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 2008 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2008 and 2007. 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, under the Petroleum Resources Management System (PRMS) reserve reporting methodology.

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, and we sell our natural gas volumes exclusively in the Russian domestic market. We export our stable gas condensate directly to international markets while our 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, as well as conducting limited commercial trading operations through our wholly-owned Swiss-based trading subsidiary, RUNITEK; primarily purchasing and reselling refined products, on international markets.

In September 2007, we acquired a 50% 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 48 months. At 31 December 2008, we have invested approximately USD 20 million and 32 months of the initial exploration period remained. We will continue to evaluate exploration and production opportunities outside of the Russian Federation as a way to diversify our business operations.

In September 2008, we completed and launched the second phase of development at our Yurkharovskoye field. The second stage includes two processing trains: a natural gas separation unit and a condensate preparation unit both with a capacity of 20 mmcm per day. The total capacity of the second phase will exceed seven billion cubic meters per annum. The launch of the second phase at the Yurkharovskoye field enables the Group to increase total daily natural gas capacity to more than 100 mmcm per day as well as increase total gas condensate yields by more than 20%.

As a part of the Yurkharovskoye field's second phase development, we also built and connected an 87 kilometer natural gas pipeline to the Unified Gas Supply System (UGSS), owned and operated by OAO "Gazprom". The new pipeline connection will increase our transport capacity up to 34 bcm of natural gas from the Yurkharovskoye field on an annual basis.

In October and November 2008, we completed and launched, respectively, the second phase expansion of our Purovsky Gas Condensate Processing Plant (Purovsky Plant), which increased processing capacity to 5 million tons per annum and enables us to produce approximately 3.75 million tons of stable gas condensate and 1.25 million tons of LPG per annum. The capacity increase at the Purovsky Plant plays a vital role in our gas condensate value chain enabling the development of our complex gas condensate fields as well as optimizing marketing channels for gas condensate production.

In 2008, our wholly-owned subsidiary, OOO "NOVATEK-Refuelling Complexes", completed construction of a retail service station in the Chelyabinsk region. We plan to continue developing a retail network in this region through construction and acquisition of new stations, with the aim of supplying these retail service stations with liquefied petroleum gas produced by our Purovsky Plant.

Our ongoing exploration work at existing fields in 2008 resulted in the discovery of seven new gas condensate deposits at the Yurkharovskoye field as well as six new gas and gas condensate deposits in the southern and south-western parts of the Khancheyskiy license area. We also completed the documentation work for certification, by the Ministry of Natural Resources, of four additional fields, Zapadno-Yurkharovskoye, Yarudeyskoye, Raduzhnoye and North Khancheyskoye.

SELECTED DATA

millions of Russian roubles except as stated	**Year ended 31 December: 2008**	**2007**	**Change %**
Financial results			
Total revenues (net of VAT and export duties)	79,272	62,370	27.1%
Operating expenses	(46,916)	(37,115)	26.4%
Profit attributable to NOVATEK shareholders	22,899	18,736	22.2%
EBITDA [(1)]	36,702	29,283	25.3%
EBITDAX [(2)]	37,819	29,769	27.0%
Earnings per share (in Russian roubles)	7.54	6.17	22.2%
Operating results			
Natural gas sales volumes (mmcm)	33,274	32,054	3.8%
Stable gas condensate sales volumes (thousand tons)	1,583	1,508	5.0%
Liquefied petroleum gas sales volumes (thousand tons)	618	554	11.6%
Crude oil sales volumes (thousand tons)	270	269	0.4%
Oil product sales volumes (thousand tons)	66	40	65.0%
Oil product export trading volumes (thousand tons)	93	33	181.8%
Cash flow results			
Net cash provided by operating activities	31,514	21,383	47.4%
Capital expenditures	31,810	19,466	63.4%

[(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)] EBITDAX represents EBITDA as defined above excluding exploration expenses.

SELECTED MACRO-ECONOMIC DATA

Exchange rate of Russian rouble to US dollar	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**Y-o-Y, %**
At the beginning of the year	24.55	26.33	23.52	26.01	23.46	25.82	25.25	24.95	24.55	26.33	(6.8%)
At the end of the year	23.52	26.01	23.46	25.82	25.25	24.95	29.38	24.55	29.38	24.55	19.7%
Average for the year	24.26	26.31	23.63	25.86	24.25	25.51	27.26	24.65	24.85	25.58	(2.9%)

Crude oil prices, USD / bbl	1 quarter		2 quarter		3 quarter		4 quarter	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
WTI [1]								
At the end of the period	101.6	65.9	140.0	70.7	100.6	81.7	44.6	96.0
Average for the period	97.8	58.3	123.8	65.0	118.2	75.2	59.1	90.5
Brent [2]								
At the end of the period	102.7	68.6	138.9	73.5	93.7	81.1	36.6	96.0
Average for the period	96.7	57.8	121.2	68.8	115.1	74.7	55.5	88.5
Urals [2]								
At the end of the period	99.8	65.4	135.4	69.1	92.4	77.7	35.9	93.1
Average for the period	93.2	54.3	117.4	65.2	113.4	72.1	54.6	85.7

(1) Based on prices quoted by New York Mercantile Exchange (NYMEX).

(2) Based on prices quoted by Intercontinental Exchange (ICE).

Export duties, USD / ton [1]	1 quarter		2 quarter		3 quarter		4 quarter	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
Crude oil, stable gas condensate								
At the end of the period	333.8	179.7	398.1	200.6	495.9	223.9	192.1	275.4
Average for the period	314.3	180.0	359.4	171.1	463.3	216.1	283.9	258.7
LPG								
At the end of the period	237.2	133.4	280.5	147.5	346.4	163.2	141.8	197.8
Average for the period	224.1	133.6	254.4	127.6	324.4	158.0	203.6	186.6

(1) Export duties determined by the government of the Russian Federation.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

The recent downturn in global financial markets has negatively affected all borrowers by limiting access to capital markets. The general consensus amongst the international and domestic banking community calls for a period of tight credit market conditions and increasing margin spreads. Furthermore, there is a heightened awareness over excess borrowings, potential liquidity problems and the ability of a company's balance sheet to withstand a period of market turbulence.

As a company, we have taken various measures to ensure the integrity of our financial condition and mitigate counter-party credit exposure from our natural gas and liquid hydrocarbon sales. In addition, we have taken proactive steps to ensure the safety of our excess funds deposited with both domestic and international banks as well as limited our exposure from prepayments to various service providers. Presently, our cash and deposits are diversified and maintained in well capitalized banks with a minimum risk of default.

In a period of limited access to the capital markets for funding purposes, we have reviewed our capital expenditure program for the next year and have concluded that we have sufficient liquidity, through current internal cash flows and short-term borrowing facilities, to fund our core natural gas business operations and planned capital expenditure program. As a result of this, we have not made any major adjustments to our capital expenditure program as of the 31 December 2008.

Management will continue to closely monitor the economic environment in Russia as well as the domestic and international capital markets to determine if any other corrective and/or preventive measures are required to sustain the business through the financial and liquidity crisis.

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 2008, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 289 per mcm, or 22.7%, to RR 1,563 per mcm compared to RR 1,274 per mcm in 2007. 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 end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. During 2008, 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 26 per mcm, or 27.4%, compared to 2007 as a result of higher average realized prices to end-customers (see "Natural gas sales" below). In 2008, the rate of growth in our average natural gas price ex-field was approximately the same as that of our average natural gas netback price on end-customers sales.

In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011. Effective 1 January 2008, the FTS approved a 25% increase in the regulated price of natural gas for the year 2008. As part of the liberalization plan, in December 2008, the FTS approved four separate increases in the regulated price for natural gas in 2009. The increases will take place quarterly, rising 5% in the first quarter, 7% in the second quarter, 7% in the third quarter and 6.2% in the fourth quarter for an average increase of 15.9% for the year. We expect further increases in the regulated price for natural gas as part of the Russian Federation government's efforts to liberalize the price of natural gas on the Russian domestic market. The FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published as well as potentially prolong the timetable toward market price liberalization 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 2008 and 2007:

Russian roubles per mcm	Year ended 31 December: 2008	2007	Change %
Average natural gas price to end-customers [1]	1,818	1,505	20.8%
Average natural gas transportation expense for sales to end-customers	718	631	13.8%
Average natural gas netback price on end-customer sales	1,100	874	25.9%
Average natural gas price ex-field (wholesale traders)	979	779	25.7%
Average netback margin differential	121	95	27.4%

[1] Includes cost of transportation.

We also participate 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 prices on electronic trading (e-trading) are shown in the table below:

Russian roubles per mcm	Year ended 31 December: 2008	2007	Change %
Average natural gas price to customers on e-trading sales [1]	1,412	1,193	18.4%
Average natural gas transportation expense on e-trading sales	132	107	23.4%
Average natural gas netback on e-trading sales	1,280	1,086	17.9%

[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, the ability and willingness of oil producing countries to sustain or change production levels to meet changes in 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 amongst other factors. 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. The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management.

Our stable gas condensate, LPG (excluding obligatory domestic deliveries at regulated prices), crude oil and oil products prices on both international and domestic markets include transportation expense in accordance with the terms of delivery. Our delivery terms for the sale of crude oil on the domestic market changed effective January 2008 whereby we are responsible for transportation to the point of destination and this is reflected in our contract prices. The buyer takes ownership and any further associated risks upon delivery to the point of destination. Correspondingly, revenues and prices for the comparable period in 2007 were adjusted (grossed up) to reflect transportation expenses to the point of destination.

In 2008, as well as in 2007, 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 2008 was approximately USD 853 per ton compared to approximately USD 646 per ton in 2007.

In 2008, as well as in 2007, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany). In 2008, our average crude oil export contract price, including export duties, was approximately USD 419 per ton compared to USD 491 per ton in 2007.

During 2008, benchmark crude oil prices rose to historic highs in July reaching USD 145.3 per barrel and USD 144.2 per barrel for WTI and Brent, respectively, and declined sharply over the second half of the year to USD 44.6 per barrel for WTI and USD 36.6 per barrel for Brent at 31 December 2008. The volatile movements in benchmark crude oil prices throughout 2008 had a corresponding positive and/or negative impact on the ultimate prices we received for our liquid volumes sold on both the domestic and international markets, amongst other factors. The various factors affecting the movement of these benchmark prices are beyond the control of management.

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 2008 and 2007:

Russian roubles (RR) or US dollars (USD) per ton	**Year ended 31 December: 2008**	**2007**	**Change %**
Stable gas condensate			
Net export price, RR per ton	12,249	11,353	7.9%
Net export price, USD per ton	492.9	443.9	11.0%
Domestic price, RR per ton	8,135	8,464	(3.9%)
Crude oil			
Net export price, RR per ton	2,925	7,225	(59.5%)
Net export price, USD per ton	117.7	282.5	(58.3%)
Domestic price, RR per ton	7,881	6,347	24.2%

Our LPG export and CIS delivery terms during 2008 were delivery at frontier (DAF) at the border of the customer's country. In 2008, our average export LPG contract price, including export duties, was approximately USD 745 per ton compared to USD 605 per ton in 2007. 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 2008, we sold 48 thousand tons at the regulated price of RR 4,500 per ton and 437 thousand tons at a commercial price of RR 10,393 per ton, in the domestic market, compared to 42 thousand tons at RR 3,500 per ton and 380 thousand tons at RR 8,750 per ton, respectively, in 2007.

Domestic sales of oil products produced from our unstable gas condensate were priced free carrier (FCA) at the Surgut railroad station (located in the Khanty-Mansiysk Autonomous Region).

In 2008, as well as in 2007, our foreign trading subsidiary purchased oil products (naphtha) on international markets for resale. In 2008, we delivered naphtha to the United States and Europe at an average contract price of USD 939 per ton, compared to USD 819 per ton in 2007, and the delivery terms were delivery to the port of destination ex-ship (DES) and free on board (FOB, Vitino). There were no applicable export duties on these sales. In the fourth quarter 2008, we sold 20 thousand tons of oil products (light distillate) purchased at the Surgutsky refinery through our foreign trading subsidiary on the US market. The delivery terms were delivery to the port of destination ex-ship (DES) and our average export contract price, including export duties, was approximately USD 333 per ton.

In 2008, our wholly-owned subsidiary, OOO "NOVATEK-Refuelling Complexes", purchased 77 tons of liquefied petroleum gas, diesel fuel and petrol, from third parties, and subsequently resold 56 tons of these volumes through its retail station for approximately RR 24,132 per ton.

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 2008 and 2007 (excluding trading activities):

Russian roubles (RR) or US dollars (USD) per ton	**Year ended 31 December: 2008**	**2007**	**Change %**
LPG			
Net export price, RR per ton	12,333	11,535	6.9%
Net export price, USD per ton	496.2	451.0	10.0%
CIS price, RR per ton	11,853	10,264	15.5%
Domestic price, RR per ton	9,810	8,231	19.2%
Oil products			
Net export price, RR per ton	3,720	-	n/a
Net export price, USD per ton	149.7	-	n/a
Domestic price, RR per ton	7,026	6,513	7.9%

Transportation tariffs

The methodology of calculating transportation tariffs for natural gas produced in the Russian Federation 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) 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 range for the “input/output” rate effective from 1 January 2008 is RR 123.01 to RR 1,351.01 (excluding VAT) per mcm) and includes a constant rate of RR 20.01 (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 5.28 effective from 1 August 2006 and was increased by 15% to RR 6.07 from 1 March 2007 and by a further 19.1% from 1 January 2008 to RR 7.23 per mcm per 100 km (excluding VAT).

In December 2008, the FTS approved an increase in the 2009 transportation tariff for natural gas. The new tariff will be implemented in four stages, in line with the increases in natural gas prices, for an average increase of 15.7% for the year. The increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts.

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 (to the port of Vitino on the White Sea), 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 and oil products produced from our unstable 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 other overseas market destinations. The costs associated with tanker transportation are determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

Transportation transactions with related parties

All natural gas producers and wholesalers operating in Russia transport their commercial volumes of natural gas through the Unified Gas Supply System (UGSS), which is owned and operated by OAO Gazprom, a State monopoly and a shareholder of OAO NOVATEK since 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 2008 and 2007. Oil and gas production costs do not include general corporate overheads or their 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 on a boe basis in Russian roubles and US dollars:

millions of Russian roubles	Year ended 31 December:		Change
	2008	2007	%
Production costs:			
Lifting cost	3,525	3,057	15.3%
Taxes other than income tax	7,062	6,222	13.5%
Transportation expenses	16,013	13,138	21.9%
Total production costs before DD&A	**26,600**	**22,417**	**18.7%**
Depreciation, depletion and amortization (DD&A)	4,234	3,446	22.9%
Total production costs	**30,834**	**25,863**	**19.2%**

RR per boe	Year ended 31 December:		Change
	2008	2007	%
Production costs:			
Lifting cost	16.0	14.9	7.4%
Taxes other than income tax	32.0	30.4	5.3%
Transportation expenses	72.6	64.0	13.4%
Total production costs before DD&A	**120.6**	**109.3**	**10.3%**
Depreciation, depletion and amortization (DD&A)	19.2	16.8	14.3%
Total production costs	**139.8**	**126.1**	**10.9%**

USD per boe	Year ended 31 December:		Change
	2008	2007	%
Production costs:			
Lifting cost	0.64	0.58	10.3%
Taxes other than income tax	1.29	1.19	8.4%
Transportation expenses	2.92	2.50	16.8%
Total production costs before DD&A	**4.85**	**4.27**	**13.6%**
Depreciation, depletion and amortization (DD&A)	0.77	0.66	16.7%
Total production costs	**5.62**	**4.93**	**14.0%**

Production costs consist of amounts directly related to the extraction of natural gas, gas condensate and crude oil from the reservoir and other related costs; including production expenses, taxes other than income taxes (production taxes), insurance expenses and shipping/transportation/handling costs to end-customers. The average production cost on a boe basis is calculated by dividing the applicable costs by the respective barrel of oil equivalent of our hydrocarbons produced during the year. Natural gas, gas condensate and crude oil volumes produced by our fields are converted to a barrel of oil equivalent based on the relative energy content of each fields' hydrocarbons.

Hydrocarbon sales volumes

Our natural gas and liquids sales volumes, on a net basis, increased primarily due to organic production growth at our Yurkharovskoye field.

Natural gas sales volumes

millions of cubic meters	Year ended 31 December: 2008	2007	Change %
Production from:			
Yurkharovskoye field	11,540	9,554	20.8%
East-Tarkosalinskoye field	14,744	14,468	1.9%
Khancheyskoye field	4,115	4,196	(1.9%)
Other fields	31	32	(3.1%)
Total natural gas production	**30,430**	**28,250**	**7.7%**
Purchases from:			
Gazprom	1,905	1,973	(3.4%)
Other	980	1,166	(16.0%)
Total natural gas purchases	**2,885**	**3,139**	**(8.1%)**
Total production and purchases	**33,315**	**31,389**	**6.1%**
Purovsky Plant and own usage	(39)	(34)	14.7%
Decrease (increase) in pipeline and underground gas storage facilities	(2)	699	n/m
Total natural gas sales volumes	**33,274**	**32,054**	**3.8%**
Sold to end-customers	*15,357*	*14,277*	*7.6%*
E-trading sales	*438*	*661*	*(33.7%)*
Subtotal sold to end-customers	***15,795***	***14,938***	***5.7%***
Sold ex-field	***17,479***	***17,116***	***2.1%***

In 2008, our total consolidated natural gas production increased by 2,180 mmcm, or 7.7%, compared to 2007. The increase in production at our Yurkharovskoye field was primarily due to the launch of the field's second phase of development in the fourth quarter 2008. In addition, we were able to normalize 2008 production levels from the cenomanian layers (dry gas) at our East-Tarkosalinskoye field after we decreased production levels from these layers in 2007 due to the fact that natural gas underground storage facilities had reached maximum capacity. During 2007, there was a lack of available capacity at Gazprom's underground gas storage facilities caused by unseasonably warm weather.

At 31 December 2008, our cumulative natural gas volumes stored in Gazprom's underground gas storage facilities (UGSF) totaled 300 mmcm compared to 40 mmcm at 31 December 2007. We also recorded a natural gas balance of 46 mmcm in the UGSS at 31 December 2008, compared to 295 mmcm at 31 December 2007. We expect our volumes of natural gas injected into underground gas storage facilities and maintained in the UGSS 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.

Liquids sales volumes

thousands of tons	Year ended 31 December: 2008	2007	Change %
Production from:			
Yurkharovskoye field	889	698	27.4%
East-Tarkosalinskoye field	932	892	4.5%
Khancheyskoye field	651	710	(8.3%)
Other fields	91	100	(9.0%)
Total liquids production	**2,563**	**2,400**	**6.8%**
Purchases from:			
Purgazdobycha	-	16	n/m
Other	98	40	145.0%
Total liquids purchases	**98**	**56**	**75.0%**
Total production and purchases	**2,661**	**2,456**	**8.3%**
Losses [(1)]	(21)	(20)	5.0%
Decreases (increases) in liquids inventory balances	(10)	(32)	(68.8%)
Total liquids sales volumes	**2,630**	**2,404**	**9.4%**
Stable gas condensate export	*1,578*	*1,505*	*4.9%*
Stable gas condensate domestic	*5*	*3*	*66.7%*
Subtotal stable gas condensate	***1,583***	***1,508***	***5.0%***
LPG export	*90*	*77*	*16.9%*
LPG CIS	*43*	*55*	*(21.8%)*
LPG domestic	*485*	*422*	*14.9%*
Subtotal LPG	***618***	***554***	***11.6%***
Crude oil export	*17*	*109*	*(84.4%)*
Crude oil domestic	*253*	*160*	*58.1%*
Subtotal crude oil	***270***	***269***	***0.4%***
Oil products export	*20*	*-*	*n/m*
Oil products domestic	*46*	*40*	*15.0%*
Oil products export (international trading activities)	*93*	*33*	*181.8%*
Subtotal oil products	***159***	***73***	***117.8%***

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

In 2008, our liquids production increased by 163 thousand tons, or 6.8%, to 2,563 thousand tons compared to 2,400 thousand tons in the 2007 period, primarily due to the expansion of gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the field's second phase of development. The higher gas condensate yields from the East-Tarkosalinskoye field were due to changes in the technical parameters of the gas separation process which results in a higher output of gas condensate from the initial natural gas mix. The increases were offset by a decrease in gas condensate production at our Khancheyskoye field as we reduced output in the fourth quarter 2008 to optimize net back margins pending the expected changes to export duties beginning 1 January 2009.

At 31 December 2008, we had 220 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 224 thousand tons as of 31 December 2007. Our stable gas condensate in transit or storage and recognized as inventory decreased by 4 thousand tons as at 31 December 2008 as compared to the inventory balance at 1 January 2008. At 31 December 2007, our inventory balance of stable gas condensate increased by 34 thousand tons compared to 1 January 2007. The remaining change in liquids inventory balances related to changes in other liquid hydrocarbon products.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2008 COMPARED TO THE YEAR ENDED 31 DECEMBER 2007

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2008 and 2007. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	**2008**	**% of total revenues**	**2007**	**% of total revenues**
Total revenues (net of VAT and export duties)	79,272	*100.0%*	62,370	*100.0%*
including:				
natural gas sales	45,650	*57.6%*	35,605	*57.1%*
liquids sales	30,426	*38.4%*	24,801	*39.8%*
Other income (loss)	(236)	*(0.3%)*	110	*0.2%*
Total revenues and other income	**79,036**	***99.7%***	**62,480**	***100.2%***
Operating expenses	(46,916)	*(59.2%)*	(37,115)	*(59.5%)*
Profit from operations	**32,120**	***40.5%***	**25,365**	***40.7%***
Finance income (expense)	(3,384)	*(4.3%)*	124	*0.2%*
Share of income (loss) of associated companies	(147)	*(0.2%)*	-	*n/m*
Profit before income tax and minority interest	**28,589**	***36.1%***	**25,489**	***40.9%***
Total income tax expense	(5,662)	*(7.1%)*	(6,761)	*(10.9%)*
Profit for the year	**22,927**	***28.9%***	**18,728**	***30.0%***
Minority interest	(28)	*(0.0%)*	8	*0.0%*
Profit attributable to NOVATEK shareholders	**22,899**	***28.9%***	**18,736**	***30.0%***

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 2008 and 2007:

millions of Russian roubles	Year ended 31 December: 2008	2007	Change %
Natural gas sales	**45,650**	**35,605**	**28.2%**
End-customer	*27,915*	*21,483*	*29.9%*
E-trading	*619*	*788*	*(21.4%)*
Subtotal of end-customers sales	***28,534***	***22,271***	***28.1%***
Ex-field sales	***17,116***	***13,334***	***28.4%***
Stable gas condensate sales	**19,374**	**17,106**	**13.3%**
Export	*19,334*	*17,082*	*13.2%*
Domestic	*40*	*24*	*66.7%*
Liquefied petroleum gas sales	**6,376**	**4,926**	**29.4%**
Export	*1,112*	*884*	*25.8%*
CIS	*507*	*569*	*(10.9%)*
Domestic	*4,757*	*3,473*	*37.0%*
Crude oil sales	**2,043**	**1,802**	**13.4%**
Export	*48*	*784*	*(93.9%)*
Domestic	*1,995*	*1,018*	*96.0%*
Oil products sales	**2,633**	**967**	**172.3%**
Export	*2,186*	*674*	*224.3%*
Domestic	*447*	*293*	*52.6%*
Total oil and gas sales	**76,076**	**60,406**	**25.9%**
Sales of polymer and insulation tape	2,098	1,602	31.0%
Other revenues	1,098	362	203.3%
Total revenues	**79,272**	**62,370**	**27.1%**
Other income (loss)	(236)	110	n/a
Total revenues and other income	**79,036**	**62,480**	**26.5%**

Natural gas sales

In 2008, our revenues from sales of natural gas increased by RR 10,045 million, or 28.2%, compared to 2007. 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 57.6% and 57.1% of our total revenues in 2008 and 2007, respectively. The marginal increase in natural gas sales as a percentage of total revenues was primarily due to the greater increase in the growth rate of natural gas sales prices compared to that of liquids sales prices.

In 2008, our average realized natural gas price per mcm increased by RR 261 per mcm, or 23.5%, to RR 1,372 per mcm from RR 1,111 per mcm in 2007. Our proportion of natural gas sold to end-customers, including e-trading sales, to total natural gas sales volumes, increased from 46.6% in 2007 to 47.5% in 2008 due to an increase in the end-customers sales component. The average realized prices of our natural gas sold directly to end-customers, on the electronic trading system and ex-field were higher by 20.8%, 18.4% and 25.7%, respectively, in 2008 compared to 2007. In both periods, our sales of natural gas to end-customers were primarily to energy utilities and large industrial companies.

In 2008, our e-trading natural gas sales decreased by RR 169 million, or 21.4%, due to a general decrease in demand for volumes sold on the electronic trading exchange during the period. In 2008, our total electronic exchange trading volumes decreased by 223 mmcm, or 33.7%, from 661 mmcm in 2007 to 438 mmcm in 2008 which was partially offset by an increase in the average sales prices we received in 2008 compared to 2007. Our e-trading natural gas sales were primarily to energy utility companies in both periods. The volumes we sell on the e-trading platform are subject to fluctuation based on demand and our commitment to fulfill existing contractual obligations.

As of 1 January 2009, trading on the electronic exchange has been suspended, due to a lack of trading activity, subject to further notice.

Stable gas condensate sales

In 2008, our revenues from sales of stable gas condensate increased by RR 2,268 million, or 13.3%, compared to the corresponding period in 2007 primarily due to an increase in average realized prices and, to a lesser extent, by an increase in volumes sold.

In 2008, we exported 1,578 thousand tons of stable gas condensate, or 99.7% of our sales volumes, to markets in the United States and Europe, while in 2007, our export sales volumes to these markets were lower by 73 thousand tons. The increase in stable gas condensate sales volumes resulted primarily from a decrease in our “goods in transit” balance from 159 thousand tons at 31 December 2007 to 56 thousand tons at 31 December 2008.

We delivered all of our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers.

In 2008, our average realized price, excluding export duties and translated into US dollars, for stable gas condensate sold on the export market increased by USD 49.0 per ton, or 11.0%, to USD 492.9 per ton (DES and CFR) from USD 443.9 per ton (DES and CFR) in 2007. The increase in the average realized export price was the result of a 32.0% increase in our average export contract price that was partially offset by a 76.3% increase in our average export duty per ton. The increase in our average realized contract price was due to higher average prices on international markets in 2008 compared to 2007.

Liquefied petroleum gas sales

In 2008, our revenues from the sales of LPG increased by RR 1,450 million, or 29.4%, compared to the corresponding period in 2007, due primarily to an increase in both domestic sales volumes and prices, and, to a lesser extent, to an increase in export sales volumes and prices.

In 2008, we increased our sales volumes of LPG by 64 thousand tons, or 11.6%, to 618 thousand tons from 554 thousand tons in 2007, mainly due to an increase in throughput at our Purovsky Plant, of which 78.5% was sold domestically at an average price of RR 9,810 per ton (FCA excluding VAT). This represents an increase in the average domestic sales price of RR 1,579 per ton, or 19.2%, compared to 2007. The remaining volumes of LPG were sold as follows: 14.6% was sold to the export market for an average price of USD 496.2 per ton (DAF excluding export duties) and 6.9% was sold to the CIS for an average price of RR 11,853 per ton (DAF excluding export duties). In 2008, our average LPG sales prices on the export market and in the CIS increased by USD 45.2 per ton, or 10.0%, and by RR 1,589 per ton, or 15.5%, respectively, compared to 2007. The increase in our average realized export prices (excluding export duties) was primarily due to a 23.1% increase in our average contract prices which was offset by a 69.6% increase in our average export duty per ton in 2008.

As of 1 January 2009, the customs duties on LPG volumes sold to the export market have been reduced to zero subject to further review.

Crude oil sales

In 2008, our revenues from the sales of crude oil increased by RR 241 million, or 13.4%, compared to 2007, due to a shift in volumes sold from the international markets to the domestic market and an increase in domestic crude oil prices. Our crude oil volumes available for sale increased marginally by 1 thousand tons, or 0.4%, from 269 thousand tons in 2007, to 270 thousand tons in 2008, primarily due to an increase in our crude oil production that was partially offset by an increase in our crude oil inventory balance, recorded as “goods in transit”, in Transneft’s pipelines as at 31 December 2008.

Our average realized sales prices, excluding export duties, translated into US dollars for crude oil exported to international markets decreased by USD 164.8 per ton, or 58.3%, to USD 117.7 per ton (DAF) in 2008, compared to USD 282.5 per ton (DAF) in 2007. The decrease in the average realized export price was the result of a 14.7% decrease in our average export contract price and a 55.1% increase in our average export duty per ton. The decrease in our average realized contract price was due to the fact that we sold a majority of our export volumes in the fourth quarter 2008 when the average crude oil price on international markets was significantly lower than the average 2007 price.

Our average realized crude oil domestic sales price (excluding VAT) increased by RR 1,534 per ton, or 24.2%, to RR 7,881 per ton in 2008, compared to RR 6,347 per ton in 2007. The increase in our average realized price was due to the overall strength in crude oil prices domestically in 2008.

Oil products sales

In 2008, our revenue from the sales of oil products increased by RR 1,666 million, or 172.3%, compared to 2007, primarily due to the full effect of our foreign trading subsidiary's oil products trading activities on international markets which commenced in August 2007.

In 2008, we purchased 89 thousand tons of oil products (naphtha) and resold 93 thousand tons (including 4 thousand tons held in inventories) to customers in the US and Europe for an average contract price of USD 938.6 per ton (DES and FOB) compared to 2007 sales volumes of 33 thousand tons for an average contract price of USD 819.0 per ton (DES and FOB). At 31 December 2008 and 2007, our inventory balance of naphtha recorded as "goods in transit" was nil and 4 thousand tons, respectively.

Our domestic oil products sales in 2008 increased by RR 154 million, or 52.6%, to RR 447 million from RR 293 million in 2007, primarily due to an increase in average prices and a slight increase in sales volumes.

In 2008, our domestic sales volumes of oil products produced from our unstable gas condensate were the same as in 2007, or 37 thousand tons. Our oil products sales price increased by RR 513 per ton, or 7.9%, from RR 6,513 per ton in 2007, to RR 7,026 per ton in 2008, due to a general increase in prices on the domestic market.

In 2008, our domestic oil products sales volumes sold via our domestic trading operations increased from 3 thousand tons to 9 thousand tons. The price we received from our trading activities increased by RR 2,710 per ton, or 15.0%, from RR 18,084 per ton in 2007, to RR 20,794 per ton in 2008, due to a general increase in market prices.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 496 million, or 31.0%, to RR 2,098 million in 2008, compared to RR 1,602 million in 2007, due to an increase in BOPP film wrap production.

Revenues from our sales of BOPP film wrap increased by RR 568 million, or 74.1%, from RR 767 million in 2007, to RR 1,335 million in 2008, due to more efficient utilization of the plant's facilities which resulted in an increase in the volumes available for sale. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 15.7% to 63.6% in 2008, compared to 47.9% in 2007.

Our revenues from pipe insulation product sales decreased by RR 23 million, or 4.2%, from RR 550 million in 2007, to RR 527 million in 2008, mainly due to a decrease in volumes sold. Revenues from polymer pipe sales decreased by RR 23 million, or 10.1%, from RR 228 million in 2007, to RR 205 million in 2008, also due to a decrease in volumes sold. The remaining revenue comprising RR 30 million and RR 57 million in 2008 and 2007, respectively, related to sales of other polymer products.

Other revenues

Other revenues include geological and geophysical research services, rent, polymer tolling, transportation, handling, storage and other services. In 2008, other revenues increased by RR 736 million, or 203.3%, to RR 1,098 million from RR 362 million in 2007. The increase in other revenues was primarily related to the commencement of geological and geophysical research sales to our associates in the fourth quarter 2007, which accounted for RR 753 million in 2008, compared to RR 20 million in 2007.

In 2008, revenues from polymer tolling decreased by RR 49 million which was partially offset by an increase in income from rent and transportation services of RR 54 million and RR 17 million, respectively. The remaining decrease of RR 19 million in other revenues was composed of various immaterial items.

Other income (loss) and net gain (loss) on disposals

In 2008, we realized other loss of RR 236 million, while in 2007 we recognized net other income of RR 110 million.

In June 2008, we disposed our long-term finance lease with OAO "Gazprom" for a cash consideration of RR 360 million and, as a result, recognized a net loss of RR 212 million. The subject of the finance lease was for the use of certain oil and gas assets located at the West-Tarkosalinskoye field, a field licensed to Gazprom. The usage of the disposed items was no longer considered economically viable to maintain on our balance sheet.

In 2007, we realized other net income of RR 110 million, of which RR 95 million related to the sale of our non-core subsidiary, OAO "Geolog Yamala".

Operating expenses

In 2008, total operating expenses increased by RR 9,801 million, or 26.4%, to RR 46,916 million compared to RR 37,115 million in 2007, largely due to increases in transportation costs, purchases of oil, gas condensate and natural gas, materials, services and other expenses and general and administrative expenses. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased by 2.0% in 2008 to 54.0% compared to 56.0% in 2007. Total operating expenses as a percentage of total revenues decreased by 0.3% from 59.5% in 2007 to 59.2% in 2008, as shown in the table below.

	Year ended 31 December:			
millions of Russian roubles	**2008**	**% of total revenues**	**2007**	**% of total revenues**
Transportation expenses	18,153	*22.9%*	14,421	*23.1%*
Taxes other than income tax	7,186	*9.1%*	6,379	*10.2%*
Non-controllable expenses	**25,339**	***32.0%***	**20,800**	***33.3%***
Materials, services and other	6,332	*8.0%*	4,924	*7.9%*
General and administrative expenses	5,064	*6.4%*	3,873	*6.2%*
Purchases of oil, gas condensate and natural gas	4,665	*5.9%*	3,242	*5.2%*
Depreciation, depletion and amortization	4,478	*5.6%*	3,668	*5.9%*
Exploration expenses	1,117	*1.4%*	486	*0.8%*
Net impairment expense	105	*n/m*	153	*n/m*
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(184)	*n/m*	(31)	*n/m*
Total operating expenses	**46,916**	***59.2%***	**37,115**	***59.5%***

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 2008, non-controllable expenses of transportation and taxes other than income tax increased by RR 4,539 million, or 21.8%, to RR 25,339 million from RR 20,800 million in 2007. The change was primarily due to increases in the natural gas transportation tariff and end-customer sales volumes as well as the railroad tariff for liquids transportation. Taxes other than income tax increased primarily due to higher mineral production taxes (UPT) resulting from an increase in natural gas production volumes, an increase in the average UPT rate for crude oil and an increase in gas condensate UPT. As a percentage of total revenues our non-controllable expenses decreased by 1.3% to 32.0% in 2008, compared to 33.3% in 2007.

Transportation expenses

Our total transportation expenses in 2008 increased by RR 3,732 million, or 25.9%, compared to 2007.

millions of Russian roubles	**Year ended 31 December:** 2008	**2007**	**Change %**
Natural gas transportation to customers	11,080	9,077	22.1%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	4,384	3,376	29.9%
Stable gas condensate transported by tankers	2,168	1,690	28.3%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	232	115	101.7%
Crude oil transportation to customers	123	127	(3.1%)
Other transportation costs	166	36	361.1%
Total transportation expenses	**18,153**	**14,421**	**25.9%**

In 2008, our transportation expenses for natural gas increased by RR 2,003 million, or 22.1%, to RR 11,080 million from RR 9,077 million in 2007. The increase was mainly due to higher transportation tariffs effective from 1 January 2008 (see "Transportation tariffs" above) and to a lesser extent a 5.7% 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. 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. However, our average transportation distance for natural gas sold to end-customers fluctuated insignificantly between the 2008 and 2007 periods.

In 2008, our total expenses for transportation by rail increased by RR 1,008 million, or 29.9%, due to higher railroad transportation tariffs and a slight increase in liquids volumes sold. In 2008, our combined volumes of stable gas condensate, LPG and oil products sold and transported via rail increased by 127 thousand tons, or 6.0%, to 2,228 thousand tons from 2,101 thousand tons in 2007.

In 2008, our expense for stable gas condensate transported by rail to export markets increased by RR 523 million, or 24.9%, to RR 2,626 million from RR 2,103 million in 2007. In 2008, our transportation rate per ton for stable gas condensate increased to RR 1,664 from RR 1,398 in 2007, primarily due to tariff increases of approximately 14.9% from 1 January 2008, 1.2% from 1 April 2008 and 10.0% from 1 July 2008 resulting in an average tariff increase of 27.9% during the respective period.

In 2008, our expense for LPG transported by rail amounted to RR 1,703 million, of which RR 488 million was related to export sales, RR 125 million to CIS sales, and RR 1,090 million to domestic sales, or RR 5,408 per ton, RR 2,935 per ton, and RR 2,247 per ton, respectively. In 2007, transportation expenses for LPG 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 2008, our LPG rail transportation expense was higher primarily due to increases in transportation tariffs and volumes sold.

In 2008, we incurred RR 41 million of railroad transportation expenses related to the export sales of oil products produced from our unstable gas condensate production. The transportation rate per ton was RR 2,057. There were no such sales in 2007.

The remaining RR 14 million of transportation expenses by rail in 2008, and RR 23 million in 2007, were related to the transportation of oil products sold on the domestic market and other railroad services not allocated between products.

In 2008, total transportation expense for delivery of stable gas condensate by tanker to international markets increased by RR 478 million, or 28.3%, to RR 2,168 million from RR 1,690 million in 2007. The change was primarily due to higher average freight rates in 2008, longer average distances and a 4.9% increase in volumes sold. In 2008, we delivered 93.0% of our stable gas condensate export volumes to the US market compared to 70.8% in 2007.

Taxes other than income tax

millions of Russian roubles	Year ended 31 December: 2008	2007	Change %
Unified natural resources production tax (UPT)	6,558	5,703	15.0%
Property tax	670	544	23.2%
Other taxes	92	132	(30.3%)
Subtotal	7,320	6,379	14.8%
Less: reversal of provision for additional taxes (UPT)	(134)	-	n/m
Total taxes other than income tax	**7,186**	**6,379**	**12.7%**

In 2008, taxes other than income tax increased by RR 807 million, or 12.7%, of which RR 855 million and RR 126 million were due to UPT and property tax increases, respectively, which were offset by a reversal in a tax provision of RR 134 million.

In 2008, our UPT for natural gas increased by RR 334 million due to a 7.7% increase in natural gas production volumes. The increases in our UPT for gas condensate and crude oil of RR 306 million and RR 215 million, respectively, were primarily caused by an increase in the production cost of gas condensate and an increase in our average crude oil production tax rate, respectively. Our average UPT rate for crude oil increased from RR 2,497 per ton in 2007 to RR 3,347 per ton in 2008. The natural gas production tax rate in the 2008 and 2007 periods remained unchanged at RR 147 per mcm.

In 2008, our property tax expense increased by RR 126 million, or 23.2%, to RR 670 million from RR 544 million in the corresponding period in 2007, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In 2008, other taxes decreased by RR 40 million primarily due to a RR 28 million decrease in excise tax expense. We received a higher proportion of diesel fuel and distillate in 2008 from the processing of our unstable gas condensate at the Surgutsky refinery; however, we sold fewer volumes of these products on the domestic market which are subject to excise tax.

Materials, services and other

In 2008, our materials, services and other expenses increased by RR 1,408 million, or 28.6%, to RR 6,332 million compared to RR 4,924 million in 2007. The main components of this expense were employee compensation and materials and supplies expense, which comprised 34.3% and 27.9%, respectively, of total materials, services and other expenses in 2008.

millions of Russian roubles	Year ended 31 December: 2008	2007	Change %
Employee compensation	2,169	1,897	14.3%
Materials and supplies	1,766	1,521	16.1%
Repair and maintenance services	405	367	10.4%
Tolling and processing fees	341	213	60.1%
Electricity and fuel	308	216	42.6%
Fire safety and security expense	168	263	(36.1%)
Other	454	379	19.8%
Subtotal materials, services and other	**5,611**	**4,856**	**15.5%**
Operator services expense	721	68	n/m
Total materials, services and other	**6,332**	**4,924**	**28.6%**

In 2008, our materials, services and other expenses, excluding operator services expense, increased by RR 755 million, or 15.5%, to RR 5,611 million compared to RR 4,856 million in 2007.

Our employee compensation increased by RR 272 million, or 14.3%, to RR 2,169 million compared to RR 1,897 million in 2007, primarily due to an increase in average salaries and additional staffing at our subsidiaries, mainly OOO "NOVATEK-YURKHAROVNEFTEGAS" and the Purovsky Plant, both of which experienced significant growth in their activities during the period.

Materials and supplies expense increased by RR 245 million, or 16.1%, mainly due to the growth in production of polymers and insulation tape products and the associated increase in purchases of raw materials, which accounted for RR 318 million, or 22.5%, of the total change to materials, services and other expense. The offsetting decrease in materials and supplies expense of RR 73 million related to cost savings in methanol purchases resulting from the substitution of our own production from our new methanol plant.

Tolling and processing fees increased by RR 128 million, or 60.1%, primarily due to a 22.1% increase in third party processing tariffs related to de-ethanization of unstable gas condensate produced at the Yurkharovskoye field and a 27.4% increase in volumes de-ethanized, which accounted for RR 101 million of the total change. The remaining RR 27 million related to the processing of our unstable gas condensate at the Surgutsky refinery.

In 2008, our electricity and fuel expenses increased by RR 92 million, or 42.6%, due to higher tariffs for electricity at our production subsidiaries and a general increase in fuel prices.

Fire safety and security expenses decreased by RR 95 million, or 36.1%, to RR 168 million from RR 263 million in 2007, primarily due to a reduction in fire safety services provided by third parties at our production subsidiaries. During the fourth quarter 2007, the Group organized its own fire and safety departments to meet overall fire and safety requirements as well as to optimize costs by providing these services in-house at our production and processing facilities.

Operator services expense represents 11.4% of this category in 2008 and refers to the geological and geophysical research provided by the Group primarily to our associated companies and, to a lesser extent, third parties. In 2008, we provided services totaling RR 713 million to our associates at the Severo Russkiy, Anomalniy, Zapadno-Tazovskiy Sredniy Chaselskiy and Yuzhno-Zapolyarniy license areas, as compared to RR 61 million for services rendered in the fourth quarter 2007. Corresponding revenues received from our associates and third parties are shown as other revenues in the consolidated statement of income.

General and administrative expenses

In 2008, our general and administrative expenses increased by RR 1,191 million, or 30.8%, to RR 5,064 million compared to RR 3,873 million in 2007. The main components of these expenses were employee compensation, maintenance of social infrastructure and charitable contributions, and legal, audit, and consulting services which, on aggregate, comprised 76.4% and 75.5% of total general and administrative expenses for 2008 and 2007, respectively.

millions of Russian roubles	**Year ended 31 December: 2008**	**2007**	**Change %**
Employee compensation	3,053	1,961	55.7%
Maintenance of social infrastructure and charitable contributions	499	559	(10.7%)
Legal, audit, and consulting services	319	404	(21.0%)
Business trip expenses	216	199	8.5%
Rent expense	184	146	26.0%
Fire safety and security expense	139	123	13.0%
Depreciation – administrative buildings	103	66	56.1%
Insurance expense	90	117	(23.1%)
Other	461	298	54.7%
Total general and administrative expenses	**5,064**	**3,873**	**30.8%**

Our employee compensation increased by RR 1,092 million, or 55.7%, to RR 3,053 million compared to RR 1,961 million in the corresponding period in 2007. Additional employees' wages and staff at NOVATEK accounted for RR 878 million, or 80.4%, of the total increase in employee compensation, of which RR 787 million related to increases in employee wages and bonuses and RR 91 million related to increased head count.

In 2008, our maintenance of social infrastructure and charitable contributions decreased by RR 60 million, or 10.7%, to RR 499 million compared to RR 559 million in 2007. We are committed to continuing our support for charities and social programs in the regions where we operate and this expense will fluctuate depending on the funding needs and implementation schedules of specific programs.

Legal, audit and consulting service expenses decreased by RR 85 million, or 21.0%, to RR 319 million compared to RR 404 million in 2007. The decrease was largely due to the completion of the initial stage of consulting services related to management efficiency programs and information technology system reviews provided to the Group in the 2007 period.

In 2008, our rent expense increased by RR 38 million, or 26.0%, primarily due to the relocation of our Moscow office and the renting of additional office space to accommodate the consolidation of our Moscow head office operations. The relocation to the new Moscow office overlapped the termination of the lease for our old premises and this increase is thus considered a one-time event.

Insurance expense decreased by RR 27 million, or 23.1%, to RR 90 million compared to RR 117 million in 2007. The decrease was primarily due to lower Group insurance rates which are the result of a reduction in accident claims.

Other general and administrative expenses increased by RR 163 million, or 54.7%, in 2008 as compared to 2007. The increase in these items was mainly due to an increase in transportation expense, repair and maintenance expense (primarily expenses related to preparation work at the new Moscow office) and Board of Directors remuneration, which accounted for RR 37 million, RR 22 million and RR 15 million, respectively, of the increase. The remaining increase was spread among different expense categories within other general and administrative expenses which, taken individually, increased immaterially during the period.

Purchases of natural gas and liquid hydrocarbons

Purchases of natural gas and liquid hydrocarbons increased by RR 1,423 million, or 43.9%, to RR 4,665 million in 2008, from RR 3,242 million in 2007, primarily due to purchases of oil products, namely naphtha, on the international markets for resale, which amounted to RR 1,886 million in 2008 as compared to RR 730 million in 2007. Purchases of natural gas increased by RR 186 million, or 7.7%, from RR 2,407 million in 2007 to RR 2,593 million in 2008, primarily due to an increase in purchase prices that was partially offset by a decrease in volumes purchased.

Depreciation, depletion and amortization

In 2008, our depreciation, depletion and amortization ("DDA") expense increased by RR 810 million, or 22.1%, compared to the corresponding period in 2007, primarily due to an increase in the depreciation and depletion per unit rate for our oil and gas properties under the "units of production" method as well as an increase in our natural gas and liquids production.

During 2008, we completed two major capital expansion programs at the Yurkharovskoye field and the Purovsky Plant significantly increasing the capitalized oil and gas properties and equipment cost base used in the unit of production depreciation and depletion calculation, which is the primary driver in the per unit DDA charge during the year. In the 2008 period, our DDA per barrel of oil equivalent (boe) was RR 18.1 compared to DDA per boe of RR 15.7 in the corresponding period in 2007. The Purovsky Plant is depreciated on a straight-line basis.

Exploration expenses

In 2008, our exploration expenses increased by RR 631 million, or 129.8%, to RR 1,117 million from RR 486 million 2007. The increase was primarily due to 3D seismic works performed under the El Arish Concession Agreement during the fourth quarter 2008, which amounted to RR 344 million, or 54.5%, of the total increase. In addition, we have written off the cost of a dry well at the Ust-Purpeyskoye field in the amount of RR 96 million in 2008. The remaining RR 191 million of the increase was primarily related to further exploration activities at our three core fields.

Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress

In 2008, our inventory balance of stable gas condensate in transit and storage decreased by 4 thousand tons in 2008 compared to an increase of 34 thousand tons in 2007. Our balances of natural gas in the UGSF and the UGSS increased by 11 mmcm in 2008 compared to a decrease of 699 mmcm in 2007. We also recorded a charge of RR 82 million to change in inventory expense in 2008, due to a decrease in our naphtha inventory balance, compared to a reversal of the same amount in 2007.

The net effect was a reversal of RR 184 million to our change in inventory in 2008, compared to RR 31 million in the corresponding period in 2007.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 6,755 million, or 26.6%, to RR 32,120 million in 2008, compared to RR 25,365 million in 2007. In 2008, our profit from operations as a percentage of total revenues remained relatively consistent period-to-period (40.5% in 2008 compared to 40.7% in 2007).

Finance income (expense)

In 2008, we recorded a net finance loss of RR 3,384 million compared to net finance income of RR 124 million in 2007. The reversal was mainly due to a significant non-cash foreign exchange loss in 2008, due to the devaluation of the Russian rouble relative to the US dollar.

In 2008, interest income increased by RR 31 million, or 8.2%, primarily due to an increase in interest income on funds held on account as bank deposits, that was partially offset by a decrease in interest income on loans issued to our associates. In 2008, interest expense decreased by RR 41 million, or 15.6%.

In 2008, we recorded a net foreign exchange loss of RR 3,569 million compared to a net foreign exchange gain of RR 11 million in 2007. The net foreign exchange loss we recorded in 2008 was primarily due to a 19.7% strengthening of the US dollar against the Russian rouble and its effect on our foreign currency denominated borrowings.

Share of income (loss) of associated companies

In 2008, we recognized our proportionate share in the loss of associated companies of RR 147 million. The loss recognized by our associated companies was due to expensing of geological and geophysical research incurred in 2008 under the successful efforts accounting policy.

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 19.7% and 26.5% for the years ended 31 December 2008 and 2007, respectively. Our 2008 effective income tax rate, after excluding the effect from the change in the statutory income tax rate from 24% to 20% enacted in November 2008 and effective as of 1 January 2009, was 24.2%. Our effective income tax rate, after excluding the change in the statutory income tax rate in 2008 and the effect of foreign subsidiaries, was 24.5% and 27.0% in 2008 and 2007, respectively. The 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 RR 4,199 million, or 22.4%, to RR 22,927 million in 2008 from RR 18,728 million in 2007. The profit attributable to NOVATEK shareholders increased by RR 4,163 million, or 22.2%, to RR 22,899 million in 2008 from RR 18,736 million in 2007.

We increased our weighted average basic and diluted earnings per share by RR 1.37 per share, or 22.2%, to RR 7.54 per share in 2008, from RR 6.17 per share in 2007 based on the increase in profits attributable to NOVATEK 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 2008 and 2007:

	Year ended 31 December:		
millions of Russian roubles	**2008**	**2007**	**Change, %**
Net cash provided by operating activities	31,514	21,383	47.4%
Net cash used in investing activities	(31,886)	(20,747)	53.7%
Net cash used in financing activities	8,143	(3,678)	n/m

Liquidity ratios	**31 December 2008**	**31 December 2007**	**Change, %**
Current ratio	1.79	1.41	27.0%
Total debt to equity	0.27	0.08	237.5%
Long-term debt to long term debt and equity	0.172	0.001	n/m
Net debt to total capitalization (1)	0.12	0.03	300.0%

(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 10,131 million, or 47.4%, to RR 31,514 million in 2008 compared to RR 21,383 million in 2007. The increase was mainly attributable to higher operating income from our oil and gas sales as a result of increases in our natural gas and liquids realized prices and, to a lesser extent, increases in our overall hydrocarbon volumes sold domestically and internationally, that was partially offset by an increase in income tax paid.

Net cash used in investing activities

Net cash used in investing activities increased by RR 11,139 million to RR 31,886 million in 2008 compared to RR 20,747 million in 2007. The increase in 2008 was primarily due to an increase in capital expenditures related to further development at our three core fields, particularly phase two expansion at the Yurkharovskoye field, and the construction activities for the second phase expansion at the Purovsky Plant.

Net cash used in financing activities

In 2008, net cash provided by financing activities amounted to RR 8,143 million compared to net cash used in financing activities of RR 3,678 million in 2007. The change was primarily due to a significant increase in our proceeds from long-term borrowings that was partially offset by an increase in repayments of short-term debt and dividends in 2008.

Working capital

At 31 December 2008, our net working capital position (current assets less current liabilities) was RR 11,259 million compared to RR 4,963 million at 31 December 2007. The increase by RR 6,296 million was mainly due to increases in cash and cash equivalents at 31 December 2008, which resulted from an increase in cash from operations and proceeds from our syndicated term loan facility. The increase was offset by trade payables and accrued liabilities of RR 2,624 million as a result of increased capital expenditures at the Yurkharovskoye field and Purovsky Plant.

Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2008 and 2007 are as follows:

millions of Russian roubles	Year ended 31 December: 2008	2007	Change %
Exploration and production	30,145	18,638	61.7%
Other	1,665	828	101.1%
Total	**31,810**	**19,466**	**63.4%**

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. During 2008, we spent RR 1,035 million, RR 2,824 million, RR 15,090 million and RR 2,970 million for field development at the Khancheyskoye, East-Tarkosalinskoye, Yurkharovskoye and Sterkhovoye fields, respectively, and RR 7,343 million on construction of the second phase at the Purovsky Plant.

Debt obligations

During 2008, the Group repaid a short-term USD denominated loan from BNP PARIBAS in the amount of RR 2,501 million (USD 100 million) and repaid loans from CALYON S.A. and CALYON RUSBANK Corporate and Investment Bank totalling RR 2,367 million (USD 100 million) according to their scheduled maturities.

On 21 April 2008, the Group obtained an USD 800 million three-year unsecured syndicated term loan facility for general corporate purposes including funding capital expenditure programs. At 31 December 2008, RR 23,293 million (USD 793 million), net of transaction costs incurred, was withdrawn under this facility agreement.

At 31 December 2008, the Group had short-term credit facilities for available use in the aggregate amount of RR 4,407 million (USD 150 million) on either fixed or variable interest rates subject to the specific type of credit facility. In addition, the Group had an unused two-year credit line facility obtained from “UniCredit Bank” in November 2007 up to the maximum amount of RR 2,938 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 2008, RR 19,935 million, or 100.0%, of our long-term debt was denominated in US dollars (out of RR 26,277 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 28.5% in 2008, is denominated in US dollars. As of 31 December 2008, the Russian rouble had depreciated by approximately 19.7% against the US dollar since 1 January 2008.

A hypothetical and instantaneous 30% strengthening in the Russian rouble in relation to the US dollar as of 31 December 2008 would have resulted in an estimated foreign exchange gain of approximately RR 7,870 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 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 reduced demand for our hydrocarbons available for sale and the corresponding revenues generated from these sales 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; thereby, adversely affecting our financial and operating results.

Off balance sheet activities

As of 31 December 2008, 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.