5%) of natural gas prices calculated using a price formula in the previous quarter from the annual wholesale price changes set by the Russian Federation government.

As of 1 July 2012, the FTS increased the wholesale prices for natural gas sold to end-customers on the domestic market by 15.0%.

In 2013, average natural gas prices for sales to end-customers on the domestic market (excluding residential customers), as a result of the above pricing regulations becoming effective, were decreased by 3.0% from 1 April and increased by 15.0% from 1 July, by 3.1% from 1 August, and by 1.9% from 1 October. Effective from 1 January 2014, the FTS adjusted wholesale natural gas prices back to the August-September levels of 2013.

Based on the Ministry of Economic Development Forecast published in September 2013, wholesale natural gas prices in 2014 for sales to all customers' categories on the domestic market (excluding residential customers) will remain at the same price level as the August-September 2013 prices, and in July 2015 and 2016 will be increased by 4.8% and 4.9%, respectively. The Russian Federation government continues to debate various policies relating to the natural gas industry and natural gas pricing on the Russian domestic market.

Based on changes to the Russian Federation Tax Code, effective 1 July 2014, adjustments to the natural gas prices will be taken into account as one of the main parameters, together with transportation tariffs, for the calculation of UPT rates for natural gas (see "Our tax burden and obligatory payments" below). Therefore, deviations of potential future natural gas prices and transportation tariffs from the key parameters as defined in the current Forecasts of the Ministry of Economic Development will be considered in the determination of UPT rates, thus smoothing fluctuations and decreasing the volatility of gross profits of independent gas producers.



The specific terms for delivery of natural gas affect our average realized prices. Natural gas sold “ex-field” is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses. Historically, we have realized higher prices and net margins for natural gas volumes sold directly to end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. However, the historical norm may or may not prevail in the present or future market situations.

We deliver natural gas to residential customers of the Chelyabinsk and Kostroma regions of the Russian Federation at regulated prices as a result of our acquisitions of regional gas traders Gazprom mezhregiongas Chelyabinsk and Gazprom mezhregiongas Kostroma. We disclose such residential sales within our end-customers category.

In 2013, our average natural gas price to end-customers increased by 19.3%, respectively, primarily due to an increase in the average regulated FTS price by 14.5% as compared to 2012 (cumulative effect of a 3% decrease effective from 1 April 2013, and 15.0%, 3.1% and 1.9% increases effective from 1 July, 1 August and 1 October 2013), as well as due to the conclusion of new contracts with end-customers located at more distant regions (see “Recent Developments” above). Our average transportation expense for the delivery of natural gas to end-customers increased by 19.4% largely due to the same reason; namely, an increase in our average transportation distance (see “Transportation tariffs” below), as well as an average increase of 7.0% from 1 July 2012 and 6.4% from 1 August 2013 in the natural gas transportation tariff set by the FTS.

As a result, our average netback price on end-customers sales increased by 19.3%, while our total average natural gas price excluding transportation expense increased by 20.5% compared to respective prices in 2012.

The following table shows our average realized natural gas sales prices (net of VAT), excluding volumes purchased for resale in the location of our end-customers in 2012:

| <i>Russian roubles per mcm</i>                                          | <b>Year ended 31 December:</b> |              | <b>Change<br/>%</b> |
|-------------------------------------------------------------------------|--------------------------------|--------------|---------------------|
|                                                                         | <b>2013</b>                    | <b>2012</b>  |                     |
| Average natural gas price to end-customers <sup>(1)</sup>               | 3,366                          | 2,821        | 19.3%               |
| Average natural gas transportation expense for sales to end-customers   | (1,473)                        | (1,234)      | 19.4%               |
| Average natural gas netback price on end-customer sales                 | 1,895                          | 1,589        | 19.3%               |
| Average natural gas price ex-field (wholesale traders)                  | 1,830                          | 1,518        | 20.6%               |
| <b>Total average natural gas price excluding transportation expense</b> | <b>1,887</b>                   | <b>1,566</b> | <b>20.5%</b>        |

<sup>(1)</sup> Includes cost of transportation.

### **Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices**

Crude oil, stable gas condensate, LPG and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, the ability and willingness of oil producing countries to sustain or change production levels to meet changes in global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters.

The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management, such as movements in international benchmark crude oil and oil products prices. Crude oil that we sell bound for international markets is transported through the OAO AK Transneft (“Transneft”) pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as “Urals blend”, which historically trades at a discount to the international benchmark Brent crude oil. Among many other factors volatile movements in benchmark crude oil and oil products prices can have a positive and/or negative impact on the ultimate prices we receive for our liquids volumes sold on both the domestic and international markets.

Our stable gas condensate and refined products, LPG and crude oil prices on both the international and domestic markets include transportation expenses in accordance with the specific terms of delivery.

### *Stable gas condensate and refined products*

Our average realized stable gas condensate export contract price, including export duties, in 2013 marginally decreased by USD 29 per ton, or 3.1%, to approximately USD 904 per ton compared to approximately USD 933 per ton in 2012. The decrease in our average realized contract price was due to an overall decrease in the underlying benchmark of crude oil and related commodity prices on international markets used in price calculation (see “Selected macro-economic data” above).

In addition, our average realized export contract price depends on the geographical region and delivery terms, the quality of a product and the distance of shipment. In 2013, the share of stable gas condensate volumes sold to Europe increased while the share to the United States and South America decreased by 9% as compared to 2012; the share of volumes sold to the Asia Pacific Region (“APR”) remained at the same level. We sold stable gas condensate at different delivery terms: cost and freight (CFR), delivery to the port of destination ex-ship (DES), delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF).

In 2013, our average realized net export price for stable gas condensate, excluding export duties and translated to US dollars using the average exchange rate for the period, decreased by USD 35.5 per ton, or 6.7%, to USD 493.0 per ton from USD 528.5 per ton in 2012 due to a 3.1% decrease in our average export US dollars contract price, as mentioned above, and a 2.4% increase in the Russian rouble average exchange rate against the US dollar. That was partially offset by a 3.0% decrease in average export duties per ton, as set by the Russian Federation government (see “Selected macro-economic data” above).

Our average realized export contract prices for naphtha and other gas condensate refined products produced at the Ust-Luga Complex, including export duties, in 2013, were approximately USD 973 and USD 950 per ton, respectively. We sold naphtha and other gas condensate refined products at different delivery terms: CFR, CIF, DAP, DES, or free on board (FOB). There were no sales of gas condensate refined products in 2012 as the Ust-Luga Complex was formally commissioned in June 2013.

In 2013, our average realized net export price, excluding export duties and translated to US dollars using the average exchange rate for the period, for naphtha and other gas condensate refined products produced at the Ust-Luga Complex amounted to USD 633.5 per ton and USD 711.9 per ton, respectively.

The following table shows our average realized stable gas condensate and refined products, excluding trading activities. Prices in the table below are shown net of VAT and export duties, where applicable. Prices in US dollars were translated from Russian roubles using the average exchange rate for the period:

| <i>Russian roubles or US dollars per ton</i> | <b>Year ended 31 December:</b> |             | <b>Change<br/>%</b> |
|----------------------------------------------|--------------------------------|-------------|---------------------|
|                                              | <b>2013</b>                    | <b>2012</b> |                     |
| <b>Stable gas condensate</b>                 |                                |             |                     |
| Net export price, RR per ton                 | 15,703                         | 16,432      | (4.4%)              |
| Net export price, USD per ton                | 493.0                          | 528.5       | (6.7%)              |
| Domestic price, RR per ton                   | 12,979                         | 12,489      | 3.9%                |
| <b>Naphtha</b>                               |                                |             |                     |
| Net export price, RR per ton                 | 20,176                         | -           | n/a                 |
| Net export price, USD per ton                | 633.5                          | -           | n/a                 |
| <b>Other gas condensate refined products</b> |                                |             |                     |
| Net export price, RR per ton                 | 22,674                         | -           | n/a                 |
| Net export price, USD per ton                | 711.9                          | -           | n/a                 |

### *Liquefied petroleum gas*

In 2013, our average export contract price for LPG produced at the Purovsky Plant, including export duties, excise and fuel taxes expense, decreased by USD 74 per ton, or 8.4%, and was approximately USD 807 per ton compared to USD 881 per ton in 2012. The decrease in our average realized contract price was due to a decrease in the underlying benchmark of LPG prices on international markets used in price calculation (see “Selected macro-economic data” above). In 2013 and 2012, LPG export delivery terms were DAP at the border of the customer’s country and free carrier (FCA) at terminal points in Poland, as well as carriage paid to (CPT) the Port of Temryuk (southern Russia) in 2012.

In 2013, our average realized LPG net export price produced at the Purovsky Plant, excluding export duties, excise and fuel taxes expense, and translated to US dollars using the average exchange rate for the period, decreased by USD 22.1 per ton, or 3.4%, to USD 624.7 per ton from USD 646.8 per ton in 2012. The decrease of our average realized LPG net export price was due to a decrease in the average realized contract price by 8.4%, as mentioned above, that was partially offset by a 29.8% decrease in our average export duty per ton set by the Russian Federation government (see “Selected macro-economic data” above).

In 2013, we sold 502 thousand tons of our LPG on the domestic market at an average price of RR 14,527 per ton compared to sales of 426 thousand tons, including volumes purchased for resale, at an average price of RR 14,011 per ton in 2012.

The following table shows our average realized LPG sales prices, excluding trading activities. Prices in the table below are shown net of VAT, export duties, excise and fuel taxes expense, where applicable. Prices in US dollars were translated from Russian roubles using the average exchange rate for the period:

| <i>Russian roubles or US dollars per ton</i> | <b>Year ended 31 December:</b> |             | <b>Change<br/>%</b> |
|----------------------------------------------|--------------------------------|-------------|---------------------|
|                                              | <b>2013</b>                    | <b>2012</b> |                     |
| <b>LPG</b>                                   |                                |             |                     |
| Net export price, RR per ton                 | 19,897                         | 20,109      | (1.1%)              |
| Net export price, USD per ton                | 624.7                          | 646.8       | (3.4%)              |
| Domestic price, RR per ton                   | 14,527                         | 14,009      | 3.7%                |

#### *Crude oil*

Our average realized crude oil export contract price, including export duties, decreased by USD 18 per ton, or 2.3%, and was approximately USD 768 per ton compared to USD 786 per ton in 2012. The decrease in our average crude oil contract price was a result of a decrease in Brent benchmark crude oil price on the international markets (see “Selected macro-economic data” above). In 2013 and 2012, our crude oil export delivery terms were DAP (Feneshlitke, Hungary). In 2013, our crude oil was also sold under DAP (Budkovtse, Slovakia) delivery term.

In 2013, our average realized crude oil net export price, excluding export duties and translated to US dollars using the average exchange rate for the period, marginally decreased by USD 8.4 per ton, or 2.2%, to USD 375.5 per ton from USD 383.9 per ton in 2012 as a result of a decrease in our average export US dollars contract price by 2.3%, as mentioned above. It was partially offset by a 3.0% decrease in average export duties per ton, as set by the Russian Federation government (see “Selected macro-economic data” above).

Our average realized crude oil domestic price in 2013 was RR 11,819 per ton (excluding VAT) representing an increase of RR 834 per ton, or 7.6%, from RR 10,985 per ton (excluding VAT) in 2012 as a result of changes in customer mix and delivery of crude oil to the more remote regions.

The following table shows our average realized crude oil sales prices, net of VAT and export duties, where applicable. Prices in US dollars were translated from Russian roubles using the average exchange rate for the period:

| <i>Russian roubles or US dollars per ton</i> | <b>Year ended 31 December:</b> |             | <b>Change<br/>%</b> |
|----------------------------------------------|--------------------------------|-------------|---------------------|
|                                              | <b>2013</b>                    | <b>2012</b> |                     |
| <b>Crude oil</b>                             |                                |             |                     |
| Net export price, RR per ton                 | 11,959                         | 11,935      | 0.2%                |
| Net export price, USD per ton                | 375.5                          | 383.9       | (2.2%)              |
| Domestic price, RR per ton                   | 11,819                         | 10,985      | 7.6%                |

## Transportation tariffs

### *Natural gas*

We transport our natural gas through our own pipelines into the Unified Gas Supply System (“UGSS”), which is owned and operated by OAO Gazprom, a Russian Federation government controlled monopoly. Transportation tariffs for the use of the Gas Transmission System (“GTS”), as part of the UGSS, by independent producers are set by the FTS.

In accordance with the existing methodology of calculating transportation tariffs for natural gas produced in the Russian Federation for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan), the transportation tariff consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 kilometers (km). The rate for utilization of the trunk pipeline is based on an “input/output” function, which is determined by where natural gas enters and exits the trunk pipeline and includes a constant rate for end-customers using Gazprom’s gas distribution systems. The constant rate is deducted from the utilization rate for end-customers using non-Gazprom gas distribution systems.

Effective from 1 July 2012, the FTS approved a 7.0% average increase of the transportation tariff for natural gas, and the rate for utilization of the trunk pipeline was set on an average between RR 50.78 to RR 1,995.44 (excluding VAT) per mcm and the transportation rate was set at RR 12.02 (excluding VAT) per mcm per 100 km.

Effective from 1 August 2013, the FTS approved a 6.4% average increase of the transportation tariff for natural gas, and the rate for utilization of the trunk pipeline was set on an average between RR 57.18 to RR 2,048.11 (excluding VAT) per mcm and the transportation rate was set at RR 12.79 (excluding VAT) per mcm per 100 km.

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in September 2013, transportation tariffs for natural gas produced by independent producers in 2014-2016 will not exceed the increase in wholesale natural gas prices and will be increased by zero percent in 2014 and by 4.8% and 4.9% in 2015 and 2016, respectively.

### *Stable gas condensate and LPG by rail*

We transport our stable gas condensate (from the Purovsky Plant to the Port of Vitino on the White Sea and to the Port of Ust-Luga on the Baltic Sea or to customers on the domestic markets) and LPG (from the Purovsky Plant to customers on the domestic market and to the border of the Russian Federation for export market sales) by rail which is owned by Russia’s state-owned monopoly railway operator – OAO Russian Railways (“RZD”). Our transportation tariffs for transport by rail are set by the FTS and vary depending on the type of a product and the length of the transport route. For our stable gas condensate and LPG transportation purposes we use our own rail cars and rail cars rented from independent Russian transportation companies.

According to orders issued by the FTS, we applied the discount co-efficients to the railroad transportation tariffs related to export deliveries from the Limbey rail station of stable gas condensate during 2012 and LPG during 2012 and January 2013. The discount co-efficients for stable gas condensate and LPG were set at 0.89 and 0.71, respectively.

In December 2012, the FTS made amendments to the regulations governing railroad transportation tariffs within the territory of the Russian Federation, and approved the terms and conditions of applying the railroad tariffs within the predetermined limits (the minimum and maximum range). In addition, in December 2012, the FTS announced changes to the railroad transportation tariffs effective from January 2013, which provided the FTS ability to apply discounts and multiply co-efficients to the existing railroad transportation tariffs based on the type of product, direction and length of the transportation route. According to the amendments, the FTS sets the minimum and maximum range of railroad tariffs for the transportation of all types of goods transported by the railroad system, and for certain segments of railroad transportation services. Russia’s state-owned monopoly railway operator RZD may vary railroad transportation tariffs within the minimum and maximum range. In March 2013, the Management Board of RZD took a decision to apply the discount co-efficient of 0.917 to the existing railroad transportation tariffs related to stable gas condensate deliveries from the Limbey rail station (located in close proximity to our Purovsky Plant). We applied the discount co-efficient from 18 April 2013 until the end of 2013. In 2014, we will apply the discount co-efficient of 0.94 to the existing railroad transportation tariffs.

### *Stable gas condensate and refined products by tankers*

We deliver our stable gas condensate to international markets via the Port of Vitino on the White Sea and the Port of Ust-Luga on the Baltic Sea using chartered tankers. We deliver stable gas condensate refined products (light and heavy naphtha, jet fuel, gasoil and fuel oil) to international markets via the loading terminal at the Port of Ust-Luga on the Baltic Sea. The tanker transportation cost is determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

### *Crude oil*

We transport most of our crude oil through the pipeline network owned and operated by Transneft, Russia's state-owned monopoly crude oil pipeline operator. The FTS sets tariffs for transportation of crude oil through Transneft's pipeline network, which includes transport, dispatch, pumping, loading, charge-discharge, transshipment and other services. The FTS sets tariffs for each separate route of the pipeline network, so the overall expense for the transport of crude oil primarily depends on the length of the transport route from the producing fields to the ultimate destination, transportation direction and other factors.

Crude oil transportation tariffs within the Russian Federation territory were increased on average by 5.5% in November 2012. In 2013, crude oil transportation tariffs within the Russian Federation territory did not change.

### **Our tax burden and obligatory payments**

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax, significant taxes to which we are subject include VAT, unified natural resources production tax ("UPT", commonly referred as "MET" – mineral extraction tax), export duties, property tax, payments to non-budget funds and other contributions.

In practice, Russian tax authorities often have their own interpretation of tax laws that rarely favors taxpayers, who have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to an inspection of their activities for a period of three calendar years immediately preceding the year in which the audit is conducted. Previous audits do not completely exclude subsequent claims relating to the audited period. In addition, in some instances, new tax regulations may have a retroactive effect.

We have not employed any tax minimization schemes using offshore or domestic tax zones in the Russian Federation.

### *UPT*

According to the Russian Federation Tax Code, the UPT rate for natural gas produced by independent natural gas producers is determined by a stated base rate and a reducing co-efficient for independent natural gas producers. In 2012, the UPT rate for independent natural gas producers was set at RR 251 per mcm and was increased to RR 265 per mcm and to RR 402 per mcm effective from 1 January and 1 July 2013, respectively. From 1 January 2014, the UPT rate for independent gas producers is set at RR 471 per mcm, and it will be in effect until 1 July 2014 when the amendments to the Russian Tax Code on the new methodology of UPT rate calculation become effective (see below).

In 2012, the UPT rate for gas condensate was set at RR 556 per ton and was subsequently increased to RR 590 per ton in 2013. Effective from 1 January 2014, the UPT rate for gas condensate for 2014 is set at RR 647 per ton. This rate will also be in effect until 1 July 2014 when the amendments to the Russian Tax Code on the new methodology of UPT rate calculation become effective (see below).

In June 2012, the Russian Federation government made a decision to develop a new approach on taxation of the natural gas producers by linking the UPT rate for natural gas to regulated natural gas prices and transportation tariffs growth. In September 2013, the amendments to the Russian Federation Tax Code were made which changed the current approach to natural gas and gas condensate UPT rate calculation (fixed rate) to a formula-based approach that takes into account the base UPT rate, the base value of a standard fuel equivalent and a co-efficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field. The new approach to the calculation of UPT rates becomes effective 1 July 2014. Furthermore, from 1 January 2015, the UPT rate will also depend on the excess of the set average transportation tariff for the prior year over the 2013 tariff adjusted to the change in consumer prices. The base UPT rate is set at RR 35 per one thousand meter of extracted natural gas and at RR 42 per one ton of extracted gas condensate. A co-efficient characterizing the difficulty of extracting natural gas and gas condensate is defined as a minimum value from the co-efficients characterizing either the reserves' depletion, the field's geographical location, the deposit's (or reservoir's) depth, assignment of the field to the regional gas supply chain or particular features of certain field deposits development.

The UPT rate for crude oil is calculated each month based on a formula that links the base UPT rate and coefficients characterizing crude oil price dynamics, reserve depletion and the size of a particular field, as well as the difficulty of extracting and reserve depletion of a particular hydrocarbon deposit. The base crude oil UPT rate in 2012 was set at RR 446 per ton and increased to RR 470 per ton in 2013.

In September 2013, the Government of the Russian Federation approved changes to the regulations based on which the base UPT rate is increased to RR 493 per ton effective 1 January 2014 (in 2015 and 2016 the base value is set at RR 530 per ton and RR 559 per ton, respectively). Also, the formula for crude oil export duty rate calculation was changed (see "Export duties" below). The UPT rate for crude oil is calculated in US dollar and translated into Russian roubles using the monthly average exchange rate established by the Central Bank of Russian Federation.

The Russian Tax Code provides for reduced or zero UPT rate for crude oil produced in certain geographical areas of Russian Federation. According to the Russian Tax Code a zero UPT rate is set for crude oil produced at fields located fully or partially in the YNAO to the north of the 65th degree of the northern latitude effective from 1 January 2012. Our Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye fields are located in the mentioned geographical areas; therefore, we applied the zero UPT rate for crude oil produced at these fields effective from 1 January 2012.

#### *Export duties*

We are subject to export duties on our exports of liquid hydrocarbons (stable gas condensate and refined products, LPG, and crude oil). According to the amendments to the Law of the Russian Federation "Concerning the Customs Tariff", effective from 1 April 2013, the Russian Federation government established formulas for the Ministry of Economic Development for calculating the monthly export duties for exported liquid hydrocarbons (see "Selected macro-economic data" above).

The export duty rate for stable gas condensate and crude oil is calculated based on the average Urals crude oil price for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month and is set for the following month after the current calendar month. Calculation of the export duty rate when the average Urals crude oil price is more than USD 182.5 per ton is set as follows: USD 29.2 plus 60% of the difference between the average Urals crude oil price and USD 182.5 per ton. Changes in the regulations, which became effective 1 January 2014, decreased the set percentage of the difference used in the formula from 60% to 59%. In 2015 and 2016, set percentages will amount to 57% and 55%, respectively.

The export duty rate for LPG is calculated based on the average LPG price at the Polish border (DAF, Brest) for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month and is set for the following month after the current calendar month.

The export duty rate for oil products is calculated based on the export duty rate for crude oil and is adjusted by a co-efficient set for each category of oil products. Effective from 1 October 2011, the export duty rate for naphtha was set at 90% of the crude oil export duty rate. The export duty rate for jet fuel and gasoil is set at 66% of the crude oil export duty rate. Effective 1 January 2014, the export duty rate for our gasoil is set at 65% of the crude oil export duty rate and will be reduced to 63% and 61% in 2015 and 2016, respectively. The export duty rate for fuel oil is currently set at 66% of the crude oil export duty rate until 1 January 2015 and will be equal to the crude oil export duty rate thereafter.

### *Social insurance tax*

Effective from 2012, the social insurance tax rates for contributions to the Pension Fund of the Russian Federation, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund of the Russian Federation paid by the employer on behalf of employees were set at 22.0%, 5.1% and 2.9%, respectively, for a cumulative social burden of 30.0%. The maximum taxable base for these rates per each employee was set at RR 512 thousand and RR 568 thousand of annual income in 2012 and 2013, respectively, and was increased to RR 624 thousand of annual income in 2014. For annual income above the maximum taxable base, the tax rate is set to 10.0% to the Pension Fund and nil for other funds.

## OIL AND GAS RESERVES

We do not file with the SEC nor are obliged to report our reserves in compliance with these standards. However, we have consistently disclosed proved oil and gas reserves as unaudited supplemental information in the Group's IFRS audited consolidated financial statements. The Group's total proved reserves, comprised of proved developed and proved undeveloped reserves as of 31 December 2013 and 2012, are provided using the SEC reserves reporting classification. We also provide additional information about our hydrocarbon reserves based on the widely-industry accepted PRMS reserves reporting classification, which in addition to total proved reserves discloses information on our probable and possible reserves. Our reserves estimates are appraised annually by the Group's independent petroleum engineers, DeGolyer and MacNaughton ("D&M").

Proved reserves disclosed in the "*Unaudited Supplemental Oil and Gas Disclosures*" in the Group's IFRS consolidated financial statements are presented under SEC reserve reporting methodology based on 100% of the reserves attributable to all consolidated subsidiaries (whether or not wholly owned), as well as our proportionate share of proved reserves in companies accounted for by the equity method based on our equity ownership interest.

Our total SEC proved reserves, as presented in the tables below, differ from the total net proved reserves as reported in the "*Unaudited Supplemental Oil and Gas Disclosures*" in the Group's IFRS consolidated financial statements, in that total net proved reserves as presented in the Group's IFRS consolidated financial statements include net proved reserves of natural gas and liquids attributable to non-controlling interest in our subsidiaries. Thus the proved reserves disclosure in this report differs from the proved reserves disclosure in the consolidated financial statements.



The tables below provide a comparison of the Group's estimated reserves under SEC and PRMS reserve classifications attributable to all consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in the respective fields.

|                                                                                            | Natural gas                   |                                 |                               |                                 |
|--------------------------------------------------------------------------------------------|-------------------------------|---------------------------------|-------------------------------|---------------------------------|
|                                                                                            | SEC                           |                                 | PRMS                          |                                 |
|                                                                                            | <i>Billions of cubic feet</i> | <i>Billions of cubic meters</i> | <i>Billions of cubic feet</i> | <i>Billions of cubic meters</i> |
| <i>Based on our equity ownership interest in the fields</i>                                |                               |                                 |                               |                                 |
| <b>Total proved reserves at 31 December 2011</b>                                           | <b>46,663</b>                 | <b>1,321</b>                    | <b>55,979</b>                 | <b>1,585</b>                    |
| <i>including subsidiaries</i>                                                              | <i>26,427</i>                 | <i>748</i>                      | <i>27,417</i>                 | <i>776</i>                      |
| <i>including joint ventures</i>                                                            | <i>20,236</i>                 | <i>573</i>                      | <i>28,562</i>                 | <i>809</i>                      |
| Changes attributable to:                                                                   |                               |                                 |                               |                                 |
| Revisions of previous estimates, extensions and discoveries                                | 1,970                         | 56                              | 2,920                         | 83                              |
| Acquisitions in 2011 <sup>(1)</sup>                                                        | 12,717                        | 360                             | 17,386                        | 492                             |
| Acquisitions <sup>(2)</sup>                                                                | 2,729                         | 77                              | 3,221                         | 91                              |
| Production                                                                                 | (1,992)                       | (56)                            | (1,992)                       | (56)                            |
| <b>Total proved reserves at 31 December 2012</b>                                           | <b>62,087</b>                 | <b>1,758</b>                    | <b>77,514</b>                 | <b>2,195</b>                    |
| <i>including subsidiaries</i>                                                              | <i>38,324</i>                 | <i>1,085</i>                    | <i>44,062</i>                 | <i>1,248</i>                    |
| <i>including joint ventures</i>                                                            | <i>23,763</i>                 | <i>673</i>                      | <i>33,452</i>                 | <i>947</i>                      |
| Changes attributable to:                                                                   |                               |                                 |                               |                                 |
| Revisions of previous estimates, extensions and discoveries                                | 2,899                         | 82                              | 1,880                         | 53                              |
| Acquisitions <sup>(3)</sup>                                                                | 5,699                         | 161                             | 7,727                         | 219                             |
| Disposals <sup>(4)</sup>                                                                   | (7,073)                       | (200)                           | (9,349)                       | (265)                           |
| Production                                                                                 | (2,157)                       | (61)                            | (2,157)                       | (61)                            |
| <b>Total proved reserves at 31 December 2013</b>                                           | <b>61,455</b>                 | <b>1,740</b>                    | <b>75,615</b>                 | <b>2,141</b>                    |
| <i>including subsidiaries</i>                                                              | <i>36,824</i>                 | <i>1,042</i>                    | <i>42,622</i>                 | <i>1,207</i>                    |
| <i>including joint ventures</i>                                                            | <i>24,631</i>                 | <i>698</i>                      | <i>32,993</i>                 | <i>934</i>                      |
| Plus: non-controlling interest                                                             | 128                           | 4                               |                               |                                 |
| <b>Total proved reserves at 31 December 2013 per the consolidated financial statements</b> | <b>61,583</b>                 | <b>1,744</b>                    |                               |                                 |

<sup>(1)</sup> Acquisitions in 2011 represent reserves attributable to licenses acquired (Salmanovskoye (Utrenneye) and Geofizicheskoye fields), which were appraised in 2012 and include exploration surveys made after acquisition.

<sup>(2)</sup> Acquisitions represent reserves attributable to our acquisition of a 49% equity stake in our joint venture Nortgas completed in 2012.

<sup>(3)</sup> Acquisitions represent reserves attributable to the East-Tazovskoye field acquired in March 2013, as well as acquisition of additional shares of our joint ventures Nortgas and SeverEnergiya acquired in June and December 2013, respectively.

<sup>(4)</sup> Disposals represent reserves related to the sale of a 51% ownership interest in Sibneftegas and a 20% ownership interest in Yamal LNG in December 2013.

| <i>Based on our equity ownership interest in the fields</i>                                | Crude oil, gas condensate and natural gas liquids |                         |                     |                         |
|--------------------------------------------------------------------------------------------|---------------------------------------------------|-------------------------|---------------------|-------------------------|
|                                                                                            | SEC                                               |                         | PRMS                |                         |
|                                                                                            | Millions of barrels                               | Millions of metric tons | Millions of barrels | Millions of metric tons |
| <b>Total proved reserves at 31 December 2011</b>                                           | <b>752</b>                                        | <b>91</b>               | <b>970</b>          | <b>118</b>              |
| <i>including subsidiaries</i>                                                              | 469                                               | 57                      | 571                 | 70                      |
| <i>including joint ventures</i>                                                            | 283                                               | 34                      | 399                 | 48                      |
| Changes attributable to:                                                                   |                                                   |                         |                     |                         |
| Revisions of previous estimates, extensions and discoveries                                | 17                                                | 0                       | 89                  | 9                       |
| Acquisitions in 2011 <sup>(1)</sup>                                                        | 78                                                | 9                       | 119                 | 14                      |
| Acquisitions <sup>(2)</sup>                                                                | 85                                                | 10                      | 100                 | 12                      |
| Production                                                                                 | (36)                                              | (4)                     | (36)                | (4)                     |
| <b>Total proved reserves at 31 December 2012</b>                                           | <b>896</b>                                        | <b>106</b>              | <b>1,242</b>        | <b>149</b>              |
| <i>including subsidiaries</i>                                                              | 526                                               | 63                      | 706                 | 86                      |
| <i>including joint ventures</i>                                                            | 370                                               | 43                      | 536                 | 63                      |
| Changes attributable to:                                                                   |                                                   |                         |                     |                         |
| Revisions of previous estimates, extensions and discoveries                                | 98                                                | 10                      | 64                  | 6                       |
| Acquisitions <sup>(3)</sup>                                                                | 236                                               | 27                      | 375                 | 43                      |
| Disposals <sup>(4)</sup>                                                                   | (34)                                              | (4)                     | (51)                | (6)                     |
| Production                                                                                 | (40)                                              | (5)                     | (40)                | (5)                     |
| <b>Total proved reserves at 31 December 2013</b>                                           | <b>1,156</b>                                      | <b>134</b>              | <b>1,590</b>        | <b>187</b>              |
| <i>including subsidiaries</i>                                                              | 485                                               | 58                      | 649                 | 79                      |
| <i>including joint ventures</i>                                                            | 671                                               | 76                      | 941                 | 108                     |
| Plus: non-controlling interest                                                             | 17                                                | 2                       |                     |                         |
| <b>Total proved reserves at 31 December 2013 per the consolidated financial statements</b> | <b>1,173</b>                                      | <b>136</b>              |                     |                         |

- (1) Acquisitions in 2011 represent reserves attributable to licenses acquired (Salmanovskoye (Utrenneye) and Geofizicheskoye fields), which were appraised in 2012 and include exploration surveys made after acquisition.
- (2) Acquisitions represent reserves attributable to our acquisition of a 49% equity stake in our joint venture Nortgas completed in 2012.
- (3) Acquisitions represent reserves attributable to the East-Tazovskoye field acquired in March 2013, as well as acquisition of additional shares of our joint ventures Nortgas and SeverEnergiya acquired in June and December 2013, respectively.
- (4) Disposals represent reserves related to the sale of a 51% ownership interest in Sibneftegas and a 20% ownership interest in Yamal LNG in December 2013.

The following table provides for our combined SEC and PRMS proved reserves on a total barrel of oil equivalent basis.

| <i>Based on our equity ownership interest in the fields</i> | Combined natural gas, crude oil, gas condensate and natural gas liquids in millions of barrels of oil equivalent |        |
|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------|--------|
|                                                             | SEC                                                                                                              | PRMS   |
| <b>Total proved reserves:</b>                               |                                                                                                                  |        |
| At 31 December 2011                                         | 9,393                                                                                                            | 11,337 |
| At 31 December 2012                                         | 12,394                                                                                                           | 15,597 |
| At 31 December 2013                                         | 12,537                                                                                                           | 15,593 |
| <i>including subsidiaries</i>                               | 7,304                                                                                                            | 8,542  |
| <i>including joint ventures</i>                             | 5,233                                                                                                            | 7,051  |

As of 31 December 2013, the Group's SEC proved reserves attributable to all consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in the respective fields aggregated approximately 1.74 trillion cubic meters ("tcm") of natural gas and 134 million tons of crude oil, gas condensate and natural gas liquids. Combined, these proved reserves represent approximately 12.54 billion barrels of oil equivalent.

The increase in our total SEC proved reserves in barrels of oil equivalent basis from 12.39 billion to 12.54 billion barrels of oil equivalent in 2013 was primarily due to the increase in our liquid hydrocarbons reserves from 106 million to 134 million tons as a result of the change in Group's oil and gas assets' composition. The Group swapped its 51% share in Sibneftegas for the increase in its share in SeverEnergia (see "Recent Developments" above). SeverEnergia's license areas contain significant volumes of wet gas (rich in gas condensate) while Sibneftegas' license areas contain mostly dry natural gas, which resulted in the increase of liquid hydrocarbons and a decrease in natural gas reserves of the Group. The sale of our 20% stake in the Yamal LNG joint venture to CNPC in accordance with the Group's strategy also had a significant impact on our total proved natural gas reserves, which were partially offset by the reserves attributable to the acquisition of the East-Tazovskoye field.

As we continue to invest capital into the development of our fields, we anticipate that we will increase our resource base as well as migrate reserves among the reserve categories.

The PRMS reserve classification standards allows for the reporting of reserves estimates for probable and possible reserves as presented in the following table:

| <i>Under PRMS classification<br/>(based on our equity ownership interest in the fields)</i> | Natural gas                   |                                 | Crude oil, gas condensate and natural gas liquids |                                |
|---------------------------------------------------------------------------------------------|-------------------------------|---------------------------------|---------------------------------------------------|--------------------------------|
|                                                                                             | <i>Billions of cubic feet</i> | <i>Billions of cubic meters</i> | <i>Millions of barrels</i>                        | <i>Millions of metric tons</i> |
| <b>Probable reserves:</b>                                                                   |                               |                                 |                                                   |                                |
| At 31 December 2011                                                                         | 18,471                        | 523                             | 652                                               | 81                             |
| At 31 December 2012                                                                         | 32,168                        | 911                             | 801                                               | 98                             |
| At 31 December 2013                                                                         | 34,760                        | 984                             | 1,055                                             | 126                            |
| <i>including subsidiaries</i>                                                               | <i>22,612</i>                 | <i>640</i>                      | <i>480</i>                                        | <i>59</i>                      |
| <i>including joint ventures</i>                                                             | <i>12,148</i>                 | <i>344</i>                      | <i>575</i>                                        | <i>67</i>                      |
| <b>Possible reserves:</b>                                                                   |                               |                                 |                                                   |                                |
| At 31 December 2011                                                                         | 17,187                        | 487                             | 1,000                                             | 127                            |
| At 31 December 2012                                                                         | 24,664                        | 698                             | 1,193                                             | 146                            |
| At 31 December 2013                                                                         | 23,649                        | 670                             | 1,390                                             | 171                            |
| <i>including subsidiaries</i>                                                               | <i>14,505</i>                 | <i>411</i>                      | <i>611</i>                                        | <i>77</i>                      |
| <i>including joint ventures</i>                                                             | <i>9,144</i>                  | <i>259</i>                      | <i>779</i>                                        | <i>94</i>                      |

The increase in the Group's PRMS probable reserves during 2013 was primarily due to the increased ownership interest in SeverEnergia's reserves that was partially offset by the disposal of ownership interest in Sibneftegas and the decreased ownership interest in Yamal LNG and their reserves, respectively (see "Recent Developments" above).

The Group's reserves are located in the Russian Federation, in the Yamal-Nenets Autonomous Region (Western Siberia), thereby representing one geographical area.

The below table contains information about reserve/production ratios for the years ended 31 December 2013 and 2012 under both reserves reporting methodologies based on our equity ownership interest in the fields attributable to consolidated subsidiaries and joint ventures:

| <i>Number of years (based on our equity ownership interest in the fields)</i> | SEC                         |             | PRMS                        |             |
|-------------------------------------------------------------------------------|-----------------------------|-------------|-----------------------------|-------------|
|                                                                               | <i>At 31 December: 2013</i> | <i>2012</i> | <i>At 31 December: 2013</i> | <i>2012</i> |
| Total proved reserves to production                                           | 29                          | 31          | 36                          | 39          |
| Total proved and probable reserves to production                              | -                           | -           | 53                          | 55          |
| Total proved, probable and possible reserves to production                    | -                           | -           | 66                          | 69          |

The Group's oil and gas estimation and reporting process involves an annual independent external appraisal as well as internal technical appraisals of reserves. The Group maintains its own internal reserve estimates that are calculated by qualified technical staff working directly with the oil and gas properties. The Group periodically updates reserves estimates during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for reserve determinations. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history. Our reserves estimates were prepared using standard geological and engineering methods generally accepted in the petroleum industry. The Group and D&M's technical staffs meet to review and discuss the information provided, and upon completion of the process, senior management reviews and approves the final reserves estimates issued by D&M.

The Reserves Management and Assessment Group ("RMAG") is comprised of qualified technical staff from various departments – geological and geophysical, gas and liquids commercial operations, capital construction, production, financial planning and analysis and includes technical and financial representatives from the Group's subsidiaries, which are the principal holders of the mineral licenses. The person responsible for overseeing the work of the RMAG is a member of the Management Board.

The approval of the final reserve estimates is the sole responsibility of the Group's senior management.

## OPERATIONAL HIGHLIGHTS

### Oil and Gas Production Costs

Oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the “*Unaudited Supplemental Oil and Gas Disclosures*” in our consolidated financial statements and relate to our consolidated subsidiaries. Oil and gas production costs do not include general corporate overheads or their associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the years presented in millions of Russian roubles and on a barrel of oil equivalent (boe) basis in Russian roubles and US dollars:

| <i>millions of Russian roubles</i>               | Year ended 31 December: |               | Change<br>%  |
|--------------------------------------------------|-------------------------|---------------|--------------|
|                                                  | 2013                    | 2012          |              |
| <b>Production costs:</b>                         |                         |               |              |
| Lifting costs                                    | 7,103                   | 6,505         | 9.2%         |
| Taxes other than income tax                      | 21,296                  | 16,546        | 28.7%        |
| Transportation expenses                          | 87,157                  | 57,888        | 50.6%        |
| <b>Total production costs before DDA</b>         | <b>115,556</b>          | <b>80,939</b> | <b>42.8%</b> |
| Depreciation, depletion and amortization (“DDA”) | 12,274                  | 10,589        | 15.9%        |
| <b>Total production costs</b>                    | <b>127,830</b>          | <b>91,528</b> | <b>39.7%</b> |
| <i>RR per boe</i>                                |                         |               |              |
|                                                  |                         |               |              |
| <b>Production costs:</b>                         |                         |               |              |
| Lifting costs                                    | 18.8                    | 17.8          | 5.6%         |
| Taxes other than income tax                      | 56.4                    | 45.3          | 24.5%        |
| Transportation expenses                          | 230.8                   | 158.4         | 45.7%        |
| <b>Total production costs before DDA</b>         | <b>306.0</b>            | <b>221.5</b>  | <b>38.1%</b> |
| Depreciation, depletion and amortization         | 32.6                    | 29.0          | 12.4%        |
| <b>Total production costs</b>                    | <b>338.6</b>            | <b>250.5</b>  | <b>35.2%</b> |
| <i>USD per boe <sup>(1)</sup></i>                |                         |               |              |
|                                                  |                         |               |              |
| <b>Production costs:</b>                         |                         |               |              |
| Lifting costs                                    | 0.59                    | 0.57          | 3.5%         |
| Taxes other than income tax                      | 1.77                    | 1.46          | 21.2%        |
| Transportation expenses                          | 7.25                    | 5.09          | 42.4%        |
| <b>Total production costs before DDA</b>         | <b>9.61</b>             | <b>7.12</b>   | <b>35.0%</b> |
| Depreciation, depletion and amortization         | 1.02                    | 0.94          | 8.5%         |
| <b>Total production costs</b>                    | <b>10.63</b>            | <b>8.06</b>   | <b>31.9%</b> |

<sup>(1)</sup> Production costs in US dollars per boe were translated from Russian roubles per boe using the average exchange rate for the period (see “Selected macro-economic data” above).

Production costs represent the amounts directly related to the extraction of natural gas and liquids, gas condensate and crude oil from the reservoir and other related costs; including production expenses, taxes other than income tax (production taxes), insurance expenses and shipping, transportation and handling costs to end-customers. The average production cost on a barrel of oil equivalent basis is calculated by dividing the applicable costs by the respective barrel of oil equivalent of our hydrocarbons produced during the year. Natural gas, gas condensate and crude oil volumes produced by our fields are converted to a barrel of oil equivalent based on the relative energy content of each fields’ hydrocarbons.

Our lifting costs, as presented in the tables above, differ from lifting costs as reflected in the “*Unaudited Supplemental Oil and Gas Disclosures*” in the Group’s IFRS consolidated financial statements, in that the lifting costs as presented in the Group’s IFRS consolidated financial statements include changes in balances of natural gas and hydrocarbon liquids to more appropriately match costs incurred to revenues under the IFRS matching principles. A reconciliation of lifting costs as reflected in the “*Unaudited Supplemental Oil and Gas Disclosures*” in the Group’s IFRS consolidated financial statements is set forth below:

| <i>millions of Russian roubles</i>                                                                                                   | <b>Year ended 31 December:</b> |              | <b>Change<br/>%</b> |
|--------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|--------------|---------------------|
|                                                                                                                                      | <b>2013</b>                    | <b>2012</b>  |                     |
| Lifting costs presented in “Oil and Gas Production Costs” above                                                                      | 7,103                          | 6,505        | 9.2%                |
| Change in balances of natural gas and hydrocarbon liquids stated at cost in the Group’s Consolidated Statement of Financial Position | 1,927                          | 1,094        | 76.1%               |
| <b>Lifting costs per<br/>“Unaudited Supplemental Oil and Gas Disclosures”</b>                                                        | <b>9,030</b>                   | <b>7,599</b> | <b>18.8%</b>        |

## Hydrocarbon production and sales volumes

Our natural gas sales volumes in 2013 increased due to a combination of increased production at our Yurkharovskoye field and at our joint venture's fields, as well as increased purchases from our related parties, that was partially offset by an increase in natural gas volumes injected into Underground Gas Storage Facilities ("UGSF") and the GTS as of 31 December 2013.

Our liquids sales volumes increased mainly due to an increase in unstable gas condensate production of the Group's joint ventures, and, to a lesser extent, due to a decrease in liquids inventory balance at the end of 2013 as compared to a significant increase at the end of 2012. Our liquids inventory balances tend to fluctuate periodically due to loading schedules and final destinations of stable gas condensate and its refined products shipments.

### *Natural gas production volumes*

In 2013, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 4,747 mmcm, or 8.4%, to 61,216 mmcm from 56,469 mmcm in 2012.

| <i>millions of cubic meters</i>                                                                           | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|-----------------------------------------------------------------------------------------------------------|--------------------------------|---------------|---------------------|
|                                                                                                           | <b>2013</b>                    | <b>2012</b>   |                     |
| <b>Production by subsidiaries from:</b>                                                                   |                                |               |                     |
| Yurkharovskoye field                                                                                      | 37,775                         | 34,054        | 10.9%               |
| East-Tarkosalinskoye field                                                                                | 10,946                         | 12,742        | (14.1%)             |
| Khancheyskoye field                                                                                       | 3,256                          | 3,647         | (10.7%)             |
| Other fields                                                                                              | 237                            | 64            | 270.3%              |
| <b>Total natural gas production by subsidiaries</b>                                                       | <b>52,214</b>                  | <b>50,507</b> | <b>3.4%</b>         |
| <b>Group's proportionate share in the production of joint ventures:</b>                                   |                                |               |                     |
| Sibneftegas                                                                                               | 5,396                          | 5,335         | 1.1%                |
| Nortgas                                                                                                   | 2,382                          | 197           | n/m                 |
| SeverEnergia                                                                                              | 1,224                          | 430           | 184.7%              |
| <b>Total Group's proportionate share<br/>in the natural gas production of joint ventures</b>              | <b>9,002</b>                   | <b>5,962</b>  | <b>51.0%</b>        |
| <b>Total natural gas production including<br/>proportionate share in the production of joint ventures</b> | <b>61,216</b>                  | <b>56,469</b> | <b>8.4%</b>         |

In 2013, our volumes of natural gas produced by our subsidiaries increased by 1,707 mmcm, or 3.4%, to 52,214 mmcm from 50,507 mmcm in 2012 primarily due to an increase in production at our Yurkharovskoye field resulting from the field's ongoing development activities and the launch of the fourth stage of the second phase development in October 2012 (see "Recent developments" above). The main reason for the reduction in natural gas production at the East-Tarkosalinskoye field was the Groups' decision to optimize the production of liquid hydrocarbons: we reduced our natural gas production at the East-Tarkosalinskoye field that allowed us to grow natural gas production at the Yurkharovskoye field, thus increasing unstable gas condensate production. In addition, our natural gas production decreased at the East-Tarkosalinskoye and Khancheyskoye fields due to the natural declines in the reservoir pressure at the current gas producing horizons.

In 2013, our proportionate share in the production of our joint ventures increased by 3,040 mmcm, or 51.0%, to 9,002 mmcm from 5,962 mmcm in 2012 as a result of the acquisition of a 49% ownership interest in Nortgas in November 2012 (subsequently increased to 50%), as well as the launch of the Samburgskoye field's two phases development in 2012 by our joint venture SeverEnergia.

### Natural gas sales volumes

In 2013, our total natural gas sales volumes increased by 5,272 mmcm, or 9.0%, to 64,152 mmcm from 58,880 mmcm in 2012.

| <i>millions of cubic meters</i>                                  | Year ended 31 December: |               | Change<br>%    |
|------------------------------------------------------------------|-------------------------|---------------|----------------|
|                                                                  | 2013                    | 2012          |                |
| Natural gas production by subsidiaries                           | 52,214                  | 50,507        | 3.4%           |
| Purchases from the Group's joint ventures                        | 7,799                   | 5,335         | 46.2%          |
| Other purchases                                                  | 6,443                   | 3,533         | 82.4%          |
| <b>Total production and purchases</b>                            | <b>66,456</b>           | <b>59,375</b> | <b>11.9%</b>   |
| Purovsky Plant, own usage and methanol production                | (137)                   | (126)         | 8.7%           |
| Decrease (increase) in GTS, UGSS and own pipeline infrastructure | (2,167)                 | (369)         | n/m            |
| <b>Total natural gas sales volumes</b>                           | <b>64,152</b>           | <b>58,880</b> | <b>9.0%</b>    |
| <i>Sold to end-customers</i>                                     | <i>57,021</i>           | <i>40,806</i> | <i>39.7%</i>   |
| <i>Sold ex-field</i>                                             | <i>7,131</i>            | <i>18,074</i> | <i>(60.5%)</i> |

In 2013, natural gas purchases from our joint ventures increased by 2,464 mmcm, or 46.2%, primarily due to the commencement of purchases from Nortgas in January 2013.

Other natural gas purchases increased by 2,910 mmcm, or 82.4%, primarily due to increased purchases from our related party OAO SIBUR Holding ("SIBUR"). Other natural gas purchases are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as optimizing customers' portfolios.

In 2013, we used 77 mmcm of natural gas as feedstock for the production of methanol compared to 75 mmcm in 2012. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation during the production, preparation and transportation of hydrocarbons.

As of 31 December 2013, our natural gas inventory balance in GTS, UGSS and our own pipeline infrastructure comprised 3,296 mmcm and increased by 2,167 mmcm during the year as compared to an increase by 369 mmcm in 2012. The increase in our natural gas inventory balance during 2013 was caused by abnormally warm weather in Russia in the fourth quarter of 2013, as well as the planned significant withdrawal of natural gas in the first quarter of 2014 due to contractual obligations (see "Change in natural gas, liquid hydrocarbons and work-in-progress" below).



### Liquids production volumes

In 2013, our total liquids production (including our proportionate share in the production of joint ventures) increased by 481 thousand tons, or 11.3%, to 4,751 thousand tons from 4,270 thousand tons in 2012.

| <i>thousands of tons</i>                                                                              | Year ended 31 December: |              | Change<br>%  |
|-------------------------------------------------------------------------------------------------------|-------------------------|--------------|--------------|
|                                                                                                       | 2013                    | 2012         |              |
| <b>Production by subsidiaries from:</b>                                                               |                         |              |              |
| Yurkharovskoye field                                                                                  | 2,712                   | 2,672        | 1.5%         |
| East-Tarkosalinskoye field                                                                            | 1,094                   | 984          | 11.2%        |
| Khancheyskoye field                                                                                   | 483                     | 518          | (6.8%)       |
| Other fields                                                                                          | 38                      | 19           | 100.0%       |
| <b>Total liquids production by subsidiaries</b>                                                       | <b>4,327</b>            | <b>4,193</b> | <b>3.2%</b>  |
| <b>Group's proportionate share in the production of joint ventures:</b>                               |                         |              |              |
| SeverEnergia                                                                                          | 174                     | 58           | 200.0%       |
| Nortgas                                                                                               | 250                     | 19           | n/m          |
| <b>Total Group's proportionate share<br/>in the liquids production of joint ventures</b>              | <b>424</b>              | <b>77</b>    | <b>n/m</b>   |
| <b>Total liquids production including<br/>proportionate share in the production of joint ventures</b> | <b>4,751</b>            | <b>4,270</b> | <b>11.3%</b> |

In 2013, the volumes of liquids produced by our subsidiaries increased by 134 thousand tons, or 3.2%, primarily due to a significant increase in crude oil production. The intensification of crude oil production at the East-Tarkosalinskoye field and, to a lesser extent, the Khancheyskoye field, was a result of new wells drilled and technological works performed at these fields to increase our crude oil production flow rates. The increase in the efficiency of crude oil production at the East-Tarkosalinskoye and Khancheyskoye fields allowed us to offset the decrease in gas condensate production at these fields. The increase in our liquids production at the Yurkharovskoye field was due to the launch of new wells during 2013, as well as due to the optimization of our hydrocarbons production (see "Natural gas production volumes" above). Natural declines in the concentration of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

In 2013, our proportionate share in liquids production increased by 347 thousand tons to 424 thousand tons from 77 thousand tons in 2012 as a result of the acquisition of a 49% ownership interest in Nortgas in November 2012 (subsequently increased to 50%), as well as the launch of the Samburgskoye field's two phases development in 2012 by our joint venture SeverEnergia.

### Liquids sales volumes

In 2013, our total liquids sales volumes increased by 1,235 thousand tons, or 29.4%, to 5,438 thousand tons from 4,203 thousand tons in the corresponding period in 2012.

| <i>thousands of tons</i>                                                             | Year ended 31 December: |                     | Change<br>%           |
|--------------------------------------------------------------------------------------|-------------------------|---------------------|-----------------------|
|                                                                                      | 2013                    | 2012                |                       |
| Liquids production by subsidiaries                                                   | 4,327                   | 4,193               | 3.2%                  |
| Purchases from the Group's joint ventures                                            | 1,170                   | 259                 | 351.7%                |
| Other purchases                                                                      | 15                      | 38                  | (60.5%)               |
| <b>Total production and purchases</b>                                                | <b>5,512</b>            | <b>4,490</b>        | <b>22.8%</b>          |
| Losses and own usage <sup>(1)</sup>                                                  | (102)                   | (49)                | 108.2%                |
| Filling the system of processing facilities<br>and pipelines at the Ust-Luga Complex | (3)                     | -                   | n/a                   |
| Decreases (increases) in liquids inventory balances                                  | 31                      | (238)               | n/a                   |
| <b>Total liquids sales volumes</b>                                                   | <b>5,438</b>            | <b>4,203</b>        | <b>29.4%</b>          |
| <i>Stable gas condensate export</i>                                                  | <i>1,973</i>            | <i>2,821</i>        | <i>(30.1%)</i>        |
| <i>Stable gas condensate domestic</i>                                                | <i>144</i>              | <i>26</i>           | <i>n/m</i>            |
| <b><i>Subtotal stable gas condensate</i></b>                                         | <b><i>2,117</i></b>     | <b><i>2,847</i></b> | <b><i>(25.6%)</i></b> |
| <i>Naphtha export</i>                                                                | <i>1,328</i>            | <i>-</i>            | <i>n/a</i>            |
| <i>Other gas condensate refined products export</i>                                  | <i>278</i>              | <i>-</i>            | <i>n/a</i>            |
| <b><i>Subtotal gas condensate refined products</i></b>                               | <b><i>1,606</i></b>     | <b><i>-</i></b>     | <b><i>n/a</i></b>     |
| <i>LPG export</i>                                                                    | <i>576</i>              | <i>479</i>          | <i>20.3%</i>          |
| <i>LPG domestic</i>                                                                  | <i>394</i>              | <i>323</i>          | <i>22.0%</i>          |
| <i>LPG sold through domestic retail and small wholesale stations</i>                 | <i>108</i>              | <i>103</i>          | <i>4.9%</i>           |
| <b><i>Subtotal LPG</i></b>                                                           | <b><i>1,078</i></b>     | <b><i>905</i></b>   | <b><i>19.1%</i></b>   |
| <i>Crude oil export</i>                                                              | <i>231</i>              | <i>149</i>          | <i>55.0%</i>          |
| <i>Crude oil domestic</i>                                                            | <i>396</i>              | <i>293</i>          | <i>35.2%</i>          |
| <b><i>Subtotal crude oil</i></b>                                                     | <b><i>627</i></b>       | <b><i>442</i></b>   | <b><i>41.9%</i></b>   |
| <i>Other oil products domestic</i>                                                   | <i>10</i>               | <i>9</i>            | <i>11.1%</i>          |
| <b><i>Subtotal other oil products</i></b>                                            | <b><i>10</i></b>        | <b><i>9</i></b>     | <b><i>11.1%</i></b>   |

<sup>(1)</sup> Losses associated with processing at the Purovsky Plant and the Ust-Luga Complex, as well as during railroad, trunk pipeline and tanker transportation.

In 2013, we significantly increased our purchases of unstable gas condensate from SeverEnergiya and its wholly owned subsidiary OAO Arcticgas due to the launch of the Samburgskoye field's second phase development effective from December 2012. In addition, starting from 1 November 2012, we commenced purchasing of unstable gas condensate from Nortgas, which became our joint venture from the end of November 2012. Purchases from Nortgas in November 2012 are disclosed as "Other purchases" and purchases since December 2012 are disclosed as "Purchases from the Group's joint ventures" in the table above.

From July 2013, most of our stable gas condensate produced at the Purovsky Plant was sent as raw material feedstock to the Ust-Luga Complex for additional processing. Thus in 2013, we transferred 1,905 thousand tons of stable gas condensate (or 51.3% from the total stable gas condensate volumes produced) to the Ust-Luga Complex for further processing.

**RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2013  
COMPARED TO THE YEAR ENDED 31 DECEMBER 2012**

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2013 and 2012. Each line item is also shown as a percentage of our total revenues.

| <i>millions of Russian roubles</i>                                         | <b>Year ended 31 December:</b> |                            |                |                            |
|----------------------------------------------------------------------------|--------------------------------|----------------------------|----------------|----------------------------|
|                                                                            | <b>2013</b>                    | <b>% of total revenues</b> | <b>2012</b>    | <b>% of total revenues</b> |
| <b>Total revenues (net of VAT, export duties, excise and fuel taxes)</b>   | <b>298,158</b>                 | <b>100.0%</b>              | <b>210,973</b> | <b>100.0%</b>              |
| <i>including:</i>                                                          |                                |                            |                |                            |
| natural gas sales                                                          | 204,969                        | 68.7%                      | 142,613        | 67.6%                      |
| liquids' sales                                                             | 92,530                         | 31.0%                      | 67,633         | 32.1%                      |
| Operating expenses                                                         | (192,761)                      | (64.7%)                    | (125,775)      | (59.6%)                    |
| Net gain (loss) on disposal of interest in subsidiaries and joint ventures | 37,649                         | 12.7%                      | (60)           | (0.1%)                     |
| Other operating income (loss)                                              | 880                            | 0.3%                       | 196            | 0.1%                       |
| <b>Profit from operations</b>                                              | <b>143,926</b>                 | <b>48.3%</b>               | <b>85,334</b>  | <b>40.4%</b>               |
| Finance income (expense)                                                   | (6,684)                        | (2.3%)                     | 2,986          | 1.5%                       |
| Share of profit (loss) of joint ventures, net of income tax                | (112)                          | (0.0%)                     | (2,105)        | (1.0%)                     |
| <b>Profit before income tax</b>                                            | <b>137,130</b>                 | <b>46.0%</b>               | <b>86,215</b>  | <b>40.9%</b>               |
| Total income tax expense                                                   | (27,185)                       | (9.1%)                     | (16,774)       | (8.0%)                     |
| <b>Profit (loss)</b>                                                       | <b>109,945</b>                 | <b>36.9%</b>               | <b>69,441</b>  | <b>32.9%</b>               |
| Minus: profit (loss) attributable to non-controlling interest              | 61                             | 0.0%                       | 17             | 0.0%                       |
| <b>Profit attributable to shareholders of OAO NOVATEK</b>                  | <b>110,006</b>                 | <b>36.9%</b>               | <b>69,458</b>  | <b>32.9%</b>               |

## Total revenues

The following table sets forth our sales (net of VAT, export duties, excise and fuel taxes expense, where applicable) for the years ended 31 December 2013 and 2012:

| <i>millions of Russian roubles</i>                         | Year ended 31 December: |                | Change<br>%    |
|------------------------------------------------------------|-------------------------|----------------|----------------|
|                                                            | 2013                    | 2012           |                |
| <b>Natural gas sales</b>                                   | <b>204,969</b>          | <b>142,613</b> | <b>43.7%</b>   |
| <i>End-customers</i>                                       | 191,920                 | 115,180        | 66.6%          |
| <i>Ex-field sales</i>                                      | 13,049                  | 27,433         | (52.4%)        |
| <b>Stable gas condensate sales</b>                         | <b>32,847</b>           | <b>46,684</b>  | <b>(29.6%)</b> |
| <i>Export</i>                                              | 30,980                  | 46,365         | (33.2%)        |
| <i>Domestic</i>                                            | 1,867                   | 319            | 485.3%         |
| <b>Naphtha sales</b>                                       | <b>26,789</b>           | -              | <b>n/a</b>     |
| <i>Export</i>                                              | 26,789                  | -              | n/a            |
| <b>Liquefied petroleum gas sales</b>                       | <b>18,770</b>           | <b>15,599</b>  | <b>20.3%</b>   |
| <i>Export</i>                                              | 11,474                  | 9,631          | 19.1%          |
| <i>Domestic</i>                                            | 7,296                   | 5,968          | 22.3%          |
| <b>Crude oil sales</b>                                     | <b>7,443</b>            | <b>5,000</b>   | <b>48.9%</b>   |
| <i>Export</i>                                              | 2,760                   | 1,785          | 54.6%          |
| <i>Domestic</i>                                            | 4,683                   | 3,215          | 45.7%          |
| <b>Other gas and gas condensate refined products sales</b> | <b>6,681</b>            | <b>350</b>     | <b>n/a</b>     |
| <i>Export</i>                                              | 6,322                   | -              | n/a            |
| <i>Domestic</i>                                            | 359                     | 350            | 2.6%           |
| <b>Total oil and gas sales</b>                             | <b>297,499</b>          | <b>210,246</b> | <b>41.5%</b>   |
| Other revenues                                             | 659                     | 727            | (9.4%)         |
| <b>Total revenues</b>                                      | <b>298,158</b>          | <b>210,973</b> | <b>41.3%</b>   |

### *Natural gas sales*

In 2013, our revenues from sales of natural gas increased by RR 62,356 million, or 43.7%, compared to 2012 primarily due to an increase in our average realized natural gas prices, as well as an increase in our total sales volumes. The increase in our average realized natural gas prices was due to an increase in the regulated FTS prices for natural gas (see “Natural gas prices” above) by 14.5% as compared to 2012 (cumulative effect of a 3.0% decrease effective from 1 April 2013, and 15.0%, 3.1% and 1.9% increases effective from 1 July, 1 August and 1 October 2013, respectively), as well as a significant increase in proportion of end-customer sales to total natural gas sales volumes.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes increased to 88.9% in 2013 as compared to 69.3% in 2012. The increase was due to higher natural gas deliveries to Moscow and the Moscow region through our wholly owned subsidiary NOVATEK Moscow region established in December 2012, as well as to the Kostroma region as a result of acquisition of the regional natural gas trader in December 2012. In addition, the increase in our proportion of natural gas volumes sold to end-customers was due to the conclusion of new gas sales contracts in the second half of 2012 (see “Recent developments” above).

In 2013, our average realized natural gas price on end-customers sales increased by 19.3% due to an increase in the regulated FTS price and delivery to our customers in the more remote regions (see “Natural gas prices” above).

### *Stable gas condensate sales*

In 2013, our revenues from sales of stable gas condensate decreased by RR 13,837 million, or 29.6%, compared to 2012 primarily due to a decrease in volumes sold resulting from the start of processing stable gas condensate at the Ust-Luga Complex into naphtha and other refined products.

Our total stable gas condensate sales volumes decreased by 730 thousand tons, or 25.6%, due to the transfer of 1,905 thousand tons of stable gas condensate produced at the Purovsky Plant as raw material feedstock to be subsequently processed at the Ust-Luga Complex, which was launched in June 2013. We expect that our stable gas condensate sales volumes will be insignificant in 2014 as a result of substantially all stable gas condensate volumes produced at the Purovsky Plant being processed at the Ust-Luga Complex into higher value added products.

In 2013, we sold 1,973 thousand tons of stable gas condensate, or 93.2% of our total sales volumes, to the APR, Europe and the United States and 144 thousand tons domestically. In 2012, we sold 2,821 thousand tons of stable gas condensate, or 99.1% of our total sales volumes, to the APR, Europe, the United States and South America and 26 thousand tons domestically.

In 2013, our average realized net export price for stable gas condensate, excluding export duties, decreased by RR 729 per ton, or 4.4%, to RR 15,703 per ton (CFR, DES, DAP and CIF) from RR 16,432 per ton (CFR, DES, DAP and CIF) in 2012 (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

### *Naphtha sales*

In July 2013, the Group commenced naphtha sales after the launch of the Ust-Luga Complex. In 2013, our revenues from sales of naphtha amounted to RR 26,789 million.

In 2013, we exported 1,328 thousand tons of naphtha, or 100% of our total sales volumes, to the APR and South America. Our average realized naphtha net export price, excluding export duties, amounted to RR 20,176 per ton (CFR, CIF, DAP, DES and FOB).

### *Liquefied petroleum gas sales*

In 2013, our revenues from sales of LPG increased by RR 3,171 million, or 20.3%, compared to 2012 primarily due to an increase in our sales volumes.

In 2013, we sold 576 thousand tons of LPG, or 53.4% of our total LPG sales volumes, to export markets as compared to sales of 479 thousand tons, or 52.9%, in 2012. In 2013, as in 2012, our main export LPG markets were Poland and Finland and our cumulative LPG export volumes to these markets exceeded 80% of total LPG export volumes.

Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, decreased by RR 194 per ton, or 1.0%, to RR 19,915 per ton in 2013 (DAP and FCA) compared to RR 20,109 per ton in 2012 (DAP, CPT and FCA) (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

In 2013, we sold 502 thousand tons of LPG, or 46.6% of our total LPG sales volumes, on the domestic market compared to 426 thousand tons, or 47.1%, in 2012. In 2013, our average LPG domestic price was RR 14,527 per ton, excluding VAT, representing an increase of RR 516 per ton, or 3.7%, compared to 2012.

### *Crude oil sales*

In 2013, revenues from sales of crude oil increased by RR 2,443 million, or 48.9%, compared to 2012 primarily due to an increase in sales volumes and, to a lesser extent, an increase in average realized crude oil domestic prices. Our crude oil sales volumes increased by 185 thousand tons, or 41.9%, to 627 thousand tons from 442 thousand tons in 2012 mainly due to an increase in crude oil production at our East-Tarkosalinskoye field.

In 2013, we sold 63.2% of total crude oil volumes domestically at an average price of RR 11,819 per ton (excluding VAT) representing an increase of RR 834 per ton, or 7.6%, as compared to 2012.

The remaining 36.8% of our crude oil volumes were sold to export markets at an average price of RR 11,959 per ton (DAP, excluding export duties) representing a slight increase of RR 24 per ton, or 0.2%, as compared to 2012 (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

#### *Other gas and gas condensate refined products sales*

In 2013, our revenues from other gas and gas condensate refined products sales were RR 6,681 million compared to RR 350 million in 2012 and represent our revenues from sales of jet fuel, gasoil and fuel oil produced at the Ust-Luga Complex, revenues from trading operations with oil products (diesel fuel and petrol) through our retail stations on the domestic market, revenues from sales of methanol, as well as revenues from other one-off trading operations with refined products.

In 2013, our revenues from sales of jet fuel, gasoil and fuel oil to export markets amounted to RR 6,322 million. In 2013, we exported in aggregate 278 thousand tons of jet fuel, gasoil and fuel oil, or 100% of our total sales volumes, to the European markets at RR 22,754 per ton (CIF, excluding export duties).

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 48 million, or 19.2%, to RR 298 million in 2013 from RR 250 million in 2012 due to an increase in volumes sold and realized prices. In 2013, we sold approximately 9.6 thousand tons of oil products at an average price of RR 31,107 per ton compared to sales of approximately 8.6 thousand tons at an average price of RR 29,054 per ton in 2012.

Our revenues from methanol sales on the domestic market decreased by RR 39 million, or 39.0%, to RR 61 million in 2013 from RR 100 million in 2012 due to a decrease in volumes sold. In 2012, we sold our methanol produced at the Yurkharovskoye field to our joint venture and third parties whereas in the current year the produced methanol was primarily used for our internal purposes.

#### *Other revenues*

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In 2013, other revenues decreased by RR 68 million, or 9.4%, to RR 659 million from RR 727 million in 2012 primarily due to a decrease by RR 243 million of revenues from transportation, handling and storage services resulting from the disposal of our wholly owned non-core subsidiary, OOO Purovsky Terminal, in December 2012. It was mostly offset by RR 62 million of revenues from tanker subleases, as well as increased revenues from geological and geophysical research services and rent services by RR 31 million and RR 29 million, respectively. The remaining change in other revenues related to various immaterial items.

## Operating expenses

In 2013, our total operating expenses increased by RR 66,986 million, or 53.3%, to RR 192,761 million compared to RR 125,775 million in 2012 primarily due to an increase in transportation expenses and purchases of natural gas and liquid hydrocarbons from our joint ventures and related parties. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased to 64.8% in 2013 compared to 61.8% in 2012 primarily due to a significant increase in our natural gas transportation expenses (see “Transportation expenses” below).

In 2013, our total operating expenses as a percentage of total revenues increased to 64.7% in 2013 compared to 59.6% in 2012, as shown in the table below. The increase in our total operating expenses as a percentage of total revenues was mainly due to an increase in our transportation expenses and an increase of purchases of natural gas and liquid hydrocarbons. The margins we receive from such trading operations are slightly lower than the margin we obtain from the sales of our produced hydrocarbons. In addition, we significantly increased the volumes of natural gas sold to end-customers, which correspondingly increased our transportation expenses during the reporting period.

| <i>millions of Russian roubles</i>                              | Year ended 31 December: |                     |                |                     |
|-----------------------------------------------------------------|-------------------------|---------------------|----------------|---------------------|
|                                                                 | 2013                    | % of total revenues | 2012           | % of total revenues |
| Transportation expenses                                         | 103,245                 | 34.6%               | 60,848         | 28.8%               |
| Taxes other than income tax                                     | 21,645                  | 7.3%                | 16,846         | 8.0%                |
| <b>Subtotal non-controllable expenses</b>                       | <b>124,890</b>          | <b>41.9%</b>        | <b>77,694</b>  | <b>36.8%</b>        |
| Purchases of natural gas and liquid hydrocarbons                | 34,707                  | 11.6%               | 17,483         | 8.3%                |
| Depreciation, depletion and amortization                        | 13,503                  | 4.5%                | 11,499         | 5.5%                |
| General and administrative expenses                             | 11,029                  | 3.7%                | 10,622         | 5.0%                |
| Materials, services and other                                   | 8,282                   | 2.8%                | 7,216          | 3.4%                |
| Net impairment expenses (reversals)                             | 2,611                   | 0.9%                | 325            | n/m                 |
| Exploration expenses                                            | 427                     | n/m                 | 2,022          | 1.0%                |
| Change in natural gas, liquid hydrocarbons and work-in-progress | (2,688)                 | n/m                 | (1,086)        | n/m                 |
| <b>Total operating expenses</b>                                 | <b>192,761</b>          | <b>64.7%</b>        | <b>125,775</b> | <b>59.6%</b>        |

### *Non-controllable expenses*

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities.

In 2013, our non-controllable expenses increased by RR 47,196 million, or 60.7%, to RR 124,890 million from RR 77,694 million in 2012. The change in transportation expenses was due to both an increase in the natural gas volumes sold to end-customers in which we incurred transportation expenses (see “Transportation expenses” below), as well as an increase in the natural gas transportation tariff combined with an increase in the average transportation distance. Taxes other than income tax increased primarily due to an increase in the natural gas production tax rate by 5.6% from 1 January 2013 and 51.7% from 1 July 2013 (see “Our tax burden and obligatory payments” above) and an increase in natural gas production volumes. As a result, our non-controllable expenses, as a percentage of total revenues, increased to 41.9% in 2013 compared to 36.8% in 2012.

### *Transportation expenses*

In 2013, our total transportation expenses increased by RR 42,397 million, or 69.7%, to RR 103,245 million compared to RR 60,848 million in 2012.

| <i>million of Russian roubles</i>             | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|-----------------------------------------------|--------------------------------|---------------|---------------------|
|                                               | <b>2013</b>                    | <b>2012</b>   |                     |
| Natural gas transportation to customers       | 83,884                         | 45,925        | 82.7%               |
| Liquid hydrocarbons transportation by rail    | 13,996                         | 10,537        | 32.8%               |
| Liquid hydrocarbons transportation by tankers | 4,291                          | 3,742         | 14.7%               |
| Crude oil transportation by pipeline          | 885                            | 527           | 67.9%               |
| Other                                         | 189                            | 117           | 61.5%               |
| <b>Total transportation expenses</b>          | <b>103,245</b>                 | <b>60,848</b> | <b>69.7%</b>        |

In 2013, our transportation expenses for natural gas increased by RR 37,959 million, or 82.7%, to RR 83,884 million from RR 45,925 million in 2012. The increase was mainly due to a 53.0% increase in our natural gas sales volumes to end-customers, for which we incurred transportation expenses (excluding volumes of natural gas purchased for resale in the location of our end-customers in 2012). The additional factors which affected our transportation expenses growth were an increase in the natural gas transportation tariff set by the FTS by an average of 7.0% and 6.4% effective from 1 July 2012 and 1 August 2013, respectively (see "Transportation tariffs" above), as well as an increase in average transportation distance due to higher natural gas deliveries to Moscow, the Moscow region, as well as the Vologda and Kostroma regions. In 2012, we did not incur transportation expenses in respect of natural gas volumes purchased for resale in the location of our end-customers, as the purchase price included the cost of transportation. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

In 2013, our total expenses for liquids transportation by rail increased by RR 3,459 million, or 32.8%, to RR 13,996 million from RR 10,537 million in 2012 due to an increase in volumes of liquids sold and transported via rail by 1,047 thousand tons, or 27.9%, to 4,796 thousand tons from 3,749 thousand tons primarily due to an increase in purchases of unstable gas condensate from our joint ventures. In 2013, our weighted average transportation tariff for liquids delivered by rail increased by 3.8% to RR 2,918 per ton from RR 2,811 per ton in 2012 primarily due to a 7.0% indexation of railroad tariffs for the domestic market set by the FTS effective 1 January 2013.

Total transportation expenses for liquids delivered by tankers to international markets increased by RR 549 million, or 14.7%, to RR 4,291 million in 2013 from RR 3,742 million in 2012 due to an increase of stable gas condensate and refined products sales volumes of 26.8% which was partially offset by our refined products transshipment savings since such services are performed internally at the Ust-Luga Complex.

In 2013, we sold 65.8% of our total stable gas condensate and gas condensate refined products export volumes to the APR, 28.6% to Europe, 3.4% to the United States and 2.2% to South America, whereas in 2012, we sold 56.4% to the APR, 28.7% to Europe, 10.6% to the United States and 4.3% to South America.

In 2013, our expenses for crude oil transportation to customers through the pipeline network increased by RR 358 million, or 67.9%, to RR 885 million from RR 527 million in 2012. The change was primarily due to a 41.7% increase in volumes transported and, to a lesser extent, due to an increase in transportation tariffs in Russian Federation by 5.5% in November 2012 and our sales to more distant regions.

Other transportation expenses include motor transportation expenses, insurance expenses related to our liquid hydrocarbons transportation and other expenses. In 2013, other transportation expenses increased by RR 72 million, or 61.5%, to RR 189 million from RR 117 million in 2012.



### *Taxes other than income tax*

In 2013, taxes other than income tax increased by RR 4,799 million, or 28.5%, to RR 21,645 million from RR 16,846 million in 2012 primarily due to an increase in the unified natural resources production tax expense.

| <i>millions of Russian roubles</i>       | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|------------------------------------------|--------------------------------|---------------|---------------------|
|                                          | <b>2013</b>                    | <b>2012</b>   |                     |
| Unified natural resources production tax | 19,619                         | 14,833        | 32.3%               |
| Property tax                             | 1,790                          | 1,754         | 2.1%                |
| Other taxes                              | 236                            | 259           | (8.9%)              |
| <b>Total taxes other than income tax</b> | <b>21,645</b>                  | <b>16,846</b> | <b>28.5%</b>        |

In 2013, our UPT expense for natural gas increased by RR 4,718 million, or 36.9%, primarily due to an increase in natural gas production tax rate per mcm by 5.6% from 1 January 2013 and 51.7% from 1 July 2013 (from RR 251 to RR 265 and subsequently to RR 402 per mcm), and, to a lesser extent, a 3.4% increase in our natural gas production volumes by our producing subsidiaries. The UPT expense for unstable gas condensate production increased by RR 68 million, or 3.3%, due to an increase in the UPT rate by 6.1% from RR 556 per ton in 2012 to RR 590 per ton in 2013.

In 2013, as well as in 2012, we applied a zero UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye and Khancheyevskoye fields due to changes in the Russian Tax Code effective from 1 January 2012 (see “Our tax burden and obligatory payments” above).

In 2013, our property tax expense increased by RR 36 million, or 2.1%, to RR 1,790 million from RR 1,754 million in 2012 primarily due to the launch of the Ust-Luga Complex in June 2013.

### *Purchases of natural gas and liquid hydrocarbons*

In 2013, our purchases of natural gas and liquid hydrocarbons increased by RR 17,224 million, or 98.5%, to RR 34,707 million from RR 17,483 million in 2012.

| <i>millions of Russian roubles</i>                            | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|---------------------------------------------------------------|--------------------------------|---------------|---------------------|
|                                                               | <b>2013</b>                    | <b>2012</b>   |                     |
| Natural gas                                                   | 23,992                         | 14,706        | 63.1%               |
| Unstable gas condensate                                       | 10,304                         | 2,498         | 312.5%              |
| Other liquid hydrocarbons                                     | 411                            | 279           | 47.3%               |
| <b>Total purchases of natural gas and liquid hydrocarbons</b> | <b>34,707</b>                  | <b>17,483</b> | <b>98.5%</b>        |

In 2013, our purchases of natural gas increased by RR 9,286 million, or 63.1%, to RR 23,992 million from RR 14,706 million in 2012 primarily due to the commencement of natural gas purchases from our joint venture Nortgas effective from 1 January 2013, as well as due to higher purchases from our related party SIBUR.

In 2013, our purchases of unstable gas condensate from our joint ventures increased by RR 7,806 million, or by 3.1 times, to RR 10,304 million from RR 2,498 million in 2012 due to higher purchases from SeverEnergia and its wholly owned subsidiary Arcticgas, as well as purchases from Nortgas which we commenced effective from November 2012.

In 2013, our purchases of other liquid hydrocarbons increased by RR 132 million, or 47.3%, to RR 411 million from RR 279 million in 2012. Other liquid hydrocarbons purchases represent our purchases of oil products and LPG for resale.

### *Depreciation, depletion and amortization*

In 2013, our depreciation, depletion and amortization (“DDA”) expense increased by RR 2,004 million, or 17.4%, to RR 13,503 million from RR 11,499 million in 2012 mainly as a result of the Ust-Luga Complex launch in June 2013, additions to property, plant and equipment at our production subsidiaries, as well as a 3.3% increase in our total hydrocarbon production (excluding our proportionate share in the production of joint ventures) in barrels of oil equivalent basis. The Group accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In 2013, our DDA per barrel of oil equivalent was RR 27.6 as compared to RR 26.4 in 2012. The increase in our DDA charge calculated on a barrel of oil equivalent basis was due to the capitalization of costs related to the launch of the fourth stage of the second phase development at our Yurkharovskoye field and ongoing crude oil development activities at the East-Tarkosalinskoye field, as well as a slight decrease in our proved reserves estimates as of 31 December 2013 compared to 31 December 2012 at our core producing fields.

Our reserve base is only appraised on an annual basis as of 31 December and does not fluctuate during the year, whereas our depletable cost base does change each quarter due to the ongoing capitalization of our costs throughout the year.

### *General and administrative expenses*

In 2013, our general and administrative expenses increased by RR 407 million, or 3.8%, to RR 11,029 million compared to RR 10,622 million in 2012. The main components of these expenses were employee compensation as well as social expenses and compensatory payments, which, on aggregate, comprised 74.0% and 74.1% of total general and administrative expenses in the years ended 31 December 2013 and 2012, respectively.

| <i>millions of Russian roubles</i>               | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|--------------------------------------------------|--------------------------------|---------------|---------------------|
|                                                  | <b>2013</b>                    | <b>2012</b>   |                     |
| Employee compensation                            | 6,983                          | 6,869         | 1.7%                |
| Social expenses and compensatory payments        | 1,178                          | 1,001         | 17.7%               |
| Legal, audit, and consulting services            | 924                            | 1,347         | (31.4%)             |
| Business trips expense                           | 363                            | 292           | 24.3%               |
| Fire safety and security expenses                | 231                            | 199           | 16.1%               |
| Advertising expenses                             | 213                            | 60            | 255.0%              |
| Insurance expense                                | 191                            | 86            | 122.1%              |
| Other                                            | 946                            | 768           | 23.2%               |
| <b>Total general and administrative expenses</b> | <b>11,029</b>                  | <b>10,622</b> | <b>3.8%</b>         |

Employee compensation related to administrative personnel increased by RR 114 million, or 1.7%, to RR 6,983 million in 2013 from RR 6,869 million in 2012. The increase was mainly due to an increase in average number of employees from the expansion of activities at our Ust-Luga Complex, the acquisition of a regional gas trader Gazprom mezhregiongas Kostroma in December 2012 as well as an indexation of base salaries effective 1 July 2013. These increases were partially offset by our post-employment benefit program costs decrease of RR 315 million as a result of the lump sum retirement benefit paid in 2012. Also, our costs related to share-based compensation program decreased by RR 96 million as a result of the end of the vesting period for most of the participants.

In 2013, our social expenses and compensatory payments increased by RR 177 million, or 17.7%, to RR 1,178 million compared to RR 1,001 million in 2012. The increase was primarily related to compensatory payments made in 2013 as a part of the development of Salmanovskoye and Geofizicheskoye fields. Social expenses changed marginally and were mainly related to our donations to sport clubs and sports activities, educational schools, as well as continued support of charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support.

In 2013, legal, audit, and consulting services expenses decreased by RR 423 million, or 31.4%, to RR 924 million compared to RR 1,347 million in 2012 primarily due to significant consulting services expenses related to acquisitions in 2012.

Fire safety and security expenses increased by RR 32 million, or 16.1%, to RR 231 million in 2013 from RR 199 million in 2012 primarily due to an increase in rates charged for security services.

Advertising expenses increased by RR 153 million, or by 2.6 times, to RR 213 million in 2013 from RR 60 million in 2012 primarily due to the commencement of a sponsorship contract for advertising during sporting events.

Insurance expenses increased by RR 105 million, or 122.1%, to RR 191 million in 2013 from RR 86 million in 2012 due to the expansion of the Group's activities.

In 2013, other general and administrative expenses increased by RR 178 million, or 23.2%, to RR 946 million from RR 768 million in 2012. The increase was a result of a RR 60 million increase in bank charges, as well as an increase by RR 30 million, RR 20 million and RR 17 million, respectively, of materials purchases, staff training and transportation expenses of Group personnel to remote production facilities. The remaining increase of RR 51 million was made up of other immaterial expense items of an administrative nature.

*Materials, services and other*

In 2013, our materials, services and other expenses increased by RR 1,066 million, or 14.8%, to RR 8,282 million compared to RR 7,216 million in 2012. The main components of this expense category were employee compensation and repair and maintenance services, which on aggregate comprised 68.5% and 74.9% of total materials, services and other expenses in 2013 and 2012, respectively.

| <i>millions of Russian roubles</i>         | Year ended 31 December: |              | Change<br>%  |
|--------------------------------------------|-------------------------|--------------|--------------|
|                                            | 2013                    | 2012         |              |
| Employee compensation                      | 3,920                   | 3,808        | 2.9%         |
| Repair and maintenance                     | 1,755                   | 1,598        | 9.8%         |
| Materials and supplies                     | 698                     | 412          | 69.4%        |
| Electricity and fuel                       | 638                     | 457          | 39.6%        |
| Transportation services                    | 368                     | 186          | 97.8%        |
| Security services                          | 327                     | 271          | 20.7%        |
| Processing fees                            | 100                     | 99           | 1.0%         |
| Other                                      | 476                     | 385          | 23.6%        |
| <b>Total materials, services and other</b> | <b>8,282</b>            | <b>7,216</b> | <b>14.8%</b> |

Operating employee compensation increased by RR 112 million, or 2.9%, to RR 3,920 million compared to RR 3,808 million in 2012. The increase was due to an indexation of base salaries effective from 1 July 2013 and an increase in the average number of employees as a result of the launch of the Ust-Luga Complex, an expansion of our trading activities at NOVATEK-AZK and the acquisition of a regional gas trader Gazprom mezhhregiongas Kostroma. At the same time, our post-employment benefit program costs decreased by RR 155 million as a result of the lump sum retirement benefit paid in 2012.

Repair and maintenance services increased by RR 157 million, or 9.8%, to RR 1,755 million in 2013 compared to RR 1,598 million in 2012 due to repair works at our production subsidiaries and maintenance expenses, related to the launch of the Ust-Luga Complex.

Materials and supplies expense increased by RR 286 million, or 69.4%, to RR 698 million in 2013 compared to RR 412 million in 2012 due to an increase in materials used for the repair of our roads to the Group's fields and maintenance of the oil production technological process at our East-Tarkosalinskoye and Yurkharovskoye fields, as well as materials used for construction of the Ust-Luga Complex.

In 2013, electricity and fuel expenses increased by RR 181 million, or 39.6%, to RR 638 million from RR 457 million in 2012. The increase was due to an increase in electricity consumption by our production subsidiaries related to new energy-consuming projects, as well as a higher electricity rates.

In 2013, transportation expenses increased by RR 182 million, or 97.8%, to RR 368 million from RR 186 million in 2012 due to an increase in expenses related to the delivery of materials and equipment to our main fields and processing facilities, as well as our operating personnel transportation.

In 2013, security expenses increased by RR 56 million, or 20.7%, to RR 327 million from RR 271 million in 2012 due to additional security services related to recently completed capital construction projects in our production subsidiaries, as well as an increase in security services rates effective from January 2013.

In 2013, other material, services and other expenses increased by RR 91 million, or 23.6%, to RR 476 million from RR 385 million in 2012 primarily due to additional crude oil wells monitoring services performed at our Yurkharovskoye field as a result of the commencement of crude oil production in November 2012, as well as ensuring ecological safety at our Ust-Luga Complex.

*Net impairment expenses*

In 2013, we recognized an impairment expense of RR 2,611 million, of which RR 2,203 million was related to the impairment of oil and gas properties and equipment at West-Tazovskoye and Pilyalkinskoye fields. The remaining net impairment expense of RR 408 million, as well as RR 325 million in 2012, was primarily related to trade accounts receivable for natural gas sold to small-scale companies and residential customers.

*Exploration expenses*

In 2013, our exploration expenses decreased by RR 1,595 million, or 78.9%, to RR 427 million from RR 2,022 million in 2012.

| <i>millions of Russian roubles</i>                                             | <b>Year ended 31 December:</b> |              | <b>Change<br/>%</b> |
|--------------------------------------------------------------------------------|--------------------------------|--------------|---------------------|
|                                                                                | <b>2013</b>                    | <b>2012</b>  |                     |
| Cost of seismic surveys                                                        | 1,680                          | 2,523        | (33.4%)             |
| Less: capitalized 3-D seismic surveys                                          | (1,253)                        | (1,352)      | (7.3%)              |
| Unsuccessful exploratory wells                                                 | -                              | 851          | n/a                 |
| <b>Total exploration expenses per<br/>the Consolidated Statement of Income</b> | <b>427</b>                     | <b>2,022</b> | <b>(78.9%)</b>      |

In 2013, our seismic works expenses decreased by RR 843 million, or 33.4%, to RR 1,680 million from RR 2,523 million in 2012. Our seismic works expenses fluctuate period-to-period in accordance with approved working schedule of seismic surveys at our producing subsidiaries. The costs of 3-D seismic surveys to sustain production, increase reserves' recoverability and the efficiency of drilling additional development wells on our proved properties are capitalized to property, plant and equipment used in oil and gas exploration according to our accounting policy.

In 2012, we incurred RR 851 million related to the costs of two unsuccessful exploratory wells at the West-Urengoyenskoye and North-Yubileynoye license areas, which were written-off in accordance with our successful efforts accounting policy.

*Change in natural gas, liquid hydrocarbons and work-in-progress*

In 2013, we recorded a reversal of RR 2,688 million to change in inventory expense as compared to a reversal of RR 1,086 million in 2012:

| <i>millions of Russian roubles</i>                                                                            | <b>Year ended 31 December:</b> |                |
|---------------------------------------------------------------------------------------------------------------|--------------------------------|----------------|
|                                                                                                               | <b>2013</b>                    | <b>2012</b>    |
| Natural gas                                                                                                   | (2,148)                        | (228)          |
| Naphtha                                                                                                       | (963)                          | -              |
| Stable gas condensate                                                                                         | 746                            | (897)          |
| Other refined products                                                                                        | (176)                          | -              |
| Other                                                                                                         | (147)                          | 39             |
| <b>Increase (decrease) in operating expenses due to<br/>change in inventory balances and work-in-progress</b> | <b>(2,688)</b>                 | <b>(1,086)</b> |

In 2013, we recorded a reversal to our operating expenses of RR 2,148 million due to a 2,167 mmcm increase in our natural gas inventory balance, as well as a slight increase in the cost of natural gas per mcm. The increase in our inventory balance was caused by an abnormally warm weather in Russia in the fourth quarter of 2013, as well as the planned significant withdrawal of natural gas in the first quarter of 2014 due to contractual obligations. Our volumes of natural gas injected into Gazprom's underground gas storage facilities fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods.

In 2013, we recorded a reversal to our operating expenses of RR 963 million due to a 193 thousand tons increase in our naphtha inventory balance, which was not sold as at 31 December 2013 and thus recognized as inventory in transit and storage. At the same time, we recorded a charge to our operating expenses of RR 746 million due to a 281 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage, which was partially offset by an increase in the cost of stable gas condensate.

The following table highlights movements in our hydrocarbons inventory balances:

| <i>Inventory balances in transit or in storage</i> | 2013              |                 |                          | 2012              |                 |                          |
|----------------------------------------------------|-------------------|-----------------|--------------------------|-------------------|-----------------|--------------------------|
|                                                    | At<br>31 December | At<br>1 January | Increase /<br>(decrease) | At<br>31 December | At<br>1 January | Increase /<br>(decrease) |
| <b>Natural gas (millions of cubic meters)</b>      | <b>3,296</b>      | <b>1,129</b>    | <b>2,167</b>             | <b>1,129</b>      | <b>760</b>      | <b>369</b>               |
| <i>including Gazprom's UGSF</i>                    | <i>2,334</i>      | <i>1,096</i>    | <i>1,238</i>             | <i>1,096</i>      | <i>732</i>      | <i>364</i>               |
| <b>Liquid hydrocarbons (thousand tons)</b>         | <b>535</b>        | <b>563</b>      | <b>(28)</b>              | <b>563</b>        | <b>325</b>      | <b>238</b>               |
| <i>including stable gas condensate</i>             | <i>180</i>        | <i>461</i>      | <i>(281)</i>             | <i>461</i>        | <i>228</i>      | <i>233</i>               |
| <i>naphtha</i>                                     | <i>193</i>        | <i>-</i>        | <i>193</i>               | <i>-</i>          | <i>-</i>        | <i>-</i>                 |

#### **Net gain (loss) on disposal of interest in subsidiaries and joint ventures**

In 2013, the Group recorded a gain on the disposal of interest in joint ventures in the amount of RR 37,649 million as compared to the loss on disposal of subsidiaries of RR 60 million in 2012.

In December 2013, the Group exchanged its 51% of equity stake in joint venture Sibneftegas for a 40% of equity stake in Artic Russia B.V., which holds a 49% participation interest in SeverEnergia. As a result of the transaction, the Group recorded a gain of RR 27,111 million, net of associated income tax of RR 6,693 million.

In December 2013, the Group sold its 20% equity stake in Yamal LNG, the Group's joint venture, to CNPC, a partner of the Group in the Yamal LNG project, which resulted in a gain of RR 3,070 million, net of associated income tax of RR 775 million.

In 2012, we recorded a loss of RR 60 million on the disposal of the Groups' wholly owned, non-core subsidiary Purovsky Terminal in December 2012.

#### **Other operating income (loss)**

In 2013, our other operating income increased by RR 684 million, or by 3.5 times, to RR 880 million from RR 196 million in 2012.

In October 2012, we started natural gas trading activities on the European market and recognized net operating income of RR 112 million. In 2013, we purchased and sold 14 terawatt-hours (or approximately 1,340 mmcm) of natural gas and recognized operating income of RR 180 million. Correspondingly, in 2013, we recognized non-cash income from this trading activity in the amount of RR 549 million as compared to a RR 36 million loss in 2012 related to the movements in fair values of natural gas purchase and sales contracts, which were classified as derivative instruments in accordance with IAS 39 "*Financial instruments: recognition and measurement*".

The remaining amount of other operating income increased by RR 31 million to RR 151 million in 2013 from RR 120 million in 2012 and was primarily related to penalties charges received from our suppliers due to non-compliance of their contractual obligations as well as other immaterial profit and loss items received from disposal of materials, fixed assets, equipment and other similar transactions.

## Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 58,592 million, or 68.7%, to RR 143,926 million in 2013, as compared to RR 85,334 million in 2012. Our normalized profit from operations net of gain (loss) on the disposal of interest in subsidiaries and joint ventures increased by RR 20,883 million, or 24.5%, to RR 106,277 million in 2013 from RR 85,394 million in 2012. However, as a result of a significant increase in hydrocarbons purchases from our joint ventures and related parties during 2013, our profit from operations net of gain (loss) on the disposal of interest in subsidiaries and joint ventures, as a percentage of total revenues decreased to 35.6% in 2013 from 40.5% in 2012 due to lower trading margins we received for these volumes compared to the margins we receive usually from the production and sales of our own hydrocarbons.

## Finance income (expense)

In 2013, we recorded net finance expense of RR 6,684 million compared to a net finance income of RR 2,986 million in 2012 primarily due to foreign exchange loss and an increase in interest expense on loans received.

In 2013, accrued interest expense on loans received increased by RR 2,857 million, or 50.1%, to RR 8,559 million from RR 5,702 million in 2012 primarily due to an increase in the aggregate amount of loans received by the Group in 2013 (see “Debt obligations” below).

| <i>millions of Russian roubles</i>                                                             | <b>Year ended 31 December:</b> |              | <b>Change<br/>%</b> |
|------------------------------------------------------------------------------------------------|--------------------------------|--------------|---------------------|
|                                                                                                | <b>2013</b>                    | <b>2012</b>  |                     |
| Accrued interest expense on loans received                                                     | 8,559                          | 5,702        | 50.1%               |
| Less: capitalized interest                                                                     | (3,460)                        | (2,698)      | 28.2%               |
| Provisions for asset retirement obligations:<br>effect of the present value discount unwinding | 248                            | 232          | 6.9%                |
| <b>Total interest expense per<br/>the Consolidated Statement of Income</b>                     | <b>5,347</b>                   | <b>3,236</b> | <b>65.2%</b>        |

Interest income increased by RR 610 million, or 35.2%, to RR 2,341 million in 2013 from RR 1,731 million in 2012 primarily due to a significant increase in loans provided to our joint ventures related to the development and expansion of their activities (see “Loans provided” below).

In 2013, we recorded a net foreign exchange loss of RR 3,678 million compared to a net foreign exchange gain of RR 4,491 million in 2012 due primarily to the revaluation of our US dollar denominated borrowings and loans provided. The Russian rouble depreciated by 7.8% against the US dollar during 2013 compared to the appreciation of the Russian rouble by 5.7% in 2012. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio.

## Share of profit (loss) of joint ventures, net of income tax

In 2013, the Group’s proportionate share in loss of joint ventures accounted for RR 112 million as compared to a loss of RR 2,105 million in 2012.

The change in our proportionate share in profit (loss) of joint ventures was due to higher operating results (increased hydrocarbon production and sales prices) in Sibneftegas and SeverEnergiya, as well as the acquisition of interest in Nortgas in 2012.

## Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 19.8% and 19.5% for the years ended 31 December 2013 and 2012, respectively.

The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses or non-taxable income.

### **Profit attributable to shareholders and earnings per share**

Our profit attributable to shareholders and earnings per share may vary period-to-period due to one-off events or extraordinary items. In order to normalize earnings and make period-on-period comparisons more meaningful certain adjustments are required to exclude these events.

As a result of the factors discussed above, our profit for the period increased by RR 40,504 million, or 58.3%, to RR 109,945 million in 2013 from RR 69,441 million in 2012. The profit attributable to shareholders of OAO NOVATEK increased by RR 40,548 million, or 58.4%, to RR 110,006 million in 2013 from RR 69,458 million in 2012. The profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interest in subsidiaries and joint ventures, increased by RR 10,307 million, or 14.8%, to RR 79,825 million in 2013 as compared to RR 69,518 million in 2012.

Our EBITDA, excluding the effect of the disposal of interest in subsidiaries and joint ventures, increased by RR 26,625 million, or 28.0%, to RR 121,791 million in 2013 from RR 95,166 million in 2012 primarily due to an increase in natural gas sales prices and volumes that was partially offset by an increase in our transportation expenses and purchases of hydrocarbons. In addition, an increase in our EBITDA was due to the commencement of the Ust-Luga Complex higher value added products sales in the third quarter of 2013.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 13.42 per share, or 58.6%, to RR 36.31 per share in 2013 from RR 22.89 per share in 2012. Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interest in subsidiaries and joint ventures, increased by RR 3.44 per share, or 15.0%, to RR 26.35 per share in 2013 from RR 22.91 per share in 2012.

## LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2013 and 2012:

| <i>millions of Russian roubles</i>                  | <b>Year ended 31 December:</b> |             | <b>Change<br/>%</b> |
|-----------------------------------------------------|--------------------------------|-------------|---------------------|
|                                                     | <b>2013</b>                    | <b>2012</b> |                     |
| Net cash provided by operating activities           | 88,525                         | 75,825      | 16.7%               |
| Net cash provided by (used in) investing activities | (100,492)                      | (84,124)    | 19.5%               |
| Net cash provided by (used in) financing activities | (7,132)                        | 2,603       | n/a                 |

| <i>Liquidity and credit ratios</i>                | <b>31 December 2013</b> | <b>31 December 2012</b> | <b>Change, %</b> |
|---------------------------------------------------|-------------------------|-------------------------|------------------|
| Current ratio                                     | 1.38                    | 1.06                    | 30.2%            |
| Total debt to total equity                        | 0.44                    | 0.45                    | (2.2%)           |
| Long-term debt to long-term debt and total equity | 0.28                    | 0.25                    | 12.0%            |
| Net debt to total capitalization <sup>(1)</sup>   | 0.28                    | 0.26                    | 7.7%             |
| Net debt to EBITDA <sup>(2)</sup>                 | 0.99                    | 1.20                    | (17.5%)          |
| Net debt to normalized EBITDA <sup>(2)</sup>      | 1.30                    | 1.20                    | 8.3%             |
| Interest coverage ratio <sup>(3)</sup>            | 20                      | 24                      | (16.7%)          |

<sup>(1)</sup> Net debt represents total debt less cash and cash equivalents. Total capitalization represents total debt, total equity and deferred income tax liability.

<sup>(2)</sup> Net debt to EBITDA and to normalized EBITDA ratios are calculated as Net debt divided by EBITDA or normalized EBITDA for the last twelve months.

<sup>(3)</sup> Interest coverage ratio is calculated as normalized EBITDA divided by interest expense, including capitalized interest, less interest income from the Consolidated Statement of Income.

### *Net cash provided by operating activities*

In 2013, our net cash provided by operating activities increased by RR 12,700 million, or 16.7%, to RR 88,525 million compared to RR 75,825 million in 2012 mainly due to higher natural gas sales volumes and prices, as well as the commencement of our Ust-Luga Complex higher value added products sales in the third quarter of 2013. This was partially offset by changes in our working capital as a result of increased trade and other receivables (see "Working capital" below).

| <i>millions of Russian roubles</i>                                                                     | <b>Year ended 31 December:</b> |               | <b>Change<br/>%</b> |
|--------------------------------------------------------------------------------------------------------|--------------------------------|---------------|---------------------|
|                                                                                                        | <b>2013</b>                    | <b>2012</b>   |                     |
| Operating profit                                                                                       | 122,401                        | 98,589        | 24.2%               |
| Working capital changes                                                                                | (19,199)                       | (5,157)       | 272.3%              |
| Income taxes paid                                                                                      | (14,677)                       | (17,607)      | (16.6%)             |
| <b>Total net cash provided by operating activities per<br/>the Consolidated Statement of Cash Flow</b> | <b>88,525</b>                  | <b>75,825</b> | <b>16.7%</b>        |

### *Net cash provided by (used for) investing activities*

In 2013, our net cash used for investing activities increased by RR 16,368 million, or 19.5%, to RR 100,492 million compared to RR 84,124 million in 2012.

| <i>millions of Russian roubles</i>                                                | <b>Year ended 31 December:</b> |                 | <b>Change<br/>%</b> |
|-----------------------------------------------------------------------------------|--------------------------------|-----------------|---------------------|
|                                                                                   | <b>2013</b>                    | <b>2012</b>     |                     |
| Purchases of property, plant and equipment<br>(financing of capital expenditures) | (51,127)                       | (37,378)        | 36.8%               |
| Loans provided to joint ventures                                                  | (45,801)                       | (4,818)         | n/m                 |
| Repayments of loans provided to joint ventures                                    | 8,564                          | 8,102           | 5.7%                |
| Acquisition of joint ventures and additional stakes in joint ventures             | 1,703                          | 42,697          | (96.0%)             |
| Additional capital contributions to joint ventures                                | (2,247)                        | (5,213)         | (56.9%)             |
| Other                                                                             | (8,178)                        | (2,120)         | 285.8%              |
| <b>Net cash provided by (used for) investing activities</b>                       | <b>(100,492)</b>               | <b>(84,124)</b> | <b>19.5%</b>        |



Our cash used for purchases of property, plant and equipment increased by RR 13,749 million, or 36.8%, and was mainly related to the ongoing development activities at our Yurkharovskoye field, construction of our Purovsky Plant's third stage development and our Ust-Luga Complex construction activities, as well as further development of the East-Tarkosalinskoye field's crude oil deposits.

In 2013, loans provided to our joint ventures increased by RR 40,983 million to RR 45,801 million from RR 4,818 million primarily due to loans provided to our Yamal LNG joint venture in 2013 (see "Loans provided" below).

In 2012, our net cash used in acquisition of joint ventures amounted to RR 42,697 million and related to the acquisition of a 49% ownership interest in Nortgas. In 2013, we increased our share in Nortgas to 50% through the subscription to the entity's additional share emission in the amount of RR 1,703 million.

In 2013, we made an additional capital contribution to our joint venture Terneftegas in the amount of RR 2,247 million as compared to RR 5,213 million of additional capital contribution to our joint venture Yamal LNG in 2012.

#### *Net cash provided by (used for) financing activities*

In 2013, our net cash used for financing activities amounted to RR 7,132 million as compared to RR 2,603 million provided by financing activities in 2012.

| <i>millions of Russian roubles</i>                          | <b>Year ended 31 December:</b> |              | <b>Change<br/>%</b> |
|-------------------------------------------------------------|--------------------------------|--------------|---------------------|
|                                                             | <b>2013</b>                    | <b>2012</b>  |                     |
| Proceeds from long-term debt                                | 47,778                         | 81,149       | (41.1%)             |
| Repayments of long-term debt                                | (34,964)                       | (40,412)     | (13.5%)             |
| Acquisition of non-controlling interest                     | -                              | (16,290)     | n/a                 |
| Dividends paid                                              | (22,002)                       | (19,718)     | 11.6%               |
| Other                                                       | 2,056                          | (2,126)      | n/a                 |
| <b>Net cash provided by (used for) financing activities</b> | <b>(7,132)</b>                 | <b>2,603</b> | <b>n/a</b>          |

In 2013, our cash proceeds from loans and borrowings amounted to RR 47,778 million as compared to RR 81,149 million in 2012 and related to the issuance of Russian rouble denominated Eurobonds in the amount of RR 14 billion in February 2013 as well as the withdrawal of USD 1.07 billion under our syndicated credit line facility. In addition, we used RR 34,964 million for repayments of loans as compared to RR 40,412 million in 2012 (see "Debt Obligations" below). Furthermore, in 2012, we used RR 16.3 billion for the repayment of the remaining debt for the 49% equity stake in Yamal LNG acquired in September 2011. The remaining change related to repayment of interest on debts and other miscellaneous categories.

#### **Working capital**

Our net working capital position (current assets less current liabilities) as of 31 December 2013 was a positive RR 22,553 million compared to RR 3,113 million as of 31 December 2012. The change of our net working capital position was primarily due to an increase in our trade and other receivables by RR 33,113 million, or 201.8%, mostly related to RR 18,420 million receivable from CNPC for the sale of a 20% equity stake in Yamal LNG (which was fully paid in January 2014) as well as a decrease in short-term debt and current portion of long-term debt (see "Debt obligations" below) by RR 10,656 million, or 30.7%. This was partially offset by a decrease in our cash and cash equivalents by RR 10,531 million, or 57.2%, as well as an increase in current income tax payable by RR 7,167 million.

The Group's management believes that it presently has and will continue to have the ability to generate sufficient cash flows (from operating and financing activities) to repay all current liabilities and to finance the Group's capital construction programs.

## Capital expenditures

Total capital expenditures on property, plant and equipment were as follows:

| <i>millions of Russian roubles</i>                                                                                                                             | Year ended 31 December: |               | Change<br>%  |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|---------------|--------------|
|                                                                                                                                                                | 2013                    | 2012          |              |
| Capital expenditures                                                                                                                                           | 59,254                  | 43,554        | 36.0%        |
| Payment for mineral licenses                                                                                                                                   | 3,196                   | -             | n/a          |
| <b>Total additions to property, plant and equipment per<br/>Note "Property, plant and equipment" in the Group's<br/>IFRS Consolidated Financial Statements</b> | <b>62,450</b>           | <b>43,554</b> | <b>43.4%</b> |

Our total capital expenditures represent our investments in developing our oil and gas properties. In addition, in 2013, the Group paid RR 3,196 million for East-Tazovskoye field's oil and gas exploration and production license (see "Recent Developments" above). The following table shows the expenditures at our main fields and processing facilities:

| <i>millions of Russian roubles</i> | Year ended 31 December: |               |
|------------------------------------|-------------------------|---------------|
|                                    | 2013                    | 2012          |
| Yurkharovskoye field               | 18,777                  | 14,067        |
| East-Tarkosalinskoye field         | 10,788                  | 7,157         |
| Purovsky Plant                     | 8,633                   | 1,443         |
| Ust-Luga Complex                   | 6,360                   | 11,801        |
| Olimpiyskiy license area           | 2,793                   | 599           |
| Khancheyevskoye field              | 2,478                   | 1,017         |
| Salmanovskoye (Utrennee) field     | 1,963                   | 819           |
| Yarudeyskiy license area           | 1,499                   | 495           |
| North-Khancheyevskiy license area  | 872                     | 982           |
| North-Russkiy license area         | 662                     | 657           |
| West-Urengoiyskiy license area     | 306                     | 327           |
| Other                              | 4,123                   | 4,190         |
| <b>Capital expenditures</b>        | <b>59,254</b>           | <b>43,554</b> |

Total capital expenditures on property, plant and equipment in 2013 increased by RR 15,700 million, or 36.0%, to RR 59,254 million from RR 43,554 million in 2012. The increase was primarily related to construction of the third stage expansion at the Purovsky Plant, ongoing development activities at our Yurkharovskoye field and Olimpiyskiy license area, further development of the East-Tarkosalinskoye field's crude oil deposits, as well as production sustainability at the Khancheyevskoye field.

## Loans provided

Total loans provided by the Group increased from RR 12,930 million at 31 December 2012 to RR 47,638 million at 31 December 2013, or by RR 34,708 million.

Our loans provided with a breakdown by borrowers (remeasured based on commercial market borrowing rates in accordance with IAS 39 "Financial instruments: recognition and measurement") at 31 December 2013 and 31 December 2012 were as follows:

| Borrower                    | Currency | Maturity                 | Interest rate | At<br>31 December 2013 | At<br>31 December 2012 |
|-----------------------------|----------|--------------------------|---------------|------------------------|------------------------|
| Yamal LNG                   | USD      | after the commencement   | 5.09%         | 42,804                 | 2,915                  |
| Terneftegas                 | USD      | of commercial production | 3.88%-4.52%   | 2,611                  | 1,451                  |
| Yamal Development           | RR       | December 2015            | 9.25%         | 2,200                  | -                      |
| Sibneftegas                 | RR       | November 2014            | 9.5%-10%      | -                      | 8,564                  |
| Other                       |          |                          |               | 23                     | -                      |
| <b>Total loans provided</b> |          |                          |               | <b>47,638</b>          | <b>12,930</b>          |

The increase in loans provided was primarily due to the loans provided by the Group to our joint venture Yamal LNG used to finance the Yamal LNG project. In January 2014, the loan was partially repaid in the amount of RR 12,045 million (USD 364 million) as a result of CNPC entering the project.

## Debt obligations

We utilize a variety of financial instruments to ensure the flexibility of our financing strategy. This includes maintaining a debt portfolio with a balance of short-term and long-term financing, a mix of fixed and floating interest rate instruments and a debt portfolio denominated in either Russian roubles or US dollars.

### Overview

Our total debt increased from RR 132,487 million at 31 December 2012 to RR 165,621 million at 31 December 2013, or by RR 33,134 million. In February 2013, the Group issued Russian rouble denominated Eurobonds in the amount of RR 14 billion and withdrew USD 1.07 billion under our syndicated term credit line facility obtained in June 2013. In addition, in December 2013, the Group withdrew USD 431 million under short-term credit line facilities, including bank overdrafts, from BNP PARIBAS Bank and Credit Agricole Corporate and Investment Bank, which were fully repaid in January 2014. In 2013, we repaid loans from Sberbank in the amount of RR 15 billion in February 2013, and a USD 200 million loan from Nordea Bank in March 2013. We also repaid Russian rouble denominated bonds in the amount of RR 10 billion in June 2013. We utilize credit facilities to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields and to construct and/or expand processing assets such as the Purovsky Plant and the Ust-Luga Complex, as well as acquisitions of new oil and gas assets.

Our total debt position (net of unamortized transaction costs) at 31 December 2013 and 31 December 2012 was as follows:

| Facility                                                           | Amount           | Maturity      | Interest rate | At<br>31 December 2013 | At<br>31 December 2012 |
|--------------------------------------------------------------------|------------------|---------------|---------------|------------------------|------------------------|
| Syndicated term credit line facility                               | USD 1.07 billion | June 2018     | LIBOR+1.75%   | 34,363                 | -                      |
| Eurobonds Ten-Year                                                 | USD 1 billion    | December 2022 | 4.422%        | 32,595                 | 30,232                 |
| Eurobonds Ten-Year                                                 | USD 650 million  | February 2021 | 6.604%        | 21,163                 | 19,620                 |
| Russian bonds                                                      | RR 20 billion    | October 2015  | 8.35%         | 19,980                 | 19,969                 |
| Eurobonds Five-Year                                                | USD 600 million  | February 2016 | 5.326%        | 19,583                 | 18,146                 |
| Eurobonds Four-Year                                                | RR 14 billion    | February 2017 | 7.75%         | 13,911                 | -                      |
| Sberbank                                                           | RR 10 billion    | December 2014 | 7.9%-8.9%     | 9,911                  | 9,837                  |
| Sberbank                                                           | RR 15 billion    | December 2013 | 7.5%          | -                      | 14,984                 |
| Russian bonds                                                      | RR 10 billion    | June 2013     | 7.5%          | -                      | 9,991                  |
| Nordea Bank                                                        | USD 200 million  | November 2013 | LIBOR+1.9%    | -                      | 6,075                  |
| Sumitomo Mitsui <sup>(4)</sup>                                     | USD 300 million  | December 2013 | LIBOR+1.45%   | -                      | 3,633                  |
| <b>Total</b>                                                       |                  |               |               | <b>151,506</b>         | <b>132,487</b>         |
| Less: current portion of long-term debt                            |                  |               |               | (9,911)                | (34,682)               |
| <b>Total long-term debt</b>                                        |                  |               |               | <b>141,595</b>         | <b>97,805</b>          |
| Short-term debt                                                    |                  |               |               | 14,115                 | -                      |
| Plus: current portion of long-term debt                            |                  |               |               | 9,911                  | 34,682                 |
| <b>Total short-term debt and current portion of long-term debt</b> |                  |               |               | <b>24,026</b>          | <b>34,682</b>          |
| <b>Total debt</b>                                                  |                  |               |               | <b>165,621</b>         | <b>132,487</b>         |

<sup>(4)</sup> Sumitomo Mitsui Banking Corporation Europe.

### *Maturities of long-term loans*

Scheduled maturities of our long-term debt at 31 December 2013 were as follows:

| <i>Maturity schedule:</i>     | <b>RR million</b> |
|-------------------------------|-------------------|
| 1 January to 31 December 2015 | 27,913            |
| 1 January to 31 December 2016 | 30,155            |
| 1 January to 31 December 2017 | 24,483            |
| 1 January to 31 December 2018 | 5,286             |
| After 31 December 2018        | 53,758            |
| <b>Total long-term debt</b>   | <b>141,595</b>    |

### *Available credit facilities*

At 31 December 2013, the Group also had funds available under credit facilities with interest rates predetermined or negotiated at time of each withdrawal:

|                                          | <b>Par value</b> | <b>Expiring</b>        |                              |
|------------------------------------------|------------------|------------------------|------------------------------|
|                                          |                  | <b>Within one year</b> | <b>Between 1 and 3 years</b> |
| Syndicated term loan facility            | USD 430 million  | 14,074                 | -                            |
| UniCredit Bank                           | USD 55 million   | -                      | 1,810                        |
| <b>Total available credit facilities</b> |                  | <b>14,074</b>          | <b>1,810</b>                 |

At 31 December 2013, the Group had available funds in the form of bank overdrafts with various international banks in the aggregate amount of RR 2.7 billion (USD 84 million) on variable interest rates subject to the specific type of credit facility.

Management believes it has sufficient internally generated cash flows, as well as access to available external borrowings (both short- and long-term) to fund its capital expenditure program, service its existing debt and meet its current obligations as they become due.

## **QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS**

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates and interest rates. We are exposed to commodity price risk as our prices for crude oil, stable gas condensate and refined products destined for export sales are linked to international crude oil prices and other benchmark price references. We are exposed to foreign exchange risk to the extent that a portion of our sales, costs, receivables, loans and debt are denominated in currencies other than Russian roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. From time to time we may use derivative instruments, such as commodity forward contracts, commodity price swaps, commodity options, foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks, and we may hold or issue derivative or other financial instruments for trading purposes.

### **Foreign currency risk**

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 December 2013, the total amount of our long-term debt denominated in US dollars was RR 107,704 million, or 65.0% of our total borrowings at that date. Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms, as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, approximately 24.2% in 2013, is denominated in US dollars. As of 31 December 2013, the Russian rouble depreciated by approximately 7.8% against the US dollar since 31 December 2012.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 31 December 2013 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 12,182 million on foreign currency denominated borrowings held at that date.

### **Commodity risk**

Substantially all of our stable gas condensate and refined products, LPG and crude oil export sales are sold under spot market contracts. Our export prices are primarily linked to international crude oil and oil products prices. External factors such as geopolitical developments, natural disasters and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

The weather is another factor affecting demand for natural gas. Changes in weather conditions from year to year can influence demand for natural gas and to some extent gas condensate and refined products.

From time to time we may employ derivative instruments to mitigate the price risk of our sales activities. In our consolidated financial statements all derivative instruments are recorded at their fair values. Unrealized gains or losses on derivative instruments are recognized within other operating income (loss), unless the underlying arrangement qualifies as a hedge.

The Group purchases and sells natural gas on the European market under long-term contracts based on formulas with reference to benchmark natural gas prices quoted for the North-Western European natural gas hubs, crude oil and oil products prices and/or a combination thereof. Therefore, the Group's financial results from natural gas trading activities are subject to commodity price volatility based on fluctuations or changes in the respective benchmark reference prices.

### **Pipeline access**

We transport substantially all of our natural gas through the Gas Transmission System ("GTS") owned and operated by OAO Gazprom, which is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia. Under existing legislation, Gazprom must provide access to the GTS to all independent suppliers on a non-discriminatory basis provided there is capacity available that is not being used by Gazprom. In practice, Gazprom exercises considerable discretion over access to the GTS because it is the sole owner of information relating to capacity. There can be no assurance that Gazprom will continue to provide us with access to the GTS; however, we have not been denied access in prior periods.

**Ability to reinvest**

Our business requires significant ongoing capital expenditures in order to grow our production and meet our strategic plans. An extended period of reduced demand for our hydrocarbons available for sale and the corresponding revenues generated from these sales would limit our ability to maintain an adequate level of capital expenditures, which in turn could limit our ability to increase or maintain current levels of production and deliveries of natural gas, gas condensate, crude oil and other associated products; thereby, adversely affecting our financial and operating results.

**Off balance sheet activities**

As of 31 December 2013, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.