

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 for the three months ended 31 March 2013 and 2012 together with our unaudited consolidated interim condensed financial information as of and for the three months ended 31 March 2013. The unaudited consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". This consolidated interim condensed financial information should be read together with the audited consolidated financial statements for the year ended 31 December 2012 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. We export our stable gas condensate directly to international markets, while our liquefied petroleum gas ("LPG") and crude oil are generally delivered to both international (including the Commonwealth of Independent States ("CIS")) and domestic markets.

RECENT DEVELOPMENTS

In March 2013, the Group won a tender for exploration and production license for the East-Tazovskoye field, a field located in the Yamal Nenets Autonomous Region ("YNAO"). As of 1 January 2013, the estimated reserves of the field according to the Russian reserve classification C1+C2 amounted to 65.3 billion cubic meters ("bcm") of natural gas and 13.4 million tons of liquid hydrocarbons. We paid RR 3.19 billion for the license.

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

In the three months ended 31 March 2013, we increased our proportion of natural gas volumes sold to end-customers to 88.8% due to the conclusion during 2012 of a range of long-term contracts for the period of 10-15 years. The 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. Our share of natural gas volumes sold under the mentioned contracts in the three months ended 31 March 2013 was 33.1% of total natural gas sales volumes.

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 Kostroma region. In February 2013, OOO Gazprom mezhregiongas Kostroma was renamed to OOO NOVATEK-Kostroma ("NOVATEK-Kostroma").

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 sales in the region.

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

In November 2012, the Group acquired a 49% ownership interest in ZAO Nortgas (“Nortgas”) for total consideration of USD 1,375 million. Nortgas is a Russian oil and gas production company that holds the production license for the North-Urengoykoye field (expires in 2018), located in the YNAO, which is located in a close proximity to our transport and processing infrastructure. The estimated proved reserves appraised under the PRMS reserve methodology totalled 186 billion cubic meters of natural gas and 25 million tons of liquid hydrocarbons as of 31 December 2012, for combined total of 1.4 billion barrels of oil equivalent.

In October 2012, we launched the fourth stage of the second phase development at our Yurkharovskoye field, which allows us to achieve the design production capacity of the field. The fourth stage complex includes two gas treatment trains with total annual capacity of seven billion cubic meters. The fourth stage launch increases natural gas production at the field to a plateau level of 36.5 bcm per annum.

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 with the total volume of natural gas supplied over this period is estimated to be approximately 210 terawatt-hours (or approximately 20 bcm). 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).

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

SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Three months ended 31 March:		Change %
	2013	2012	
Financial results			
Total revenues (net of VAT, export duties, excise and fuel taxes)	80,565	54,097	48.9%
Operating expenses	(51,056)	(31,575)	61.7%
Profit attributable to shareholders of OAO NOVATEK	22,711	21,245	6.9%
EBITDA ⁽¹⁾	32,905	24,217	35.9%
EBITDAX ⁽²⁾	33,040	25,113	31.6%
Earnings per share (in Russian roubles)	7.49	7.00	6.9%
Operating results			
Natural gas sales volumes (million cubic meters)	18,739	16,050	16.8%
Stable gas condensate sales volumes (thousand tons)	1,210	624	93.9%
Liquefied petroleum gas sales volumes (thousand tons)	265	238	11.3%
Crude oil sales volumes (thousand tons)	137	84	63.1%
Total hydrocarbons production (million barrels of oil equivalent) ⁽³⁾	113.6	103.6	9.7%
Total daily production (thousand barrels of oil equivalent per day) ⁽³⁾	1,262	1,139	10.9%
Cash flow results			
Net cash provided by operating activities	25,532	23,949	6.6%
Capital expenditures ⁽⁴⁾	11,264	7,519	49.8%
Free cash flow ⁽⁵⁾	14,268	16,430	(13.2%)

⁽¹⁾ 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 from the "Financial instruments and financial risk factors" in the notes to the consolidated financial statements.

⁽²⁾ EBITDAX represents EBITDA as adjusted for the add-back of exploration expenses.

⁽³⁾ Total hydrocarbons production and total daily production are calculated based on net production, including our proportionate share in the production of our joint ventures.

⁽⁴⁾ Capital expenditures represent additions to property, plant and equipment excluding prepayments for participation in tenders for mineral licenses.

⁽⁵⁾ Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Profit attributable to shareholders of OAO NOVATEK	22,711	21,245	6.9%
Depreciation, depletion and amortization	3,157	2,614	20.8%
Net impairment expenses (reversals)	(4)	25	n/a
Loss (income) from changes in fair value of derivative financial instruments	(509)	-	n/a
Total finance expense (income)	1,924	(5,624)	n/a
Total income tax expense	5,626	5,957	(5.6%)
EBITDA	32,905	24,217	35.9%
Exploration expenses	135	896	(84.9%)
EBITDAX	33,040	25,113	31.6%

SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate, Russian roubles for one US dollar</i> ⁽¹⁾	Three months ended 31 March:		Change %
	2013	2012	
At the beginning of the period	30.37	32.20	(5.7%)
At the end of the period	31.08	29.33	6.0%
Average for the period	30.41	30.26	0.5%
Depreciation (appreciation) of Russian rouble to US dollar	2.3%	(8.9%)	n/a

⁽¹⁾ 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, USD / bbl</i>	Three months ended 31 March:		Change %
	2013	2012	
WTI ⁽²⁾			
At the end of the period	97.2	103.0	(5.6%)
Average for the period	94.4	103.0	(8.3%)
Brent ⁽³⁾			
At the end of the period	107.4	123.5	(13.0%)
Average for the period	112.6	118.6	(5.1%)
Urals ⁽³⁾			
At the end of the period	106.5	120.0	(11.3%)
Average for the period	110.8	116.9	(5.2%)

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

⁽³⁾ Based on Brent (Dtd) 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>Propane-butane mix prices, USD / ton</i> ⁽⁴⁾	Three months ended 31 March:		Change %
	2013	2012	
At the end of the period	633.0	837.5	(24.4%)
Average for the period	698.9	782.6	(10.7%)

⁽⁴⁾ 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, USD / ton</i> ⁽⁵⁾	Three months ended 31 March:		Change %
	2013	2012	
Crude oil, stable gas condensate			
At the end of the period	420.6	411.2	2.3%
Average for the period	406.5	400.8	1.4%
LPG			
At the end of the period	131.4	157.3	(16.5%)
Average for the period	176.8	180.0	(1.8%)

⁽⁵⁾ Export duties are determined by the Government of the Russian Federation 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 twelve months remains in the forefront of present discussions, as noted by the recent events in Cyprus, 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 current 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

As an independent natural gas producer, we are not subject to the Russian Government's regulation of natural gas prices, except for those volumes delivered to residential customers, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service ("FTS"), a governmental agency, and present market conditions.

As of 1 July 2012, the FTS increased the prices for natural gas on the domestic market by 15%. According to the Forecast of Socio-economic Development of the Russian Federation for 2013 through 2015, prepared by Ministry of Economic development of Russia, indexation of the natural gas prices on the domestic market will take place annually from 1 July by 15%. In April 2013, the Government of the Russian Federation approved the Fundamental parameters of the Forecast of Socio-economic Development of the Russian Federation for 2014 through 2016, that sets the average annual increase of natural gas prices by 15% in 2014 and 2015 and by 10% in 2016.

According to the Russian 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 range of maximum and minimum wholesale price. 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 on the European markets within a range of +/-3% from the average prices set previously.

The wholesale gas prices to end-customers on the domestic market (excluding residential customers) were decreased by 3% effective from 1 April 2013 due to the recalculations performed in the first quarter 2013 based on changes in oil products prices on the European markets.

The FTS under the Governmental decisions may modify the percentages published, as well as to potentially prolong the timetable toward domestic market natural gas price liberalization based on market conditions and other factors.

In June 2012, the Government of the Russian Federation made a decision to develop a new approach to the tax regulation of the Russian gas industry, which will make correlation between natural gas UPT rate and the natural gas prices and transportation tariffs growth rates from 1 January 2014. The potential future natural gas prices and transportation tariffs deviations from the key parameters as defined in the current Forecasts of the Ministry of Economic Development of Russia, will be considered in the UPT rates determination, thus smoothing fluctuations and decreasing volatility of gross profits of independent gas producers.

According to the Forecast of Long-term Socio-economic Development of the Russian Federation for the period until 2030 the regulation of natural gas prices on the domestic market will be based on the netback parity of natural gas prices on the domestic and export markets.

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

In the three months ended 31 March 2013, our average natural gas price to end-customers and ex-field price increased by 19.3% and 21.2%, respectively, primarily due to an increase in the regulated FTS price tariff by 15% on the average by regions effective from 1 July 2012. Our average transportation expense for the delivery of natural gas to end-customers increased by 21.7% primarily due to a 7.0% average increase in the natural gas transportation tariff effective 1 July 2012, as well as an increase in our average transportation distance (see “Transportation tariffs” below). As a result, our average netback price on end-customers sales increased by 17.4%, while our total average natural gas price excluding transportation expense increased by 18.6% compared to respective prices in the corresponding period 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>	Three months ended 31 March:		Change %
	2013	2012	
Average natural gas price to end-customers ⁽¹⁾	3,120	2,616	19.3%
Average natural gas transportation expense for sales to end-customers	(1,409)	(1,158)	21.7%
Average natural gas netback price on end-customer sales	1,712	1,458	17.4%
Average natural gas price ex-field (wholesale traders)	1,708	1,409	21.2%
Total average natural gas price excluding transportation expense	1,712	1,444	18.6%

⁽¹⁾ Includes cost of transportation.

Crude oil, stable gas condensate, liquefied petroleum gas and oil products 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 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 normally (or historically) trades at a discount to the international benchmark Brent crude oil. Volatile movements in benchmark crude oil 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, among many other factors.

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

In the three months ended 31 March 2013, as well as in the corresponding period in 2012, our stable gas condensate export delivery terms were cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or priced at cost, insurance and freight (CIF), or delivery at point of destination (DAP). Our average stable gas condensate export contract price, including export duties, in the three months ended 31 March 2013, was approximately USD 935 per ton compared to approximately USD 1,020 per ton in the corresponding period in 2012.

In the three months ended 31 March 2013, as well as in the corresponding period in 2012, our crude oil export delivery terms were DAP (Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 792 per ton compared to USD 842 per ton in the corresponding period in 2012.

The following table shows our average realized stable gas condensate and 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>	Three months ended 31 March:		Change %
	2013	2012	
Stable gas condensate			
Net export price, RR per ton	16,079	18,633	(13.7%)
Net export price, USD per ton	528.7	615.8	(14.1%)
Domestic price, RR per ton	13,256	14,186	(6.6%)
Crude oil			
Net export price, RR per ton	11,684	13,403	(12.8%)
Net export price, USD per ton	384.2	442.9	(13.3%)
Domestic price, RR per ton	11,095	11,576	(4.2%)

In the three months ended 31 March 2013, LPG export delivery terms were DAP at the border of the customer’s country and free carrier (FCA) at terminal points in Poland, compared to DAP at the border of the customer’s country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and FCA (at terminal points in Poland) in the corresponding period in 2012. In the three months ended 31 March 2013, our average export contract price for LPG produced at the Purovsky Gas Condensate Plant (“Purovsky Plant”), including export duties and excise and fuel taxes expense, was approximately USD 815 per ton compared to USD 904 per ton in the corresponding period in 2012.

In the three months ended 31 March 2013, we sold 137 thousand tons of our LPG, including volumes sold through our wholly owned subsidiary OOO NOVATEK-AZK (“NOVATEK-AZK”), on the domestic market at an average price of RR 13,400 per ton compared to sales of 114 thousand tons, including volumes purchased for resale, at an average price of RR 13,094 per ton in the corresponding period in 2012.

In the three months ended 31 March 2013, we sold approximately 0.4 thousand tons of produced by the Group methanol to our joint venture at an average price of RR 18,644 per ton as compared to sales of approximately 1.2 thousand tons at an average price of RR 10,004 per ton in the corresponding period in 2012.

The following table shows our average realized LPG and methanol sales prices, excluding LPG 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>	Three months ended 31 March:		Change %
	2013	2012	
LPG			
Net export price, RR per ton	16,990	19,190	(11.5%)
Net export price, USD per ton	558.7	634.2	(11.9%)
Domestic price, RR per ton	13,400	13,101	2.3%
Methanol			
Domestic price, RR per ton	18,644	10,004	86.4%

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 Government controlled monopoly. Transportation tariffs for the use of the UGSS by independent producers are set by the FTS.

In accordance with the 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 averaged between RR 50.78 to RR 1,995.44 (excluding VAT) per mcm and the transportation rate was RR 12.02 (excluding VAT) per mcm per 100 km.

According to the Forecast of Socio-economic Development of the Russian Federation for 2013 announced in September 2012 by the Ministry of Economic Development of the Russian Federation, the transportation tariff for natural gas produced by independent producers will be increased in 2013, 2014 and 2015 effective from 1 July and will not exceed the forecasted inflation rate (excluding an increase in the transportation tariffs as a result of possible property tax benefit cancellation for OAO Gazprom). According to preliminary estimates of the Ministry of Economic Development, the transportation tariff will be increased by 5.4% effective from 1 July 2013, by 5.0% effective from 1 July 2014 and by 4.8% effective from 1 July 2015 (excluding an increase in the transportation tariffs as a result of possible property tax benefit cancellation for OAO Gazprom).

The increases in the transportation tariffs for natural gas will be taken into account as one of complex parameters during the calculation of UPT rates for natural gas (see “Natural gas prices” above).

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 were increased in November 2012 on average by approximately 5.5%.

Stable gas condensate and LPG

We transport our stable gas condensate (from the Purovsky Plant to the Port of Vitino on the White Sea or to customers on the domestic markets) and LPG (from the Purovsky Plant to the customers on the domestic market) by rail which is owned and operated 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 product and 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 the FTS orders, we applied the discount co-efficients to the existing 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 January 2013, the FTS announced changes to the railroad transportation tariffs, which provide the ability to apply discount co-efficients based on the type of product, direction and length of the transport route.

In January 2013, the FTS approved the terms and conditions of application the rail tariffs in the range of limits (minimum and maximum) based on which in March 2013 the Management Board of RZD took decision to apply the discount co-efficient of 0.917 to existing railroad transportation tariffs related to stable gas condensate deliveries from the Limbey rail station (located in close proximity to our Purovsky Plant) effective from 18 April 2013 throughout the end of 2013.

We deliver our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and tankers for transportation to US, European, South American and countries of the APR. The cost of tanker transportation is generally determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms, all in accordance with general industry practice.

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 favours 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 have been given retroactive effect.

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

UPT

In 2012, our UPT rate for natural gas was set at RR 251 per mcm (consisting of base rate of RR 509 per mcm and a reducing co-efficient for independent natural gas producers of 0.493) and was increased to RR 265 per mcm effective from 1 January 2013. In addition, the Russian Tax Code provides for the UPT rate for natural gas produced by independent natural gas producers at RR 402 per mcm effective from 1 July 2013, RR 471 per mcm effective from 1 January 2014 and RR 552 per mcm effective from 1 January 2015.

The Russian Government is currently considering replacing the existing approach to the calculation of the UPT rate for natural gas with a formula that takes into account the category of extracted gas, field's location, access to export markets and dynamics in regulated prices and transportation tariffs. The proposed change in the calculation of UPT rate for natural gas is expected to be applied effective from 1 January 2014 (see "Natural gas prices" above); however, the discussions are not yet completed as of the date of the issuance of our financial statements.

In 2012, the UPT rate for gas condensate was set at RR 556 per ton and was increased to RR 590 per ton effective from 1 January 2013. In addition, the UPT rate for gas condensate for 2014 and 2015 was set at RR 647 per ton and RR 679 per ton respectively.

The UPT rate for crude oil is linked to the Urals benchmark crude oil price and changes every month. It is calculated in US dollar and translated and paid in Russian roubles using the monthly average exchange rate established by the Central Bank of Russia.

The Russian Tax Code provides for reduced or zero UPT rate for crude oil produced in certain geographical areas. We did not use the reduced or zero UPT rates from the production of crude oil prior to 1 January 2012. According to the amendments to the Russian Tax Code, effective from 1 January 2012, a zero UPT rate is set for crude oil produced at fields located in the YNAO to the north of the 65th degree of the northern latitude. Our Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye fields are located in the mentioned geographical area; therefore, we applied the allowed 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 stable gas condensate, LPG and crude oil. The Government of the Russian Federation sets the export customs duties for exported liquids on a monthly basis (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.

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.

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 is set at 22.0%, 5.1% and 2.9% respectively. The maximum taxable base per each employee was set at RR 512 thousand and RR 568 thousand of annual income in 2012 and 2013 respectively. For income above the maximum taxable base the rates of 10.0% for the Pension Fund of the Russian Federation and nil for other funds are applied.

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes in the three months ended 31 March 2013 increased due to a combination of increased purchases from our related party and joint ventures, increased production at our Yurkharovskoye field and higher volumes withdrawn from the Underground Gas Storage Facilities (“UGSF”) as compared to the corresponding period in 2012. Liquids sales volumes increased due to a decrease in liquids inventory balances in the three months ended 31 March 2013 as compared to an increase in the corresponding period in 2012 and unstable gas condensate purchases from the Group’s joint ventures. Our liquids inventory balances tend to fluctuate periodically due to loading schedules and final destinations of stable gas condensate shipments.

Natural gas sales volumes

<i>millions of cubic meters</i>	Three months ended 31 March:		Change %
	2013	2012	
Production from (subsidiaries):			
Yurkharovskoye field	9,604	8,703	10.4%
East-Tarkosalinskoye field	3,171	3,406	(6.9%)
Khancheyevskoye field	876	920	(4.8%)
Other fields	14	16	(12.5%)
Total natural gas production	13,665	13,045	4.8%
Purchases from the Group’s joint ventures	1,953	1,409	38.6%
Total production and purchases from Group’s joint ventures	15,618	14,454	8.1%
Other purchases	2,114	900	134.9%
Total production and purchases	17,732	15,354	15.5%
Purovsky Plant, own usage and methanol production	(38)	(32)	18.8%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	1,045	728	43.5%
Total natural gas sales volumes	18,739	16,050	16.8%
<i>Sold to end-customers</i>	<i>16,632</i>	<i>12,172</i>	<i>36.6%</i>
<i>Sold ex-field</i>	<i>2,107</i>	<i>3,878</i>	<i>(45.7%)</i>

In the three months ended 31 March 2013, our total natural gas production increased by 620 mmcm, or 4.8%, to 13,665 mmcm from 13,045 mmcm in the corresponding period 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). Our natural gas production at the East-Tarkosalinskoye and Khancheyevskoye fields decreased due to the natural declines in the reservoir pressure at the current gas producing horizons.

In the three months ended 31 March 2013, natural gas purchases from our joint ventures increased by 544 mmcm, or 38.6%, primarily due to the commencement of purchases from our joint venture Nortgas in January 2013.

In the three months ended 31 March 2013, other natural gas purchases increased by 1,214 mmcm, or 134.9%, as a result of the increased purchases from our related party OAO SIBUR Holding (“SIBUR”).

In the three months ended 31 March 2013, we used 21 mmcm of natural gas as feedstock for the production of methanol compared to 20 mmcm in the corresponding period in 2012. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation (condensation) during the production, preparation and transportation of hydrocarbons.

Liquids sales volumes

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2013	2012	
Production from (subsidiaries):			
Yurkharovskoye field	703	710	(1.0%)
East-Tarkosalinskoye field	265	231	14.7%
Khancheyskoye field	124	134	(7.5%)
Other fields	4	5	(20.0%)
Total liquids production	1,096	1,080	1.5%
Purchases from:			
The Group's joint ventures	239	-	n/a
Other	2	2	0.0%
Total production and purchases	1,337	1,082	23.6%
Losses and own usage ⁽¹⁾	(18)	(10)	80.0%
Decreases (increases) in liquids inventory balances	295	(124)	n/a
Total liquids sales volumes	1,614	948	70.3%
<i>Stable gas condensate export</i>	<i>1,167</i>	<i>623</i>	<i>87.3%</i>
<i>Stable gas condensate domestic</i>	<i>43</i>	<i>1</i>	<i>n/m</i>
<i>Subtotal stable gas condensate</i>	<i>1,210</i>	<i>624</i>	<i>93.9%</i>
<i>LPG export</i>	<i>128</i>	<i>124</i>	<i>3.2%</i>
<i>LPG domestic</i>	<i>116</i>	<i>94</i>	<i>23.4%</i>
<i>LPG sold through domestic retail and small wholesale stations</i>	<i>21</i>	<i>20</i>	<i>5.0%</i>
<i>Subtotal LPG</i>	<i>265</i>	<i>238</i>	<i>11.3%</i>
<i>Crude oil export</i>	<i>56</i>	<i>27</i>	<i>107.4%</i>
<i>Crude oil domestic</i>	<i>81</i>	<i>57</i>	<i>42.1%</i>
<i>Subtotal crude oil</i>	<i>137</i>	<i>84</i>	<i>63.1%</i>
<i>Oil products domestic</i>	<i>2</i>	<i>2</i>	<i>0.0%</i>
<i>Subtotal oil products</i>	<i>2</i>	<i>2</i>	<i>0.0%</i>

⁽¹⁾ Losses associated with processing at the Purovsky Plant, as well as during railroad, trunk pipeline and tanker transportation.

In the three months ended 31 March 2013, our liquids production increased by 16 thousand tons, or 1.5%, primarily due to a significant increase in crude oil production at the East-Tarkosalinskoye and, to a lesser extent, Khancheyskoye fields, while our gas condensate production decreased marginally. The decrease in gas condensate production at our Khancheyskoye field was partially offset by an increase in crude oil production. 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.

Purchases from the Group's joint ventures in the three months ended 31 March 2013, include purchases of unstable gas condensate from SeverEnergia and its wholly owned subsidiary OAO Arctic Gas Company, which we commenced in April 2012 after the launch of the Samburgskoye field's first phase development, and from Nortgas after the acquisition of a 49% ownership interest in November 2012.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2013 COMPARED TO THE CORRESPONDING PERIOD IN 2012

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

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2013	% of total revenues	2012	% of total revenues
Total revenues (net of VAT, export duties, excise and fuel taxes)	80,565	100.0%	54,097	100.0%
<i>including:</i>				
natural gas sales	55,483	68.9%	37,305	69.0%
liquids' sales	24,965	31.0%	16,571	30.6%
Operating expenses	(51,056)	(63.4%)	(31,575)	(58.4%)
Other operating income (loss)	691	0.9%	41	0.1%
Profit from operations	30,200	37.5%	22,563	41.7%
Finance income (expense)	(1,924)	(2.4%)	5,624	10.4%
Share of profit (loss) of joint ventures, net of income tax	48	0.1%	(991)	(1.8%)
Profit before income tax	28,324	35.2%	27,196	50.3%
Total income tax expense	(5,626)	(7.0%)	(5,957)	(11.0%)
Profit (loss)	22,698	28.2%	21,239	39.3%
Non-controlling interest	13	0.0%	6	0.0%
Profit attributable to shareholders of OAO NOVATEK	22,711	28.2%	21,245	39.3%

Total revenues

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Natural gas sales	55,483	37,305	48.7%
<i>End-customers</i>	51,884	31,842	62.9%
<i>Ex-field sales</i>	3,599	5,463	(34.1%)
Stable gas condensate sales	19,331	11,623	66.3%
<i>Export</i>	18,762	11,610	61.6%
<i>Domestic</i>	569	13	n/a
Liquefied petroleum gas sales	4,014	3,871	3.7%
<i>Export</i>	2,179	2,381	(8.5%)
<i>Domestic</i>	1,835	1,490	23.2%
Crude oil sales	1,547	1,024	51.1%
<i>Export</i>	653	370	76.5%
<i>Domestic</i>	894	654	36.7%
Oil and gas products sales	73	53	37.7%
<i>Domestic</i>	73	53	37.7%
Total oil and gas sales	80,448	53,876	49.3%
Other revenues	117	221	(47.1%)
Total revenues	80,565	54,097	48.9%

Natural gas sales

In the three months ended 31 March 2013, our revenues from sales of natural gas increased by RR 18,178 million, or 48.7%, compared to the corresponding period in 2012 due primarily to an increase in our average realized natural gas price, as well as an increase in our total sales volumes. The increase in our average realized natural gas price was driven by a combination of increases in the regulated FTS price tariff for natural gas by 15% on the average by regions effective from 1 July 2012 and in our 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 88.8% in the three months ended 31 March 2013 as compared to 75.8% in the corresponding period 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 a regional natural gas trader Gazprom Mezhrefiongas Kostroma acquisition in December 2012 (NOVATEK-Kostroma since February 2013). In addition, the increase in our proportion of natural gas volumes sold to end-customers was due to the conclusion in 2012 of several long-term contracts with OAO MMK, E.ON's and Fortum's Russian subsidiaries, Mechel Group for a period of 10-15 years (see "Recent developments" above).

In the three months ended 31 March 2013, our average netback price on end-customers sales, excluding volumes purchased for resale in the location of our end-customers in 2012, increased by 17.4% as compared to the corresponding period in 2012, while our average realized end-customers sales price increased by 19.3%. The increase in our average realized end-customers sales netback price was primarily due to a 15% increase in the regulated FTS natural gas prices on the average by regions effective from 1 July 2012. In addition, our average natural gas transportation tariff for sales to end-customers increased by 21.7% due to the significant growth in the average transportation distance resulted from the new customers (see "Recent developments" above) and an increase in average transportation tariff by 7.0% set by the FTS effective from 1 July 2012.

Our average realized ex-field price increased by 21.2% as compared to the corresponding period in 2012 due to an increase in the regulated FTS price for natural gas by 15% effective from 1 July 2012, as well as an optimization of the traders mix with the increased proportion of our natural gas sold to end-customers.

Stable gas condensate sales

In the three months ended 31 March 2013, our revenues from sales of stable gas condensate increased by RR 7,708 million, or 66.3%, compared to the corresponding period in 2012 primarily due to an increase in volumes sold, that was partially offset by a decrease in our average realized prices.

Our total stable gas condensate sales volumes increased by 586 thousand tons, or 93.9%, due to the initiation of unstable gas condensate purchases from our joint ventures and a significant decrease in the stable gas condensate inventory balance in the three months ended 31 March 2013 as compared to an increase in the corresponding period in 2012 (see “Change in natural gas, liquid hydrocarbons and work-in-progress” below).

In the three months ended 31 March 2013, we exported 1,167 thousand tons of stable gas condensate, or 96.4% of our total sales volumes, to Europe, the APR and the United States with the remaining 43 thousand tons sold domestically. In the corresponding period in 2012, we exported 623 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to Europe, the United States and the APR with the remaining one thousand tons sold domestically.

In the three months ended 31 March 2013, our average realized net export price for stable gas condensate, excluding export duties and translated to US dollars from Russian roubles using the average exchange rate for the period, decreased by USD 87.1 per ton, or 14.1%, to USD 528.7 per ton (CFR, DES, CIF and DAP) from USD 615.8 per ton (CFR, DES, DAP and CIF) in the corresponding period in 2012 primarily due to a 8.3% decrease in our average export contract price in US dollars, and, to a lesser extent, an 0.7% increase in our average export duty per ton. The decrease in our average realized contract price was due to an overall decrease in the underlying benchmark crude oil and related commodity prices on international markets used in the price formulation.

Liquefied petroleum gas sales

In the three months ended 31 March 2013, our revenues from sales of LPG increased by RR 143 million, or 3.7%, compared to the corresponding period in 2012 due to an increase in our sales volumes that was partially offset by a decrease in our average realized prices.

In the three months ended 31 March 2013, we sold 128 thousand tons of LPG, or 48.3% of our total LPG sales volumes, to export markets as compared to sales of 124 thousand tons, or 52.1%, in the corresponding period in 2012. In the three months ended 31 March 2013, as well as in the corresponding period in 2012, our export sales volumes of LPG representing greater than 10% of total LPG export volumes were to customers located in Poland and Finland.

Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense and translated to US dollars from Russian roubles using the average exchange rate for the period, decreased by USD 75.5 per ton, or 11.9%, to USD 558.7 per ton in the three months ended 31 March 2013 (DAP and FCA) compared to USD 634.2 per ton in the corresponding period in 2012 (DAP, CPT and FCA) primarily due to a 9.8% decrease in our average contract price that was partially offset by a decrease in our average export duty per ton by 5.4%. The reduction in our average contract price was due to a decrease in the LPG prices on international markets.

In the three months ended 31 March 2013, we sold 137 thousand tons of LPG, or 51.7% of our total LPG sales volumes, on the domestic market compared to 114 thousand tons, or 47.9%, in the corresponding period in 2012. In the three months ended 31 March 2013, our average LPG domestic price was RR 13,400 per ton (excluding VAT) representing an increase of RR 306 per ton, or 2.3%, compared to the corresponding period in 2012.

Crude oil sales

In the three months ended 31 March 2013, revenues from sales of crude oil increased by RR 523 million, or 51.1%, compared to the corresponding period in 2012 due to an increase in sales volumes. Our crude oil sales volumes increased by 53 thousand tons, or 63.1%, to 137 thousand tons from 84 thousand tons in the corresponding period in 2012 primarily due to an increase in crude oil production at our East-Tarkosalinskoye and Khancheykoye fields.

In the three months ended 31 March 2013, we sold 59.1% of total crude oil volumes domestically at an average price of RR 11,095 per ton (excluding VAT) representing a decrease of RR 481 per ton, or 4.2%, compared to the corresponding period in 2012.

The remaining 40.9% of our crude oil volumes were sold to export markets at an average price of USD 384.2 per ton (DAP, excluding export duties) representing a decrease of USD 58.7 per ton, or 13.3%, compared to the corresponding period in 2012. The decrease in our average realized crude oil net export price (excluding export duties and translated to US dollars from Russian roubles using the average exchange rate for the period) was the result of a 5.9% decrease in our average export contract price, as well as a 1.4% increase in the average export duty per ton. The decrease in our average realized contract price was due to a decrease in the underlying benchmark crude oil prices on international markets used in the price formulation.

Oil and gas products sales

Oil and gas products sales include trading operations with oil products on the domestic market through our retail stations and methanol sales. In the three months ended 31 March 2013, our revenue from sales of oil and gas products increased by RR 20 million, or 37.7%, to RR 73 million from RR 53 million in the corresponding period in 2012.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 24 million, or 58.5%, to RR 65 million in the three months ended 31 March 2013 compared to RR 41 million in the corresponding period in 2012 primarily due to an increase in volumes sold. In the three months ended 31 March 2013, we sold approximately two thousand tons of oil products (diesel fuel and petrol) for an average price of RR 30,470 per ton compared to sales of approximately one thousand tons for an average price of RR 27,868 per ton in the corresponding period in 2012.

In the three months ended 31 March 2013, our revenue from methanol sales decreased by RR four million, or 33.3%, to RR eight million from RR 12 million in the corresponding period in 2012 due primarily to a decrease in volumes sold that was partially offset by an increase in our average realized prices.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In the three months ended 31 March 2013, other revenues decreased by RR 104 million, or 47.1%, to RR 117 million from RR 221 million in the corresponding period in 2012 primarily due to a decrease by RR 92 million of revenues from transportation, handling and storage services resulting from the disposal in December 2012 of our wholly owned non-core subsidiary, OOO Purovsky Terminal, and a decrease by RR 38 million of revenues from geological and geophysical research services provided primarily to our joint ventures. The remaining other revenues which is made up of various immaterial items increased of RR 26 million.

Operating expenses

In the three months ended 31 March 2013, our total operating expenses increased by RR 19,481 million, or 61.7%, to RR 51,056 million compared to RR 31,575 million in the corresponding period in 2012 primarily due to an increase in transportation expenses and purchases of natural gas and liquid hydrocarbons. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased to 66.5% in the three months ended 31 March 2013 compared to 65.6% in the corresponding period in 2012 primarily due to a significant increase in our natural gas transportation expenses (see “Transportation expenses” below).

In the three months ended 31 March 2013, total operating expenses as a percentage of total revenues increased to 63.4% in the three months ended 31 March 2013 compared to 58.4% in the corresponding period in 2012, as shown in the table below. The increase in our operating expenses as a percentage of total revenues was caused by two main reasons. In the three months ended 31 March 2013, we significantly increased our purchases of natural gas and liquid hydrocarbons from our related party and joint ventures. The margin we receive from such operations is slightly lower than the margin we obtain from the sales of our produced hydrocarbons. In addition, increases in the UPT rates occurred effective 1 January 2013, while the regulated price for natural gas is expected to be increased effective 1 July 2013.

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2013	% of total revenues	2012	% of total revenues
Transportation expenses	29,230	36.3%	16,379	30.3%
Taxes other than income tax	4,717	5.9%	4,337	8.0%
Subtotal non-controllable expenses	33,947	42.1%	20,716	38.3%
Purchases of natural gas and liquid hydrocarbons	8,432	10.5%	3,351	6.2%
Depreciation, depletion and amortization	3,157	3.9%	2,614	4.8%
General and administrative expenses	2,419	3.0%	2,327	4.3%
Materials, services and other	1,677	2.1%	1,586	2.9%
Exploration expenses	135	0.2%	896	1.7%
Net impairment expenses (reversals)	(4)	n/m	25	n/m
Change in natural gas, liquid hydrocarbons and work-in-progress	1,293	n/m	60	n/m
Total operating expenses	51,056	63.4%	31,575	58.4%

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 the three months ended 31 March 2013, non-controllable expenses of transportation and taxes other than income tax increased by RR 13,231 million, or 63.9%, to RR 33,947 million from RR 20,716 million in the corresponding period 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, and excluded volumes of natural gas purchased for resale in the location of our end-customers in 2012 (see “Transportation expenses” below), as well as an increase in the natural gas transportation tariff. Taxes other than income tax increased primarily due to a 5.6% increase in the natural gas production tax rate effective from 1 January 2013 (see “Our tax burden” above) and an increase in natural gas production volumes. As a percentage of total revenues, our non-controllable expenses increased to 42.1% in the three months ended 31 March 2013 compared to 38.3% in the corresponding period in 2012.

Transportation expenses

In the three months ended 31 March 2013, our total transportation expenses increased by RR 12,851 million, or 78.5%, compared to the corresponding period in 2012.

<i>million of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Natural gas transportation to customers	23,402	13,059	79.2%
Liquid hydrocarbons transportation by rail	3,995	2,410	65.8%
Liquid hydrocarbons transportation by tankers	1,600	781	104.9%
Crude oil transportation to customers	179	98	82.7%
Other	54	31	74.2%
Total transportation expenses	29,230	16,379	78.5%

In the three months ended 31 March 2013, our transportation expenses for natural gas increased by RR 10,343 million, or 79.2%, to RR 23,402 million from RR 13,059 million in the corresponding period in 2012. The change was mainly due to a 47.6% increase in our natural gas sales volumes to end-customers, for which we incurred transportation expense, and excluding volumes of natural gas purchased for resale in the location of our end-customers in 2012, a 7.0% average increase in the natural gas transportation tariff set by the FTS effective 1 July 2012 (see “Transportation tariffs” above), as well as an increase in average transportation distance due to higher natural gas deliveries to Moscow, the Moscow 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 the three months ended 31 March 2013, our total expenses for liquids transportation by rail increased by RR 1,585 million, or 65.8%, to RR 3,995 million from RR 2,410 million in the corresponding period in 2012 primarily due to an increase in our stable gas condensate volumes sold and transported via rail. In the three months ended 31 March 2013, our combined liquids volumes sold and transported via rail increased by 614 thousand tons, or 71.3%, to 1,475 thousand tons from 861 thousand tons in the corresponding period in 2012 due primarily to a decrease in stable gas condensate inventory balance during the three months ended 31 March 2013 compared to an increase in the corresponding period in 2012. The transportation costs incurred in respect of liquids volumes recognized as part of our inventory balance or in transit are capitalized in current assets as future period expenses until the recognition of such volumes as sold.

In the three months ended 31 March 2013, our weighted average transportation tariff for liquids delivered by rail decreased by 3.2% to RR 2,709 per ton from RR 2,798 per ton in the corresponding period in 2012 primarily due to an increase in stable gas condensate share in total liquids volumes sold and transported via rail that was partially offset by a 7.0% indexation in rail tariffs for the domestic market set by the FTS effective 1 January 2013. The change in the share of stable gas condensate volumes in our total liquids volumes delivered by rail affects our weighted average rail tariff due to the relatively low transportation expense for stable gas condensate compared to LPG. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-to-period and depends on products type and the geography of deliveries.

Total transportation expense for liquids delivered by tankers to international markets increased by RR 819 million, or 104.9%, to RR 1,600 million in the three months ended 31 March 2013 from RR 781 million in the corresponding period in 2012. The increase was primarily due to a 87.3% increase in volumes sold as a result of a significant decrease in inventory balance. In the three months ended 31 March 2013, we sold 48.2% of our total stable gas condensate export volumes to Europe, 41.4% to APR and 10.4% to the United States, whereas in the corresponding period in 2012, we sold 42.3% to Europe, 29.0% to the United States and 28.7% to APR.

Taxes other than income tax

In the three months ended 31 March 2013, taxes other than income tax increased by RR 380 million, or 8.8%, primarily due to an increase in the unified natural resources production tax expense.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Unified natural resources production tax	4,199	3,845	9.2%
Property tax	458	439	4.3%
Other taxes	60	53	13.2%
Total taxes other than income tax	4,717	4,337	8.8%

In the three months ended 31 March 2013, our UPT expense for natural gas increased by RR 350 million, or 10.6%, due to both a 5.6% increase in the natural gas production tax rate effective from 1 January 2013 (from RR 251 per mcm to RR 265 per mcm) and a 4.8% increase in our natural gas production volumes. The UPT expense for unstable gas condensate production increased marginally by RR four million, or 0.7%, due to an increase in the UPT rate (from RR 556 per ton to RR 590 per ton), that was partially offset by a decrease in our unstable gas condensate production volumes.

In the three months ended 31 March 2013, as well as in the corresponding period in 2012, we applied a zero UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye fields due to changes in the Russian Tax Code effective from 1 January 2012 (see “Our tax burden” above).

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2013, our purchases of natural gas and liquid hydrocarbons increased by RR 5,081 million, or 151.6%, to RR 8,432 million from RR 3,351 million in the corresponding period in 2012.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Natural gas	6,476	3,309	95.7%
Unstable gas condensate	1,895	-	n/a
Other liquid hydrocarbons	61	42	45.2%
Total purchases of natural gas and liquids hydrocarbons	8,432	3,351	151.6%

In the three months ended 31 March 2013, our purchases of natural gas increased by RR 3,167 million or 95.7% to RR 6,476 million from RR 3,309 million in the corresponding period in 2012 primarily due to higher purchases from our related party SIBUR, as well as the commencement of purchases from our joint venture Nortgas effective from 1 January 2013.

In the three months ended 31 March 2013, purchases of unstable gas condensate from our joint ventures SeverEnergiya and Nortgas accounted for RR 1,895 million. We commenced purchasing of unstable gas condensate from Nortgas effective from November 2012 after the acquisition of a 49% equity stake in the company and from SeverEnergiya and its wholly owned subsidiary OAO Arctic Gas Company effective from April 2012 after the launch of the first phase development of the Samburgskoye field. We had no purchases of unstable gas condensate in the corresponding period in 2012.

In the three months ended 31 March 2013, our purchases of other liquid hydrocarbons increased by RR 19 million, or 45.2%, to RR 61 million from RR 42 million in the corresponding period in 2012 due to the expansion of trading activities at our wholly owned subsidiary NOVATEK-AZK. Other liquid hydrocarbons purchases represent our purchases of oil products (diesel fuel and petrol) and LPG.

Depreciation, depletion and amortization

In the three months ended 31 March 2013, our depreciation, depletion and amortization (“DDA”) expense increased by RR 543 million, or 20.8%, to RR 3,157 million from RR 2,614 million in the corresponding period in 2012 as a result of an increase in our depletable cost base, as well as a 4.4% 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 the three months ended 31 March 2013, our DDA per barrel of oil equivalent was RR 26.5 compared to RR 23.0 in the corresponding period 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 ongoing crude oil development activities at the East-Tarkosalinskoye field and the launch of the fourth stage of the second phase development at our Yurkharovskoye field, as well as a decrease in our proved reserves estimates as of 31 December 2012 compared to 31 December 2011, used as the denominator in the calculation of the DDA under the “units of production” method, at our core producing fields.

Our reserve base, used as the denominator in the calculation of the DDA charge under the “units of production” method, 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 the three months ended 31 March 2013, our general and administrative expenses increased by RR 92 million, or 4.0%, to RR 2,419 million compared to RR 2,327 million in the corresponding period in 2012. The main components of these expenses were employee compensation, social expenses and compensatory payments and legal, audit, and consulting services, which, on aggregate, comprised 85.0% and 88.2% of total general and administrative expenses in the three months ended 31 March 2013 and 2012, respectively.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Employee compensation	1,476	1,697	(13.0%)
Compensatory payments and social expenses	433	223	94.2%
Legal, audit, and consulting services	146	132	10.6%
Business trip expenses	78	39	100.0%
Fire safety and security expenses	56	49	14.3%
Repair and maintenance expenses	42	28	50.0%
Bank charges	32	16	100.0%
Rent expense	23	26	(11.5%)
Insurance expense	22	19	15.8%
Other	111	98	13.3%
Total general and administrative expenses	2,419	2,327	4.0%

Employee compensation related to administrative personnel decreased by RR 221 million, or 13.0%, to RR 1,476 million in the three months ended 31 March 2013 as compared to RR 1,697 million in the corresponding period in 2012 due to a change in the method of bonus accruals to key management and a decrease in the charges related to NOVATEK’s share-based compensation program for the Group’s senior and key management. The decreases were partially offset by an indexation of base salaries by 6.0% effective 1 July 2012 and an increase in the average number of employees resulted from the expansion of activities at our Ust-Luga project, as well as the acquisition of a regional gas trader Gazprom mezhregiongas Kostroma in December 2012.

In the three months ended 31 March 2013, our compensatory payments and social expenses increased by RR 210 million, or 94.2%, to RR 433 million compared to RR 223 million in the corresponding period in 2012. Compensatory payments increased by RR 220 million primarily due to the commencement of compensatory payments for the Salmanovskoye and Geofizicheskoye fields. Social expenses changed marginally and represented expenses related to our donations to sport clubs and activities, educational schools, as well as continued support for charities and social programs in the regions where we operate. Social expenses fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support.

Legal, audit, and consulting services expenses increased by RR 14 million, or 10.6%, to RR 146 million compared to RR 132 million in the corresponding period in 2012 largely due to additional consulting services rendered to the Group.

Fire safety and security expenses increased by RR seven million, or 14.3%, to RR 56 million in the three months ended 31 March 2013 from RR 49 million in the corresponding period in 2012 primarily due to an increase in rates charged for security services, as well as the consolidation of fire safety and security services expenses related to our recently acquired subsidiary.

Repair and maintenance expenses increased by RR 14 million, or 50.0%, to RR 42 million in the three months ended 31 March 2013 from RR 28 million in the corresponding period in 2012 primarily due to repair works of administrative fixed assets rented by our subsidiary, OOO NOVATEK-Chelyabinsk.

Bank charges increased by RR 16 million, or 100.0%, to RR 32 million in the three months ended 31 March 2013 from RR 16 million in the corresponding period in 2012 primarily due to service charges applied to letters of credit, as well as commission services fees charged by banks for the acceptance of payments for natural gas at our recently acquired regional natural gas traders, supplying natural gas to residential and small-scale customers.

In the three months ended 31 March 2013, our rent expense marginally decreased by RR three million, or 11.5%, to RR 23 million from RR 26 million in the corresponding period in 2012.

Insurance expense marginally increased by RR three million, or 15.8%, to RR 22 million in the three months ended 31 March 2013 from RR 19 million in the corresponding period in 2012.

In the three months ended 31 March 2013, other general and administrative expenses increased by RR 13 million, or 13.3%, to RR 111 million from RR 98 million in the corresponding period in 2012. The increase was made up of various immaterial expense items of an administrative nature.

Materials, services and other

In the three months ended 31 March 2013, our materials, services and other expenses increased by RR 91 million, or 5.7%, to RR 1,677 million compared to RR 1,586 million in the corresponding period in 2012. The main components of this expense category were employee compensation and repair and maintenance services, which on aggregate comprised 74.4% and 78.4% of total materials, services and other expenses in the three months ended 31 March 2013 and 2012, respectively.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Employee compensation	904	918	(1.5%)
Repair and maintenance services	344	326	5.5%
Electricity and fuel	130	102	27.5%
Security expenses	78	70	11.4%
Materials and supplies	64	42	52.4%
Transportation expenses	51	39	30.8%
Processing fees	25	25	0.0%
Other	81	64	26.6%
Total materials, services and other	1,677	1,586	5.7%

Our operating employee compensation decreased by RR 14 million, or 1.5%, to RR 904 million compared to RR 918 million in the corresponding period in 2012. The decrease was primarily due to the disposal in December 2012 of our wholly owned non-core subsidiary OOO Purovsky Terminal, that was partially offset by a 6.0% indexation of base salaries effective from 1 July 2012 and an increase in the average number of employees as a result of an expansion of our trading activities at NOVATEK-AZK, as well as the acquisition of a regional gas trader Gazprom mezhregiongas Kostroma in December 2012.

Repair and maintenance services increased by RR 18 million, or 5.5%, to RR 344 million in the three months ended 31 March 2013 compared to RR 326 million in the corresponding period in 2012. The increase was primarily due to ongoing repair works at our production subsidiaries and was consistent with our ongoing maintenance schedules, as well as due to repair works of our own rail cars used for the transportation of LPG.

In the three months ended 31 March 2013, electricity and fuel expenses increased by RR 28 million, or 27.5%, to RR 130 million from RR 102 million in the corresponding period in 2012. The increase was primarily due to an increase in electricity and fuel volumes used by our production subsidiaries resulting from recently completed infrastructure projects, as well as higher electricity rates.

Security expenses increased by RR eight million, or 11.4%, to RR 78 million in the three months ended 31 March 2013 from RR 70 million in the corresponding period in 2012 largely due to an increase in security services rates effective from January 2013.

Materials and supplies expense increased by RR 22 million, or 52.4%, to RR 64 million in the three months ended 31 March 2013 from RR 42 million in the corresponding period in 2012 mainly due to an increase in materials (including methanol) used in the technological process at our East-Tarkosalinskoye field.

Transportation expenses represent expenses related to the delivery of materials and equipment to our fields, as well as the transportation of our operating personnel by cars. In the three months ended 31 March 2013, transportation expenses increased by RR 12 million, or 30.8%, to RR 51 million from RR 39 million in the corresponding period in 2012.

In the three months ended 31 March 2013, other material, services and other expenses increased by RR 17 million, or 26.6%, to RR 81 million from RR 64 million in the corresponding period in 2012 primarily due to an increase in works performed at our Yurkharovskoye field as a result of the commencement of crude oil production.

Exploration expenses

In the three months ended 31 March 2013, our exploration expenses decreased by RR 761 million, or RR 84.9%, to RR 135 million from RR 896 million in the corresponding period in 2012. The change was primarily due to the capitalization of exploration expenses related to 3-D seismic activities to the property, plant and equipment starting from the reporting period for the six months ended 30 June 2012.

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

In the three months ended 31 March 2013, we recorded a charge of RR 1,293 million to change in inventory expense as compared to a charge of RR 60 million in the corresponding period in 2012:

<i>millions of Russian roubles</i>	Three months ended 31 March:	
	2013	2012
Natural gas	536	353
Stable gas condensate	831	(336)
Other	(74)	43
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	1,293	60

In the three months ended 31 March 2013, we recorded a charge to our operating expenses of RR 536 million primarily due to a 1,045 mmcm decrease in our natural gas inventory balance, as well as an increase in the cost of natural gas per mcm. 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 of seasonality.

In addition, in the three months ended 31 March 2013, we recorded a charge of RR 831 million to our operating expenses due to a 302 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage, as well as an increase in the cost of stable gas condensate per ton.

The following table highlights movements in our inventory balances:

<i>Inventory balances in transit or in storage</i>	2013			2012		
	At 31 March	At 1 January	Increase / (decrease)	At 31 March	At 1 January	Increase / (decrease)
Natural gas (millions of cubic meters)	84	1,129	(1,045)	32	760	(728)
<i>including Gazprom's UGSF</i>	33	1,096	(1,063)	-	732	(732)
Liquid hydrocarbons (thousand tons)	268	563	(295)	449	325	124
<i>including stable gas condensate</i>	159	461	(302)	352	228	124

Other operating income (loss)

In the three months ended 31 March 2013, we recognized other operating income of RR 691 million. In October 2012, we commenced trading operations for the purchase and sale of natural gas on the European market. As a result, in the three months ended 31 March 2013, we purchased and sold 3.7 terawatt-hours (or approximately 350 mmcm) of natural gas. The total effect from natural gas trading operations on the European market and from the changes in fair values of long-term contracts, which were classified as derivative instruments in accordance with IAS 39 "*Financial instruments: recognition and measurement*", in the three months ended 31 March 2013 resulted in the recognition of net income in the amount of RR 596 million.

In the three months ended 31 March 2013, we recognized other operating income of RR 46 million related to penalties charges received from our suppliers due to non-compliance of their contractual obligations. The remaining other operating income of RR 49 million related to other different immaterial items, including profit (loss) on disposal of materials, fixed assets, equipment and other similar transactions.

In the corresponding period in 2012, we recognized other operating income of RR 41 million of which RR 49 million related to profit on disposal of fixed assets at our production subsidiaries and was partially offset by other operating loss of RR eight million, which was made up of various immaterial items.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 7,637 million, or 33.8%, to RR 30,200 million in the three months ended 31 March 2013, compared to RR 22,563 million in the corresponding period in 2012. In the three months ended 31 March 2013, our profit from operations as a percentage of total revenues decreased to 37.5% compared to 41.7% in the corresponding period in 2012 primarily due to a significant increase in natural gas and liquid hydrocarbons purchases during the 2013 reporting period and the lower trading margins we received for these volumes compared to margins we receive usually from the production and sales of our own hydrocarbons.

In addition, our operating expenses exceeded the growth rate of our total revenues due to the UPT rate for natural gas was increased effective from 1 January 2013, while the regulated price for natural gas is expected to increase only effective from 1 July 2013.

Finance income (expense)

In the three months ended 31 March 2013, we recorded net finance expense of RR 1,924 million as compared to a net finance income of RR 5,624 million in the corresponding period in 2012 due primarily to the depreciation of the Russian rouble relative to the US dollar in the reporting period 2013 compared to the appreciation of the Russian rouble relative to the US dollar in the corresponding period in 2012.

In the three months ended 31 March 2013, interest expense increased by RR 574 million, or 72.7%, to RR 1,364 million from RR 790 million in the corresponding period in 2012 primarily due to an increase in accrued interest expense on loans received as a result of Eurobonds issue by the Group in December 2012 and February 2013, respectively.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change
	2013	2012	%
Accrued interest expense on loans received	2,144	1,209	77.3%
Less: capitalized interest	(839)	(475)	76.6%
Other interest expenses	59	56	5.4%
Total interest expense per the Consolidated Statement of Income	1,364	790	72.7%

Interest income decreased by RR 56 million, or 10.5%, to RR 478 million in the three months ended 31 March 2013 from RR 534 million in the corresponding period in 2012 primarily due to a decrease in the weighted average interest rate for new loans provided to our joint ventures.

In the three months ended 31 March 2013, we recorded a net foreign exchange loss of RR 1,038 million compared to a net foreign exchange gain of RR 5,880 million in the corresponding period in 2012 due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble depreciated by 2.3% against the US dollar during the three months ended 31 March 2013 compared to the appreciation of the Russian rouble by 8.9% in the corresponding period 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 the three months ended 31 March 2013, the Group's proportionate share in profit of joint ventures accounted for RR 48 million, while in the corresponding period in 2012 we recognized a loss of RR 991 million. The change was due to a significant increase in natural gas sales prices at our joint venture Sibneftegas effective from 1 July 2012, commencement of natural gas and gas condensate production at the Samburgskoye field after the launch of its first phase development in April 2012, and significant compensatory payments related to the Yamal LNG project in the 2012 reporting period as scheduled.

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 19.9% and 21.9% for the three months ended 31 March 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

As a result of the factors discussed above, our profit for the period increased by RR 1,459 million, or 6.9%, to RR 22,698 million in the three months ended 31 March 2013 from RR 21,239 million in the corresponding period in 2012. The profit attributable to shareholders of OAO NOVATEK increased by RR 1,466 million, or 6.9%, to RR 22,711 million in the three months ended 31 March 2013 from RR 21,245 million in the corresponding period in 2012.

Our EBITDA increased by RR 8,688 million, or 35.9%, to RR 32,905 million in the three months ended 31 March 2013, from RR 24,217 million in the corresponding period in 2012 primarily due to an increase in natural gas sales prices and volumes, as well as an increase in stable gas condensate sales volumes, that was partially offset by an increase in our transportation expenses and purchases of hydrocarbons.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 0.49 per share, or 6.9%, to RR 7.49 per share in the three months ended 31 March 2013 from RR 7.00 per share in the corresponding period in 2012.

LIQUIDITY AND CAPITAL RESOURCES

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Net cash provided by operating activities	25,532	23,949	6.6%
Net cash provided by (used in) investing activities	(17,932)	(2,535)	n/m
Net cash provided by (used in) financing activities	(9,651)	(15,669)	(38.4%)

<i>Liquidity and credit ratios</i>	31 March 2013	31 December 2012	Change, %
Current ratio	1.66	1.06	56.6%
Total debt to total equity	0.40	0.45	(11.1%)
Long-term debt to long-term debt and total equity	0.27	0.25	8.0%
Net debt to total capitalization ⁽¹⁾	0.24	0.26	(7.7%)
Net debt to EBITDA ⁽²⁾	1.05	1.20	(12.5%)

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

⁽²⁾ Net debt to EBITDA ratio is calculated as Net debt divided by EBITDA for the last twelve months adjusted for the net gain on disposal of interest in subsidiaries (where applicable)

Net cash provided by operating activities

In the three months ended 31 March 2013, our net cash provided by operating activities increased by RR 1,583 million, or 6.6%, to RR 25,532 million compared to RR 23,949 million in the corresponding period in 2012 mainly due to higher natural gas sales volumes and prices that was partially offset by an increase in income tax payments.

Net cash provided by (used for) investing activities

In the three months ended 31 March 2013, our net cash used for investing activities increased by RR 15,397 million, or more than seven times, to RR 17,932 million compared to RR 2,535 million in the corresponding period in 2012.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Purchases of property, plant and equipment (financing of capital expenditures)	(9,642)	(5,955)	61.9%
Repayments of loans provided (loans provided), net	(4,625)	6,331	n/a
Additional capital contributions to joint ventures	(1,436)	(2,507)	(42.7%)
Other	(2,229)	(404)	451.7%
Net cash provided by (used for) investing activities	(17,932)	(2,535)	607.4%

Our cash used for purchases of property, plant and equipment increased by RR 3,687 million, or 61.9%, primarily due to ongoing development activities at our Yurkharovskoye field, construction of the third stage of development at the Purovsky Plant, as well as further development of the East-Tarkosalinskoye field's crude oil deposits.

In the three months ended 31 March 2013, our cash used for loans provided to our joint ventures increased by RR 4,619 million compared to the corresponding period in 2012. In addition, in the three months ended 31 March 2013, we received RR 847 million due to the repayment of loans provided to our joint ventures as compared to RR 7,184 million in the corresponding period in 2012.

Net cash provided by (used for) financing activities

In the three months ended 31 March 2013, our net cash used for financing activities decreased by RR 6,018 million, or 38.4%, to RR 9,651 million compared to RR 15,669 million in the corresponding period in 2012.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2013	2012	
Proceeds from long-term debt	13,860	-	n/a
Repayments of long-term debt	(22,028)	(14,546)	51.4%
Other	(1,483)	(1,123)	32.1%
Net cash provided by (used for) financing activities	(9,651)	(15,669)	(38.4%)

In the three months ended 31 March 2013, our cash used for repayment of debts increased by RR 7,482 million, or 51.4%, to RR 22,028 million from RR 14,546 million in the corresponding period in 2012 due to the repayment of loans from Sberbank and Nordea Bank in the 2013 reporting period ahead of maturity schedules (see “Debt obligations” below). Our cash proceeds from loans and borrowings increased by RR 13,860 million due to the issue of Russian rouble denominated Eurobonds in the amount of RR 14 million in February 2013. The remaining change was related to repayment of interest on debts and other miscellaneous categories.

Working capital

Our net working capital position (current assets less current liabilities) at 31 March 2013 was a positive RR 23,564 million compared to RR 3,113 million at 31 December 2012. The change of our net working capital position was primarily due to a decrease in the current portion of long-term debt by RR 21,896 million, or 63.1%, as a result of the repayment of loans ahead of maturity schedule (see “Debt obligations” below), as well as an increase in our trade and other receivables by RR 11,870 million, or 72.3%, that was partially offset by a RR 9,284 million, or 50.0%, decrease in our prepayments and other current assets.

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

Our total capital expenditures in the 2013 reporting period represent our investments in developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities:

<i>millions of Russian roubles</i>	Three months ended 31 March:	
	2013	2012
Yurkharovskoye field	3,476	1,850
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga)	1,898	2,000
East-Tarkosalinskoye field	1,599	1,351
Purovsky Plant	1,318	65
Olimpiyskiy license area	583	112
Khancheyskoye field	541	432
Salmanovskoye (Utrenneye) field	520	76
West-Urengoiyskiy license area	105	81
North-Russkiy license area	103	163
North-Khancheyskiy license area	64	46
Yarudeyskiy license area	54	39
Geofizicheskoye field	48	20
Other	955	1,284
Capital expenditures	11,264	7,519

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2013 increased by RR 3,745 million, or 49.8%, to RR 11,264 million from RR 7,519 million in the corresponding period in 2012. The increase was primarily related to ongoing development activities at our Yurkharovskoye field and construction of the third stage of development at the Purovsky Plant, as well as further development of the East-Tarkosalinskoye field’s crude oil deposits.

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 decreased from RR 132,487 million at 31 December 2012 to RR 126,091 million at 31 March 2013, or by RR 6,396 million, due primarily to the repayment of a RR 15 billion loan from Sberbank in February 2013 and a USD 200 million loan from Nordea Bank in March 2013 ahead of maturity schedule, that was partially offset by the issue of Russian rouble denominated Eurobonds in the aggregate amount of RR 14 billion in February 2013. We periodically 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 Ust-Luga, as well as acquisitions of new oil and gas assets.

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

Facility	Amount	Maturity	Interest rate	At	At
				31 March 2013	31 December 2012
Eurobonds Ten-Year	USD 1 billion	December 2022	4.422%	30,943	30,232
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	20,084	19,620
Russian rouble Bonds	RR 20 billion	October 2015	8.35%	19,973	19,969
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	18,578	18,146
Eurobonds Four-Year	RR 14 billion	February 2017	7.75%	13,892	-
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,995	9,991
Sberbank	RR 10 billion	December 2014	8.9%	9,835	9,837
Sumitomo Mitsui ⁽¹⁾	USD 300 million	December 2013	LIBOR+1.45%	2,791	3,633
Sberbank ⁽²⁾	RR 15 billion	December 2013	7.5%	-	14,984
Nordea Bank ⁽³⁾	USD 200 million	November 2013	LIBOR+1.9%	-	6,075
Total				126,091	132,487

⁽¹⁾ Sumitomo Mitsui Banking Corporation Europe Limited.

⁽²⁾ The RR 15 billion loan from Sberbank was repaid ahead of maturity schedule in February 2013.

⁽³⁾ The loan from Nordea Bank was repaid ahead of maturity schedule in March 2013.

Maturities of long-term loans

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

Maturity schedule:	RR million
1 April 2014 to 31 March 2015	9,835
1 April 2015 to 31 March 2016	38,550
1 April 2016 to 31 March 2017	13,892
1 April 2017 to 31 March 2018	-
After 31 March 2018	51,028
Total long-term debt	113,305

Available credit facilities

At 31 March 2013, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 7,430 million (USD 175 million and EUR 50 million) on variable interest rates subject to the specific type of credit facility.

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

	Par value	Expiring	
		Within one year	Between 1 and 3 years
BNP PARIBAS Bank	USD 100 million	3,108	-
Credit Agricole Corporate and Investment Bank	USD 100 million	3,108	-
UniCredit Bank	USD 350 million	-	10,879
Total available credit facilities		6,216	10,879

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 and stable gas condensate 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 March 2013, the total amount of our long-term debt denominated in US dollars was RR 69,605 million, or 55.2% 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 25.2% in the three months ended 31 March 2013, is denominated in US dollars. As of 31 March 2013, the Russian rouble depreciated by approximately 2.3% 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 March 2013 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 7,240 million on foreign currency denominated borrowings held at that date.

Commodity risk

Substantially all of our crude oil, stable gas condensate and LPG export sales are sold under spot market contracts, and our export prices are primarily linked to international crude oil 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 oil 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 Unified Gas Supply System ("UGSS") 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 UGSS 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 UGSS 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 UGSS; 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 March 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.