

**OAO AK TRANSNEFT**

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

**FOR THE THREE MONTHS ENDED 31 MARCH 2015**





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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 2014 and results of operations for the three months ended 31 March 2015, compared to the three months ended 31 March 2014, 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 three months ended 31 March 2015.

**Key financial and operating results**

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, %
Revenue	201,477	188,114	7.1
Net profit	63,388	40,637	56.0
EBITDA	101,235	90,995	11.3
EBITDA margin, %*	61.9	62.6	x
Oil delivered to consignees, mln. tons	120.1	118.4	1.4
including:			
Russian oil refineries, mln. tons	61.8	64.5	(4.2)
transshipment into the CPC-R system, mln. tons	0.5	0.5	-
exports to neighboring countries, mln. tons	5.6	5.1	9.8
exports to other countries, mln. tons	52.3	48.2	8.5
Oil products delivered to consignees, mln. tons	8.1	7.7	5.2
including:			
Russia's domestic market, mln. tons	1.3	1.7	(23.5)
exports to the Customs Union member countries, mln.tons	0.07	0.04	75.0
exports to other countries, mln. tons	6.8	5.9	15.3

\* 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 three months ended 31 March 2015 amounted to RUB 63,388 which is RUB 22,751 bn or 56.0% higher than for the three months ended 31 March 2014 which amounted to RUB 40,637 bn.

The Group's profit was mainly affected by the following non-production factors:

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
<b>Profit for the period</b>	<b>63,388</b>	<b>40,637</b>	<b>22,751</b>	<b>56.0</b>
Net loss from exchange	6,103	3,660	2,443	66.7
Net interest expense	1,099	4,078	(2,979)	(73.1)
(Profit)/ loss from change in fair value of derivatives	(10,274)	5,118	(15,392)	x
Share of (profit) / loss from associates and jointly-controlled entities	(1,443)	408	(1,851)	x
<b>Net profit for the period net of afore-mentioned factors</b>	<b>58,873</b>	<b>53,901</b>	<b>4,972</b>	<b>9.2</b>



## 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, oil compounding, crude 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-and-delivery facilities, and for data collection and summarizing.

The Group as at 31 March 2015 possesses an extensive network of trunk oil pipelines with a total length of approximately 53.2 thousand km and trunk oil products pipelines with a total length of some 18.7 thousand km.

During the three months ended 31 March 2015 the Group transported approximately 88% of oil produced in Russia and more than 25% 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, Europe, USA and Canada.



### 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.

Fulfillment of the investment projects regarding development of the system of trunk pipelines will allow to create unified pipelines system that allows for the effective redistribution of export flows of both the Western and Eastern directions depending on the situation market.

The largest investment projects for construction and expansion of pipeline systems under realization are:

- Construction of Zapolyarie–Purpe oil trunk pipeline;
- Construction of Kuyumba – Tayshet oil trunk pipeline;
- Expansion of the ESPO pipeline system in the GNPS Taishet – NPS Skovorodino section to 80 mln tons annually;
- Expansion of the ESPO pipeline system in the NPS Skovorodino – SMNP Kozmino to 50 mln. tons annually;
- Development of the trunk pipeline system for increase of deliveries of oil products to Primorsk Sea Port to 15 mln tons (Project “Sever”);
- Development of the trunk pipeline system for increase of deliveries of oil products to Primorsk Sea Port to 25 mln tons (Project “Sever”);
- Reconstruction of the trunk pipeline system for increase of transportation volumes of oil products to the Moscow area;
- The project “Yug”, 1<sup>st</sup> stage, reconstruction of the trunk pipelines Tikhoretsk-Novorossiysk;
- The project “Yug”, 2<sup>nd</sup> stage, construction of MNPP Volgograd-Tikhoretsk.

### 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. OAO AK 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» have 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.

During the year 2014 and three months ended 31 March 2015 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 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 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 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 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 Sheskharis route;
  - Order of the FTS of Russia of 03.12.2013 No. 225-e/6 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the Purpe – Samotlor trunk pipeline system rendered to OAO NK Rosneft;
  - Order of the FTS of Russia of 26.11.2013 No. 219-e/1 Concerning the setting of fees for the services of OAO AK Transneft for transportation of oil via the Tikhoretsk – Tuapse-2 trunk pipeline section for OAO NK Rosneft;
  - Order of the FTS of Russia of 03.12.2013 No. 224-e/5 Concerning the setting of fees for the services of ZAO Morskoy portoviy servis for filling of railway wagons with oil in the territory of Grushevaya industrial site of the transshipment complex Sheskharis;
  - Order of the FTS of Russia of 08.04.2014 No. 74-e/1 Concerning the setting of fee for the service of OAO AK Transneft for transportation of oil via the Border of the Republic of Azerbaijan/the Russian Federation (Shirvanovka) – PK Sheskharis route;
  - Order of the FTS of Russia of 31.10.2014 No. 240-e/2 Concerning the setting of fee for the service of OAO AK Transneft for transportation of oil via the Ephimoffka – OOO LUKoil-Volgogradneftepererabotka route rendering for OAO LUKoil;
  - Order of the FTS of Russia of 27.11.2014 No. 275-e/1 Concerning the setting of fee for the service of OAO AK Transneft for transportation of oil via the trunk pipeline system;
  - Order of the FTS of Russia of 10.02.2015 No. 18-e/1 Concerning the setting of fee for the service of OAO AK Transneft for transportation of oil via Tikhoretsk – Tuapse-2 rendering for OAO NK Rosneft;
  - The agreement on transportation of Azerbaijan oil through the territory of the Russian Federation of 16.02.1996, Baku;
  - Agreement dated 14.02.2014 No. 0014502 for provision of oil transportation services by transiting through the territory of the Russian Federation during 2014 between OAO AK Transneft and GNKAR.



## 2.1. Oil and oil products transportation tariffs (continued)

- 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 23.09.2010 No. 234-e/2 Concerning fee rates for the services of OAO Transneft 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. 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 (repealed with issuance of the Order of the FTS of Russia No. 224-e/2 dated 07.10.2014 put into force from the date of put into force of Order of the FTS of Russia No.223-e/1 of 07.10.2014);
  - 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;
  - Order of the FTS of Russia of 30.04.2013 No. 90-e/2 Concerning the setting of maximum tariff rates for services of OAO AK Transneft for execution of orders and scheduling deliveries of oil products which are in transit to LPDS Sokur and are further exported outside the customs territory of the Russian Federation and the states - members of the Customs Union;
  - Order of the FTS of Russia of 30.05.2014 No. 132-e/2 Concerning the setting of tariff for services rendered by OAO AK Transneft for transportation of oil products through the route “LUKOIL – Nizhegorodnefteorgsynthez” – MP “Primorsk” for OAO NK LUKOIL;
  - Order of the FTS of Russia of 02.09.2014 No. 211-e/1 Concerning the setting of tariff for the services rendered by OAO AK Transneft for transportation of oil products through OOO KINEF – MP “Primorsk” route for OAO Surgutneftegaz;
  - Order of the FTS of Russia No.223-e/1 of 07.10.2014 Concerning the setting of tariff for the services of OAO AK Transneft and its affiliated parties for transportation of oil products by trunk pipelines;
  - Order of the FTS of Russia No.307-e/1 of 24.12.2014 Concerning the setting of maximum rates of tariff for the services of OAO AK Transneft and its affiliated entities for loading of oil products from trunk pipeline system and making amendments to the Order of the FTS of Russia No.223-e/1 of 07.10.2014;
  - Order of the FTS of Russia No.19-e/2 of 10.02.2015 Concerning the setting of maximum rate of tariff for the services of OAO AK Transneft and making amendments to appendix 1 of the Order of the FTS of Russia No.223-e/1 of 07.10.2014.

## 2.2. Oil production and refining volumes

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

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, %
Oil production volume in the Russian Federation, mln tons	131.0	130.0	0.8
Oil refining volume in the Russian Federation, mln tons	31.8	31.5	1.0

Oil production volume increased for the three months ended 31 March 2015 as compared to the similar period of the previous year by 1.0 mln tons or by 0.8% (ref. to 3.1.1.).

Growth in light oil refining during the three months ended 31 March 2015 in the Russian Federation accounted for 0.3 mln tons or for 1.0% as compared to the relative period of the previous year (ref. to 3.1.1.).



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

Services for transportation of oil through trunk oil pipelines which are situated in the territory of the Russian Federation are paid for in Russian roubles except for the transit of crude oil from Azerbaijan which is paid for in US Dollars till 13 February 2014.

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 has a significant portion of US dollar-denominated loans. Increase of US dollar to Russian rouble exchange rate may result in additional expenses in regard to servicing and settlement of liabilities nominated in foreign currency (ref. to 3.4).

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, %
Change in the rouble's exchange rate against the US dollar, %	3.9	9.04	x
Average exchange rate for the period (roubles per US dollar)	62.1838	34.9591	77.9
Exchange rate at the end of the period (roubles per US dollar)	58.4643	35.6871	63.8

### 2.4. Inflation rates

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

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, pp
Rouble inflation (CPI), %	7.4	2.3	5.1

### 2.5. Taxation

Most of the Group's companies are incorporated in the Russian Federation and subject to taxation under the Tax Code of the Russian Federation.

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

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, %
Current income tax	21,954	13,650	60.8
Property tax	4,218	3,284	28.4
Other taxes and levies	210	161	30.4

#### 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.

Increase in the amount of income tax as for the three months ended 31 March 2015 as compared to the three months ended 31 March 2014 was primarily a result of recognition in tax accounts of foreign exchange gains from loans denominated in foreign currency because of growth of exchange rate of USD to RUB (ref to 2.3).





## 2.5. Taxation (continued)

### Property tax

The amount of property tax increased by RUB 934 or by 28.4%. The increase was a result of putting into use of fixed assets, revaluation held at 31.12.2014 as well as increase in a tax rate applied to trunk pipelines as well as constructions which are integral technological part of these pipelines. These properties are taxed at the rates set locally by regions of the Russian Federation and can not be more than 0.7% during 2014, 1.0% during 2015.

### 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.

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
<b>Revenue</b>	<b>201,477</b>	<b>188,114</b>	<b>13,363</b>	<b>7.1</b>
revenue from oil transportation services	137,443	123,353	14,090	11.4
revenue from oil products transportation services	15,169	12,391	2,778	22.4
revenue from crude oil sales	43,097	46,299	(3,202)	(6.9)
other revenue	5,768	6,071	(303)	(5.0)
Operating expenses	(129,426)	(123,297)	(6,129)	5.0
<b>Operating profit</b>	<b>72,051</b>	<b>64,817</b>	<b>7,234</b>	<b>11.2</b>
Net financial items	3,072	(12,856)	15,928	x
Share of profit/(loss) from associates and jointly controlled entities	1,443	(408)	1,851	x
<b>Profit before income tax</b>	<b>76,566</b>	<b>51,553</b>	<b>25,013</b>	<b>48.5</b>
Current income tax	(22,012)	(13,635)	(8,377)	61.4
Deferred income tax	8,834	2,719	6,115	3.2 times
<b>Income tax expense</b>	<b>(13,178)</b>	<b>(10,916)</b>	<b>(2,262)</b>	<b>20.7</b>
<b>Profit for the period</b>	<b>63,388</b>	<b>40,637</b>	<b>22,751</b>	<b>56.0</b>
Other comprehensive (loss)/ gain, net of income tax	(774)	606	(1,380)	x
<b>Total comprehensive income, net of tax</b>	<b>62,614</b>	<b>41,243</b>	<b>21,371</b>	<b>51.8</b>

During the three months ended 31 March 2015 the Group recognised gain in net financial items in the amount of RUB 3,072 as compared to the loss amounting to RUB 12,856 for the similar period of 2014. This dynamics was caused by recognition of net gain from operations with derivatives for the three months ended 31 March 2015 as compared to the loss as for the three months ended 31 March 2014.



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### 3.1. Revenue

Revenue by type of operations	Three months ended 31 March 2015	Share of total revenue, %	Three months ended 31 March 2014	Share of total revenue, %	Absolute change	Change, %
<b>Revenue from crude oil transportation services</b>	<b>137,443</b>	<b>68.2</b>	<b>123,353</b>	<b>65.5</b>	<b>14,090</b>	<b>11.4</b>
exports, except the CIS	76,799	38.1	64,392	34.2	12,407	19.3
exports in the CIS	4,273	2.1	3,846	2.0	427	11.1
domestic sales	56,371	28.0	55,115	29.3	1,256	2.3
Revenue from oil products transportation services	15,169	7.5	12,391	6.6	2,778	22.4
Revenue from oil compounding services	1,112	0.6	1,304	0.7	(192)	(14.7)
Other revenue	4,140	2.0	3,655	2.0	485	13.3
<b>Total revenue (without revenue from sales of crude oil and oil products)</b>	<b>157,864</b>	<b>78.3</b>	<b>140,703</b>	<b>74.8</b>	<b>17,161</b>	<b>12.2</b>
Revenue from export sales of crude oil	37,822	18.8	42,740	22.7	(4,918)	(11.5)
Revenue from sales of crude oil in the domestic market	5,275	2.6	3,559	1.9	1,716	48.2
Revenue from sales of oil products	516	0.3	1,112	0.6	(596)	(53.6)
<b>Total revenue</b>	<b>201,477</b>	<b>100.0</b>	<b>188,114</b>	<b>100.0</b>	<b>13,363</b>	<b>7.1</b>

For the three months ended 31 March 2015, the Group's revenue increased by RUB 13,363 or by 7.1%, attributable mainly to an increase in revenue from crude oil transportation and oil products transportation services. Without taking into account crude oil sales and oil products sales, revenue for the three months ended 31 March 2015 increased by RUB 17,161 or 12.2% compared to the three months ended 31 March 2014 and accounted for 78.3% of total revenue.

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

An increase in revenue from oil transportation services amounted to RUB 14,090, or by 11.4% for the three months ended 31 March 2015 comparable to the same period of 2014 and was attributable to increase of tariffs and by changes in oil transportation turnover and turnover volumes.

An increase in revenue from oil products transportation services by RUB 2,778 or by 22.4% for the three months ended 31 March 2015 as compared to the same period of 2014 was driven by growth in oil products transportation tariffs as well as changes in turnover volumes and turnover.

#### 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 collateral for a loan obtained from the China Development Bank. The respective oil volumes are being purchased from OAO NK Rosneft.

Decrease in revenue from export sales of crude oil as for the three months ended 31 March 2015 compared to the three months ended 31 March 2014 was a result of decline in oil market price of USD per barrel.

Increase in revenue from domestic sales of crude oil as for the three months ended 31 March 2015 as compared to the relative period of the previous year was a result of increase of sale volumes of crude oil by the companies of the Group.

Decrease in revenue from sales of oil products as for the three months ended 31 March 2015 by RUB 596 or by 53.6% was driven by a decline of oil products volume sold.

#### 3.1.3. Revenue from oil compounding services

A decline in revenue from oil compounding services by RUB 192 or by 14.7% as for the three months ended 31 March 2015 compared to the three months ended 31 March 2014 was a result of decrease in oil compounding volumes by 20.7% (7,835.5 thousand tons for the three months ended 31 March 2015; 9,884.7 thousand tons for the three months ended 31 March 2014).



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### 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 three months ended 31 March 2015 as compared to the similar period of the previous year was a result of increase in revenue from connection of companies to the trunk pipeline system.

### 3.2. Operating expenses

Operating expenses for the three months ended 31 March 2015, and the three months ended 31 March 2014, are detailed in the table below:

Operating expense line items	Three months ended 31 March 2015	Share of total revenue, %	Three months ended 31 March 2014	Share of total revenue, %	Absolute change	Change, %
Salaries, social funds contributions and social expenses	29,791	23.0	26,891	21.8	2,900	10.8
Energy	8,911	6.9	8,230	6.7	681	8.3
Materials	4,235	3.3	4,835	3.9	(600)	(12.4)
Repairs services and maintenance of relevant technical condition of pipeline	1,915	1.5	1,911	1.5	4	0.2
Insurance expenses	1,551	1.2	1,484	1.2	67	4.5
Taxes (except income tax)	4,287	3.3	3,311	2.7	976	29.5
Pension expense	2,672	2.1	960	0.8	1,712	2.8 times
Other operating expenses	4,520	3.5	2,581	2.1	1,939	75.1
<b>Total operating expenses (net of D&amp;A and cost of goods sold)</b>	<b>57,882</b>	<b>44.8</b>	<b>50,203</b>	<b>40.7</b>	<b>7,679</b>	<b>15.3</b>
Depreciation and amortization	29,600	22.9	27,229	22.1	2,371	8.7
Cost of export crude oil sales (including export custom duties)	37,406	28.9	41,689	33.8	(4,283)	(10.3)
Cost of crude oil sold in the domestic market	3,939	3.0	3,070	2.5	869	28.3
Cost of oil products sold	432	0.3	1,039	0.8	(607)	(58.4)
Cost of other goods sold	167	0.1	67	0.1	100	2.5 times
<b>Total operating expenses</b>	<b>129,426</b>	<b>100.0</b>	<b>123,297</b>	<b>100.0</b>	<b>6,129</b>	<b>5.0</b>

For the three months ended 31 March 2015, compared to the three months ended 31 March 2014, the amount of operating expenses net of depreciation and amortization, one-time expenses and cost of crude oil and oil products sold increased by RUB 7,679 or by 15.3%, while total operating expenses increased by RUB 6,129 or by 5.0%.

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

- growth in depreciation and amortization. The growth of depreciation was mainly associated with putting into operation of new items of PPE, reconstruction and modernization of PPE during 2014 and three months of 2015;
- salaries, social funds contributions and social expenses (ref. to 3.2.1);
- growth in pension contributions (ref. to 3.2.2);
- growth in the amount of other taxes recognised in operating expenses (ref. to 3.2.7).



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**3.2 Operating expenses (continued)**

After applying inflation rates\*, operating expenses for the three months ended 31 March 2015, and for the three months ended 31 March 2014, were as follows:

Operating expense line items	Three months ended 31 March 2015	Share of total expenses, %	Inflation rates (2015 to 2014), %*	Three months ended 31 March 2014 (inflated to 2015)	Share of total expenses, %	Absolute change	Change, %
Salaries, social funds contributions and social expenses	29,791	23.0	15.8	31,140	23.8	(1,349)	(4.3)
Energy	8,911	6.9	7.5	8,847	6.8	64	0.7
Materials	4,235	3.3	8.2	5,231	4.0	(996)	(19.0)
Repairs services and maintenance of relevant technical condition of pipeline	1,915	1.5	3.7	1,982	1.5	(67)	(3.4)
Insurance expenses	1,551	1.2	8.2	1,606	1.2	(55)	(3.4)
Taxes (except income tax)	4,287	3.3	8.2	3,583	2.7	704	19.6
Pension expense	2,672	2.1	15.8	1,112	0.9	1,560	2.4 times
Other operating expenses	4,520	3.5	8.2	2,793	2.2	1,727	61.8
<b>Total operating expenses (net of D&amp;A and cost of goods sold)</b>	<b>57,882</b>	<b>44.8</b>	<b>12.1</b>	<b>56,294</b>	<b>43.1</b>	<b>1,588</b>	<b>2.8</b>
Depreciation and amortization	29,600	22.9	X	27,229	20.8	2,371	8.7
Cost of export crude oil sales (including export custom duties)	37,406	28.9	3.0	42,940	32.8	(5,534)	(12.9)
Cost of crude oil sold in the domestic market	3,939	3.0	3.0	3,162	2.4	777	24.6
Cost of oil products sold	432	0.3	2.4	1,064	0.8	(632)	(59.4)
Cost of other goods sold	167	0.1	8.2	72	0.1	95	2.3 times
<b>Total operating expenses</b>	<b>129,426</b>	<b>100.0</b>	<b>X</b>	<b>130,761</b>	<b>100.0</b>	<b>(1,335)</b>	<b>(1.0)</b>

\*The inflation rates used are based on scenarios prepared by the Ministry of Economic Development for devising socio-economic development scenarios for 2015-2017, as well as on 2014-2015 inflation rates.



### 3.2 Operating expenses (continued)

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

Unit costs km are calculated using operating expenses indicator formed under aggregated RAS data with previous year indicator adjusted for a change in oil turnover / volume turnover of oil products transportation and turnover for each of the above-mentioned activities. For calculation of inflated unit costs the index of inflation used to calculate inflated operating expenses (net of depreciation, taxes, one-time expenses and cost of goods sold) is taken.

Unit costs for transportation of oil as per 100 tons-kilometers as for the three months ended 31 March 2015 and for the three months ended 31 March 2014 were as follows:

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
<b>Oil transportation services</b>				
Turnover, mln. tons x km	294,523	283,013	11,510	4.1
Unit costs per 100 tons x km, RUB		14.33	0.57	4.0
Inflated unit costs per 100 tons x km, RUB (inflated to 2015, adjusted to turnover as for 2015)	14.90	15.24	(0.34)	(2.2)

Unit costs for oil products transportation per ton as for the three months ended 31 March 2015 and as for the three months ended 31 March 2014 were as follows:

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
<b>Oil products transportation services</b>				
Volume turnover, mln. of tons	8.1	7.7	0.4	5.2
Unit costs per ton, RUB		531.80	36.31	6.8
Inflated unit costs per ton, RUB (inflated to 2015, adjusted to volume turnover as for 2015)	568.11	553.60	14.51	2.6

#### 3.2.1. Salaries, social funds contributions and social expenses

Salaries comprise wages, accrual of provision for annual bonus, provision for unused vacation, staff training, and other remuneration.

The increase in salaries, social funds contributions and social expenses for the three months ended 31 March 2015 as compared to the three months ended 31 March 2014 in the amount of RUB 2,900 or 10.8% was influenced by an increase of average employee headcount related primarily to construction and putting into operation of new oil trunk pipelines and indexation of wages in 2015 and improvements in remuneration system of oil-products transportation subsidiaries.

#### 3.2.2. Pension expense

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.

Pension expense includes accruals to the non-state pension fund as well as other accruals in conjunction with IAS 19 Employee benefits.

The amount of pension expenses increased under following factors which influence expenses from 31 December 2014:

- Inclusion of pension liabilities of NPF Transneft in the consolidated interim condensed financial statements of the Group;
- recognition of obligations of the Group under defined benefit plan in accordance with IAS 19.



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### 3.2.2. Pension expense (continued)

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Employers' contributions to NPF Transneft in favor of employees	1,470	1,285	185	14.4

### 3.2.3. Energy

Energy expenses for the three months ended 31 March 2015 decreased by RUB 681 or 8.3% as compared to the same period of the previous year. The decrease was caused by growth of tariffs of natural monopolies for energy and power consumption, as well as a decline of volume of declared power and energy consumed at the same 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 as well as the Energy Strategy for the period till 2030 approved by the Russian Government.

The dynamics of power and energy consumption for the group of oil transporting entities is presented in the table below:

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Average annual capacity, thsd. kW	1,484	1,428	56	3.9
Consumption of energy, (mln. kW*h)	3,344	3,108	236	7.6

### 3.2.4. Materials

Expenses on materials for the three months ended 31 March 2015 as compared to the same period of 2014, decreased by RUB 600 or 12.4%.

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

An increase in these expenses for the three months ended 31 March 2015, amounted to RUB 4 or 0.2% compared to the three months ended 31 March 2014.

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

The cost of crude oil sold for export for the three months ended 31 March 2015, amounted to RUB 37,406, including custom duties in the amount of RUB 12,083, which was a result 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.

Increase in cost of marketable oil sold in the domestic market as for the three months ended 31 March 2015 amounted to RUB 869 or 28.3% as compared to the relative period of 2014 and was caused by increase in volume of sales of marketable oil.

The cost of marketable oil products sold decreased by RUB 607 or 58.4% due to decline in the Group companies' oil products sales volumes (ref. to 3.1.2.).

### 3.2.7. Taxes (except for the income tax)

The amount of the Group's other taxes included in operating expenses primarily contains property tax, tax on land and transport tax. The increase of these items was mainly caused by the increase of the property tax expenses (ref. to 2.5).

### 3.2.8. Other operating expenses

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

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

### 3.3. Share of results 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 gain from associates and jointly controlled entities for the three months ended 31 March 2015 compared to the loss for the relative period in 2014, was mainly attributed to income of Group OAO NCSP (ref. to 3) for the three months ended 31 March 2015 as compared to comprehensive loss for the relative period of 2014.

The Group's effective share in OAO NCSP was 35.57% as at 31 March 2015.



### 3.4. Finance income and costs

#### 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 three months ended 31 March 2015, by RUB 6,074 or 2.4 times, was driven mainly:

- Inclusion of interest income from deposits and other financial assets of NPF Transneft in the consolidated interim condensed financial statements;
- increase of income on the deposits.

Interest income	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Interest income from cash and equivalents	2,732	1,133	1,599	2.4 times
Interest income from other financial assets	7,603	3,425	4,178	2.2 times
Other interest income	144	81	63	77.8
<b>Total interest receivable</b>	<b>10,479</b>	<b>4,639</b>	<b>5,840</b>	<b>2.3 times</b>
Less interest income on the temporary investment of borrowings	(50)	(284)	234	(82.4)
<b>Total interest income recognised in the statement of profit and loss and other comprehensive income</b>	<b>10,429</b>	<b>4,355</b>	<b>6,074</b>	<b>2.4 times</b>

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

Interest expenses	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Interest expenses on loans and borrowings	11,078	8,317	2,761	33.2
Interest expenses regarding the dismantlement provision	-	580	(580)	x
Other interest expenses	944	264	680	3.6 times
<b>Total interest expenses</b>	<b>12,022</b>	<b>9,161</b>	<b>2,861</b>	<b>31.2</b>
Less finance costs to be capitalised	(494)	(728)	234	(32.1)
<b>Total interest expense recognised in the statement of profit and loss and other comprehensive income</b>	<b>11,528</b>	<b>8,433</b>	<b>3,095</b>	<b>36.7</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 1,050 mln for the three months ended 31 March 2015 and USD 2,350 for the similar period of the previous year;
- interest payable on series 01-03 of non-convertible interest-bearing documentary bonds amounting to RUB 135,000;
- interest payable of non-convertible interest-bearing documentary bonds on series B0-03 for the amount 15,000 for the three months ended 31 March 2015 and for the amount RUB 34,000 on series B0-01 and B0-02 for the three months ended 31 March 2014.

The increase in interest expense as for the three months ended 31 March 2015 as compared to 2014 was mainly driven by depreciation of exchange rate of RUB to USD.

During the three months ended 31 March 2015, interest in the amount of RUB 444 was capitalised as part of cost of assets under construction (for the three months ended 31 March 2014 – RUB 444) including:

- interest expenses to be capitalised in the amount of RUB 494 (for the three months ended 31 March 2014 – RUB 728);
- interest income to be excluded from interest expenses to be capitalised in the amount of RUB 50 (for the three months ended 31 March 2014 – RUB 284).



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**3.4. Finance income and costs (continued)**

**Foreign currency exchange gains and losses**

The sum of foreign currency exchange gains and losses and their growth for the three months ended 31 March 2015, compared to the three months ended 31 March 2014, 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.

Disclosure of foreign exchange differences by sources is presented in the tables below:

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Foreign exchange gains on financial investments	90,056	31,635	58,421	2.8 times
Foreign exchange gains on loans and borrowings	112,220	4,021	108,199	27.9 times
Other foreign exchange gains	21,314	5,524	15,790	3.9 times
<b>Total foreign exchange gains recognised in the statement of profit or loss and other comprehensive income</b>	<b>223,590</b>	<b>41,180</b>	<b>182,410</b>	<b>5.4 times</b>
Foreign exchange loss on financial investments	(75,316)	(3,294)	(72,022)	22.9 times
Foreign exchange loss on loans and borrowings	(136,185)	(40,361)	(95,824)	3.4 times
Other foreign exchange loss	(18,192)	(1,185)	(17,007)	15.4 times
<b>Total foreign exchange loss recognised in the statement of profit or loss and other comprehensive income</b>	<b>(229,693)</b>	<b>(44,840)</b>	<b>(184,853)</b>	<b>5.1 times</b>
<b>Net exchange differences</b>	<b>(6,103)</b>	<b>(3,660)</b>	<b>(2,443)</b>	<b>66.7</b>

Dynamics of exchange differences presented in the table was driven by weakening of the ruble against the dollar and the Euro for the three months ended 31 March 2015 compared to the relative period in 2014.

**Derivatives**

As for the three months ended 31 March 2015 the Group recognised the net gain from operations with derivatives in the amount of RUB 10,274 as compared to the loss of RUB 5,118 for the same period of 2014. The dynamics was driven by significant volatility and depreciation of the RUB/USD exchange rate during 2015 (see para 2.3).

**3.5. Reconciliation of profit and EBITDA**

	Three months ended 31 March 2015	Three months ended 31 March 2014	Change, %
<b>Profit for the period</b>	<b>63,388</b>	<b>40,637</b>	<b>56.0</b>
Increased/(decreased) by:			
income tax expense	13,178	10,916	20.7
depreciation and amortization	29,600	27,229	8.7
result of oil sales to China	(416)	(1,051)	(60.4)
net finance (gains)/ costs	(3,072)	12,856	x
share of loss from associates and jointly controlled entities	(1,443)	408	x
<b>EBITDA</b>	<b>101,235</b>	<b>90,995</b>	<b>11.3</b>
<b>EBITDA margin*, %</b>	<b>61.9</b>	<b>62.6</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

	Three months ended 31 March 2015	Three months ended 31 March 2014	Absolute change	Change, %
Cash flows from operating activities	100,567	100,325	242	0.2
Cash flows used in investing activities	(69,145)	(55,827)	(13,318)	23.9
<b>Free cash inflow*</b>	<b>31,422</b>	<b>44,498</b>	<b>(13,076)</b>	<b>(30.1)</b>
Cash flows used in financing activities	(18,026)	(46,948)	28,922	(61.6)
<b>Net cash (outflow) / inflow</b>	<b>13,396</b>	<b>(2,450)</b>	<b>15,846</b>	<b>x</b>
Change in cash and cash equivalents due to deviation of currency exchange rate	2,296	6,618	(4,322)	(65.3)
<b>Net increase in cash and cash equivalents</b>	<b>15,692</b>	<b>4,168</b>	<b>(11,524)</b>	<b>x</b>

\*Including purchase and sale of promissory notes and net effect from placement of funds on deposits.

Free cash flows excluding investments in promissory notes of banks and deposits for the three months ended 31 March 2015 amounted to RUB 46,099 (the three months ended 31 March 2014: RUB 44,819).

### 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 100,567 for the three months ended 31 March 2015, which is RUB 242 or 0.2% higher than for the three months ended 31 March 2014.

The main factors which influenced on the decrease of cash from operating activities for the three months ended 31 March 2015 as compared to the similar period in 2014 were as follows:

- an increase in cash receipts from customers by RUB 10,538;
- decrease in cash paid to suppliers by RUB 6,999;
- decrease in cash received from the refund of VAT and other taxes from the budget by RUB 22,410;
- increase in amount of interest paid by RUB 2,168;
- decrease of the net amount of payments of income tax amounting to RUB 7,348.

### 4.2. Investing activities

The primary factors resulting in a decrease in cash used in investment activities by RUB 13,318 or 23.9% for the three months ended 31 March 2015, as compared to the same period for the previous year, were:

- decrease in the amount of purchase of property, plant and equipment by RUB 2,318;
- net cash outflow as for the three months ended 31 March 2015 in the amount of RUB 14,677 from purchase-and-sale transactions in regards to promissory notes and allocation-closure of funds in deposits as compared to net cash outflow for 2014 amounting to RUB 321.

### 4.3. Financing activities

The main factors which influenced on increase of cash flows used in financing activities for the three months ended 31 March 2015 as compared to 2014 by RUB 28,922 or 61.6% were:

- decrease of cash used to repay bonds and loans in the amount of RUB 36,633.  
For the three months ended 31 March 2015 monthly repayment of the loan to China Development Bank in the amount of USD 166.7 mln. (RUB 10,315 at the rate of Central Bank of the Russian Federation on the date of operation).  
Eurobonds in the amount of USD 1,300 mln. were settled (RUB 47,040 at the rate of Central Bank of the Russian Federation on the date of operation).
- payments for acquisition of non-controlling interests in OAO SZMN (36%) and 25% in OOO Transneft-Terminal amounting for RUB 7 856.



#### 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 interim condensed statements of cash flows prepared using the direct method and disclosed in the consolidated interim condensed financial statements prepared in accordance with IFRS for the three months ended 31 March 2015.

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.

	Three months ended 31 March 2015	Three months ended 31 March 2014
<b>OPERATING ACTIVITIES</b>		
<b>Profit before tax</b>	<b>76,566</b>	<b>51,553</b>
<b>Adjustments for:</b>		
Depreciation and amortization	29,600	27,229
Loss from disposal of property, plant and equipment	22	263
Finance income	(244,293)	(45,535)
Finance costs	241,221	58,391
Share of (profit)/loss from associates and jointly-controlled entities	(1,443)	408
Others	(2,480)	(816)
<b>Operating profit before changes in working capital</b>	<b>99,193</b>	<b>91,493</b>
Changes in operating assets and liabilities:		
(Increase)/decrease in inventories	1,274	(1,741)
(Increase)/decrease in trade and other receivables relating to operating activity and VAT assets	(3,154)	15,171
Increase in trade and other payables, and accruals relating to operating activity	14,027	11,355
<b>Cash flows from operating activities before payment of income tax expense and interest</b>	<b>111,340</b>	<b>116,278</b>
Income tax paid	(2,717)	(10,168)
Income tax refund	307	410
Interest paid	(8,363)	(6,195)
<b>Cash flows received from operating activities</b>	<b>100,567</b>	<b>100,325</b>



## 5. Liquidity analysis

	31 March 2015	31 December 2014	Change, %
Current assets	739,820	697,494	6.1
including:			
cash and cash equivalents	128,416	113,060	13.6
short-term bank promissory notes, deposits and bonds*	440,938	406,479	8.5
Current liabilities	397,506	383,719	3.6
Net working capital	342,314	313,775	9.1
Current ratio	1.9	1.8	x
Quick ratio**	1.5	1.6	x
Debt / EBITDA	2.2	2.2	x
Debt / Equity	0.5	0.6	x

\* Short-term bank promissory-notes, deposits and bonds consist of promissory notes, deposits and bonds issued by banks with credit ratings at Ba1 – Ba3 at the Moody's adjusted scale. Thus, short-term bank promissory notes, deposits and bonds consist of highly reliable or reliable financial instruments issued by credit organisations and companies.

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