

ОАО АК ТРАНСНЕФТ

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

FOR THE YEAR ENDED 31 DECEMBER 2012





**OAO AK TRANSNEFT**  
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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 31 December 2012 and results of operations for the year ended 31 December 2012, compared to the year ended 31 December 2011, 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 year ended 31 December 2012.

**Key financial and operating results**

	Year ended 31 December 2012	Year ended 31 December 2011	Change, %
Revenue	732,375	670,270	9.3
Profit for the period	184,390	191,218	(3.6)
EBITDA	323,985	291,189	11.3
EBITDA margin, %*	56.1	55.3	x
Oil delivered to consignees, mln. tons including	480.4	471.7	1.8
Russian oil refineries, mln. tons	241.7	233.4	3.6
transshipment into the CPC-R system, mln. tons	0.4	1.3	(69.2)
exports to FSU countries, mln. tons	27.9	29.0	(3.8)
exports to ROW, mln. tons	210.4	208.0	1.2
Oil products delivered to consignees, mln. tons including:	27.5	29.3	(6.1)
Russia's domestic market, mln. tons	8.9	8.6	3.5
exports to the Customs Union member countries, mln.	1.9	2.2	(13.6)
exports to ROW, mln. tons	16.6	18.4	(9.8)

\* 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 year ended 31 December 2012 amounted to RUB 184.4 bn which is RUB 22.2 bn or 13.7% higher than for the year ended 31 December 2011 which amounted to RUB 162.2 bn excluding gain from disposal of the Group's share in OOO Primorsk Trade Port in the amount of RUB 29.0 bn.

Furthermore, the profit for the year ended 31 December 2012 contains net foreign currency exchange gain amounting to RUB 10.5 bn (as for the year ended 31 December 2011 - RUB 3.8 bn), net interest expense amounting to RUB 19.7 bn (RUB 12.2 bn – for the year ended 31 December 2011). Should these factors be excluded the profit for the year ended 31 December 2012 would amount to RUB 193.5 bn (for the year ended 31 December 2011 – RUB 170.6 bn) showing an increase of RUB 22.9 bn or 13.4%.



## 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; and
- 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; and
- 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, and oil customs clearance.

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 is a natural monopoly and, as at 31 December 2012, it possesses an extensive network of trunk oil pipelines with a total length of approximately 53.5 thousand km and trunk oil products pipelines with a total length of some 19.1 thousand km.

During the year ended 31 December 2012 the Group transported 89% of oil produced in Russia and more than 23% 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; and
- 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 – 2012 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);
- 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 pipeline system.

### **1.2. Changes in the Group's investments**

In March 2012 the Group acquired a significant share (26%) in OOO Nevskaya truboprovodnaya companya for US Dollars 19 million (RUB 554 at the CBR exchange rate at the date of transaction). The company is the owner of oil-loading infrastructure in the Ust-Luga seaport.

In May 2012 the Group acquired the additional share of 49% of OAO VOSTOKNEFTETRANS for the consideration of RUB 3,600 which was paid out in cash. The acquisition resulted in increase of a total share in OAO VOSTOKNEFTETRANS from 51% to 100%. As at the date of acquisition the carrying value of net assets in the Group's consolidated financial statements amounted to RUB 7,252. The Group recognized a decrease in non-controlling interests in the amount of RUB 3,553 and an increase in retained earnings amounting to RUB 47.

### **1.3. 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 of 16.10.2002 No. 70-e/5.

During 2011 and 2012, 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 Service of Tariffs of Russia (FST of Russia):

- Order of the FST 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 FST 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 FST of Russia of 29.03.2011 No. 55-e/3 Concerning the Setting of Fee Rates for OAO AK Transneft's Oil Loading Services;
- Order of the FST 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's Route;
- Order of the FST of Russia of 30.12.2010 No. 496-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 FST of Russia of 26.11.2010 No. 336-e/2 Concerning the Setting of a Long-Term Fee Rate for the Services of OAO AK Transneft for Transportation of Oil along the LPDS Starolikeevo–Ryazan Oil Refinery Route of the Trunk Pipeline System for OAO TNK-BP Holding;
- Order of the FST 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 FST of Russia of 29.07.2010 No. 167-e/1 Concerning the Setting of Fees for the Services of OAO AK Transneft for Transportation of Oil via the Trunk Pipeline System;
- Order of the FST 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 FST 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 FST 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 FST 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 Oil via the Trunk Pipeline System;
- Order of the FST 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 FST of Russia of 31.08.2011 No. 202-e/2;
- Order of the FST 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 FST 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 FST of Russia of 31.08.2011 No. 202-e/2;
- Order of the FST 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;
- The intergovernmental agreement on transportation of Azerbaijan oil through the territory of the Russian Federation of 16.02.1996, Baku;
- Order of the FST of Russia of 27.09.2012 No. 227-e/3 Concerning the Cancelling of the Orders of the FST:



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- 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 FST of Russia of 31.08.2011 No. 202-e/2;
  - 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 FST of Russia of 31.08.2011 No. 202-e/2;
- Order of the FST of Russia of 30.10.2012 No. 252-e/2 Concerning the Cancelling of the Order of the FST 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 FST of Russia of 16.12.2011 No. 355-e/1 Cancelling the Order of the FST of Russia of 30.12.2010 No. 496-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 FST of Russia of 09.12.2011 No. 332-e/1 Cancelling the Order of the FST of Russia of 26.11.2010 No. 336-e/2 Concerning the Setting of a Long-Term Fee Rate for the Services of OAO AK Transneft for Transportation of Oil along the LPDS Starolikeevo–Ryazan Oil Refinery Route of the Trunk Pipeline System for OAO TNK-BP Holding.

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 (FST of Russia):

- Order of the FST 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 FST of Russia of 24.12.2010 No. 472-e/2 Concerning the Inclusion of Amendments to the Order of the FST 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 FST 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 FST of Russia of 24.12.2010 No. 471-e/1;
- Order of the FST of Russia of 03.07.2012 No. 165-e/3 Concerning the Inclusion of Amendments to the Order of the FST 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 2011 and 2012, oil transportation tariff rates increased:

- by 2.85% effective 1 September 2011;
- by 5.0% effective 1 November 2011;
- by 5.5% effective 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.

	Year ended 31 December 2012	Year ended 31 December 2011	Change, %
Oil mining volume in the Russian Federation, mln tons	518.0	511.4	1.3
Oil products refining volume in the Russian Federation, mln tons	192.4	185.4	3.8

As a result of growth during the year ended 31 December 2012 in oil mining volume in the Russian Federation by 6.6 mln tons, or 1.3%, the Group's oil transportation turnover and the Group's revenue from oil transportation services increased (ref. to subparagraph 3.1.1.).



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Growth in oil products refining during the year ended 31 December 2012 in the Russian Federation by 3.8% had not resulted in growth of oil products transportation (ref. to subparagraph 3.1.1.).

In 2012, for the first time 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 in 2013.

### 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; and
- 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 foreign exchange exposure mainly arises on US dollar and EURO-denominated borrowings. Decrease of rouble's rate may result in additional expenses in regard to servicing and settlement of liabilities nominated in foreign currency.

	Year ended 31 December 2012	Year ended 31 December 2011	Change, %
Change in the rouble's exchange rate against the US dollar, %	(5.66)	5.64	x
Average exchange rate for the period (roubles per US dollar)	31.0930	29.3874	5.8
Exchange rate at the end of the period (roubles per US dollar)	30.3727	32.1961	(5.7)

### 2.4. Inflation rates

Russia's inflation rates during the period in question were as follows:

	Year ended 31 December 2012	Year ended 31 December 2011	Change, pp
Rouble inflation (CPI,)%	6.6	6.1	0.5

### 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:

	Year ended 31 December 2012	Year ended 31 December 2011	Change, %
Current income tax	47,934	44,140	8.6
VAT	(53,156)	(10,765)	4.9 times
Property tax	4,716	3,925	20.2
Other taxes and levies	881	868	3.4





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**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.

**VAT**

An increase in the amount of the VAT subject to reimbursement from the budget was a result of:

- of claiming refunds for constructing amenities by subsidiaries participating in the investment projects of the Company in the amount of RUR 52,442 for the year ended 31 December 2012 (RUR 11,372 for the year ended 31 December 2011);
- rendering of services for transportation of oil and oil products for export in the amount of RUR 56,269 for the year ended 31 December 2012 and RUR 53,346 for the year ended 31 December 2011;
- export of oil to China in the amount of RUR 14,544 for the year ended 31 December 2012 and RUR 12,617 for the year ended 31 December 2011.

**Property tax**

The property tax is assessed at a rate not exceeding 2.2% of average annual fixed asset book value. The existing legislation provides for reduction of the taxable base by the book value of trunk pipeline facilities as well as of any structures constituting an integral technological part of these facilities.

**Other taxes and levies**

Other taxes mainly include the transport tax, the land tax, special-purpose levies established by local authorities, and other taxes and levies.



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

The table below presents consolidated statement of comprehensive income for the periods showed therein.

	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
<b>Revenue</b>				
Revenue from oil transportation services	494,542	455,752	38,790	8.5
Revenue from crude oil sales	166,275	152,108	14,167	9.3
Other revenue	71,558	62,410	9,148	14.7
Operating expenses	(492,587)	(457,848)	(34,739)	7.6
<b>Operating profit</b>	<b>239,788</b>	<b>212,422</b>	<b>27,366</b>	<b>12.9</b>
Exchange gains	130,329	129,375	954	0.7
Exchange losses	(119,758)	(125,589)	5,831	(4.6)
Interest income	10,501	9,884	617	6.2
Interest expense	(30,154)	(22,049)	(8,105)	36.8
Share of profit from associates and jointly controlled entities	3,938	31,486	(27,548)	(87.5)
<b>Profit before income tax</b>	<b>234,644</b>	<b>235,529</b>	<b>(885)</b>	<b>(0.4)</b>
Current income tax	(48,038)	(44,500)	(3,538)	8.0
Deferred income tax	(2,216)	189	(2,405)	X
<b>Income tax expense</b>	<b>(50,254)</b>	<b>(44,311)</b>	<b>(5,943)</b>	<b>13.4</b>
<b>Profit for the period</b>	<b>184,390</b>	<b>191,218</b>	<b>(6,828)</b>	<b>(3.6)</b>
Defined benefit plan actuarial loss	(1,291)	-	(1,291)	X
Currency translation differences, net of income tax	(40)	44	(84)	X
Fair value losses on available-for-sale financial assets, net of income tax	(25)	(100)	75	(75.0)
<b>Total comprehensive income</b>	<b>183,034</b>	<b>191,162</b>	<b>(8,128)</b>	<b>(4.3)</b>
<b>Profit attributable to:</b>				
Shareholders of OAO AK Transneft	180,514	188,105	(7,591)	(4.0)
Non-controlling interests	3,876	3,113	763	24.5
<b>Total comprehensive income attributable to:</b>				
Shareholders of OAO AK Transneft	179,229	188,049	(8,820)	(4.7)
Non-controlling interests	3,805	3,113	692	22.2



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**3.1. Revenue**

Revenue By Type Of Operations	Year ended 31 December 2012	Share Of Total Revenue, %	Year ended 31 December 2011	Share Of Total Revenue, %	Absolute change	Change, %
<b>Revenue from crude oil transportation services</b>	<b>494,542</b>	<b>67.5</b>	<b>455,752</b>	<b>68.0</b>	<b>38,790</b>	<b>8.5</b>
Exports and sales in international markets, except the CIS	269,304	36.8	243,905	36.4	25,399	10.4
Exports and sales in the CIS	15,664	2.1	13,731	2.0	1,933	14.1
Domestic sales	209,574	28.6	198,116	29.6	11,458	5.8
Revenue from oil products transportation services	33,371	4.6	31,068	4.6	2,303	7.4
Revenue from oil compounding services	6,096	0.8	4,727	0.7	1,369	29.0
Other revenue	17,806	2.4	13,944	2.1	3,862	27.7
<b>Total revenue (less revenue from sales of crude oil and oil products)</b>	<b>551,815</b>	<b>75.3</b>	<b>505,491</b>	<b>75.4</b>	<b>46,324</b>	<b>9.2</b>
Revenue from export sales of crude oil	155,134	21.2	143,639	21.4	11,495	8.0
Revenue from sales of crude oil in the domestic market	11,141	1.5	8,469	1.3	2,672	31.6
Revenue from sales of oil products	14,285	2.0	12,671	1.9	1,614	12.7
<b>Total revenue</b>	<b>732,375</b>	<b>100.0</b>	<b>670,270</b>	<b>100.0</b>	<b>62,105</b>	<b>9.3</b>

During the year ended 31 December 2012, the Group's revenue increased by RUB 62,105, or 9.3%, 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 year ended 31 December 2012, amounted to RUB 551,815, which is RUB 46,324, or 9.2%, higher than for the year ended 31 December 2011.

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

An increase in revenue from oil transportation services by RUB 38,790, or 8.5%, was driven by the following factors:

- growth in oil transportation tariffs (paragraph 2.1);
- growth in turnover by 1.1% (1,127,698.9 mln tons x km for the year ended 31 December 2012; 1,115,583.4 mln tons x km for the year ended 31 December 2011).



An increase in revenue from oil products transportation services by 7.4% was driven by growth in oil products transportation tariffs (paragraph 2.1) despite the decrease in the oil products transportation turnover by 5.7% (for the year ended 31 December 2012 – 34,498.37 mln tons x km; and 36,565.57 mln tons x km in the year ended 31 December 2011) due to restriction of turnover of fuel from a mass fraction of sulfur more than 500 mg / kg (Government Decree on 07.09.2011 № 748).

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

An increase in revenue from sales of crude oil in the domestic market by RUB 2,672, or 31.6%, was driven by a decrease in volume of crude oil sold by the Group.

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.

Growth in revenue from sales of marketable oil products for the year ended 31 December 2012 by RUB 1,614 or by 12.7%, was driven by growth in volumes of marketable oil products sales by the Group's companies.

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

An increase in revenue from oil compounding services was a result of the following:

- growth in average tariff for compounding of high-sulfur content oil (the specific revenue amounted to RUR 135.16\* for the year ended 31 December 2012 which is by 29.1% higher compared to the year ended 31 December 2011);
- growth in oil compounding volumes by 1.0% (45,625.98 thousand tons for the year ended 31 December 2012; 45,144.79 thousand tons for the year ended 31 December 2011).

### **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 year ended 31 December 2012 as compared to the previous year was a result of:

- increase of revenue for construction services in the amount of RUR 1,461;
- start of activities on the organization of transportations of cargoes (the amount of revenue for the year ended 31 December 2012 was RUR 993);
- increase of insurance services by RUR 703;
- increase in oil and oil products storage services by RUR 480.

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\* the specific revenue represents the amount of revenue received from compounding of one ton of oil



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### 3.2. Operating expenses

Operating expenses for the year ended 31 December 2012, and the year ended 31 December 2011, are detailed in the table below:

Operating expense line items	Year ended 31 December 2012	Share of total expenses, %	Year ended 31 December 2011	Share of total expenses, %	Absolute change	Change, %
Staff costs	105,199	21,3	100,745	22,0	4,454	4,4
Energy	30,951	6,3	34,187	7,5	(3,236)	(9,5)
Transportation of oil using railways	31,411	6,4	29,764	6,5	1,647	5,5
Materials	20,459	4,2	16,460	3,6	3,999	24,3
Repairs services and maintenance of relevant technical condition of pipeline	11,494	2,3	10,961	2,4	533	4,9
Insurance expenses	5,952	1,2	4,839	1,1	1,113	23,0
Taxes (except income tax)	5,183	1,1	4,604	1,0	579	12,6
Other operating expenses	13,846	2,8	13,676	2,9	171	1,2
<b>Total operating expenses (net of D&amp;A and cost of crude oil and oil products sold)</b>	<b>224,495</b>	<b>45,6</b>	<b>215,236</b>	<b>47,0</b>	<b>9,259</b>	<b>4,3</b>
Depreciation and amortization	84,197	17,1	78,767	17,2	5,430	6,9
One-off non-production expenses	4,401	0,9	1,192	0,3	3,209	3,7 times
Cost of export crude oil sales (including export custom duties)	155,381	31,5	143,358	31,3	12,023	8,4
Cost of crude oil sold in the domestic market	10,556	2,1	7,348	1,6	3,208	43,7
Cost of oil products sold	13,557	2,8	11,947	2,6	1,610	13,5
<b>Total operating expenses</b>	<b>492,587</b>	<b>100,0</b>	<b>457,848</b>	<b>100,0</b>	<b>34,739</b>	<b>7,6</b>

For the year ended 31 December 2012, compared to the year ended 31 December 2011, the amount of operating expenses (less depreciation and amortization and cost of crude oil and oil products sold) increased by RUB 9,259, or 4.3%, while total operating expenses increased by RUB 34,739, or 7.6%.

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

- growth in cost of crude oil sold by RUB 12,023, attributable to oil supplies to the People's Republic of China effective January 1, 2011, under a crude supply contract (ref. paragraph 3.2.6.);
- growth in depreciation and amortization by RUB 5,430, or 6.9%. The growth of depreciation associated mainly with putting into operation of the Baltic Pipeline System (BPS-2) in early 2012 ;
- growth in staff costs by RUB 4,454, or by 4.4% (ref. paragraph 3.2.1.).





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After applying deflation rates, operating expenses for the year ended 31 December 2012, and for the year ended 31 December 2011, were as follows:

Operating Expense Line Items	Deflation Rates (2012 To 2011)	Year Ended 31 December 2012 (Deflated To 2011)	Share Of Total Expenses, %	Year Ended 31 December 2011	Share Of Total Expenses, %	Absolute Change	Change, %
Staff costs	5.2	99,999	21.4	100,745	22.0	(746)	(0.7)
Energy	3.2	29,991	6.4	34,187	7.5	(4,196)	(12.3)
Transportation of oil using railways	4.3	30,116	6.5	29,764	6.5	352	1.2
Materials	3.6	19,748	4.2	16,460	3.6	3,288	20.0
Repairs services and maintenance of relevant technical condition of pipeline	7.6	10,682	2.3	10,961	2.4	(279)	(2.5)
Insurance expenses	3.6	5,745	1.2	4,839	1.1	906	18.7
Taxes (except income tax)	3.6	5,003	1.1	4,604	1.0	399	8.7
Other operating expenses	3.6	13,365	2.9	13,676	3.0	(367)	(2.7)
<b>Total operating expenses (net of D&amp;A and cost of crude oil and oil products sold)</b>	<b>X</b>	<b>214,649</b>	<b>46.1</b>	<b>215,236</b>	<b>47.0</b>	<b>(587)</b>	<b>(0,3)</b>
Depreciation and amortization	X	84,197	18.1	78,767	17.2	5,430	6.9
One-off non-production expenses	X	4,401	0.9	1,192	0.3	3,209	3.7 times
Cost of export crude oil sales	10.9	140,109	30.1	143,358	31.3	(3,249)	(2.3)
Cost of crude oil sold in the domestic market	10.9	9,518	2.0	7,348	1.6	2,170	29.5
Cost of oil products sold	4.1	13,023	2.8	11,947	2.6	1,076	9.0
<b>Total operating expenses</b>	<b>X</b>	<b>465,897</b>	<b>100.0</b>	<b>457,848</b>	<b>100.0</b>	<b>8,049</b>	<b>1.8</b>

The deflation rates used are based on scenarios prepared by the Ministry of Economic Development for devising socio-economic development scenarios for 2012-2014, as well as on 2011-2012 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 year ended 31 December 2012</b>				
Operating expenses	220,110	19,653	(15,268)	224,495
Cargo turnover, mln tons x km	1,127,699	34,498	-	-
<b>For the year ended 31 December 2011</b>				
Operating expenses	202,500	17,519	(4,783)	215,236
Cargo turnover, mln tons x km	1,115,583	36,566	-	-

\*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 year ended 31 December 2012, and for the year ended 31 December 2011, were as follows:

	For the year ended 31 December 2012	For the year ended 31 December 2011	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	19.52		1.37	7.5
Deflated unit costs per 100 tons x km, RUB	18.59	18.15	0.44	2.4
<b>Oil products transportation services</b>				
Unit costs per 100 tons x km, RUB	56.97		9.06	18.9
Deflated unit costs per 100 tons x km, RUB	54.26	47.91	6.35	13.3

### 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 year ended 31 December 2012 as compared to the year ended 31 December 2011 in the amount of RUB 4,454 or 4.4% was influenced by:

- an increase of average employee headcount for 4.3% related primarily to construction and operation of new oil pipelines, as well as facilities that are an integral part of the process;
- indexation of wages and salaries during 2011 and from 1 January 2012 according to growth in consumer prices.

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.



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	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
Employers' contributions to NPF Transneft* in favor of employees	6,742	6,749	(7)	(0.1)

Key management personnel (the members of the Board of Directors and Management Committee of the Company and general directors of subsidiaries) receive short-term compensations, including salary, bonuses, other payments and long-term and short-term interest-free loans. Short-term compensations payable to the key management personnel of the Company and subsidiaries consists of contractual remuneration for their services in full time executive positions. The remunerations for the members of the Boards of Directors of Company are subject to approval by the General Meeting of Shareholders. According to Russian legislation, the Group makes contributions to the Russian Federation State pension fund for all of its employees including key management personnel. Key management personnel also participate in certain post-retirement compensation programs. The programs include pension benefits provided by the non-governmental pension fund, NPF Transneft, and one-time payments at the retirement date.

	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
Salaries and bonuses	1,341	1,022	319	31.2
Termination benefits	16	18	(2)	(11.1)
Other	17	17	-	-
	<b>1,374</b>	<b>1,057</b>	<b>317</b>	<b>30.0</b>

During the year ended 31 December 2012 the Group contributed to NPF "Transneft in favour of the key management personnel RUB 245 (for 2011 – RUB 289).

Contributions to the Pension Fund Transneft due to the transfer to the fund the present value of future pension payments in connection with reaching retirement age in accordance with the terms of contracts of non-state pension provision. These payments will be made after the right to receive pension in accordance with established rules of NPF Transneft.

As a key management personnel, information about the payments to which was disclosed in the financial statements, are recognized members of the Board of Directors and the Board of OAO AK Transneft, as well as CEOs and their families (including change of management during the reporting periods) subsidiaries recognized the most significant in the implementation of productive activities of the Group.

Total quantity of the persons who have received payments as the key management personnel, constituted in 2012 - 67 persons, in 2011 - 64 persons.

### 3.2.2. Energy

Energy expenses for the year ended 31 December 2012, decreased by RUB 3,236, or 9.5%, due to optimization in tariffs for consumed energy.

### 3.2.3. Transportation of oil using railways

The amount of expenses on transportation of oil using railways as for the year ended 31 December 2012 increased on RUB 1,647 or 5.5% as compared to the previous period. 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.

### 3.2.4. Materials

Expenses on materials for the year ended 31 December 2012, increased by RUB 3,999, or 24.3%, 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;
- change of the structure of carried out works - increase in volume of work performed by an economic way and decrease of the volume of work performed by subcontractors;
- growth of cost of oil and oil products for own needs.

\* NPF Transneft – Non-state pension fund Transneft



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

An increase in these expenses for the year ended 31 December 2012, amounted to RUB 533, or 4.9% compared to the year ended 31 December 2011.

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

The cost of crude oil sold for export for the year ended 31 December 2012, amounted to RUB 155,381, including custom duties in the amount of RUB 75,526, 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 increased due to growth in the Group companies' oil products sales volumes.

**3.2.7. Insurance expenses**

Insurance expenses increased on RUB 1,113 or 23.0% for the year ended 31 December 2012 as compared to the year ended 31 December 2011. These expenses represent the Group's expenditures on insurance companies' services, including expenses on insurance operations of ZAO SK Transneft and OOO SOT-TRANS. The increase in expenses was attributed to expansion of operations provided to legal entities and individuals who are not part of the Group and related reinsurance costs and formation of insurance reserves as well as expansion of insurance coverage of the Group's companies.

**3.2.8. Taxes (except income tax)**

The Group's other taxes include primarily the property tax, which amounted to RUB 4,716 for the year ended 31 December 2012. Increase in the amount of RUB 791 or by 20.2% of property tax as compared to the prior period. The property tax is assessed at a rate not exceeding 2.2% of average annual fixed asset book value.

**3.2.9. 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.

**3.2.10. 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 year ended 31 December 2012 compared to the relative period in 2011, was mainly attributed to the sale in January 2011 of Transneft Group's 50% stake in OOO Primorsk Trade Port (total income from the transaction amounted to RUB 29,034).

**3.2.11. Interest income and expenses**

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

An increase in interest income for the year ended 31 December 2012, by RUB 617, or by 6.2%, was driven by a decrease in the amount of income generated by investing temporarily available cash and cash equivalents (ref. to Para 5).



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Interest income	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
Interest income from cash and equivalents	6,491	11,941	(5,450)	(45.6)
Interest income from other financial assets	7,851	3,865	3,986	103.1
Other interest income	342	254	88	34.6
<b>Total interest receivable</b>	<b>14,684</b>	<b>16,060</b>	<b>(1,376)</b>	<b>(8.6)</b>
less interest income on the temporary investment of borrowings	(4,183)	(6,176)	1,993	(32.3)
<b>Total interest income recognized in the consolidated statement of comprehensive income</b>	<b>10,501</b>	<b>9,884</b>	<b>617</b>	<b>6.2</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 3,450 mln and 700 mln Euros; and
- interest payable on series 01-03 non-convertible interest-bearing documentary bonds for a total of RUB 135,000.

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.

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

Interest expenses	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
Interest expenses on loans and borrowings	33,920	34,836	(916)	(2.6)
Interest expenses regarding the dismantlement provision	7,180	8,741	(1,561)	(17.9)
Other interest expenses	626	585	41	7.0
<b>Total interest expenses</b>	<b>41,726</b>	<b>44,162</b>	<b>(2,436)</b>	<b>(5.5)</b>
Less finance costs to be capitalised	(11,572)	(22,113)	10,541	(47.7)
<b>Total accrued interest recognized in the consolidated income statement</b>	<b>30,154</b>	<b>22,049</b>	<b>8,105</b>	<b>36.8</b>

During the year ended 31 December 2012, interest in the amount of RUB 7,389 was capitalised as part of cost of assets under construction (for the year ended 31 December 2011 – RUB 15,937) including:

- interest expenses to be capitalised in the amount of RUB 11,572 (for the year ended 31 December 2011 – RUB 22,113);
- interest income to be excluded from interest expenses to be capitalised in the amount of RUB 4,183 (for the year ended 31 December 2011 – RUB 6,176).

### 3.2.12. Foreign currency exchange gains and losses

The sum of foreign currency exchange gains and losses and their growth for the year ended 31 December 2012, compared to the year ended 31 December 2011, 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 in detail.





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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:

<b>Currency-translation effect for foreign-currency-denominated loans and borrowings facilities</b>	<b>Year ended 31 December 2012</b>	<b>Year ended 31 December 2011</b>
Gains	87,074	75,297
Losses	64,356	99,153

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 year ended 31 December 2012 and the year ended 31 December 2011.

### 3.3. Reconciliation of profit and EBITDA

	<b>Year ended 31 December 2012</b>	<b>Year ended 31 December 2011</b>	<b>Change, %</b>
<b>Profit for the period</b>	<b>184,390</b>	<b>191,218</b>	<b>(3.6)</b>
Increased (decreased) by:			
income tax	50,254	44,311	13.5
depreciation and amortization	84,197	78,767	6.9
interest expenses	30,154	22,049	36.8
interest and dividend income	(10,501)	(9,884)	6.2
exchange gains	(130,329)	(129,375)	0.7
exchange losses	119,758	129,589	(4.6)
share of profit from associates and jointly controlled entities*	(3,938)	(31,486)	(87.5)
<b>EBITDA</b>	<b>323,985</b>	<b>291,189</b>	<b>11.3</b>
<b>EBITDA margin**, %</b>	<b>56.1</b>	<b>55.3</b>	<b>x</b>

\*Including a RUB 29.0 bn income from the sale of the Group's stake in OOO Primorsk Trade Port during the year ended 31 December 2011.

\*\*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

	Year ended 31 December 2012	Year ended 31 December 2011	Absolute change	Change, %
Cash flows from operating activities	216,587	171,611	44,976	26.2
Cash flows used in investing activities	(255,877)	(312,340)	56,463	(18.1)
<b>Free cash flows*</b>	<b>(39,290)</b>	<b>(140,729)</b>	<b>101,439</b>	<b>(72.1)</b>
Cash flows generated from/(used in) financing activities	(18,473)	(1,291)	(17,182)	(14.3 times)
<b>Net cash flows</b>	<b>(57,763)</b>	<b>(142,020)</b>	<b>84,257</b>	<b>(59.3)</b>
Change in cash due to deviation of currency exchange rate	(3,266)	3,702	6,968	X
<b>Net decrease in cash and cash equivalents</b>	<b>(61,029)</b>	<b>(138,318)</b>	<b>77,289</b>	<b>(55.9)</b>

\*Including purchase and sale of promissory notes. Free cash flows excluding investments in promissory notes for the year ended 31 December 2012 amounted to RUB 25,313 (year ended 31 December 2011: RUB 28,651)

##### 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 216,587 for the year ended 31 December 2012, which is 26.2% (or RUB 44,976) higher than for the year ended 31 December 2011.

This dynamics was driven by an increase in cash received from customers due to growth in tariffs and cargo turnover by RUB 73,243, while payments to suppliers and contractors increased by RUB 35,913. The key drivers of the increase in cash received from operating activities was an increase in income tax payment by RUB 5,379 and an increase in cash received from the recovery of VAT and other taxes from the budget by RUB 11,779.

##### 4.2. Investing activities

The primary factors resulting in a general decrease in cash used in investment activities by 18.1% or by RUB 56,463 for the year ended 31 December 2012, as compared to the same period for the previous year, were:

- a decrease by RUB 12,539 or 6.0% in purchases of fixed assets and capital investment in accordance with key investment projects (refer to Para 1.1);
- a decrease by RUB 47,475 or by 42.4% 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 64,603 for the year ended 31 December 2012, and RUB 112,078 for the year ended 31 December 2011);

##### 4.3. Financing activities

The outflow of cash amounted to RUB 18,473 for the year ended 31 December 2012, which was a result of repayment of Eurobonds in the amount of USD 500 mln and 700 mln of Euros (which is equivalent to RUB 46,192), issue of non-convertible interest-bearing bonds BO-01 and BO-02 amounting to RUB 34,000, as well as an acquisition of non-controlling interest in OAO VOSTOKNEFTETTRANS (49%) for RUB 3,600 and payment of dividends amounting to RUB 2,768.

The outflow of cash amounted to RUB 1,291 including the payment of dividends of RUB 1,308 for the year ended 31 December 2011, including dividends paid in the amount of RUB 1,173.



#### 4.4. 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 year ended 31 December 2012.

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

- (a) changes during the period in inventories and operating receivables and payables;
- (b) non-cash items such as depreciation, provisions, deferred taxes, 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.

	<u>Year ended</u> <u>31 December 2012</u>	<u>Year ended</u> <u>31 December 2011</u>
<b>Operating activities</b>		
<b>Profit before tax</b>	<b>234,644</b>	<b>235,529</b>
<b>Adjustments for:</b>		
Depreciation and amortization	84,197	78,767
(Profit) / loss from disposal of property, plant and equipment	925	2,220
Interest income and share of profit from associates and jointly controlled entities	(14,439)	(41,370)
Interest expenses	30,154	22,049
Profit from currency-translation	(10,571)	(7,488)
Others	(9,822)	(9,076)
<b>Operating profit before changes in working capital</b>	<b>315,088</b>	<b>280,631</b>
Changes in operating assets and liabilities:		
Increase in inventories	(3,353)	(5,037)
Increase in trade and other receivables relating to operating activity	(10,581)	(37,707)
Decrease in trade and other payables, and accruals relating to operating activity	6,078	19,764
<b>Cash flows from operating activities before payment of income tax expense and interest</b>	<b>307,232</b>	<b>257,651</b>
Income tax paid	(70,976)	(52,315)
Income tax refund	14,821	1,539
Interest paid	(34,490)	(35,264)
<b>Cash flows received from operating activities</b>	<b>216,587</b>	<b>171,611</b>



**OAO AK TRANSNEFT**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE GROUP'S FINANCIAL POSITION**  
**AND RESULTS OF ITS OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2012**  
(in millions of Russian roubles, if not stated otherwise)

## 5. Liquidity analysis

	31 December 2012	31 December 2011	Change, %
Current assets	461,669	442,892	4.2
including:			
cash and cash equivalents	84,517	145,546	(41.9)
short-term bank promissory notes*	206,855	177,760	16.4
Current liabilities	152,122	180,483	(15.7)
Net working capital	309,547	262,409	18.0
Current ratio	3.0	2.5	20.0
Quick ratio**	2.2	2.0	10.0
Debt / EBITDA	1.8	2.1	(14.3)
Debt / Equity	0.5	0.6	(16.7)

\* Short-term bank promissory-notes consist of promissory notes by banks with investment-grade international credit ratings (99.5%), banks with credit ratings of BB+/Ba1/BB+, BB/Ba2/BB, BB-/Ba3/BB- (0.5%) 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 amount of RUB 61,029 decrease of cash and cash equivalents as at 31 December 2012 compared to the balances of cash and cash equivalents as at 31 December 2011 was a result of repayment of Eurobonds in the amount of USD 500 mln and 700 mln of Euros (RUB equivalent of 46,192), as well as purchase during the year ended 31 December 2012 of short-term and long-term discount and interest-bearing notes which are included in non-current and current other financial assets in the consolidated interim condensed statement of financial position. As at 31 December 2012 these promissory notes amounted to RUB 206,855 (as at 31 December 2011 – RUB 177,760) and which changed in the amount of RUB 29,095.

The following are the contractual undiscounted cash flows of financial liabilities, including estimated interest payments:

### 31 December 2012:

	Carrying amount	Contractual cash flows						More than 5 years
		Total	2013	2014	2015	2016	2017	
Loans and borrowings	569,634	737,645	52,889	117,313	184,004	33,449	32,610	317,380
Trade and other payables	39,651	39,651	39,651	-	-	-	-	-
	<b>609,285</b>	<b>777,296</b>	<b>92,540</b>	<b>117,313</b>	<b>184,004</b>	<b>33,449</b>	<b>32,610</b>	<b>317,380</b>

### 31 December 2011:

	Carrying amount	Contractual cash flows						More than 5 years
		Total	2012	2013	2014	2015	2016	
Loans and borrowings	605,311	815,687	84,074	52,555	84,808	186,132	35,696	372,422
Trade and other payables	44,601	44,601	44,601	-	-	-	-	-
	<b>649,912</b>	<b>860,288</b>	<b>128,675</b>	<b>52,555</b>	<b>84,808</b>	<b>186,132</b>	<b>35,696</b>	<b>372,422</b>

The presented debt structure assumes the possible redemption date of RUB 135,000 non-convertible interest-bearing documentary bonds in 2015.