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 2007 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2007 and 2006. 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 "we" or 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 and processing of natural gas, gas condensate, crude oil and related oil products have been conducted primarily within the Russian Federation. We sell our natural gas volumes exclusively in the Russian domestic market. We export our stable gas condensate directly to international markets while liquefied petroleum gas and crude oil are generally delivered to both international (including CIS) and domestic markets. We generally sell our oil products produced from our unstable gas condensate on the domestic market. We began limited commercial trading operations in September 2007 through our wholly-owned Swiss-based trading subsidiary, RUNITEK, by primarily purchasing and reselling refined products, on the international markets.

In September 2007, we acquired a 50 percent working interest in the Concession Agreement for Gas and Crude Oil Exploration and Exploitation in El Arish Offshore Area (hereinafter referred to as the "Concession Agreement") in the Arab Republic of Egypt. The remaining working interest is held by Tharwa Petroleum S.A.E. Pursuant to the Concession Agreement, we are committed to spend a minimum of USD 40 million on various exploration activities during the initial exploration period of four years. We will continue to evaluate exploration and production opportunities outside of the Russian Federation as a way to diversify our business operations.

During the year, we discovered three new fields – North Khancheyskoye, Yarudeyskoye, and Radyzhnoye.

SELECTED DATA

millions of Russian roubles except as stated	Year ended 31 December: 2007	2006	Change %
Financial results			
Total revenues (net of VAT and export duties)	62,321	49,373	26.2%
Operating expenses	(37,066)	(30,081)	23.2%
Profit attributable to NOVATEK shareholders	18,736	14,079	33.1%
EBITDA [(1)]	29,283	23,129	26.6%
Earnings per share (in Russian roubles)	6.17	4.64	33.0%
Operating results			
Natural gas sales volumes (mmcm)	32,054	30,308	5.8%
Stable gas condensate sales volumes (thousand tons)	1,508	1,358	11.0%
Liquefied petroleum gas sales volumes (thousand tons)	554	505	9.7%
Crude oil sales volumes (thousand tons)	269	305	(11.8%)
Oil product sales volumes (thousand tons)	73	81	(9.9%)
Cash flow results			
Net cash provided by operating activities	21,383	16,938	26.2%
Capital expenditures	19,466	4,703	313.9%

[(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.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

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), a governmental agency. In 2007, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 164 per mcm, or 14.8%, to RR 1,274 per mcm compared to RR 1,110 per mcm in 2006. 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 realize higher prices and net margins for natural gas volumes sold directly to the end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. During 2007, 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 22 per mcm, or 30.1%, compared to 2006 as a result of higher average realized prices to end-customers (see "Natural gas sales" below).

In November 2006, the FTS published it guidelines for raising the regulated natural gas prices in Russia for the years 2008, 2009 and 2010 based on an approved governmental protocol. Effective 1 January 2008, the FTS approved a 25% increase in the regulated price of natural gas for the year 2008. As part of this program, the FTS announced the expected percentage increases in the regulated natural prices for 2009 and 2010 at 13% and 13%, respectively, on the 1 January and 1 July of each year. The FTS approves the effective increase on an annual basis and reserves the right to modify the percentages published based on market conditions and other factors.

The following table shows our average realized natural gas sales prices (net of VAT) for the years ended 31 December 2007 and 2006:

	Year ended 31 December:		**Change**
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to end-customers [(1)]	1,505	1,253	20.1%
Gas transportation expense for sales to end-customers	631	516	22.3%
Average natural gas netback price on end-customer sales	874	737	18.6%
Average natural gas price ex-field (wholesale traders)	779	664	17.3%
Average netback margin differential	95	73	30.1%

[(1)] Includes cost of transportation.

In November 2006, we started participating in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. Our average natural gas netback price on electronic trading (e-trading) sales exceeded the average natural gas netback price on end-customers sales by 24.3% in 2007 and 22.0% in 2006 as shown in the table below:

	Year ended 31 December:		**Change**
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to customers on e-trading sales [(1)]	1,193	991	20.4%
Gas transportation expense on e-trading sales	107	92	16.3%
Average natural gas netback on e-trading sales	1,086	899	20.8%

[(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 stable gas condensate, LPG (excluding obligatory domestic deliveries at regulated prices) and oil products prices at both international and domestic markets, as well as crude oil prices at international markets include transportation expense in accordance with the terms of delivery. Delivery terms for our crude oil and obligatory LPG domestic sales are such that the buyer takes ownership at the point of loading or at the entrance to the trunk pipeline and is responsible for the transportation expense to the final destination.

In 2007, as well as in 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). Our average export stable gas condensate contract price, including export duties, in 2007 was approximately USD 646 per ton compared to approximately USD 573 per ton in 2006.

In 2007, as well as in 2006, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany). In 2007, our average crude oil export contract price, including export duties, was approximately USD 491 per ton compared to USD 414 per ton in 2006. In addition, in 2006, our foreign subsidiary purchased and resold 27 thousand tons of crude oil 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.

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 2007 and 2006:

Russian roubles (RR) or US dollars (USD) per ton	**Year ended 31 December: 2007**	**2006**	**Change %**
Stable gas condensate			
Net export price, RR per ton	11,353	10,143	11.9%
Net export price, USD per ton	443.9	373.1	19.0%
Domestic price, RR per ton	8,464	8,182	3.4%
Crude oil			
Net export price, RR per ton	7,225	7,107	1.7%
Net export price, USD per ton	282.5	261.4	8.1%
Domestic price, RR per ton [(1)]	6,039	5,993	0.8%

[(1)] Net of transportation costs.

Our LPG export and CIS delivery terms during 2007 were delivery at frontier (DAF) at the border of the customer's country. In 2007, our average export LPG contract price, including export duties, was approximately USD 605 per ton compared to USD 548 per ton in 2006. We are obliged to sell a portion of our LPG volumes at regulated prices while the remaining portion of our sales are sold under commercial terms. In 2007, we sold 42 thousand tons at the regulated price of RR 3,500 per ton and 380 thousand tons at a commercial price of RR 8,750 per ton in the domestic market, compared to 40 thousand tons at RR 1,697 per ton and 370 thousand tons at RR 7,592 per ton, respectively, in 2006.

Domestic sales of oil products associated with our own production were priced free carrier (FCA) at the Surgut railroad station (located in the Khanty-Mansiysk Autonomous Region). In 2007, our foreign trading subsidiary purchased from third parties approximately 33 thousand tons of naphtha which were resold to the US and European markets at an average contract price USD 819 per ton. The delivery terms for these volumes were delivery to the port of destination ex-ship (DES Houston, USA) and free on board (FOB, Vitino). There were no applicable export duties on these sales.

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 2007 and 2006 (excluding foreign trading activities):

	Year ended 31 December:		Change
Russian roubles (RR) or US dollars (USD) per ton	**2007**	**2006**	**%**
LPG			
Net export price, RR per ton	11,535	10,970	5.2%
Net export price, USD per ton	451.0	403.5	11.8%
CIS price, RR per ton	10,264	8,538	20.2%
Domestic price, RR per ton	8,231	7,014	17.4%
Oil products			
Domestic price, RR per ton	7,358	6,174	19.2%

Transportation tariffs

In the first seven months of 2006, the transportation tariff set by the FTS (effective 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) was RR 23.84 (excluding VAT) per mcm per 100 km.

Starting from 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 effective from 1 March 2007 is RR 1,061.51 (excluding VAT) per mcm) and includes a constant rate of RR 13.8 (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 using non-Gazprom 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 was set at RR 6.07 (excluding VAT) per mcm per 100 km.

The increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts. 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 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, European and South American markets. The costs associated with the transportation of stable gas condensate by tanker are determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

Transactions with related parties

All natural gas producers and wholesalers operating in Russia transport their natural gas volumes through the Unified Gas Supply System (UGSS), which is owned and operated by OAO Gazprom, a State monopoly and a shareholder of OAO NOVATEK from October 2006. As an independent natural gas producer, we utilize the UGSS to transport natural gas to end-customers at the tariff established by the FTS

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 precedes 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 in our consolidated financial statements as of and for the years ended 31 December 2007 and 2006. 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 and Russian roubles per boe:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	3,057	2,518	21.4%
Long-term supply purchases	3,242	1,805	79.6%
Taxes other than income tax	6,222	6,019	3.4%
Transportation expenses	14,358	11,342	26.6%
Total production costs before DD&A	**26,879**	**21,684**	**24.0%**
Depreciation, depletion and amortization (DD&A)	3,446	3,466	(0.6%)
Total production costs	**30,325**	**25,150**	**20.6%**

USD/boe	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	0.58	0.45	28.9%
Long-term supply purchases	6.03	3.74	61.2%
Taxes other than income tax	1.19	1.07	11.2%
Transportation expenses	2.49	1.86	33.9%
Total production costs before DD&A	**4.66**	**3.56**	**30.9%**
Depreciation, depletion and amortization (DD&A)	0.66	0.62	6.5%
Total production costs	**5.26**	**4.13**	**27.4%**

RR/boe	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	14.9	12.2	22.1%
Long-term supply purchases	154.2	101.7	51.6%
Taxes other than income tax	30.4	29.2	4.1%
Transportation expenses	63.7	50.6	25.9%
Total production costs before DD&A	**119.2**	**96.8**	**23.1%**
Depreciation, depletion and amortization (DD&A)	16.8	16.8	0.0%
Total production costs	**134.4**	**112.3**	**19.7%**

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

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to an increase in purchases from the third parties and natural gas withdrawal from the underground gas storage facilities. Our liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) also increased in 2007 primarily due to a one-time stable gas condensate inventory buildup in 2006 which was related to a change in export delivery terms for this product.

Natural gas sales volumes

	Year ended 31 December:		Change
millions of cubic meters	**2007**	**2006**	**%**
Production from:			
Yurkharovskoye field	9,554	9,538	0.2%
East-Tarkosalinskoye field	14,468	15,735	(8.1%)
Khancheyskoye field	4,196	3,277	28.0%
Other fields	32	28	14.3%
Total natural gas production	**28,250**	**28,578**	**(1.1%)**
Purchases from:			
Gazprom	1,973	2,054	(3.9%)
Other	1,166	529	120.4%
Total natural gas purchases	**3,139**	**2,583**	**21.5%**
Total production and purchases	**31,389**	**31,161**	**0.7%**
Purovsky Plant and own usage	(34)	(36)	(5.6%)
Decrease (increase) in pipeline and underground gas storage facilities	699	(817)	n/m
Total natural gas sales volumes	**32,054**	**30,308**	**5.8%**
sold to end-customers	*14,277*	*13,433*	*6.3%*
e-trading sales	*661*	*10*	*n/m*
Subtotal sales treated as to end-customers	*14,938*	*13,443*	*11.1%*
Sold ex-field	*17,116*	*16,865*	*1.5%*

In 2007, our total consolidated natural gas production decreased by 328 mmcm, or 1.1%, compared to 2006. The decrease in production was due to a temporary reduction in production of dry Cenomanian gas mainly at our East-Tarkosalinskoye field as a result of our inability to inject natural gas into storage due to the lack of available capacity at Gazprom’s underground gas storage facilities. During the year, however, we increased our natural gas production capacity at the Khancheyskoye field due to the commissioning of the field’s second phase of development.

The unseasonably warm winter weather in Western, Central and Eastern Europe resulted in decreased export deliveries of natural gas from Gazprom, which directly affected the normal seasonal withdrawal of natural gas from underground storage facilities. As a result, due to the overfilled underground storage system we did not have the ability to produce and inject our planned natural gas volumes in the 2007.

At 31 December 2007, our cumulative natural gas volumes stored in Gazprom’s underground gas storage facilities totaled 40 mmcm compared to 1,000 mmcm at 31 December 2006. We expect our volumes of natural gas injected into underground gas storage facilities to continue fluctuating period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

Despite the warmest winter in Russia over the past 126 years, base natural gas demand on the domestic market remained reasonably robust. In 2007, we increased our purchases of natural gas from “other” suppliers by 556 mmcm, or 21.5%, as compared to 2006 largely due to meet increased market demand.

Liquids sales volumes

thousands of tons	Year ended 31 December: 2007	2006	Change %
Production from:			
Yurkharovskoye field	698	671	4.0%
East-Tarkosalinskoye field	892	853	4.6%
Khancheyskoye field	710	712	(0.3%)
Other fields	100	108	(7.4%)
Total liquids production	**2,400**	**2,344**	**2.4%**
Purchases from:			
Purgazdobycha	16	78	(79.5%)
Other	40	27	48.1%
Total liquids purchases	**56**	**105**	**(46.7%)**
Total production and purchases	**2,456**	**2,449**	**0.3%**
Losses [(1)]	(20)	(21)	(4.8%)
Decreases (increases) in liquids inventory balances	(32)	(179)	(82.1%)
Total liquids sales volumes	**2,404**	**2,249**	**6.9%**
Stable gas condensate export	*1,505*	*1,355*	*11.1%*
Stable gas condensate domestic	*3*	*3*	*0.0%*
LPG export	*77*	*41*	*87.8%*
LPG CIS	*55*	*54*	*1.9%*
LPG domestic	*422*	*410*	*2.9%*
Crude oil export	*109*	*98*	*11.2%*
Crude oil domestic	*160*	*207*	*(22.7%)*
Oil products export	*33*	*-*	*n/m*
Oil products domestic	*40*	*81*	*(50.6%)*

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

In 2007, our gas condensate and crude oil production increased by 56 thousand tons, or 2.4%, to 2,400 thousand tons compared to 2,344 thousand tons in 2006. The higher gas condensate yields from the East-Tarkosalinskoye field were due to changes in the technical parameters of the gas separation process resulting from the start-up of a new compressor station on the field as well as organic growth in gas condensate production combined with a higher proportion liquid concentration in the gas production at the Yurkharovskoye field.

At 31 December 2007, we had 224 thousand tons of stable gas condensate in transit or storage and recognized as inventory until such time as it is delivered to the port of destination as compared to 190 thousand tons as of 31 December 2006. Our stable gas condensate in transit or storage and recognized as inventory was increased by 34 thousand tons as at 31 December 2007 as compared to the inventory balance at 1 January 2007. At 31 December 2006, our inventory balance of stable gas condensate increased by 179 thousand tons. The remaining change in liquids inventory balances related to changes in other liquid products.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2007 COMPARED TO THE YEAR ENDED 31 DECEMBER 2006

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2007 and 2006. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Total revenues (net of VAT and export duties)	62,321	*100.0%*	49,373	*100.0%*
including:				
natural gas sales	35,605	*57.1%*	28,048	*56.8%*
liquids sales	24,752	*39.7%*	19,999	*40.5%*
Other income (loss)	110	*0.2%*	(139)	*(0.3%)*
Total revenues and other income	**62,431**	***100.2%***	**49,234**	***99.7%***
Operating expenses	(37,066)	*(59.5%)*	(30,081)	*(60.9%)*
Profit from operations	**25,365**	***40.7%***	**19,153**	***38.8%***
Finance income (expense)	124	*0.2%*	(31)	*(0.1%)*
Profit before income tax and minority interest	**25,489**	***40.9%***	**19,122**	***38.7%***
Total income tax expense	(6,761)	*(10.8%)*	(5,115)	*(10.4%)*
Profit for the period	**18,728**	***30.1%***	**14,007**	***28.4%***
Minority interest	8	*n/m*	72	*0.1%*
Profit attributable to NOVATEK shareholders	**18,736**	***30.1%***	**14,079**	***28.5%***

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 2007 and 2006:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Natural gas sales	**35,605**	**28,048**	**26.9%**
End-customer	*21,483*	*16,838*	*27.6%*
E-trading	*788*	*10*	*n/m*
Ex-field	*13,334*	*11,200*	*19.1%*
Stable gas condensate sales	**17,106**	**13,768**	**24.2%**
Export	*17,082*	*13,742*	*24.3%*
Domestic	*24*	*26*	*(7.7%)*
Liquefied petroleum gas sales	**4,926**	**3,804**	**29.5%**
Export	*884*	*455*	*94.3%*
CIS	*569*	*465*	*22.4%*
Domestic	*3,473*	*2,884*	*20.4%*
Crude oil sales	**1,753**	**1,928**	**(9.1%)**
Export	*784*	*695*	*12.8%*
Domestic	*969*	*1,233*	*(21.4%)*
Oil products sales	**967**	**499**	**93.8%**
Export	*674*	*-*	*n/m*
Domestic	*293*	*499*	*(41.3%)*
Total oil and gas sales	**60,357**	**48,047**	**25.6%**
Sales of polymer and insulation tape	1,602	1,109	44.5%
Other revenues	362	217	66.8%
Total revenues	**62,321**	**49,373**	**26.2%**
Other income (loss)	110	(139)	n/m
Total revenues and other income	**62,431**	**49,234**	**26.8%**

Natural gas sales

In 2007, our revenues from sales of natural gas increased by RR 7,557 million, or 26.9%, compared to 2006. The increase in natural gas revenues was primarily attributable to an overall increase in prices and to a lesser extent an increase in sales volumes. Revenues from the sale of natural gas accounted for 57.1% and 56.8% of our total revenues in 2007 and 2006, respectively. The marginal increase in natural gas sales as a percentage of total revenues was primarily due to a decrease in crude oil volumes sold.

In 2007, our average realized natural gas price per mcm increased by RR 186 per mcm, or 20.1%, to RR 1,111 per mcm from RR 925 per mcm in 2006. Our proportion of natural gas sold to end-customers, including e-trading sales, on a volume basis, increased from 44.4% in 2006 to 46.6% in 2007 due to an increase in sales at electronic trading system. The average realized prices of our natural gas sold directly to end-customers, at the electronic trading system and natural gas sold ex-field were higher by 20.1%, 20.4% and 17.3%, respectively, in 2007 compared to 2006. Our sales of natural gas to end-customers were primarily to energy utilities and large industrial companies in both periods.

In November 2006, we started participating in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. In 2007, we sold 661 mmcm of natural gas at an average price of RR 1,193 per mcm (netback price RR 1,086 per mcm). These sales were primarily to energy utility companies and are recorded in our end-customer volumes and average end-customer price.

Effective 1 January 2008, the expected volumes to be sold on the electronic gas exchange will be increased from five billion cubic meters each (Independent gas producers and Gazprom) to 7.5 billion cubic meters each. We continue to view the success of electronic trading of natural gas as a positive development in the domestic natural gas market.

Stable gas condensate sales

In 2007, our revenues from sales of stable gas condensate increased by RR 3,338 million, or 24.2%, compared to 2006 due to an increase in both export contract prices and export sales volumes.

In 2007, we increased our export sales volumes of stable gas condensate to the US, European and South American markets by 150 thousand tons, or 11.1%, to 1,505 thousand tons as compared to 1,355 thousand tons exported in 2006. We deliver stable gas condensate to the international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers. The increase was due to sales of stable gas condensate balance in transit or storage recognized as inventory at 31 December 2006. In 2007, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market increased by USD 70.8 per ton, or 19.0%, to USD 443.9 per ton (DES and CFR) from USD 373.1 per ton (DES and CFR) in 2006. The increase in the average realized export price was the result of a 12.7% increase in our average export contract price that was partially offset by a 1.9% increase in our average export duty per ton. The increase in our average realized contract prices was due to the overall increase in prices on international markets in 2007. The average domestic price for stable gas condensate increased by RR 282 per ton, or 3.4%, in 2007 compared to 2006 due to the strengthening of prices on the domestic market.

Liquefied petroleum gas sales

In 2007, our revenues from the sales of LPG increased by RR 1,122 million, or 29.5%, compared to 2006, primarily due to an increase in domestic prices and to a lesser extent an increase in export volumes.

In 2007, we increased our sales volumes of LPG by 49 thousand tons, or 9.1%, to 554 thousand tons mainly due to an increase in throughput at our Purovsky Plant, of which 76.2% of LPG volumes was sold domestically for an average price of RR 8,231 per ton (FCA excluding VAT); an increase of RR 1,217 per ton, or 17.4%, compared to 2006. The remaining volumes of LPG were sold as follows: 13.9% was sold to the export market for an average price of USD 451.0 per ton (DAF excluding export duties) representing an increase of USD 47.5 per ton, or 11.8%, compared to 2006; and 9.9% was sold in the CIS for an average price of RR 10,264 per ton (DAF excluding VAT) representing an increase of RR 1,726 per ton, or 20.2%, compared to 2006. The increase in our average realized export prices (excluding export duties) was primarily due to an increase in our average contract prices by 10.3% that was partially offset by a 4.6% increase in our average export duty per ton in the 2007.

In 2006, 81.2%, 8.1% and 10.7% of LPG volumes were sold on domestic markets, export markets and in the CIS, respectively. LPG volumes sold on the export market was primarily due to a better pricing market on the international markets during 2007.

Crude oil sales

In 2007, our revenues from the sales of crude oil decreased by RR 175 million, or 9.1%, compared to 2006, due to a reduction in volumes sold on the domestic market. The decrease in crude oil volumes available for sale by 36 thousand tons from 305 thousand tons in 2006 to 269 thousand tons in 2007, or 11.8%, was mainly attributable to a decrease in unstable gas condensate deliveries to the Surgutsky refinery due to 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).

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 21.1 per ton, or 8.1%, to USD 282.5 per ton (DAF) in 2007 compared to USD 261.4 per ton (DAF) in 2006. If we exclude the effect from sales of crude oil by our foreign trading subsidiary in 2006, 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 58.2 per ton, or 25.9%, to USD 282.5 per ton (DAF) in 2007 compared to USD 224.3 per ton (DAF) in 2006. The increase in the average realized export price was the result of a 13.4% increase in our average export contract price and to a lesser extent due to a 0.7% decrease in our average export duty per ton. The increase in our average realized contract prices was due to the overall increase in prices on international markets in 2007.

Our average realized crude oil domestic sales price (excluding VAT) marginally increased by RR 46 per ton, or 0.8%, to RR 6,039 per ton in 2007, compared to RR 5,993 per ton in 2006.

Oil products sales

In 2007, our revenue from the sales of oil products increased by RR 468 million, or 93.8%, compared to 2006, primarily due to the initiation of oil products trading on international markets by our foreign trading subsidiary.

During the year we purchased 37 thousand tons of oil products and resold 33 thousand tons to customers in the US and Europe for an average contract price of USD 819 per ton (terms DES and FOB). The remaining 4 thousand tons were recorded as "goods in transit" in inventories until such time as they are delivered to the port of destination.

Our domestic oil products sales volumes decreased by 41 thousand tons, or 50.6%, to 40 thousand tons in 2007 from 81 thousand tons in 2006. The decrease was mainly due to the migration of processing of our unstable gas condensate from the Surgutsky refinery to the Purovsky Plant, which resulted in a decrease in the output of oil products available for sale.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 493 million, or 44.5%, to RR 1,602 million in 2007, compared to RR 1,109 million in 2006 due to an increase in BOPP film wrap and certain pipes insulation products. Revenues from our sales of BOPP film wrap increased by RR 276 million from RR 491 million in 2006 to RR 767 million in 2007 due to a more efficient utilization of the facilities which increased the volumes available for sale. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 3.6% to 47.9% in 2007 compared to 44.3% in 2006.

Our revenues from pipe insulation products sales increased by RR 181 million from RR 369 million in 2006 to RR 550 million in 2007 mainly due to an increase in new regional customers and a corresponding increase in volumes sold.

Other revenues

Other revenues include rent, polymer tolling, transportation, handling, storage and other services. In 2007, other revenues increased by RR 145 million, or 66.8%, to RR 362 million from RR 217 million in 2006. The increase in other revenues was primarily due to an increase in transportation, handling and storage services which accounted for RR 128 million of other revenues in 2007 compared to RR 37 million in 2006 and an increase in geological and geophysical research provided to our associates from RR 32 million in 2006 to RR 56 million in 2007. In 2007, revenues from tolling and rent services increased marginally by RR 5 million and RR 7 million to RR 82 million and RR 57 million, respectively.

Other income (loss)

In 2007, we realized other income of RR 110 million, of which RR 95 million related to sale of our non-core subsidiary, Geolog Yamala. In 2006, we realized other loss of RR 83 million relating to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). The remaining other loss of RR 56 million related to disposals of fixed assets, equipment and materials.

Operating expenses

In 2007, total operating expenses increased by RR 6,985 million, or 23.2%, to RR 37,066 million compared to RR 30,081 million in 2006, largely due to increases in transportation costs, purchases of oil, gas condensate and natural gas, and an increase in materials, services and other. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased in 2007 by 2.5% to 56.0% compared to 58.5% in 2006. Total operating expenses decreased as a percentage of total revenues to 59.5% in the 2007 compared to 60.9% in 2006, as shown in the table below.

	Year ended 31 December:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Transportation expenses	14,372	*23.1%*	11,362	*23.0%*
Taxes other than income tax	6,379	*10.2%*	6,223	*12.6%*
Materials, services and other	4,924	*7.9%*	3,893	*7.9%*
General and administrative expenses	3,873	*6.2%*	3,165	*6.4%*
Depreciation, depletion and amortization	3,668	*5.9%*	3,671	*7.4%*
Purchases of oil, gas condensate and natural gas	3,242	*5.2%*	1,805	*3.7%*
Exploration expenses	486	*0.8%*	459	*0.9%*
Net impairment expense	153	*0.2%*	100	*0.2%*
Change in inventory	(31)	*0.0%*	(597)	*(1.2%)*
Total operating expenses	**37,066**	***59.5%***	**30,081**	***60.9%***

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 2007, non-controllable expenses of transportation and taxes other than income tax increased by RR 3,166 million, or 18.0%, to RR 20,751 million from RR 17,585 million in 2006. The increase was primarily due to an increase in the transportation tariff for natural gas and a combined increase in the transportation tariffs and volumes sold for liquids. There were marginal changes in taxes other than income between the reporting dates. As a percentage of total revenues, our non-controllable expenses decreased by 2.3% to 33.3% in the 2007 compared to 35.6% in 2006.

Transportation expenses

Our total transportation expenses in 2007 increased by RR 3,010 million, or 26.5%, compared to 2006.

	Year ended 31 December:		Change
millions of Russian roubles	**2007**	**2006**	**%**
Natural gas transportation to customers	9,077	6,934	30.9%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	3,376	2,753	22.6%
Stable gas condensate transported by tankers	1,690	1,484	13.9%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	115	78	47.4%
Crude oil transportation to customers	78	93	(16.1%)
Other transportation costs	36	20	80.0%
Total transportation expenses	**14,372**	**11,362**	**26.5%**

In 2007, our transportation expense for natural gas increased by RR 2,143 million, or 30.9% to RR 9,077 million from RR 6,934 million in 2006. The increase was mainly due to higher transportation tariffs effective from 1 March 2007 (see “Transportation tariffs” above) and to a lesser extent due an 11.1% increase in our sales volumes of natural gas sold directly to end-customers and via the electronic trading system, where the cost of transportation is included in the sales price. 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. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period.

In 2007, our total expenses for transportation by rail increased by RR 623 million, or 22.6%, due to higher railroad transportation tariffs and volumes sold during the year. During 2007, our combined volumes of stable gas condensate, LPG and oil products sold and transported via rail increased by 158 thousand tons, or 8.1%, to 2,102 thousand tons from 1,944 thousand tons in 2006.

Our expense for stable gas condensate transported by rail to international markets increased by RR 366 million, or 21.1%, from RR 1,737 million to RR 2,103 million, or from RR 1,282 per ton in 2006 to RR 1,398 per ton in 2007. The increase in the transportation rate per ton was primarily due to a tariff increase of approximately 12.7% in January 2007.

In 2007, our expense for LPG transported by rail amounted to RR 1,250 million, of which RR 381 million was related to export sales, RR 133 million to CIS sales, and RR 736 million to domestic sales, or RR 4,971 per ton, RR 2,391 per ton, and RR 1,745 per ton, respectively. In 2006, transportation expenses for LPG amounted to RR 989 million, of which RR 225 million was related to export sales, RR 121 million to CIS sales, and RR 643 million to domestic sales, or RR 5,432 per ton, RR 2,220 per ton and RR 1,564 per ton, respectively. Our LPG rail transportation expense in 2007 was also affected by an increase in transportation tariffs which was partially offset by shorter distances for deliveries of LPG to export markets.

The remaining RR 23 million of the transportation expenses by rail in 2007 and RR 27 million in 2006 were related to the transportation of oil products and other railroad services not allocated between products.

Total transportation expense for delivery of stable gas condensate by tanker to international markets increased by RR 206 million, or 13.9%, from RR 1,484 million in 2006 to RR 1,690 million in 2007. The change was primarily due to an 11.1% increase in stable gas condensate volumes sold and higher average freight rates primarily due to an increase in the average delivery distance to international markets. In 2007, the percentage of stable gas condensate export volumes delivered to the US market increased by 6.2% to 70.8% of total volumes delivered compared to 64.6% in 2006.

Taxes other than income tax

millions of Russian roubles	**Year ended 31 December: 2007**	**2006**	**Change %**
Unified natural resources production tax (UPT)	5,703	5,556	2.6%
Property tax	544	483	12.6%
Other taxes	132	184	(28.3%)
Total taxes other than income tax	**6,379**	**6,223**	**2.5%**

In 2007, taxes other than income tax increased by RR 156 million, or 2.5%, of which RR 147 million and RR 61 million was due to UPT and property tax increase, respectively, that was partially offset by a decrease in other taxes.

Our increase in UPT of 2.6%, or RR 147 million, was largely attributable to higher mineral production taxes for crude oil of RR 110 million. During the year, we increased our volumes of crude oil produced by 11.3% and also incurred an increase in our crude oil production tax rate by 10.4%. The remaining balance related to an increase in our gas condensate UPT expense of RR 77 million, which was partially offset by a decrease in natural gas UPT expense for RR 40 million. The reduction in our natural gas UPT expense resulted from a decrease in natural gas production.

In 2007, our property tax expense increased by RR 61 million, or 12.6%, to RR 544 million compared to RR 483 million in 2006. The increase was primarily due to additions of property, plant and equipment (“PPE”) at NOVATEK-YURKHAROVNEFTEGAS, which accounted for RR 42 million of the tax increase, and additions of PPE at other companies in the Group, resulting in an additional RR 19 million in property tax increase.

Materials, services and other

In 2007, our materials, services and other expenses increased by RR 1,031 million, or 26.5%, to RR 4,924 million compared to RR 3,893 million in 2006. The main components of this expense were employee compensation and materials and supplies expense, which comprised 38.5% and 30.9%, respectively, of total materials, services and other expenses in 2007.

millions of Russian roubles	**Year ended 31 December:**		**Change**
	2007	**2006**	**%**
Employee compensation	1,897	1,351	40.4%
Materials and supplies	1,521	1,219	24.8%
Repair and maintenance services	367	333	10.2%
Fire safety and security expense	263	254	3.5%
Electricity and fuel	216	192	12.5%
Tolling and processing fees	213	226	(5.8%)
Other	447	318	40.6%
Total materials, services and other	**4,924**	**3,893**	**26.5%**

Employee compensation increased by RR 546 million, or 40.4%, to RR 1,897 million compared to RR 1,351 million in 2006. The increase was due to additional bonuses and an increase in wages at our production entities, which resulted in an additional RR 364 million in employee compensation in 2007. In 2007, we increased staff at NOVATEK-YURKHAROVNEFTEGAS, our production subsidiary, resulting in an employee compensation increase of RR 75 million. We also recorded an additional RR 106 million of employee compensation related to the accrual of pension obligations due to the implementation of a post-employment benefit program in February 2007.

Materials and supplies expense increased by RR 302 million, or 24.8%, mainly due to an increase in production of polymers and insulation tape products and the associated increase in purchases of raw materials.

Our increase in repair and maintenance expenses by RR 34 million, or 10.2%, from RR 333 million in 2006 to RR 367 million in 2007 was primarily related to repair works at the Purovsky Plant. Fire safety and security expenses increased by RR 9 million, or 3.5%, to RR 263 million from RR 254 million in 2006, and was primarily related to ongoing fire safety activities at our field sites.

We incurred an increase in our average electricity tariff mainly at our production entities which increased our electricity and fuel expenses by RR 24 million, or 12.5%, during 2007. Our tolling and processing services expense decreased by RR 37 million due to reduced volumes of unstable gas condensate sent to the Surgutsky refinery in 2007. The decrease was partially offset by an increase in services related to the de-ethanization of unstable gas condensate produced at the Yurkharovskoye field by RR 24 million due to an increase in both processing tariffs and volumes processed.

Other expenses include rent expenses, transport of raw materials, telecommunication services, and miscellaneous operating expenses. Other expenses increased by RR 129 million, or 40.6%, in 2007 compared to 2006 mainly due to increases in transport and rent expenses of RR 46 million and RR 24 million, respectively.

General and administrative expenses

In 2007, our general and administrative expenses increased by RR 708 million, or 22.4%, to RR 3,873 million compared to RR 3,165 million in 2006. The main components of these expenses were employee compensation, maintenance of social infrastructure and charitable contributions, legal, audit, and consulting services which, on aggregate comprised 75.5% and 70.2% of total general and administrative expenses for the 2007 and 2006, respectively.

millions of Russian roubles	**Year ended 31 December: 2007**	**2006**	**Change %**
Employee compensation	1,961	1,476	32.9%
Maintenance of social infrastructure and charitable contributions	559	491	13.8%
Legal, audit, and consulting services	404	256	57.8%
Rent expense	146	123	18.7%
Insurance expense	117	225	(48.0%)
Other	686	594	15.5%
Total general and administrative expenses	**3,873**	**3,165**	**22.4%**

Employee compensation increased by RR 485 million, or 32.9%, to RR 1,961 million compared to RR 1,476 million in 2006. Additional employees' wages and staff at NOVATEK accounted for RR 219 million, or 45.2%, of the total increase in employee compensation, of which RR 88 million related to increases in staff wages and RR 131 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. In 2007, we accrued pension obligations in the amount of RR 110 million.

Maintenance of social infrastructure and charitable contributions increased by RR 68 million, or 13.8%, to RR 559 million compared to RR 491 million in 2006, and were primarily related to our continued support for charities and social programs in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 148 million, or 57.8%, to RR 404 million compared to RR 256 million in 2006. The increase was primarily due to consulting services related to our information technology systems updates and management efficiency programs improvements.

Throughout the year, we engaged our external independent auditors, ZAO "PricewaterhouseCoopers Audit" ("PwC"), to provide various types of professional services to the Group. Audit related fees paid to PwC for the audit of the Group's consolidated financial statements and the statutory audit of the Parent company totaled RR 28 million in both 2007 and 2006. In addition, we paid fees to PwC for non-audit services, mainly tax related work, in the amount of RR 3 million in 2007 and RR 1 million in 2006.

In 2007, rent expense increased by RR 23 million, or 18.7%, to RR 146 million as compared to RR 123 million in 2006. The increase in rent expense was mainly attributable to a general increase in rental rates and additional office space rented in Moscow.

Insurance expense decreased by RR 108 million, or 48.0%, to RR 117 million compared to RR 225 million in 2006. The decrease was primarily due to lower Group insurance rates due to a reduction in claims for accidents and a re-assessment of items to be insured.

Other general and administrative expenses increased by RR 92 million, or 15.5%, in 2007 as compared to 2006 mostly due to an increase in fire safety and security expenses and business trips expenses, which accounted for RR 38 million and RR 33 million, respectively, of the increase.

Depreciation, depletion and amortization

In 2007, our depreciation, depletion and amortization ("DDA") expense decreased by RR 3 million, or 0.1%, compared to 2006. The decrease was primarily due to lower production levels which decreased depletion of our oil and gas properties. Associated depletion of oil and gas properties decreased by RR 19 million, or 0.6%, compared to 2006. In 2007 as well as in 2006, our DDA per barrel of oil equivalent (boe) was RR 15.7 per boe. The decrease in our depreciation expense accrued using the "units of production" method was partially offset by an increase in straight-line depreciation for assets at Purovsky Plant by RR 10 million and an increase in straight-line depreciation for other assets by RR 6 million.

Purchases of oil, gas condensate and natural gas

Our purchases of hydrocarbons increased by RR 1,437 million, or 79.6%, to RR 3,242 million in 2007 from RR 1,805 million in the corresponding period in 2006 primarily due to an increase in natural gas volumes purchased from third parties to maximize end-customer sales during the period and our purchases of oil products on international markets for resale which, amounted to RR 730 million in 2007.

Change in inventory

We reduced our operating expenses by recording credit amounts to our change in inventory of RR 31 million and RR 597 million in 2007 and 2006, respectively. The credits represent an adjustment to our operating expenses for "goods in transit" and volumes held in storage at the end of the period. At 31 December 2006, we increased our volumes of natural gas stored in underground gas facilities and stable gas condensate in transit as compared to 1 January 2006. During 2007, we withdrew nearly all natural gas volumes from underground gas storage facilities and increased the balance of liquids by volumes of oil products purchased on international markets.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 6,212 million, or 32.4%, to RR 25,365 million in 2007 compared to RR 19,153 million in 2006. In 2007, our profit from operations as a percentage of total revenues increased to 40.7% as compared to 38.8% in 2006.

Finance income (expense)

We reversed our position from net finance expense of RR 31 million in 2006 to net finance income of RR 124 million in 2007. The reversal was mainly due to reduced interest expenses and higher interest income received which was partially offset by a decrease in foreign exchange gains in 2007.

In 2007, interest expense decreased by RR 253 million, or 49.0%, due to a reduction in our weighted average debt balances while interest income increased by RR 102 million, or 37.2%, due to an increase in interest income on funds held on account as bank deposits. In 2007, we recorded a net foreign exchange gain of RR 11 million compared to RR 211 million in 2006. The decrease of foreign exchange gain was due to the combination of a higher proportion of US dollar denominated assets than liabilities and the strengthening of the Russian rouble against US dollar in 2007.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 26.5% and 26.7% for the years ended 31 December 2007 and 2006, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 27.0% and 27.2% in 2007 and 2006, respectively. Russian statutory income tax rate for both periods was 24%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the year increased by 4,721 million, or 33.7%, to RR 18,728 million in 2007 from RR 14,007 million in 2006. The profit attributable to NOVATEK shareholders increased by RR 4,657 million, or 33.1%, to RR 18,736 million in 2006 from RR 14,079 million in 2006.

We increased our weighted average basic and diluted earnings per share by RR 1.53 per share, or 33.0%, from RR 4.64 per share in 2006 to RR 6.17 per share in 2007 based on the profits attributable to NOVATEK's shareholders.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2007 and 2006:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Net cash provided by operating activities	21,383	16,938	26.2%
Net cash used in investing activities	(20,747)	(5,041)	311.6%
Net cash used in financing activities	(3,678)	(9,037)	(59.3%)

Liquidity ratios	31 December 2007	31 December 2006	Change %
Current ratio	1.41	3.04	(53.6%)
Total debt to equity	0.08	0.05	60.0%
Long-term debt to long term debt and equity	0.001	0.008	(87.5%)
Net debt to total capitalization [1]	0.03	(0.03)	n/m

[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 4,445 million, or 26.2%, to RR 21,383 million in 2007 compared to RR 16,938 million in 2006. The increase was mainly attributable to higher operating income from our oil and gas sales as a result of increase in our natural gas and liquids realized prices that were partially offset by an increase in trade receivables and prepayments.

Net cash used in investing activities

Net cash used in investing activities increased by RR 15,706 million to RR 20,747 million in 2007 compared to RR 5,041 million in 2006. The increase in 2007 was primarily due to an increase in capital expenditures related to further development of our three core fields, the construction activities for the second phase of the Purovsky Processing Plant and the payment for the acquisition of the license for the West-Urengoiskoye field.

Net cash used in financing activities

Net cash used for financing activities decreased by RR 5,359 million, or 59.3 %, to RR 3,678 million in 2007 compared to RR 9,037 million in 2006. The decrease was primarily due to significant repayments of short-term and long-term debt in 2006 compared to 2007 that was partially offset by an increase in dividends paid.

Working capital

At 31 December 2007, our net working capital position (current assets less current liabilities) was RR 4,963 million compared to RR 10,389 million at 31 December 2006. The decrease by RR 5,426 million was mainly due to increases in short-term debts, trade payables and accrued liabilities at 31 December 2007.

Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2007 and 2006 are as follows:

millions of Russian roubles	**Year ended 31 December:** 2007	2006	**Change %**
Exploration and production	18,638	4,347	328.8%
Other	828	356	132.6%
Total	**19,466**	**4,703**	**313.9%**

Exploration and production expenditures represent our investments in exploring for and developing our oil and gas properties. During both reporting periods, the majority of our capital expenditures related to ongoing development and exploration activities at our three core fields. In addition, in February 2007 we acquired and obtained the license to exploration and production of hydrocarbons at the West-Urengoiskoye field for RR 1,710 million. During 2007, we spent RR 951 million, RR 2,208 million and RR 10,759 million for field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 1,758 million on construction of the second phase at the Purovsky Processing Plant.

Debt obligations

At 31 December 2007, the Group repaid RR 1,975 million (USD 75 million) of long-term debt to BNP PARIBAS Bank ahead of its maturity schedule and received additional short-term debt in the amount of RR 2,455 million (USD 100 million) repayable in August and September 2008.

In 2007 the Group additionally borrowed from CALYON S.A. and CALYON RUSBANK Corporate and Investment Bank short-term USD denominated loans of RR 2,455 million (USD 100 million) that are repayable in May 2008.

At 31 December 2007, the Group had unused short-term credit facilities in the aggregate amount of RR 4,148 million (USD 169 million) on either fixed or variable interest rates subject to the specific type of credit facility. In addition, in November 2007, the Group obtained a two-year credit line facility with International Moscow Bank (from December 2007 – “UniCredit Bank”) up to the maximum amount of RR 2,455 million (USD 100 million) with interest rates negotiated at each withdrawal date.

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 prices for 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 a portion of 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 2007, RR 54 million, or 0.8%, of our long-term debt was denominated in US dollars (out of RR 6,602 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 31.2% in 2007, is denominated in US dollars. As of 31 December 2007, the Russian rouble had appreciated by approximately 7% against the US dollar since 1 January 2007.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 31 December 2007 would have resulted in an estimated foreign exchange gain of approximately RR 633 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 consolidated interim condensed financial information 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 2007, 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 established for the purpose of facilitating off-balance sheet arrangements.