

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations as of 31 December 2006 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2006 and 2005. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial and operating information contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" comprises information of OAO NOVATEK and its consolidated subsidiaries (hereinafter jointly referred to as the "Group").

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom. In terms of proved natural gas reserves, we are the fourth largest holder of natural gas resources in Russia after Gazprom, Rosneft and LUKOIL.

Our exploration, development, production, processing and marketing of natural gas, gas condensate, crude oil and related products have been conducted primarily within the Russian Federation and, prior to June 2005, most of our revenues were derived from sales within the Russian Federation. However, with the commissioning of the Purovsky Gas Condensate Processing Plant (Purovsky Plant) in June 2005, we now export the majority of our stable gas condensate directly to international markets, significantly increasing the share of our revenues derived from international sales.

In October 2006, we established OOO NOVATEK-Refueling Complexes, a wholly-owned subsidiary, to manage our wholesale and retail trading of liquefied petroleum gas and other oil products.

In September 2006, we and OAO OGK-5 established OAO Northern Energy Company for the purpose of evaluating potential investment opportunities in the power generation sector. At 31 December 2006 the Group owned 50 percent plus one share of this new subsidiary.

In July 2006, we executed a 1,000:1 share split of our ordinary shares outstanding which has been given retroactive effect in the consolidated financial statements. The weighted average number of our ordinary shares, adjusted for the share split, outstanding for both years shown was 3,036,306,000.

In November and December 2005, we established Novatek Overseas AG and Runitek GmbH, respectively, both registered in Switzerland, to manage the administration, marketing and trading of crude oil, stable gas condensate, liquefied petroleum gas, and other oil products to international markets. Effective January 2006, we commenced export sales through our newly established foreign subsidiaries.

SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Year ended 31 December:		Change %
	2006	2005	
Financial results			
Total revenues (net of VAT and export duties)	48,814	38,477	26.9%
Operating expenses	(29,522)	(22,861)	29.1%
Profit attributable to NOVATEK shareholders	14,079	13,697	2.8%
EBITDA ⁽¹⁾	23,129	23,022	0.5%
Normalized EBITDA ⁽²⁾	23,120	19,391	19.2%
Earnings per share (EPS) of common stock (post share split, in Russian roubles)	4.64	4.51	2.9%
Normalized EPS ⁽³⁾ of common stock (post share split, in Russian roubles)	4.63	3.32	39.5%
Operating results			
Natural gas sales volumes (mmcm)	30,308	27,330	10.9%
Stable gas condensate sales volumes (thousand tons)	1,358	762	78.2%
Liquefied petroleum gas sales volumes (thousand tons)	506	241	109.9%
Crude oil sales volumes (thousand tons)	305	862	(64.6%)
Oil products sales volumes (thousand tons)	81	595	(86.4%)
Cash flow results			
Net cash provided by operating activities	16,607	10,246	62.1%
Capital expenditures	4,703	6,460	(27.2%)

⁽¹⁾ EBITDA represents net income before finance income (expense) and income taxes from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

⁽²⁾ Normalized EBITDA excludes one-time effect from disposal of investments.

⁽³⁾ Normalized EPS excludes one-time effect from disposal of investments.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Transactions with related parties

During 2005, we had significant transactions with companies related to our shareholders and other related parties in connection with sales of crude oil, stable gas condensate and liquefied petroleum gas and sales of equity securities. Our reported results of operations, financial position and cash flows may have been different had such transactions been carried out amongst unrelated parties. During 2006, no such sales activities have occurred; however, certain other related party transactions have continued (see Note 21, "Related Party Transactions" in our consolidated financial statements).

Commencement of Purovsky Plant

Prior to June 2005, all of our unstable gas condensate was transported through our own pipeline network and pipelines owned by Gazprom to the Surgutsky refinery for processing into crude oil and oil products (including diesel fuel and light distillate). The crude oil and oil products mix that we receive from the Surgutsky refinery are then transported to market using a combination of the Transneft crude oil pipeline network and the Russian Railways system.

With the commissioning of our Purovsky Plant in June 2005, we began transporting our unstable gas condensate production volumes from our East-Tarkosalinskoye and Khancheyskoye fields through our own pipeline network directly to the Purovsky Plant. We have an agreement with Gazprom to access its gas condensate pipeline network to deliver the unstable gas condensate produced at our Yurkharovskoye field to the Purovsky Plant. The commissioning of Purovsky Plant and the establishment of our foreign trading subsidiaries has significantly changed our distribution channel for delivery of stable gas condensate to the market, whereby we now export the majority of our stable gas condensate to international markets via rail and tankers.

Our revenues and margins have increased since prices for stable gas condensate in international markets have historically exceeded prices for Urals blend crude oil on both the export and domestic markets.

Natural gas prices

As an independent natural gas producer, we are not subject to the government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS). In 2006, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 103 per mcm, or 10.2%, to RR 1,110 per mcm compared to RR 1,007 per mcm in 2005. The terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale traders allow us to diversify our gas sales without incurring additional commercial expenses. However, we generally realize higher prices and net margins for natural gas volumes sold directly to the end-customer, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. During 2006, the average netback margin differential we received on end-customer sales compared to ex-field sales (average end-customer netback less average ex-field price) increased by RR 3 per mcm, or 4.3%, compared to 2005 despite the increase in the transportation tariff per mcm in October 2005 and the changes in the methodology for calculating transportation tariffs in August 2006.

The following table shows our average realized natural gas sales prices (net of VAT) for the years ended 31 December 2006 and 2005:

<i>Russian roubles per mcm</i>	Year ended 31 December:		Change %
	2006	2005	
Average natural gas price to end-customers ⁽¹⁾	1,253	1,121	11.8%
Gas transportation expense for sales to end-customers	516	434	18.9%
Average natural gas netback on end-customer sales	737	687	7.3%
Average natural gas price ex-field (wholesale traders)	664	617	7.6%
Average netback margin differential	73	70	4.3%

⁽¹⁾ Includes cost of transportation.

Crude oil, stable gas condensate, liquefied petroleum gas and oil products prices

Crude oil, stable gas condensate, liquefied petroleum gas ("LPG") and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, and the ability and willingness of oil producing countries to sustain production levels to meet increasing global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters. Crude oil, stable gas condensate, LPG and oil products prices on the domestic market also fluctuate depending on supply and demand fundamentals. Crude oil prices in Russia have generally remained below prices in the international market primarily due to constraints on the ability of many Russian oil companies to transport their crude oil, whereas certain oil products and LPG prices in Russia have more closely followed prices on international markets. This has occasionally led to crude oil surpluses in key consuming regions in Russia driving down the price in the domestic market. Moreover, there is no independent or uniform benchmark price for crude oil in Russia because the majority of all crude oil destined for sale in Russia is produced and refined by the same vertically integrated Russian oil companies. Crude oil that is not exported from Russia or refined by the producer is offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as "Urals blend", which normally trades at a discount to the international benchmark Brent crude oil.

Our crude oil, stable gas condensate, LPG and oil products export and CIS prices include transportation expenses in accordance with the terms of delivery while prices for domestic sales do not. Under these agreements, the buyer takes ownership at the named place and responsibility for further transportation of the product to its final destination.

During 2006, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany) while crude oil export delivery terms in 2005 were a combination of DAF Adamova Zastava, Germany, and free on board (FOB) at the port of Butinge, Lithuania. In 2006, our average crude oil export contract price, including export duties, was USD 414 per ton compared to USD 321 per ton in 2005. In addition, in 2006, our foreign subsidiaries purchased and resold 27 thousand tons of crude oil and sold under delivery terms priced at cost, insurance and freight (CIF) at the port of Porvoo, Finland, at an average contract price of USD 364 per ton.

During 2006, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost and freight (CFR) while export terms in 2005 were primarily carriage paid to (CPT) the Port of Vitino. Our average export stable gas condensate contract price, including export duties, in 2006 was approximately USD 573 per ton compared to approximately USD 449 per ton for 2005. The following table shows our average realized stable gas condensate and crude oil sales prices (net of VAT and export duties where applicable) for the years ended 31 December 2006 and 2005:

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Year ended 31 December:		Change %
	2006	2005	
Stable gas condensate			
Net export price, RR per ton ⁽¹⁾	10,143	8,339	21.6%
Net export price, USD per ton	373.1	294.8	26.6%
Domestic price, RR per ton	8,015	6,268	27.9%
Crude oil			
Net export price, RR per ton ⁽¹⁾	7,107	6,102	16.5%
Net export price, USD per ton	261.4	215.7	21.2%
Domestic price, RR per ton	5,993	4,100	46.2%

⁽¹⁾ Includes cost of transportation.

Our LPG export and CIS delivery terms during 2006 were delivery at frontier (DAF) at the Belarusian-Polish and Russian-Latvian borders. In 2006, our average export LPG contract price, including export duties, was approximately USD 548 per ton compared to USD 450 per ton in 2005. We are obliged to sell a portion of our domestic sales volumes of LPG at contract prices which are regulated by the FTS while the remaining portion of our domestic sales are sold under commercial terms. In 2006, we sold 40 thousand tons at the regulated price of approximately RR 1,697 per ton and 370 thousand tons at a commercial price of approximately RR 7,790 per ton, including transportation, compared to 10 thousand tons at approximately RR 1,350 per ton and 203 thousand tons at approximately RR 7,016 per ton, respectively, in 2005. Domestic sales of oil products from Surgutsky refinery are priced free carrier (FCA) at the Surgut railroad station.

The following table shows our average realized liquefied petroleum gas and oil products sales prices (net of VAT and export duties where applicable) for the years ended 31 December 2006 and 2005:

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Year ended 31 December:		Change %
	2006	2005	
LPG			
Net export price, RR per ton ⁽¹⁾	10,970	9,515	15.3%
Net export price, USD per ton	403.5	336.4	19.9%
CIS price, RR per ton ⁽¹⁾	8,538	-	n/a
Domestic price, RR per ton	5,716	5,647	1.2%
Oil products			
Domestic price, RR per ton	5,857	4,704	24.5%

⁽¹⁾ Includes cost of transportation.

Transportation tariffs

Transportation tariffs established by the FTS from 1 October 2005 for the transport of natural gas produced in Russia for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan) are set at RR 23.84 (excluding VAT) per mcm per 100 km. This represents a 23.1% increase from the tariffs of RR 19.37 (excluding VAT) per mcm per 100 km set on 1 October 2004.

As of 1 August 2006, the general methodology for calculating transportation tariffs for natural gas produced in the Russian Federation was changed by the FTS. Under the new methodology the transportation tariff consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 km. The rate for utilization of the trunk pipeline is based on an “input/output” function which is determined by where natural gas enters and exits the trunk pipeline (the maximum “input/output” rate is RR 931.97 (excluding VAT) per mcm) and includes a constant rate of RR 12 (excluding VAT) per mcm for end-customers using Gazprom’s gas distribution systems. The constant rate is deducted from the utilization rate for end-customers with their own gas distribution systems. The second component of the transportation rate for natural gas delivered within the customs territory of the Russian Federation and the member states of the Customs Union Agreement is presently set at RR 5.28 (excluding VAT) per mcm per 100 km.

The increases in regulated transportation tariffs may be passed on to our end-customers pursuant to contract terms. There is no set timetable for reviews or changes in transportation tariffs set by the FTS, and thus changes in transportation tariffs occur on an irregular basis.

We transport most of our crude oil through the pipeline network owned and operated by Transneft, Russia’s state-owned monopoly crude oil pipeline operator. Our transportation tariffs for the transport of crude oil through Transneft’s pipeline network are also set by the FTS. The overall expense per ton for the transport of crude oil depends on the length of the transport route from the producing field to the ultimate destination.

Our stable gas condensate, LPG and oil products are transported by rail which is owned and operated by Russian Railways, Russia’s state-owned monopoly railway operator. Our transportation tariffs for transport by rail are also set by the FTS and vary depending on product and length of transport route.

We deliver our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and tankers for transportation to US and European markets. The costs associated with the transportation of stable gas condensate by tanker are determined by the distance to the final destination, tanker availability and standard shipping terms. The majority of our LPG and oil products are sold in Russia and the CIS.

Our tax burden

We have not employed any tax minimization schemes using offshore or domestic tax zones in the Russian Federation.

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax, significant taxes to which we are subject include VAT, unified natural resources production tax (UPT), export duties, property tax, social taxes and contributions.

In practice, Russian tax authorities often have their own interpretation of tax laws that rarely favors taxpayers, who have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to an inspection of their activities for a period of three calendar years which immediately proceeds the year in which the audit is conducted. Previous audits do not completely exclude subsequent claims relating to the audited period. In addition, in some instances, new tax regulations have been given retroactive effect.

OPERATIONAL HIGHLIGHTS

Oil and gas production costs

Our oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the unaudited supplemental oil and gas disclosures for the years ended 31 December 2006 and 2005. Oil and gas production costs do not include general corporate overheads or its associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the years presented in millions of Russian roubles and in US dollars per boe:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Production costs:			
Lifting cost	2,518	2,676	(5.9%)
Long-term supply purchases	1,805	2,065	(12.6%)
Taxes other than income tax	6,019	4,336	38.8%
Transportation expenses	10,791	6,581	64.0%
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Total production costs before DD&A	21,133	15,658	35.0%
Depreciation, depletion and amortization (DD&A)	3,466	3,255	6.5%
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Total production costs	24,599	18,913	30.1%

<i>USD/boe</i>	Year ended 31 December:		Change %
	2006	2005	
Production costs:			
Lifting cost	0.45	0.52	(13.5%)
Long-term supply purchases	3.74	3.76	(0.5%)
Taxes other than income tax	1.07	0.85	25.9%
Transportation expenses	1.77	1.16	52.6%
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Total production costs before DD&A	3.47	2.76	25.7%
Depreciation, depletion and amortization (DD&A)	0.62	0.63	(1.6%)
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Total production costs	4.03	3.33	21.0%

Production costs consist of amounts directly related to the operation and maintenance of our producing oil and gas wells, related equipment and facilities, purchases of natural gas and crude oil and gas condensate from our affiliates and other third parties, and transportation cost to end-customers. The average production costs per boe reflect the crude oil equivalent of natural gas and gas condensate at our prospective producing fields converted based on the relative energy content of each field's hydrocarbons.

Hydrocarbon sales volumes

In 2006, we increased our natural gas sales volumes due to steady increases in our natural gas production compared to 2005. Our liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) decreased in 2006, as compared to 2005, due to increased volumes in transit and the disposal of Geoilbent. Our total liquids sales volumes were affected by the commencement of export sales through our newly established foreign subsidiaries, and the terms of delivery for these sales, which resulted in significant volumes recorded as "goods in transit". Furthermore, our liquid sales volumes, mainly crude oil, decreased as a result of the disposal of our participation interest in Geoilbent in June 2005 and termination of respective crude oil purchases.

Our overall growth in production was achieved through the efficient exploitation of our existing producing asset base. We expect our total production volumes to continue growing, primarily as a result of the development activities at our existing producing fields and by exploring and developing other oil and gas fields in our asset portfolio.

Natural gas sales volumes

<i>millions of cubic meters</i>	Year ended 31 December:		Change %
	2006	2005	
Production from:			
Yurkharovskoye field	9,538	8,916	7.0%
East-Tarkosalinskoye field	15,735	13,327	18.1%
Khancheyskoye field	3,277	2,767	18.4%
Other fields	28	26	7.7%
Total natural gas production	28,578	25,036	14.1%
Purchases from:			
Gazprom	2,043	1,852	10.3%
Other	540	666	(18.9%)
Total natural gas purchases	2,583	2,518	2.6%
Total production and purchases	31,161	27,554	13.1%
Purovsky Plant and own usage	(36)	(22)	63.6%
Decrease (increase) in pipeline and underground storage of natural gas	(817)	(202)	<i>n/a</i>
Total natural gas sales volumes	30,308	27,330	10.9%
<i>Sold to end-customers</i>	<i>13,443</i>	<i>11,650</i>	<i>15.4%</i>
<i>incl. e-trading sales</i>	<i>10</i>	<i>-</i>	<i>n/a</i>
<i>Sold ex-field</i>	<i>16,865</i>	<i>15,680</i>	<i>7.6%</i>

In 2006, our total consolidated natural gas production increased by 3,542 mmcm, or 14.1%, compared to 2005. The increase in natural gas production in 2006 was primarily due to development at our three core fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye), including the completion of the second phase of development at the Khancheyskoye field, and a combination of increased demand for natural gas on the domestic market and our ability to transport larger volumes of natural gas through the unified gas supply system (UGSS) of Gazprom.

In 2006, purchases increased by 65 mmcm, or 2.6%, compared to 2005 primarily due to an increase in purchases from Gazprom under the terms and conditions of the West-Tarkosalinskoye agreement (in 2004 we sold to Gazprom our subsidiary, Purgazdobycha, which held the mineral license in the West-Tarkosalinskoye field). In 2006, our purchases of natural gas from Gazprom increased by 191 mmcm, or 10.3%, compared to 2005, due to increased production at the West-Tarkosalinskoye field while purchases from "Other" decreased by 126 mmcm, or 18.9%, in 2006, due to the availability of sufficient gas from our own production and purchase rights to meet demand.

In 2006, the Purovsky Plant's and our own usage of natural gas increased by 14 mmcm, or 63.6%, compared to 2005. The increase was primarily due to increased throughput of unstable gas condensate at the Purovsky Plant in 2006.

As of 31 December 2006, our cumulative natural gas volumes stored in Gazprom's underground gas storage facilities (excluding gas in pipeline) totaled 1,000 mmcm, increasing by 885 mmcm during the year. We expect our volumes of natural gas injected into underground gas storage facilities to fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

Liquids sales volumes

<i>thousands of tons</i>	Year ended 31 December:		Change %
	2006	2005	
Production from:			
Yurkharovskoye field	671	662	1.4%
East-Tarkosalinskoye field	853	742	15.0%
Khancheyskoye field	712	644	10.6%
Other fields	108	83	30.1%
Total liquids production	2,344	2,131	10.0%
Purchases from:			
Geoilbent	-	240	n/a
Gazprom	78	140	(44.3%)
Other	27	-	n/a
Total liquids purchases	105	380	(72.4%)
Total production and purchases	2,449	2,511	(2.5%)
Losses ⁽¹⁾	(21)	(39)	(46.2%)
Decreases (increases) in liquids inventory balances	(179)	(12)	n/a
Total liquids sales volumes	2,249	2,460	(8.6%)
<i>Stable gas condensate export</i>	<i>1,355</i>	<i>760</i>	<i>78.3%</i>
<i>Stable gas condensate domestic</i>	<i>3</i>	<i>2</i>	<i>50.0%</i>
<i>LPG export</i>	<i>41</i>	<i>28</i>	<i>46.4%</i>
<i>LPG CIS</i>	<i>54</i>	<i>-</i>	<i>n/a</i>
<i>LPG domestic</i>	<i>410</i>	<i>213</i>	<i>92.5%</i>
<i>Crude oil export</i>	<i>98</i>	<i>183</i>	<i>(46.4%)</i>
<i>Crude oil domestic</i>	<i>207</i>	<i>679</i>	<i>(69.5%)</i>
<i>Oil products domestic</i>	<i>81</i>	<i>595</i>	<i>(86.4%)</i>

⁽¹⁾ Losses associated with processing at the Purovsky Plant and Surgutsky refinery as well as during rail road and tanker transportation.

In 2006, our crude oil and gas condensate production increased by 213 thousand tons, or 10.0%, compared to 2005. The increase in 2006 was largely attributable to an increase in gas condensate production capacity due to the completion of the second phase of development at the Khancheyskoye field and improvements in the deethanization facilities at our East-Tarkosalinskoye and Khancheyskoye fields. Gas condensate production at our Yurkharovskoye field increased marginally in 2006, compared to 2005, due to natural declines in the concentration of liquids from the current producing horizons at the field.

In 2006, purchases decreased by 275 thousand tons, or 72.4%, compared to 2005, primarily due to the disposal of Geoilbent in June 2005 and a decrease in purchases from Gazprom. In 2006, purchases from Gazprom decreased by 62 thousand tons, or 44.3%, due to a decrease in production of liquids at the West-Tarkosalinskoye field.

During 2006, we delivered 2,061 thousand tons and 149 thousand tons of unstable gas condensate to the Purovsky Plant and Surgutsky refinery, respectively, compared to 1,031 thousand tons and 1,052 thousand tons, respectively, in 2005. Our processed products from the Purovsky Plant are sold separately from the processed products we receive from the Surgutsky refinery. After processing gas condensate at the Surgutsky refinery we receive crude oil and a slate of oil products. The crude oil is sold as Ural's blend and delivered through the Transneft pipeline network. In 2006, our crude oil output comprised 43.8% of the total yield from the Surgutsky refinery compared to 41.7% in 2005.

Our total liquids sales volumes were affected by the commencement of export sales through our newly established foreign subsidiaries and the terms of delivery for these sales. As of 31 December 2006, we had 179 thousand tons of stable gas condensate in transit and recognized as inventory until such time as it is delivered to the port of destination.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2006 COMPARED TO THE YEAR ENDED 31 DECEMBER 2005

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2006 and 2005. Each line item is also shown as a percentage of our total revenues.

<i>millions of Russian roubles</i>	Year ended 31 December:			
	2006	% of total revenues	2005	% of total revenues
Total revenues (net of VAT and export duties)	48,814	100.0%	38,477	100.0%
Other income (loss)	(139)	(0.3%)	3,710	9.6%
Total revenues and other income	48,675	99.7%	42,187	109.6%
Operating expenses	(29,522)	(60.5%)	(22,861)	(59.4%)
Profit from operations	19,153	39.2%	19,326	50.2%
Finance income (expense)	(31)	(0.1%)	(729)	(1.9%)
Share of income from associates	-	-	143	0.4%
Profit before income tax and minority interest	19,122	39.2%	18,740	48.7%
Total income tax expense	(5,115)	(10.5%)	(5,078)	(13.2%)
Profit for the period	14,007	28.7%	13,662	35.5%
Minority interest	72	0.1%	35	0.1%
Profit attributable to NOVATEK shareholders	14,079	28.8%	13,697	35.6%

Total revenues and other income

The following table sets forth our sales (net of VAT and export duties where applicable) and other income for the years ended 31 December 2006 and 2005:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Natural gas sales	28,048	22,729	23.4%
<i>End-customer sales</i>	16,848	13,056	29.0%
<i>Ex-field sales</i>	11,200	9,673	15.8%
Stable gas condensate sales	13,768	6,349	116.9%
<i>Export sales</i>	13,742	6,336	116.9%
<i>Domestic sales</i>	26	13	100.0%
Liquefied petroleum gas sales	3,270	1,472	122.1%
<i>Export sales</i>	455	271	67.9%
<i>CIS sales</i>	465	-	n/a
<i>Domestic sales</i>	2,350	1,201	95.7%
Crude oil sales	1,928	3,899	(50.6%)
<i>Export sales</i>	695	1,114	(37.6%)
<i>Domestic sales</i>	1,233	2,785	(55.7%)
Oil products sales	474	2,797	(83.1%)
Total oil and gas sales	47,488	37,246	27.5%
Sales of polymer and insulation tape	1,109	964	15.0%
Other revenues	217	267	(18.7%)
Total revenues	48,814	38,477	26.9%
Net gain (loss) on disposal	9	3,631	n/a
Net other income (loss)	(148)	79	n/a
Total revenues and other income	48,675	42,187	15.4%

Natural gas sales

In 2006, our revenues from sales of natural gas increased by RR 5,319 million, or 23.4%, compared to 2005. The increase in natural gas revenues was primarily attributable to increases in both prices and sales volumes during the year. Revenues from the sale of natural gas accounted for 57.5% and 59.1% of our total revenues in 2006 and 2005, respectively. The decrease in natural gas sales as a percentage of total revenues was primarily due to a combination of increased sales volumes of stable gas condensate to international markets, where we are able to realize higher net prices, and the general increase in prices for liquid hydrocarbons in 2006 compared to 2005. We sell our natural gas volumes exclusively in the Russian domestic market.

In 2006, our average realized natural gas price per mcm increased by RR 93 per mcm, or 11.2%, to RR 925 per mcm from RR 832 per mcm in 2005, due to an overall increase in prices and an increase in sales volumes to end-customers. Our proportion of natural gas sales volumes to end-customers increased from 42.6% in 2005 to 44.4% in 2006. The average realized prices of our natural gas sold to end-customers and natural gas sold ex-field were higher by 11.8% and by 7.6%, respectively, in 2006 compared to 2005.

In 2006, Russian independent gas producers (including oil companies) and Gazprom commenced electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhrefiongaz, a subsidiary of Gazprom. During 2006, the natural gas exchange held separate trading sessions in November and December. In the November session, we sold 10 mmcm of natural gas at an average price of RR 991 per mcm for delivery in December. These sales were primarily to regional distributors and energy utility companies and are recorded in our end-customer volumes and average end-customer price. We have participated in each of the subsequent trading sessions and view this as a positive development in the domestic natural gas market.

Stable gas condensate sales

In 2006, our revenues from sales of stable gas condensate increased by RR 7,419 million, or 116.9%, compared to 2005. The increase in revenues is directly related to the increased throughput at our Purovsky Plant in 2006 combined with higher net realized prices as compared to 2005. The Purovsky Plant was commissioned in June 2005 and did not reach maximum operating capacity until the fourth quarter 2005. In 2006, we increased our sales volumes of stable gas condensate by 596 thousand tons compared to 2005.

In 2006, we exported 99.8% of our stable gas condensate sales volumes, 1,355 thousand tons, from the Purovsky Plant to markets in the United States and Europe using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers. In 2006, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market increased by USD 78.3 per ton, or 26.6%, to USD 373.1 per ton (DES and CFR) from USD 294.8 per ton (CPT) in 2005. The significant increase was due to the overall strengthening of prices in international markets in 2006 and the change in our delivery terms due to the commencement of sales through our trading subsidiary beginning in January 2006. The average domestic price for stable gas condensate increased by RR 1,747 per ton, or 27.9%, in 2006 compared to 2005 due to the strengthening of prices on the domestic market.

Liquefied petroleum gas sales

In 2006, our revenues from the sales of LPG increased by RR 1,798 million, or 122.1%. The increase was also directly related to an increase in throughput at our Purovsky Plant in 2006 as explained above. In 2006, we increased our sales volumes of LPG by 264 thousand tons to 505 thousand tons, of which 81.2% was sold domestically for an average price of RR 5,716 per ton (FCA excluding VAT); an increase of RR 69 per ton, or 1.2%, compared to 2005. The remaining volumes of LPG were sold as follows: 8.1% was sold to the export market for an average price of USD 403.5 per ton (DAF excluding export duties) representing an increase of USD 67.1 per ton, or 19.9%, compared to 2005; and 10.7% was sold in the CIS for an average price of RR 8,538 per ton (DAF excluding VAT). We had no sales of LPG to the CIS markets in 2005.

Crude oil sales

In 2006, our revenues from the sales of crude oil decreased by RR 1,971 million, or 50.6%, compared to 2005, due to a reduction in the overall volumes of crude oil sold during 2006. The reduction in crude oil sales volumes was partially offset by higher prices received on the domestic market.

Total sales volumes of crude oil decreased in 2006 by 557 thousand tons, or 64.6%, compared to 2005. The decrease in sales volumes of crude oil in 2006 was due to the disposal of Geoilbent in June 2005 and the migration of processing of our unstable gas condensate from the Surgutsky refinery to the Purovsky Plant (a portion of gas condensate processed at the Surgutsky refinery is sold as crude oil) starting in June 2005. In 2006, we received 64 thousand tons of crude oil from the Surgutsky refinery as compared to 427 thousand tons in 2005.

Our average realized export sales price for crude oil produced by our production subsidiaries and those volumes purchased by our trading subsidiary and resold on international markets (which are not subject to export duties) translated into US dollars increased by USD 45.7 per ton, or 21.2%, to USD 261.4 per ton (DAF, CIF) in 2006 compared to USD 215.7 per ton in 2005. Our average realized sales price for sales volumes produced by our production subsidiaries, excluding export duties, translated into US dollars for crude oil exported to international markets increased by USD 8.6 per ton, or 4.0%, to USD 224.3 per ton (DAF, CIF) in 2006 compared to USD 215.7 per ton (DAF, FOB) in 2005. The growth in the average export duty (100.4%) exceeded the growth in our average crude oil contract price (33.2%) during 2006. Our average realized crude oil domestic sales price (excluding VAT) increased by RR 1,893 per ton, or 46.2%, to RR 5,993 per ton in 2006, compared to RR 4,100 per ton in 2005.

Oil products sales

In 2006, our revenue from the sales of oil products decreased by RR 2,323 million, or 83.1%, compared to 2005. The decrease in oil products revenues was primarily due to a decrease in the volumes of unstable gas condensate delivered to the Surgutsky refinery, which resulted in a decrease in the output of oil products available for sale. In 2006, oil products sales volumes from the Surgutsky refinery amounted to 81 thousand tons compared to 595 thousand tons in 2005. The decrease in sales volumes of 514 thousand tons, or 86.4%, was partly offset by an increase in the average domestic price of RR 1,153 per ton, or 24.5%. In both years we received primarily diesel fuel and light distillate which realized a premium over the light hydrocarbon fraction and sold 100% of our oil products' volumes to the domestic market.

Sales of polymer and insulation tape

In 2006, our revenues from the sales of polymer and insulation tape increased by RR 145 million, or 15.0%, to RR 1,109 million in 2006 compared to RR 964 million in 2005. In June 2005, we commenced production of BOPP film wrap at our subsidiary NOVATEK-Polimer which generated RR 501 million in revenue in 2006 compared to RR 88 million in 2005. Other polymer sales contributed an additional RR 608 million in revenues compared to RR 876 million in 2005. The decrease in other polymer sales was due to a gradual shift of production to more prospective types of polymer products, including BOPP film wrap, and an overall decrease in the market for pipe insulation tapes.

Other revenues

Other revenues include rent, polymer tolling and other services. In 2006, other revenues decreased by RR 50 million, or 18.7%, to RR 217 million from RR 267 million in 2005. The decrease was primarily due to a reduction in services provided to third parties.

Other income (loss)

In 2006, other loss equaled RR 139 million, while in 2005 we realized other income in the amount of RR 3,710 million. In 2006, other income on disposals of investments in oil and gas producing associates and subsidiaries decreased to RR 9 million compared to RR 3,631 million in 2005. In 2006, net other loss increased by RR 227 million compared to net other income of RR 79 million in 2005 primarily due to losses on the disposal of fixed assets, in the amount of RR 278 million, and losses in the amount of RR 83 million which were related to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). The losses were offset by income from the sale of equipment and materials in the amount of RR 58 million and RR 76 million, which comprised fines and penalties received and other various items.

Operating expenses

In 2006, total operating expenses increased by RR 6,661 million, or 29.1%, to RR 29,522 million compared to RR 22,861 million in 2005 largely due to increases in non-controllable expenses such as transportation costs and taxes other than income tax. Most of our controllable expenses in 2006 were lower as a percentage of total revenues as compared with 2005. Total operating expenses rose slightly as a percentage of total revenues to 60.5% in 2006 compared to 59.4% in 2005, as shown in the table below.

<i>millions of Russian roubles</i>	Year ended 31 December:			
	2006	% of total revenues	2005	% of total revenues
Transportation expenses	10,803	22.1%	6,605	17.2%
Taxes other than income tax	6,223	12.8%	4,494	11.7%
Materials, services and other	3,893	8.0%	3,737	9.7%
Depreciation, depletion and amortization	3,671	7.5%	3,372	8.8%
General and administrative expenses	3,165	6.5%	2,417	6.3%
Purchases of oil, gas condensate and natural gas	1,805	3.7%	2,065	5.4%
Exploration expenses	459	0.9%	348	0.9%
Net impairment expense	100	0.2%	87	0.2%
Change in inventory	(597)	(1.2%)	(264)	(0.8%)
Total operating expenses	29,522	60.5%	22,861	59.4%

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In 2006, non-controllable expenses of transportation and taxes other than income tax increased by RR 5,927 million, or 53.4%, to RR 17,026 million from RR 11,099 million in 2005, primarily due to the increase in hydrocarbon production from our three core fields and the change in our delivery terms for stable gas condensate. As a percentage of total revenues our non-controllable expenses increased by 6.0% to 34.9% in 2006 compared to 28.9% in 2005.

Transportation expenses

Our total transportation expenses in 2006 increased by RR 4,198 million, or 63.6%, compared to 2005.

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Natural gas transportation to customers	6,934	5,052	37.3%
Stable gas condensate and liquefied petroleum gas transported by rail	2,194	943	132.7%
Stable gas condensate transported by tankers	1,484	-	n/a
Transportation of unstable gas condensate from the fields to the processing facilities through third party pipelines	78	163	(52.1%)
Crude oil transportation to customers by pipeline	93	133	(30.0%)
Insurance expense	8	290	(97.2%)
Other	12	24	(50.0%)
Total transportation expenses	10,803	6,605	63.6%

In 2006, our transportation expenses for natural gas increased by RR 1,882 million, or 37.3%. The increase in our gas transportation expenses was due to a 15.4% increase in our sales volumes of natural gas sold to end-customers, for whom the cost of transportation is included in the sales price, and a combination of an increase in transportation tariff per mcm per 100 km and a change in the calculation methodology effective 1 August 2006. The transportation tariff for the January - July period of 2006 increased by RR 4.47 (excluding VAT) per mcm per 100 km, or 23.1%, compared to the tariff set by the FTS on 1 October 2004. As a result of the change in methodology and an increase in the average distance for our end-customer sales, from 2,051 km in the January - July period to 2,140 km for the August - December period, our average transportation expense per mcm in 2006 increased from RR 488.9 per mcm in the January - July period to RR 544.3 per mcm in the August - December period, or by 11.3%. We are not able to influence the transportation route of natural gas sold to end-customers and therefore we have no control over our average delivery distance. Under the new methodology, the implied gas transportation tariff per mcm per 100 km increased by RR 1.6, or 6.7%, in the August - December period to RR 25.43 compared to RR 23.84 in the January - July period.

In 2006, our total expense for transportation by rail increased by RR 1,251 million, or 132.7%, due to an increase in export and CIS volumes sold. During the year, our combined export and CIS sales volumes of stable gas condensate and LPG sold increased by 662 thousand tons, or 84.1%, from 788 thousand tons in 2005 to 1,450 thousand tons in 2006. We did not sell any oil products to the export market in 2006 and 2005.

Our expense for stable gas condensate transported by rail to export markets increased by RR 982 million, or 122.8%, from RR 800 million to RR 1,782 million, or from approximately RR 1,158 per ton in 2005 to approximately RR 1,315 per ton in 2006. The increase in the rate per ton was primarily due to a tariff increase of approximately 12.7% during the year and to a lesser extent the increase in expenses related to the use of cisterns. Transportation expense for LPG amounted to RR 342 million in 2006, of which RR 225 million was related to export sales and RR 117 million to CIS sales, or approximately RR 5,440 per ton and RR 2,151 per ton, respectively. Transportation expenses for LPG amounted to RR 96 million in 2005. The remaining amounts in both periods were related to railway infrastructure maintenance and were not allocated between products.

With the commencement of export sales through our foreign subsidiary, as of 1 January 2006, we now incur tanker expense for delivery of stable gas condensate to US and European markets. Total transportation expense for delivery of stable gas condensate by tanker amounted to RR 1,484 million in 2006 and included RR 44 million for services provided by ice breakers.

In 2006, our expense for transportation of crude oil to export markets decreased by RR 40 million, or 30.0%, compared to 2005. The decrease in crude oil transportation expense was primarily due to a reduction in export volumes delivered which was slightly offset by an increase in the expense per ton due to increases in the transportation tariff in 2006 compared to 2005.

In 2006, transportation expense for unstable gas condensate from the fields to the processing facilities through third party pipelines decreased by RR 85 million, or 52.1%, compared to 2005, due to a reduction in volumes sent to the Surgutsky refinery resulting from the migration of unstable gas condensate processing to our Purovsky Plant.

In 2006, insurance expense decreased by RR 282 million, or 97.2%, compared to 2005, due to the termination of insurance on natural gas shipped via the UGSS. The decision to stop insuring natural gas in transit was based on the relative security of the UGSS and the fact that losses from potential incidents were deemed lower than current insurance premiums.

Taxes other than income tax

In 2006, taxes other than income tax increased by RR 1,729 million, or 38.5%, compared to 2005. The increase was mainly due to increases in UPT and property tax.

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Unified natural resources production tax (UPT)	5,556	4,367	27.2%
Property tax	483	327	47.7%
Excise tax	80	102	(21.6%)
Other taxes	104	125	(16.8%)
Subtotal	6,223	4,921	26.5%
Less: reversal of provision for additional taxes	-	(427)	n/a
Total tax other than income tax	6,223	4,494	38.5%

In 2006, the increase in taxes other than income tax resulted primarily from a RR 1,189 million, or 27.2%, increase in the UPT. The UPT on natural gas increased by RR 807 million in 2006, and was primarily due to a 14.1% increase in natural gas production volumes and an 8.9% increase in the production tax rate for natural gas, from RR 135 per mcm in 2005, to RR 147 per mcm in 2006. Increases in production and prices for gas condensate and crude oil, both of which affect the UPT tax rates for these products, also contributed to the increase in 2006.

In 2006, our property tax expense increased by RR 156 million, or 47.7%, to RR 483 million compared to RR 327 million in 2005. The increase was primarily due to additions of property, plant and equipment (PPE) at the Purovsky Plant, which accounted for RR 82 million of the tax increase, and additions of PPE at other companies in the Group, resulting in an additional RR 74 million in property tax increase.

In 2006, our excise tax expense decreased by RR 22 million, or 21.6%, compared to 2005. The decrease was due to lower volumes of unstable gas condensate processed at the Surgutsky refinery in 2006 due to the launch of the Purovsky Plant in June 2005. Also, during 2006, we received a higher proportion of light fraction oil products from the Surgutsky refinery which were not subject to the excise tax, while in 2005 we received a higher proportion of diesel fuel and light distillate which were subject to the excise tax.

Depreciation, depletion and amortization

In 2006, our depreciation, depletion and amortization (DDA) expense increased by RR 299 million, or 8.9%, compared to 2005. The increase was primarily due to higher production levels which increased depletion of our oil and gas properties. Associated depletion of oil and gas properties increased by RR 83 million, or 2.6%, compared to 2005. In 2006, our DDA per barrel of oil equivalent (boe) was RR 15.7 compared to DDA per boe of RR 18.2 in 2005 as a result of an increase in our proved developed reserves estimates. The remaining balance was due to increases in straight-line depreciation for other assets, including RR 60 million relating to NOVATEK-Polimer.

Materials, services and other expenses

In 2006, our materials, services and other expenses increased by RR 156 million, or 4.2%, to RR 3,893 million compared to RR 3,737 million in 2005. The main components of this expense are payroll and materials expense which comprised 34.7% and 31.3%, respectively, of total materials, services and other expenses in 2006.

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Payroll expense	1,351	1,161	16.4%
Materials expense	1,219	1,212	0.6%
Security and fire safety expense	254	148	71.6%
Processing services expense	226	507	(55.4%)
Energy expense	192	135	42.2%
Other expenses	651	574	13.4%
Total materials, services and other expenses	3,893	3,737	4.2%

Payroll expense increased by RR 190 million, or 16.4%, to RR 1,351 million compared to RR 1,161 million in 2005. The increase was due to additional bonuses and an increase in wages at our production entities, which resulted in an additional RR 98 million in payroll expense in 2006. In 2006, we increased staff at the Purovsky Plant and NOVATEK-Transervice, our subsidiary responsible for rail transportation services for the delivery of stable gas condensate and LPG, resulting in a payroll expense increase of RR 70 million and RR 30 million, respectively.

Materials expense increased marginally by RR 7 million, or 0.6%, to RR 1,219 million compared to RR 1,212 million in 2005. The increase was mainly due to the commencement of BOPP production at NOVATEK-Polimer and the associated increase in purchases of raw materials. Materials expense at NOVATEK-Polimer increased from RR 760 million in 2005 to RR 817 million in 2006, or by RR 57 million. The increase was substantially offset by a materials expense decrease of RR 24 million related to one time local railway repair work in 2005 and decrease in other material expenses.

Processing services expense decreased by RR 281 million, or 55.4%, to RR 226 million from RR 507 million in 2005, mainly due to an 85.8% decrease in the volumes of unstable gas condensate processed at the Surgutsky refinery in 2006. Processing expenses at the Purovsky Plant are allocated among our various expense categories.

Security and fire safety expenses increased by RR 106 million, or 71.6%, to RR 254 million from RR 148 million in 2005, of which RR 42 million related to activities at the Purovsky Plant and RR 50 million related to security and ongoing fire safety activities at our field sites and RR 14 million related to other activities.

In 2006, other expenses increased by RR 77 million compared to 2005. The increase was related to repair and maintenance, rent and other expenses which increased by RR 65 million, RR 13 million and RR 15 million respectively. These increases were partially offset by a decrease in polymer product purchases for resale in the amount of RR 16 million.

General and administrative expenses

In 2006, general and administrative expenses increased by RR 748 million, or 30.9%, to RR 3,165 million compared to RR 2,417 million in 2005. The main components of these expenses, comprising 77.3% of the total expenses, were payroll, social and charitable, insurance and legal, audit and consulting expenses.

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Payroll expense	1,476	1,004	47.0%
Social and charitable expenses	491	280	75.4%
Legal, audit and consulting expenses	256	233	9.9%
Insurance expense	225	367	(38.7%)
Rent expenses	123	59	108.5%
Other expenses	594	474	25.3%
Total general and administrative expenses	3,165	2,417	30.9%

Payroll expense increased by RR 472 million, or 47.0%, to RR 1,476 million compared to RR 1,004 million in 2005. Additional employees' wages and staff at NOVATEK accounted for RR 378 million, or 80.1%, of the total increase in payroll expense, of which RR 276 million related to increases in staff wages and RR 102 million related to staff additions. In 2006, we initiated an independent review of our employee compensation levels in an effort to bring the Group's total remuneration packages in line with domestic and international peers as part of a broader human resources initiative to attract, retain and motivate employees. The review process is ongoing and will affect payroll expenses in future periods.

Social and charitable expenses increased by RR 211 million, or 75.4%, to RR 491 million compared to RR 280 million in 2005, and were primarily related to our continued support for charities and social programs in the regions where we operate.

Insurance expense decreased by RR 142 million, or 38.7%, to RR 225 million compared to RR 367 million in 2005. The decrease was the result of lower Group insurance rates due to a reduction in claims for accidents and the termination of insurance related to the processing of liquids at the Surgutsky refinery due to the decrease in volumes delivered in 2006.

Legal, audit and consulting expenses increased by RR 23 million, or 9.9%, to RR 256 million compared to RR 233 million in 2005. The increase in 2006 was primarily attributable to a RR 43 million increase in consulting services provided to the Group to increase the effectiveness of our management systems, which was partly offset by a decrease in expenses related to the listing of the Group's shares on the London Stock Exchange in the form of global depositary receipts in 2005.

Rent expenses increased by RR 64 million, or approximately twofold, to RR 123 million as compared to RR 59 million in 2005. The increase in rent expenses was largely attributable to additional office space rented in Moscow and other domestic sites of RR 53 million and for office space used in our international operations of RR 11 million.

Other general and administrative expenses increased by RR 120 million, or 25.3%, compared to 2005. The increase in these items was mainly due to an increase in repair and maintenance expense (primarily expenses related to the establishment of our representative office in London and our trading subsidiaries in Switzerland, as well as repair work in the Moscow offices), fire safety and security, business trips expense and other, which accounted for RR 44 million, RR 23 million, RR 19 million and RR 34 million, respectively of the increase.

Purchases of oil, gas condensate and natural gas

In 2006, our purchases of hydrocarbons decreased by RR 260 million, or 12.6%, to RR 1,805 million in 2006 from RR 2,065 million in 2005 primarily as a result of our disposal of Geoilbent in June 2005.

Profit from operations

As a result of the factors discussed above and excluding the impact of our disposal of Geoilbent and other non-core subsidiaries in the second quarter of 2005, in the amount of RR 3,631 million, our profit from operations increased by RR 3,458 million, or 22.0%, in 2006 compared to 2005. In 2006, our profit from operations as a percentage of total revenues decreased to 39.2% as compared to 50.2% (inclusive of gains on disposals) in 2005.

Finance income (expense)

Total finance expense decreased by RR 698 million, or 95.7%, from a net expense of RR 729 million in 2005 to a net expense of RR 31 million in 2006. The decrease was primarily due to lower interest expense and an increase in foreign exchange gain which was offset by a decrease in interest income in 2006 compared to 2005.

In 2006, interest expense decreased by RR 605 million, or 54.0%, to RR 516 million compared to 2005, primarily due to a reduction in our total debt. The decrease in interest expense was partly offset by a decrease in interest income of RR 398 million, or 59.2%, in 2006, due to the repayment of certain loans provided to related parties in prior periods.

Foreign exchange gain increased by RR 491 million to RR 211 million in 2006, compared to foreign exchange loss in the amount of RR 280 million in 2005. The increase in foreign exchange gain was primarily due to the strengthening of the Russian rouble against the US dollar and Euro and its affect on our foreign currency denominated borrowings which was partially offset by foreign exchange losses recorded on forward contracts described below.

During 2006, the Group entered into short-term foreign currency forward contracts to manage its exposure to foreign currency fluctuations on debt repayment in US dollars. Neither of these contracts qualified for hedge treatment under IAS 39. Under the foreign currency forward contracts, the Group entered into a firm commitment to purchase USD 50 million in exchange for selling Russian roubles in the aggregate amount of RR 1,402 million at expiry. Upon the settlement of the contracts, the Group recognized an aggregate loss of RR 52 million recorded within foreign exchange gain (loss) in the consolidated statement of income. The Group did not have any open positions related to foreign currency instruments at 31 December 2006.

Share of profit of associated companies

In 2006, our share of the net income of associated companies was nil compared to RR 143 million in 2005 as a result of the disposal of our participation interest in Geoilbent in June 2005.

Income tax expense

Our overall consolidated effective income tax rates (total tax expense calculated as a percentage of our reported IFRS profit before income tax and share of net income from associates) were 26.7% and 27.3% for the years ended 31 December 2006 and 2005, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries in Switzerland (beginning 1 January 2006), was 27.2% in 2006. Our effective tax rates in 2006 and 2005 correlate closely with our Russian statutory income tax rate of 24%. The differences between our effective and statutory tax rates are primarily due to certain non-deductible expenses.

Profit for the period and earnings per share

As a result of the factors discussed above, profit for the year increased by 345 million, or 2.5%, to RR 14,007 million in 2006 from RR 13,662 million in 2005. The profit attributable to NOVATEK shareholders increased by RR 382 million, or 2.8%, to RR 14,079 million in 2006 from RR 13,697 million in 2005. Excluding the impact of our disposal of Geoilbent and other non-core subsidiaries net of associated income tax in 2005, profit attributable to NOVATEK shareholders increased by RR 3,068 million, or 27.9%, compared to 2005.

Our weighted average basic and diluted earnings per share (post share split) increased to RR 4.64 per share in 2006 from RR 4.51 per share in 2005. Excluding the impact of one-time disposals of investments, our weighted average basic and diluted earnings per share increased to RR 4.63 per share in 2006 from RR 3.32 per share in 2005. The weighted average number of ordinary shares outstanding during both years adjusted for the effect of the share split was 3,036,306,000.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2006 and 2005:

<i>millions of Russian roubles except ratios</i>	Year ended 31 December:		Change %
	2006	2005	
Net cash provided by operating activities	16,607	10,246	62.1%
Net cash (used for) provided by investing activities	(4,710)	8,983	n/a
Net cash used for financing activities	(9,037)	(19,280)	(53.1%)

<i>Liquidity ratios</i>	31 December 2006	31 December 2005	Change %
Current ratio	3.10	1.14	171.5%
Total debt to equity	0.05	0.16	(71.4%)
Long-term debt to long term debt and equity	0.01	0.02	(48.6%)
Net debt to total capitalization ⁽¹⁾	(0.03)	0.08	n/a

⁽¹⁾ Net debt represents total debt less cash and cash equivalents. Total capitalization represents total debt, total equity and deferred income tax liability.

Net cash provided by operating activities

Net cash provided by operating activities increased by RR 6,361 million, or 62.1%, to RR 16,607 million in 2006 compared to RR 10,246 million in 2005. The increase was mainly attributable to significantly higher operating income from our oil and gas sales as a result of increases in our sales volumes and realized prices in 2006 compared to 2005. We also had positive changes to our working capital balances during the year.

Net cash from investing activities

Net cash flow from investing activities reversed from an inflow in the amount of RR 8,983 million in 2005 to an outflow of RR 4,710 million in 2006 mainly due to the repayment of certain loans provided to related parties and the receipt of proceeds from disposals in 2005.

Net cash from financing activities

Net cash used for financing activities decreased by RR 10,243 million, or 53.1%, to RR 9,037 million in 2006 compared to RR 19,280 million in 2005. The decrease is primarily due to a significant reduction in our borrowings resulting from our ability to fund operating, exploration and development activities from cash generated by operations (see "Debt obligations" below).

Working capital

As of 31 December 2006, our net working capital position (current assets less current liabilities) was RR 10,720 million compared to RR 1,490 million as of 31 December 2005. The strengthening of our working capital position is the result of strong operating results. The increase was mainly due to the growth in cash and cash equivalents and other current assets and a decrease in short-term debt.

Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2006 and 2005 are as follows:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2006	2005	
Exploration and production	4,347	4,990	(12.9%)
Other	356	1,470	(75.8%)
Total	4,703	6,460	(27.2%)

Exploration and production expenditures represent our investments in exploring for and developing our oil and gas properties. During both years capital expenditures in exploration and production were mainly attributable to the further development at our three core fields. During 2006, we spent RR 540 million, RR 1,418 million and RR 1,874 million for field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 265 million on construction of the second phase at the Purovsky Plant.

Debt obligations

As of 31 December 2006, the Group had opened a line of credit facility with Bayerische Hypo- und Vereinsbank AG, CALYON RUSBANK Corporate and Investment Bank and UBS AG with available borrowing capacity of USD 50 million, USD 50 million and USD 100 million, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

During 2006, the Group entered into a USD 100 million loan agreement with BNP PARIBAS Bank, of which RR 1,975 million (USD 75 million) was outstanding at 31 December 2006. The loan agreement bears annual interest rate of LIBOR plus 1 percent (6.3% as of 31 December 2006), and is repayable monthly in equal parts through March 2008.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates, and interest rates. We are exposed to commodity price risk as our crude oil and stable gas condensate destined for export sales are linked to international crude oil prices. We are exposed to foreign exchange risk to the extent that our sales revenues, costs, receivables, loans and debt are denominated in currencies other than Russian roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. From time to time we may use derivative instruments, such as commodity forward contracts, commodity price swaps, commodity options, foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks, and we may hold or issue derivative or other financial instruments for trading purposes.

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar and Euro. As of 31 December 2006, RR 1,975 million, or 74.2%, of our long-term debt was denominated in US dollars (out of RR 3,108 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, approximately 30.5% in 2006, is denominated in US dollars. As of 31 December 2006, the Russian rouble had strengthened against the US dollar by approximately 8.5% since 1 January 2006.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the U.S. dollar as of 31 December 2006 would have resulted in an estimated foreign exchange gain of approximately RR 242 million on foreign currency denominated borrowings held at that date.

Commodity risk

Substantially all of our crude oil, stable gas condensate and LPG export sales are sold under spot contracts. Our export prices are linked to international crude oil prices. External factors such as geopolitical developments, natural disasters and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

The weather is another factor affecting demand for and, therefore, the price of natural gas. Changes in weather conditions from year to year can influence demand for natural gas and to some extent gas condensate and oil products.

From time to time we may employ derivative instruments to mitigate the price risk of our sales activities. In our financial statements all derivative instruments are recorded at their fair values. Unrealized gains or losses on derivative instruments are recognized within other income (loss), unless the underlying arrangement qualifies as a hedge.

Pipeline access

We transport substantially all of our natural gas through the Gazprom owned UGSS. Gazprom is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia. Under existing legislation, Gazprom must provide access to the UGSS to all independent suppliers on a non-discriminatory basis provided there is capacity not being used by Gazprom. In practice, however, Gazprom exercises considerable discretion over access to the UGSS because it is the sole owner of information relating to capacity. There can be no assurance that Gazprom will continue to provide us with access to the UGSS, however, we have not been denied access in prior periods.

Ability to reinvest

Our business requires significant ongoing capital expenditures in order to grow our production. An extended period of low natural gas prices or high transportation tariffs would limit our ability to maintain an adequate level of capital expenditures, which in turn could limit our ability to increase or maintain current levels of production and deliveries of natural gas, gas condensate, crude oil and other associated products, adversely affecting our results.

Off balance sheet activities

As of 31 December 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically founded for the purpose of facilitating off-balance sheet arrangements.