



**Company:** OAO NOVATEK  
**Conference Title:** Q3 2012 Results  
**Presenter:** Mark Gyetvay  
**Date:** Tuesday 13<sup>th</sup> November 2012 – 15h00 CET

**Operator:** Good morning and welcome to the NOVATEK Third Quarter 2012 Results Conference Call. Today's conference is being recorded. At this time I'd like to turn the conference over to Mr. Oleg Maximov, Senior Analyst Oil & Gas Sberbank CIB. Please go ahead sir.

**Oleg Maximov:** Thank you. Good afternoon and welcome. I'm Oleg Maximov from Sberbank and welcome to the NOVATEK Q3 2012 Results Call. Today with me are Leonid Mikhelson, Chairman of the Board; Mark Gyetvay, Chief Financial Officer and Member of the Board of Directors; and Alexander Palivoda, Head of NOVATEK's Investor Relations. Mark, please start with your presentation.

**Mark Gyetvay:** Thank you Oleg. Ladies and gentlemen, shareholders and colleagues, good evening and welcome to our Third Quarter 2012 Conference Call. I would like to thank everyone for joining us this evening and again extend our sincere gratitude to Troika Dialog Sberbank for organising and hosting our earnings conference call. As Oleg mentioned joining me this evening during the question and answer session will be Mr. Leonid Mikhelson, CEO, Chairman of the Management Committee and a Member of the Board of Directors. The question and answer session will be handled simultaneously in the Russian and English languages, so when we come to this part of today's conference call I will ask you to keep this important point in consideration when asking questions. There will be plenty of time allotted to answer your important questions.

Before we begin with the specific conference call details I would like to refer you to our disclaimer statement as is our normal practice. During this conference call we may make reference to forward-looking statements by using words such as 'plans', 'objectives', 'goals', 'strategies' and other similar words which are other than statements of historical facts. Actual results may differ materially from those implied by such forward-looking statements due to



known and unknown risks and uncertainties and reflects our views at the date of this presentation. We undertake no obligation to revise or publicly release the result of any revisions to these forward-looking statements in light of new information or future events. Please refer to our regulatory filings including our annual review for the year ended 31<sup>st</sup> December 2011 as well as our earnings press releases and documents throughout the past year for more descriptions of risk that may influence our results.

We were pleased to release another set of strong financial and operational results for the third quarter and nine months of 2012 in accordance with International Financial Report Standards; but before I discuss the financial and operational results in more detail I would like to begin tonight's conference call with my usual update on the news flows to our investors and analysts.

On 6<sup>th</sup> November we formally announced our intention to acquire a 49% equity stake in closed joint stock company Nortgas for a transaction value of approximately \$1.4 billion subject to the completion of certain conditions and representation and warranties that are customary in mergers and acquisitions. This past Friday we announced that we have received preliminary consent for the transaction by the Federal Anti-Monopoly Commission and that the appropriate waivers for the transaction were received from Gazprom, contrary to market rumours and what was published in the press. The transaction is expected to close in November and when closed this acquisition will be value accretive to our shareholders based on the expected transaction multiples. The announcement to acquire Nortgas should not come as a major surprise for most investors and analysts as this transaction had been rumoured and previously discussed in the marketplace.

The Nortgas acquisition is consistent with our overall strategy to develop and/or acquire assets that are in close proximity to our transport and processing infrastructure to capture economies of scale as well as operational and financial synergies. Nortgas's primary asset is the North Urengoykoye field which is located approximately 25km south of our Yurkharovskoye field. Strategically Nortgas's estimated proven reserves of 225 billion cubic metres of natural gas and 27 million tonnes of liquids for a combined 1.7 billion barrels of oil equivalent as appraised under the PRMS reserve methodology at 31<sup>st</sup> December 2011 by DeGolyer and MacNaughton.



Hydrocarbon deposits on the North Urengoykoye field are allocated between the Western and Eastern domes but the field has been primarily producing from the Western dome with initial production commencing in 2001. Current infrastructure in the field consists of 50 producing wells, a gas treatment facility with a capacity of 5.5 billion cubic metres, a booster compressor station as well as various gas and condensate gathering lines.

During the first nine months of 2012 the North Urengoykoye field produced 3.1 bcm of natural gas and 320,000 tonnes of gas condensate and is currently estimated to produce approximately 4.2 bcm of natural gas and 400,000 tonnes of condensate for the full year 2012. Once the transaction is closed in November we will receive our pro rata share of natural gas production through the remainder of the year but more importantly we have already begun off-taking 100% of the gas condensate production from the field and are currently processing these volumes through the Purovsky Processing Plant.

The economic and operational rationale to acquire this asset is quite straightforward. Estimated production growth of Nortgas is similar to the estimated growth of NOVATEK's production from 2011 to 2020 but we estimate that this growth will happen much faster thus accelerating our production growth rates in the near and long term. More importantly 13% of the appraised proven reserves are classified as liquid reserves, mainly gas condensate which is consistent with our commercial and operational strategy to accelerate our growth of liquid production to monetise these higher value products. With the expected field development of the Eastern domes over the next couple of years we anticipate that the overall field's annual production will more than double for natural gas between 9-10 bcm and triple for the output of gas condensate to roughly 1.4 million tonnes at plateau levels, providing those with significant upside potential as well as the opportunity to optimise the overall field's development programme.

Equally important if we compare the North Urengoykoye field with our existing core producing assets excluding the assets of SeverEnergiya, the overall proven reserve base of Nortgas according to the prior year PRMS appraised reserves has a higher proportional share of liquid reserves than our Yurkharovskoye, East Takisolinskoye and Khancheykoye fields which



increases the overall economic of this field to us as we expect to process and market the liquids through our liquids value chain. It is relatively clear looking at the existing asset portfolio and financial results that the monetary value per unit produced is much higher for a wet gas field due primarily to the higher netback margins we received for these sales of hydrocarbons on the international markets. Nortgas's higher production of liquid reserves will allow us to grow our gas condensate production at a rate exceeding that of our three core fields and correspondingly capture these higher incremental margins to improve our cash flow generation.

The Nortgas acquisition will add approximately 829 billion barrels of oil equivalent to our existing PRMS proven reserve base or a transaction multiple of \$1.66 per barrel of oil equivalent which we believe is immediately value accretive to our shareholders. This represents an increase of roughly 7% to total proven PRMS reserves on a pro forma basis to 12.2 billion barrels of oil equivalent which represents a 7% increase on our natural gas reserves to 1.7 trillion cubic metres and a 10% increase in our liquid reserves to 131 million tonnes as of 31<sup>st</sup> December 2011.

Another important point to note on this transaction is that the management of Nortgas will be on a parity with Gazprom's subsidiary, Urengoy Gazprom; and the corporate structure contemplated post this transaction will allow NOVATEK to pay mineral extraction tax at the lower rate applied to independent gas producers. We are currently discussing the upcoming development plans of the Eastern dome of the field and we believe that we may commission production in late 2013 rather than 2014 as originally planned based on optimising the exploitation of the field's hydrocarbon layers utilising the techniques and experiences employed at our other fields.

We are optimistic that this optimisation programme should reduce the field's overall development capital expenditures, expedite future production growth and generate higher product netback margins for our shareholders, thus enhancing the overall project's free cash flow generation consistent with our operating norms and create incremental shareholder value beyond traditional reserve based value multiples. We are very excited to have formally concluded this value accretive transaction with its upside production potential, low capital



intensities and free cash flow generation and we will update the investment community on these revised development plans towards the latter part of the first quarter 2013.

Moving forward I would like to discuss the recent topic regarding Rosneft and Inter RAO, but first I would like to firmly reiterate the production guidance that we've provided to the investment community this past December as part of our new corporate strategy. Our goal remains the same – we plan to double our production profile and increase our market share in the Russian domestic market by the year 2020 and we have not revised these targets as a result of the announced switch of the Inter RAO contract to Rosneft commencing in 2016, or based on the speculated changes to the gas demand picture in Russia. The existing contract with Inter RAO remains in-force for the next three years and we fully expect the terms and conditions of this agreement will be fulfilled and the associated revenues, operating cash flows and net back margins to be realised.

Let me reassure everyone again this evening that we understand the evolving dynamics of the Russian domestic natural gas market as well as the potential for future competition on end customer sales. This dynamically changing scenario was embedded into our overall assessment of the Russian domestic gas market taking into consideration a full assessment of our market share position, our expected production profile and our commercial marketing capabilities vis-à-vis our competitors. Contrary to market speculation we have neither lost our commercial marketing abilities nor our influences in the Russian domestic market, but instead have completely accessed this level of market competition and are fully capable and prepared to market our present and future natural gas production as outlined in our Strategy Day presentation.

We faced these similar challenges in the past when we articulated our initial production target of 45 billion cubic metres by 2010 in mid-2005 as part of our IPO road show when in fact we were only producing approximately 20 billion cubic metres at that time. The same market concerns were raised at the height of the financial and economic crisis in 2009. We were questioned many times by potential investors and analysts on the challenges we face marketing our volume of natural gas on the domestic market and our experience and proven track record



has clearly demonstrated that we have successfully met these challenges and continued to grow our market share over the ensuing time periods.

As already reported this year we continue to add new long term gas contracts to our existing portfolio of clients such as Fortum, EON, Mechel, MNK and Severstal to name a few as well as successfully penetrating the Chelyabinsk and Perm regions through our recent acquisitions of gas traders and the establishment of a firm market presence in these important industrial consuming regions and we strongly believe that we will continue to make notable inroads into other regional areas and secure new customers for future gas production as well as diversify our portfolio away from single large consumers to a more balanced marketing approach.

Another important point I'd like to highlight this evening. Our commercial marketing goal is continue moving our sales volumes towards the end consumer market to capture incremental margins and secure market share and with the new contracts already mentioned we will continue to grow our proportional share of end customers versus wholesale traders in 2013 and beyond. We have outlined the strategic intent in our strategy presentation and this goal will continue to serve as a guiding principle underlying our commercial marketing activities.

Another issue that seems to be raised these days is the pricing terms of our products and our future potential contracts. I have repeatedly stated that our primary aim is to improve the netback margins we receive across our portfolio of clients in the regions where we deliver natural gas. We continued to deliver expanding markets according to this aim. Pricing is obviously an important element in any contractual negotiation and our general pricing formulation is the FTS tariff price subject to market based adjustments. It is important to distinguish that the independent gas producers are not bound by the FTS pricing model but nonetheless use these prices as reference points. We have confirmed many times in the past that we do adjust our pricing formula for both premiums and discounts but the circumstances are largely driven by market supply and demand and more recently since the economic crisis this trend has been skewed more towards discounts than premiums. Our policy has been and will continue to be that commercial terms and conditions with our counterparties will not be



disclosed; however, you can review our financial results and determine if we are achieving our goal of expanding rather than contracting our netback margins.

We are confident that we will be able to market and sell our natural gas production based on the commercial terms of our contracts and more importantly our proven track record to be a reliable supplier of natural gas on the Russian domestic market. Competition will no doubt be a factor in future pricing discussions but it is highly unlikely that we will experience and you will witness a severe collapse in the domestic pricing of natural gas as witnessed in the United States with the so-called “shale revolution” because the fundamental structure and the competitive landscape of the natural gas industry is not the same.

On a similar topic I would like to note that our wholly owned subsidiary NOVATEK Gas & Power commenced gas trading activities on the European market in early October with the initial EnBW contract and we are continuing our ongoing discussions to expand these activities to support our future trading efforts as well as gain a crucial foothold into the European markets when we commence our LNG project and its requisite trading and commercial activities. We will provide future updates on these and other international trading activities as new developments emerge.

Operationally, we announced the launch of the fourth stage of the Phase II development at our Yurkharovskoye field by adding two additional gas treatment trains for a total annual capacity of 7 billion cubic metres, which essentially allows us to reach the field’s plateau design capacity of approximately 36.5 bcm. We are also in the final stages of testing the first booster compressor station comprising three compressor units with a total capacity of 75 megawatts required to maintain the field’s production plateau levels.

As I mentioned on previous earnings conference calls the majority of capital has already been spent on the Yurkharovskoye field as required to reach the field’s design capacity and achieve the field’s planned development programme and we are very proud of the operational success we have achieved at this field as well as the ability to leverage our development experiences on other NOVATEK projects. We have achieved very high production flow well rates on a well designed development programme, essentially reducing the overall capital intensity and the



number of wells to exploit this field, which ultimately translates into generating high free cash flow returns and industry leading performance and financial metrics.

As with the Ust-Luga project, construction of the first phase of the gas construction fractionation unit is almost complete as well as ancillary infrastructure activities such as the reservoir tank farm comprising 25 storage tanks with a total storage capacity of 640,000 cubic metres. We also completed a tender process to select contractors and suppliers for the construction of the project's Phase II and recently announced the conclusion of our first long term contract with BrasChem, a Brazilian company for the sale and purchase of naphtha products once processing commences. We anticipate beginning the operational line-fill and testing phases some time towards the end of 2012 and early 2013 prior to the commencement of actual fractionation and trans-shipment.

We continued our ongoing work activities at the Yamal LNG project as planned and recently submitted the LNG plant design documentation package for state expert review as formally required in Russia. This state expert review is one of the pre-conditions for FID, final investment decision, and we anticipate that this forthcoming expert opinion report will be received soon. We also recently confirmed that the bidding process to award the EPC contract for the construction of the LNG plant is progressing as scheduled and we anticipate the receipt of contractors' proposals in December of 2012, which when received will allow us to commence detailed LNG plant design work in early 2013. Project design works are also being carried out for the approach channels in the Gulf of Ob and the cargo handling facility as well as project design for three well clusters and four roads.

We have no additional news to report on potential project partners other than to state that we are continuing our ongoing discussions as previously reported. More importantly all work activities on the project are proceeding as planned. We anticipate making the FID decision in early 2013, we are proceeding with all work activities regarding the project's "bankability" for project financing purposes and we recently concluded a series of preliminary meetings with export credit agencies regarding their financial participation in the project based on sourcing of construction and project content.





Yesterday we announced a cooperation agreement with Rosatom, a state agency, whereby we will mutually work together to ensure that the ice-breaking services and cargo handling will be available when needed and that Rosatom is committed to building new nuclear powered icebreakers that are safe, efficient and reliable to transport our LNG production through the Arctic Ocean's Northern Sea route. This announcement is yet another positive indication of the Russian government's firm commitment and support to our LNG project.

At SeverEnergiya we commenced initial production at the Sambugrsky field in April of 2012 as previously announced with the initial production capacity of 2.3 bcm of natural gas and approximately 360,000 tonnes of gas condensate. Post this announcement we have continued work activities on this field and we expect to launch the field's second phase of development by year end, which will double the sales production capacity to 4.8 bcm of natural gas and roughly 700,000 tonnes of gas condensate. We have also commenced construction and drilling work activities at both the Urengoyskoye and Yaro-Yahinskiye fields and we anticipate that the first train will be completed at the Urengoyskoye field during the latter part of 2013 to allow us to commence field production. The importance of SeverEnergiya's current and future development activities cannot be overstated. This joint venture will be a major contributor to the overall growth in our production profile in terms of both natural gas and gas condensate over the next several years. SeverEnergiya is expected to produce approximately 37 billion cubic of natural gas and 11.7 billion tonnes of liquids comprising gas condensate and crude oil at its plateau levels as outlined in our strategy presentation and we have not changed our production forecast and/or the timing of production.

In regards to the natural gas mineral extraction tax or MET, the proposed amendments recently passed the first reading of the state on 16<sup>th</sup> October and according to procedural rules should be finalised in early December but are subject to the final approval of the Russian Federation budget. The second meeting is being conducted today and it is my understanding that the proposal has been approved. The proposed gas MET is not punitive to the independent gas producers as initially speculated and we believe that this issue is behind us and that the amendments introduced were approved accordingly. Looking ahead we expect ongoing



dialogue amongst industry participants and the relevant government ministries on potential changes to the gas MET formulation post 2014.

As for price liberalisation we expect the Russian government to maintain its present policy of indexing the FTS prices at 15% for the next three years as already announced, supported and confirmed by the Ministry of Energy. However I would like to reiterate again that it is not our internal view that we will revert to an export netback pricing model once the so-called market liberalisation programme is formally instituted. It is my understanding that the energy minister has stated recently in London that the government has abandoned the export parity concept but will stick to the indexation as already approved. Competition and market dynamics as already mentioned will obviously factor into future pricing discussions.

I would now like to discuss the operational and financial results achieved in the third quarter before opening tonight's session to questions and answers.

During the third quarter and first nine months of 2012 we invested capital on various exploration, development and processing activities consistent with our announced capital expenditure programme of approximately 51 billion rubles of which we already spent roughly 31.3 billion rubles during the first nine months of 2012. Specifically in the third quarter we mainly invested capital in the Ust-Luga gas fractionation and trans-shipment complex and the Yurkharovskoye field which represented about 69% of our total capital expenditures during the quarter and approximately 58% of our capital programme in the first nine months of the year as well as increasing our capital spend at both the East-Tarkisolinskoye and Khancheyskoye fields as part of our plan to exploit the crude oil layers at these fields.

As for exploration activities we drilled approximately 30,000 metres or approximately 90,000 feet of exploration activity during the first nine months of 2012, which exploration activities were mainly distributed amongst the Olimpinsky, Samburgsky, North Khancheyskoye and the West Yurkharovskoye licence areas as well as conducting a series of geological surveys at various licence areas. Overall our exploration activities continued to yield positive results but no new



discoveries we made during the third quarter of 2012. We recently relinquished three exploration licence areas thus reducing our existing number of licences from some 38 to 35.

Excluding purchases and inventory movements, we reported a 2.9% decrease in our natural gas production from our core producing fields as compared to the prior year which was largely attributable to a conscientious decision made in the second quarter to increase production at these fields ahead of the expected transport tariff increase effective 1<sup>st</sup> July 2012 and inject these additional volumes into underground storage facilities.

During the first nine months of 2012 our total gas production including purchases and our share of equity production grew by 5.1 billion cubic metres or by 13.7% to 43.7 bcm over the corresponding time period and a portion of this growth was driven by a 7.3% or a 2.5 bcm increase in organic production from our core producing fields excluding our share of equity production.

We had relatively strong production growth from our three core fields for the first nine months of 2012 led by the resumption of gas production at both the East-Tarkisolinskoye and Khancheyskoye fields of 11.6% and 14.4% respectively as well as continued output growth at the Yurkharovskoye field of roughly 5.1% representing a total growth in our gas production of 2.5 bcm as compared to prior year. Our purchases of natural gas from Sibneftegas were relatively consistent period on period at approximately 4 billion cubic metres and we commenced purchasing of natural gas from Sibur Holdings, a related party in January 2012 in the amount of 2.5 bcm.

In the third quarter of 2012 we increased our total sales volumes of natural gas by 1.2 bcm or 10.1% to 13.5 bcm as compared to the prior year. We have significantly increased our percentage of natural gas sold to end customers from 57% in the third quarter of 2011 to 65% in the current reporting period which meant that we were able to capture additional retail margins of 97 rubles per thousand cubic metres or approximately \$3 an mcm or an eight fold increase during the current reporting period.



We also managed to increase our average end customer netback margins quarter on quarter by approximately 240 rubles per mcm or by 16.2% reflecting stronger pricing dynamics in the geographical regions where we market our natural gas as well as benefiting from the across the board 15% average price indexation by the federal tariff service effective 1<sup>st</sup> July 2012. We achieved an increase on our end customer sales mix from 62% to 65% quarter on quarter realising additional retail netback margins of 19 rubles per mcm or by 25%.

The change in our natural gas sales mix is important for a number of reasons but essentially meant that we achieved a higher realised average price, stronger netback realisations and was able to effectively control our production profile by maintaining our customer relationships. We significantly increased our volumes sold to the Chelyabinsk region year on year representing approximately 34% of our end customer volumes sold which contributed to higher realised average price and improved netback realisations. During the first nine months of 2012 59% of our sales volumes were sold to the power sector, 32% to large industrial consumers and the remaining 9% split between regional gas companies 1%, residential customers 2% and others at 6%.

Our average realised prices for end consumer sales during the third quarter increased by 15.7% year on year and 15% quarter on quarter primarily reflecting the FTS gas price tariff increase as well as our mix of customers. For ex-sales or wholesale trader sales our average realised price increased year on year by 229 rubles per thousand cubic metres or by 16.5% and quarter on quarter by 220 rubles per thousand cubic metres or by 15.7%. We continued to achieve a higher margin differential between end customers and ex-field netbacks excluding trading activities and sales to residential customers as compared to prior years which continues the pricing dynamic trends achieved prior to the economic crisis although we cannot be certain that these trends will remain consistent or continue to fluctuate period on period.

Our overall average distance to transport our natural gas to end consumers averaged approximately 1,960 km during the third quarter 2012 which was higher than the prior year by approximately 180 km but relatively consistent quarter on quarter. The geographical markets



representing at least 10% of our sales volumes were Chelyabinsk, Perm, Moscow and the Orenburg regions.

Our total liquid volumes of sales increased year on year by 14.1% or by 132,000 tonnes and was largely comprised of purchases and inventory movements during the respective reporting period. In terms of liquid production from our core producing fields we continued to achieve positive growth in crude oil production from the East-Tarkisolinskoye field sufficient to offset declining liquid concentrations in the field's wet gas stream, but overall declines in output from the Khancheyskoye field were consistent with our recent field experience and the reduction in wet gas production at the Yurkharovskoye field resulted in an overall 2.1% decline in our liquids output. Our production output was nevertheless offset by purchases of unstable gas condensate from SeverEnergiya's Sambursky field which commenced first phase production from 2012. Overall Yurkharov still represents about 62% of our total liquid outputs from our core producing fields.

Stable gas condensate continued to represent the largest portion of our total liquid sales sold during the third quarter 2012 accounting for approximately 69% of our total sales volumes. We sold 737,000 tonnes of stable gas condensate versus 658,000 tonnes in the corresponding period and 785,000 tonnes in the second quarter realising an average netback price per tonne of \$441 per tonne in the third quarter as compared to \$357 per tonne in the corresponding period and \$339 per tonne in the second quarter. We continue to see an overall strengthening in both the general pricing and average netbacks on cargoes delivered in the fourth quarter.

During the second quarter we dispatched 12 tankers of stable gas condensate for the Port of Vitino of which 10 tankers or approximately 605,000 tonnes were destined to the Asia Pacific region. The significant increase in the volumes sold to the Asia Pacific region is a good example of diversifying our product markets when we anticipated (and eventually realised) that the US markets will reduce the volume of imports of stable gas condensate as a result of the significant increase in shale liquids.



Our liquid hydrocarbon volumes in inventory aggregated 374,000 tonnes at period end versus 442,000 tonnes year on year and 402,000 tonnes at the end of the second quarter of which 268,000 tonnes represented stable gas condensate in various stages of the inventory supply chain. On a barrel of oil equivalent basis we had a slight decrease in our total third quarter hydrocarbon production to 94 million barrels of oil equivalent versus 95 million barrels of oil equivalent in the prior reporting period representing an average hydrocarbon production per day of 1,200,000 barrels per day representing a slight decrease of 1.5% year on year.

There were no major surprises to our operating expenses during the third quarter 2012 relative to the composition and growth of our revenues. Our total operating expenses increased in absolute terms from 22.9 billion rubles to 29.8 billion largely due to an increase in transportation expenses and a significant increase in third party purchase of natural gas but slightly decreased year on year as a percentage of total revenues. Operating expenses in the second quarter of 2012 aggregated 26.8 billion rubles but was higher as a percentage of revenues as compared to the current reporting period.

One of the most significant changes in our operating expenses for the comparative periods was the relative increase in our transportation expenses which is explainable by the overall year on year and quarter on quarter growth in customer sales volumes by approximately 14% and 4% respectively combined with a higher per unit transport cost as compared to the prior period due to a 7% transport tariff indexation and an increase in the average distance to market. In addition during the third quarter we increased the amount of natural gas purchased from our related party Sibur Holdings which was zero in the prior period as well as increase the volume purchased from our joint venture Sibneftegas to complement our commercial gas marketing strategy.

As a result of the facts enumerated above our EBITDA margin continued to remain robust in the respective reporting period achieving a level of approximately 48% for the third quarter of 2012 which is consistent with our overall financial guidance. Moreover we continue to see high levels of volatility in the currency markets which can positively and/or negatively influence the Russian ruble and US dollar exchange rates and when applied to our US dollar weighted debt portfolio



we tend to report wide swings in non-cash forex gains and losses during the reporting periods. We adjust our net profit numbers and margin in an attempt to smooth out these fluctuations and when adjusting in the current period our net profit margin is also consistent with our financial guidance.

Our balance sheet and liquidity position continued to remain strong throughout the reporting period although we had some movements in our debt and working capital positions during the period. Our net debt position decreased from 77.8 billion at the end of the second quarter to 67.2 billion rubles in the current reporting period largely due to repayment of debt according to maturity schedules and an increase on our cash and cash equivalents position. All of our liquidity and credit ratios improved and remained strong throughout the reporting period and we ended the third quarter with a cash and cash equivalent position of 17.5 billion rubles or approximately \$565 million. We ended the current reporting period in a positive free cash flow position of 12.3 billion rubles or approximately \$400 million and reversed the negative position from the second quarter which was the first negative cash flow position over the past 12 quarters. We will continue to fund our capital expenditure programme through internally generated cash flows and have the ability to meet all of our debt obligations and liabilities when they mature or come due for payment.

In conclusion we ended the current reporting period with another very strong financial and operational results as well as the recent announcement to acquire a 49% equity stake in Nordgas at value accretive multiples to our shareholders. Unfortunately the negative market sentiment has trumped the excellent financial and operational result we have achieved, the announcement of the Nordgas acquisition and the very fact that we have delivered everything we said we would deliver according to our strategic guidance. We have significantly underperformed our Russian peers group year to date for both GDRs and ordinary shares as a result of this negative market sentiment and the negative bias on market news flows and rumours. Obviously the share price trend has been disappointing from senior management's perspective as we collectively continue to hold a notable equity stake in NOVATEK. More importantly however I want to unequivocally state that our focus has been and will continue to be to create shareholder value for all of our stakeholders as well as to maintain our adherence



to sound corporate governance and transparency, adhere to our stated dividend policy and continue to focus on cost control and project execution.

We firmly believe that the investment community is misreading and overreacting to the current news flow and market speculations and accordingly we believe that the current share price does not reflect the underlying value of the company and its future prospects. That said perceptions do move markets and the overall perception today is not positive which ultimately divorces our equity price from its true underlying value. As a result we will continue to closely monitor this negative price share trend in relation to our previously announced share buyback programme.

I would also like to strongly reiterate again that we are very confident that our commercial marketing group will be able to successfully market all of our current and future natural gas production including the volumes attributable to the Inter RAO contract expiring in 2016 and we are currently negotiating new long term sales and purchaser contracts as well as targeting new regional markets. We have demonstrated many times in the past that we understand the dynamics of the Russian domestic gas market and over the years we have built a very credible reputation as a reliable supplier of natural gas. We have an enviable track record to prove this point.

In retrospect we have delivered what we outlined in our financial and operational guidance for the first nine months of 2012. We have grown our liquids and natural gas production. We have maintained a strict focus on cost control and project execution. SeverEnergiya's Sambursky field's initial production and the Yurkharovskoye field's fourth phase were both delivered on time and within budget. The Ust-Luga project is now geared up for operational line fill prior to commencing processing and the crude oil programmes at the East-Tarkisolinskoye and Khancheyskoye fields are now producing.

We have completed the front end engineering design phase on the Yamal LNG project as promised and we are now working towards FID and we have delivered on a series of other commitments by working closely with the Russian government. We have begun trading natural gas on the European market in October to support future trading activities and start building a





marketing presence. We have raised our annual dividend every year since we went public despite being considered a high growth stock. We added constructive input into the recent gas MET discussions and the preliminary results announced confirmed our viewpoint as stated during our first quarter conference call that the changes to the gas MET rate would not be punitive to the independent gas producers.

Finally we are very excited about the Nortgas acquisition and its potential to complement our near term natural gas and gas condensate production growth as well as to immediately accrete shareholder value. I would like to sincerely thank all of our valued shareholders for participating in tonight's conference call and encourage everyone to look beyond the present negative sentiment and focus on the company's strong business fundamentals and excellent track record of delivering financial and operational results. We are keenly focused on things that we can control rather than things that are out of our control. We are poised for growth in the business and we believe that we have the requisite management team in place to deliver on our strategic objectives.

I would like to end this portion of the conference call and now open the session to questions and answers. Thank you very much.

Operator: Thank you. If you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone keypad. If you find that your question has already been answered you may remove yourself from the queue by pressing \*2. Again please press \*1 to ask a question. We'll pause for just a moment to allow everyone to signal.

We will take our first question from Oleg Maximov, Senior Analyst Oil & Gas Sberbank CIB. Please go ahead.

Oleg Maximov: Which is the additional gas volume that the company is planning to do in terms of sales of contracts, that it is planning to conclude before the end of the year? Second question, do you expect any dramatic increase of tax for gas condensate for the next two years and what kind of discussions are taking place on this particular topic? The third question: what is the size of



capital spending that the company is planning for next year particularly for the Yurkharovskoye field and separately for the Ust-Luga plant? Thank you.

Leonid Mikhelson: In terms of your first question we do see a certain trend in the way the market is evolving and that is specifically following the market trend to the domestic market and we don't in the domestic market grow slightly faster than the amount of our production, so all of our production including the additional acquisitions are supported by contracts. It is a very important trend that NOVATEK started pursuing within the strategy itself which is switching away from just supplying major consumers under the long term contracts but additionally also going forward the regional sales specifically because you are aware that we supply the entire Chelyabinsk region. We account for quite a bit share of the Perm consumption and so currently the balance that we see evolving into the next year, our regional strategy will encompass about 40% within our total supplies against the existence of the long term contract portfolio which accounts for approximately 40% as well.

We feel ourselves extremely confident in the market and very grateful to our current partner in the person of Inter RAO who has chosen a very long term approach three years ahead before our contract expires. It looks at the way the supplier landscape is going to change and so it's going to be quite easy for us to manoeuvre around and so we don't expect any risks to happen for us, so if the answer is in this particular part.

As far as MET tax for the gas condensate is concerned, neither here do we expect anything negative to happen in terms of the government trying to consider any significant growth in terms of the taxation. No other kind of taxation burden is being considered with respect to the associated petroleum gas for the oil companies so we are submitting our own proposals in line with the possibility of MET gas and we believe that it will demonstrate growth but not a significant one and within the inflation parameters.

As far as capital investments are concerned, they will be excluding the Yamal LNG project approximately at the level of this year. We practically completed major investments which we've done during the past few years into the Yurkharovskoye field and with respect to



specifically the Ust-Luga project this year we will finish off the construction work and right up to the new year we will start testing and also commence supplying the product in the first quarter and would commission this project fully into operation. Thank you. Next question.

Operator: We will take our next question from Karen Konstantin from Bank of America. Please go ahead.

Karen Konstantin: The first question is about the buyback. What is the current plan for the buyback considering the recent market events or trends? Does the company plan to change its buyback plans? What kind of money already has been spent in this project and if there are any plans imminently to be changed for buybacks, what are those? The second question is about the Nortgas because currently Gazprom is taking all of the gas they are producing. Are you expecting this to change and if so when?

Leonid Mikhelson: [answer in Russian]

Translation: So as far as buyback is concerned, you know that we have made an announcement and we have identified this as a potential project but so far we haven't undertaken any activities within this program but if we were to do anything, we would definitely inform, notify the market. We are not going to change the amount of buyback, and possibly because of the acquisition of Nortgas in the first place because of very often unpredictable response from the market to the ratings of our shares, because of this or that announcement, we didn't undertake the buyback but we are thinking about it and we are always ready to act on this, but within the specified amounts.

Now with respect to Nortgas, a big share of gas has been taken by Gazprom. Some gas has been sold by Nortgas directly to the market, and today we already have reached an understanding with Gazprom about the pricing policy between Gazprom and Nortgas and as of January 1<sup>st</sup>, we will be taking the amount of gas which corresponds to the ratio of our proportionate interest. Next question please.



Operator: We'll take our next question from Tatiana Boroditskaya from UBS. Please go ahead.

Tatiana Boroditskaya: [question in Russian]

Translation: There are two questions. The first one: could you please comment on the situation of, with respect to the exports of gas under the contracts with EnBW, including when you are going to start supplies? And the second question: is NOVATEK planning to issue Eurobonds before the end of this year or is planning to do so next year?

Leonid Mikhelson: [answer in Russian]

Translation: Mark Gyetvay, in his presentation, mentioned that we have signed a trading contract worth 2 billion of supplies with EnBW. The deliveries started as of October 1<sup>st</sup> this year so we're working within the terms of this contract. It is a very important aspiration for us to be able to work in the European market, considering the future of Yamal LNG project, and everything of this particular account is taking place in compliance with this [aim].

Now as far as the financings are concerned, we are planning to consider a range of financing options for this acquisition but a decision has not yet been reached. Right now there is a Board of Directors in session which is going to consider this issue at this point, and depending upon the market environment, we'll see what amount of financing we will need; I guess around approximately 1 billion. Well, or maybe slightly more than that. Next question please.

Operator: We'll take our next question from Max Moshkov from UBS. Please go ahead.

Max Moshkov: [question in Russian]

Translation: There are three questions. The first one, because of the Yurkharovskoye field achieving its full capacity of [36] million cubic metres a year, what is the volume of condensate that you are planning to have from Yurkharovskoye against the maximum production out of Yurkharovskoye over the next three years, and we then how many years we're going to maintain



that level at the Yurkharovskoye field. The second question is about free cash flow. You have stated that because of a possible decline in the need to maintain capital investments, just some of the projects are going to be completed, do you expect a considerable increase in your free cash flow because of that? Are you having any plans to adjust your dividend policies, so to raise the dividends? And third question with respect to the Nortgas pricing policy, I understand that you considerably raised the gas acquisition price from Gazprom and Sibneftegas. Should we, in our analytics, take into account the pricing figures when you acquire gas from Sibneftegas when basically creating any outlook projections for Sibneftegas.

Leonid Mikhelson: [answer in Russian]

Translation: So I should say that despite the fact that I believe that I know very well all of the figures which describe NOVATEK's performance; however, I am not in a position to give you the exact figure of the production (gas condensate) of the company from the Yurkharovskoye as far as [we couldn't] do that. And I can definitely say that right now we are having about 8,000 tons of daily output from the field in terms of condensate production, and the increasing of the compressor station and within the next 18 months the commissioning of the second compressor station is exactly aimed at having the ability to maintain this production for as long as possible. Now a thing that the investors should know about the Yurkharovskoye field, we are now finishing exploration facilities there as well as considering how we could best improve the development plan for this field so as to achieve the longest possible production and in the first place, we definitely focused upon the economies [involved] in the gas amongst other things. We have run exploration activities not only for the Khadyryakhinskiy licence, which we are currently holding, but also the Urengoykoye and Jurassic layers. So this is a continuous process and we're doing our best to achieve the maximum benefit from this field.

Leonid Mikhelson: [answer in Russian]

Translation: And as far as the dividend policy is concerned, we are not anticipating to the change this policy—I should say that it corresponds to the market expectations because the company has to develop in the first place and invest in additional production volumes, trying to maximise as best



as possible any potential increase in its pay-out. Our dividend policy is not a small one, which is another 30% from what the company is achieving as a profit, and so capital investment definitely has to be considered. You mentioned Yurkharovskoye field and the Ust-Luga project, but apart from that, we are expecting our Purovsky gas processing plant to expand and next year we shall commission into operation additional processing to the [6] million tons we are expanding our condensate pipeline so that taking into account that only existing production but also taking into account the future production volumes from Nortgas to guarantee the maximum possible throughput for all these additional volumes and to achieve the most optimum processing at the Purovsky plant, where subsequent additional processing will be handled, thank you. Next question.

Leonid Mikhelson: [answer in Russian]

Translation: And in answer to your third question, which was whether one can compare the pricing for the acquisition of Nortgas, that will start taking place in January 1<sup>st</sup> with Sibneftegas, I would say yes, we can compare that way. Next question please.

Operator: We'll take our next question from Ildar Khaziev from HSBC. Please go ahead.

Ildar Khaziev: [question in Russian]

Translation: Well, the question was about the growing prices for the end users in the third quarter, what was the effect of the changing sales structure upon the pricing? It was a positive one but I would like to find out what would be the ratio, the existing ratio, whether it could generate additional effect in the future and should it be connected in any way to deliveries of gas into the regions which require a larger transport cost, at least in terms of the distance.

Leonid Mikhelson: [answer in Russian]

Translation: I guess in this case, one should speak not about prices growing for the end users but about a net effect growing from the gas which we generate when selling gas to an end users.



And we definitely could see in our report that we are able to enjoy slightly bigger profitability from selling gas specifically to an end user. As Mark Gyetvay mentioned, in this year we witnessed growth in terms of the share of end users in the overall sales portfolio and that would say that one should expect significant growth as well during 2013, I mean in the numbers of the end users which count for a large proportion of our sales. And one should also take into account two factors. The first one is that the government, through a certain target service, per unit has been trying to achieve equal profitability between main sales regions with respect to the point of production, many have said that the netback from closer located end users compared to more remotely located so this equalisation has been a continuous process. So we used to say two years ago as well as three years ago that we can cover much a bigger larger geographical region with the same kinds of profitability with our supplies.

And the second thing we're saying which definitely we want you to bear this in mind, specifically because I think government is talking about the domestic gas prices growing and the growth of the tariffs is expected to take place at a different kind of pace considering what the government's announced. For next year, the transportation tariff is going to be also equal to inflation, which in turn would enable us to achieve a better netback profitability specifically in the case of end users. Next question.

Operator: We'll take our next question from Pavel Sorokin from Morgan Stanley. Please go ahead.

Pavel Sorokin: [question in Russian]

Translation: Could you possibly share with us your expectations of the long-term prices that you use in your domestic business planning for 2015, '16, and '17? What kind of scenario do you follow and if it is possible, it would be great if you could share your views in respect to the pricing policy in the case of SeverEnergiya. What is the kind of discount that we should expect against the domestic prices for that company?

Leonid Mikhelson: [answer in Russian]



Translation: To answer your first question, with respect to the domestic prices which the company is putting into the business plan, we are relying upon the terms and conditions that we achieved through negotiating with our consumers as well as the prerequisites and information that the gas market players, all of the participants in the gas market are receiving from the Russian government.

Leonid Mikhelson: [answer in Russian]

Translation: And as far as the second question is concerned, no discount when – by SeverEnergia is used. It is all taking place according to the market price and according to the formula which was pre-agreed with SeverEnergia and which is correlating with the market, and level with the Brent price with the deduction of the cost of the transportation. Next question please.

Pavel Sorokin: *Spasiba.* (Thank you.)

Operator: We'll take our next question from Viacheslav Shilin from Deutsche Bank. Please go ahead.

Viacheslav Shilin: [question in Russian]

Translation: So two questions. The first one is about the general approach to managing the company's financial liabilities. Obviously the share of financial debt that is subject to repayment in 2013, of which part is going to be refinanced and which is going to be repaid using [our own money], particularly taking into account, as I understand it now, the acquisition of Nortgas, it's going to be considered by the Board. And in connection with this, do we have any target indicated of the net financial leverage that you are planning to have in 2013 that you can share with us? Second question, the second question, would you please confirm whether I understand currently that the amount of, in general the amount of production for 2013 is 80% covered by already existing contracts with customers?

Leonid Mikhelson: [answer in Russian]





Translation: Mark Gyetvay will be answering the first question and Mr. Mikhelson will answer the second question.

Mark Gyetvay: In regards to the debt position, I think it's extremely important to understand, first and foremost, that we generate a series of cash flow. The cash flow is then used, in terms of considering what our dividend policy would be, how much we may internally generate cash flow into the operations as part of the capital expenditure programme and lastly to service our debt. As you can see in our presentation, on page 40 of the presentation material, we have outlined a debt maturity profile that essentially says that we have approximately RUB 19 billion of debt that's expected to be due over the same corresponding period from nine months to nine months numbers in the upcoming year. I mean, we have paid back and we continue to pay back debt according to the maturity schedule.

We have actually paid back a series of debt before the maturity schedules as noted in the second quarter. In terms of incurring additional debt, we have a financial policy in place. The financial policy is available on our presentation material and our website, etc. that essentially says the company targets a debt to EBITDA number of 1 times. We have actually adhered to that particular criteria and if you notice, inside the financial statements, in our management discussion and analysis or MD&A, you can actually see that as a result of the cash flow generation, the repayment of debt, etc. that all of our liquidity and/or our credit ratio metrics have improved.

We don't have *per se* a target range. What we try to look at is a balanced approach – that is probably as Mr. Mikhelson alluded to earlier, you know, it's probably unrealistic to assume in the near term that we will be reverting back to a net cash position as a result of the cash flow generation. We have a series of investments that we anticipate to make over the next five or so years to meet the objectives we outlined in our strategy presentation. So the debt position will be more or less balanced between what we need to spend in terms of capital expenditure over this corresponding period as well as what is the expected debt maturity profile as you see outlined on our presentation material and then whatever's available left for dividend



distribution, but there is really no set guidance that we provide in terms of whether or not we'll maintain a 20% debt to equity ratio, etc. We have not done that. We've basically reviewed our maturity profile at any particular period, and as you can see on that slide, it's relatively flat and that's our goal. Our goal is to maintain a relatively consistent level of debt on the balance sheets where we have enough cash flow to service the debt, meet our obligations, make our investments into our capital expenditure program and hence pay dividends.

In terms of financing structures, we are looking at acquiring additional debt to fund this acquisition but I think the most important thing in terms of this acquisition, say relatively to the SeverEnergia as an example, Nortgas is a cash-producing asset today and it's a cash-producing asset which allows us to immediately be able to accrue cash flow that we can use to eventually service debt, and that's an important distinction. We believe that given the additional balance of debt that we anticipate as a result of financing this transaction on market conditions will not jeopardise those financial metrics and the debt to EBITDA number as outlined. And you can see that same issue reflected in our credit rating and also you can see that reflected in the announcements made by the credit rating agencies as a result of this transaction. I'd like to turn the question over now to Mr. Mikhelson.

Leonid Mikhelson: [answer in Russian]

Translation: I guess that my first response was not very articulate and that's why a bit of confusion happened. Necessarily for 2013, the whole gas we plan to produce or to additionally acquire has been contracted and my first two figures here which we added up earlier were some figures, that were provided to me by our marketing people because that's where I'm told we have started working on the regional sales strategy and regional supplies, the overall sales of 40% while long-term contracts – between 5 to 15 years – constitutes the share of approximately 40%, but the whole of the year 2013 volume definitely has been contracted already. Next question please.

Operator: We'll take our next question from Alex Popovich from Wood McKenzie. Please go ahead.



Alex Popovich: [question in Russian]

Translation: The question was about for additional clarification. Once the Nortgas deal is finished, which will be the rate which will be applicable to it, like in the case of the independent producers or like in the case of Gazprom? And if this is going to be like in the case of Gazprom, will it be possible in some day in the future for this rate to be changed like in the case of independent gas producers?

Leonid Mikhelson: [answer in Russian]

Translation: Mark Gyetvay in his presentation referred to a particular point, saying that the Nortgas operating structure for the gas MET rate will be similar to that of the independent producers, not like in the case of Gazprom. Next question please.

Alex Popovich: *Spasiba.* (Thank you.)

Operator: We'll take our next question from Max Moshkov from UBS. Please go ahead.

Max Moshkov: [question in Russian]

Translation: The question is about the exact figure for the production for next year, in essence the number considering the market or taking into account the acquisition from the independent gas producers and the capital expenditure which you said was going to be in line with the current period but could you be more specific in terms of what you're seeing it look like?

Leonid Mikhelson: [answer in Russian]

Translation: We have also touched upon this particular point in our presentation. The production growth taking into account the Nortgas acquisition will be corresponding to the production growth as outlined, the biggest this year, but to give any specific figures I believe is not very



appropriate, because it is very difficult to make exact growth by much during the 2013 season in terms of what's going to be the winter temperature, how cold it's going to be and what will be the overall seasonal fluctuation. In our presentation, we have stated that we are pretty much targeting to increase the share of end users in our portfolio, particularly the share of end users, one should understand that would make us more susceptible to the risk of the seasonal temperature changes and because of this consideration, in our next year balance because of the growth of the end user share, we also anticipate a much greater volume of gas, much greater than this year, to be injected underground in order to maintain the balanced landscape in terms of temperature changes and the volumes that we are going to deliver.

Leonid Mikhelson: [answer in Russian]

Translation: And additionally, so as to avoid any misunderstanding, when I said that approximately the same growth as this year, I meant the percentage of this growth.

Leonid Mikhelson: [answer in Russian]

Translation: And you also refer to the capital investment figure. The amount of capital investments without taking into account Yamal LNG project will approximately be the same as we mentioned. So it is a project, I shall not repeat myself, including the development of the transportation infrastructure and the additional volumes for processing at Purovsky gas processing plant is going to be exactly what we are having in 2012. Next question.

Operator: We'll take our next question from Artem Konchin from JP Morgan.

Artem Konchin: [question in Russian]

Translation: So here two questions, the first one is about Nortgas, if you are going to take 100% of Nortgas' condensate is going to processing, does it mean that you will end up having a percentage of that reduction. And the second question, the Yamal LNG, you have recently stated the effect that local currency can have on the plant operation, do you have any



understanding about the extent that the rouble exchange rate may offset your planned capital expenditure programme?

Leonid Mikhelson: [answer in Russian]

Translation: As far as the acquisition of gas condensate for subsequent processing from Norgas, we have already proven and established arrangements in the case of SeverEnergiya whereby it is exactly like the case with the gas condensate we have now, the Gazprom structure moving together with NOVATEK, so exactly the same kind of a market formula is going to be applied to this gas from Nordgas.

Leonid Mikhelson: [answer in Russian]

Translation: And with respect to Australian LNG, we are also familiarising ourselves with these projects which are being constructed in the LNG markets and in Australia, we do not see any strong effect which would change the capital spending in the Yamal LNG product because of the rouble exchange rate. We completed the FEED stage and we're running tenders for equipment, the EPC contract for the construction as of today, here our estimates remain exactly the ones that we've announced a year ago.

Operator: Ladies and gentlemen, if you wish to ask a question, please press \*1 on your telephone keypad. That's \*1 to ask a question. Gentlemen, we have no further questions in the queue.

Leonid Mikhelson: [statement in Russian]

Translation: Mr. Mikhelson would like to express his appreciation to all the participants of this telephone conference.

Leonid Mikhelson: [statement in Russian]



Translation: Mr. Mikhelson agrees 100% with what Mark Gyetvay said, that we do not think that considering the current stock valuations, that the company is valued in the way that reflects the true underlying value of the Company and its future prospects.

Leonid Mikhelson: [statement in Russian]

Translation: And, NOVATEK's management sometimes finds it extremely strange that the valuation indicated for the company's stock price are affected by different statements made about the probability of various events taking place.

Leonid Mikhelson: [statement in Russian]

Translation: The Management Board of the Company as well as the senior management of NOVATEK does everything necessary for investors to stay happy and well informed and for the strategic plans and performance indicators which we disclosed to the investment community to be met each year by the company.

Leonid Mikhelson: [statement in Russian]

Translation: Quite possibly, that some of the negative sentiment can be explained by the fact that we're not sharing all of the figures as well as the information that one would like to have in terms of what we think in figures, in terms of what will happen to the company in two or three years' time.

Leonid Mikhelson: [statement in Russian]

Translation: We are very serious about our fundamental performance, our announcements, the statements that we make, considering the background and historical performance since our IPO clearly shows that we're doing the best we can, and that maximum efforts that we will apply and the commitments we make towards achieving the strategic plan covering a period up to



2020 that we shared with the investment community last year. We'll do everything in our power to reach it 100%. Thank you very much for your participation and attention.

Operator: That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.