

Cost and Cost Structure

Analysis of production cost and structure of costs

| EBIt _h , in RUB mln | 2010 | 2011 | 2012 | 2013 | 2014 |
|---------------------------------------|--------|--------|--------|--------------------|--------------------|
| Production cost, total | 25,145 | 27,781 | 28,129 | 38,293 | 40,030 |
| Uncontrolled costs | 15,069 | 15,998 | 15,800 | 25,327 | 26,800 |
| Services of JSC FGC UPS | 7,096 | 8,177 | 8,371 | 8,339 | 8,439 |
| Services of TGCo | 1,273 | 1,503 | 819 | 2,812 ¹ | 4,045 ² |
| Purchased power for loss compensation | 4,177 | 3,646 | 3,629 | 4,257 ³ | 4,341 ⁴ |
| Purchased electricity for sale | 0 | 0 | 0 | 6,429 | 6,037 |
| Depreciation | 2,522 | 2,672 | 2,981 | 3,491 | 3,938 |
| Controlled costs | 10,076 | 11,783 | 12,329 | 12,966 | 13,230 |
| Raw and other materials | 1,376 | 1,540 | 1,684 | 1,795 | 1,753 |
| Electricity for the company's needs | 327 | 313 | 302 | 314 | 311 |
| Production works and services | 741 | 952 | 1,034 | 1,099 | 1,041 |
| Labor costs with deductions | 6,421 | 7,525 | 7,742 | 8,252 | 8,489 |
| Communication services | 91 | 108 | 108 | 121 | 84 |
| Utility services | 97 | 103 | 102 | 103 | 93 |
| IT services | 77 | 117 | 106 | 84 | 133 |
| Land survey | 15 | 90 | 58 | 118 | 93 |
| Security services | 179 | 202 | 207 | 212 | 211 |
| Taxes | 160 | 158 | 160 | 275 | 347 |
| Miscellaneous costs | 593 | 676 | 826 | 592 | 675 |

Total actual net cost for 2014 amounted to RUB 40,030 million, which is more than the 2013 level by RUB 1,737 million, or 4.5%. The greatest increase of expenses is noted in the following items:

- The increase of costs of TGCo services as compared to 2013 amounted to RUB 1,233 million, of which RUB 1,213 million was the increase of costs of TGCo services that are classified as sales activity. The cost increase is due to the Company's new function of guaranteed supplier at Kolenergo and Novgorodenergo and relevant costs incurred in the following periods:
 - In the Murmansk Region (JSC Kola Energy Sales Company) in the periods from March 01, 2013 to December 31, 2013 (10 months) and from January 01, 2014 to December 31, 2014 (1 year);
 - In the Novgorod Region in the following periods:
 - Novgorodenergosbyt LLC from April 01, 2013 to December 31, 2013 (9 months), from January 01, 2014 the contract was terminated.
 - JSC Novgorodoblenergosbyt from October 10, 2013 to December 31, 2013 (2 months) and from 01.01.2014 to 01.10.2014 (9 months)

Therefore, the increase of costs of TGCo services in 2014 as compared to 2013 was due to the different duration of the time when the Company acted as guaranteed supplier in these periods.

- The costs of purchased energy to compensate losses increased in comparison with the actual amount of 2013 by RUB 84 million (of which the increase of the cost classified as sales activity amounted to RUB 30 million). The main reasons for the cost increase were as follows:
 - increase of actual values of electricity losses for the Company as a whole by 43 million kW·h or 2% as compared to the business plan;

- reduction of actual values of load losses at Novgorodenergo and Pskovenergo as compared to the target.

The greatest deviations of costs of electricity and capacity purchase for compensation of losses occurred at the following branches:

- Vologdaenergo: the actual cost of electricity that the branch purchased to compensate losses amounted to RUB 733 million, which is RUB 23 million or 3% greater than the target. This is due to the reduction of the actual losses by RUB 4 million or 1% in comparison with the target in the 2014 business plan.
- Komienenergo: the actual cost of electricity that the branch purchased to compensate losses amounted to RUB 1,045 million, which is RUB 37 million or 4% greater than the target. This is due to the reduction of the actual losses by RUB 11 million or 2% in comparison with the target in the 2014 business plan.
- Novgorodenergo: the actual cost of electricity that the branch purchased to compensate losses amounted to RUB 564 million, which is RUB 56 million or 10% greater than the target. The reason for the cost increase was the growth of the loss amount by 29 million kW·h or 9% and RUB 4.9 million reduction of load losses.

In payroll with allowances, there was a RUB 237 million or 2.9% increase due to the economic effect from indexation of wage rates (salaries) in accordance with the real consumer price index (RCPI) pursuant to the Industry Tariff Agreement in the Electricity Sector and a corresponding increase of allowance paid to social funds.

In services of JSC FGC UES, the increase of RUB 100 million or 1.2% was due to the increase of the loss compensation tariff in 2014 in comparison with 2013. There was no increase of the grid maintenance costs in 2014, as the increase of the grid maintenance tariff was compensated for by the declared capacity reduction at Vologdaenergo and Karelenenergo.

In depreciation allowance, the cost increase of RUB 447 million or 12.8% was caused by a great amount of fixed assets that was commissioned in comparison with 2013.

In IT services, the cost increase of RUB 49 million or 58% was due to the replication of the news ASUD electronic document exchange system to new workplaces and new contracts for software support, implementation, and licensing of unified electricity accounting systems.

The significant increase of tax payments, RUB 72 million or 26%, was primarily due to the property tax increase and was, in particular, caused by amendments to the tax law.

Dynamics of controlled and uncontrolled costs, RUB mln

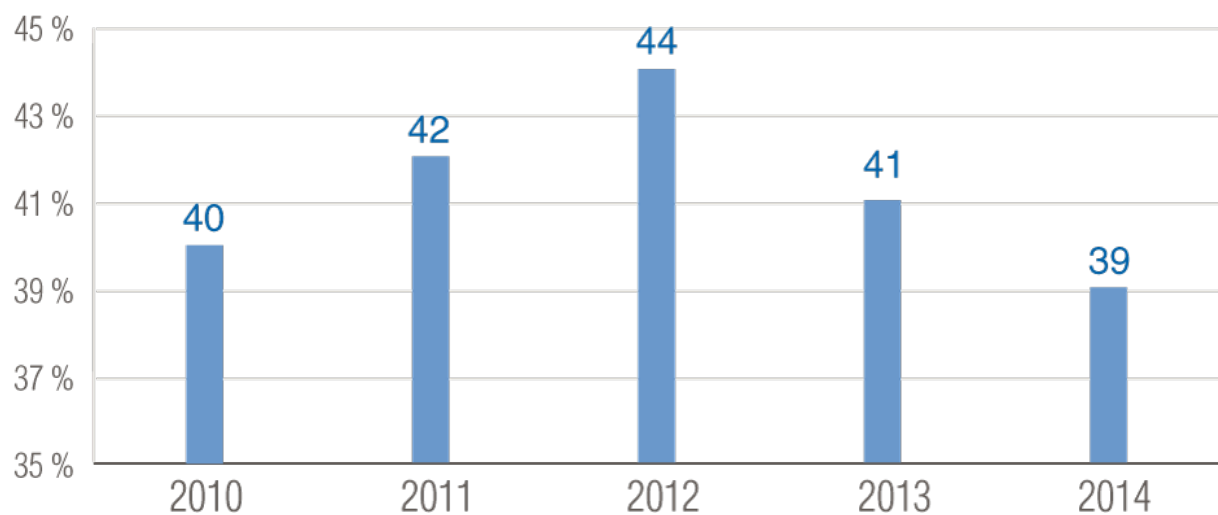


On the results of 2014, the increase of controlled costs amounted to 2% while the actual RCPI was 11.4% (percentage in December 2014 as compared to December 2013).

The growth of uncontrolled costs amounted to RUB 1,473 million or 5.8%. The increase of uncontrolled costs was mainly due to presence of electricity sale activity costs in the Company's costs (the increase of costs of TGCo services in sales amounted to RUB 1,213 million), and the increase of depreciation allowances in 2014 by RUB 447 million (12.8%)

The following chart shows the dynamics of reduction of the share of controlled costs in the total production cost of JSC IDGC of the North-West.

Share of controlled costs in the total production cost



Despite the dynamics of the increase of the total production cost of JSC IDGC of the North-West, there is a clear trend to a decrease of the share of controlled costs in the structure of the Company's production cost. Having reached its peak in 2012 (44%), in 2014, the share of controlled costs reduced down to 39%, which is evidence of an objective positive result of implementation of the Efficiency Management Program (EMP) at JSC IDGC of the North-West.

1: 2,812 - With consideration of the costs by the types of business entitled Electricity transfer and Electricity sales.

2: 4,045 - With consideration of the costs by the types of business entitled Electricity transfer and Electricity sales.

3: 4,257 - With consideration of the costs by the types of business entitled Electricity transfer and Electricity sales.

4: 4,341 - With consideration of the costs by the types of business entitled Electricity transfer and Electricity sales.