



Company: OAO NOVATEK
Conference Title: 2010 Annual Results
Presenters: Mark Gyetvay, Leonid Mikhelson
Date: Monday 14th March 2011 – 14h00 GMT

Operator: Good day ladies and gentlemen and welcome to the NOVATEK 2010 Annual Results Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Oleg Maximov, Senior Analyst Troika Dialog. Please go ahead sir.

Oleg Maximov: Good afternoon and welcome. I am Oleg Maximov from Troika Dialog and this is NOVATEK's Fourth Quarter and Full Year 2010 IFRS Results Conference Call. With us today is Mark Gyetvay, Chief Financial Officer and Member of the Board of Directors of NOVATEK.

Mark, over to you. Please start your presentation. Thank you.

Mark Gyetvay: Thank you Oleg. Good evening and welcome to our Full Year and Fourth Quarter 2010 Earnings Conference Call. I would like to thank everyone for joining us this evening and again extend our sincere gratitude to Troika Dialog for organising and hosting this important conference call.

As customary before we begin with the specific conference call details I would like to refer you to our disclaimer statement. During this conference call we may make reference to forward-looking statements by using words such as 'plans', 'objectives', 'goals', 'strategies' and other similar words which are other than statements of historical facts. Actual results may differ materially from those implied by such forward-looking statements due to known and unknown risks and uncertainties and reflect our views at of the date of this presentation. We undertake no obligation to revise or publicly release the results and any revisions to these forward-looking statements in light of new information or future events. Please refer to our regulatory filings as well as any of our earnings press releases for more descriptions of the risks that may influence our results.



Joining me this evening is Mr. Leonid Mikhelson, Chief Executive Officer and Chairman of the Management Board who will be available to take questions during the Q&A session as well as provide some additional clarity on some recent events. By focusing our discussions on the key highlights tonight's conference call format will allow for more time for questions and answers and hopefully a more interactive dialogue with our investors.

2010 was another exceptional year for the company as we grew our core operations in terms of production and reserves as well as complemented our existing portfolio of assets with value accretive transactions. During the year we also addressed a series of key issues involving our LNG project which were critical in moving forward our discussion with potential strategic partners.

So to begin tonight's discussion I would like to talk about the recent announcements regarding the selection of a strategic partner of the Yamal LNG project and some brief comments on Total's equity stake in NOVATEK. The Yamal LNG project is a transforming project for NOVATEK as it provides a global perspective to complement our core Russian natural gas operations. In order to undertake a project of this scale however we sought strategic partners who could provide technical and commercial expertise on the operations and marketing of LNG as well as a strong balance sheet for financing of the project. After completing the initial tender process we determined that an optimum mix of partners providing key skills and experience throughout the LNG value chain would enhance the success and viability of the project. As a result we felt that a combination of partners comprising one major strategic partner as well as other project partners would enter the project at a combined stake of 49% with NOVATEK retaining the majority stake of 51%. This structure is suitable for a project of this nature and corresponds to the expectations of the marketplace.

On 2nd March 2011 we formally signed a memorandum of cooperation announcing that Total was selected as a strategic partner in the Yamal LNG project and accordingly they will acquire an equity stake of 20% in the project. To complete this transaction NOVATEK will execute its original option to purchase 23.9% from the existing shareholders and then sell a 20% equity



stake to Total. After a considerable and lengthy review we felt that Total met all of the criteria outlined in the tender process and possessed the requisite technical and commercial expertise in commercialising large scale LNG projects as well as maintaining a significant presence in the global LNG markets. All transaction documents are expected to be finalised by 1st July 2011 and upon completion of this process we plan to conduct a conference call to specifically address the details of this transaction.

Simultaneously Total announced that they would purchase a direct equity stake of 12% in NOVATEK after revealing market quotes on the MICEX and that the share purchase transaction is expected to be closed on or before 1st April. In their press released Total announced that they would like to increase their equity stake in NOVATEK to 15% within 12 months and 19.4% within three years. I have been informed by our core shareholders that in principle they accepted Total's expressed interest to increase their direct equity stake in the company but presently there are no formal or binding obligations to do so at this time. The 12% equity stake does not provide Total with any management positions within the company but it does afford them one director's seat on the board. The majority of the 12% equity stake will initially be purchased from our two core shareholders, Mr. Mikhelson and Mr. Timchenko, however upon the execution of the 9.4% option held by Hibridge Ventures Limited both Mr. Mikhelson and Mr. Timchenko will restore their respective holdings in NOVATEK. Moreover as far as we know and understand Gazprom does not intend to sell its 10% equity stake in the company therefore Total's aim to increase their direct stake in NOVATEK to 19.4% within three years does not imply that they will purchase these additional shares from Gazprom as has been speculated in the market.

Returning back to the LNG project in June 2010 we executed an agency agreement between Gazprom Export and Yamal LNG whereby Gazprom Export will act as an agent for export sales of LNG between Yamal LNG and Yamal LNG's wholly owned international sales subsidiary. The signing of this agency agreement removes a significant question as to the marketing of the LNG as well as address one of the key issues raised by potential strategic partners during the tender process.



In addition in December 2010 there was an executive order signed by Prime Minister Putin announcing a series of tax concessions for the development of LNG on the Yamal Peninsula. In summary the tax concessions stipulate zero mineral extraction tax, zero export duty, zero property taxes on LNG production and related facilities; and a reduction in profits tax to 15.5%. The tax concessions stipulate a maximum period of 12 years and are quantities of up to 250 billion cubic metres of cumulative volumes after the start of LNG production, whichever comes first and are only applicable if LNG is produced. The complete details of the tax concession can be found on the Russian government's website.

In our view the proposed tax concessions clearly demonstrate the government's commitment to the Yamal LNG project as well as the importance of this project to the overall Russian gas industry. Moreover the tax concessions provide additional clarity on the project's fiscal regime as well as enhancing the project's economic viability. We also completed the pre-FEED study conducted by CB&I Lummus and are ready to begin front end engineering and design for FEED work phase of the project. Based on the initial estimates the project's capital expenditures range between \$15-20 billion excluding the tanker fleet and we believe the capital expenditure estimates will be further refined during the FEED phase. We expect to launch the first of three trains of LNG comprising 5-5.5 million tonnes by 2016. Pre-FEED is expected to be announced by the end of 2012.

In a related corporate development we expect to execute an option arrangement to purchase the remaining 25.1% in Yamal LNG in the nearest timeframe. The combined shares inclusive of the equity stake acquired as part of the new option arrangement and the remaining shares from the execution of the first option arrangement will eventually be sold to the other partners in the project. Detailed discussions are presently underway with a number of companies interested in taking an equity stake in the project and we believe that an announcement of the two or three possible partners forming the LNG consortium will most likely be made by the end of 2011. As previously mentioned NOVATEK will retain 51% of the project and a consortium of partners the remaining 49%.



During the fourth quarter of 2010 we announced two key strategic acquisitions: our proportional equity stake of 25.5% in SeverEnergia purchased through our 50:50 joint venture with Yamal Development which was completed in November; and our direct equity stake of 51% in Sibneftegaz which was completed in December. We have been studying the opportunity to acquire certain assets and expand our operational footprint in the Yamal-Nenets Autonomous Region for quite some time. By completing these acquisitions we managed to complement our existing portfolio of assets with a range of quality mid-term exploration and development opportunities. Moreover the acquired fields and licence areas are in close proximity to our existing asset base which affords us the opportunity to achieve additional synergies by optimising the utilisation of our present condensate, processing and transport facilities.

To finance the acquisitions we utilised a \$600 million bridge loan facility and other credit facilities thus increasing our present debt position as well as utilising a portion of our existing cash balances. In February 2011 we successfully issued our dual tranche debt Eurobond in the amount of \$1.25 billion which was used to repay the bridge loan facility ahead of its maturity schedule and partially finance the outstanding balance due on the Sibneftegaz transaction. We expect to complete full payment on this transaction during the month of March through the use of our internal cash balances thus reducing the overall acquisition price by approximately \$30 million.

SeverEnergia is comprised of three legal entities: Arcticgaz, Urengoil and Neftegaztehnologia. We are presently in a process of verifying all the geological and geophysical data, conducting geological work and devising a new plan for field development thus it is still too early to make any meaningful comments on capital requirements, production profiles etc. However we do expect significant future production contributions from the overall development of these fields and licence areas. More specifically the Tambeyskoye field owned by Arcticgaz is the most advanced in terms of its development stage and we will concentrate our initial efforts on developing the northern portion of the field. It is anticipated that initial production will commence during the upcoming winter period and we have not planned any significant capital expenditures to initially launch production because of the existing equipment and infrastructure in place. In terms of marketing we will sell the natural gas produced ex-field to Gazprom which



we consider to be a profitable contractual arrangement and the unstable gas condensate will be processed and sold through NOVATEK's marketing channels. We are presently negotiating with our joint venture partners the terms and conditions for utilising our transport and processing facilities. Sibneftegaz holds four exploration production licences in the Yamal-Nenets Autonomous Region which are also located in close proximity to our existing fields and infrastructure. The largest of the four licence areas is the Beregovoye field which was presently producing dry gas and is already connected to the UGSS pipeline network. Natural gas produced from this field does not require further processing for commercial suitability. Since the Beregovoye field is already producing to date it requires limited capital expenditures to maintain its current production rate producing approximately 9 billion cubic metres in 2010. Effective 1st January we began to market our proportionate share of dry gas produced from the field of approximately 14 million cubic metres per day. Sibneftegaz also produces small quantities of natural gas from the [Paranya] field which has completed 12 development wells, some treatment facilities and is presently connected to the UGSS via 36km pipeline.

For 2011 we have budgeted approximately 200 million rubles for total capital expenditures at Sibneftegaz. In conjunction with the acquisition we refinanced 51% of Sibneftegaz's total debt by providing a loan facility in an amount of 11 billion rubles or approximately \$361 million at year end exchange rates. With the marketing arrangements NOVATEK is considered the profit centre for Sibneftegaz and our contractual arrangements provide that we pay the entity a sufficient purchase price to service its existing debt over the next four years as well as cover its ongoing operating expenses. Presently Sibneftegaz is free cash flow positive.

Since both acquisitions were completed towards the end of 2010 there were no material effects to our fourth quarter financial statements except for the increase in our debt position as discussed.

I have been receiving many questions regarding NOVATEK's plans for additional acquisitions or our participation in upcoming licence tenders and auctions. To make it absolutely clear it is our intention to continue reviewing any and all potential acquisition opportunities that meet our strategic objectives of expanding our production capabilities and our hydrocarbon resource base



especially if the potential opportunities are located in close proximity to our existing core fields and infrastructure and processing facilities. You should assume that the review and study of potential opportunities are within the normal scope of our business activities. As for the Kovykta field which was recently auctioned as part of RUSIA Petroleum's bankruptcy proceedings we did not participate in the auction process and we are not in any current negotiations regarding this particular field.

As for the upcoming tenders mentioned by Prime Minister Putin we will actively participate in this open tender process due to the proximity of these licences to our Yamal LNG project. Accordingly we will submit our intent to participate in this tender by mid-April which will be followed by the requirements and time schedules of the tender. We anticipate that a final decision on the winner of this tender process will be announced by the end of June.

Demand from natural gas on the Russian domestic market continues to show signs of recovering to post-crisis levels as previously mentioned and continues to be aided by growth in GDP and weather conditions. This past year we produced approximately 37.2 billion cubic metres of natural gas from our core three fields representing a 15% year on year growth or an absolute growth of 4.9 billion cubic metres. Our production growth was accomplished on the back of a 6.3% increase in our natural gas production in 2009 despite the negative effects of the economic crisis which effectively means we had real year on year growth rather than a recovery of production. Since our IPO in 2005 we have managed to increase our overall production of natural gas by 89% for our compound annual growth rate of approximately 10%. The main driver of our growth has been the successful development and exploitation of the Yurkharovskoye field which represented about two thirds of our natural gas production for the year and has almost tripled since the IPO. We completed and launched into production 15 new wells at the Yurkharovskoye field during the year which represented the majority of work activities for the second and third stages of the field's second phase development programme. In 2010 production of natural gas from the Yurkharovskoye field increased by 37.5% reaching volumes of 24.4 billion cubic metres of natural gas. In the fourth quarter the Yurkharovskoye field represented 7.1 billion cubic metres out of a total 10.7 billion cubic metres that we produced with the planned launch into the third stage of Phase 2 in October 2010. As compared



to the third quarter 2010 we increased our natural gas production by 2.4 billion cubic metres or by 28.3% reaching the new milestones for production. For 2011 we planned to increase the field's production to approximately 32 billion cubic metres by completing the field's planned development programme which effectively means that we will be transitioning into maintenance capital expenditure mode by mid to late 2012. For the year we continue to reduce the level of gas output from the East-Tarkosalinskoye field at the expense of maximising wet gas production at the Yurkharovskoye field. On several of my conference calls I explained that we enhanced the overall company's revenues by optimising the core production mix to capture more economic value from the wet gas stream. This essentially means we are able to continue growing both our natural gas and liquids production while at the same time maximising the revenue per barrel of oil equivalent reduced to our export channels.

Our total natural gas daily output for 2010 averaged approximately 103 million cubic metres or 3.7 billion cubic feet per day. Since the beginning of 2011 we have been producing at a rate of approximately 150-155 million cubic metres per day through the months of January and February and recently reduced our daily volumes to approximately 140 million cubic metres per day with the warming temperatures. This represents a year on year growth in our daily average gas production from our core fields excluding the daily production contribution from our proportionate share of Sibneftegaz's production of approximately 32%.

As a result of the strong start to the year we have been fielding a series of enquiries lately regarding our production forecasts for 2011. I would like to reiterate what has already been communicated to the market. For 2011 we are forecasting similar production growth from our core producing fields as that we achieved in 2010 meaning roughly at 15% year on year growth. This has been revised upwards from the preliminary forecast of 12% which was provided to the market on our last two conference calls. If we combine our proportionate share of production from Sibneftegaz with the expected growth in our core producing fields namely from the Yurkharovskoye field we are looking at a combined growth of approximately 30% in natural gas production for 2011. These forecasts are predicated on the assumptions of continued economic recovery in the Russian domestic market as well as normal seasonal weather patterns.



Moving on to the liquids side of our business during 2010 we increased our total production of liquid hydrocarbons by 579,000 tonnes or by 19.1% driven primarily by continued strong production growth of 41.4% at the Yurkharovskoye field. Unstable gas production increased by 615,000 tonnes year on year at the Yurkharovskoye field with the launch of the third stage in October and the completion of the 326km pipeline connecting the field to the Purovsky Processing Plant in September. With the increase in wet gas production at the Yurkharovskoye field of 7.1 billion cubic metres in the fourth quarter as previously mentioned the corresponding quarter on quarter growth in unstable gas condensate was 623,000 tonnes representing roughly 17.2% of the total 2010 production.

The growth in the Yurkharovskoye field has offset declines in our other fields. Most notably we have been experiencing natural declines in our liquid production from the East-Tarkosalinskoye field over the past several years due mainly to decreasing field reservoir pressures. The eventual decline in reservoir pressures is a natural phenomenon of the field's reservoir characteristics and we fully account for this eventuality in our future development and capital expenditure plans. The future planned development of SeverEnergiya should more than offset the expected liquid hydrocarbon declines in our core fields. The continued expansion of our liquid production and the further penetration of new markets is a key element to our corporate strategy. During 2010 we successfully navigated the first large tanker of stable gas condensate through the Arctic Ocean's northern sea route which essentially provides us with market and delivery operations when the sea route is navigable, thus we plan to take further advantage of this commercial opportunity in 2011.

The next market opportunity for us is the eventual launching of the Ust-Luga gas fractionation complex in late 2012. Essentially we plan to construct a new 6 million tonne capacity gas fractionation unit and terminal facility at the port of Ust-Luga on the Baltic Sea which will be used to fractionate our stable gas condensate into constituent higher value products like light and heavy naphtha, jet fuels, diesels and other refined products. We plan to launch the first phase of the project comprising 3 million tonnes per annum by the end of 2012 which ultimately means that we will significantly increase the potential number of our customers for our products as well as enhance our risk adjusted margins for our liquid products. The total capital



expenditure to construct a 6 million tonne capacity plant and related terminal facilities is estimated between 20-21 billion rubles and we plan to expand approximately 8.5 billion rubles in 2011 and 5 billion rubles in 2012 inclusive of VAT to complete the first stage launch. The overall project once completed is expected to have a maximum payback period of approximately four years. We will continue to provide periodic updates on the Ust-Luga project on future conference calls.

Speaking about capital expenditures I would like to say a few words about our plan for 2011 and highlight some of the key results for the past year. During 2010 we invested approximately 26.1 billion in capital expenditures representing a 46.1% increase over the corresponding 2009 period of which 15.4 billion was spent on the Yurkharovskoye infrastructure and the second phase field development activities. Of the 6.6 billion of capital expenditure programme which occurred in the fourth quarter approximately one third related to the Yurkharovskoye field development activities.

Besides completing and launching 15 new operating wells at the field we also completed a series of infrastructure related activities aimed at enhancing the efficiencies of our operations. We completed and launched a 40,000 tonne methanol plant at the Yurkharovskoye field thus increasing the methanol capacity at the field to 52,000 tonnes providing enough methanol production for all of our core field operations. We will transport to produce methanol via our 326km unstable gas pipeline to the Purovsky Processing Plant where it will be separated and transferred onwards to be used at the East-Tarkosalinskoye field.

We also completed and launched a 3 million tonne de-ethinisation unit which allowed us to construct a small diameter pipeline to transport unstable gas condensate from the Yurkharovskoye field to the Purovsky Plant. The utilisation of our own facility allows us to optimise the production of unstable gas condensate relative to de-ethinised gas at the field while minimising historical process and output and line losses as a result of using third party facilities.



Other capital related projects during the period included completing a compressor boosting station at the East-Tarkosalinskoye field to maintain current production levels of gas and gas condensate in the Valanginian layer, the construction of a 10,000 cubic metre storage facility at the Purovsky Plant to store raw materials for de-ethanised gas condensate, ongoing land preparation activities and design work at the Ust-Luga facility as well as ancillary infrastructure activities at Yamal LNG.

For 2011 we plan to spend approximately 31 billion rubles excluding VAT on a series of capital related projects with the primary spending projected at the Yurkharovskoye field of 11.7 billion rubles, the Ust-Luga project 7.2 billion rubles, the South Tambeyskoye field 2.9 billion rubles, and the East-Tarkosalinskoye field of 1.8 billion rubles amongst other projects. The majority of our activities are essentially ongoing development work or the continuation of construction and infrastructure projects.

In the fourth quarter we completed our first exploratory well at the El-Arish concession block in the Arab republic of Egypt and determined that there was not sufficient commercial production, therefore we decided to write off the costs of the exploration well in the fourth quarter which significantly increased our exploration expenses by approximately 1 billion and 766 million year on year and quarter on quarter respectively. We are presently discussing the current political and economic situation in the region as well as reviewing all the geological and geophysical data we possess with our joint venture partners. We will take a decision sometimes in the second quarter to determine whether or not we will continue with exploration work or abandon the project. I will update everyone on the situation during our first quarter conference call. In addition we also wrote off an exploration well on the anomaly licence area during the period. The aggregate write-off of the two exploration wells during the period was approximately 821 million rubles.

Operationally we managed to increase our proven gas reserves by 1.2 billion barrels of oil equivalent to approximately 8.1 billion barrels of oil equivalent under the SEC reserve methodology representing a 551% reserve replacement rate for the year and a 567% reserve replacement over the three year average. We have managed to add approximately 3.1 billion



barrels of oil equivalent over the past two years from the combination of organic growth through the drill bit and timely and accretive acquisitions. These accomplishments were achieved when most oil and gas companies are still struggling to maintain let alone grow their resource base. Based on our prudent gas reserves NOVATEK is the largest independent gas company in the world and rates equally amongst many of the so-called super majors in this respect. We continue to produce some of the best statistics in the global oil and gas industry relating to efficiency of capital deployment, the corresponding flow rates from our producing wells and the attractive reserve acquisition multiples. Collectively the combination of these factors along with our prolific resource base has consistently ranked NOVATEK as one of the lowest cost producers in the industry. We are very proud of this unique distinction and it demonstrates the quality of our resource base, the efficient design of our field development programme and the close attention we pay to controlling costs throughout our operations.

Strategically our goal is to continue undertaking projects to grow our gas and gas condensate production as well as expand our processing and market capabilities. The ability to achieve this strategic goal through joint development of oil, gas and gas condensate projects or singularly through the continued development of our existing licence areas will ultimately achieve our stated aim: the ability to improve the overall operational efficiency and utilisation of the Purovsky Processing Plant as well as expand its capacity when required and eventually launching the new gas condensate fractionation and terminal facility at Ust-Luga once it is completed is completely consistent with our strategic objectives of enhancing downstream markets in our liquid value chain. I believe the move towards building our commercial activities throughout our hydrocarbon value chain will enhance the margins we achieved for our products as well as solidify and expand our position in the market. I will continue to provide more updates on these important activities on future conference calls.

Our natural gas business remained robust in 2010. For the year we increased our sales of natural gas by 32.5%. These stellar results were achieved on the back of strong growth and year on year sales volumes of 12.7% combined with a 17.5% increase in our average natural gas prices. For the year our sales mix of volumes sold to end customers versus wholesale traders were 64% and 36% respectively. In the fourth quarter we achieved a record volume sold of



approximately 11 billion cubic metres representing 2.1 billion cubic metres more than the prior year period. Specifically we increased our year on year volume sold to end customers by approximately 171 million cubic metres or by 2.7% and to our wholesale traders by 1.9 billion cubic metres or by 70%. However during the fourth quarter 2010 our percentage of end customer sales decreased year on year to 58% as compared to 70% in 2009. The reason for this shift in sales mix during the quarter comprises a couple of factors. As you recall we ceased deliveries to traders in remote points effective 1st January 2010 which effectively distorts the comparability of our overall customer sales mix between the corresponding years. In the fourth quarter of 2010 we reduced the volumes sold to end customers by 17% largely to compensate for the reduction in volumes sold to wholesale traders during the hot summer months. During this past summer we sold more volumes of natural gas directly to our power generation consumers due to the increased consumption of power during the heat wave. As a result we did not meet all of our contractual obligations to wholesale traders. This explains why the volumes sold to wholesale traders increased by 126% during the fourth quarter which essentially represents the make-up of contractual volumes to this customer segment, therefore our quarter on quarter sales mix comprised 58% sold to end customers and 42% sold to wholesale customers versus 75% to 25% split in the third quarter 2010. Our fourth quarter average end customer realised prices and netbacks increased by approximately 17% and 12% respectively over the corresponding 2009 period. The primary difference between the reported periods was a geographical shift in our deliveries which effectively increased our average transport distance by 174km or by 9%. Our quarter on quarter end customer netbacks were relatively unchanged where ex-field sale prices decreased marginally explained by the change in customer mix between periods.

During 2010 our largest sales markets remained the Perm and Chelyabinsk regions supporting our decisions to establish direct marketing presence in those particular regions. We withdrew approximately 268 million cubic metres from underground storage to meet contractual obligations during the quarter. Our inventory balance and underground storage at 31st December stood at approximately 790 million cubic metres as compared to 1.1 billion cubic metres as of 30th September 2010 and 744 million cubic metres as of 31st December 2009.



We continued to demonstrate strong growth in our liquid business by increasing our full year revenues by 32.5%. The increase in revenues was driven by growth in our sales volume of 8.7% and strong commodity prices throughout the year. In the fourth quarter of 2010 we increased our total liquid sales revenues by 18% primarily due to higher average product prices across all our product ranges although our year on year sales volumes remained relatively unchanged largely due to a 153,000 tonne increase at our stable gas condensate inventory balances at year end. In comparison to the third quarter 2010 we decreased the volume of stable gas condensate sold by 67,000 tonnes largely due to a 58,000 tonne increase at our stable gas volumes in transit. During the full year 2010 we dispatched 41 tankers from the port of Vitino versus 35 tankers in 2009 recognising 39 tankers as sales versus 36 tankers in the respective periods. During the fourth quarter we dispatched 12 tankers carrying approximately 716,000 tonnes to international markets and recognised sales during the period of 11 tankers or approximately 656,000 tonnes inclusive of one tanker which was dispatched in the third quarter to the US market.

During the fourth quarter our Purovsky Processing Plant operated at 75% of its rated capacity with total plant output reaching 933,000 tonnes. Our export netbacks on a US dollar basis for stable gas condensate and LPG volumes sold increased year on year by approximately 16% and 36% respectively despite increases in both export duties and average transportation expenses.

Turning our attention to the expense side of the income statement, our total operating expenses increased in 2010 relative to 2009 by 22.1% which corresponds to growth in our core business operations as well as an increase in our oil and gas revenues. Looking at the quarterly changes our total operating expenses increased year on year by 19.9% and quarter on quarter by 9.6% which again correlates to the growth in our core oil and gas revenues.

The increase in our non-controllable expenses was primarily due to changes in taxes and other incomes which increased in line with our production growth during the quarter. For transportation expenses the overall increase was somewhat lower due to the shift in our natural gas sales mix between the respective quarters as previously explained but it did reflect higher



average transport tariffs due to the increase in the average distance to market as well as a relative increase in end customer volumes.

Our general admin expenses increased quarter on quarter by 19.4% largely due to the accrual of bonuses and the recognition of share based compensation which affects our employee compensation and an increase in legal services related to the two recent acquisitions and ongoing legal work on the Yamal LNG projects. These expenses were offset by a reduction in charitable contributions which tend to fluctuate period on period depending on funding requirements.

The year on year increase in employee compensation was primarily due to the 10% salary indexation effective July 2010, an increase in bonuses reflecting the financial results achieved in 2010 and the costs associated with the share based compensation plan which was initiated in the second quarter of 2010. The quarter on quarter increase was due to an increase in bonus accruals at year end as well as the continued recognition of share based compensation. Our employee expenses were offset by a reduction in head counts in the fourth quarter primarily due to the disposal of NOVATEK-Polymer.

The year on year quarter on quarter decrease in materials, services and other expenses was mainly due to the decrease in materials and supplies in total and in processing fees. With the disposal of NOVATEK-Polymer in the third quarter 2010 we significantly reduced our purchases of raw materials for the production of Polymer and insulation tape. During the same periods our total in-processing fees decreased by approximately 152 million rubles and 95 million rubles respectively due to the launch of our own de-ethinisation facilities allowing us to discontinue using third party facilities to de-ethinise our stable gas condensate.

We also had an impairment expense during the period, a increase of approximately 293 million and 198 million rubles respectively due to the accident at the Khancheyskoye field in the fourth quarter of 2010.



As a result of these factors enumerated above our EBITDA and net profits continued to remain strong and consistent with our financial guidance during each respective periods. Our balance sheet and liquidity position continued to remain strong throughout the fourth quarter although we increased our debt position relative to our year end and third quarter balances due to the bridge financing facility and other debt we obtained to complete the acquisitions in November and December. Post balance sheet we successfully issued a dual-tranche Eurobond which were used to repay the bridge loan facility and a large portion of the outstanding liability to complete the Sibneftegaz transaction. We will continue to service our debt facilities as they become mature.

Finally we continue to remain positive free cash flow during the fourth quarter and the full year 2010.

In conclusion the past year was a very busy year for the company and one that we believe provides a platform for future growth opportunities. It was also another successful year demonstrating to our investors that we possess the necessary capabilities to grow and market our hydrocarbon products. We will continue to invest the necessary capital to further enhance our abilities to penetrate new markets.

The next couple of years will be challenging ones for the company as we begin to transform our operations with the development of Yamal LNG, the construction and launch of Ust-Luga's complex and the integration of the assets we acquired in the fourth quarter. We were up to these challenges and senior management is fully committed to providing the resources and personnel to achieve our strategic objectives and goals. The financial and operational results achieved during 2010 solidifies our position as one of the premier companies operating in the oil and gas industry and continues to reflect positively on the strategic and operating decisions entrusted to management to create sustainable shareholder value. Our hard work and the collective efforts of all of our people combined with the technical excellence we strive to achieve in our operational performance has been instrumental in leading to these extraordinary results and driven our impressive shareholder returns.



It has been five years since we went public and the story outlined then remains firmly intact today. We continue to remain highly confident in the future prospects of NOVATEK and the growth strategy that we have adopted. Our goal is to transform NOVATEK into a world class company competing not only in the Russian domestic market but in the global markets. The foundation that we have built will be the cornerstone for our future success.

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

Operator: Thank you very much. Ladies and gentlemen, if you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered you may remove yourself from the queue by pressing *2. Again please press *1 to ask a question. We will pause for just a moment to allow everyone to signal.

We will take our first question today from Oleg Maximov of Troika Dialog. Please go ahead.

Oleg Maximov: Hi Mark and congratulations on your strong results. Two questions from me, one on Sibneftegaz capex. Did I understand correctly that the budget provides only for \$7 million of capex for Sibneftegaz? The second question on Yamal LNG, do you expect NOVATEK to be at least partially carried on capex by Total or by other future partners? Thank you.

Mark Gyetvay: Oleg, on the first question you're answer is right. I said that the total capex expected for 2011 on Sibneftegaz is approximately 200 million rubles. On the second question I will let Leonid answer that.

Leonid Mikhelson: As Mark has already mentioned we are going to finalise Total's role in this deal by July 1st. The current memorandum of cooperation which has been signed by the two companies and is already legally binding does provide for disproportionate contribution. Thank you.



Oleg Maximov: Thank you very much.

Operator: Our next question comes from Lev Snykov of VTB Capital. Please go ahead.

Lev Snykov: Yes, hello, thank you. I have two questions, first about the share of end customer business. Should we expect it to revert back to the 60-65% range in Q1 given Mark what you've said regarding the trends in Q4 and during 2010? That's the first question.

Mark Gyetvay: Lev, if you're modelling the company I would say that you're modelling about 2/3 end customers roughly, roughly 1/3 self-traders.

Lev Snykov: Ok. The second question is more of a longer term nature on let's say a three year horizon. How would you expect the dividend payment to evolve given that you have a significant step-down in Yurkharovskoye on the one hand and potentially some incremental capex due to Yamal LNG on the other hand?

Leonid Mikhelson: I understand your question Lev but I actually think it's somewhat of the wrong view to look at it from that perspective. First of all the company has historically been increasing its dividend payouts on an annual basis based on our financial results and I expect that we will continue to do that in line with the financial results that we achieved in the next three years as you referred. I think it's a mistake to assume that we'll be generating all this excess cash because the aim of our operation is to reinvest that cash back into SeverEnergiya, the Ust-Luga project and any of our cash contributions that we need to make for the development of Yamal LNG. So I would stick with the numbers that we gave you right now. As I mentioned we are anticipating about 31 billion rubles in capex. You are right to say that the intensity of capital at Yurkharov will go down but that money will be reinvested in other growth opportunities as I mentioned.

Lev Snykov: Ok, thank you very much.



Operator: We will take our next question from Svetlana Grizan of VTB Capital. Please go ahead.

Svetlana Grizan: Good afternoon, thank you very much for your presentation. I have two questions. First of all as I understand Total said that they are going to increase their stake to 15% within one year and to 19% within three years for NOVATEK, so the question is – if of course if it's public, the question is if they are going to buy if from the market to major shareholders? As you said it will not be from Gazprom for sure, right?

Leonid Mikhelson: As Mark has correctly pointed out we are nearing closure of this 12% transaction with Total and they have indicated their interest in increasing their share over 19% over three years, however they are under no obligation to do so and after these rumours in the market started spreading that Gazprom was considering to decrease its 10% stake in NOVATEK all we can tell you is we have not heard that and we can't give you any guidance whatsoever at this stage where these shares will be bought.

Svetlana Grizan: Thank you very much. The other question is about capex, Mark mentioned that total capex for Yamal LNG is estimated at around \$15-20 billion excluding tanker fleets and that the first one would be done at 5-5.5 million tonnes by 2016. Can you please tell us for how many years that capex at \$15-20 billion is expected to be spent, like 5 years, 7, 10 and about the volumes, 5-5.5 million tonnes by 2016, if it means that in 2018 we will see doubling of the capex? Thank you.

Leonid Mikhelson: It's premature now to tell you exactly what the capex is going to be. As Mark has correctly pointed out we are still in the pre-FEED stage now and that's why Mark has given you such a broad range of 15-20 billion. We believe that in 12 months' time FEED will be complete, then we'll have a much clearer picture of how much it's going to cost us, but in any case the amount you have heard from Mark corresponds to total production capacity of 15-16 million tonnes that is going to come from three trains, the first of which is expected to be completed by late 2016 or 2018 the latest, so as soon as it goes on stream it will start generating revenue of its own that is going to be used to support the implementation of Train 2 and Train 3.



Svetlana Grizan: Thank you.

Operator: Our next question today comes from William Powell of Platts. Please go ahead.

William Powell: Good afternoon, I had two questions if I may. First of all will this be a standard LNG project, in other words you will line up say 80% of the capacity on long term contracts before you commit to the final investment decision? Secondly please what do you think is going to happen with the marketing of the gas? Will it be mainly done by Total? Will Gazprom have a role in this? I know it used to be or still is an export monopoly. Can you explain how that's going to work out in the future? Thank you very much.

Leonid Mikhelson: This project is going to be funded primarily through project finance which means that we do need to produce some guarantees that a significant portion of the produce will be effectively sold. That off take is essentially guaranteed and it is also part and parcel of our contract with Total. You have mentioned a number of 80% and I agree that this is a very sensible number to go for as we will need to raise and repay that. As regards other participants all I can tell you at this stage is that we are negotiating with a multitude of different companies and their numbers have swollen since the Prime Minister promised such huge support for the project. We believe that a lot will be done in 2011 but most importantly we have attracted a major and although we believe that we will find other strategic partners in 2011 we don't consider it critical. Now that we have a major we can safely move ahead and take some time to find other strategics.

Mark Gyetvay: Also I just want to add too as I mentioned in my commentary that we have already dealt with that export issue by signing the agency agreement with Gazprom Export, so I believe the structure that is in place will satisfy that requirement of the well and export rights.

William Powell: Thank you.



Operator: As a reminder ladies and gentlemen please press *1 to ask a question. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment.

We will take our next question from Nadia Kazakova from JP Morgan. Please go ahead.

Nadia Kazakova: The first is dealing with capex for 2010 and 2011, comparison data talking about capex for Sibneftegaz. The second question deals with the Gazprom paying option for NOVATEK shares, what's the sale price of this public data and when are you going to execute it? The final question deals with the speculation that it could be some other state support going beyond the tax cuts, is there anything you can tell us?

Leonid Mikhelson: I'm not sure I really understand your first question because two of the major fields owned by Sibneftegaz, that's Beregovoye and [Sarenye] have been in operation for over a year which means that capex in 2010 there was negligible and it will be negligible this year as well. There is also the Valanginian layer in the Beregovoye field which hasn't been penetrated yet. We're going to reassess its potential this year and it will involve a bit of capex which will drive our revenue and production as well. So we have mentioned already we are going to sell shares straight from the existing shareholders and the option that we have is valid until mid next year. We are going to execute it, there should be no doubt about this but we can't tell you as of now when it's going to happen. We are not going to procrastinate or drag our feet. The strike price will be determined by the quotes over the last 30 days before the option is executed. As regards to your third question there has been and will no direct state support for Yamal LNG project. The state is going to commit some funds to infrastructural development programmes in the Yamal region and Yamal LNG is going to benefit from these programmes just like so many other parties operating there and we believe that there will other projects in the Yamal Peninsula, for example other projects in hydrocarbon production or processing and liquefaction that will also benefit from the same infrastructural development programme.

Nadia Kazakova: Thank you.



Operator: As a reminder ladies and gentlemen please press *1 to ask a question. Our next question comes from Lev Snykov of VTB Capital. Please go ahead.

Lev Snykov: What is the company planning to close this 20% acquisition transaction and what kind of price are we talking about for this? I am referring specifically to the share in Yamal LNG.

Leonid Mikhelson: As Mark has mentioned already we are going to finalise it before 1st July.

Lev Snykov: Thank you.

Mark Gyetvay: If there's no further questions again we'd like to thank everybody but I hope we have addressed all your questions tonight. Like I said it has been a busy year for the company and we look forward to addressing you in the future as we move forward with both Yamal LNG and as well as other projects that we believe will transform NOVATEK. So again thank you very much and we look forward to seeing you again in the future.

Leonid Mikhelson: Thank you for your questions.

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