



Company: NOVATEK
Conference Title: Q2 2010 IFRS Results
Presenter: Mark Gyetvay
Date: Tuesday 17th August 2010 – 15h00 CET

Operator: Good day and welcome to the NOVATEK Second Quarter 2010 Financial Results Conference Call. Today's conference is being recorded. At this time I would like to turn the call over to your host today, Mr. Oleg Maximov. Please go ahead sir.

Oleg Maximov: Good afternoon and welcome. I'm Oleg Maximov from Troika Dialog and this is NOVATEK's Second Quarter 2010 IFRS Results Conference Call. With us today is Mark Gyetvay, NOVATEK's Chief Financial Officer and Member of the Board of Directors. Now over to you Mark to start the presentation. Thank you.

Mark Gyetvay: Thank you Oleg. Good evening and welcome to our Second Quarter 2010 Earnings Conference Call. I would like to thank everyone for joining us this evening and extend our sincere gratitude for Troika Dialog for hosting and organising 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 reflects our views at 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 included in our annual review with the year ended 31st December 2009 as well as any of our earnings press releases for more description of the risks that may influence our results.

For today's conference call I would like to separate my discussion into two parts, the first part focused on providing our investors and analysts with an operational update for the first half



2010 as well as some views looking forward; and for the second part a brief discussion on the financial results during the second quarter 2010 particularly with a focus on the quarter on quarter seasonality effects.

Let me begin the first part of my discussion by highlighting some of the exploration results we achieved during the first half of 2010. We managed to drill and complete two exploratory wells at the Severo-Russkiy and the Severo-Yamsoveyskiy fields as well as continued ongoing drilling activities in the Olimpiyskiy licence area and the Termokarstovoye field. At the Severo-Russkiy field we managed to discover five new gas and gas condensate layers and as a result of these discoveries our geologists are presently finalising the approval of the reserves in accordance to Russian reserve classification C1 and C2. We expect that the Severo-Russkiy reserves will be appraised and included in our annual reserve appraisal reports in accordance with international reserve reporting standards prepared by DeGolyer & MacNaughton. For the Severo-Yamsoveyskiy field we managed to discover two new layers containing gas and gas condensate and our geologists will continue to appraise this field accordingly. At the Termokarstovoye field where ongoing exploratory drilling continues we removed and tested core samples from some of the targeted production zones confirming our geological model of the subsurface. We will continue to work closely with Total's personnel on preparing the field's integrated geological model as well as the continued exploration activities at the field as required by our licence terms and conditions. We undertook a series of geophysical activities at a number of our fields and licence areas as part of our exploration activities. Specifically we ran and interpreted 200 km² and 324 km² of 3D seismic at the Yarudeyskoye and the West Yurkharovskoye fields respectively which allowed our geologists to analyse sub-surface characteristics to determine future drilling targets as well as 2D seismic at the South Tambeyskoye field. At South Tambeyskoye we ran 320 linear kilometres of 2D seismic over an area of the field known as the transition zone which is a zone from the present onshore licence area to offshore. The seismic work was the forum to determine the potential resource migration offshore and determine if any what levels of future exploratory activities may be required to assess this potential area as an extension to the field. We also completed a hydrodynamic model at South Tambeyskoye used by our geologists to better understand the reserve characteristics and pressure dynamics of the field and upon completing this stage of the



work we are now in the process of finalising the field development. We are presently preparing for some additional exploration drilling on this field during the winter drilling season.

We also ran and interpreted 3D seismic at the El-Arish field in Egypt and based on the interpretations we have identified the primary targets for exploration drilling on the first Wildcat well called the El-Arish A1 which we plan to commence drilling in the middle of October 2010. The second exploration well is expect to begin drilling towards the end of 2010 or early 2011. We will work closely with our joint venture partners to fulfil the concession's initial contractual obligations during this exploratory phase of work.

I would also like to highlight that we have successfully extended the Khancheykoye licence from 2019 to 2044 which essentially covers the economic life of the field. We have now successfully completed the extension of licences through the economic life of the field for all of our three core producing assets, the East-Tarkosalinskoye, Yurkharovskoye and now the Khancheykoye field as well as the South Tambeyskoye field.

That concludes my brief update on the exploration activities. I would now like to briefly discuss some of the highlights of our development programme. As you know we have some of the best statistics in the global oil and gas industry relating to the efficiency of capital deployment and the corresponding flow rates from our producing wells. Collectively the combination of these factors has consistently ranked NOVATEK as one of the lowest cost producers in the industry. Obviously we are very proud of this unique distinction but more importantly it demonstrates the quality of our resource base, the efficient design of our field development programme and the close attention we have paid to controlling costs throughout our operations.

There are a couple of points I'd like to make in this important yet often overlooked area. Firstly I would like to comment on the production wells completed in the first half of 2010; and then secondly I will provide some data on the production and number of wells across all our fields. Hopefully this information demonstrates the robustness of our producing assets which ultimately translates into low cost capital intensity as well as our low future maintenance capital.



During the first and second quarters of 2010 we completed and launched seven new production wells on the Yurkharovskoye field with initial daily production ranging from 923,000 cubic metres, 33 mcf per day to 4.7 million cubic metres or 166 mcf a day along with the requisite production of unstable gas condensate. We capitalised approximately 2.5 billion rubles to launch these seven wells as part of our depletion cost base culminating in an average well cost of roughly \$11,900,000 per completed well. Based on the productivity of these new wells relative to the cost to complete we estimate that the average payback period per well based on the financial results achieved in the second quarter 2010 ranges from approximately 70 days to 330 days thus reconfirming our position as one of the most efficient producers in the global oil and gas industry. Last year we managed to produce approximately 32.8 billion cubic metres from our three core producing fields despite the economic crisis representing a 6.2% year on year growth which was accomplished with 108 producing wells at the East-Tarkosalinskoye field, 22 producing wells at the Khancheykskoye and 40 producing wells at the Yurkharovskoye field. The Yurkharovskoye field has been the main driver of production growth and represents the cornerstone of the company's mid-term strategy. Production from the Yurkharovskoye field's Valanginian layer has more than doubled since the IPO from 8.4 billion cubic metres to 17.8 billion cubic metres on an increase in the number of operating wells from 13 to 35. We also have five wells producing from the [sendimaniyan] or dry gas layer. The growth in wet gas production has been instrumental in the company's ability to correspondingly grow our gas condensate production and to optimise fields' development. Looking forward we expect the number of producing wells required to grow and sustain production from this key field to essentially double from the current producing well stock implying relatively low capital intensity based on our present cost structure and absent significant inflationary pressures. We believe the company will continue maintaining its cost competitiveness on our core producing fields vis-à-vis the global oil and gas industry as well as demonstrating the low maintenance capital costs to sustain present production levels as borne out by the recent levels of invested capital at our legacy assets.

During the first half of 2010 we invested approximately 12.3 billion rubles in capital expenditures representing a 41.7% increase over the corresponding 2009 period of which



10 billion rubles were spend on the Yurkharovskoye infrastructure and second phase field development. Besides completing the seven new operating wells as previously mentioned we also completed a series of infrastructure related activities at our field aimed at enhancing the efficiencies of our operation. Namely we completed and launched a 40,000 tonne methanol unit at the Yurkharovskoye field thus increasing the methanol capacity at the field to 52,000 tonnes which provides enough methanol production for all of our four field operations. We will transport the produced methanol via the new 326 km unstable gas pipeline to the Purovsky Processing Plant where we will separate it and transport it onwards to the East-Tarkosalinskoye field. Methanol is presently used to reduce condensation in the pipeline and as a result of launching this facility we expect to decrease our third party purchases classified in our operating expenses by approximately 620 million rubles which will be partially offset by internally generated costs such as electricity, labour, transport and materials.

We also launched and completed a 3 million tonne de-ethanisation unit which allowed us to construct a smaller diameter pipeline to transport unstable gas condensate from the Yurkharovskoye field to the Purovsky Processing Plant. The utilisation of our own facility allows us to optimise the production of unstable gas condensate relative to de-ethanised gas at the field while minimising processing output and line losses which we experienced as a result of using third party facilities. We estimate reducing third party charges by approximately 370 million rubles during the remainder of 2010 with the launch of the de-ethanisation unit and the unstable gas condensate pipeline.

Other capital related projects during the period included completing the compressor booster 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 and ongoing land preparation activities and design work at the Ust-Luga facility. We plan to increase our capital expenditure for the Ust-Luga project over the next two years and we expect the initial 3 million tonne gas fractionation unit and related terminal facilities to be operationally ready by late 2012.



I would like to spend a few minutes now discussing some updates on Yamal LNG; the recent acquisition of 100% of Tambeyneftegas in the Malo-Yamalskoye field; and the recent announcement of a 50-50 joint venture with Gazprom Neft called Yamal Development. We are presently working on the pre-FEAD stage which stands for Funding, Engineering and Design at Yamal LNG which we expect to be completed towards the end of the first quarter 2011. After conducting a series of meetings and discussions with contractors on various project design options, one of the most interesting outcomes from the work performed on this pre-FEAD stage is the significant deviations in the initial cost estimates, approximately around plus or minus 30%. The substantial deviations are one of the main reasons why we are reluctant to discuss potential capital expenditures on the project until such time as we've concluded this crucial stage of work. Once completed we will have more concrete information on the conceptual design and type of facilities providing a more defined scope of work for contractors to bid. In the meantime we are still undertaking proprietary work at the field to continue moving forward with planned activities. The Russian government also recently considered the future development of the Yamal Peninsula including our Yamal LNG project and based on the outcomes of these meetings we expect the governmental decree to be adopted by the end of 2010. It is very important that we understand the government's commitment supporting the future development of this hydrocarbon rich area. For these two main reasons we have temporarily suspended our discussions with strategic partners until we get more clarity on these important issues. I have previously mentioned that the participant store tenders have expressed clarity on a number of important topics including the government's support for this project. The concerns raised by potential strategic partners on these important points are fully aligned with our own view. Up to today we are pleased with the detailed discussions we have conducted with potential strategic partners and the terms and conditions offered for an equity stake in the project. The commitments offered by the strategic partners demonstrate to us their serious intent and interest in this large scale LNG project and we look forward to renewing our partner selection process once some of the aforementioned issues are resolved. The final investment decision on the Yamal LNG project should be taken towards the end of 2012 or early 2013.



The acquisition of Tambeyneftegas for \$10 million was originally discussed as part of the overall agreement when we acquired the South-Tambeyskoye field but a subsequent decision was made to exclude this entity from the initial transaction although the purchase price to acquire the asset was already agreed upon. The Yamalskaya field reserve base of 161 billion cubic metres of natural gas and 14.4 million tonnes of gas condensate or approximately 1.2 billion barrels of oil equivalent is fairly established in terms of the Russian reserve classification C1 and C2, thus making this acquisition accretive to the shareholders of NOVATEK at current reserve multiples. We have established an exploration plan on this field for the next three years and will begin work activities in 2011.

We also recently announced the establishment of Yamal Development, a 50-50 joint venture with Gazprom Neft with the primary aim of developing new oil, gas and condensate fields in the Yamal-Nenets Autonomous Region. We felt that Gazprom Neft offers a joint venture direct with professional experience in oil field development and refining and marketing whereas we contribute our expertise in gas and gas condensate development, processing and marketing. We believe the professional experience of our respective teams provides the necessary synergies to consider new marketing and development opportunities that are mutually beneficial to both companies, some of which we may not have considered individually due to the oil characteristics of the targeted reservoirs. Strategically our goal is to undertake projects to continue growing our gas and gas condensate production as well as expanding our processing and marketing capabilities. The ability to facilitate the strategic goal through joint development of oil, gas and gas condensate projects that are mutually beneficial to the joint venture achieves this aim. Moreover the ability to improve the operational utilisation of the Purovsky Processing Plant and eventually the new gas condensate fractionation and terminal facility at Ust-Luga once it is completed is completely consistent with our strategic objective of enhancing downstream markets in our liquid value chain. We will provide more updates on the activities of this joint venture on subsequent conference calls.

Demand for natural gas on the Russian domestic market has shown signs of improvement relative to 2009 despite some seasonal weaknesses in May and June and as such we continue to believe that domestic demand will recover quicker vis-à-vis the pre-crisis levels. Despite recent



signs of a slowdown in industrial output largely caused by the excessive heat wave the overall statistics confirm year on year growth in domestic GDP and power generation consumption. Our natural gas production over the first half 2010 has increased by 2.4 billion cubic metres or by 15.3% over the prior period thus representing a continued growth in our production profile. The production growth achieved so far this year is not skewed by lower 2009 production levels stemming from the effects of the economic downturn. Instead we have continued to maintain higher production levels throughout the seasonal trough period as compared to the prior year and based on the production levels achieved today I can confirm that we will achieve the higher end of our production guidance for 2010 assuming normal weather patterns for the remainder of the year. Our natural gas production output the first half of 2010 averaged 102 million cubic metres per day or 3.6 bcf per day.

Looking ahead we believe we are well positioned to benefit from continued and/or sustained economic recovery in the Russian domestic market and correspondingly we are presently preparing our natural gas contracts for the upcoming year. Based on these positive economic trends supporting domestic demand recovery combined with the fact that we will be adding an additional 7 billion cubic metres to our production capacity in October of this year we are now in a position to provide you this evening with our production guidance for 2011. We are forecasting 2011 natural gas production growth of approximately 12% over 2010 levels and based on this forecasted growth we will continue to grow our gas condensate production at comparable volumes we achieved in 2010. These forecasts are predicated on the assumptions of continued economic recovery in the Russian domestic market as well as normal seasonal weather patterns. During the first half of 2010 we increased our total production of liquid hydrocarbons by 272,000 tonnes or by 18.5% driven primarily by continued strong production growth of 38.6% at the Yurkharovskoye field. Even though we had a combined 1.5 billion cubic metres reduction in natural gas production between the first and second quarters of 2010 we still managed to increase our liquid productions mainly on stable gas condensate quarter on quarter by increasing natural gas production at the Yurkharovskoye field by 145 million cubic metres and decreasing output at other fields again demonstrating how we optimised field production and hence our financial results. The expansion of our liquid production and the further penetration of new markets is a key element in our corporate strategy and as such we



officially dispatched the first high tonnage tanker to navigate the northern route. The vessel Baltika owned and operated by Sovcomflot with deadweight capacity of over 100,000 tonnes was dispatched from the Murmansk port carrying a consignment of approximately 70,000 tonnes of stable gas condensate destined to the Asia-Pacific region. The tanker will be accompanied by icebreaking support provided by Russia's Atomflot and will represent a significant milestone for being the first tanker of hydrocarbon to navigate the Arctic Ocean's northern sea route. Moreover the strategic importance of this high tonnage voyage will facilitate future development of the Arctic regions as well as provide future logistical and commercial support for our LNG project.

I would like to now move on to the second part of my conference call and talk about the financial results for the second quarter and first half 2010. Let's begin by discussing the effect of seasonality on our oil and gas revenues. We have consistently highlighted the seasonal variations in our natural gas production and sales by stating that we peaked during the first and fourth quarters of the winter season and we troughed during the second and third quarters, the summer months. We have not deviated significantly from these seasonal patterns since we began publishing our financial results to the investment community. So if we look at the decrease between the first and second quarters 2010 it is definitely more pronounced in this period because of the very cold winter we had in this past year combined with a shift in our sales mix towards more power generation. The first quarter 2010 also represented the first time that we exceeded 10 billion cubic metres in sales volumes. If you look back at our sales volumes in the corresponding 2009 period, power generation as a percentage of end customer sales represented 58% and 32% in the first and second quarters respectively which is significantly lower than the 73% and 76% penetration we achieved in the corresponding 2010 periods.

Another point I would like to highlight relates to the change in our underground storage position. During the first quarter of 2010 we withdrew approximately 272 million cubic metres of gas from underground storage to meet our contractual sales obligation. Conversely in the second quarter 2010 we injected approximately 358 million cubic metres into underground storage thus recording a net change of 640 million cubic metres between the respective periods.



Our balance in underground storage at 30th June stood at approximately 829 million cubic metres.

Moving forward I would like to make a few brief observations on average realised prices in transportation. We do not anticipate large variations in our average realised prices throughout 2010 since the FTS tariffs are expected to increase only once in 2010 which already occurred effective in January. Last year they were adjusted four separate times. Despite this fact our average netbacks continued to change slightly quarter on quarter based on the sales mix and transport distance. Between the first and second quarters 2010 our average netback for end customer sales decreased by 6/10 of 1% or marginally from 1,205 rubles per thousand cubic metres to 1,198 rubles per thousand cubic metres respectively. The change in our average transport distance was also marginal between periods decreasing from 1,951 kilometres to 1,944 or by 7km meaning that the primary difference between reporting periods was solely related to the changes in regional deliveries of natural gas. During the second quarter of 2010 our proportion of sales to customers in the region of Sverdlovsk and Orenburg with higher transport costs increased as a percentage of our total natural gas sales which was partially offset by proportionally higher sales to the Chelyabinsk region with lower transport costs. I have repeated stated that one of our key commercial trading KPIs is maximising product netbacks rather than average realised prices. For example we delivered a little less than one quarter of our sales volumes to the Perm region which is why we established a subsidiary in this region to further penetrate this important industrial market. The average netback we received for this important industrial region was higher than the overall total average netback we received during the second period by approximately 8%, again demonstrating that our netbacks vary depending on the mix of the customers, regional markets and transport distances despite any top line pricing concessions we may consider to grow potential market share. Our focus is on maximising our netbacks.

Sales of natural gas to end customers were 65.7% in the second quarter as compared to 60.3% in the first quarter. I want to again emphasise the commercial importance of maximising a proportion of end customer sales in our overall natural gas sales mix because the underlying commercial strategy continues to be missed. The more we control the amount of natural gas



sold to end customers, the better we control our operations. Last year for instance during the height of the economic crisis we were able to continue growing our natural gas production whereas those companies relying solely on ex-field sales to traders were curtailed. As a result we were able to continue growing our gas condensate output thus optimising our revenues and margins. The netback trade-off between the first and second quarters was approximately 25 rubles per thousand cubic metres or less than \$1 on the differential volumes sold ex-field versus end customers which by the way is really only a theoretical argument because we cannot control the volume sold by traders. More importantly we can control the volumes sold to end customers.

Overall we are very pleased with the seasonally adjusted financial results achieved for our natural gas business. The average realised price for end customer sales during the first and second quarters were in line with our price expectations vis-à-vis the general tariff increase and the regional geographical mix of our primary customer base. Our total volumes sold for liquids increased by 20% or by approximately 137,000 tonnes as compared to the first quarter 2010. Specifically we increased the volume of stable gas condensate sold quarter on quarter from 412,000 tonnes to 593,000 tonnes or by 30.8% of which we recognised approximately 111,000 tonnes of stable gas condensate that was previously recorded as in transit. We also managed to marginally increase our volumes sold for LPG and crude oil by 6,000 tonnes and 4,000 tonnes respectively.

During the second quarter we increased the volume of stable gas condensate in transit and storage by approximately 55,000 tonnes culminating in a period ending inventory balance of 332,000 tonnes at 30th June as compared to 277,000 tonnes at the end of the first quarter. At June 30th 2009 we had period ending inventory volumes of 172,000 tonnes representing a year on year increase of 160,000 tonnes or by 93%. We dispatched ten tankers carrying approximately 596,000 tonnes from the Vitino sea port terminal of which four tankers or 40.3% of the volumes dispatched were destined to the US market as compared to seven tankers or 77.4% in the first quarter of 2010. The remaining tankers were evenly dispatched to Brazil, Singapore and China, therefore we had no tanker sales to the European markets in the second quarter of 2010. Our Purovsky Processing Plant operated at 67% of its rated capacity with a



total plant output reaching 825,000 tonnes comprised of 595,000 tonnes of stable gas condensate and 230,000 tonnes of LPG. During the first quarter of 2010 our average processing plant utilisation was approximately 65%. One of the most notable differences in our liquid sales year on year was the continued increase in commodity prices between the respective periods which positively impacted our liquid netbacks. Our average export netbacks on a US dollar basis for stable gas condensate and LPG volumes sold during the period increased year on year by approximately 8.8% and 98.8% respectively despite increases in both export duties and average transportation expenses. In comparison to the first quarter 2010 however our average export netback for stable gas condensate and LPG decreased by 2.4% and 1.7% respectively largely attributable to increases in transport and export duties of stable gas condensate and a reduction in the contract price for export and domestic sales of LPG. For stable gas condensate we sold 536,000 tonnes realising an average netback per tonne of \$292 in the second quarter 2010 as compared to \$268 per tonne in the second quarter of 2009 and \$299 per tonne in the first quarter 2010. The reduction in quarter on quarter netbacks of approximately \$7 per tonne was largely attributable to a 5.4% increase in export duties and a 3.4% increase in transport charges which was partially offset by a 1.6% increase in the average contractual price period on period. For LPG we managed to significantly increase our year on year average export netback by \$187 per tonne on sales volume of 115,000 tonnes whereas our quarter on quarter comparatives showed a reduction in our average export net price by \$7 per tonne on the equivalent sales volume basis. This quarter on quarter reduction was largely due to a reduction in the average contractual price we received which was partially offset by the application of the real and export duty concessions. Domestically we had a slight reduction in both volumes and average netbacks received. There were no sales of LPG to the CIS countries during the reporting periods. The export netbacks we received for our liquid products were reasonably consistent quarter on quarter and again fully in line with price expectations and market conditions. Overall we are pleased with the strength of our liquid business in the second quarter 2010 despite the build-up in stable gas condensate volumes in transit during the period which had been recognised as revenues in the third quarter. Volumes in transit are essentially a timing difference in revenue recognition. Unfortunately we expect to continue experiencing volatility in our transit volumes period on period as we move products across a diverse geographical area.



Our total operating expenses increased year on year in absolute terms from 15 billion rubles to 15.7 billion rubles but decreased as a percentage of total revenues from 65% to 61.1%, however for the remaining discussions on operating costs during this conference call I will primarily focus my attention between quarter on quarter comparatives. Total operating expenses decreased by approximately 200 million rubles between the first and second quarters but increased as a percentage of total revenues from 57.5% to 61.1% largely due to the decrease in total revenues.

One of the primary differences between our operating expenses quarter on quarter was the overall impact on total operating expenses due to volumetric changes which reduced some of the variable related expenses one would expect. For example our total volumes sold to end customers decreased by 904 million cubic metres or 14.8% which meant that we had a corresponding reduction in transportation expenses even though our end customer sales as a percentage of total sales increased quarter on quarter from 60.3% to 65.7%. Furthermore we had a slight reduction in our average transport distance by 7km which also reduced transportation expense during the quarter.

Conversely our liquid transportation expense increased quarter on quarter on more volumes sold but a portion of this expense category or approximately 154 million rubles was recaptured in a change in inventory adjustment for the period and will be recognised in operating expenses when a product reaches its intended destination. We also had a similar adjustment of 126 million rubles for operating expenses for the increase in our inventory balances of natural gas. The same sort of volumetric analysis can be applied to the variable nature of our taxes other than income. For example quarter on quarter we reduced natural gas production by 1.6 billion cubic metres or by 16% which reduced the variable mineral extraction tax burden between periods. The only real notable change between the first and second quarters was the introduction of the excise and fuel tax we incurred for movements of LPG into Poland through our wholly owned subsidiary NOVATEK Polska which amounted to 56 million rubles in the second quarter. All other changes in the tax balance were considered immaterial. Therefore we do not experience anything unusual with our non-controllable expense items between the respective quarters that are not explainable either by the effects of seasonality, inventory in transit or changes in volumes produced and/or sold. The increase in material service and other



operating expense by 192 million rubles during the second quarter was largely attributable to employee compensation and materials and supplies which accounted for roughly 90% of the change between periods. Employee compensation accounted for 49 million rubles of the change whereas materials and supplies accounted for the remaining 123 million rubles. The main reasons for the quarter on quarter increase in employee compensation relates to the expensing of 59 million rubles for repair and maintenance work on employees' housing located in the far north included as part of their overall compensation package and a payment of bonuses in the amount of 16 million rubles which was partially offset by a reduction of headcount and related salaries of 26 million rubles. We expect to periodically incur expenses relating to ongoing repair and maintenance activities with renovation and general repairs to employee's housing complexes located at our field sites that ensure that these facilities are adequately maintained. The quarter on quarter increase in our materials and supplies expense line item was solely due to the purchases of more expensive raw materials with the feedstock used in the production of polymer products, namely film wrap. Correspondingly we also managed to increase our revenues from the sale of polymer products by 142 million rubles or by 30.3% as compared to the first quarter 2010 largely attributable to the sale of film wrap. Each quarter there seems to be much attention paid to our general & administrative expenses even though we consider it as an important expense category to be well controlled by senior management and does not fluctuate dramatically period on period. Specifically the focus tends to focus on employee compensation, so as usual I will attempt to alleviate concerns that our employee compensation is not excessive for the scope of our business or the stellar results that we have achieved. We increased our general & administrative expenses or G&A by 168 million rubles or by 11.5% between the respective periods. Within this expense category we had various fluctuations between different line items during the reporting periods, some of which we consider immaterial. Our employee compensation expenses increased quarter on quarter by 163 million accounting for approximately 3.9% of our total revenues for the period as compared to 3% in the first quarter 2010. For the sake of full disclosure employee compensation represented 3.3% and 3.1% in the first and second quarters of 2009 respectively when all salaries were frozen and held constant during the crisis. During the second quarter we increased our total headcount by nine employees to 1,027 which are expensed within this G&A category. Although the absolute number is relatively small the largest increase in our head



count was due to the start-up of NOVATEK's new research centre in the Tyumen region which increased its respective headcount by 22 employees as well as increasing other general operating expenses as part of this start-up. The primary reasons for the increase in employee compensation was the increase in bonus payments based on the 2009 results and the initiation of the share based compensation as part of our long term employee motivation programme which excludes members of the management board. In the second quarter we expensed 86 million rubles to employee compensation for the share based programme which was initiated during the quarter. Moreover we paid an additional 107 million rubles in bonus payments in the second quarter as a result of finalising our year end financial results in March 2010 which were all set by a reduction in miscellaneous social payments including compensation thus accounting for the net increase in the period of 163 million rubles. It is our intention to continue paying our employees annual and semi-annual bonuses based on the financial performance of the company as well as periodic inflation and wage adjustments. During the recent economic crisis we asked all of our employees to make personal sacrifices in terms of salary freezes, reductions in some of the social benefits and other cost control initiatives. Each and every one of our employees fully understood the need for the company to remain profitable and focus on cost control during this difficult period. They make a personal sacrifice in the best interests of NOVATEK despite a large portion of our employees living in climatic harsh conditions throughout the year. Moreover providing a portion of our employee's total compensation package and share based compensation or any other incentives linked to the creation of shareholder value is considered best practice and should be considered positive by our shareholders as this aligns our respective interests. Effective July 1st 2010 we made a 10% company-wide inflationary wage adjustment which represents a partial recovery from frozen salaries in 2009 and this is the first wage adjustment for employees at NOVATEK's headquarters in three years.

Within other operating expense categories we increased our compensation pay to Members of the Board of Directors as recently improved at our annual general meeting of shareholders on 28th April 2010 as well as increase the compensation paid to members of the company's revision committee which was also approved at the same AGM. The company has grown in size and complexity over the years and it is necessary for us to attract and maintain qualified candidates to the board as well as compensate them for their active participation in board committees. As



for members of the revision committee, the increase in our annual compensation was completely justified on the increased scope of the review activities across NOVATEK and its subsidiaries. Also within this expense category other expenses accounted for 40 million rubles or 45.7% largely comprising miscellaneous bank charges and the cost of maintaining a bank guarantee with the Bank of Moscow as part of the acquisition of Yamal LNG which expires on 27th August.

Although depreciation, depletion and amortisation or DD&A decreased quarter on quarter by 53 million rubles, the actual per barrel of oil equivalent unit costs used in the unit of production method increased from 19.6 rubles per barrel of oil equivalent to 22 rubles per barrel of oil equivalent largely due to the capitalisation of an additional 6 billion rubles to the cost depletion base. We fully expect that the depletion cost base will continue to increase over the course of the year as we capitalise costs to our oil gas properties each period which is fully explained in our MD&A. Our exploration expense increased quarter on quarter by 204 million rubles or 158% largely due to the geophysical and geological work at our field and licence areas and is consistent with our accounting policy to expense these types of activities in the period incurred.

As mentioned above in my summary of work activities over the course of the first half 2010 I mentioned that we ran and interpreted a series of 2D and 3D seismics. This type of work activity is charged against the profit and loss statement in the period incurred. As a result of the factors enumerated above, our EBITDA and net profit margins have remained healthy and consistent with our financial guidance despite contracting relative to the record results we achieved in the first quarter of 2010. Our profits from operations decreased quarter on quarter from 13.4 billion to 10 billion largely due to the recognition of a 1.6 billion ruble gain on disposal in the first quarter 2010 and the corresponding reduction of our oil gas revenues due to seasonal adjustments for natural gas and a build up of inventories for our stable gas condensate. Our net profit between periods continues to be positively or negatively affected by fluctuations in the exchange rates of the Russian ruble relative to the US dollar and the application of these foreign exchange movements to a portion of our debt position denominated in US dollars. During the second quarter the Russian ruble depreciated against the US dollar by 6.2% resulting in a non-cash foreign exchange loss of 1.1 billion rubles whereas our first quarter net profits were



positively aided by a 646 million non-cash foreign exchange gain. Our balance sheet and liquidity positions continued to remain strong throughout the second quarter 2010 although we increased our debt position in the second quarter relative to our year end balances in the first quarter 2010 largely due to the placement of a 10 billion ruble bond in June 2010 as well as some minor draw-downs on some of our credit lines. We decided to place our debt ruble bond to extend the maturities of our existing loan portfolio as well as reducing the cost of financing on our Russian denominated debt. We accomplished these aims with the successful placement of our Russian ruble bonds with a maturity of three years and a coupon rate of 7.5%. Post balance sheet we repaid the 5 billion ruble Sberbank loan facility in full and made a scheduled payment of \$114 million to our syndicated loan in July 2010. We will continue to service our syndicate loan facility and other debt facilities as they mature. We also received a corporate investment grade rating of BBB stable outlook by Standard & Poor's during the period and now have corporate investment grade ratings from all three of our credit reporting agencies. Finally we continue to remain free cash flow positive during the first and second quarters 2010.

In conclusion we have delivered another solid quarter of financial and operational results completely in line with the seasonality trend of our natural gas business. Our ability to continue growing our production is directly linked to the continued recovery of domestic demand as well as the normal seasonal weather patterns. Tonight I was able to provide you with our initial guidance for 2011 natural gas production which continues to underscore the fundamental growth story of the company. I trust our shareholders understand that senior management is focused on controlling costs throughout our business operations despite period on period fluctuations, in particular line items that we feel are justifiable and explainable for the size and growth of our business and that you also understand that from time to time we will make the necessary adjustments to wages and compensation packages to our valued employees because we expect to maintain a dedicated and highly competent workforce that fulfils the strategic objectives that we have outlined for NOVATEK.

The results achieved during the first half of 2010 attest to the strength, viability and operating leverage of our business model and reflects positively on the strategic and operating decisions entrusted to senior management to create sustainable shareholder value. We continue to



remain highly confident in future prospects of NOVATEK and the growth strategy that we have adopted.

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

Oleg Maximov: Two related maybe clarifications if I may. You guided for 12% year on year gas production growth. What level is this growth pencilled against, 37 or 38 billion cubic metres? The second related question is given that you've provided guidance fairly early in the year, should we assume that these volumes have already been contracted to your end customers, traders and as well agreed upon with the owner of the pipe? Thank you.

Mark Gyetvay: The answer to the first part of the question, it's based on achieving at least 37 billion cubic metres by the end of the year. Again it's dependent on the remaining weather patterns for this upcoming peak season. We as I mentioned are also finalising the contracting process and yes, we have agreed the transport side of the volumes delivered. Hopefully Oleg you and I are the only ones on this call.

Oleg Maximov: No, there are plenty of people on the call. For some reason we cannot hear the operator.

Mark Gyetvay: It's unfortunate that we're experiencing this difficulty but I hope that the text of the presentation answers a lot of the questions that were raised in your reviews. We tried to follow a pattern by addressing some of the major changes between the period that we felt that would have been of interest to our shareholders and analytical community. I just want to again reiterate that we believe that the results achieved today were completely in line with what we expected, seasonally adjusted as well as results or the expenses that we acquired excuse me in our operating expenses as they were also seasonally adjusted. The large increases that you saw mostly in employee compensation I believe are fully explainable and I think they're completely in line with our business. Oleg, do you have any other questions?



Oleg Maximov: We are still contacting the operator. She simply cannot hear us for some reason, something on their side. I suggest we wait a couple more minutes, if not then I guess we'll have to drop it.

Mark Gyetvay: Do you have any specific questions on the operating side of the business as relates to expenses Oleg?

Oleg Maximov: Yes, if you can discuss Capex, maintenance Capex going forward after you built infrastructure on the Yurkharovskoye field that would be great.

Mark Gyetvay: As you know if you look at the production and the contribution from the East-Tarkosalinskoye and Khancheyskoye field for two consecutive quarters we've spent about \$7 million each, the ruble equivalent of \$7 million each on both of these periods. I don't expect we'll continue to see significant increases in any capital expenditure for these particular fields but we will undertake some additional drilling activity at Khancheyskoye to ramp up production to its field level, 5.6, 5.7 pcm, so theoretically on that perspective the intensity to maintain revenues generated from that particular field are quite low. I've kind of alluded, you can do the math if you assume that we added seven wells at approximately \$11.9 million per well, add a little inflation you can theoretically back in that the overall remaining capital expenditure programme at the Yurkharov field should be in the tune of about \$500 million give or take 10% either way in terms of the additional capital. That should just support going forward that continuously maintaining production at these levels and drilling a few wells from time to time, the ongoing maintenance capital to sustain the full sales production will correspondingly be low.

Oleg Maximov: Thanks Mark. We still cannot reach the operator, something happened on their side.

Mark Gyetvay: Again we apologise and I hope it didn't cut off the discussions throughout the presentation. Do we know if people are still on the line?

Oleg Maximov: People are on the line.



Mark Gyetvay: Ok, so we know that. Is there any way they can text us messages or we can answer questions?

Oleg Maximov: The only thing I suggest is that people who want to ask questions is just email them to you.

Mark Gyetvay: Email them directly to me.

Oleg Maximov: Or to Investor Relations.

Mark Gyetvay: Alright Oleg, I guess there's really nothing we can do about it. I apologise to everybody for the technical glitch. If you have any questions that you were unable to get asked during this particular conference call, as Oleg suggested please send them to us and we'll answer all questions and we'll post the questions that were asked by everybody on the website so that's available to everybody so they can see what the questions and answers were. Again Oleg, thank you very much and it's unfortunate we had this glitch but I hope that the information provided tonight clarifies some of the differences and also that the guidance that we provided tonight again continues to demonstrate the strong growth story of NOVATEK. I guess at that point we should just end the call.

Oleg Maximov: Thanks Mark.

Mark Gyetvay: Thank you.

The question and answer session of NOVATEK's conference call was not possible due to technical difficulties. As a result, please see below the questions which were submitted to NOVATEK Investor Relations by participants on the conference call and Mark Gyetvay's responses:

Question and Answer session with Mark Gyetvay, NOVATEK CFO and Member of the Board:



Pavel Kushnir, Deutsche Bank

1. What specific government decree do you expect to be released by the end of 2010 on Yamal LNG? I cannot think of any format for such a document?

RESPONSE: The RF Government recently met to discuss the future development of the Yamal Peninsula, including our Yamal LNG project, during a scheduled session, and based on the feedback that we have received, the Russian Government is expected to formally issue a Governmental Decree by the end of 2010 outlining their position on various issues and topics of interest to us. I suspect that during this meeting many issues were discussed such as levels of capital expenditure required to explore and exploit this hydrocarbon rich area, the strategic nature of the licenses, employment in the Far North, mineral extraction and other tax related issues, amongst other items.

Once the official governmental decree is published we can determine the level of commitment and support that will be provided, and based on this position, we can hopefully address some of the questions raised to us by potential strategic partners and provide them with some clarity.

2. Can you please repeat the number of wells you operate at each subsidiary and clarify on your point that you need to drill certain number of wells to maintain production?

RESPONSE: During the presentation I mentioned that we presently have 108 producing wells at the East Tarkosalinskoye field, 22 producing wells at the Khancheykoye field and 40 producing wells at the Yurkharovskoye field that was responsible for achieving the 32.8 billion cubic meters of production in 2009. Going forward, I said we will essentially double the number of producing wells at the Yurkharovskoye field, and thereafter will only require a limited number of wells (no figure given) to sustain production levels as demonstrated from our past production history, decline rates et cetera.

3. You mentioned that gas condensate growth in 2011 will be comparable to growth level in 2010. What is your official guidance for gas condensate growth in 2010 y-o-y?

RESPONSE: To date, we have increased our stable gas condensate by 18.5%, which is higher than the production guidance issued in 2009. I believe we were targeting approximately 15% year-on-year growth in 2010; therefore, I believe it is reasonable to assume the same production guidance of approximately 15% in 2011.

4. You said during the call that 2010 production will be in the upper end of the guidance range. Is this range 37-38bcm? Still you provide 2011 production growth guidance of 12% y-o-y on the basis of 37bcm production?

RESPONSE: I stated that our initial production guidance for natural gas in 2011 to be 12% depending on continued demand recovery and normal seasonal weather. Our full production is expected to be around 37 billion cubic meters, or slightly more, based on our production results to date, and the fact that we will be entering the peak season with additional production capacity.

5. I understand that RR 86 million charge related to the initiation of the share based compensation program in 2Q 2010 – is this a one-off charge?



RESPONSE: The employee share based compensation program is a three-year program, whereby each quarter the underlying strike price, which is the average acquisition cost and related charges, will be marked-to-market at each quarter period end, and the difference between the strike price and the end of period share price will be charged (or amortized) to employee compensation expense.

- I understand that the RR 59 million Board and revision committee compensation is a one-off charge and should not appear in future periods - is this correct?

RESPONSE: Generally speaking, we do not expect continued increases in the compensation package to Board members unless approved at the Annual General Meeting of Shareholders. Compensation to Board members will be reviewed periodically to determine whether or not the package offered by NOVATEK is competitive in the market and against other companies in the industry. The determination of Board compensation considers various factors, such as participation in committees, sub-committees, attendance et cetera, and is benchmarked against companies listed with similar ranges of market capitalization on major stock exchanges.

- Should we expect payment of excise taxes by Novatek Polska in future periods and what is the best way to estimate this expense – volumes or based on prices?

RESPONSE: Yes, we expect to incur this expense in future periods as we expand the level of commercial trading activities in Poland and other Central and Eastern European countries. Our excise tax is volume based and in the 2Q 2010 was set at Polish Zloty (PLN) 695/ton for LPG volumes which enter Polish territory and our fuel tax is set at PLN 119.82/ton and calculated on the same volumes. There is zero excise and fuel tax rates on LPG sold for home use.

Yuri Maslov, Nevsky Capital LLP

- Can you please provide guidance for total capex in 2010 and 2011. I think your previous guidance was for 2010 capex of ~RUB28bn, but so far in the 1st half of 2010 total capex was only RUB9.3bn (according to the cash flow in the IFRS financials)

RESPONSE: You are correct that our initial guidance for 2010 capital expenditures is approximately RR 28 billion (excluding VAT), and that the results year-to-date is significantly less. We expect to increase our capital expenditures in the second half of 2010 which correlates to our traditional winter drilling season. Also, it is important to understand, that our full year drilling program straddles two different winter periods, and as result, there may be some movement of invested capital over two financial calendar years. But generally speaking, this amount is what we have planned to spend on capital projects in 2010.

As for 2011, we have not provided our formal capital expenditure program as of yet, and this will more likely be in the later part of 2010, largely due to our ongoing review and budget process, as well as approval of the 2011 business plan by the Board of Directors. Once these steps are completed we will make this announcement.

Evgenia Dyshlyuk, TKB Capital

- Could you please provide guidance for growth in average transportation tariffs in 2010 and 2011?



RESPONSE: The transportation tariff on average has been increased by 12.3% effective 1 January 2010, and the increase is approved by the Federal Tariff Service (FTS). We have not received any formal notification, or official publication by the FTS as of yet for 2011; therefore, it is too premature to comment at this point.

2. What is your view on possible increase in mineral extraction tax (MET) for gas? When do you expect it? What increase have you budgeted for?

RESPONSE: There is a lot of speculation of the extent of the increase in mineral extraction tax for 2011 that has been reported in the Russian press and by the analytical community. At this point, we do not speculate what the increase in MET will be in 2011, but we are working with the relevant governmental bodies, as well as our traditional lobbying efforts, to ensure that any change in the MET in 2011 and beyond will not be punitive.