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 2014 and 2013 together with our unaudited consolidated interim condensed financial information as of and for the three months ended 31 March 2014. 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 2013 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 for both reporting periods. In terms of proved natural gas reserves, we are 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 are conducted within the Russian Federation.

In accordance with Russian law, we sell our produced natural gas volumes exclusively in the Russian domestic market.

We deliver all of our extracted unstable gas condensate through our own pipelines to our Purovsky Gas Condensate Plant for processing into stable gas condensate and liquefied petroleum gas (LPG). Prior to the third quarter of 2013, the majority of our stable gas condensate from the Purovsky plant was shipped to international markets, but commencing from the third quarter of 2013, most of our stable gas condensate is sent for further processing to the Gas Condensate Fractionation and Transshipment Complex located at the Port of Ust-Luga on the Baltic Sea.

The Ust-Luga Complex consists of two fractionation units (launched in June and October 2013) with a total capacity of six million tons per annum. The Ust-Luga Complex processes our stable gas condensate into light and heavy naphtha, jet fuel, gasoil and fuel oil ("gas condensate refined products") which are subsequently shipped to the international markets by tankers. The Ust-Luga complex enables us to increase the added value of our liquid hydrocarbons sales and allows us to diversify our sales market. The remaining stable gas condensate volumes are sold domestically.

We deliver our crude oil and liquefied petroleum gas produced at Purovsky Plant to both international and domestic markets.

The Group jointly with our partners Total and China National Petroleum Corporation ("CNPC") conducts a strategic project on the construction of a LNG plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula. The project includes the construction of transportation infrastructure, including the seaport and the international airport. The projected commissioning works at the first liquefaction train is scheduled for 2016 with the planned commercial launch and start of shipments in 2017.

RECENT DEVELOPMENTS

In March 2014, the Group approved a series of transactions which, when concluded, will enable the shareholders to equalize their equity stakes in the SeverEnergia joint venture. Consequently, on 31 March 2014, the Group sold its 20% equity stake in Artic Russia B.V. to its joint venture Yamal Development thus decreasing its effective interest in SeverEnergia from 59.8% to 54.9%. The remaining 4.9% effective interest in SeverEnergia will be disposed within the framework of the restructuring activities during the twelve months after the receipt of formal corporate approvals.

In February 2014, the Group acquired an additional 15% equity stake in NOVATEK-Kostroma, a regional natural gas trader in the Kostroma region of the Russian Federation, thus increasing the Group's effective participation interest to 100 percent.

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

We historically delivered our liquefied petroleum gas from the Purovsky Plant where it is produced to the sales markets via railroad. In 2014, we plan to optimize our liquefied petroleum gas sales and transport all of our liquefied petroleum gas from the plant via a pipeline to the southern part of the Tyumen region to the refining capacities of OOO Tobolsk-Neftekhim. A portion of the liquefied petroleum gas will be sold ex-works at the Purovsky Plant while another part, after additional processing, will be transported by rail from the Tobolsk station to our end-customers in the domestic and international markets. The implementation of new sales and distribution logistics for our liquefied petroleum gas will let us bypass one of the busiest areas of the railroad and diversify our sales.

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 31 March: 2014	2013	Change %
Financial results			
Total revenues [(1)]	88,676	80,565	10.1%
Operating expenses	(53,875)	(51,056)	5.5%
Profit attributable to shareholders of OAO NOVATEK	25,115	22,826	10.0%
Normalized profit attributable to shareholders of OAO NOVATEK [(2)]	23,016	22,826	0.8%
EBITDA [(3)]	45,602	34,860	30.8%
Normalized EBITDA [(2)]	42,979	34,860	23.3%
Normalized EBITDAX [(4)]	42,987	34,995	22.8%
Earnings per share (in Russian roubles)	8.30	7.53	10.2%
Normalized Earnings per share (in Russian roubles) [(2)]	7.60	7.53	1.0%
Net debt [(5)]	125,087	109,184	14.6%
Production volumes [(6)]			
Total hydrocarbons production (million barrels of oil equivalent)	112.2	113.6	(1.2%)
Total daily production (thousand barrels of oil equivalent per day)	1,247	1,262	(1.2%)
Operating results			
Natural gas sales volumes (million cubic meters)	17,772	18,739	(5.2%)
Naphtha sales volumes (thousand tons)	775	-	n/a
Liquefied petroleum gas sales volumes (thousand tons)	351	265	32.5%
Crude oil sales volumes (thousand tons)	195	137	42.3%
Other gas condensate refined products (thousand tons) [(7)]	190	-	n/a
Stable gas condensate sales volumes (thousand tons)	32	1,210	(97.4%)
Cash flow results			
Net cash provided by operating activities	27,090	25,532	6.1%
Capital expenditures [(8)]	13,727	11,264	21.9%
Free cash flow [(9)]	13,363	14,268	(6.3%)

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

millions of Russian roubles	**Three months ended 31 March: 2014**	**2013**	**Change %**
Profit attributable to shareholders of OAO NOVATEK	**25,115**	**22,826**	**10.0%**
Depreciation, depletion and amortization	4,056	3,157	28.5%
Net impairment reversals	(586)	(4)	n/a
Loss (income) from changes in fair value of derivative financial instruments	731	(509)	n/a
Total finance expense (income)	4,320	1,924	124.5%
Total income tax expense	6,192	5,626	10.1%
Share of loss (profit) of joint ventures, net of income tax	1,762	(163)	n/a
Share in EBITDA of joint ventures	4,012	2,003	100.3%
EBITDA [3]	**45,602**	**34,860**	**30.8%**
Net loss (gain) on disposal of interests in joint ventures	(2,623)	-	n/a
Normalized EBITDA [2]	**42,979**	**34,860**	**23.3%**
Exploration expenses	8	135	(94.1%)
Normalized EBITDAX [4]	**42,987**	**34,995**	**22.8%**

(1) Net of VAT, export duties, excise and fuel taxes.

(2) Excluding the effect from the disposal of interests in joint ventures.

(3) EBITDA includes our proportionate share in the EBITDA of our joint ventures and 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, share of profit (loss) of joint ventures, net of income tax and finance income (expense) from the Consolidated Statement of Income, income (loss) from changes in fair value of derivative financial instruments.

(4) Normalized EBITDAX represents EBITDA as adjusted for the add-back of exploration expenses and excludes the effect from the disposal of interests in joint ventures.

(5) Net Debt represents our total debt net of cash and cash equivalents.

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

(7) Other gas condensate refined products include jet fuel, gasoil and fuel oil.

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

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

SELECTED MACRO-ECONOMIC DATA

Exchange rate, Russian roubles for one US dollar [1]	Three months ended 31 March: 2014	2013	Change %
At the beginning of the period	32.73	30.37	7.8%
At the end of the period	35.69	31.08	14.8%
Average for the period	34.96	30.41	15.0%
Depreciation (appreciation) of Russian rouble to US dollar	9.0%	2.3%	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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Crude oil prices, USD per bbl	Three months ended 31 March: 2014	2013	Change %
Brent [2]			
At the end of the period	106.0	107.4	(1.3%)
Average for the period	108.2	112.6	(3.9%)
Dubai [2]			
At the end of the period	104.8	107.1	(2.1%)
Average for the period	104.4	108.1	(3.4%)
Urals [2]			
At the end of the period	105.3	106.5	(1.1%)
Average for the period	106.5	110.8	(3.9%)

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

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Oil products prices, USD per ton	Three months ended 31 March: 2014	2013	Change %
Naphtha Japan [3]			
At the end of the period	936	922	1.5%
Average for the period	935	960	(2.6%)
Jet fuel [3]			
At the end of the period	956	984	(2.8%)
Average for the period	975	1,038	(6.1%)
Gasoil [3]			
At the end of the period	899	918	(2.1%)
Average for the period	917	961	(4.6%)
Fuel oil [3]			
At the end of the period	647	628	3.0%
Average for the period	625	654	(4.4%)

[3] Based on Naphtha C+F (cost plus freight) Japan, Jet CIF NWE, Gasoil 0.1% CIF NWE, Fuel Oil 1.0% CIF NWE prices provided by Platts.

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Liquefied petroleum gas prices, USD per ton [4]	Three months ended 31 March: 2014	2013	Change %
At the end of the period	654	633	3.3%
Average for the period	758	699	8.4%

[4] Based on spot prices for propane-butane mix at the Belarusian-Polish border (DAF, Brest) as provided by Argus.

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Export duties, USD per ton [5]	Three months ended 31 March: 2014	2013	Change %
Crude oil, stable gas condensate			
At the end of the period	384.4	420.6	(8.6%)
Average for the period	390.6	406.5	(3.9%)
Liquefied petroleum gas			
At the end of the period	169.1	131.4	28.7%
Average for the period	189.3	176.8	7.1%
Naphtha			
At the end of the period	345.9	378.6	(8.6%)
Average for the period	351.5	365.9	(3.9%)
Jet fuel, fuel oil			
At the end of the period	253.7	277.6	(8.6%)
Average for the period	257.7	268.3	(4.0%)
Gasoil			
At the end of the period	249.8	277.6	(10.0%)
Average for the period	255.1	268.3	(4.9%)

[5] Export duties are determined by the Russian Federation government in US dollars and are paid in Russian roubles.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

The economic instability in the Euro-Zone has began showing signs of improving as a result of the various measures taken by the respective governments, Central Banks and other quasi-governmental financial institutions. Although the main financial and economic issues plaguing the Euro-Zone over the last few years still remain, 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.

The recent political events in Ukraine post March 2014 has prompted an immediate negative reaction by the world community, including economic sanctions levied by the United States, Canada and the European Union against certain Russian individuals and legal entities. We have assessed the potential impact of the economic sanctions on the Group's activities taking into consideration the current state of the Russian economy, our business and our long-term projects with foreign partners. We have concluded that as of the date of disclosure of the consolidated interim condensed financial information as of and for the three months ended 31 March 2014, the recent developments do not have any material effect on the Group, its business operations and financial condition.

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

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

Natural gas prices

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

During 2013, natural gas prices for sales to end-customers on the domestic market (excluding residential customers) were set by the FTS using a price formula which provided for quarterly changes of natural gas prices, as well as the possibility of adjusting natural gas prices within the quarter in case there was a significant deviation (more than 5%) of natural gas prices calculated using a price formula in the previous quarter from the annual wholesale price changes set by the Russian Federation government.

In 2013, natural gas prices for sales to end-customers on the domestic market (excluding residential customers) were decreased by an average of 3.0% from 1 April and subsequently increased by an average of 15.0%, 3.1% and 1.9% from 1 July, 1 August and 1 October, respectively. Effective from 1 January 2014, the FTS set natural gas prices back to the August-September levels of 2013, decreasing the natural gas prices by an average of 1.9% from the December 2013 price levels.

In March 2014, the FTS made changes to the “Statement of Gas Price Formula Definition”, which effectively abandoned the quarterly wholesale price calculation based on the natural gas price formula. As a result, natural gas prices in 2014 for sales to all customer categories on the domestic market (excluding residential customers) were calculated using a price formula based on parameters set by FTS in December 2013 and will not be changed during 2014 (effectively remaining at the same price level as the August-September 2013 prices).

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

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

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

We deliver natural gas to residential customers of the Chelyabinsk and Kostroma regions of the Russian Federation at regulated prices through our subsidiaries OOO NOVATEK-Chelyabinsk and OOO NOVATEK-Kostroma. We disclose such residential sales within our end-customers category.

In the three months ended 31 March 2014, our average natural gas price to end-customers increased by 9.0% primarily due to an increase in the average regulated FTS price by 15.0% as compared to the corresponding period in 2013 (cumulative effect of a 3.0% decrease effective from 1 April 2013 and 1.9% from 1 January 2014 and 15.0%, 3.1% and 1.9% increases effective from 1 July, 1 August and 1 October 2013), that was partially offset by sales to our end-customers located closer to our production fields in the first quarter 2014 as compared to the corresponding period in 2013. This factor also had a significant impact on the dynamics of our average transportation expense per mcm and resulted in a 4.5% decrease in our average transportation expense per mcm although the natural gas transportation tariff set by the FTS increased by 6.4% effective from 1 August 2013 (see “Transportation tariffs” below).

As a result, our average netback price on end-customers sales increased by 20.2%, while our total average natural gas price excluding transportation expense increased by 19.3% compared to the respective prices in the corresponding period in 2013.

Our average natural gas price for sales to wholesale traders also increased as compared to the corresponding period in 2013 due to an increase in the regulated FTS price that was partially offset by a change in the mix of wholesale traders while the proportion of natural gas sold to end-customers increased. Therefore, our average natural gas price for sales to wholesale traders increased by 7.4%.

The following table shows our average realized natural gas sales prices (net of VAT):

Russian roubles per mcm	**Three months ended 31 March: 2014**	**2013**	**Change %**
Average natural gas price to end-customers [(1)]	3,400	3,120	9.0%
Average natural gas transportation expense for sales to end-customers	(1,345)	(1,409)	(4.5%)
Average natural gas netback price on end-customer sales	2,057	1,712	20.2%
Average natural gas price ex-field (wholesale traders)	1,834	1,708	7.4%
Total average natural gas price excluding transportation expense	**2,043**	**1,712**	**19.3%**

[(1)] Includes cost of transportation.

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

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

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

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

Stable gas condensate and refined products

There were no sales of stable gas condensate to export markets in the three months ended 31 March 2014 as a result of substantially all stable gas condensate volumes produced at the Purovsky Plant are transferred to the Ust-Luga Complex for the processing into higher value added products of gas condensate refining.

In the corresponding period in 2013, our average realized stable gas condensate export contract price, including export duties, was USD 935 per ton and our average realized net export price for stable gas condensate, excluding export duties and translated to US dollars using the average exchange rate for the period, amounted to USD 528.7 per ton.

Our average realized export contract prices for naphtha and other gas condensate refined products produced at the Ust-Luga Complex, including export duties, in the three months ended 31 March 2014, were approximately USD 959 per ton and USD 908 per ton, respectively. In the three months ended 31 March 2014, our average realized net export price, excluding export duties and translated to US dollars using the average exchange rate for the period, for naphtha and other gas condensate refined products produced at the Ust-Luga Complex amounted to USD 608.2 per ton and USD 654.3 per ton, respectively. There were no sales of gas condensate refined products in the corresponding period in 2013 as the Ust-Luga Complex was formally commissioned in June 2013.

In the three months ended 31 March 2014, we sold naphtha and other gas condensate refined products at different delivery terms: cost and freight (CFR), priced at cost, insurance and freight (CIF), delivery to the port of destination ex-ship (DES), or delivery at point of destination (DAP).

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

	Three months ended 31 March:		Change
Russian roubles or US dollars per ton	**2014**	**2013**	**%**
Stable gas condensate			
Net export price, RR per ton	-	16,079	n/a
Net export price, USD per ton	-	528.7	n/a
Domestic price, RR per ton	13,724	13,256	3.5%
Naphtha			
Net export price, RR per ton	21,263	-	n/a
Net export price, USD per ton	608.2	-	n/a
Other gas condensate refined products			
Net export price, RR per ton	22,876	-	n/a
Net export price, USD per ton	654.3	-	n/a

Liquefied petroleum gas

In the three months ended 31 March 2014, our average export contract price for LPG produced at the Purovsky Plant, including export duties, excise and fuel taxes expense, increased by USD 78 per ton, or 9.6%, and was approximately USD 893 per ton compared to USD 815 per ton in the corresponding period in 2013. The increase in our average realized contract price was due to an increase in the underlying benchmark of LPG prices on international markets used in price calculation (see "Selected macro-economic data" above). Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, and translated to US dollars using the average exchange rate for the period, increased by USD 44.1 per ton, or 7.9%, to USD 602.8 per ton from USD 558.7 per ton due to an increase in the average realized contract prices, that was partially offset by a 7.1% increase in our average export duty per ton set by the Russian Federation government (see "Selected macro-economic data" above).

In the 2013 and 2014 reporting periods, our LPG export delivery terms were DAP at the border of the customer's country or free carrier (FCA) at terminal points in Poland.

Our average realized LPG domestic price for sales to end-customers marginally increased by RR 43 per ton, or 0.3%, to RR 13,443 per ton from RR 13,400 per ton in the corresponding period in 2013.

The following table shows our average realized LPG sales prices, excluding trading activities. Prices 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:

	Three months ended 31 March:		Change
Russian roubles or US dollars per ton	**2014**	**2013**	**%**
LPG			
Net export price, RR per ton	21,074	16,990	24.0%
Net export price, USD per ton	602.8	558.7	7.9%
Domestic price, RR per ton	13,443	13,400	0.3%

Crude oil

Our average realized crude oil export contract price, including export duties, decreased by USD 25 per ton, or 3.2%, and was approximately USD 767 per ton compared to USD 792 per ton in the corresponding period in 2013. The decrease in our average crude oil contract price was a result of a decrease in Brent benchmark crude oil price on the international markets (see "Selected macro-economic data" above). Our average realized crude oil net export price, excluding export duties and translated to US dollars using the average exchange rate for the period, marginally increased by USD 2.3 per ton, or 0.6%, to USD 386.5 per ton from USD 384.2 per ton in the corresponding period in 2013 primarily due to a 3.9% decrease in average export duties per ton, as set by the Russian Federation government (see "Selected macro-economic data" above).

In the three months ended 31 March 2014, our crude oil export delivery terms were DAP (Budkovtse, Slovakia) compared to DAP (Feneshlitke, Hungary) in the corresponding period in 2013.

In the three months ended 31 March 2014, our average realized crude oil domestic price was RR 13,032 per ton (excluding VAT) representing an increase of RR 1,937 per ton, or 17.5%, from RR 11,095 per ton (excluding VAT) in the corresponding period in 2013 as a result of changes in customer mix and delivery of crude oil to the more remote regions.

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

	Three months ended 31 March:		Change
Russian roubles or US dollars per ton	**2014**	**2013**	**%**
Crude oil			
Net export price, RR per ton	13,511	11,684	15.6%
Net export price, USD per ton	386.5	384.2	0.6%
Domestic price, RR per ton	13,032	11,095	17.5%

Transportation tariffs

Natural gas

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

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

In the 2013, the transportation rate was set at RR 12.02 (excluding VAT) per mcm per 100 km and the rate for utilization of the trunk pipeline was set on an average between RR 50.78 to RR 1,995.44 (excluding VAT) per mcm. Effective 1 August 2013, the FTS approved a 6.4% average increase of the transportation tariff for natural gas. As a result, the transportation rate was increased to RR 12.79 (excluding VAT) per mcm per 100 km and the rate for utilization of the trunk pipeline was set on an average between RR 57.18 to RR 2,048.11 (excluding VAT) per mcm.

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

Stable gas condensate and LPG by rail

We transport our stable gas condensate from the Purovsky Plant to the Port of Ust-Luga on the Baltic Sea or to customers on the domestic markets (and to the Port of Vitino on the White Sea in 2013) and LPG from the Purovsky Plant to customers on the domestic market and to the border of the Russian Federation for export market sales by rail which is owned by Russia's state-owned monopoly railway operator – OAO Russian Railways ("RZD").

Our transportation tariffs for transport by rail are set by the FTS and vary depending on the type of a product and the length of the transport route. The launch of our Ust-Luga Complex resulted in a decrease in our average transport distance from Purovsky Plant to the Port of Ust-Luga that is almost 400 kilometers less than the route to the Port of Vitino.

In December 2012, the FTS made amendments to the regulations governing railroad transportation tariffs within the territory of the Russian Federation, and approved the terms and conditions of applying the railroad tariffs within the predetermined limits (the minimum and maximum range). According to the new amendments, the FTS sets the range of railroad tariffs for the transportation of all types of goods transported by the railroad system and for certain segments of railroad transportation services within which the monopoly railway operator RZD may vary railroad transportation tariffs based on the type of product, direction and length of the transportation route based on current railroad transportation and market conditions.

In January 2013, we applied a discount co-efficient of 0.71 to the railroad transportation tariffs related to export deliveries of LPG by rail from the Limbey rail station (located in close proximity to our Purovsky Plant). The discount co-efficient was set by FTS for companies with annual transportation volumes of more than or equal to 445 thousand tons. During the 2014 reporting period, we did not apply any discount co-efficients to our deliveries of LPG by rail.

Effective 18 April 2013, we started applying the discount co-efficient of 0.917 to the existing railroad transportation tariffs related to stable gas condensate deliveries from the Limbey rail station set by the Management Board of RZD in March 2013. Starting from January 2014 the discount co-efficient was set at 0.94 to the existing railroad transportation tariffs and will be in effect until the end of 2014.

For our stable gas condensate and LPG transportation purposes we use our own rail cars and rail cars provided by independent Russian transportation companies.

Stable gas condensate and refined products by tankers

In 2013, we delivered our stable gas condensate to international markets via the Port of Vitino on the White Sea and the Port of Ust-Luga on the Baltic Sea using chartered tankers. After the launch of the Ust-Luga Complex in June 2013, we deliver stable gas condensate refined products (light and heavy naphtha, jet fuel, gasoil and fuel oil) to international markets via the loading terminal at the Port of Ust-Luga on the Baltic Sea. The tanker transportation cost is determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

Crude oil

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

In the 2013 and 2014 reporting periods, crude oil transportation tariffs within the Russian Federation territory did not change.

Our tax burden and obligatory payments

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

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

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

UPT

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

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

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

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

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

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

Export duties

According to the Law of the Russian Federation "Concerning the Customs Tariff" we are subject to export duties on our exports of liquid hydrocarbons (stable gas condensate and refined products, LPG and crude oil). Formulas for export duty rates calculation are set by the Russian Federation government. Based on the set formulas the Ministry of Economic Development calculates export duty rates on a monthly basis for exported liquid hydrocarbons (see "Selected macro-economic data" above).

The export duty rate for stable gas condensate and crude oil is calculated based on the average Urals crude oil price for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month and is set for the following month after the current calendar month. In 2013, calculation of the export duty rate when the average Urals crude oil price is more than USD 182.5 per ton was set as follows: USD 29.2 plus 60% of the difference between the average Urals crude oil price and USD 182.5 per ton. Changes in the regulations, which became effective 1 January 2014, decreased the set percentage of the difference used in the formula from 60% to 59%. In 2015 and 2016, set percentages will amount to 57% and 55%, respectively.

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

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

Social insurance tax

In 2013 and 2014, 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 did not change and were set at 22.0%, 5.1% and 2.9%, respectively, for a cumulative social burden of 30.0%. The maximum taxable base for these rates per each employee was set at RR 568 thousand of annual income in 2013 and was increased to RR 624 thousand of annual income in 2014. For annual income above the maximum taxable base, the tax rate is set to 10.0% to the Pension Fund and nil for other funds.

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

Our natural gas sales volumes in the three months ended 31 March 2014 decreased by 967 mmcm, or 5.2%, mainly due to the decreased purchases that was partially offset by an increase in natural gas volumes withdrawals from the Underground Gas Storage Facilities ("UGSF") and the GTS compared to the corresponding period in 2013.

Our liquids sales volumes decreased marginally by 69 thousand tons, or 4.3%, due to a sale of significant liquids inventory balances during the first quarter of 2013 that was almost completely offset by an increase in unstable gas condensate production in our joint ventures and crude oil production in our subsidiaries. Our liquids inventory balances tend to fluctuate periodically due to loading schedules and final destinations of stable gas condensate and its refined products shipments.

Natural gas production volumes

In the three months ended 31 March 2014, our total natural gas production (including our proportionate share in the production of joint ventures) decreased by 444 mmcm, or 2.8%, to 15,423 mmcm from 15,867 mmcm in the corresponding period in 2013 mainly due to the disposal of our joint venture OAO Sibneftegas. Excluding the share of natural gas production in Sibneftegas and the acquired additional 19.6% effective share in SeverEnergia (as a result of the asset swap transaction) our total natural gas production increased by 5.2%.

	Three months ended 31 March:		**Change**
millions of cubic meters	**2014**	**2013**	**%**
Production by subsidiaries from:			
Yurkharovskoye field	9,609	9,604	0.1%
East-Tarkosalinskoye field	2,766	3,171	(12.8%)
Khancheyskoye field	778	876	(11.2%)
Other fields	245	14	n/m
Total natural gas production by subsidiaries	**13,398**	**13,665**	**(2.0%)**
Group's proportionate share in the production of joint ventures:			
Nortgas	1,300	517	151.5%
SeverEnergia	725	260	178.8%
Sibneftegas	-	1,425	(100.0%)
Total Group's proportionate share in the natural gas production of joint ventures	**2,025**	**2,202**	**(8.0%)**
Total natural gas production including proportionate share in the production of joint ventures	**15,423**	**15,867**	**(2.8%)**

In the three months ended 31 March 2014, our volumes of natural gas produced by our subsidiaries marginally decreased by 267 mmcm, or 2.0%, to 13,398 mmcm from 13,665 mmcm in the corresponding period in 2013 due to the natural declines in the reservoir pressure at the current gas producing horizons at our East-Tarkosalinskoye and Khancheyskoye fields. A decrease in production was mostly offset by an increase in natural gas production at our Urengoyskoye and Dobrovolskoye fields, located within the Olimpiyskiy license area, which were launched at the end of 2013 (disclosed as "Other fields" in the table above).

In the three months ended 31 March 2014, our proportionate share in the production of our joint ventures decreased by 177 mmcm, or 8.0%, to 2,025 mmcm from 2,202 mmcm in the corresponding period in 2013. Excluding the share of Sibneftegas' production and an additional participation interest in SeverEnergia (see the description above) our proportionate share in the production of joint ventures increased by 130.1% due to the launch of the Eastern dome of the North-Urengoyskoye field at our joint venture Nortgas in October 2013.

Natural gas sales volumes

In the three months ended 31 March 2014, our total natural gas sales volumes decreased by 967 mmcm, or 5.2%, to 17,772 mmcm from 18,739 mmcm in the corresponding period in 2013.

millions of cubic meters	**Three months ended 31 March: 2014**	**2013**	**Change %**
Natural gas production by subsidiaries	13,398	13,665	(2.0%)
Purchases from the Group's joint ventures	284	1,953	(85.5%)
Other purchases	1,677	2,114	(20.7%)
Total production and purchases	**15,359**	**17,732**	**(13.4%)**
Purovsky Plant, own usage and methanol production	(46)	(38)	21.1%
Decrease (increase) in GTS, UGSS and own pipeline infrastructure	2,459	1,045	135.3%
Total natural gas sales volumes	**17,772**	**18,739**	**(5.2%)**
Sold to end-customers	*16,677*	*16,632*	*0.3%*
Sold ex-field	*1,095*	*2,107*	*(48.0%)*

In the three months ended 31 March 2014, natural gas purchases from our joint ventures significantly decreased to 284 mmcm from 1,953 mmcm in the corresponding period in 2013 due to the disposal of our equity interest in Sibneftegas in December 2013.

In addition, in the three months ended 31 March 2014 we decreased other natural gas purchases by 437 mmcm, or 20.7%, due to sufficient volumes of our own natural gas produced in the current reporting period and held in both the GTS and UGSS to cover our contractual obligations.

In the three months ended 31 March 2014, we used 20 mmcm of natural gas as feedstock for the production of methanol compared to 21 mmcm in the corresponding period in 2013. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation during the production, preparation and transportation of hydrocarbons.

As of 31 December 2014, our natural gas inventory balance in the GTS, the UGSS and our own pipeline infrastructure comprised 837 mmcm and decreased by 2,459 mmcm during the quarter as compared to a decrease by 1,045 mmcm in the corresponding period in 2013. We withdrew a significant quantity of natural gas from our inventory balance during the first quarter 2014 to fulfill our contractual obligations (see "Change in natural gas, liquid hydrocarbons and work-in-progress" below).

Liquids production volumes

In the three months ended 31 March 2014, our total liquids production (including our proportionate share in the production of joint ventures) increased by 181 thousand tons, or 15.3%, to 1,362 thousand tons from 1,181 thousand tons in the corresponding period in 2013.

thousands of tons	**Three months ended 31 March: 2014**	**2013**	**Change %**
Production by subsidiaries from:			
Yurkharovskoye field	652	703	(7.3%)
East-Tarkosalinskoye field	308	265	16.2%
Khancheyskoye field	107	124	(13.7%)
Other fields	27	4	n/m
Total liquids production by subsidiaries	**1,094**	**1,096**	**(0.2%)**
including gas condensate	*859*	*931*	*(7.7%)*
including crude oil	*235*	*165*	*42.4%*
Group's proportionate share in the production of joint ventures:			
Nortgas	155	50	210.0%
SeverEnergia	113	35	222.9%
Total Group's proportionate share in the liquids production of joint ventures	**268**	**85**	**215.3%**
Total liquids production including proportionate share in the production of joint ventures	**1,362**	**1,181**	**15.3%**

In the three months ended 31 March 2014, the volumes of liquids produced by our subsidiaries changed insignificantly. In the 2014 reporting period, we ramped up liquids production at the East-Tarkosalinskoye field due to the intensification of crude oil production including new wells drilled and technological works performed to increase crude oil production flow rate. In addition, at the end of 2013, we launched the Dobrovolskoye field, located within the Olimpiyskiy license area that allowed us to increase gas condensate production (the production at this field is disclosed as "Other fields" in the table above). In the three months ended 31 March 2014, gas condensate production at our mature fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) decreased due to the natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons.

In the three months ended 31 March 2014, our proportionate share in liquids production of joint ventures increased by 183 thousand tons to 268 thousand tons from 85 thousand tons in the corresponding period in 2013 due to the launch of the Eastern dome of the North-Urengoyskoye field in our joint venture Nortgas in October 2013, as well as an increase in the effective share in SeverEnergia from 25.5% to 59.8% (decreased to 54.9% effective 31 March 2014).

Liquids sales volumes

In the three months ended 31 March 2014, our total liquids sales volumes decreased by 69 thousand tons, or 4.3%, to 1,545 thousand tons from 1,614 thousand tons in the corresponding period in 2013 due to sales of significant liquids inventory balances during the first quarter of 2013.

thousands of tons	Three months ended 31 March: 2014	2013	Change %
Liquids production by subsidiaries	1,094	1,096	(0.2%)
Purchases from the Group's joint ventures	496	239	107.5%
Other purchases	7	2	250.0%
Total production and purchases	**1,597**	**1,337**	**19.4%**
Losses and own usage [(1)]	(32)	(18)	77.8%
Decreases (increases) in liquids inventory balances	(20)	295	n/a
Total liquids sales volumes	**1,545**	**1,614**	**(4.3%)**
Naphtha export	*775*	*-*	*n/a*
Other gas condensate refined products export	*190*	*-*	*n/a*
Subtotal gas condensate refined products	***965***	***-***	***n/a***
LPG export	*152*	*128*	*18.8%*
LPG domestic	*199*	*137*	*45.3%*
Subtotal LPG	***351***	***265***	***32.5%***
Crude oil export	*67*	*56*	*19.6%*
Crude oil domestic	*128*	*81*	*58.0%*
Subtotal crude oil	***195***	***137***	***42.3%***
Stable gas condensate export	*-*	*1,167*	*(100.0%)*
Stable gas condensate domestic	*32*	*43*	*(25.6%)*
Subtotal stable gas condensate	***32***	***1,210***	***(97.4%)***
Other oil products domestic	*2*	*2*	*0.0%*
Subtotal other oil products	***2***	***2***	***0.0%***

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

In the three months ended 31 March 2014, our purchases of liquid hydrocarbons from joint ventures increased by 257 thousand tons, or 107.5%, and were primarily related to a significant increase in our purchases of unstable gas condensate from Nortgas resulting from the launch of the Eastern dome of the North-Urengoyskoye field in October 2013.

From July 2013, most of our stable gas condensate produced at the Purovsky Plant was sent as raw material to the Ust-Luga Complex for further processing. As a result, there were no stable gas condensate sales to export markets in the 2014 reporting period (see the table above). Naphtha, jet fuel, gasoil and fuel oil sales volumes received from the processing of stable gas condensate are disclosed as "Subtotal gas condensate refined products".

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2014 COMPARED TO THE CORRESPONDING PERIOD IN 2013

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2014 and 2013. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March:			
millions of Russian roubles	**2014**	**% of total revenues**	**2013**	**% of total revenues**
Total revenues [(1)]	**88,676**	***100.0%***	**80,565**	***100.0%***
including:				
natural gas sales	58,714	*66.2%*	55,483	*68.9%*
liquids' sales	29,819	*33.6%*	24,965	*31.0%*
Operating expenses	(53,875)	*(60.8%)*	(51,056)	*(63.4%)*
Net gain (loss) on disposal of interests in joint ventures	2,623	*3.0%*	-	*n/a*
Other operating income (loss)	(41)	*(0.0%)*	691	*0.9%*
Profit from operations	**37,383**	***42.2%***	**30,200**	***37.5%***
Finance income (expense)	(4,320)	*(4.9%)*	(1,924)	*(2.4%)*
Share of profit (loss) of joint ventures, net of income tax	(1,762)	*(2.0%)*	163	*0.2%*
Profit before income tax	**31,301**	***35.3%***	**28,439**	***35.3%***
Total income tax expense	(6,192)	*(7.0%)*	(5,626)	*(7.0%)*
Profit (loss)	**25,109**	***28.3%***	**22,813**	***28.3%***
Minus: profit (loss) attributable to non-controlling interest	6	*0.0%*	13	*0.0%*
Profit attributable to shareholders of OAO NOVATEK	**25,115**	***28.3%***	**22,826**	***28.3%***

[(1)] Net of VAT, export and import duties, excise and fuel taxes expense, where applicable.

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 2014 and 2013:

millions of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Natural gas sales	**58,714**	**55,483**	**5.8%**
End-customers	*56,705*	*51,884*	*9.3%*
Ex-field sales	*2,009*	*3,599*	*(44.2%)*
Gas condensate refined products sales	**20,818**	**-**	**n/a**
Export (naphtha)	*16,474*	*-*	*n/a*
Export (other refined products)	*4,344*	*-*	*n/a*
Liquefied petroleum gas sales	**5,907**	**4,014**	**47.2%**
Export	*3,217*	*2,179*	*47.6%*
Domestic	*2,690*	*1,835*	*46.6%*
Crude oil sales	**2,575**	**1,547**	**66.5%**
Export	*900*	*653*	*37.8%*
Domestic	*1,675*	*894*	*87.4%*
Stable gas condensate sales	**444**	**19,331**	**(97.7%)**
Export	*-*	*18,762*	*n/a*
Domestic	*444*	*569*	*(22.0%)*
Other refined products sales	**75**	**73**	**2.7%**
Domestic	*75*	*73*	*2.7%*
Total oil and gas sales	**88,533**	**80,448**	**10.0%**
Other revenues	143	117	22.2%
Total revenues	**88,676**	**80,565**	**10.1%**

Natural gas sales

In the three months ended 31 March 2014, our revenues from sales of natural gas increased by RR 3,231 million, or 5.8%, compared to the corresponding period in 2013 due to an increase in our average realized natural gas prices which was partially offset by a decrease in total natural gas sales volumes by 5.2% mainly due to the divestiture of our equity stake in Sibneftegas in December 2013. The increase in our average realized natural gas prices was due to an increase in the regulated FTS prices for natural gas by 15.0% as compared to the corresponding period in 2013 (see “Natural gas prices” above), as well as an increase in the 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 93.8% in the three months ended 31 March 2014 as compared to 88.8% in the corresponding period in 2013 due to the cessation of natural gas deliveries to a major trader in December 2013. In addition, we significantly increased natural gas deliveries to our end-customers located at the Khanti-Mansiiskiy Autonomous Region under long-term natural gas sales contracts.

Gas condensate refined products sales

Gas condensate refined products sales represent our revenues from sales of naphtha, jet fuel, gasoil and fuel oil produced at the Ust-Luga Complex to export markets. In the three months ended 31 March 2014, our revenues from sales of gas condensate refined products amounted to RR 20,818 million. There were no sales of gas condensate refined products in the corresponding period in 2013 as the Ust-Luga Complex was formally commissioned in June 2013.

In the three months ended 31 March 2014, our revenues from sales of naphtha amounted to RR 16,474 million. In the reporting period we exported 775 thousand tons of naphtha, or 100% of our total sales volumes, to the APR, Europe and the United States. Our average realized naphtha net export price, excluding export duties, amounted to RR 21,263 per ton (CFR, DES, DAP and CIF).

In the three months ended 31 March 2014, our revenues from sales of jet fuel, gasoil and fuel oil amounted to RR 4,344 million. In the reporting period we exported in aggregate 190 thousand tons of jet fuel, gasoil and fuel oil, or 100% of our total sales volumes, to the European markets at an average price of RR 22,876 per ton (CIF, excluding export duties).

Liquefied petroleum gas sales

In the three months ended 31 March 2014, our revenues from sales of LPG increased by RR 1,893 million, or 47.2%, compared to the corresponding period in 2013 due to an increase in our sales volumes and realized prices.

In the three months ended 31 March 2014, we sold 152 thousand tons of LPG, or 43.3% of our total LPG sales volumes, to export markets as compared to sales of 128 thousand tons, or 48.3%, in the corresponding period in 2013. In the 2014 reporting period, as well as in the corresponding period in 2013, our main export LPG markets were Poland and Finland and our cumulative LPG export volumes to these markets exceeded 80% of total LPG export volumes.

Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense and including trading activities, increased by RR 4,198 per ton, or 24.7%, to RR 21,188 per ton in the three months ended 31 March 2014 (DAP and FCA) compared to RR 16,990 per ton in the corresponding period in 2013 (DAP and FCA, see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

In the three months ended 31 March 2014, we sold 199 thousand tons of LPG on the domestic market compared to sales of 137 thousand tons in the corresponding period in 2013. Our average realized LPG domestic price, including trading activities, in the three months ended 31 March 2014, was RR 13,480 per ton representing an increase of RR 80 per ton, or 0.6%, compared to the corresponding period in 2013.

Crude oil sales

In the three months ended 31 March 2014, revenues from sales of crude oil increased by RR 1,028 million, or 66.5%, compared to the corresponding period in 2013 primarily due to an increase in sales volumes and, to a lesser extent, an increase in average realized crude oil prices. Our crude oil sales volumes increased by 58 thousand tons, or 42.3%, to 195 thousand tons from 137 thousand tons in the corresponding period in 2013 mainly due to an increase in crude oil production at our East-Tarkosalinskoye field.

In the three months ended 31 March 2014, we sold 65.6% of total crude oil volumes domestically at an average price of RR 13,032 per ton (excluding VAT) representing an increase of RR 1,937 per ton, or 17.5%, as compared to the corresponding period in 2013.

The remaining 34.4% of our crude oil volumes were sold to export markets at an average price of RR 13,511 per ton (DAP, excluding export duties) representing an increase of RR 1,827 per ton, or 15.6%, as compared to the corresponding period in 2013 (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

Stable gas condensate sales

In the three months ended 31 March 2014, our revenues from sales of stable gas condensate decreased by RR 18,887 million, or 97.7%, compared to the corresponding period in 2013 due to a decrease in volumes sold resulting from the start of further processing of stable gas condensate at the Ust-Luga Complex into naphtha and other gas condensate refined products effective June 2013.

Our total stable gas condensate sales volumes decreased by 1,178 thousand tons, or 97.4%, due to the transfer of substantially all stable gas condensate produced at the Purovsky Plant as raw material feedstock to be subsequently processed at the Ust-Luga Complex in the 2014 reporting period. As a result, in the three months ended 31 March 2014, we did not sell stable gas condensate to the export markets. In the corresponding period in 2013, we sold 1,167 thousand tons of stable gas condensate, or 96.4% of our total sales volumes, to Europe, the APR and the United States at an average realized net export price, excluding export duties, of RR 16,079 per ton (CFR, DES, CIF and DAP).

In the three months ended 31 March 2014, we sold 32 thousand tons of stable gas condensate on the domestic market compared to 43 thousand tons in the corresponding period in 2013. Our average realized price for stable gas condensate sales on the domestic market in the three months ended 31 March 2014 amounted to RR 13,724 per ton (net of VAT), representing an increase of RR 468 per ton, or 3.5%, as compared to the corresponding period in 2013 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

We expect that our aggregate stable gas condensate sales volumes will be insignificant in 2014 compared to 2013.

Other refined products sales

Other refined products sales represent our revenues from methanol sales on the domestic market, as well as revenues from trading operations with oil products (diesel fuel and petrol) through our retail stations. In the three months ended 31 March 2014, our revenues from other refined products sales marginally increased by RR two million, or 2.7%, to RR 75 million as compared to RR 73 million in the corresponding period in 2013.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation and other services. In the three months ended 31 March 2014, other revenues increased by RR 26 million, or 22.2%, to RR 143 million from RR 117 million in the corresponding period in 2013 primarily due to pipeline maintenance services provided to our joint venture in the amount of RR 12 million, as well as a RR seven million increase in revenues from geological and geophysical research services to our joint ventures. The remaining change in other revenues related to various immaterial items.

Operating expenses

In the three months ended 31 March 2014, our total operating expenses increased by RR 2,819 million, or 5.5%, to RR 53,875 million compared to RR 51,056 million in the corresponding period in 2013 primarily due to an increase in taxes other than income tax. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased to 65.3% in the three months ended 31 March 2014 compared to 66.5% in the corresponding period in 2013 primarily due to a significant decrease in hydrocarbon transportation expenses (see “Transportation expenses” below).

In the three months ended 31 March 2014, our total operating expenses as a percentage of total revenues decreased to 60.8% compared to 63.4% in the corresponding period in 2013, as shown in the table below. The decrease in our total operating expenses as a percentage of total revenues was mainly due to an increase in the average natural gas prices and the commencement of higher value added products sales from the Ust-Luga Complex combined with a decrease in transportation expenses. Our transportation expenses decreased as a result of a reduction in our average transport distance for natural gas, as well as a decrease in liquids transportation volumes due to the sales of significant inventory balances in the first quarter of 2013 compared to the 2014 reporting period, as well as savings on liquids railroad transportation expenses related to the launch of our Ust-Luga Complex as the distance from Purovsky Plant to the Port of Ust-Luga is almost 400 kilometers less than the route to the Port of Vitino.

	Three months ended 31 March:			
millions of Russian roubles	**2014**	**% of total revenues**	**2013**	**% of total revenues**
Transportation expenses	27,657	*31.2%*	29,230	*36.3%*
Taxes other than income tax	7,508	*8.5%*	4,717	*5.9%*
Subtotal non-controllable expenses	**35,165**	***39.7%***	**33,947**	***42.2%***
Purchases of natural gas and liquid hydrocarbons	9,052	*10.2%*	8,432	*10.5%*
Depreciation, depletion and amortization	4,056	*4.6%*	3,157	*3.9%*
General and administrative expenses	2,612	*2.9%*	2,419	*3.0%*
Materials, services and other	2,340	*2.6%*	1,677	*2.1%*
Change in natural gas, liquid hydrocarbons and work-in-progress	1,228	*1.4%*	1,293	*1.6%*
Exploration expenses	8	*n/m*	135	*n/m*
Net impairment reversals	(586)	*n/m*	(4)	*n/m*
Total operating expenses	**53,875**	***60.8%***	**51,056**	***63.4%***

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 2014, our non-controllable expenses increased by RR 1,218 million, or 3.6%, to RR 35,165 million from RR 33,947 million in the corresponding period in 2013 due to a significant increase in taxes other than income tax that was partially offset by a decrease in transportation expenses. Taxes other than income tax increased due to a significant increase in the natural gas production tax rate by 51.7% from 1 July 2013 and subsequently by 17.2% from 1 January 2014 (see “Our tax burden and obligatory payments” above). Transportation expenses decreased due to a decrease in the natural gas average transportation distance and a decrease in our liquid hydrocarbons volumes transported (see “Transportation expenses” below). As a result, our non-controllable expenses, as a percentage of total revenues, decreased to 39.7% in the three months ended 31 March 2014 compared to 42.1% in the corresponding period in 2013.

Transportation expenses

In the three months ended 31 March 2014, our total transportation expenses decreased by RR 1,573 million, or 5.4%, to RR 27,657 million as compared to RR 29,230 million in the corresponding period in 2013.

million of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Natural gas transportation to customers	22,403	23,402	(4.3%)
Liquid hydrocarbons transportation by rail	3,741	3,995	(6.4%)
Liquid hydrocarbons transportation by tankers	1,139	1,600	(28.8%)
Crude oil transportation by pipeline	284	179	58.7%
Other	90	54	66.7%
Total transportation expenses	**27,657**	**29,230**	**(5.4%)**

In the three months ended 31 March 2014, our transportation expenses for natural gas decreased by RR 999 million, or 4.3%, to RR 22,403 million from RR 23,402 million in the corresponding period in 2013. The decrease was mainly due to a decrease in our average transport distance related to lower natural gas deliveries to Moscow and higher natural gas deliveries to the Khanti-Mansiiskiy Autonomous Region. The decrease in our natural gas transportation expenses was offset by an increase in natural gas transportation tariff set by the FTS by an average of 6.4% effective from 1 August 2013 (see “Transportation tariffs” above) and a marginal increase in volumes transported. 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 2014, our total expenses for liquids transportation by rail decreased by RR 254 million, or 6.4%, to RR 3,741 million from RR 3,995 million in the corresponding period in 2013 due to a decrease in volumes of liquids sold and transported via rail by 208 thousand tons, or 14.1%, to 1,267 thousand tons from 1,475 thousand tons (see “Liquids sales volumes” above). In addition, savings on transportation expenses were related to the launch of our Ust-Luga Complex as the distance from Purovsky Plant to the Port of Ust-Luga is almost 400 kilometers less than the route to the Port of Vitino. In the three months ended 31 March 2014, our weighted average transportation tariff for liquids delivered by rail increased by 9.0% to RR 2,953 per ton from RR 2,709 per ton in the corresponding period in 2013 primarily due to a change in the route and the geography of our LPG deliveries and an increase in the share of LPG volumes as part of the total liquids volumes sold and transported via rail. The change in the share of LPG volumes in our total liquids volumes delivered by rail affects the weighted average railroad tariff due to the relatively high transportation expense for LPG compared to other liquid hydrocarbons. 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 expenses for liquids delivered by tankers to international markets decreased by RR 461 million, or 28.8%, to RR 1,139 million in the three months ended 31 March 2014 from RR 1,600 million in the corresponding period in 2013 due to a decrease in stable gas condensate and refined products sales volumes of 17.3%, as well as costs savings for hydrocarbons transshipped into tankers since such services are performed internally at the Ust-Luga Complex unlike those external services performed at the Port of Vitino. The decrease in transportation volumes was due to a decrease in sales volumes as a result of the realization of significant liquid hydrocarbons inventory balances in the first quarter of 2013.

The change in the geography of stable gas condensate and refined products shipments affects our tanker transportation expenses per ton since expenses incurred for transportation to the APR and the United States are higher compared to the European sales markets. In the three months ended 31 March 2014, we sold to the APR, Europe and the United States 61.2%, 32.9% and 5.9% of our total gas condensate refined products export volumes whereas in the corresponding period in 2013, we sold to these markets 41.4%, 48.2% and 10.4% of our stable gas condensate volumes.

In the three months ended 31 March 2014, our expenses for crude oil transportation to customers through the pipeline network increased by RR 105 million, or 58.7%, to RR 284 million from RR 179 million in the corresponding period in 2013. The change was primarily due to a 43.3% increase in volumes transported and, to a lesser extent, due to an increase in our sales to more distant regions on the domestic market.

Other transportation expenses include motor transportation expenses, insurance expenses related to our liquid hydrocarbons transportation and other expenses. In the three months ended 31 March 2014, other transportation expenses increased by RR 36 million, or 66.7%, to RR 90 million from RR 54 million in the corresponding period in 2013.

Taxes other than income tax

In the three months ended 31 March 2014, taxes other than income tax increased by RR 2,791 million, or 59.2%, to RR 7,508 million from RR 4,717 million in the corresponding period in 2013 primarily due to an increase in the unified natural resources production tax expense.

millions of Russian roubles	**Three months ended 31 March:** 2014	2013	**Change** %
Unified natural resources production tax (UPT)	6,933	4,199	65.1%
Property tax	525	458	14.6%
Other taxes	50	60	(16.7%)
Total taxes other than income tax	**7,508**	**4,717**	**59.2%**

In the three months ended 31 March 2014, our unified natural resources production tax expense increased by RR 2,734 million, or 65.1%, to RR 6,933 million from RR 4,199 million in the corresponding period in 2013 due to a significant increase in natural gas production tax rate. The tax rate was increased from RR 265 to RR 402 per mcm, or 51.7%, from 1 July 2013 and from RR 402 to RR 471 per mcm, or 17.2%, from 1 January 2014, respectively.

In the three months ended 31 March 2014, as well as in the corresponding period in 2013, we applied a zero UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye fields (see “Our tax burden and obligatory payments” above).

In the three months ended 31 March 2014, our property tax expense increased by RR 67 million, or 14.6%, to RR 525 million from RR 458 million in the corresponding period in 2013 primarily due to additions to property, plant and equipment at our production subsidiaries.

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2014, our purchases of natural gas and liquid hydrocarbons increased by RR 620 million, or 7.4%, to RR 9,052 million from RR 8,432 million in the corresponding period in 2013.

millions of Russian roubles	**Three months ended 31 March:** 2014	2013	**Change** %
Natural gas	4,249	6,476	(34.4%)
Unstable gas condensate	4,653	1,895	145.5%
Other liquid hydrocarbons	150	61	145.9%
Total purchases of natural gas and liquid hydrocarbons	**9,052**	**8,432**	**7.4%**

In the three months ended 31 March 2014, our purchases of natural gas decreased by RR 2,227 million, or 34.4%, to RR 4,249 million from RR 6,476 million in the corresponding period in 2013 primarily due to the cessation of natural gas purchases from Sibneftegas as a result of its disposal in December 2013. In addition, we decreased natural gas purchases due to sufficient quantities of our own natural gas produced in the current reporting period and held in GTS and UGSS to fulfill our contractual obligations.

In the three months ended 31 March 2014, our purchases of unstable gas condensate from our joint ventures significantly increased by RR 2,758 million, or 145.5%, to RR 4,653 million from RR 1,895 million in the corresponding period in 2013 due to increases in purchase volumes and, to a lesser extent, purchase prices. We increased our purchases of unstable gas condensate primarily from Nortgas as a result of the launch of the Eastern dome of the North-Urengoyskoye field in October 2013 which significantly increased the production capacity of Nortgas.

In the three months ended 31 March 2014, our purchases of other liquid hydrocarbons increased by RR 89 million, or 145.9%, to RR 150 million from RR 61 million in the corresponding period in 2013. Other liquid hydrocarbons purchases represent our purchases of oil products and LPG for resale.

Depreciation, depletion and amortization

In the three months ended 31 March 2014, our depreciation, depletion and amortization ("DDA") expense increased by RR 899 million, or 28.5%, to RR 4,056 million from RR 3,157 million in the corresponding period in 2013 mainly due to the launch of the first and second stages of the Ust-Luga Complex in June and October 2013, respectively, as well as additions to property, plant and equipment at our production subsidiaries which was partially offset by a marginal 1.8% decrease 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.

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

General and administrative expenses

In the three months ended 31 March 2014, our general and administrative expenses increased by RR 193 million, or 8.0%, to RR 2,612 million compared to RR 2,419 million in the corresponding period in 2013. The main components of these expenses were employee compensation, legal, audit and consulting services, as well as social expenses and compensatory payments, which, on aggregate, comprised 77.5% and 85.7% of total general and administrative expenses in the three months ended 31 March 2014 and 2013, respectively.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2014**	**2013**	**%**
Employee compensation	1,645	1,476	11.4%
Legal, audit and consulting services	204	164	24.4%
Social expenses and compensatory payments	176	433	(59.4%)
Advertising expenses	150	5	n/a
Fire safety and security expenses	68	56	21.4%
Business trips expense	67	78	(14.1%)
Insurance expense	65	22	195.5%
Repair and maintenance expenses	53	42	26.2%
Bank charges	38	32	18.8%
Other	146	111	31.5%
Total general and administrative expenses	**2,612**	**2,419**	**8.0%**

Employee compensation related to administrative personnel increased by RR 169 million, or 11.4%, to RR 1,645 million in the three months ended 31 March 2014 from RR 1,476 million in the corresponding period in 2013. The increase was mainly due to an indexation of base salaries effective 1 July 2013, as well as a slight increase in bonuses accrued to key management based on results achieved for the first quarter of 2014.

In the three months ended 31 March 2014, legal, audit, and consulting services expenses increased by RR 40 million, or 24.4%, to RR 204 million compared to RR 164 million in the corresponding period in 2013 primarily due to additional expenses related to software renewals by our key subsidiaries.

In the three months ended 31 March 2014, our social expenses and compensatory payments decreased by RR 257 million, or 59.4%, to RR 176 million compared to RR 433 million in the corresponding period in 2013. The decrease was primarily related to compensatory payments made in 2013 as a part of the development of Salmanovskoye and Geofizicheskoye fields (no such payments were made in the first quarter of 2014). Social expenses changed marginally and were mainly related to our donations to sport clubs and sports activities, educational schools, as well as continued support of charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support.

Advertising expenses increased to RR 150 million in the three months ended 31 March 2014 from RR five million in the corresponding period in 2013 primarily due to the commencement of a corporate sponsorship contract for advertising during sporting events.

Fire safety and security expenses increased by RR 12 million, or 21.4%, to RR 68 million in the three months ended 31 March 2014 from RR 56 million in the corresponding period in 2013 primarily due to an increase in rates charged for security services in January 2014.

Insurance expenses increased by RR 43 million, or 195.5%, to RR 65 million in the three months ended 31 March 2014 from RR 22 million in the corresponding period in 2013 due to the expansion of the Group's activities.

Repair and maintenance expenses increased by RR 11 million, or 26.2% , to RR 53 million in the three months ended 31 March 2014 from RR 42 million and mainly related to one of our foreign subsidiaries moving to a new office.

Bank charges marginally increased to RR 38 million in the three months ended 31 March 2014 from RR 32 million as a result of an increase in service fees charged by banks for the acceptance of payments for natural gas supplied by our regional natural gas traders to residential and small-scale customers.

In the three months ended 31 March 2014, other general and administrative expenses increased by RR 35 million, or 31.5%, to RR 146 million from RR 111 million in the corresponding period in 2013. The increase was related to immaterial expense items of an administrative nature.

Materials, services and other

In the three months ended 31 March 2014, our materials, services and other expenses increased by RR 663 million, or 39.5%, to RR 2,340 million compared to RR 1,677 million in the corresponding period in 2013. The main components of this expense category were employee compensation and repair and maintenance services, which on aggregate comprised 69.6% and 74.4% of total materials, services and other expenses in the three months ended 31 March 2014 and 2013, respectively.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2014**	**2013**	**%**
Employee compensation	1,223	904	35.3%
Repair and maintenance	405	344	17.7%
Electricity and fuel	209	130	60.8%
Materials and supplies	146	64	128.1%
Security services	96	78	23.1%
Transportation services	92	51	80.4%
Processing fees	48	25	92.0%
Other	121	81	49.4%
Total materials, services and other	**2,340**	**1,677**	**39.5%**

Operating employee compensation increased by RR 319 million, or 35.3%, to RR 1,223 million compared to RR 904 million in the corresponding period in 2013. The increase was due to an indexation of base salaries effective from 1 July 2013, as well as an increase in the average number of employees as a result of the launch of the Ust-Luga Complex and an expansion of our activities at the Purovsky Plant due to the launch of the third stage development.

Repair and maintenance services increased by RR 61 million, or 17.7%, to RR 405 million in the three months ended 31 March 2014 compared to RR 344 million in the corresponding period in 2013 due to repair works at our production subsidiary NOVATEK-Yurkharovneftegas, as well as maintenance expenses related to the launch of the Ust-Luga Complex.

In the three months ended 31 March 2014, electricity and fuel expenses increased by RR 79 million, or 60.8%, to RR 209 million from RR 130 million in the corresponding period in 2013. The increase was due to higher electricity rates, as well as an increase in electricity consumption at our production and processing facilities related to new energy-consuming projects and an increase in volumes being processed at these facilities.

Materials and supplies expense increased by RR 82 million, or 128.1%, to RR 146 million in the three months ended 31 March 2014 compared to RR 64 million in the corresponding period in 2013 due to an increase in materials used for general maintenance at our East-Tarkosalinskoye field and the purchase of materials and supplies at the Ust-Luga Complex.

In the three months ended 31 March 2014, security expenses increased by RR 18 million, or 23.1%, to RR 96 million from RR 78 million in the corresponding period in 2013 due to additional security services related to recently completed capital construction projects in our production subsidiaries, as well as an increase in security services rates effective from January 2014.

In the three months ended 31 March 2014, transportation services expenses increased by RR 41 million, or 80.4%, to RR 92 million from RR 51 million in the corresponding period in 2013 due to an increase in expenses related to the delivery of materials and equipment to our main fields and processing facilities, as well as our operating personnel transportation.

In the three months ended 31 March 2014, other material, services and other expenses increased by RR 40 million, or 49.4%, to RR 121 million from RR 81 million in the corresponding period in 2013 primarily due to ensuring ecological safety at our Ust-Luga Complex.

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

In the three months ended 31 March 2014, we recorded a charge of RR 1,228 million to change in inventory expense as compared to a charge of RR 1,293 million in the corresponding period in 2013:

	Three months ended 31 March:	
millions of Russian roubles	**2014**	**2013**
Natural gas	1,969	536
Naphtha	(379)	-
Stable gas condensate	(243)	831
Other	(119)	(74)
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	**1,228**	**1,293**

In the three months ended 31 March 2014, we recorded a charge to our operating expenses of RR 1,969 million due to a 2,459 mmcm decrease in our natural gas inventory balance, as well as a slight increase in the cost of natural gas per mcm. The decrease in our inventory balance was mainly caused by the seasonal withdrawal of natural gas in the first quarter of 2014 due to contractual obligations. Our volumes of natural gas injected into Gazprom's underground gas storage facilities fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods.

In the three months ended 31 March 2014, we recorded reversals to our operating expenses of RR 379 million and RR 243 million due to an increase in our naphtha and stable gas condensate inventory balances by 28 thousand tons and four thousand tons, respectively, which were recognized as inventory in transit and storage, as well as an increase in the cost of stable gas condensate and refined products.

The following table highlights movements in our hydrocarbons inventory balances:

	2014			**2013**		
Inventory balances in transit or in storage	**At 31 March**	**At 1 January**	**Increase / (decrease)**	**At 31 March**	**At 1 January**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**837**	**3,296**	**(2,459)**	**84**	**1,129**	**(1,045)**
including Gazprom's UGSF	*806*	*2,334*	*(1,528)*	*33*	*1,096*	*(1,063)*
Liquid hydrocarbons (thousand tons)	**555**	**535**	**20**	**268**	**563**	**(295)**
including naphtha	*221*	*193*	*28*	-	-	-
stable gas condensate	*184*	*180*	*4*	*159*	*461*	*(302)*

Exploration expenses

In the three months ended 31 March 2014, our exploration expenses decreased by RR 127 million, or 94.1%, to RR eight million from RR 135 million in the corresponding period in 2013.

millions of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Cost of seismic surveys	199	824	(75.8%)
Less: capitalized 3-D seismic surveys	(191)	(689)	(72.3%)
Total exploration expenses per the Consolidated Statement of Income	**8**	**135**	**(94.1%)**

In the three months ended 31 March 2014, our costs of seismic surveys decreased by RR 625 million, or 75.8%, to RR 199 million from RR 824 million in the corresponding period in 2013. Our costs of seismic surveys fluctuate period-to-period depending on the season and the approved working schedule of seismic surveys at our production subsidiaries. The costs of 3-D seismic surveys to sustain production, increase reserves' recoverability and the efficiency of drilling additional development wells on our proved properties are capitalized to property, plant and equipment used in oil and gas exploration according to our accounting policy.

Net impairment reversals

In the three months ended 31 March 2014, we recorded a reversal to our net impairment expense of RR 586 million that was related to the management's revision of the probability of trade accounts receivable repayment by our customers. As a result, we recovered a portion of a provision for impairment of receivables established at the end of 2013.

Net gain (loss) on disposal of interests in joint ventures

In the three months ended 31 March 2014, the Group recorded a gain on the disposal of interest in joint ventures in the amount of RR 2,623 million.

In March 2014, the Group approved a series of transactions on restructuring procedures to achieve parity shareholdings in SeverEnergia (see "Recent Developments" above). As part of these transactions, the Group sold a 20% ownership interest in Artic Russia B.V. for RR 34,972 million (USD 980 million) to its joint venture OOO Yamal Development (both Artic Russia and Yamal Development hold participation interests in SeverEnergia) and realized a gain on disposal of RR 2,623 million.

Other operating income (loss)

In the three months ended 31 March 2014, we recognized other operating loss of RR 41 million compared to other operating income of RR 691 million in the corresponding period in 2013.

In the three months ended 31 March 2014, within our trading activities on the European market we purchased and sold approximately 5.3 terawatt-hours (or 505 mmcm) of natural gas and recognized RR 101 million of operating income as compared to RR 87 million in the corresponding period in 2013. At the same time, in the three months ended 31 March 2014, we recognized a non-cash loss of RR 731 million as a result of a decrease in the fair value of the purchase and sales contracts as compared to RR 509 million of non-cash income in the corresponding period in 2013 as a result of an increase in the fair value of contracts. These contracts are classified as derivative instruments in accordance with IAS 39 "*Financial instruments: recognition and measurement*".

In addition, in the three months ended 31 March 2014 we recorded other operating income of RR 589 million which related to the recognition of the one-off positive effect from the recalculation of the fair value of the loan provided to Yamal LNG due to its partial repayment after CNPC entered into the Yamal LNG project. In the corresponding period in 2013, we recognized RR 95 million as other operating income which was primarily related to penalties charges received from our suppliers due to non-compliance of their contractual obligations as well as other immaterial profit and loss items received from disposal of materials, fixed assets, equipment and other similar transactions.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 7,183 million, or 23.8%, to RR 37,383 million in the three months ended 31 March 2014, as compared to RR 30,200 million in the corresponding period in 2013. Our normalized profit from operations net of gain (loss) on the disposal of interests in joint ventures increased by RR 4,560 million, or 15.1%, to RR 34,760 million in the three months ended 31 March 2014 as compared to RR 30,200 million in the corresponding period in 2013 mainly due to an increase in average realized natural gas prices and the commencement of higher value added products sales from the Ust-Luga Complex. In the three months ended 31 March 2014, our profit from operations net of gain (loss) on the disposal of interests in joint ventures, as a percentage of total revenues, did not change significantly (39.2% as compared to 37.5% in the corresponding period in 2013).

Finance income (expense)

In the three months ended 31 March 2014, we recorded net finance expense of RR 4,320 million compared to a net finance expense of RR 1,924 million in the corresponding period in 2013 due to recognition of foreign exchange losses as a result of depreciation of the Russian rouble against the US dollar.

In the three months ended 31 March 2014, accrued interest expense on loans received increased by RR 135 million, or 6.3%, to RR 2,279 million from RR 2,144 million in the corresponding period in 2013 primarily due to an increase in the aggregate amount of loans received by the Group, as well as the depreciation of the Russian rouble against the US dollar (see “Selected macro-economic data” above).

millions of Russian roubles	**Three months ended 31 March: 2014**	**2013**	**Change %**
Accrued interest expense on loans received	2,279	2,144	6.3%
Less: capitalized interest	(915)	(839)	9.1%
Provisions for asset retirement obligations: effect of the present value discount unwinding	72	59	22.0%
Total interest expense per the Consolidated Statement of Income	**1,436**	**1,364**	**5.3%**

Interest income increased by RR 312 million, or 65.3%, to RR 790 million in the three months ended 31 March 2014 from RR 478 million in the corresponding period in 2013 primarily due to a significant increase in loans provided to our joint ventures related to the development and expansion of their activities compared to the first quarter of 2013.

In the three months ended 31 March 2014, we recorded a net foreign exchange loss of RR 3,674 million compared to a net foreign exchange loss of RR 1,038 million in the corresponding period in 2013 due primarily to the revaluation of our US dollar denominated borrowings and loans provided. The Russian rouble depreciated by 9.0% against the US dollar in the three months ended 31 March 2014 compared to the depreciation of the Russian rouble by 2.3% in the corresponding period in 2013. 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 2014, the Group's proportionate share in loss of joint ventures accounted for RR 1,762 million as compared to a gain of RR 163 million in the corresponding period in 2013.

The change in our proportionate share in profit (loss) of joint ventures was due to the recognition of significant net foreign exchange losses on US dollar denominated loans at our joint ventures Yamal LNG and Terneftegas in the 2014 reporting period which was partially offset by higher operating results (increased hydrocarbons production and sales prices) in Nortgas and SeverEnergia. In addition, our proportionate share in profit of SeverEnergia increased due to an increase in our effective participation interest in the joint venture in December 2013.

The Group's proportionate share in profit of joint ventures in the reporting period 2013 is different from the profit shown in the first quarter 2013 report (an increase by RR 115 million). This change was due to an adjustment made to the net income of Nortgas in the reporting period 2013 after the final fair value assessment of its' identifiable assets and liabilities independent appraisal completion in July 2013. They were initially recognized based on preliminary data.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 19.8% for the three months ended 31 March 2014 and 2013.

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

Profit attributable to shareholders and earnings per share

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

As a result of the factors discussed above, our profit for the period increased by RR 2,296 million, or 10.1%, to RR 25,109 million in the three months ended 31 March 2014 from RR 22,813 million in the corresponding period in 2013. The profit attributable to shareholders of OAO NOVATEK increased by RR 2,289 million, or 10.0%, to RR 25,115 million in the three months ended 31 March 2014 from RR 22,826 million in the corresponding period in 2013. The profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interests in joint ventures, increased by RR 190 million, or 0.8%, to RR 23,016 million in the three months ended 31 March 2014 as compared to RR 22,826 million in the corresponding period in 2013.

Our EBITDA, excluding the effect of the disposal of interests in joint ventures, increased by RR 8,119 million, or 23.3%, to RR 42,979 million in the three months ended 31 March 2014 from RR 34,860 million in the corresponding period in 2013 primarily due to an increase in natural gas sales prices and commencement of the Ust-Luga Complex higher value added products sales in the third quarter of 2013 that was partially offset by an increase in our taxes other than income tax expenses.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 0.77 per share, or 10.2%, to RR 8.30 per share in the three months ended 31 March 2014 from RR 7.53 per share in the corresponding period in 2013. Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interests in joint ventures, increased by RR 0.07 per share, or 1.0%, to RR 7.60 per share in the three months ended 31 March 2014 from RR 7.53 per share in the corresponding period in 2013.

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 2014 and 2013:

millions of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Net cash provided by **operating** activities	27,090	25,532	6.1%
Net cash provided by (used in) **investing** activities	14,977	(17,932)	n/a
Net cash provided by (used in) **financing** activities	(2,533)	(9,651)	(73.8%)

Liquidity and credit ratios	31 March 2014	31 December 2013	Change, %
Current ratio	3.99	1.38	189.1%
Total debt to total equity	0.42	0.44	(4.5%)
Long-term debt to long-term debt and total equity	0.30	0.28	7.1%
Net debt to total capitalization (1)	0.21	0.28	(25.0%)
Net debt to EBITDA (2)	0.91	1.30	(30.0%)

(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 (loss) on disposal of interests in joint ventures, if applicable

Net cash provided by operating activities

In the three months ended 31 March 2014, our net cash provided by operating activities increased by RR 1,558 million, or 6.1%, to RR 27,090 million compared to RR 25,532 million in the corresponding period in 2013 mainly due to higher operating results (higher natural gas sales prices, as well as higher liquid hydrocarbons sales prices as a result of the commencement of our Ust-Luga Complex products sale from the third quarter of 2013) which was partially offset by a significant increase in income tax paid.

millions of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Operating profit	38,367	32,720	17.3%
Working capital changes	1,796	(2,244)	n/a
Income taxes paid	(13,073)	(4,944)	164.4%
Total net cash provided by operating activities per the Consolidated Statement of Cash Flow	**27,090**	**25,532**	**6.1%**

Net cash provided by (used for) investing activities

In the three months ended 31 March 2014, our net cash provided by investing activities amounted to RR 14,977 million as compared to RR 17,932 million used for investing activities in the corresponding period in 2013.

millions of Russian roubles	Three months ended 31 March: 2014	2013	Change %
Purchases of property, plant and equipment (financing of capital expenditures)	(13,977)	(9,642)	45.0%
Loans provided to joint ventures	(765)	(5,472)	(86.0%)
Repayments of loans provided to joint ventures	11,735	847	n/m
Proceeds from disposal of participation interest in joint ventures	18,641	-	n/a
Additional capital contributions to joint ventures	-	(1,436)	n/a
Other	(657)	(2,229)	(70.5%)
Net cash provided by (used for) investing activities	**14,977**	**(17,932)**	**n/a**

Our cash used for purchases of property, plant and equipment increased by RR 4,335 million, or 45.0%, and mainly related to the development of crude oil deposits at the Yarudeyskiy license area, further development of crude oil deposits at the East-Tarkosalinskoye field as well as the ongoing development of the North-Khancheyskiy license area.

In the three months ended 31 March 2014, we provided loans to our joint venture Yamal Development in the aggregate amount of RR 765 million as compared RR 5,472 million provided to Yamal LNG and Terneftegas in the corresponding period in 2013. In addition, in the first quarter 2014 we received RR 11,735 million as a partial repayment of the loan provided to Yamal LNG as compared to RR 847 million as a partial repayment of the loan provided to Sibneftegas in the first quarter 2013 (see "Loans provided" below).

In the three months ended 31 March 2014, we received RR 18,641 million from the disposal of our 20% participation interest in Yamal LNG joint venture in December 2013.

During the reporting period 2013, we made an additional capital contribution to our joint venture Terneftegas in the amount of RR 1,436 million.

Net cash provided by (used for) financing activities

In the three months ended 31 March 2014, our net cash used for financing activities decreased by RR 7,118 million, or 73.8%, to RR 2,533 million from RR 9,651 million in the corresponding period in 2013.

millions of Russian roubles	**Three months ended 31 March: 2014**	**2013**	**Change %**
Proceeds from loans	17,170	13,860	23.9%
Repayments of loans	(16,656)	(22,028)	(24.4%)
Other	(3,047)	(1,483)	105.5%
Net cash provided by (used for) financing activities	**(2,533)**	**(9,651)**	**(73.8%)**

In the three months ended 31 March 2014, our cash proceeds from loans and borrowings increased by RR 3,310 million, or 23.9%, to RR 17,170 million from RR 13,860 million in the corresponding period in 2013 mainly due to the withdrawal of USD 430 million in the reporting period 2014 under our syndicated credit line facility as compared to the issuance of Russian rouble denominated Eurobonds in the amount of RR 14 billion in the corresponding period in 2013. In addition, in the three months ended 31 March 2014, we used RR 16,656 million for repayments of loans as compared to RR 22,028 million in the corresponding period in 2013 (see "Debt Obligations" below). The remaining change related to repayment of interest on debts, shares buy-back and other miscellaneous categories.

Working capital

Our net working capital position (current assets less current liabilities) as of 31 March 2014 was a positive RR 101,154 million compared to RR 22,553 million as of 31 December 2013. The change of our net working capital position was primarily due to an increase in our cash and cash equivalents by RR 35,455 million (or 449.4%), trade and other receivables by RR 15,252 million (or 30.8%) as well as a decrease in short-term debt and current portion of long-term debt (see "Debt obligations" below) by RR 22,407 million (or 93.3%). The significant increase in our cash and cash equivalents in the reporting period 2014 mainly related to cash proceeds from the disposal of our 20% participation interest in Yamal LNG in December 2013 as well as a partial repayment of the loan provided to Yamal LNG. The increase in trade and other receivables was mainly due to the inclusion of RR 34,972 million (USD 980 million) related to the disposal of a 20% participation interest in Artic Russia B.V. into other receivables which was partially offset by RR 18,420 million payment from CNPC related to the disposal of a 20% participation interest in Yamal LNG in January 2014 (recorded in other receivables as of 31 December 2013).

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 both reporting periods represent our investments in developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities:

	Three months ended 31 March:	
millions of Russian roubles	**2014**	**2013**
Yarudeyskiy license area	4,864	54
Yurkharovskoye field	3,406	3,476
East-Tarkosalinskoye field	2,084	1,599
North-Khancheyskiy license area	492	64
Olimpiyskiy license area	488	583
Khancheyskoye field	447	541
Salmanovskoye (Utrennee) field	246	520
North-Russkiy license area	171	103
Purovsky Plant	161	1,318
Ust-Luga Complex	83	1,898
Other	1,285	1,108
Capital expenditures	**13,727**	**11,264**

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2014 increased by RR 2,463 million, or 21.9%, to RR 13,727 million from RR 11,264 million in the corresponding period in 2013. The increase was primarily related to the development of the Yarudeyskiy license area's crude oil deposits, further development of the East-Tarkosalinskoye field's crude oil deposits, as well as an ongoing development of the North-Khancheyskiy license area.

Loans provided

Total loans provided by the Group decreased from RR 47,638 million at 31 December 2013 to RR 40,999 million at 31 March 2014, or by RR 6,639 million.

Our loans provided with a breakdown by borrowers (remeasured based on commercial market borrowing rates in accordance with IAS 39 "*Financial instruments: recognition and measurement*") at 31 March 2014 and 31 December 2013 were as follows:

Borrower	**Currency**	**Maturity**	**Interest rate**	**At 31 March 2014**	**At 31 December 2013**
Yamal LNG	USD	after the commencement of commercial production	5.09%-4.46%	35,129	42,804
Yamal Development	RR	December 2015	9.25%	2,965	2,200
Terneftegas	USD	after the commencement of commercial production	3.88%-4.52%	2,880	2,611
Other				25	23
Total loans provided				**40,999**	**47,638**

The decrease in loans provided was primarily due to RR 12,045 million (USD 364 million) partial repayment of the loan provided to our joint venture Yamal LNG as a result of the 20% equity stake sale in Yamal LNG to CNPC.

The decrease in loans provided in Russian roubles was mostly offset by the depreciation of a Russian rouble relative to the US dollar by 9.0% at 31 March 2014 compared to 31 December 2013. In addition, in March 2014, the Group issued RR 765 million to our joint venture Yamal Development under the credit line facility provided in December 2013 in the amount of up to RR 13 billion.

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 slightly increased from RR 165,621 million at 31 December 2013 to RR 168,431 million at 31 March 2014, or by RR 2,810 million, primarily due to the depreciation of the Russian rouble against the US dollar by 9.0% at 31 March 2014 compared to 31 March 2014. During the first quarter of 2014, the Group withdrew a final tranche in the amount of USD 430 million under our syndicated credit line facility obtained in June 2013 in the amount of USD 1.5 billion and obtained a short-term loan from a non-controlling shareholder in the amount of RR 1,619 million. In addition, we repaid short-term loans, including bank overdrafts in the amount of USD 431 million from BNP PARIBAS Bank and Credit Agricole Corporate and Investment Bank in January 2014 as well as repaid the Sberbank loan in the amount of RR 10 billion in March 2014 ahead of its maturity schedule. We utilize credit facilities to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields and to construct and/or expand processing assets such as the Purovsky Plant, as well as acquisitions of new oil and gas assets.

Our total debt position (net of unamortized transaction costs) at 31 March 2014 and 31 December 2013 was as follows:

Facility	Amount	Maturity	Interest rate	At 31 March 2014	At 31 December 2013
Syndicated term credit line facility	USD 1.5 billion	June 2018	LIBOR+1.75%	52,930	34,363
Eurobonds Ten-Year	USD 1 billion	December 2022	4.422%	35,546	32,595
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	23,081	21,163
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	21,360	19,583
Russian bonds	RR 20 billion	October 2015	8.35%	19,983	19,980
Eurobonds Four-Year	RR 14 billion	February 2017	7.75%	13,912	13,911
Sberbank	RR 10 billion	December 2014	7.9%-8.9%	-	9,911
Total				**166,812**	**151,506**
Short-term debt				1,619	14,115
Total debt				**168,431**	**165,621**

Maturities of long-term loans

Scheduled maturities of our long-term debt at 31 March 2014 were as follows:

Maturity schedule:	**RR million**
1 April 2015 to 31 March 2016	57,629
1 April 2016 to 31 March 2017	30,198
1 April 2017 to 31 March 2018	16,286
1 April 2018 to 31 March 2019	4,072
After 31 March 2019	58,627
Total long-term debt	**166,812**

Available credit facilities

At 31 March 2014, the Group also had funds available under credit facilities with interest rates predetermined or negotiated at time of each withdrawal:

		Expiring	
	Par value	**Within one year**	**Between 1 and 2 years**
Credit Agricole Corporate and Investment Bank	USD 100 million	3,569	-
BNP PARIBAS Bank	USD 100 million	3,569	-
UniCredit Bank	USD 48 million	-	1,706
Total available credit facilities		**7,138**	**1,706**

At 31 March 2014, the Group had available funds in the form of bank overdrafts with various international banks in the aggregate amount of RR 9.8 billion (USD 275 million) on variable interest rates subject to the specific type of credit facility.

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 March 2014, the total amount of our long-term debt denominated in US dollars was RR 132,917 million, or 78.9% 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 25.9% in the three months ended 31 March 2014, is denominated in US dollars. As of 31 March 2014, the Russian rouble depreciated by approximately 9.0% against the US dollar since 31 December 2013.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 31 March 2014 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 13,292 million on foreign currency denominated borrowings held at that date.

Commodity risk

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

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

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

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

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

As of 31 March 2014, 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.