



Company: Novatek
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Presenters: Mark Gyetvay, Oleg Maximov
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Operator: Please stand by, we're about to begin. Good day and welcome to the Novatek Q1 2011 Financial Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to 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 First Quarter Financial and Operating Results conference call. With us today is Mark Gyetvay, the Chief Financial Officer of Novatek and Member of the Board of Directors. Mark, please start with your presentation. Thank you.

Mark Gyetvay: Ladies and gentlemen, shareholders and colleagues, good evening and welcome to our First Quarter 2011 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 our earnings conference call.

Before we begin with the specific conference call details, I would like to refer you to our disclaimer statement, as is our normal practice. During this conference call, we may make reference to forward-looking statements by using words such as 'plans', 'objectives', 'goals', 'strategies' and other similar words which are other than statements of historical facts. Actual results may differ materially from those implied by such forward-looking statements due to known and unknown risk and uncertainties, and reflect our views as of the date of this presentation. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements in light of new information or future events. Please refer to our regulatory filings, including our Annual Review for the year ended the 31st December 2010 as well as any of our earnings press releases, for more descriptions on the risks that may influence our results.



We continue to demonstrate positive year-on-year and quarter-on-quarter financial and operational results and for the first quarter 2011 was another record quarter for Novatek. With the successful integration of the Sibneftegas acquisition, combined with strong seasonal demand, we managed to increase our natural gas business to record levels, both in terms of production and volumes sold. It is also interesting to note that our record financial results achieved in the first quarter 2011 almost exceeded the financial results for the whole of 2006, the first full year after we went public, and already represents approximately 50% of our EBITA achieved in 2010.

Unfortunately, the record financial and operational results achieved over the past quarter have been overshadowed by the recent noise or speculation in the market of impending changes to the mineral extraction tax and the rate of growth in the natural gas prices vis-à-vis the market liberalisation program. As you can appreciate, it is not our position to comment on market speculation and rumours as a matter of course. However, since we are actively involved in the ongoing discussions with the various ministerial bodies responsible for reviewing and formulating policies, we felt that it is warranted to voice our views on this matter tonight. Therefore, I would like to spend a few minutes talking about these two points, namely the ongoing discussions on the mineral extraction tax and the rate of increase in the price tariffs.

Frankly speaking, we completely understand everyone's concerns on these two key points because predictability, rather than uncertainty, lowers the market's perception of risk. From what has been published in the press and commented on by the analytical community, I believe everyone is aware that the Russian government, particularly the Ministry of Finance, is trying to settle an issue on generating additional budget revenues in the upcoming election year. Despite a higher-than-budgeted crude oil price environment, it appears that there is concerted effort to fulfil an ambitious social program preceding the upcoming 2012 elections. As a result, it is probably safe to assume that 2011 will be a year of heightened volatility in both the equity and debt capital markets, particularly resultant from the rhetoric spoken by the government officials and other anonymous sources and the market's interpretation of these comments, whether or not the comments are made specifically attributable to responsible individuals or credible



sources. This volatility is quite unfortunate for the company as it raises the investors' perception of Russian country risk despite the very positive dynamics in the natural gas markets.

Considering the political dynamics in a pre-election year as well as the ongoing rhetoric, it is understandable to assume the worst but in reality the situation is not as drastic as being portrayed in the market. Representatives of the relevant ministerial bodies within the Russian government, Gazprom and members of the independent gas producers including ourselves are all contributing information and meaningful analysis, and collectively we are actively taking part in constructive dialog. I can assure everyone on this call that Novatek's representatives are significantly involved in all aspects of these discussions and we will strongly, and hopefully convincingly, put forth our case to minimise any negative consequences to either our financial results and/or our capital investment program. It is my understanding that there are various mechanisms being discussed that could potentially achieve the government's aim of generating additional budget revenues and that many of these discussions are not completely centred on raising the mineral extraction tax for participants in the natural gas sector.

When speaking about the possibility of raising budget revenues, many of the market comments have been centred on significantly raising the mineral extraction tax, a position posited by the Ministry of Finance. However, let's not forget the fact that the mineral extraction tax or MET was already significantly raised by 61.2% effective the 1st January 2011 and despite this large increase, we still managed to post strong financial results for the quarter. The plan going forward was expected MET increases in line with inflation of approximately 5.9% and 5.3% for 2012 and 2013 respectively.

Throughout these discussions, there have been proposals formulated that would differentiate MET between wet and dry gas production, with the underlying assumption that wet gas is more costly to extract and process, thus a lower MET is warranted. Under this scenario, we would be a net beneficiary of a lower MET because roughly 80% of our natural gas production is for deeper Valanginian layers representing wet gas. I would also like to note that this tax differentiation scheme is not new information as this geological difference in operation has



already been discussed and positions formulated two years ago when there was a similar aim to significantly raise the mineral extraction tax for natural gas.

I would also like to mention at this point, and for those investors who meet with me on a regular basis have already heard my views on this issue, the natural gas sector is already significantly taxed through price subsidies on the Russian domestic market, a de facto tax that nobody wants to talk about but let me assure everyone that we have made this point very clear and it's one of the central themes of our arguments against punitive taxes to the natural gas sector. We have also heard many counterarguments from the oil sector that they are unduly taxed at the expense of the gas sector but seriously speaking, both Urals Blend crude oil and petrol prices at the service station pumps are consistent with global oil commodity prices and product prices. I believe that argument cannot be said for the commodity prices we receive for our natural gas on the Russian domestic market. Therefore, on the question of raising mineral extraction tax, we expect to continue meeting with the government officials over the next couple of months. We will continue to strongly lobby, together with Gazprom and other independent producers, against any punitive tax increases and we believe that the ultimate outcome will not significantly affect us.

I would now like to move on to the next issue, which addresses the speculation on the potential slowdown in the rate of natural gas tariff increases. First of all, we are not obligated to sell our natural gas at the FTS or Federal Tariff Service prices, as you all well know, since we are not considered a natural monopoly. However, despite this fact, the prices we receive for our natural gas on the domestic market are highly influenced by the regulated price environment, so obviously this topic is of great importance to us. Our position on this matter is more complicated than just a simple focus on one item, the percentage increase in the gas tariff. We have framed our discussions more broadly, taking into consideration the expected MET and the rate of transport tariff increase because we believe ultimately the combination of these factors, which affect our netback prices, is more important to us. Furthermore, the combination of these factors is of particular relevance to us because we tend to sell more than 50% of our natural gas to end consumers, although this mix between end consumers and wholesale traders fluctuates period-on-period.



To illustrate this point, if we look at the average changes in our end customer price and transport cost per 1,000 cubic metres between the respective periods and compare this delta against the 61.2% MET increase as noted earlier, we can ultimately calculate the average impact on our netback price.

Taking all these factors into consideration, you will know that our average netback in the first quarter of 2011 increased by RUB 131 per 1,000 cubic metres, essentially mitigating the larger percentage increase in MET. As of this conference call, our netback expectations for 2012 is premised on a similar scenario: the rate of transport tariff not to exceed inflation; no punitive MET changes; and the gas price tariff program to remain relatively the same and on course as outlined in a recent amendment to the liberalisation program. According to our sources, we presently understand that the Russian government is not considering any changes to the proposed 15% tariff increase or the slowdown in the liberalisation program for that matter. I would also like to reiterate an important point that both administrative finance and administrative economics confirm that they are not proposing changes to the gas liberalisation program, and this confirmation was provided after the various stories emerged regarding changes to the mineral extraction tax. Furthermore, in February the Russian Federation government extended the gas liberalisation program by one year to 2015, and at the very same time reconfirmed the expected tariff price increases. As of today, this represents the most current information we have on these two important topics and as usual, we will keep everyone apprised of any impending changes to any of these factors or the confirmation of our expectations.

I would now like to shift the focus of my discussions to demand for natural gas which, as everyone recalls, was a recent hot topic and one of that almost all industry analysts painted a dire picture of, whereas we remained steadfast in our position that the recovery in demand for natural gas in the Russian domestic market was stronger than the market's view. I believe the results are the priority here and the first quarter 2010—'11, excuse me—confirm our view, and I can definitely state, just returning from the Flame gas conference in Amsterdam, that the general sentiment amongst the energy producers and the analytic community has drastically



changed regarding this topic as the so-called glut of natural gas was not a significant point of discussion.

Moreover, I can also state that the market's perception of Russia as a reliable supplier of natural gas has also dramatically changed with the recent political uprisings in North Africa and the Middle East. The March 11th earthquake in Japan and the Fukushima nuclear crisis has put into spotlight the important role natural gas plays in the world's hydrocarbon mix. Equally important has been the psychological effect of potential nuclear disasters and the ensuing global reaction toward nuclear power. Particularly noteworthy was reaction from the German government to temporarily shut down all nuclear reactors within approximately 100 hours after the Japanese nuclear crisis, which according to some reliable sources indicates that they, the German government, may abandon their plans to extend the operational lives of some of the older nuclear plants.

As a result of these dramatic events, we have seen a shift in the flow of LNG between geographical markets, the additional call on natural gas via pipeline to offset these directional flow changes, the uncertainty and shutdown of gas flows from North Africa and a general pause of sentiment that we are beyond the economic crisis in terms of demand recoverment. Ultimately natural gas will be a benefactor of these tragic events but fundamentally the pendulum swings in supply/demand forecasts were not realistic because there were really no structural changes in the gas market besides the shale story in the United States, but rather a cyclical downturn that would eventually reverse course. Already we can see the increased flow of natural gas via the pipeline to the European market by Gazprom's reported export numbers and hopefully this translates into additional opportunities for us on the Russian domestic market. In Russia we clearly demonstrated robust production growth organically from our core fields, notably the Yurkharovskoye field, and positive contributions from our production profile by the recent acquisition of Sibneftegas.

More importantly, we can clearly see that overall demand is stable and that there are clear signs of increased demand from all segments of the economy. Paradoxically, despite the seasonally adjusted demand in Russia due to the cold winter weather, we experienced isolated cases of



natural gas shortages this past winter. This prompted a call by Prime Minister Putin to ensure priority access to the pipeline network for those companies delivering natural gas to the power sector. When we speak about demand for natural gas, it is very important to take into account the seasonal trends in the consumption patterns. Demand for natural gas this past winter season, inclusive of the first quarter 2011, was supported by colder-than-normal winter temperatures, which we believe is the primary determinant for demand. The colder winter weather obviously had a positive effect on the consumption of natural gas in Russia as one would expect. However, we should not underestimate the positive drivers of continued economic recovery in Russia during the period as well.

Another clear sign of demand recovery is our production so far in the second quarter, which is already exceeding our planned production for the period due to strong demand for natural gas in Russia. As a good barometer of continued demand recovery, I believe that it is very important to note the robust demand pull during the seasonal trough period as well as the increased flow of natural gas to Western Europe to offset LNG directional movements and earlier-than-normal underground storage fill in Western Europe. The storage fill season in Russia traditionally begins in the latter part of the first quarter or early second quarter depending of course on the winter weather, but it is my understanding that Gazprom only recently began injecting natural gas in the underground gas storage facilities, which would further support strong demand for natural gas.

During the first quarter 2011, we continued to expand our natural gas liquid production year-on-year and sequentially quarter-on-quarter, largely due to the expansion of production at our Yurkharovskoye field and the contribution of dry gas from our pro rate equity share in Sibneftegas. Moreover, with the general recovery demand in the Russian domestic market as well as our ongoing drilling program, we were able to supply the majority of natural gas from our own productive capacity, which correspondingly reduced the need to purchase natural gas from third parties. We continue to add productive capacity during the first quarter with our present capital expenditure program and we will continue to optimise the commercial marketing efforts with our operational flexibility between wet and dry gas. This particular



quarter is the first time that we began reporting our core production with our equity share of production from Sibneftegas as one combined number.

Our natural gas production increased 35.1% year-on-year and 24% quarter-on-quarter, averaging approximately 148 million cubic metres per day or the equivalent 5.2 billion cubic feet. We exceeded 13 billion cubic metres of production during the quarter, which is a great start for 2011 and a record for Novatek. We have read many comments that one of our primary drivers for our stellar first quarter results was the natural gas we purchased from our recent acquisition. We managed to organically increase our core production year-on-year by 2.1 billion cubic metres or by 21.1% and quarter-on-quarter by 1.2 billion cubic metres of by 11.3%. Therefore, the overall production growth of 35.1% we achieved in the first quarter was achieved through a combination of continued organic growth at our core fields and our equity share of gas production at Sibneftegas. We are presently producing approximately 131 million cubic metres per day or 4.6 bcf per day adjusted seasonally, which is significantly higher than our production profile as compared to the prior year trough period as well as our full year 2010 daily average. We also continued to demonstrate strong production growth by increasing our production by 18.8% year-on-year and 3.2% quarter-on-quarter during the first quarter, again reflecting strong demand across the regions where we sell our stable gas condensate and LPG are consumed. As we continue to increase our volumes of liquids produced, we will continue to have quarterly fluctuations in both goods in transit and storage facilities, which generally reverses itself in the ensuing one or two quarters.

Stepping back for a moment, I would like to say that 2010 was a very productive year for Novatek for many reasons and an especially active one acquiring assets that we believe will increase our overall productive capacity and reserve base and provides us with an opportunity set, a drilling prospect over the mid-term horizon. The successful integration of Sibneftegas into our production profile commenced on the 1st January demonstrates the cash flow-positive nature of this transaction.

Taking all these factors into consideration in our financial and operational performance, we increased our dividend payout to RUB 4.00, or roughly by 45% over the 2009 payout, which was



unanimously approved at our recent AGM meeting. We will continue to look at ways to increase total shareholder returns, which will be prudently balanced between funding capital expenditures, normal operating expenses and debt servicing. We believe the strong momentum in our earnings, combined with sufficient cash flow generation, will accomplish these strategic objectives. We will continue to assess M&A opportunities in the market that are in close proximity to our producing fields and pipeline and processing infrastructure and accordingly meet our strategic objective, increasing our productive capacity and reserve base both for natural gas and liquids.

Assessing potential market opportunities also entails participating in acquisition of new licences when they are tendered. We recently submitted our bid to acquire four new licence areas in the Yamal and Gydan peninsulas, and we were recently informed that our bid was the only qualifying bid in the tender process. We are finalising our development plans for the submission to the relevant governmental bodies and we expect to receive positive confirmation in June. We are excited about the future prospects of these licence areas and the opportunity they accord us in our ongoing exploration and development activities. The ability to integrate these licence areas into our Yamal LNG project is an important element in our overall strategy for expanding our operational presence in both the Yamal Nenets Autonomous Region and the Yamal peninsula, as well as providing the necessary resource platform to continue our growth trajectory as outlined in our long-term strategic plans. I will provide some information on the four licences and future development plans during the second quarter conference call once we receive positive confirmation concluding the tender process.

Moving forward, I would now like to make a couple of brief comments regarding the Yamal LNG project. We are actively working with Total and other contractors and consultants according to the project schedule. Recently, CB&I Lummus began work on the FEED stage of the project and we expect this work to be completed within the next 12 months. We are active in the dialogue with our other potential projects—partners to the project—and our timeline for announcing additional partners is still targeted towards the end of this year or early 2012. We are continuing work on exploration and infrastructure activities including additional technical studies, and we have allocated approximately RUB 2.9 billion in capital expenditures for 2011.



Reverting back to some of my earlier comments on the recent events in the global gas market, it is becoming readily apparent to the industry that additional liquefaction facilities will be required to meet future demand requirements of LNG post-2016. It is worth noting that LNG growth rate has grown from approximately 7% on a compound annual rate—growth rate, excuse me—over the past decade and achieved the highest growth rate of all fossil fuels during this period. Liquefied natural gas now counts for approximately 8.5%-9% of the global natural gas market trade and that percentage of market participants—penetration, excuse me—is expected to continue rising in the future. The significant projected growth and the timing of additional liquefaction facilities completely corresponds to our project timetables and our optimism to fully integrate the facilities' LNG output into the market. As such, we recently re-branded our trading subsidiary Vynatek to Novatek Gas & Power to begin developing and reorienting our commercial capabilities beyond just our present slate of liquid hydrocarbons. We expect that the information flow will continue to increase as we move forward with this transformational project.

We sold approximately 14 billion cubic metres of gas during the quarter, by far the best quarter in the company's history, for an average realised price of RUB 2,025 per 1,000 cubic metres, representing an increase in average realised prices of approximately 8.2% year-on-year and 9% quarter-on-quarter. Our natural gas volumes sold to end customers as a percentage of our total gas sales mix decreased by 9 percentage points as compared to the first quarter 2010 and represented 51% of our total sales volume versus 60% year-on-year. This trend was similar to the quarter-on-quarter comparators as we decreased our proportion of end customer sales by 7 percentage points, largely due to the re-initiation of wholesale trader sales to Itera which were not part of our sales mix in 2010 as well as some other sales to other regional traders in the first quarter of 2011.

During the quarter, we continued to deliver strong organic production growth from our Yurkharovskoye field of 39.7% with the completion of the second and third stages of Phase II development activities. Consistent with prior periods, we decreased natural gas production at both the East-Tarkosalinskoye and the Khancheyskoye field to capitalise on the wet gas layers at



Yurkharovskoye, and this largely attributed to the 44.5% increase in liquid production at the Yurkharovskoye field during the quarter. We fully utilised our operational capacity to fulfil our volume commitments and also withdrew 713 million cubic metres of natural gas from the underground storage facilities to meet our contractual obligations. We will continue to invest capital to further expand our operational capacity and, when needed, utilise the underground storage facilities to balance the effects of seasonal patterns.

In comparison, in the fourth quarter 2010, we increased our quarter-on-quarter volumes sold by 3 billion cubic metres or by 27.4%, demonstrating continued positive momentum in domestic demand during the peak consumption period for natural gas as well as the additional sales contribution from Sibneftegas. As previously stated, Novatek is considered the profit centre, and we will continue to purchase gas in proportion to our equity holdings in our associated companies and integrate those purchased volumes into our commercial sales activities. We purchased 1.4 billion cubic metres for approximately RUB 933 million or roughly RUB 681 per mcm, representing the cost to service debt, maintain operations and retain a small profit. One of the key comparator differences year-on-year and quarter-on-quarter was the increased volumes sold ex-field to Gazprom and other traders, which essentially accounted for the volumetric shift in our sales mix during the respective period. If you recall, during the first quarter 2010, we had no ex-field sales sold to Itera as we let the contract expire and we began moving away from selling gas directly to Mezhhregiongaz and now directly to Gazprom. Presently, we reinitiated the contract to Itera with the extension of a long-term sales contract and we will continue delivering gas directly to Gazprom accordingly.

With that said, I would like to make a few brief conversations about our average realised prices and transportation. Our average realised prices for end customer sales during the first quarter 2011 increased by 14.3% and 12.8% year-on-year and quarter-on-quarter respectively, which is in line with our expectations vis-à-vis the general tariff increase and the relative geographical mix of our primary customer base. For ex-field sales, our average realised price increased by 15.4% and 16.6% year-on-year and quarter-on-quarter respectively. This was also the first quarter since the global economic crisis whereby our end customer price differential exceeded the wholesale price and with the strengthening of the domestic demand, we continued to



narrow the discount spreads for both customer segments relative to the Federal Tariff Service's regulated prices.

To transport our natural gas to end consumers, we managed to decrease our overall transport distance year-on-year and quarter-on-quarter by 110 km and 236 km respectively, with our total distance averaging roughly 1,850 km. Our average transportation expense per mcm increased by approximately RUB 100 and RUB 52 over the comparative periods, adjusted for the tariff increase effective at 1st January. The compositional mix of regions remained relatively consistent between reporting periods, with the Perm, Chelyabinsk, Khanty-Mansiysk, Moscow and Orenburg regions representing the largest markets for our natural gas. With the increase in natural gas produced at the Yurkharovskoye field, we also managed to increase our stable gas production year-on-year by approximately 209,000 tons or by 44.5% with the field accounting for now approximately 2/3 of our liquids production. This organic growth in liquid production attests to the successful implementation of the field two-phase development and related infrastructure expansion which accounted for the lion's share of our capital expenditure program over the last couple of years. Our total volumes sold for liquids increased by 46.6% or by approximately 319,000 tons as compared to the corresponding period in 2010 and by approximately 80,000 tons or 8.7% quarter-on-quarter. Specifically, the majority of our year-on-year growth, accounting for roughly 98%, was the increase in our export sales of stable gas condensate by 75.7% or 312,000 tons. We also increased our quarter-on-quarter stable gas condensate exports by 68,000 tons or by 10.4%.

During the quarter, we dispatched 14 tankers carrying approximately 756,000 tons from the Vitino sea terminal port, of which 36% and 32% each of the dispatched volumes were destined to the Chinese, European and US markets. Our Purovsky processing plant operated at 78% of its rated capacity, with total plant output reaching 969,000 tons, comprised of 740,000 tons of stable gas condensate, 225,000 tons of LPG and 4 tons of methanol products. Comparatively speaking, our average processing plant utilisation was approximately 65% and 75% in the first and fourth quarters 2010 respectively.



Our volumes of stable gas condensate in transit increased by approximately 18,000 tons from year end, culminating in a period ending inventory balance of 282,000 tons. We had three tankers in transit, carrying approximately 152,000 tons at the end of the first quarter, waiting to reach its port of destination before being realised as sales for the period.

The commodity prices we received for all our liquid hydrocarbons remained strong relative to comparative periods, which had a positive effect on our liquid netbacks and earnings during the quarter. Our average export netbacks on a US dollar basis for stable gas condensate and LPG volumes sold during the period increased by approximately 59.3% and 32.8% respectively despite increases in both export duties. In comparison to the fourth quarter 2010, our average export netbacks for stable gas increased by 24.1% whereas our LPG netbacks decreased by 14.3%, largely attributable to higher increases in transport and export duties which exceeded the increase in our average contract price we received for exported LPGs. For stable gas condensate, we sold 724,000 tons realising an average netback of USD 479 per ton in the first quarter of 2011 as compared to USD 301 per ton in the first quarter 2010 and USD 386 per ton in the fourth quarter. The year-on-year difference of USD 178 per ton was mainly due to the 36.5% increase in our average contract price, which exceeded the percentage increases in both export duties and transport charges. We also managed to increase our year-on-year LPG export volumes by approximately 12,000 tons or 11.4%, realising an average netback of USD 508 per ton, whereas our quarter-on-quarter comparison at comparable volumes of 14,000 tons was a 14.3% reduction in our average transport—average netback, largely due to an increase in both our transport and export duties of 35% and 74.9% respectively.

On a total barrel of oil equivalent basis, we increased our output to 86.6 million barrels of oil equivalent in the first quarter 2011 versus 71.6 million barrels of oil equivalent and 78.5 million barrels of oil equivalent in the first and fourth quarters 2010 respectively. We averaged 962,000 barrels of oil equivalent per day, representing an approximately 28.1% increase over our full year 2010 average of 751,000 barrels of oil per day.

Our capital expenditures remain reasonably consistent on our reporting periods but the composition of expenditures reflected the changing nature of our capital program. The majority



of our capital expenditure program has been centred on the development and expansion of the Yurkharovskoye field over the past several years, accounting for roughly 80%-85% of the allocated funds. With the recent completion of the Phase II development activities, we have begun shifting capital over to our other activities such as Yamal LNG project, the construction of the gas fractionation unit at Ust-Luga, as well as expending funds on other field development activities and capital projects. I mentioned a few times on my prior conference calls that we are beginning the early stages of ramping down capital expenditures at the Yurkharovskoye field to maintenance capital, and you can note this transition in our year-on-year capital expenditure program whereby we reduced funds spent by approximately RUB 2.2 billion or by 46%. Despite the decreasing capital intensity, the Yurkharovskoye field still accounted for approximately 41% of RUB 2.6 billion of our invested capital. Our total capital expenditure program remains unchanged as originally forecasted and we expect to spend approximately RUB 31 billion in 2011, exclusive of value added tax.

We effectively managed our operating costs during the first quarter relative to the size of our business and the growth of our revenues. Our total operating expenses increased in absolute terms to RUB 23.4 billion but decreased as a percentage of total revenues year-on-year from 57.5% to 52.2%. Although our operating expenses increased quarter-on-quarter by RUB 4.2 billion, reflecting an increase in our business activities, they decreased as a percentage of revenue. As expected, the most significant changes in our operating expenses for the comparative periods were the relative increases in our transportation expenses and taxes other than income. The increase in our transport expenses is explained by the absolute growth in end customer sales volumes of 16.1% and 11.5% as compared to the first and fourth quarters 2010 respectively as well as the transport tariff increase of 9.3%. In September 2010, we launched our 326 km unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky processing plant, effectively reducing third-party charges as well as increasing the overall quality of our processed output. During the quarter, we reduced the amount of third-party transport charged by RUB 119 million as compared to the prior period, and to give you a relative sense of the potential savings for the full year, we estimate cost savings of approximately RUB 350 million. Taxes other than income also grew year-on-year and quarter-on-quarter largely due to the volumetric natures of these expense items combined with an increase in the MET rates from



RUB 147 per mcm to RUB 237 per mcm effective the 1st January. Relatively speaking, we increased our production of natural gas by 2.1 billion cubic metres and 1.2 billion cubic metres as compared to the first and fourth quarters, which accounted for the higher mineral extraction taxes paid in the reporting periods. We demonstrated strong discipline over our controllable operating cost structure throughout the respective reporting periods. Our general & administrative expenses increased by RUB 520 million or by 36.4% year on year largely due to the 10% indexation in July, the recognition of expenses related to the employee share based compensation programme; and the accrual of certain performance bonuses in the first quarter. Even though we increased our general & administrative expenses for the year on year and quarter on quarter comparatives we believe these increases were reasonable, easily explainable and lower in relative percentage terms and continues to positively reflect management's ability to manage costs in a variety of market environments.

On the administrative side the largest increase related to the accrual of bonuses of RUB 257 million based on the payment of certain bonuses for the fully year 2010 financial results. Our total administrative head count remained reasonably consistent between the comparable periods and presently number 1,012 employees.

For materials, service and other expense category we had an overall reduction in the number of employees due to the divestiture of Novatek-Polymer but an overall increase on our employee compensation expense due to the 10% salary indexation as I mentioned in July 2010. However the most notable changes in our materials, service and other expense category was the significant reduction in material purchases for polymer production due to the divestiture of the subsidiary and a reduction in third party services for unstable condensate de-ethinisation with the launch of our own facilities at the Yurkharovskoye field. As a result of these factors enumerated above our EBITDA and net profit margins continued to improve relative to the comparable periods reaching 51.5% and 42% respectively. We also increased our earnings per share year on year and quarter on quarter by 68.6% and 55.7% respectively to RUB 6.22 per share during the period. Our profit from operations in the prior period was aided by a one-off disposal of a 49% interest in Terneftegas which was comprised of a non-cash spare market valuation gain of RUB 807 million and RUB 776 million in net consideration. Our net profit for



comparative periods was also aided by the strengthening Russian ruble relative to our US dollar denominated debt and resulted in non-cash foreign exchange gains of RUB 2.5 billion and RUB 646 million in the first quarters 2011 and 2010 respectively. Novatek's balance sheet and liquidity position continued to remain strong throughout the first quarter of 2011 due to a significant increase in the net cash provided by operating activities and the placement of our debut Eurobond in February. We reduced our short term debt position relative to our year end balances with the repayment of a bridge loan facility to finance our recent acquisitions and we will continue to service our debt when payments are due according to the maturity schedules. Post balance sheet we repaid and retired our three year syndicate term facility loan according to its maturity schedule and we also paid a remaining balance on the Sibneftegaz acquisition ahead of schedule which was recorded in our accounts as a trade payable.

Despite an increase in our overall debt position I believe our total long term and short term debt is completely manageable in respect of our cash flow generation and our ability to service our debt as they mature. We generated RUB 12.9 billion of positive free cash flow during the quarter and ended the period with cash and cash equivalents of RUB 15.4 billion.

I would like to conclude the first earnings conference call by sincerely thanking all of our valued shareholders and bondholders for your confidence in our management and your continued support of Novatek. The financial and operational results we achieved during the quarter reconfirm and support the growth potential of the company and should also alleviate some of the prior concerns about the demand for natural gas in the Russian domestic market. We have demonstrated our ability to deliver stellar financial and operational results throughout the peaks and troughs of seasonal periods and I truly believe we have created a company with the requisite managerial skills and the developed reserve base and commercial savvy to continue to deliver above average results, capture additional market share and further create shareholder value. We remain one of the lowest cost producers of natural gas and gas condensate in the global oil and gas industry and we are committed to continue growing our resource base and production profile to meet the challenges and demands of the marketplace. The positive results of the tender for the four licence areas which is effectively concluded in June have the potential to add significant reserves to our existing reserve base as well as future production capacity with



the execution of a successful exploration and development plan. Moreover as we move forward with the Yamal LNG project the timing of the project's initial production will match the market requirement for additional localisation capacity and together with our partner consortium we can deliver another world class project for our shareholders.

Today we formally commissioned the opening of our new corporate headquarters in Moscow. Since inception we have moved corporate offices seven times over the last 16 years and the opening of this new building not only signifies stability but also represents the beginning of a new chapter in our corporate history. Thank you very much.

Operator: Ladies and gentlemen, if you wish to ask a question at this time please press *1 on your telephone keypad. We will take our first question from Oswald Clint from Sanford Bernstein. Please go ahead.

Oswald Clint: Good evening Mark, thank you for the call. Two quick questions, the first one just on the operating expense associated with Sibneftgaz, I just wondered how it compares to the Novatek portfolio and if there are any differences there we should be aware of? Secondly talking about you say some of the capex is now being directed towards the Yamal project, can you just say exactly what that expenditure is related to at this point even though it might be early? Thank you.

Mark Gyetvay: Thank you. Yes, there is a difference between operating costs between our core production in Sibneftgaz and it's largely due to the fact that Sibneftgaz is dry gas so we don't have to go through the processing facility. So on an average netback price we would expect that the returns we receive on that is slightly higher than our core production and that basically bore itself out in the first quarter. In terms of your second question in terms of Yamal LNG, what we plan to do this year is essentially drill three exploration wells to complete the geological model and those wells are essentially earmarked to test the reserve potential, hydrocarbon potential in the Ob River, so we're actually going out into the Ob River and completing this sort of geological model. At the same time we began construction of various infrastructure projects like the base camps etc. We have also in the first quarter we drilled a well, it was called Exploration Well 157



and we're currently spending money on two additional exploration wells which will be Well 155 and 152. Also during the period we actually received the first delivery of materials and equipment, roughly about 12,000 tonnes of equipment etc from the Arkhangelskaya to the port of [Sobada] and we're trying to do this to demonstrate the viabilities of this particular route for deliveries during the winter season and I believe that we have demonstrated that we can actually navigate equipment and materials during the winter months, so largely a lot of the capital that we're spending is going to be earmarked towards exploration, development activities and also some of the construction materials for the infrastructure and base camps etc.

Oswald Clint: Ok, that's great. Thank you.

Operator: We will take our next question from Charles Evans Lombe from Egerton Capital. Please go ahead.

Charles Evans Lombe: Yes, hi Mark. I had a question, there has been much commentary about oil companies and their ability to develop their secondary gas reserves as independents. Could you comment on where you stand on that at the moment?

Mark Gyetvay: Charles, yes. We can provide a comment on that. Let me say largely that when we talk about collectively the independent gas producers we talk about also including eventually the gas production on the oil majors. We have done an extensive amount of work understanding the market structure in which we operate and that includes not only what we believe to be Gazprom's future development activities etc, we also study very closely the oil majors and their respective plans. What you essentially are alluding at is that there's a lot of potential forecasted production to come on-stream but one of the things that we would like to at least bring forth on this conference call when we talk about this particular item is that number one there is a lead time to bring some of this gas on-stream. Some of the companies are a little more advanced in that respect but nonetheless it requires a significant amount of capital to be expended to ensure that some of these volumes are brought on-stream during the respective periods. A lot of them we do not believe will be bought up by the time you're talking about roughly 2015. That provides Novatek with the opportunity to continue increasing our respective market share vis-à-



vis the oil majors and we continue to expect to gain market share at their expense during this particular period because we are continually investing capital into field developments. We also look at when we study this particular question in depth, we also look at the composition between their ability to process any additional wet gas, what is the transportation infrastructure etc available for them to do that and there's a lot of factors in our view that basically say that some of this production will come on-stream but not to a significant extent and it will come on-stream post 2016.

Charles Evans Lombe: Mark, if I could follow on, with estimates of gas which may or may not be developed by the oil majors being around 50 bcm in time, how much of that do you think will eventually come into the market? Can you give an idea?

Mark Gyetvay: Charles, again it's a hard question to answer. We take our time because we assume eventually whether it's before 2020 or after 2020 given the demand of Europe, given the demand on Russia combined with the possibility of Gazprom exporting gas to China that this gas will be needed and I believe that if the model to deliver gas via the Altai pipeline is probably positive for the independent gas market because I believe some of that gas will be absorbed for delivery of gas to the Chinese market. I assume and we assume that eventually all this gas will be delivered to the Russian market.

Charles Evans Lombe: Thank you. Sorry, that final question, could you give us a kind of update on the actual timing...you mentioned on the call that you are the only bidder for the Yedan Peninsula licences. When do you think that we will have more data and confirmation that your bid was accepted?

Mark Gyetvay: The deadline is June 23rd. We'll know either before that or on June 23rd and then what I'll do is I guess once we get positive confirmation obviously we'll put out a press release stating that fact but I'll address the question a little more in detail on the second quarter conference call which will be in August.

Charles Evans Lombe: Thank you.



Operator: As a reminder ladies and gentlemen, to ask a question please press *1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off for your signal to reach our equipment. Again please press *1 to ask a question. We will take our next question from Constantine Cherepanov from UBS. Please go ahead.

Constantine Cherepanov: Hello Mark, thank you for the presentation. This is Constantine Cherepanov from UBS, I have three questions if I may. The first with respect to four blocks you will obtain on Yamal in June, I would like to ask about the infrastructure within the region, so is there any risk that you will face the lack of transportation infrastructure and will have to invest heavily in it or somehow co-finance it with Gazprom? This is my first question. Then my two second questions are would you please update us on how the things are currently with respect to Nordgas, do you still study the company and also what is the status of your project construction, your split of condensate in the Ust-Luga port? Thank you.

Mark Gyetvay: Ok, Constantine on the four blocks, the question you raise is a valid question because obviously we're tendering for gas that's in either virgin territories without the respective infrastructure. I think if you look at the geographical map what you'll see is that a couple of those licences are in relatively close proximity to the South-Tambeyskoye field, one being the East-Tambeyskoye field itself and two are on the Gdansk Peninsula but again not too far from the field and also not too far from the [Yamburg] pipe infrastructure. Your question really is what about the infrastructure and right now we will do what it takes to bring that gas to market and the liquids to market. If that means that Novatek will be responsible for constructing the pipeline to connect it to the markets we will do that. We believe that the reserve base and the volume of potential gas production more than justifies that, so once we complete the tender process, put together the development plan, look at the infrastructure in the particular region and whether or not we will finance that ourselves because remember we just completed a pipeline construction, we know how to do that. We completed the loop system going from Yurkharov to the main trunk pipeline system so we're very confident that we have the ability and the capability to manage this type of project but more importantly I think is just that when you see the volume of potential gas production coming from these particular fields it will more



than justify the building of any infrastructure. In terms of Nordgas as I mentioned before we do not specifically comment on individual market rumours. As I mentioned before on this call and I've said many, many times with previous investors that you should expect as a company that we will consider and review any and all transactions that are in close proximity to our operations and we will also consider any or all licences tendered by the state that basically are in the same geographical vicinity of the Yamal Peninsula or Yamal-Nenets. So I will not answer any further questions on Nordgas at this particular point. In terms of Ust-Luga we are doing a bunch of work on Ust-Luga this year. Ust-Luga will represent a little over 7 billion in capital expenditures. What we have done so far since the beginning of the year, we began constructing the foundations for the reservoir tank farm. We expect to assemble about 800,000 cubic metres of finished product and raw material storage probably by the end of May of this particular year. In June we also planned, began a tender for subcontractors for the construction of main production facilities. I think we are doing continual ongoing work at the Ust-Luga facility and we will keep everyone abreast of this because this is a project that we have earmarked to complete Phase 1 which is 3 million tonnes by the end of 2012, so obviously as we proceed forward in this year we will provide continuous updates on where we are in terms of the status of the project.

Constantine Cherepanov: Ok, thank you very much. But just with respect to Ust-Luga, one follow-up if I may because currently there are a lot of discussions about changes in taxation for oil companies and if it really happens would you still be focused on the constructing of this refinery for condensate because it should basically worsen the economics of this project. When will you take a decision on this?

Mark Gyetvay: We're continuing with the project. I think what you're alluding to is dropping down or lowering that 60, 66 sort of tax regime. Obviously the strength of Ust-Luga clearly is predicated on our ability to take advantage of this tax situation but we don't make all our capital investments solely on tax issues. We look forward as an opportunity to expand our marketing and commercial activities and I believe as I mentioned on our annual conference call I said that one of the important elements of the Ust-Luga project was that it significantly expanded the scope of our ability to market to commercial entities from about 30 to 50 where we have today who effectively can buy stable gas condensate to over 200 which allows us to deliver a slate of



projects and one of the key elements of that is to deliver products directly to the consumer what they want. They want naphtha, we deliver naphtha, so we're trying to do something that we don't lose value by delivering a product that ultimately the market does not want and we are forced in discussions on pricing because we do not want to lose some of the constituent parts of the product. So Ust-Luga will solve some of that project but I believe that irrespective of any change in the tax regime, Ust-Luga will still be a very profitable project for Novatek and we anticipate as we mentioned before a relatively quick payback period on the capital invested.

Constantine Cherepanov: Ok, thank you very much.

Mark Gyetvay: You're welcome.

Operator: We will take our final question today from Oleg Maximov. Please go ahead.

Oleg Maximov: Hi Mark and thanks for the presentation. Just a couple of questions on your exploration I guess projects. With the Yurkharovskoye field peaking I believe next year, what is going on with new Yurkharovskoye, what are the prospects? If you can also discuss the prospects and broadly discuss what is the West [Strychtikoye] area because I saw a significant pick-up in capex there over the first quarter '11? Thank you.

Mark Gyetvay: Essentially what you're looking for is obviously providing some sort of future guidance in some of our other exploration activities and I think again it's a valid question as we start moving away from development, drilling of the Yurkharovskoye field and start looking at expending capital in other projects. I'd like to maybe comment a little more broader because not only are we talking about the three areas that you talked about, we are going to start spending capital on the SeverEnergiya acquisition we made in November particularly the Samborsky licence area as we speak, so I think it's all important when we look at not only the exploration side but also some of the other development projects that are on our plate. If you look at Yurkharovskoye what I want to say is that Yurkharov is not at its peak production today and we don't expect that it will be at its peak production in the next couple of years. We expect that Yurkharov will continue to be able to grow its plateau level but as we grow Yurkharov what we essentially need



to do is go down to lower levels. So as you know we're currently producing from the Valanginian layer and to actually maximise the complete productive capability to the field that also requires that we go down to the [ochimov] and to the lower level which is the [durastic] level. So what we have done essentially this year and in the first quarter we're repairing even on the Yurkharovskoye field and I'm not even going to take away for a second from the new Yurkharov licence area, we expect to begin drilling a well number 136 which is actually going to target the lower [durastic] condensate layer and hopefully by this work we will be able to increase the overall productive capacity of gas condensate in the particular field. We also would have to say by going on this also allows us to better manage the productivity even from the Valanginian layer but that has not been decided yet of what additional drilling and stuff we need to do to accomplish that, so if you look at just where we are just on the Yurkharovskoye field, we believe we have not reached the level plateau as we speak today. As we start expanding out for those who are relatively new we acquired the new Yurkharovskoye licence areas a few years ago and what we have essentially been doing is undertaking a bunch of either geological surveys such as 3D, 2D seismic and we have actually been starting to do a series of exploration wells to confirm and unfortunately when we talk about exploration wells we generally are talking about wells that we test various sub-surfaces. Even though we know that the primary surface might be Valanginian we tend to go down to the deepest know layers which takes time to complete and we test all those particular layers. So on the new Yurkharovskoye licence area in the first quarter we've completed an exploration well number 151 and we discovered a new gas condensate layer. We're currently evaluating the results of this particular drilling with the seismic drills that we have to determine the potential reserve additions under the Russian reserve classification. In terms of the West Yurkharov licence area which is somewhat of a break-off of the overall new Yurkharov licence area, we have started in 2011 all the project documentation as well as gaining the permission from the relevant ministries etc to begin drilling and we expect to drill the first exploration well on this licence in 2012, so it's kind of premature at this point to go into any specific debt in this particularly the West Yurkharovskoye licence area but I would say that we expect to start drilling in 2012 after we receive all the permissions and complete any project documentation. You also talked about the [Strychtikoye] field. We did drilling last year. We essentially drilled well 853 in 2010. This year we essentially have spent money hydrofracturing that particular well and we discovered a gas condensate layer



but unfortunately it wasn't in the first quarter, just recently in this quarter and so we're in the process of evaluating those reserves and production potential. We also plan to continue drilling and complete well 857 in this quarter, the second quarter which is also again another exploration well, but this well with further open up both the sandimanian and deeper gas condensate layers. So we believe given the work we've done to date we may be able to reach a production plateau or production profile of about 1.8-2 billion cubic metres per annum from this particular field. So that's relatively in a nutshell is what we've done on those particular licences. As we speak about SeverEnergia I just want to give you an update a little bit on that because we have done some work. We actually completed the first horizontal well which is well number 1,007 which has been completed in the Samborsky licence area and we had an initial production flows of about 750,000 cubic metres a day or roughly about 26 mcf per day and what we're doing right now is we're currently completing work on the gas preparation and gas gathering lines and we expect to have that done this year and as a result of that we expect that we should be able to start seeing first production albeit quite small either towards the latter part of this year 2011 or as early as 2012, so we're still working with our partners on a plan. We are focused specifically on the Samborsky licence area and we believe that we have already demonstrated with the first horizontal well because what the plan is is almost essentially to overlay the development plan that we've done at the Yurkharovskoye field on this particular field and that took a little time getting all the partners up to speed on what we've done, but I think we have all partners now in concurrence with our development plan and we see so far the fruits of our first exploration well. So as the year progresses I will continue updating everybody on these particular activities, but Oleg, I think it's a good question because we are ramping down on the Yurkharovskoye field and we will be starting spending money as you noted correctly on some of these other smaller areas of our portfolio.

Oleg Maximov: Great, thank you Mark.

Operator: That will conclude today's question and answer session. I would now like to turn the call back over to your host for any additional or closing remarks.



Mark Gyetvay: Again I'd just like to thank everybody on this conference call and I just want to reiterate that you need to focus on what we've basically talked about and stop worrying about all the rumours in the marketplace and I'd just like to assure everybody tonight that we're very closely involved with all these issues being discussed in terms of MET tax and the tariff increase and hopefully over the next quarter we will be able to give you some more updates on those particular topics. Again thank you very much for your call and we look forward to meeting again in the future.

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