

**ОАО АК ТРАНСНЕФТ**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF THE GROUP'S FINANCIAL POSITION  
AND RESULTS OF ITS OPERATIONS**

**FOR THE SIX MONTHS ENDED 30 JUNE 2013**





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**(in millions of Russian roubles, if not stated otherwise)**

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The following analysis provides an overview of the financial position of OAO AK Transneft and its subsidiaries (hereinafter – the “Group”) as at 30 June 2013 and results of operations for the six months ended 30 June 2013, compared to the six months ended 30 June 2012, as well as other important factors which could affect the future results of the Group. This analysis should be read in conjunction with the Consolidated interim condensed financial statements prepared in accordance with International financial reporting standards (hereinafter – “IFRS”) for the six months ended 30 June 2013.

**Key financial and operating results**

	Six monthsh ended 30 June 2013	Six months ended 30 June 2012	Change, %
Revenue	369,369	361,293	2.2
Profit for the period	89,384	95,360	(6.3)
EBITDA	179,664	171,181	5.0
EBITDA margin, %*	60.7%	60.5%	x
Oil delivered to consignees, mln. tons including	237.8	238.1	(0.2)
Russian oil refineries, mln. tons	121.8	117.7	3.5
transshipment into the CPC-R system, mln. tons	0.9	0.2	4.5,times
exports to FSU countries, mln. tons	13.7	14.2	(3.5)
exports to ROW, mln. tons	101.4	106.0	(4.3)
Oil products delivered to consignees, mln. tons including:	16.0	12.9	24.0
Russia's domestic market, mln. tons	4.8	4.2	14.3
exports to the Customs Union member countries, mln.	0.1	1.4	(92.9)
exports to ROW, mln. tons	11.1	7.3	52.1

\* Less crude oil sale and purchase operations under contracts with OAO NK Rosneft and the China National United Oil Corporation.

The Group's profit for the six months ended 30 June 2013 amounted to RUB 89.4 bn which is RUB 6.0 bn or 6.3% lower than for the six months ended 30 June 2012 which amounted to RUB 95.4 bn.

The profit for the six months ended 30 June 2013 contains net foreign currency exchange loss amounting to RUB 6.0 bn (net foreign gain as for the six months ended 30 June 2012 amounting to RUB 2.2 bn), net interest expense amounting to RUB 11.6 bn (RUB 9.4 bn – for the six months ended 30 June 2012), loss from changes in the fair value of derivatives amounting to RUB 0.2 dbn (RUB 0.4 bn for the six months ended 30 June 2012). Should these factors be excluded the profit for the six months ended 30 June 2013 would amount to RUB 107.1 bn (for the six months ended 30 June 2012 – RUB 102.9 bn) showing an increase of RUB 4.2 bn or 4.1%.



## 1. General information and overview of the Group's activities

The oil transporting joint stock company Transneft was established and incorporated by the Russian Government Resolution No. 810 dated 14 August 1993 under Presidential Decree No. 1403 dated 17 November 1992.

According to its Charter, OAO AK Transneft was established for the purposes of:

- promoting the technical and socio-economic interests of its shareholders, while unconditionally ensuring the Russian Federation's interests in the area of transporting oil, gas, and the products of oil & gas refining via trunk pipelines;
- generating profit.

The main areas of OAO AK Transneft and its subsidiaries' operations are as follows:

- providing services in the area of transporting oil and oil products via trunk pipelines in the Russian Federation and outside of its territory;
- carrying out prevention, diagnostic, and emergency & recovery work on trunk pipelines;
- coordinating activities aimed at comprehensive development of the trunk pipeline network and other pipeline transport facilities;
- interacting with pipeline transport companies in other countries on matters of oil and oil products transportation in accordance with intergovernmental agreements;
- participating in scientific, technical, and innovative development of the pipeline transport, and implementing new equipment, technology, and materials;
- raising investment capital for the development of the production base, as well as the expansion and reconstruction of facilities of the Transneft system's entities;
- organizing environmental work in areas where pipeline transport facilities are located.

The Group also provides services of oil storage in the trunk pipeline system, oil compounding, oil sales.

OAO AK Transneft is also responsible for oil transportation planning and management on foreign territory, for exercising control of oil storage at and delivery to foreign oil receipt & delivery facilities, and for data collection and summarizing.

The Group as at 30 June 2013 possesses an extensive network of trunk oil pipelines with a total length of approximately 53.6 thousand km and trunk oil products pipelines with a total length of some 19.1 thousand km.

During the six months ended 30 June 2013 the Group transported 88% of oil produced in Russia and more than 27% of oil products produced in Russia, as well as significant volumes of hydrocarbons and oil products from CIS countries.

OAO AK Transneft's key competitive advantages include:

- a monopoly position in the oil pipeline transport market;
- a low ratio of operating costs to total oil transportation volume compared to railway or water transport;
- average level of oil transportation tariffs, compared to those in the CIS and Western Europe.



### **1.1. Key investment projects**

OAO AK Transneft pays considerable attention to comprehensive development of its trunk pipeline network, promotion of scientific and technical progress, and implementation of new equipment and technology. OAO AK Transneft's capital investment policy is aimed at achieving system-wide targets for production base development, as well as expansion, reconstruction, and technical upgrades of pipeline transport facilities.

During 2010 – 2013 the Group has carried out capex projects in the area of building and expanding pipeline systems, the largest of which are:

- The Eastern Siberia–Pacific Ocean pipeline system, stage two, the Skovorodino–SMNP Kozmino section (ESPO II);
- Expansion of the Eastern Siberia–Pacific Ocean pipeline system's capacity, the GNPS Taishet–NPS Skovorodino section, to 50 mln tons annually;
- The Baltic Pipeline System 2, stage one (BPS-2, 1st stage);
- The Purpe– Samotlor pipeline;
- The Zapolyarie–Purpe pipeline;
- Expansion of the pipeline system to ensure transportation of 12 mln tons of oil annually to OOO RN-Tuapse Refinery;
- The construction Kuyumba – Tayshet trunk pipeline.

### **1.2. Environmental policy**

The Group's management is fully aware of potential danger of a possible negative impact of technologically complex production activities on the environment. The main areas of the Group's environmental activities have been set out in OAO AK Transneft's ecological policy, the principles of which underlie OAO AK Transneft's ecological policy for 2010–2017, which spells out specific environmental measures.

The Group's management is fully informed of the conditions of all fixed assets and the pace of their wear and tear, and uses these data to plan reconstruction or building of new facilities. Transneft's ecological strategy contains specific seven-year programs for each of its subsidiaries.

The amount of funding of the ecological safety program, building and reconstruction of environmental facilities, and acquisition of environmental protection equipment enable OAO AK Transneft to meet the strictest Russian and international environmental standards.

As at today all subsidiaries of OJSC «AK «Transneft» has developed, introduced and certified the environmental management System. All subsidiaries of the Company has received the international certificate DQS and IQNet conformity to the standard ISO 14001.



## 2. Tariffs and key macroeconomic factors affecting the Group's performance

### 2.1. Oil and oil products transportation tariffs

OAO AK Transneft has been providing tariff-based oil transportation services to consignors since 1992.

Tariff rates are currently calculated in accordance with the Rules of state regulation of fees or their maximum limits for services of natural monopolies with respect to transportation of oil and oil products via trunk pipelines, approved by a Decree of the Government of the Russian Federation of 29.12.2007 No. 980, as well as in accordance with the Regulations on setting fees for services of transportation of oil via trunk pipelines, approved by an Order of the Federal Tariff Service of Russia of 17.08.2005 No. 380-e/2 and the Methodology of setting tariffs on oil products transportation via trunk pipelines of the Russian Federation approved by Federal Energy Commission of Russia of 16.10.2002 No. 70-e/5 (in edition of the Order of the FTS of Russia of 07.12.2007 No. 437-e/24).

During 2012 and the six months ended 30 June 2013, OAO AK Transneft was performing its core operations:

- a) of transporting oil, by charging fees for its services in accordance with oil transportation tariff rates approved by orders of the state regulatory body for natural monopolies – the Federal Tariff Service of Russia (FTS of Russia) and by intergovernmental agreement:
- Order of the FTS of Russia of 31.08.2011 No. 202-e/2 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system;
  - Order of the FTS of Russia of 29.07.2011 No. 183-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of Oil along the Klin-Andreapol' route;
  - Order of the FTS of Russia of 01.02.2011 No. 12-e/7 Concerning the setting of a fee for the services of OAO AK Transneft for transportation of oil along the Makhachkala–NB Sheskhari route;
  - Order of the FTS of Russia of 29.07.2010 No. 172-e/6 Concerning the setting of a fee for the services of OAO AK Transneft for transportation of oil via the Tikhoretsk–Tuapse Oil Refinery pipeline section for OAO NK Rosneft;
  - Order of the FTS of Russia of 24.11.2009 No. 324-e/4 Concerning the setting of a fee rate for oil loading services at the PNN Skovorodino of OAO AK Transneft's trunk pipeline system;
  - Order of the FTS of Russia of 22.12.2009 No. 455-t/1 Concerning the setting of fees for sea port services provided to OOO Specialized Oil Loading Sea Port Kozmino;
  - Order of the FTS of Russia of 05.08.2008 No. 129-e/3 Concerning the approval of fees for oil loading services at the LPDS Krotovka of OAO AK Transneft's trunk pipeline system for OAO TNK-BP Holding;
  - Order of the FTS of Russia of 29.12.2011 No. 448-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of transit oil via the trunk pipeline system;
  - Order of the FTS of Russia of 28.02.2012 No. 15-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil at the Oil Base Ust-Luga and the inclusion of amendments to the order of the FTS of Russia of 31.08.2011 No. 202-e/2;
  - Order of the FTS of Russia of 27.04.2012 No. 72-e/2 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil along the Klin-Andreapol' route;
  - Order of the FTS of Russia of 10.07.2012 No. 174-e/2 Cancelling the order of the FTS of Russia of 05.08.2008 concerning the setting of fees for oil loading services at the LPDS Krotovka of OAO AK Transneft's trunk pipeline system for OAO TNK-BP Holding;
  - Order of the FTS of Russia of 31.08.2012 No. 208-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system and the inclusion of amendments to the order of the FTS of Russia of 31.08.2011 No. 202-e/2;
  - Order of the FTS of Russia of 27.09.2012 No. 226-e/3 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system;
  - Order of the FTS of Russia of 11.12.2012 No. 369-e/27 Concerning the setting of a fee for the services of OAO AK Transneft for transportation of oil along the Makhachkala–NB Sheskhari route;
  - Order of the FTS of Russia of 27.11.2012 No. 274-e/2 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system;
  - Order of the FTS of Russia of 27.09.2012 No. 227-e/3 Concerning the cancelling of the orders of the FTS:
    - of 31.08.2011 No. 202-e/2 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system;
    - of 28.02.2012 No. 15-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil at the Oil Base Ust-Luga and the inclusion of amendments to the order of the FTS of Russia of 31.08.2011 No. 202-e/2;



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- of 27.04.2012 No. 72-e/2 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil along the Klin-Andreapol' route;
- of 31.08.2012 No. 208-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the trunk pipeline system and the inclusion of amendments to the order of the FTS of Russia of 31.08.2011 No. 202-e/2;
- Order of the FTS of Russia of 30.10.2012 No. 252-e/2 Concerning the cancelling of the order of the FTS of Russia of 29.07.2010 No. 172-e/6 Concerning the setting of a fee for the services of OAO AK Transneft for transportation of oil via the Tikhoretsk–Tuapse Oil Refinery pipeline section for OAO NK Rosneft;
- Order of the FTS of Russia of 14.12.2012 No. 392-e/12 Concerning the cancelling of the order of the FTS of Russia of 29.12.2011 No. 448-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of transit oil via the trunk pipeline system;
- Order of the FTS of Russia of 14.12.2012 No. 391-e/11 Concerning the cancelling of the order of the FTS of Russia of 01.02.2011 No. 12-e/7 Concerning the setting of a fee for the services of OAO AK Transneft for transportation of oil along the Makhachkala–NB Sheshkharis route;
- The intergovernmental agreement on transportation of Azerbaijan oil through the territory of the Russian Federation of 16.02.1996, Baku;
- Order of the Government of the Russian Federation of 05.05.2013 No. 746-r about the cancelling of the intergovernmental agreement on transportation of Azerbaijan oil through the territory of the Russian Federation.

b) of transporting oil products, by charging fees for its services in accordance with fee rates approved by OAO AK Transneft in accordance with orders of the state regulatory body for natural monopolies – the Federal Tariff Service of Russia (FTS of Russia):

- Order of the FTS of Russia of 24.12.2010 No. 471-e/1 Concerning the setting of fees for the services of OAO AK Transneft and its affiliated entities for transportation of oil products via the trunk pipeline system;
- Order of the FTS of Russia of 23.09.2010 No. 234-e/2 Concerning fee rates for the services of OOO BalttransService for transportation of oil products from the trunk pipeline system in the Primorsk Commercial Seaport;
- Order of the FTS of Russia of 24.12.2010 No. 472-e/2 Concerning the inclusion of amendments to the Order of the FTS of Russia of 23.09.2010 No. 234-e/2 Concerning fee rates for the services of OOO BalttransService for transportation of oil products from the trunk pipeline system in the Primorsk Commercial Seaport
- Order of the FTS of Russia of 15.02.2011 No. 23-e/3 Concerning the setting of fees for the services of OAO AK Transneft and its affiliated entities for transportation of oil products via the trunk pipeline system, and the inclusion of amendments to the Order of the FTS of Russia of 24.12.2010 No. 471-e/1;
- Order of the FTS of Russia of 05.06.2012 No. 138-e/1 Concerning the inclusion of amendments to the Order of the FTS of Russia of 24.12.2010 No. 471-e/1 Concerning the setting of fees for the services of OAO AK Transneft and its affiliated entities for transportation of oil products via the trunk pipeline system;
- Order of the FTS of Russia of 03.07.2012 No. 165-e/3 Concerning the inclusion of amendments to the Order of the FTS of Russia of 24.12.2010 No. 471-e/1 Concerning the setting of fees for the services of OAO AK Transneft and its affiliated entities for transportation of oil products via the trunk pipeline system.

During 2012 and six months ended 30 June 2013, oil transportation tariff rates increased by 5.5% effective from 6 November 2012.

## 2.2. Oil mining and oil products refining volumes

The dynamics of oil mining and oil products refining volumes in the Russian Federation determine the dynamics of transportation turnover via the Group's oil and oil products pipelines and therefore the Group's revenue from the relevant services.

	Six months ended 30 June 2013	Six months ended 30 June 2012	Change, %
Oil mining volume in the Russian Federation, mln tons	258.7	256.5	0.9
Oil products refining volume in the Russian Federation, mln tons	58.5	57.4	1.8



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Oil mining volume increased for the six months ended 30 June 2013 as compared to the six months ended 30 June 2012 for 2.2 mln tons or by 0.9% (ref. to subparagraph 3.1.1.).

Growth in oil products refining during the six months ended 30 June 2013 in the Russian Federation for 1.1 mln tons or by 1.8% has influenced in growth of oil products transportation (ref. to subparagraph 3.1.1.).

In the 1st half year of 2013 the volume of delivery of oil to refinery plants of the Russian Federation exceeded the volume of oil transportation for export to CIS and international markets. Management estimates this would result in the growth of oil refining volumes and will lead to growth of transportation volumes of oil products (ref. to subparagraph 3.1.1.).

### 2.3. The rouble's exchange rate against foreign currencies

Oil transportation services are paid for in Russian roubles except for the transit of crude oil from Azerbaijan which is set off in US Dollars.

Oil products transportation services are paid for in the following main currencies:

- in the Russian Federation: Russian roubles;
- in the Republic of Belarus and Ukraine: US dollars;
- in the Republic of Kazakhstan: the rouble equivalent calculated at the exchange rate of the Kazakhstan tenge established by the Central Bank of the Russian Federation on the payment date.

Fluctuations of US Dollar and Kazakhstan tenge do not significantly affect the Group's operating results as the portion of revenue which is paid for in US Dollars or rouble equivalent, calculated at the Kazakhstan tenge exchange rate, established by Central Bank of Russian Federation at the date of payment, in the total revenue is relatively small.

The Group's has a significant portion of US dollars nominated loans. Increase of US dollars' to Russian roubles exchange rate may result in additional expenses in regard to servicing and settlement of liabilities nominated in foreign currency.

	Six months ended 30 June 2013	Six months ended 30 June 2012	Change, %
Change in the rouble's exchange rate against the US dollar, %	7.69	1.93	x
Average exchange rate for the period (roubles per US dollar)	31.0169	30.6390	1.23
Exchange rate at the end of the period (roubles per US dollar)	32.7090	32.8169	(0.33)

### 2.4. Inflation rates

Russia's inflation rates as per Federal state statistics service during the period in question were as follows:

	Six months ended 30 June 2013	Six months ended 30 June 2012	Change, pp
Rouble inflation (CPI), %	3.5	3.2	0.3

### 2.5. Taxation

Most of the Group's companies are incorporated in the Russian Federation, with their financial activity taxable under the Tax Code of the Russian Federation.

The amount of taxes accrued by the Group was as follows:

	Six months ended 30 June 2013	Six months ended 30 June 2012	Change, %
Current income tax	18,584	25,237	(26.4)
Property tax	5,064	2,239	2.3 times
Other taxes and levies	355	324	9.6





#### **Income tax**

The federal income tax rate is 2.0%, while the regional rates range from 13.5% to 18.0%. The Group's international operations are taxable at rates established by the laws of countries where they take place.

#### **Property tax**

The amount due increased by RUB 2,825 or 2.3 times. The significant increase was a result of introduction on 1 January 2013 of the Federal Law of 29.11.2012 # 202-FZ «Concerning amendments to Part two of the Tax Code of the Russian Federation», which cancelled tax advantages for property tax relating to the trunk pipeline facilities as well as of any structures constituting an integral technological part of these facilities, as well as the completion of construction and putting into operation during 2012 a number of investment projects, including the Baltic Pipeline System (BPS-2) and the second phase of the pipeline system Eastern Siberia - Pacific Ocean (ESPO-II).

The property tax is assessed at a rate not exceeding 2.2% of average annual fixed asset book value.

#### **Other taxes and levies**

Other taxes mainly include the transport tax, the land tax and other taxes and levies.



### 3. Analysis of the Group's performance

The table below presents consolidated statement of profit and loss and other comprehensive income for the periods showed therein.

	Six months ended 30 June 2013	Six months ended 30 June 2012	Absolute change	Change, %
<b>Revenue</b>				
Revenue from oil transportation services	250,446	245,158	5,288	2.2
Revenue from crude oil sales	79,563	83,033	(3,470)	(4.2)
Other revenue	39,360	33,102	6,258	18.9
Operating expenses	(239,892)	(230,821)	(9,071)	3.9
<b>Operating profit</b>	<b>129,477</b>	<b>130,472</b>	<b>(995)</b>	<b>(0.8)</b>
Exchange gains	31,980	81,638	(49,658)	(60.8)
Exchange losses	(37,990)	(79,466)	41,476	(52.2)
Interest income	7,324	5,117	2,207	43.1
Interest expense	(18,792)	(14,483)	(4,309)	29.8
Net change in fair value of derivatives	(240)	(374)	(134)	(35.8)
Share of profit from associates and jointly controlled entities	437	1,356	(919)	(67.8)
<b>Profit before income tax</b>	<b>112,196</b>	<b>124,260</b>	<b>(12,064)</b>	<b>(9.8)</b>
Current income tax	(18,627)	(25,237)	6,610	(26.2)
Deferred income tax	(4,185)	(3,663)	(522)	14.3
<b>Income tax expense</b>	<b>(22,812)</b>	<b>(28,900)</b>	<b>6,088</b>	<b>(6.3)</b>
<b>Profit for the period</b>	<b>89,384</b>	<b>95,360</b>	<b>(5,976)</b>	<b>(6.3)</b>
Defined benefit plan actuarial gains	522	-	522	X
Other comprehensive loss, net of income tax	(10)	(15)	5	(33.3)
<b>Total comprehensive income</b>	<b>89,896</b>	<b>95,345</b>	<b>(5,449)</b>	<b>(5.7)</b>
<b>Profit attributable to:</b>				
Shareholders of OAO AK Transneft	86,902	93,244	(6,342)	(6.8)
Non-controlling interests	2,482	2,116	366	17.3
<b>Total comprehensive income attributable to:</b>				
Shareholders of OAO AK Transneft	87,414	93,229	(5,815)	(6.2)
Non-controlling interests	2,482	2,116	366	17.3



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**3.1. Revenue**

Revenue By Type Of Operations	Six months ended 30 June 2013	Share Of Total Revenue, %	Six months ended 30 June 2012	Share of total revenue, %	Absolute change	Change, %
<b>Revenue from crude oil transportation services</b>	<b>250,446</b>	<b>67.8</b>	<b>245,158</b>	<b>67.9</b>	<b>5,288</b>	<b>2.2</b>
Exports and sales in international markets, except the CIS	137,833	37.3	135,027	37.4	2,806	2.1
Exports and sales in the CIS	7,653	2.1	7,057	2.0	596	8.4
Domestic sales	104,960	28.4	103,074	28.5	1,886	1.8
Revenue from oil products transportation services	22,438	6.1	14,800	4.1	7,638	51.6
Revenue from oil compounding services	2,581	0.7	3,093	0.9	(512)	(16.6)
Other revenue	10,563	2.9	7,309	2.0	3,254	44.5
<b>Total revenue (less revenue from sales of crude oil and oil products)</b>	<b>286,028</b>	<b>77.4</b>	<b>270,360</b>	<b>74.8</b>	<b>15,668</b>	<b>5.8</b>
Revenue from export sales of crude oil	73,360	19.9	78,390	21.7	(5,030)	(6.4)
Revenue from sales of crude oil in the domestic market	6,203	1.7	4,643	1.3	1,560	33.6
Revenue from sales of oil products	3,778	1.0	7,900	2.2	(4,122)	(52.2)
<b>Total revenue</b>	<b>369,369</b>	<b>100.0</b>	<b>361,293</b>	<b>100.0</b>	<b>8,076</b>	<b>2.2</b>

During the six months ended 30 June 2013, the Group's revenue increased by RUB 8,076, or 2.2%, attributable mainly to an increase in revenue from of oil transportation services and revenue from sales of crude oil and oil products, including oil sales to China National United Oil Corporation. Without taking into account crude oil sales and oil products sales, revenue for the six months ended 30 June 2013, amounted to RUB 286,028, which is RUB 15,668, or 5.8% higher than for the six months ended 30 June 2012.

**3.1.1. Oil and oil products transportation services**

An increase in revenue from oil transportation services by RUB 5,288, or 2.2%, was driven by the following factors:

- growth in oil transportation tariffs (ref to paragraph 2.1);
- growth in turnover by 1.8% (569,780.1 mln tons x km for the six months ended 30 June 2013; 559,873.2 mln tons x km for the six months ended 30 June 2012).

An increase in revenue from oil products transportation services was driven by the following factors:

- by growth in oil products transportation tariffs (ref to paragraph 2.1);
- growth in turnover by 37.7% (for the six months ended 30 June 2013 – 21,598.2 mln tons x km; and 15,674.8 mln tons x km in the six months ended 30 June 2012).



### **3.1.2. Revenue from sales of crude oil and oil products**

Revenue from sales of crude oil was driven by the start of oil supplies to the People's Republic of China under a 20-year contract to supply 6 mln tons of crude oil annually effective January 1, 2011. This contract was signed as a collateral for a loan obtained from the China Development Bank. The respective oil volumes are being purchased from OAO NK Rosneft.

Decline in revenue from export sales of crude oil as for the six months ended 30 June 2013 compared to the six months ended 30 June 2012 was a result of decrease of oil price nominated in US Dollars per 1 barrel for the six months ended 30 June 2013.

Decline in revenue from sales of marketable oil products for the six months ended 30 June 2013 by RUB 4,122 or by 52.2%, was driven by decrease in volumes of marketable oil products sales by the Group's companies as non-core business.

### **3.1.3. Revenue from oil compounding services**

A decrease in revenue from oil compounding services by RUB 512 or by 16.6% as for the six months ended 30 June 2013 compared to the six months ended 30 June 2012 was a result of decline in oil compounding volumes by 19.0% (18,782.8 thousand tons for the six months ended 30 June 2013; 23,191.9 thousand tons for the six months ended 30 June 2012).

### **3.1.4. Other revenue**

Other revenue includes revenue from oil and oil products storage services, information services related to oil transportation, property leasing, and insurance services, rent services, organization of transporting services, as well as other services.

An increase in the amount of other revenue for the six months ended 30 June 2013 as compared to the similar period of the previous year was a result of:

- increase of revenue for activities on the organization of transportation of cargoes by railways by RUR 1,387;
- increase of revenue for construction services in the amount of RUR 412;
- increase of insurance services by RUR 360.



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### 3.2. Operating expenses

Operating expenses for the six months ended 30 June 2013, and the six months ended 30 June 2012, are detailed in the table below:

Operating expense line items	Six months ended 30 June 2013	Share of total expenses, %	Six months ended 30 June 2012	Share of total expenses, %	Absolute change	Change, %
Staff costs	55,858	23.3	48,853	21.2	7,005	14.3
Energy	15,542	6.5	15,738	6.8	(196)	(1.2)
Transportation of oil using railways	3,444	1.4	16,548	7.2	(13,104)	(79.2)
Materials	9,481	4.0	7,352	3.2	2,129	29.0
Repairs services and maintenance of relevant technical condition of pipeline	5,298	2.2	4,553	2.0	745	16.4
Insurance expenses	3,097	1.3	2,521	1.1	576	22.8
Taxes (except income tax)	5,206	2.2	2,496	1.1	2,710	times 4.8
Other operating expenses	6,751	2.8	1,414	0.6	5,337	times
<b>Total operating expenses (net of D&amp;A and cost of crude oil and oil products sold)</b>	<b>104,677</b>	<b>43.7</b>	<b>99,475</b>	<b>43.2</b>	<b>5,202</b>	<b>5.2</b>
Depreciation and amortization	50,187	20.9	40,709	17.6	9,478	23.3
One-time non-production expenses	2,223	0.9	-	-	2,223	-
Cost of export crude oil sales (including export custom duties)	72,967	30.4	78,674	34.1	(5,707)	(7.3)
Cost of crude oil sold in the domestic market	6,194	2.6	4,463	1.9	1,731	38.8
Cost of oil products sold	3,644	1.5	7,500	3.2	(3,856)	(51.4)
<b>Total operating expenses</b>	<b>239,892</b>	<b>100.0</b>	<b>230,821</b>	<b>100.0</b>	<b>9,071</b>	<b>3.9</b>

For the six months ended 30 June 2013, compared to the six months ended 30 June 2012, the amount of operating expenses (less depreciation and amortization, one-time non-production expenses and cost of crude oil and oil products sold) increased by RUB 5,202 or 5.2%, while total operating expenses increased by RUB 9,071, or 3.9%.

An increase in the Group's total operating expenses was driven by the following factors:

- growth in depreciation and amortization by RUB 9,478 or 23.3%. The growth of depreciation associated mainly with putting into operation of the Baltic Pipeline System (BPS-2) in early 2012, as well as putting into operation of The Eastern Siberia–Pacific Ocean pipeline system, stage two the Skovorodino–SMNP Kozmino section (ESPO-II);
- growth in the amount of taxes by RUB 2,710 or in 2.1 times as a result of amendments to the Tax Code of the Russian Federation (ref. paragraph 2.5);
- growth in staff costs by RUB 7,005 or by 14.3% (ref. paragraph 3.2.1.).



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After applying deflation rates, operating expenses for the six months ended 30 June 2013, and for the six months ended 30 June 2012, were as follows:

Operating expense line items	Deflation rates (2013 To 2012)	Six months ended 30 June 2013 (Deflated To 2012)	Share of total expenses, %	Six months ended 30 June 2012	Share of total expenses, %	Absolute change	Change, %
Staff costs	6.7	52,351	23.0	48,853	21.2	3,498	7.2
Energy	9.7	14,168	6.2	15,738	6.8	(1,570)	(10.0)
Transportation of oil using railways	8.6	3,171	1.4	16,548	7.2	(13,377)	(80.8)
Materials	4.0	9,116	4.0	7,352	3.2	1,764	24.0
Repairs services and maintenance of relevant technical condition of pipeline	6.2	4,989	2.2	4,553	2.0	436	9.6
Insurance expenses	4.0	2,978	1.3	2,521	1.1	457	18.1
Taxes (except income tax)	4.0	5,006	2.2	2,496	1.1	2,510	2.0 times
Other operating expenses	4.0	6,491	2.8	1,414	0.6	5,077	4.6 times
<b>Total operating expenses (net of D&amp;A and cost of crude oil and oil products sold)</b>	<b>X</b>	<b>98,270</b>	<b>43.1</b>	<b>99,475</b>	<b>43.2</b>	<b>(1,205)</b>	<b>(1.2)</b>
Depreciation and amortization	X	50,187	22.0	40,709,	17.6	9,478	23.3
One-time non-production expenses	X	2,223	1.0	-	-	2,223	x
Cost of export crude oil sales	7.1	68,130	29.9	78,674	34.1	(10,544)	(13.4)
Cost of crude oil sold in the domestic market	7.1	5,783	2.5	4,463	1.9	1,320	29.6
Cost of oil products sold	4.0	3,504	1.5	7,500	3.2	(3,996)	(53.3)
<b>Total operating expenses</b>	<b>X</b>	<b>228,097</b>	<b>100.0</b>	<b>230,821</b>	<b>100.0</b>	<b>(2,724)</b>	<b>(1.2)</b>

The deflation rates used are based on scenarios prepared by the Ministry of Economic Development for devising socio-economic development scenarios for 2012-2016, as well as on 2012-2013 inflation rates.



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**Unit costs analysed by segments Oil transportation and Oil products transportation based on indicators developed under the Russian Accounting Standards**

The Group's management analyzes expenses broken down by the Oil transportation, Oil products transportation and Oil sales to the People's Republic of China segments based on indicators developed under the Russian Accounting Standards (RAS) without adjustment entries for compliance with the IFRS.

	Oil transportation services	Oil products transportation services	Adjustment entries	Total operating expenses*
<b>For the six months ended 30 June 2013</b>				
Operating expenses	102,336	9,708	(7,367)	104,677
Cargo turnover, mln tons x km	569,780	21,589	-	-
<b>For the six months ended 30 June 2012</b>				
Operating expenses	100,085	8,588	(9,198)	99,475
Cargo turnover, mln tons x km	559,873	15,675	-	-

\*Operating expenses were reported net of D&A and cost of crude oil and oil products sold.

Unit costs per 100 tons x km for each of the segments are based on operating expenses calculated under the Russian Accounting Standards (RAS) without adjustment entries for compliance with the IFRS and cargo turnover. Deflated unit costs are calculated using deflation rate for deflating operating expenses (net of D&A and cost of crude oil and oil products sold).

Unit costs of oil and oil products transportation per 100 tons x km for the six months ended 30 June 2013, and for the six months ended 30 June 2012, were as follows:

	For the six months ended 30 June 2013	For the six months ended 30 June 2012	Absolute change in unit costs, RUB per 100 tons x km	Change in unit costs, RUB per 100 tons x km, %
<b>Oil transportation services</b>				
Unit costs per 100 tons x km, RUB	17.96	17.88	0.08	0.4
Deflated unit costs per 100 tons x km, RUB	16.79		(1.09)	(6.1)
<b>Oil products transportation services</b>				
Unit costs per 100 tons x km, RUB	44.97	54.79	(9.82)	(17.9)
Deflated unit costs per 100 tons x km, RUB	42.03		(12.76)	(23.3)

### 3.2.1. Staff costs

Staff costs comprise wages, accrual of provision for annual bonus, provision for unused vacation, pension contributions, insurance premiums, staff training, social security expenses and other remuneration.

The increase in staff costs for the six months ended 30 June 2013 as compared to the six months ended 30 June 2012 in the amount of RUB 7,005 or 14.3% was influenced by an increase of average employee headcount related primarily to construction and operation of new oil pipelines, indexation of salaries.

OAO AK Transneft has set the protection of the life and health of its employees as well as the creation of safe working conditions for them as its highest priority. One of the key tasks of social policy is to create conditions for effective work and social protection of workers.

The non-state pension fund which offers different corporate plan options is an important part of the social policy.

	Six months ended 30 June 2013	Six months ended 30 June 2012	Absolute change	Change, %
Employers' contributions to NPF Transneft* in favor of employees	3,460	3,248	212	6.5

\* NPF Transneft – Non-state pension fund Transneft



### **3.2.2. Energy**

Energy expenses for the six months ended 30 June 2013, decreased by RUB 196 or 1.2%, due to the implementation of measures under the program of energy saving and development of energy efficiency of OAO "AK" Transneft" for the period 2012-2015.

### **3.2.3. Transportation of oil using railways**

This category of expenses represents expenditures on a complete set of services related to oil transportation by railways, including preparation and delivery of railway cars for oil loading, oil transportation by railway along the Skovorodino–SMNP Kozmino section, delivery of railway cars for oil unloading, and return of empty railway cars to Skovorodino.

The amount of expenses on transportation of oil using railways as for the six months ended 30 June 2013 decreased by RUB 13,104 or 79.2% as compared to the previous period as a result of putting into operation of The Eastern Siberia–Pacific Ocean pipeline system, stage two, the Skovorodino–SMNP Kozmino section (ESPO-II).

### **3.2.4. Materials**

Expenses on materials for the six months ended 30 June 2013, increased by RUB 2,129 or 29.0%, due to expansion of operations:

- increase in rendering of construction services to third parties;
- increase in the amount of expenses, connected with putting into operation of new oil pipelines.

### **3.2.5. Repairs services and maintenance of relevant technical condition of pipeline**

An increase in these expenses for the six months ended 30 June 2013, amounted to RUB 745 or 16.4% compared to the six months ended 30 June 2012.

### **3.2.6. Cost of crude oil and oil products sold**

The cost of crude oil sold for export for the six months ended 30 June 2013, amounted to RUB 72,967, including custom duties in the amount of RUB 36,199, which was a result of the start of oil supplies to the People's Republic of China (ref. to 3.1.2.). These expenses are related to the cost of oil purchased from OAO NK Rosneft under a contract signed in April 2009.

The cost of marketable oil products sold decreased by RUB 3,856 or 51.4% due to decline in the Group companies' oil products sales volumes as non-core activity (ref. to paragraph 3.1.2).

### **3.2.7. Taxes (except income tax)**

The Group's other taxes include primarily the property tax, which amounted to RUB 4,872 for the six months ended 30 June 2013. Increase in the amount of RUB 2,462 or in 2.0 times as compared to the prior period as a result of cancellation on 1 January 2013 of property tax advantages, as well as putting into operation a number of investment projects (ref. to paragraph 2.5).

### **3.2.8. Other operating expenses**

Other expenses include the results related to fixed assets disposals, income from posting oil surpluses, charity spending, fines and penalties received and paid, as well as other operating expenses.

OAO AK Transneft implements a policy of transparency with regard to its charity spending by disclosing detailed information on its website.

### **3.2.9. Share of profit from associates and jointly controlled entities**

The Group holds a number of financial investments in associated and jointly controlled entities reported on an equity method basis. The decrease in the Group's share of profit from associates and jointly controlled entities for the six months ended 30 June 2013 compared to the relative period in 2012, was mainly attributed to decline in profit of OAO Novorossiysk Commercial Sea Port. The Group's share in OAO Novorossiysk Commercial Sea Port is 25.05%.

### **3.2.10. Interest income and expenses**

Interest income is generated from depositing available cash in bank accounts as well as investing in fixed-income securities.





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An increase in interest income for the six months ended 30 June 2013, by RUB 2,207 or 43.1%, was driven by an growth in income from fixed-income securities as well as decline in the amount of income generated by investing temporarily available cash and cash equivalents (ref. to paragraph 5).

Interest income	Six months ended 30 June 2013	Six months ended 30 June 2012	Absolute change	Change, %
Interest income from cash and equivalents	3,415	3,605	(190)	(5.3)
Interest income from other financial assets	5,378	3,511	1,867	53.2
Other interest income	173	177	(4)	(2.3)
<b>Total interest receivable</b>	<b>8,966</b>	<b>7,293</b>	<b>1,673</b>	<b>22.9</b>
less interest income on the temporary investment of borrowings	(1,642)	(2,176)	534	(24.5)
<b>Total interest income recognised in the statement of profit and loss and other comprehensive income</b>	<b>7,324</b>	<b>5,117</b>	<b>2,207</b>	<b>43.1</b>

Accrued interest expenses and amounts of capitalized interest expenses for the relevant periods were as follows:

Interest expenses	Six months ended 30 June 2013	Six months ended 30 June 2012	Absolute change	Change, %
Interest expenses on loans and borrowings	17,257	17,448	(191)	(1.1)
Interest expenses regarding the dismantlement provision	2,896	3,614	(718)	(19.9)
Other interest expenses	511	309	202	65.4
<b>Total interest expenses</b>	<b>20,664</b>	<b>21,371</b>	<b>(707)</b>	<b>(3.3)</b>
Less finance costs to be capitalised	(1,872)	(6,888)	5,016	(72.8)
<b>Total interest expense recognised in the statement of profit and loss and other comprehensive income</b>	<b>18,792</b>	<b>14,483</b>	<b>4,309</b>	<b>29.8</b>

The amount of interest expenses is composed of:

- interest payable on a USD 10bn loan obtained from the China Development Bank at a variable LIBOR-linked rate with a 20-year maturity repayable in equal installments starting in the sixth year from the moment of issue;
- interest payable on Eurobonds issued by the Group in 2007-2008 for a total of USD 2,950 mln for the six months ended 30 June 2013 and USD 3,450 and 700 mln Euros for the similar period of the previous year;
- interest payable on series 01-03 non-convertible interest-bearing documentary bonds for a total of RUB 135,000;
- interest payable on series BO-01 and BO-02 of non-convertible interest-bearing documentary bonds amounting to RUB 34,000.

In June 2012 the Group repaid in full and on time two Eurobonds issues in the amount of USD 500 mln and 700 mln Euros.

During the six months ended 30 June 2013, interest in the amount of RUB 230 was capitalised as part of cost of assets under construction (for the six months ended 30 June 2012 – RUB 4,712) including:

- interest expenses to be capitalised in the amount of RUB 1,872 (for the six months ended 30 June 2012 – RUB 6,888);
- interest income to be excluded from interest expenses to be capitalised in the amount of RUB 1,642 (for the six months ended 30 June 2012 – RUB 2,176).

Increase in interest expenses for the six months ended 30 June 2013 as compared to the six months ended 30 June 2012 amounted to RUB 4,309 or 29.8% and was mainly attributable to the completion of investment projects which were financed by loans and borrowings.



### 3.2.11. Foreign currency exchange gains and losses

The sum of foreign currency exchange gains and losses and their growth for the six months ended 30 June 2013, compared to the six months ended 30 June 2012, was a result of changes in the exchange rates of the US dollar and the Euro to the Russian rouble during the relative periods.

Due to a restatement of assets and liabilities denominated in foreign currencies at the end of every month, positive and negative currency-translation changes results, which are presented in the reporting on gross base.

The currency-translation differences occurring with the fluctuation of foreign-currency exchange rates against the rouble were primarily driven by foreign-currency-denominated liabilities (USD and euro-denominated loans and borrowings facilities) and assets which value is expressed in foreign currencies (bank loans and balances on foreign-currency-denominated bank accounts).

The most pronounced effect on the sum total of currency-translation differences were differences for foreign-currency-denominated loans and borrowings facilities:

Currency-translation effect for foreign-currency-denominated loans and borrowings facilities	Six months ended 30 June 2013	Six months ended 30 June 2012
Gains	4,507	46,042
Losses	34,846	55,076

The dynamic of currency-translation effects presented in the table was driven by weakening of the rouble against the US dollar and the Euro for the six months ended 30 June 2013 and by strengthening for the six months ended 30 June 2012.

### 3.3. Reconciliation of profit and EBITDA

	Six months ended 30 June 2013	Six months ended 30 June 2012	Change, %
<b>Profit for the period</b>	<b>89,384</b>	<b>95,360</b>	<b>(6.3)</b>
Increased (decreased) by:			
income tax	22,812	28,900	(21.1)
depreciation and amortization	50,187	40,709	23.3
net change in fair value of derivatives	240	374	(35.8)
interest expenses	18,792	14,483	29.8
interest and dividend income	(7,324)	(5,117)	43.1
exchange gains	(31,980)	(81,638)	(60.8)
exchange losses	37,990	79,466	(52.2)
share of profit from associates and jointly controlled entities	(437)	(1,356)	(67.8)
<b>EBITDA</b>	<b>179,664</b>	<b>171,181</b>	<b>5.0</b>
<b>EBITDA margin*, %</b>	<b>60.7</b>	<b>60.5</b>	<b>x</b>

\* Less crude oil sale and purchase operations under contracts with OAO NK Rosneft and the China National United Oil Corporation.

EBITDA is a useful indicator for investors, as it reflects the Group's operating performance, including its ability to finance capital expenditures, company acquisitions, and other investments, as well as its ability to raise and service borrowings and loans. Some investors, analysts, and rating agencies tend to use EBITDA as a basis for estimating and projecting the efficiency and value of oil & gas companies. This indicator should not be considered separately, as an alternative to net income, operating income, or any other of Group's performance indicators reported in its consolidated financial statements.



#### 4. Cash flow analysis

	Six months ended 30 June 2013	Six months ended 30 June 2012	Absolute change	Change, %
Cash flows from operating activities	176,209	81,599	94,610	2.2 times
Cash flows used in investing activities	(150,734)	(102,779)	(47,955)	46.7
<b>Free cash flows*</b>	<b>25,475</b>	<b>(21,180)</b>	<b>46,655</b>	<b>2.2 times</b>
Cash flows used in financing activities	(623)	(49,703)	49,080	98.7
<b>Net cash flows</b>	<b>24,852</b>	<b>(70,883)</b>	<b>95,735</b>	<b>1.4 times</b>
Change in cash due to deviation of currency exchange rate	3,663	(223)	3,886	X
<b>Net increase/ (decrease) in cash and cash equivalents</b>	<b>28,515</b>	<b>(71,106)</b>	<b>99,621</b>	<b>2.5 times</b>

\*Including purchase and sale of promissory notes. Free cash flows excluding investments in promissory notes for the six months ended 30 June 2013 amounted to RUB 90,790 (the six months ended 30 June 2012: RUB 1,486)

##### 4.1. Operating activities

Cash received from operating activities is the Group's main source of cash. The net cash generated from operating activities amounted to RUB 176,209 for the six months ended 30 June 2013, which is RUB 94,610 or in 2.2 times higher than for the six months ended 30 June 2012.

This dynamics was driven by a decrease in cash payments to suppliers and contractors by RUB 20,838. The key drivers of the increase in cash received from operating activities was an increase in cash received from the recovery of VAT and other taxes from the budget by RUB 38,500 and simultaneous decrease in income tax payments amounting to RUB 33,132.

##### 4.2. Investing activities

The primary factors resulting in a general increase in cash used in investment activities by RUB 47,955 or 46.7% for the six months ended 30 June 2013, as compared to the same period for the previous year, were:

- an increase by RUB 45,621 or by 11.8% in cash used in purchase-and-sale transactions in regards to promissory notes for the purpose of investing of temporarily available funds (which amounted to RUB 65,315 for the six months ended 30 June 2013, and RUB 19,694 for the six months ended 30 June 2012);



#### 4.3. Disclosure of cash flows from operating activities using indirect method

Cash flows received from operating activities using the indirect method are disclosed in the table below in addition to the consolidated statements of cash flows prepared using the direct method and disclosed in the consolidated financial statements prepared in accordance with IFRS for the six months ended 30 June 2013.

Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss before tax for the effects of:

- (a) changes during the period in inventories and operating receivables and payables;
- (b) non-cash items such as depreciation, provisions, unrealized foreign currency gains and losses, and undistributed profits of associates;
- (c) all other items for which the cash effects are investing or financing cash flows.

	Six months ended 30 June 2013	Six months ended 30 June 2012
<b>OPERATING ACTIVITIES</b>		
<b>Profit before tax</b>	<b>112,196</b>	<b>124,260</b>
<i>Adjustments for:</i>		
Depreciation and amortization	50,187	40,709
Loss from disposal of property, plant and equipment	612	(122)
Interest income and share of profit from associates and jointly controlled entities	(7,761)	(6,473)
Interest expenses	18,792	14,483
Loss/ (profit) from currency-translation differences	6,010	(2,172)
Others	(1,958)	(3,981)
<b>Operating profit before changes in working capital</b>	<b>178,078</b>	<b>166,704</b>
Changes in operating assets and liabilities:		
Increase in inventories	(2,217)	(3,992)
Decrease /(increase) in trade and other receivables relating to operating activity	32,457	(7,964)
Decrease in trade and other payables, and accruals relating to operating activity	(9,661)	(22,334)
<b>Cash flows from operating activities before payment of income tax expense and interest</b>	<b>198,657</b>	<b>132,414</b>
Income tax paid	(15,385)	(48,517)
Income tax refund	6,752	12,437
Interest paid	(13,815)	(14,735)
<b>Cash flows received from operating activities</b>	<b>176,209</b>	<b>81,599</b>



## 5. Liquidity analysis

	30 June 2013	31 December 2012	Change, %
Current assets	534,127	461,669	15.7
including:			
cash and cash equivalents	113,032	84,517	33.7
short-term bank promissory notes*	287,648	206,855	39.1
Current liabilities	196,606	147,943	32.9
Net working capital	337,521	313,726	7.6
Current ratio	2.7	3.1	(12.9)
Quick ratio**	2.3	2.3	-
Debt / EBITDA	1.7	1.8	(5.6)
Debt / Equity	0.5	0.5	-

\* Short-term bank promissory-notes consist of promissory notes by banks with investment-grade international credit ratings (95.2%), banks with credit ratings of BB+/Ba1/BB+, BB/Ba2/BB, BB-/Ba3/BB-, B-/B3/B- per the S&P/Moody's/Fitch classification. Thus, short-term bank promissory notes consist of highly reliable or reliable financial instruments.

\*\*Quick ratio = (Cash and cash equivalents + Current financial assets + Short-term receivables) / Current liabilities

The growth in cash and cash equivalents in the amount of RUB 28,515 as at 30 June 2013 as compared to cash and cash equivalents as at 31 December 2012 was a result of cash received from operating activities (ref. to paragraph 4.1).