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 2011 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2011 and 2010. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial and operational 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 each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for 2011. In terms of proved natural gas reserves, we are also the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

Our exploration, development, production and processing of natural gas, gas condensate and crude oil have been conducted primarily within the Russian Federation, and, in accordance with Russian law, 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 ("LPG") and crude oil are generally delivered to both international (including CIS) and domestic markets.

RECENT DEVELOPMENTS

In November 2011 and December 2010, the Group acquired OOO Gazprom mezhregiongas Chelyabinsk ("Gazprom mezhregiongas Chelyabinsk") and OOO Yamalgazresurs-Chelyabinsk, respectively, two natural gas traders serving the Chelyabinsk Region of the Russian Federation, to support and expand the Group's regional natural gas sales commercial operations.

In September 2011, the Group increased its equity interest in Yamal LNG from 51% to 100% and subsequently disposed of a 20% interest in the company in October 2011 to TOTAL S.A., the Group's strategic partner in the Yamal LNG project.

In June 2011, the Group took part in a tender organized by the Federal Agency of Mineral Resources for four licenses in the Yamal Nenets Autonomous Region ("YNAO"): exploration and production licenses for the Salmanovskoye (Utrenneye) and Geofizicheskoye fields, which have estimated recoverable reserves, according to the Russian reserve classification category C1+C2, of 979 billion cubic meters of natural gas and 46 million tons of liquid hydrocarbons as well as geological studies and production licenses for the North-Obskiy and East-Tambeyskiy license areas, which have combined resources, according to the Russian reserve classification category D1, of 1,763 billion cubic meters of natural gas and 221 million tons of liquid hydrocarbons. In August 2011, the Russian Government approved the transfer of these licenses to us for RR 6.9 billion in total consideration.

In June 2011, we dispatched a consignment of stable gas condensate to China via the Northern Sea Route ("NSR") using a new route north of the New Siberian Islands making us the first company to utilize the NSR in the 2011 navigational period. We shipped a total of nine cargos, or more than 600 thousand tons of stable gas condensate, produced by the Purovsky Gas Condensate Plant ("Purovsky Plant"), to markets in the Asian-Pacific region ("APR") via the NSR in 2011.

In September 2010, we organized the historic voyage of a high-tonnage tanker which travelled from the Russian port of Murmansk to the Chinese port of Ningbo, via the NSR, in just 22 days, approximately half the time required by the traditional shipping route through the Suez Canal and the Strait of Malacca. The use of the NSR for hydrocarbon transportation is an integral part of our logistical strategy to develop prospective fields in the Yamal peninsula.

Our ongoing exploration work at existing fields in 2011 resulted in the discovery of one new gas condensate deposit at the Yurkharovskoye field, two new gas condensate deposits at the North-Khancheyskiy license area, two new oil deposits at the East-Tarkosalinskoye field, two new gas condensate deposits at the Olimpiyskiy license area, a new gas deposit at the North-Russkiy license area and six gas condensate deposits at the South-Tambeyskoye field. In addition, in August 2011, we received an exploration and production license for the recently discovered Ukrainsko-Yubileynoye field.

In February 2011, the Group issued a debut Eurobond in an aggregate amount of USD 1,250 million. The bond was issued at par in two tranches, a five-year USD 600 million bond with a coupon rate of 5.326% per annum and a ten-year USD 650 million bond with a coupon rate of 6.604% per annum. The proceeds from the Eurobonds were used to repay a bridge facility and a portion of the costs associated with the acquisition of OAO Sibneftegas ("Sibneftegas").

In December 2010, the Group acquired 51% of the outstanding ordinary shares of Sibneftegas, an oil and gas company, which holds four geological studies and production licenses at the Beregovoye, Pyreinoye, Zapadno-Zapolyarnoye and Khadyryakhinskoye fields located in the YNAO. Sibneftegas' proved reserves, appraised by DeGolyer and MacNaughton ("D&M") under the Securities and Exchange Commission (SEC) and PRMS reserves methodologies, as of 31 December 2010, totaled approximately 200 billion and 282 billion cubic meters of natural gas and 0.7 million and 2.0 million tons of liquid hydrocarbons, respectively.

In July 2010, we created a 50/50 joint venture, OOO Yamal Development ("Yamal Development"), with OAO Gazprom Neft to jointly develop potential hydrocarbon assets in the YNAO. In November 2010, Yamal Development acquired a 51% participation interest in OOO SeverEnergia ("SeverEnergia"), those subsidiaries hold licenses for the development of oil and gas condensate fields (Samburgskoye, Yaro-Yakhinskoye, North-Chaselskoye, Urengoiskoye and other fields) in the YNAO. SeverEnergia's proved reserves as appraised by D&M under the SEC and PRMS reserves methodologies, as of 31 December 2010, totaled approximately 224 and 245 billion cubic meters of natural gas and 39 and 42 million tons of liquid hydrocarbons, respectively.

In October 2010, we launched the third stage of the second phase development at our Yurkharovskoye field, which included two additional processing trains for separating natural gas, thus increasing the field's annual productive capacity to approximately 33 billion cubic meters of natural gas and approximately three million tons of unstable gas condensate.

In September 2010, the Group disposed of its 100% participation interest in OOO NOVATEK-Polymer ("NOVATEK-Polymer"), a non-core subsidiary representing the segment "polymer production and marketing", to CJSC SIBUR Holding.

In August 2010, we acquired 100% of the outstanding ordinary shares of Intergaz-System Sp.z.o.o. ("Intergaz-System"), an LPG trader located in the South-East of Poland, and in December 2010 it was merged with our wholly owned Polish subsidiary Novatek Polska Sp.z.o.o. ("Novatek Polska"). Intergaz-System owns and operates a discharging and transhipment facility at the wide track (Russian) and narrow track (European) railroad junction. The acquisition enables us to continue developing our commercial activities within Poland and other European countries.

In August 2010, we launched an unstable gas condensate de-ethanization facility at our Yurkharovskoye field and completed the unstable gas condensate pipeline connecting the Yurkharovskoye field to the Purovsky Plant. The launch of this infrastructure allows us to process and transport all of the unstable gas condensate produced at the Yurkharovskoye field to the Purovsky Plant without utilizing third party facilities.

In July 2010, the Group acquired 100% of the outstanding ordinary shares of OAO Tambeyneftegas, an oil and gas company, which holds the license for exploration and development of the Malo-Yamalskoye field (license expires in 2019) located in the southern part of the Yamal peninsula, in the YNAO, with estimated natural gas and gas condensate reserves according to Russian reserve classification categories C1+C2 of 161 billion cubic meters and 14.4 million tons, respectively.

SELECTED DATA

millions of Russian roubles except as stated	Year ended 31 December: 2011	2010	Change %
Financial results			
Total revenues (net of VAT and export duties)	176,064	117,024	50.5%
Operating expenses	(97,665)	(68,518)	42.5%
Profit attributable to shareholders of OAO NOVATEK	119,655	40,533	195.2%
Profit attributable to shareholders of OAO NOVATEK, excluding net gain on disposal	56,707	39,204	44.6%
EBITDA (1)	148,349	57,506	158.0%
Normalized EBITDA (2)	85,401	56,177	52.0%
Normalized EBITDAX (3)	87,220	57,772	51.0%
Earnings per share (in Russian roubles)	39.45	13.37	195.1%
Normalized Earnings per share (in Russian roubles) (4)	18.69	12.93	44.6%
Operating results			
Natural gas sales volumes (million cubic meters)	53,667	37,117	44.6%
Stable gas condensate sales volumes (thousand tons)	2,984	2,330	28.1%
Liquefied petroleum gas sales volumes (thousand tons)	880	876	0.5%
Crude oil sales volumes (thousand tons)	242	185	30.8%
Oil product sales volumes (thousand tons)	5	10	(50.0%)
Total hydrocarbons production (million barrels of oil equivalent) (5)	380.6	274.0	38.9%
Total daily production (thousand barrels of oil equivalent per day) (5)	1,043	751	38.9%
Cash flow results			
Net cash provided by operating activities	71,907	44,863	60.3%
Capital expenditures	31,143	26,030	19.6%
Free cash flow (6)	40,764	18,833	116.4%

(1) EBITDA represents profit (loss) attributable to shareholders of OAO NOVATEK adjusted for the addback of net impairment expense, income tax expense and finance income (expense) from the Consolidated Statement of Income, and depreciation, depletion and amortization and share-based compensation from the Consolidated Statement of Cash Flows.

(2) Normalized EBITDA excludes net gain on disposal of interest in subsidiaries.

(3) Normalized EBITDAX represents EBITDA as adjusted for the addback of exploration expenses and excludes net gain on disposal of interest in subsidiaries.

(4) Normalized Earnings per share represents Earnings per share adjusted for net gain on disposal of interest in subsidiaries.

(5) Total hydrocarbons production and total daily production are calculated based on net production, including our proportionate share in the production of our joint venture.

(6) Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

Reconciliation of normalized EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO NOVATEK is as follows for the years ended 31 December 2011 and 2010:

millions of Russian roubles	Year ended 31 December: 2011	2010
Profit (loss) attributable to shareholders of OAO NOVATEK	**119,655**	**40,533**
Depreciation, depletion and amortization	9,475	6,757
Net impairment expense	782	541
Total finance income (expense)	2,703	(1,197)
Total income tax expense	15,734	10,804
Share-based compensation	-	68
EBITDA	**148,349**	**57,506**
Less: Net gain on disposal of interest in subsidiaries	(62,948)	(1,329)
Normalized EBITDA	**85,401**	**56,177**
Exploration expenses	1,819	1,595
Normalized EBITDAX	**87,220**	**57,772**

SELECTED MACRO-ECONOMIC DATA

Exchange rate, Russian roubles for one US dollar	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change
	2011	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**Y-o-Y, %**
At the beginning of the period	30.48	30.24	28.43	29.36	28.08	31.20	31.88	30.40	30.48	30.24	0.8%
At the end of the period	28.43	29.36	28.08	31.20	31.88	30.40	32.20	30.48	32.20	30.48	5.6%
Average for the period	29.27	29.89	27.99	30.24	29.05	30.62	31.23	30.71	29.39	30.37	(3.2%)

Crude oil prices, USD / bbl	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change
	2011	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**Y-o-Y, %**
WTI [1]											
At the end of the period	106.7	83.8	95.4	75.6	79.2	80.0	98.8	91.4	98.8	91.4	8.1%
Average for the period	94.6	78.9	102.3	78.1	89.5	76.2	94.1	85.2	95.1	79.6	19.5%
Brent [2]											
At the end of the period	116.9	80.3	111.5	75.0	105.2	81.0	106.5	92.5	106.5	92.5	15.1%
Average for the period	105.4	76.4	117.0	78.2	113.4	76.9	109.4	86.4	111.3	79.5	40.0%
Urals [2]											
At the end of the period	113.1	78.2	110.1	74.3	102.3	79.9	104.3	90.3	104.3	90.3	15.5%
Average for the period	102.6	75.4	113.7	76.9	111.5	75.6	108.7	85.1	109.1	78.3	39.3%

(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		Year		Change
	2011	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**Y-o-Y, %**
Crude oil, stable gas condensate											
At the end of the period	365.0	253.6	462.1	292.1	444.1	273.5	406.6	303.8	406.6	303.8	33.8%
Average for the period	343.0	263.8	446.5	281.7	442.5	262.0	403.7	287.0	408.9	273.6	49.5%
LPG											
At the end of the period	150.2	80.0	189.8	27.3	192.0	45.2	221.8	118.1	221.8	118.1	87.8%
Average for the period	166.1	63.7	137.0	48.4	182.6	34.3	218.3	98.5	176.0	61.2	187.6%

(1) Export duties are determined by the government of the Russian Federation in US dollars and are paid in Russian roubles.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

We continue to witness signs of economic instability in the Euro-Zone that have prolonged a period of market volatility. The second Greek bailout package and the potential threat to the European banking community of a sovereign-debt crisis in the European Union has been the main driver of the market volatility. The recent wave of market uncertainty may continue to negatively impact all borrowers by limiting access to the capital markets as well as causing continued volatility in the equity and currency markets, especially for those companies operating in the so-called “emerging markets”.

We will continue to monitor the credit situation very closely and take various measures, we deem necessary, 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 continue to take proactive steps to ensure the safety of our excess funds deposited with both domestic and international banks, as well as limit our risk exposure from prepayments to various service providers. Presently, our cash and deposits are diversified and maintained in banks that we believe are well capitalized in accordance with international capital adequacy rules.

We have reviewed our capital expenditure program for the upcoming year and have concluded that we have sufficient liquidity, through current internal cash flows and short-term borrowing facilities, to adequately fund our core natural gas business operations and planned capital expenditure program.

Management will continue to closely monitor the economic environment in Russia, as well as the domestic and international capital markets to determine if any further corrective and/or preventive measures are required to sustain and grow our business. In addition, we will continue to assess the trends in the capital markets for opportunities to access long-term funding at a reasonable cost to the Group commensurate with our investment grade credit ratings and our capital requirements.

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian Government’s regulation of natural gas prices, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency, and present market conditions. In 2011, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 320 per mcm, or 13.9%, to RR 2,619 per mcm compared to RR 2,299 per mcm in 2010.

The specific 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 gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses. Historically, we have realized 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. However, the historical norm may or may not prevail in the present or future market situations.

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. As part of the liberalization plan, the FTS approved the increases in the regulated price for natural gas by 15% effective from 1 January 2010 and 2011.

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015 but there are various Governmental discussions indicating that this program may be further extended. The regulation of the domestic natural gas price prior to 2015 will be based on the netback parity of natural gas prices on the domestic and export markets. According to the revised Forecast of Socio-economic Development of the Russian Federation for 2012 announced in September 2011, the regulated natural gas prices will be increased by 15% effective from 1 July 2012, as well as an expected increase of 15% in 2013 and 2014. We expect that 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.

In 2011, our average natural gas price to end-customers (excluding trading activities) and ex-field price increased by 13.7% and 14.9%, respectively, whereas our average transportation expense for the delivery of natural gas to end-customers (excluding trading activities) increased by 7.9% primarily due to a 9.3% increase in the average transportation tariff set by the FTS (see "Transportation tariffs" below). As a result, our average netback price on end-customers sales (excluding trading activities) increased by 19.2%, while our total average natural gas price excluding transportation expense increased by 17.3% compared to respective prices in 2010.

Our pricing strategy for natural gas is consistent with our commercial marketing strategy to enter new regions and markets to maintain and grow our share of natural gas deliveries to the domestic market, as well as to maintain our production growth.

The following table shows our average realized natural gas sales prices excluding trading activities (net of VAT) for the years ended 31 December 2011 and 2010:

Russian roubles per mcm	**Year ended 31 December: 2011**	**2010**	**Change %**
Average natural gas price to end-customers [1]	2,627	2,310	13.7%
Average natural gas transportation expense for sales to end-customers	(1,207)	(1,119)	7.9%
Average natural gas netback price on end-customer sales	1,420	1,191	19.2%
Average natural gas price ex-field (wholesale traders)	1,392	1,211	14.9%
Total average natural gas price excluding transportation expense	**1,407**	**1,199**	**17.3%**

[1] Includes cost of transportation.

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

Crude oil, stable gas condensate, 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.

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, such as movements in international benchmark crude oil prices. 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 (or historically) trades at a discount to the international benchmark Brent crude oil.

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our liquid volumes sold on both the domestic and international markets, among many other factors. In 2011, the average benchmark crude oil prices were more than 20% higher than in 2010.

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 specific terms of delivery.

In 2011, our stable gas condensate export delivery terms were delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF), or cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or delivery at terminal (DAT), while in 2010 our delivery terms were either DES, CIF, or CFR. Our average stable gas condensate export contract price, including export duties, in 2011 was approximately USD 931 per ton compared to approximately USD 692 per ton in 2010.

In 2011, our crude oil export delivery terms were DAP Feneshlitke, Hungary, while in 2010 our delivery terms were delivery at frontier (DAF, Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 787 per ton compared to USD 557 per ton in 2010.

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 2011 and 2010 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Year ended 31 December: 2011**	**2010**	**Change %**
Stable gas condensate			
Net export price, RR per ton	15,676	12,778	22.7%
Net export price, USD per ton	533.4	420.8	26.8%
Domestic price, RR per ton	13,818	10,022	37.9%
Crude oil			
Net export price, RR per ton	10,983	8,538	28.6%
Net export price, USD per ton	373.7	281.2	32.9%
Domestic price, RR per ton	9,792	7,523	30.2%

In 2011, our LPG export delivery terms were DAP at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and free carrier (FCA) at terminal points in Poland, compared to DAF (at the border of the customer's country), CPT (the Port of Temryuk) and FCA (terminal points in Poland) in 2010. In 2011, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 904 per ton compared to USD 619 per ton in 2010.

In 2011, as well as in 2010, we were obliged to sell a portion of our LPG sales volumes on the domestic market at regulated prices, while the remaining portion of our sales was sold under commercial terms. In 2011, we sold a total of 58 thousand tons of LPG on the domestic market at the regulated price of RR 7,605 per ton, while in 2010, we sold 53 thousand tons at the regulated price of RR 6,557 per ton. In 2011, we sold 368 thousand tons at an average commercial price of RR 13,822 per ton, including volumes sold through our wholly owned subsidiary OOO NOVATEK-Refueling Complexes, compared to 389 thousand tons at an average commercial price of RR 11,167 per ton in 2010.

The following table shows our average realized LPG and oil products sales prices excluding trading activities (net of VAT and export duties, where applicable) for 2011 and 2010 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Year ended 31 December: 2011**	**2010**	**Change %**
LPG			
Net export price, RR per ton	21,401	18,433	16.1%
Net export price, USD per ton	728.2	606.9	20.0%
Domestic commercial price, RR per ton	13,822	11,167	23.8%
Domestic regulated price, RR per ton	7,605	6,557	16.0%
Oil products			
Domestic price, RR per ton	-	6,773	n/a
Methanol			
Domestic price, RR per ton	10,000	-	n/a

Transportation tariffs

Natural gas

We transport our natural gas through our own pipelines into the Unified Gas Supply System ("UGSS"), which is owned and operated by OAO Gazprom, a Russian government controlled monopoly. Transportation tariffs for the use of the UGSS by independent producers are set by the FTS.

In accordance with 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), the transportation tariff consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 kilometers (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 and includes a constant rate 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.

In December 2009, the FTS approved a 12.3% average increase for the 2010 transportation tariff for natural gas effective 1 January 2010. Effective from 1 January 2010, the rate for utilization of the trunk pipeline had a range of RR 32.92 to RR 1,818.37 (excluding VAT) per mcm and the transportation rate was RR 10.27 (excluding VAT) per mcm per 100 km.

In December 2010, the FTS approved a 9.3% average increase for the 2011 transportation tariff for natural gas effective 1 January 2011, which is 0.5% higher than the Russian Federation's official inflation rate for 2010. Effective from 1 January 2011, the rate for utilization of the trunk pipeline had a range of RR 44.97 to RR 1,964.13 (excluding VAT) per mcm and the transportation rate was RR 11.23 (excluding VAT) per mcm per 100 km.

According to the announcement from the FTS in September 2011, the transportation tariff for natural gas will be increased as of the same date as the increase in the regulated natural gas prices, effective from 1 July 2012, with a range of between 6% to 12%.

The increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts.

Crude oil

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 primarily depends on the length of the transport route from the producing field to the ultimate destination.

Stable gas condensate and LPG

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.

In January 2010, the FTS approved the discount co-efficients to existing rail road transportation tariffs related to export deliveries of stable gas condensate and LPG shipped from the Limbey rail station, located in close proximity to our Purovsky Plant. The discount co-efficient for stable gas condensate was set at 0.89 for annual volumes shipped to export markets of 2,235 thousand tons or more and the discount co-efficient for LPG was set at 0.35 for export volumes in excess of 105 thousand tons which we reached in the middle of April 2010. The discount co-efficients remained in effect throughout 2010.

In December 2010, the FTS revised the discount co-efficients to existing rail road transportation tariffs related to export deliveries of stable gas condensate and LPG shipped from the Limbey rail station in 2011. The discount co-efficient for stable gas condensate is set at 0.89 for companies with annual shipped volumes of 2,600 thousand tons or more, and the discount co-efficient for LPG is set at 0.68 for delivered annual volumes of 415 thousand tons or more. The revised discount co-efficients remained in effect throughout 2011.

In December 2011, the FTS revised the discount co-efficients to existing rail road transportation tariffs related to export deliveries of stable gas condensate and LPG shipped from the Limbey rail station in 2012. The discount co-efficient for stable gas condensate is set at 0.89 for companies with annual shipped volumes of 3,000 thousand tons or more, and the discount co-efficient for LPG is set at 0.71 for delivered annual volumes of 445 thousand tons or more. The revised discount co-efficients are expected to remain in effect throughout 2012.

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, South American and countries of the APR. The costs associated with tanker transportation are determined by the distance to the final destination, as well as tanker availability, seasonality of deliveries and standard shipping terms.

Our tax burden

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, commonly referred as "MET" – mineral extraction tax), export duties, property tax, payments to non-budget funds (formerly known as social taxes) and other contributions.

According to amendments to the Russian Tax Code, the UPT rate for natural gas was increased from RR 147 to RR 237 per mcm, or by 61.2%, effective from 1 January 2011. The natural gas UPT rate for 2012 and 2013 is set at RR 251 and RR 265 per mcm, respectively.

According to amendments to the Russian Tax Code, approved in November 2011, the UPT rate for gas condensate was set at RR 556, RR 590 and RR 647 per ton for 2012, 2013 and 2014, respectively. In 2011 and 2010, the UPT rate for gas condensate was set at 17.5% of gas condensate revenues recognized by the producing entities.

In practice, Russian tax authorities often have their own interpretation of tax laws that rarely favours 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 immediately preceding 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.

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

OIL AND GAS RESERVES

In December 2008, the US Securities and Exchange Commission released the Final Rule for the *Modernization of Oil and Gas Reporting*, which requires the disclosure of oil and gas proved reserves by significant geographic area, using a 12 month average beginning-of-the-month price for the year, rather than year-end prices, and allows the use of reliable technologies to estimate proved oil and gas reserves, if the technologies have demonstrated reliable estimates about reserves. Furthermore, companies are required to report on the independence and qualifications of its reserve preparer or auditor, and file reports when a third party is relied upon to prepare reserve estimates or conduct an audit of the company's reserves.

OAO NOVATEK does not file with the SEC nor is obliged to report its reserves in compliance with these standards. However, we have consistently disclosed proved oil and gas reserves as unaudited supplemental information in the Group's IFRS audited consolidated financial statements. As part of management's continued efforts to improve investor confidence and provide transparency regarding the Group's oil and gas reserves, we have provided additional information about our hydrocarbon reserves based on the widely-industry accepted PRMS reserves reporting classification, which in addition to total proved reserves discloses information on the Group's probable and possible reserves.

Our proved reserves estimates are appraised by the Group's independent petroleum engineers, DeGolyer and MacNaughton ("D&M"). The Group's total proved reserves, comprised of proved developed and proved undeveloped reserves as of 31 December 2011 and 2010, were appraised using both reporting and disclosure requirements promulgated by the SEC and the PRMS reserves reporting classification. Proved reserves disclosed in the *Unaudited Supplemental Oil and Gas Disclosures* in the Group's IFRS consolidated financial statements are presented under the SEC reserve reporting methodology, which requires that 100% of the reserves attributable to all consolidated subsidiaries (whether or not wholly owned) shall be included for the reporting year as well as our proportionate share of proved reserves accounted for by the equity method.

The tables below provide a comparison of the Group's estimated reserves under SEC and PRMS classifications attributable to all consolidated subsidiaries and joint ventures *based on the Group's equity ownership interest in the respective fields* and do not reconcile to the proved reserves disclosed under the SEC reserve reporting methodology as noted above.

	Natural gas			
	SEC		**PRMS**	
Based on our equity ownership interest in the fields	***Billions of cubic feet***	***Billions of cubic meters***	***Billions of cubic feet***	***Billions of cubic meters***
Total proved reserves at 31 December 2009	**34,150**	**967**	**38,124**	**1,080**
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	2,392	68	2,579	73
Disposals [(1)]	(426)	(12)	(426)	(12)
Reclassifications [(2)]	(444)	(13)	(444)	(13)
Production	(1,314)	(37)	(1,314)	(37)
Total proved reserves at 31 December 2010	**34,358**	**973**	**38,519**	**1,091**
Equity share of total proved reserves at 31 December 2010	*6,057*	*171*	*7,726*	*219*
Grand total proved reserves at 31 December 2010	**40,415**	**1,144**	**46,245**	**1,310**
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	2,238	64	2,918	82
Acquisitions [(3)]	8,161	231	11,861	336
Disposals [(1)]	(3,331)	(95)	(4,841)	(137)
Reclassifications [(2)]	(13,323)	(377)	(19,364)	(548)
Production	(1,676)	(48)	(1,676)	(48)
Total proved reserves at 31 December 2011	**26,427**	**748**	**27,417**	**776**
Equity share of total proved reserves at 31 December 2011	*20,236*	*573*	*28,562*	*809*
Grand total proved reserves at 31 December 2011	**46,663**	**1,321**	**55,979**	**1,585**

[(1)] Disposals represent reserves attributable to the sale of an equity stake in a subsidiary.

[(2)] Reclassifications represent reserves attributable to equity stake in a subsidiary reclassified to joint venture due to loss of control.

[(3)] Acquisitions represent reserves attributable to acquired equity stake in a subsidiary.

Based on our equity ownership interest in the fields	Crude oil, gas condensate and natural gas liquids			
	SEC		PRMS	
	Millions of barrels	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*
Total proved reserves at 31 December 2009	**529**	**63**	**650**	**79**
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	43	6	66	9
Disposals [(1)]	(20)	(2)	(20)	(2)
Reclassifications [(2)]	(20)	(3)	(20)	(3)
Production	(31)	(4)	(31)	(4)
Total proved reserves at 31 December 2010	**501**	**60**	**645**	**79**
Equity share of total proved reserves at 31 December 2010	*103*	*13*	*116*	*14*
Grand total proved reserves at 31 December 2010	**604**	**73**	**761**	**93**
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	91	11	91	10
Acquisitions [(3)]	84	10	125	15
Disposals [(1)]	(34)	(4)	(51)	(6)
Reclassifications [(2)]	(138)	(16)	(204)	(24)
Production	(35)	(4)	(35)	(4)
Total proved reserves at 31 December 2011	**469**	**57**	**571**	**70**
Equity share of total proved reserves at 31 December 2011	*283*	*34*	*399*	*48*
Grand total proved reserves at 31 December 2011	**752**	**91**	**970**	**118**

[(1)] Disposals represent reserves attributable to the sale of an equity stake in a subsidiary.

[(2)] Reclassifications represent reserves attributable to equity stake in a subsidiary reclassified to joint venture due to loss of control.

[(3)] Acquisitions represent reserves attributable to acquired equity stake in a subsidiary.

The following table provides for our combined SEC and PRMS proved reserves on a total boe basis.

Based on our equity ownership interest in the fields	Combined natural gas, crude oil, gas condensate and natural gas liquids in millions of barrels of oil equivalent	
	SEC	PRMS
Total proved reserves:		
At 31 December 2009	6,853	7,711
At 31 December 2010	8,088	9,325
At 31 December 2011	9,393	11,337
including subsidiaries	*5,363*	*5,649*
including equity share of reserves	*4,030*	*5,688*

The PRMS reserve classification standards allows for the reporting of reserves estimates for probable and possible reserves as presented in the following table:

	Natural gas		**Crude oil, gas condensate and natural gas liquids**	
Under PRMS classification (based on our equity ownership interest in the fields)	***Billions of cubic feet***	***Billions of cubic meters***	***Millions of barrels***	***Millions of metric tons***
Probable reserves:				
At 31 December 2009	13,520	383	375	46
At 31 December 2010	18,748	531	587	73
At 31 December 2011	18,471	523	652	81
including subsidiaries	*8,944*	*253*	*365*	*46*
including equity share of reserves	*9,527*	*270*	*287*	*35*
Possible reserves:				
At 31 December 2009	9,416	267	696	89
At 31 December 2010	14,867	421	915	117
At 31 December 2011	17,187	487	1,000	127
including subsidiaries	*6,560*	*186*	*645*	*82*
including equity share of reserves	*10,627*	*301*	*355*	*45*

The Group's PRMS proved reserves attributable to consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in the respective fields aggregated approximately 1.6 trillion cubic meters (tcm) of natural gas and 118 million tons of gas condensate and crude oil as of 31 December 2011. Combined, these proved reserves represent approximately 11.3 billion barrels of oil equivalent.

Our total PRMS proved reserves attributable to consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in their respective fields have increased by 21.6% during 2011 due primarily to the 29% increase in our equity stake in Yamal LNG as of 31 December 2011, revisions of previous estimates and organic growth at our core fields. As we continue to invest capital into the development of our fields, we anticipate that we will increase our resource base as well as migrate reserves among the reserve categories.

The increase in the Group's PRMS probable and possible reserves during 2011 was also primarily due to the increase in our equity stake in Yamal LNG that was partially offset by the migration of probable reserves to proved reserve category at SeverEnergia's fields as a result of ongoing field development activities.

The SEC and PRMS reserve tables noted above do not include reserves attributable to our recent acquisitions of four new licenses in the Yamal and Gydan peninsulas, which will be appraised in subsequent reserve reports as exploration and development activities commence.

The Group's reserves are all located in the Russian Federation, in the Yamal-Nenets Autonomous Region (Western Siberia), thereby representing one geographical area.

The below table contains information about reserve/production ratios for the years ended 31 December 2011 and 2010 under both reserves reporting methodologies *based on our equity ownership interest, rather than 100% of the reserves attributable to all consolidated subsidiaries and joint ventures*:

	SEC		**PRMS**	
	At 31 December:		**At 31 December:**	
Number of years (based on our equity ownership interest in the fields)	**2011**	**2010**	**2011**	**2010**
Total proved reserves to production	25	30	30	34
Total proved and probable reserves to production	-	-	40	49
Total proved, probable and possible reserves to production	-	-	51	62

The decrease in our total proved reserves to production was primarily due to an increase in our production.

The Group's oil and gas estimation and reporting process involves an annual independent third party appraisal as well as internal technical appraisals of reserves. The Group maintains its own internal reserve estimates that are calculated by qualified technical staff working directly with the oil and gas properties. The Group periodically updates reserves estimates during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for reserve determinations. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history. Our reserves estimates were prepared using standard geological and engineering methods generally accepted in the petroleum industry. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of the process, senior management reviews and approves the final reserves estimates issued by D&M.

The Reserves Management and Assessment Group (RMAG) is comprised of qualified technical staff from various departments – geological and geophysical, gas and liquids commercial operations, capital construction, production, financial planning and analysis and includes technical and financial representatives from the Group's subsidiaries, which are the principal holders of the mineral licenses. The person responsible for overseeing the work of the RMAG is a member of the Management Board.

The approval of the final reserves estimates is the sole responsibility of the Group's senior management.

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 for the years ended 31 December 2011 and 2010. 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 barrel of oil equivalent (boe) basis in Russian roubles and US dollars:

millions of Russian roubles	**Year ended 31 December: 2011**	**2010**	**Change %**
Production costs:			
Lifting costs	5,180	4,469	15.9%
Taxes other than income tax	17,287	9,831	75.8%
Transportation expenses	46,064	37,187	23.9%
Total production costs before DD&A	**68,531**	**51,487**	**33.1%**
Depreciation, depletion and amortization (DD&A)	8,878	6,384	39.1%
Total production costs	**77,409**	**57,871**	**33.8%**

RR per boe	**Year ended 31 December: 2011**	**2010**	**Change %**
Production costs:			
Lifting costs	15.0	16.3	(8.0%)
Taxes other than income tax	50.1	35.9	39.6%
Transportation expenses	133.6	135.8	(1.6%)
Total production costs before DD&A	**198.7**	**188.0**	**5.7%**
Depreciation, depletion and amortization (DD&A)	25.8	23.3	10.7%
Total production costs	**224.5**	**211.3**	**6.2%**

USD per boe	**Year ended 31 December: 2011**	**2010**	**Change %**
Production costs:			
Lifting costs	0.51	0.54	(5.6%)
Taxes other than income tax	1.71	1.18	44.9%
Transportation expenses	4.55	4.46	2.0%
Total production costs before DD&A	**6.77**	**6.18**	**9.5%**
Depreciation, depletion and amortization (DD&A)	0.88	0.76	15.8%
Total production costs	**7.65**	**6.94**	**10.2%**

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 tax (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.

Our lifting costs, as presented in the tables above, differ from lifting costs as reflected in the *Unaudited Supplemental Oil and Gas Disclosures* in the Group's IFRS consolidated financial statements, in that the lifting costs as presented in the Group's IFRS consolidated financial statements include changes in balances of natural gas and hydrocarbon liquids to more appropriately match costs incurred to revenues under the IFRS matching principles. A reconciliation of lifting costs as reflected in the *Unaudited Supplemental Oil and Gas Disclosures* in the Group's IFRS consolidated financial statements is set forth below:

millions of Russian roubles	**Year ended 31 December: 2011**	**2010**	**Change %**
Lifting costs presented in "Oil and Gas Production Costs" above	5,180	4,469	15.9%
Change in balances of natural gas and hydrocarbon liquids stated at cost in the Group's Consolidated Statement of Financial Position	56	385	(85.5%)
Lifting costs per *"Unaudited Supplemental Oil and Gas Disclosures"*	**5,236**	**4,854**	**7.9%**

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to a combination of increased production at our core producing fields and purchases from our joint venture, Sibneftegas. Liquids sales volumes increased primarily due to an increase in unstable gas condensate production at the Yurkharovskoye field and, to a lesser extent, a buildup in liquids inventory balances in 2010. Our inventory balances tend to fluctuate period-on-period due to loading schedules and final destinations of stable gas condensate shipments.

Natural gas sales volumes

millions of cubic meters	Year ended 31 December: 2011	2010	Change %
Production from:			
Yurkharovskoye field	32,035	24,436	31.1%
East-Tarkosalinskoye field	12,151	9,735	24.8%
Khancheyskoye field	3,263	3,013	8.3%
Other fields	72	77	(6.5%)
Total natural gas production	**47,521**	**37,261**	**27.5%**
Purchases from:			
Sibneftegas, the Group’s joint venture	5,384	-	n/a
Third parties	841	-	n/a
Total production and purchases	**53,746**	**37,261**	**44.2%**
Purovsky Plant and own usage	(109)	(98)	11.2%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	30	(46)	n/a
Total natural gas sales volumes	**53,667**	**37,117**	**44.6%**
Sold to end-customers	*29,332*	*23,745*	*23.5%*
Sold ex-field	*24,335*	*13,372*	*82.0%*

In 2011, our total natural gas production (including our share in production of our joint venture Sibneftegas) increased by 15,644 mmcm, or 42.0%, compared to 37,261 mmcm in 2010 primarily due to an increase in production at our Yurkharovskoye and East-Tarkosalinskoye fields, as well as the consolidation of our share in production of the Group’s joint venture. We were able to increase natural gas production at the Yurkharovskoye field due to the launch of the third stage of the field’s second phase development in October 2010. The increase in natural gas production at the East-Tarkosalinskoye field was due to increased demand in 2011 resulting in a greater utilization of the field’s production capacity.

In December 2011, we purchased 841 mmcm of natural gas from third parties in the Chelyabinsk region, the price of which included the cost of transportation to this region, through our subsidiary Gazprom mezhregiongas Chelyabinsk, a regional gas trader acquired in November 2011. The purchases were made according to pre-existing contractual obligations and effective January 2012 we will no longer purchase natural gas under these agreements.

In 2011, we used 63 mmcm of natural gas as feedstock for the production of methanol compared to 53 mmcm in 2010. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation (condensation) during the production, preparation and transportation of hydrocarbons.

Liquids sales volumes

thousands of tons	Year ended 31 December: 2011	2010	Change %
Production from:			
Yurkharovskoye field	2,718	2,099	29.5%
East-Tarkosalinskoye field	808	852	(5.2%)
Khancheyskoye field	560	635	(11.8%)
Other fields	25	31	(19.4%)
Total liquids production	**4,111**	**3,617**	**13.7%**
Purchases from:			
Third parties	6	12	(50.0%)
Total production and purchases	**4,117**	**3,629**	**13.4%**
Losses and own usage [(1)]	(37)	(39)	(5.1%)
Gas condensate pipeline fill and de-ethanization	-	(36)	n/a
Decreases (increases) in liquids inventory balances	31	(153)	n/a
Total liquids sales volumes	**4,111**	**3,401**	**20.9%**
Stable gas condensate export	*2,981*	*2,326*	*28.2%*
Stable gas condensate domestic	*3*	*4*	*(25.0%)*
Subtotal stable gas condensate	***2,984***	***2,330***	***28.1%***
LPG export	*453*	*434*	*4.4%*
LPG CIS	*1*	*0*	*n/a*
LPG domestic	*336*	*397*	*(15.4%)*
LPG sold through domestic retail and small wholesale stations	*90*	*45*	*100.0%*
Subtotal LPG	***880***	***876***	***0.5%***
Crude oil export	*93*	*71*	*31.0%*
Crude oil domestic	*149*	*114*	*30.7%*
Subtotal crude oil	***242***	***185***	***30.8%***
Oil products domestic	*5*	*10*	*(50.0%)*
Subtotal oil products	***5***	***10***	***(50.0%)***

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

In 2011, our liquids production increased by 494 thousand tons, or 13.7%, to 4,111 thousand tons compared to 3,617 thousand tons in 2010, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the third stage of the field’s second phase development in October 2010. The decrease in liquids production at the Khancheyskoye and East-Tarkosalinskoye fields was due to lower concentration of gas condensate in the extracted gas. Natural declines in the concentrations of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2011 COMPARED TO THE YEAR ENDED 31 DECEMBER 2010

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2011 and 2010. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	**2011**	**% of total revenues**	**2010**	**% of total revenues**
Total revenues **(net of VAT and export duties)**	**176,064**	***100.0%***	**117,024**	***100.0%***
including:				
natural gas sales	110,932	*63.0%*	71,060	*60.7%*
liquids sales	64,670	*36.7%*	44,102	*37.7%*
Operating expenses	(97,665)	*(55.5%)*	(68,518)	*(58.6%)*
Net gain on disposal of interest in subsidiaries	62,948	*35.8%*	1,329	*1.1%*
Other operating income (loss)	261	*0.1%*	396	*0.4%*
Profit from operations	**141,608**	***80.4%***	**50,231**	***42.9%***
Finance income (expense)	(2,703)	*(1.5%)*	1,197	*1.0%*
Share of profit (loss) of equity investments, net of income tax	(3,880)	*(2.2%)*	(346)	*(0.2%)*
Profit before income tax	**135,025**	***76.7%***	**51,082**	***43.7%***
Total income tax expense	(15,734)	*(8.9%)*	(10,804)	*(9.3%)*
Profit (loss)	**119,291**	***67.8%***	**40,278**	***34.4%***
Non-controlling interest	364	*0.2%*	255	*0.2%*
Profit attributable to shareholders of OAO NOVATEK	**119,655**	***68.0%***	**40,533**	***34.6%***

Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the years ended 31 December 2011 and 2010:

millions of Russian roubles	**Year ended 31 December: 2011**	**2010**	**Change %**
Natural gas sales	**110,932**	**71,060**	**56.1%**
End-customers	*77,046*	*54,860*	*40.4%*
Ex-field sales	*33,886*	*16,200*	*109.2%*
Stable gas condensate sales	**46,778**	**29,754**	**57.2%**
Export	*46,732*	*29,720*	*57.2%*
Domestic	*46*	*34*	*35.3%*
Liquefied petroleum gas sales	**15,227**	**12,747**	**19.5%**
Export	*9,697*	*8,052*	*20.4%*
CIS	*10*	*9*	*11.1%*
Domestic	*5,520*	*4,686*	*17.8%*
Crude oil sales	**2,479**	**1,458**	**70.0%**
Export	*1,021*	*603*	*69.3%*
Domestic	*1,458*	*855*	*70.5%*
Oil and gas products sales	**186**	**143**	**30.1%**
Domestic	*186*	*143*	*30.1%*
Total oil and gas sales	**175,602**	**115,162**	**52.5%**
Sales of polymer and insulation tape	-	1,699	n/a
Other revenues	462	163	183.4%
Total revenues	**176,064**	**117,024**	**50.5%**

Natural gas sales

In 2011, our revenues from sales of natural gas increased by RR 39,872 million, or 56.1%, compared to 2010 largely due to an increase in sales volumes and, to a lesser extent, an increase in natural gas prices.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased to 54.7% in 2011 from 64.0% in 2010. The decrease was due to the increase of sales volumes to one of our main gas traders and the commencement from January 2011 of natural gas sales, ex-field, to ITERA, a Russian oil and gas company, under a long-term contract signed in April 2010 for annual volumes of approximately four billion cubic meters. There were no corresponding sales of natural gas to ITERA in 2010.

The average realized prices of our natural gas sold directly to end-customers (including transportation expense and excluding trading activities) and sold ex-field were higher by 13.7% and 14.9% , respectively, in 2011 compared to 2010. In 2011, as well as in 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies. In addition, in December 2011, we commenced natural gas sales to a new end-customer segment in the Chelyabinsk region, residential customers, as a result of the acquisition of our wholly owned trading subsidiary Gazprom mezhregiongas Chelyabinsk in November 2011.

Stable gas condensate sales

In 2011, our revenues from sales of stable gas condensate increased by RR 17,024 million, or 57.2%, compared to 2010 due to both an increase in volumes sold and an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation.

Our total stable gas condensate sales volumes increased by 654 thousand tons, or 28.1%, due to an increase in our unstable gas condensate production and a decrease in the stable gas condensate inventory balance in 2011 compared to an increase in 2010 (see "Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress" below). In 2011, we exported 2,981 thousand tons of stable gas condensate, or 99.9% of our total sales volumes, to APR, Europe and the United States, with the remaining three thousand tons sold domestically. In 2010, we exported 2,326 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to the United States, APR, Europe and South America, with the remaining four thousand tons sold domestically.

In 2011, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 112.6 per ton, or 26.8%, to USD 533.4 per ton (DAP, CIF, CFR, DES and DAT) from USD 420.8 per ton (DES, CFR and CIF) in 2010 due to a 34.5% increase in our average export contract price that was partially offset by a 48.3% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in 2011 compared to 2010.

Liquefied petroleum gas sales

In 2011, our revenues from sales of LPG increased by RR 2,480 million, or 19.5%, compared to 2010, primarily due to an increase in our average realized prices.

In 2011, we sold 453 thousand tons of LPG, or 51.5% of our total LPG sales volumes, to export markets compared to 434 thousand tons, or 49.5%, in 2010. In 2011, our export sales volumes of LPG representing greater than 10% were primarily to Poland and Finland compared to sales to Poland, Finland and Turkey in 2010.

Our average realized LPG export price, excluding export duties, increased by USD 117.2 per ton, or 19.2%, to USD 728.2 per ton in 2011 (DAP, CPT and FCA) compared to USD 611.0 per ton in 2010 primarily due to a 46.0% increase in our average contract price that was partially offset by a three-fold increase in the average export duty per ton.

In 2011, we sold 426 thousand tons of LPG, or 48.4% of our total LPG sales volumes, on the domestic market at an average price of RR 12,971 per ton (FCA, excluding VAT) representing an increase of RR 2,362 per ton, or 22.3%, compared to 2010.

Crude oil sales

In 2011, our revenues from sales of crude oil increased by RR 1,021 million, or 70.0% , compared to 2010, due to an increase in sales volumes and, to a lesser extent, an increase in our average realized prices. Our crude oil sales volumes increased by 57 thousand tons, or 30.8%, to 242 thousand tons from 185 thousand tons in 2010 due primarily to an increase in crude oil production at our East-Tarkosalinskoye field.

The majority of our crude oil sales volumes, representing 61.6% in 2011, was sold domestically at an average price of RR 9,792 per ton (excluding VAT) representing an increase of RR 2,269 per ton, or 30.2%, compared to 2010. The remaining 38.4% of our crude oil volumes were sold to export markets at an average price of USD 373.7 per ton (DAP, excluding export duties) representing an increase of USD 92.5 per ton, or 32.9%, compared to 2010.

The increase in the average realized export price (excluding export duties) was the result of a 41.3% increase in our average export contract price that was partially offset by a 50.4% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in benchmark crude oil prices on international markets in 2011 compared to 2010.

Oil and gas products sales

In 2011, our revenue from the sales of oil and gas products increased by RR 43 million, or 30.1%, to RR 186 million from RR 143 million in 2010.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 37 million to RR 147 million in 2011, compared to RR 110 million in 2010 due to an increase in sales prices. In 2011 and 2010, we sold approximately 5.4 thousand and 4.8 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 27,232 and RR 22,951 per ton, respectively.

In 2011, we had no revenues from domestic sales of oil products produced at the Surgutsky refinery, compared to revenues of RR 33 million in 2010, due to the cessation of deliveries of our unstable gas condensate to the Surgutsky refinery starting in September 2010. In August 2010, we launched our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant eliminating the need for third-party transportation and processing.

In 2011, we sold approximately four thousand tons of methanol to our joint venture, Sibneftegas, and recorded revenues of RR 39 million from such sale.

Sales of polymer and insulation tape

In 2011, we had no revenues from the sales of polymer and insulation tape, compared to revenues of RR 1,699 million in 2010, due to the disposal of our polymer and insulation tape production subsidiary NOVATEK–Polymer in September 2010.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In 2011, other revenues increased by RR 299 million, or 183.4%, to RR 462 million from RR 163 million in 2010. The increase was primarily comprised of RR 131 million in other revenue for the sublet of leased tankers as well as a RR 81 million increase in revenue from transportation, handling and storage services. The remaining increase of RR 87 million in other revenues was made up of various immaterial items.

Operating expenses

In 2011, our total operating expenses increased by RR 29,147 million, or 42.5%, to RR 97,665 million compared to RR 68,518 million in 2010, primarily due to an increase in transportation expenses, taxes other than income tax and purchases of natural gas. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased to 67.3% in 2011 compared to 69.0% in 2010. Total operating expenses decreased as a percentage of total revenues to 55.5% in 2011 compared to 58.6% in 2010, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas and liquids volumes and sales prices, as well as cost optimization due to the launch of our own transport and processing infrastructure in August 2010.

	Year ended 31 December:			
millions of Russian roubles	**2011**	**% of total revenues**	**2010**	**% of total revenues**
Transportation expenses	48,176	*27.4%*	37,200	*31.8%*
Taxes other than income tax	17,557	*10.0%*	10,077	*8.6%*
Subtotal non-controllable expenses	**65,733**	***37.3%***	**47,277**	***40.4%***
Depreciation, depletion and amortization	9,277	*5.3%*	6,616	*5.7%*
General and administrative expenses	8,218	*4.7%*	6,733	*5.8%*
Purchases of natural gas and liquid hydrocarbons	5,994	*3.4%*	154	*0.1%*
Materials, services and other	5,947	*3.4%*	6,072	*5.2%*
Exploration expenses	1,819	*1.0%*	1,595	*1.4%*
Net impairment expense	782	*0.4%*	541	*0.5%*
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(105)	*n/m*	(470)	*n/m*
Total operating expenses	**97,665**	***55.5%***	**68,518**	***58.6%***

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 2011, non-controllable expenses of transportation and taxes other than income tax increased by RR 18,456 million, or 39.0%, to RR 65,733 million from RR 47,277 million in 2010. The change in transportation expenses was primarily due to an increase in natural gas sales volumes, as well as the increase in the natural gas and liquids transportation tariffs. Taxes other than income tax increased primarily due to a 61.2% increase in the natural gas production tax rate effective from 1 January 2011, as well as higher natural gas and liquids production volumes. As a percentage of total revenues, our non-controllable expenses decreased to 37.3% in 2011 from 40.4% in 2010.

Transportation expenses

In 2011, our total transportation expenses increased by RR 10,976 million, or 29.5%, compared to 2010.

million of Russian roubles	**Year ended 31 December:**		**Change**
	2011	**2010**	**%**
Natural gas transportation to customers	34,441	26,569	29.6%
Liquids transportation by rail	9,638	7,350	31.1%
Liquids transportation by tankers	3,647	2,771	31.6%
Crude oil transportation to customers	281	190	47.9%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	-	307	n/a
Other transportation costs	169	13	n/a
Total transportation expenses	**48,176**	**37,200**	**29.5%**

In 2011, our transportation expenses for natural gas increased by RR 7,872 million, or 29.6%, to RR 34,441 million from RR 26,569 million in 2010. The change was mainly due to a 20.0% increase in our sales volumes of natural gas to end-customers, for which we incurred transportation expense, as well as a 9.3% increase in the natural gas transportation tariff set by the FTS (see “Transportation tariffs” above). Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

In 2011, total expenses for liquids transportation by rail increased by RR 2,288 million, or 31.1%, to RR 9,638 million from RR 7,350 million in 2010 due to an increase in our combined liquids volumes sold and transported via rail, as well as higher average liquids transportation tariffs. In 2011, our combined liquids volumes sold and transported via rail increased by 653 thousand tons, or 20.7%, to 3,806 thousand tons from 3,153 thousand tons in 2010.

In 2011, our weighted average transportation tariff for liquids delivered by rail increased by 8.7% to RR 2,533 per ton from RR 2,331 per ton in 2010 primarily due to an 8.0% increase in rail tariffs set by the FTS effective 1 January 2011. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-to-period and depends on products type and the geography of deliveries.

In 2011, as well as in 2010, we applied a co-efficient of 0.89 to the existing rail tariff for stable gas condensate deliveries to export markets. In addition, in 2011, we applied a co-efficient of 0.68 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation compared to a co-efficient of 0.35, applicable from the middle of April 2010 (see “Transportation tariffs” above).

Total transportation expense for liquids delivered by tankers to international markets increased by RR 876 million, or 31.6%, to RR 3,647 million in 2011 from RR 2,771 million in 2010. The change was primarily due to a 28.2% increase in volumes sold, as well as a slight increase in average freight rates. In 2011, we sold 43.4% of our total stable gas condensate export volumes to the APR, 34.3% to Europe and 22.3% to the United States, whereas in 2010, we sold 53.4% to the United States, 26.1% to the APR, 12.9% to Europe and 7.6% to South America.

Starting from August 2010, we no longer incur expenses related to unstable gas condensate transportation from the fields to the processing facilities through third party pipelines due to the launch of our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant (see “Recent developments” above).

Taxes other than income tax

millions of Russian roubles	Year ended 31 December: 2011	2010	Change %
Unified natural resources production tax (UPT)	14,523	7,861	84.7%
Property tax	1,742	1,482	17.5%
Excise and fuel taxes	998	454	119.8%
Other taxes	294	280	5.0%
Total taxes other than income tax	**17,557**	**10,077**	**74.2%**

In 2011, taxes other than income tax increased by RR 7,480 million, or 74.2%, primarily due to an increase in the unified natural resources production tax expense.

In 2011, our UPT for natural gas increased by RR 5,850 million, or 106.6%, due to a 61.2% increase in the natural gas production tax rate effective 1 January 2011 (from RR 147 to RR 237 per mcm), and an increase in our natural gas production volumes. The remaining increase in UPT expenses of RR 812 million related to the UPT for gas condensate and crude oil and was primarily due to an increase in the crude oil tax rate and production volumes. Our average UPT rate for crude oil is linked to the Urals benchmark crude oil price and increased to RR 4,490 per ton in 2011 from RR 3,099 per ton in 2010.

In 2011, our property tax expense increased by RR 260 million, or 17.5%, to RR 1,742 million from RR 1,482 million in 2010, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In 2011, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska increased by RR 544 million, or 119.8%, due to an increase in our LPG export sales through this subsidiary. The excise and fuel taxes are payable when LPG enters Polish territory.

Depreciation, depletion and amortization

In 2011, our depreciation, depletion and amortization (“DDA”) expense increased by RR 2,661 million, or 40.2%, to RR 9,277 million from RR 6,616 million in 2010 as a result of an increase in our depletable cost base, as well as a 26.0% increase in our total hydrocarbon production (excluding our proportionate share in the production of joint ventures) in barrels of oil equivalent (boe). The Group accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In 2011, our DDA per boe was RR 23.1 compared to RR 20.5 in 2010. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the third stage of the second phase development at the Yurkharovskoye field in October 2010 as well as other costs capitalized during 2011.

Our reserve base, used as the denominator in the calculation of the DDA charge under the “units of production” method, is only appraised on an annual basis as of 31 December and does not fluctuate during the year, whereas our depletable cost base does change each quarter due to the ongoing capitalization of our costs throughout the year.

General and administrative expenses

In 2011, our general and administrative expenses increased by RR 1,485 million, or 22.1%, to RR 8,218 million compared to RR 6,733 million in 2010. The main components of these expenses were employee compensation, social expenses and compensatory payments and legal, audit and consulting services, which, on aggregate, comprised 80.7% and 76.5% of total general and administrative expenses in 2011 and 2010, respectively.

	Year ended 31 December:		Change
millions of Russian roubles	**2011**	**2010**	**%**
Employee compensation	4,650	3,874	20.0%
Social expenses and compensatory payments	1,212	774	56.6%
Legal, audit, and consulting services	774	504	53.6%
Business trip expenses	218	265	(17.7%)
Depreciation – administrative buildings	198	141	40.4%
Fire safety and security expenses	178	149	19.5%
Rent expense	140	270	(48.1%)
Board remuneration	103	93	10.8%
Concession management services	63	125	(49.6%)
Bank charges	58	59	(1.7%)
Other	624	479	30.3%
Total general and administrative expenses	**8,218**	**6,733**	**22.1%**

Employee compensation increased by RR 776 million, or 20.0%, to RR 4,650 million in 2011 as compared to RR 3,874 million in 2010 primarily due to a RR 530 million increase in bonuses paid for the results achieved in 2010 and accrued for the results achieved in 2011. In addition, an increase of RR 298 million was due to an indexation of base salaries by 9.6% from 1 July 2011. The increase was partially offset by a decrease in the recognition of charges related to NOVATEK's share-based compensation program for the Group's senior and key management from RR 400 million in 2010 to RR 235 million in 2011.

In 2011, our social expenses and compensatory payments increased by RR 438 million, or 56.6%, to RR 1,212 million compared to RR 774 million in 2010 primarily due to the commencement in 2011 of direct payments to the YNAO government to undertake new socio-economic programs related to the Yamal LNG project. Social expenses and compensatory payments will continue to fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 270 million, or 53.6%, to RR 774 million compared to RR 504 million in 2010 largely due to an increase in legal and consulting services connected with the development of the Yamal LNG project.

In 2011, depreciation of administrative buildings increased by RR 57 million, or 40.4% , due to the completion and opening of our new Moscow head-office in the second quarter 2011. Administrative buildings are depreciated on a straight-line basis over their estimated useful lives.

Fire safety and security expenses increased by RR 29 million, or 19.5%, to RR 178 million in 2011 from RR 149 million in 2010 as a result of the opening of our new Moscow head-office in May 2011.

In 2011, our rent expense decreased by RR 130 million, or 48.1%, to RR 140 million from RR 270 million in 2010 due to the relocation of Moscow head-office employees to our new office building in May 2011.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El-Arish concession area located in Egypt). In 2011, our expenses related to concession management services decreased by RR 62 million, or 49.6%, compared to 2010 due to the termination of the concession agreement in 2011.

In 2011, other general and administrative expenses increased by RR 145 million, or 30.3%, to RR 624 million from RR 479 million in 2010. The increase of RR 77 million related to the statutory requirement to maintain a bank guarantee in respect of minority shareholders due to the Sibneftegas acquisition. In addition, our materials and repair expenses related primarily to the maintenance of our new head-office in Moscow increased by RR 46 and RR 22 million, respectively.

Purchases of natural gas and liquid hydrocarbons

In 2011, our purchases of natural gas and liquid hydrocarbons amounted to RR 5,994 million, of which RR 5,854 million related to natural gas purchases from our joint venture Sibneftegas and from third parties related to the acquisition and consolidation of Gazprom mezhregiongas Chelyabinsk in November 2011. The remaining purchases of RR 140 million related to oil products (diesel fuel and petrol), which were resold. In 2010, our purchases of RR 154 million related to liquid hydrocarbons purchased for resale.

Materials, services and other

In 2011, our materials, services and other expenses decreased by RR 125 million, or 2.1%, to RR 5,947 million compared to RR 6,072 million in 2010. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 49.7% and 24.1%, respectively, of total materials, services and other expenses in 2011.

	Year ended 31 December:		**Change**
millions of Russian roubles	**2011**	**2010**	**%**
Employee compensation	2,953	2,572	14.8%
Repair and maintenance services	1,435	640	124.2%
Electricity and fuel	405	388	4.4%
Materials and supplies	309	1,386	(77.7%)
Security expenses	237	179	32.4%
Transportation expenses	184	106	73.6%
Processing fees	99	566	(82.5%)
Rent expenses	43	27	59.3%
Other	282	208	35.6%
Total materials, services and other	**5,947**	**6,072**	**(2.1%)**

Our employee compensation increased by RR 381 million, or 14.8%, to RR 2,953 million compared to RR 2,572 million in 2010 due primarily to a 9.6% indexation of base salaries effective 1 July 2011.

Repair and maintenance services increased by RR 795 million, or 124.2%, to RR 1,435 million in 2011 compared to RR 640 million in 2010. The increase was primarily related to on-going repair works at our production assets and was consistent with our maintenance schedules.

In 2011, electricity and fuel expenses increased by RR 17 million, or 4.4%, to RR 405 million from RR 388 million in 2010. The increase was primarily due to an increase in electricity volumes used by our production subsidiaries resulting from recently completed infrastructure projects as well as higher electricity rates in 2011 compared to 2010 which were partially offset by cost savings due to the disposal of NOVATEK-Polymer in September 2010.

Materials and supplies expense decreased by RR 1,077 million, or 77.7%, mainly due to a cessation of purchases of raw materials required for the production of polymer and insulation tape products as a result of the disposal of NOVATEK-Polymer in September 2010, which accounted for RR 1,100 million of the total decrease in materials and supplies expense.

Security expenses increased by RR 58 million, or 32.4%, to RR 237 million in 2011 from RR 179 million in 2010 largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

Transportation expenses related to the delivery of materials and equipment to our fields increased by RR 78 million, or 73.6%, to RR 184 million in 2011 from RR 106 million in 2010 primarily due to an increase in scheduled repair and maintenance works at our production subsidiaries.

Processing fees decreased by RR 467 million, or 82.5%, to RR 99 million in 2011, from RR 566 million in 2010 due primarily to the launch of our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010 that allowed us to cease contracting similar third party services.

Exploration expenses

In 2011, our exploration expenses increased by RR 224 million, or 14.0%, to RR 1,819 million from RR 1,595 million in 2010 primarily due to an increase in seismic works. In 2011, we expensed the capitalized cost of three exploratory wells in accordance with our accounting policy aggregating RR 806 million at the Raduzhny and Yarudeiskiy licence areas compared to the expensing of two exploratory wells aggregating RR 821 million at the El Arish (Egypt) and Anomalny licence areas in 2010.

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

In 2011, we recorded a reversal of RR 105 million to change in inventory expense compared to a reversal of RR 470 million in 2010:

millions of Russian roubles	**Year ended 31 December: 2011**	**2010**
Natural gas	(112)	2
Stable gas condensate	91	(379)
Other	(84)	(93)
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	**(105)**	**(470)**

In 2011, we recorded a reversal to our operating expenses of RR 112 million primarily due to an increase in the cost of natural gas balances resulting from the higher UPT rate in 2011 as compared to 2010 that was partially offset by a 30 mmcm decrease in our natural gas inventory balance. Our volumes of natural gas injected into Gazprom's underground gas storage facilities fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in 2011, we recorded a charge of RR 91 million to our operating expenses due to a 36 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage.

The following table highlights movements in our inventory balances:

	2011			**2010**		
Inventory balances in transit or in storage	**At 31 December**	**At 1 January**	**Increase / (decrease)**	**At 31 December**	**At 1 January**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**760**	**790**	**(30)**	**790**	**744**	**46**
including Gazprom's UGSF	*732*	*761*	*(29)*	*761*	*584*	*177*
Liquid hydrocarbons (thousand tons)	**325**	**356**	**(31)**	**356**	**167**	**189**
including stable gas condensate	*228*	*264*	*(36)*	*264*	*111*	*153*

Net gain on disposal of interest in subsidiaries

In 2011, we realized a net gain of RR 62,948 million on the disposal of a 20% participation interest in OAO Yamal LNG to TOTAL S.A., our strategic partner in the Yamal LNG project. The net gain is comprised of a net gain on disposal of RR 28,685 million and a gain of RR 34,263 million due to the revaluation to fair value of our remaining 80% participation interest.

In 2010, we realized a net gain of RR 1,583 million on the disposal of a 49% participation interest in our subsidiary ZAO Terneftegas to TOTAL Termokarstovoye B.V., which is comprised of a net income on disposal of RR 776 million and a gain of RR 807 million due to the revaluation to fair value of our remaining 51% participation interest. In 2010, we recognized a net loss on the disposal of our non-core, wholly owned subsidiary, NOVATEK-Polymer in the amount of RR 254 million.

Other operating income (loss)

In 2011, we recognized other operating income of RR 261 million, of which RR 192 million related to insurance compensation received in respect of insured accident which incurred in 2010. In 2010, we recognized other operating income of RR 396 million, of which RR 317 million resulted from the contribution from the depositary under our GDR program.

Profit from operations

As a result of the factors discussed above, our profit from operations, increased by RR 91,377 million, or 181.9%, to RR 141,608 million in 2011, compared to RR 50,231 million in 2010. Our profit from operations, adjusted for non-recurring transactions, primarily excluding the net gain on disposal of interest in subsidiaries, increased by RR 29,758 million, or 60.9%, to RR 78,660 million in 2011 from RR 48,902 million in 2010. In 2011, our profit from operations, excluding the net gain on disposal of interest in subsidiaries, as a percentage of total revenues increased to 44.7% compared to 41.8% in 2010 primarily due to higher natural gas and liquids sales volumes and prices.

Finance income (expense)

In 2011, we recorded net finance expense of RR 2,703 million due primarily to an increase in a non-cash foreign exchange loss from the depreciation of the Russian rouble relative to the US dollar as compared to a net finance gain of RR 1,197 million in 2010 due to a non-cash foreign exchange gain.

In 2011, our total accrued interest expense increased to RR 5,422 million compared to RR 2,192 million in 2010 as a result of an increase in our average borrowings. In 2011 and 2010, we capitalized RR 3,709 and RR 2,166 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with the Group's accounting policy. In addition, we recognized RR 437 and RR 411 million related to the fair value remeasurement of financial instruments and the unwinding of the present value discount related to provisions of asset retirement obligations as part of interest expense in 2011 and 2010, respectively.

Interest income increased to RR 3,392 million in 2011 from RR 598 million in 2010 primarily due to an increase in interest income on loans provided to our joint ventures.

In 2011, we recorded a net foreign exchange loss of RR 3,945 million compared to a net foreign exchange gain of RR 1,036 million in 2010 due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble depreciated by 5.6% against the US dollar during 2011 compared to Russian rouble depreciation of 0.8% in 2010. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio.

Share of profit (loss) of equity investments, net of income tax

Our proportionate share in loss of equity investments increased from RR 346 million in 2010 to RR 3,880 million in 2011, of which a significant portion was related to our joint ventures Sibneftegas and Yamal Development. The losses we recognized in Sibneftegas were primarily due to the revaluation of oil and gas properties acquired to fair value and the subsequent amortization of those costs under IFRS. The losses related to Yamal Development resulted from the recognition of interest expense on loans obtained.

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 11.7% and 21.2% for the years ended 31 December 2011 and 2010, respectively.

After excluding the effect of 20% disposal of Yamal LNG, the Group's effective income tax rate for the year ended 31 December 2011 was 21.7%. Our effective income tax rates, excluding the effect of foreign subsidiaries and the net gain on disposal of subsidiaries, were 22.0% and 21.8% in the years ended 31 December 2011 and 2010, respectively.

The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses or non-taxable income.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the period increased by RR 79,013 million, or 196.2%, to RR 119,291 million in 2011 from RR 40,278 million in 2010. The profit attributable to shareholders of OAO NOVATEK increased by RR 79,122 million, or 195.2%, to RR 119,655 million in 2011 from RR 40,533 million in 2010. The profit attributable to shareholders of OAO NOVATEK, adjusted to exclude the net gain on disposal of subsidiaries, increased by RR 17,503 million, or 44.6%, to RR 56,707 million in 2011 from RR 39,204 million in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 26.08 per share, or 195.1%, to RR 39.45 per share in 2011 from RR 13.37 per share in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, adjusted to exclude the net gain on disposal of subsidiaries, increased by RR 5.76 per share, or 44.6%, to RR 18.69 per share in 2011 from RR 12.93 per share in 2010.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2011 and 2010:

	Year ended 31 December:		Change
millions of Russian roubles	**2011**	**2010**	**%**
Net cash provided by operating activities	71,907	44,863	60.3%
Net cash provided by (used in) investing activities	(46,643)	(68,842)	(32.2%)
Net cash provided by (used in) financing activities	(11,735)	23,782	n/a

Liquidity and credit ratios	**31 December 2011**	**31 December 2010**	**Change, %**
Current ratio	1.16	0.51	127.5%
Total debt to equity	0.40	0.43	(7.0%)
Long-term debt to long-term debt and equity	0.24	0.22	9.1%
Net debt to total capitalization [1]	0.20	0.25	(20.0%)
Net debt to EBITDA [2]	0.48	1.08	(55.6%)
Net debt to Normalized EBITDA [2]	0.84	1.10	(23.6%)
Interest coverage ratio [3]	42	35	20.0%

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

(2) For EBITDA and Normalized EBITDA definitions see “Selected data” above.

(3) Interest coverage ratio is calculated as Normalized EBITDA divided by interest expense, including capitalized interest, less interest income from the Consolidated Statement of Income.

Net cash provided by operating activities

In 2011, our net cash provided by operating activities increased by RR 27,044 million, or 60.3%, to RR 71,907 million compared to RR 44,863 million in 2010. The increase was primarily due to an increase in natural gas and liquids sales volumes and prices that was partially offset by an increase in income tax payments.

Net cash provided by (used in) investing activities

In 2011, our net cash used in investing activities decreased by RR 22,199 million, or 32.2%, to RR 46,643 million as compared to RR 68,842 million in 2010 due primarily to a decrease in loans provided to our joint ventures, that was partially offset by the payment in 2011 for shares of our joint venture Sibneftegas, which was acquired in 2010, as well as the payment of RR 6.9 billion for four licenses in YNAO (see “Recent developments” above).

Net cash provided by (used in) financing activities

In 2011, our cash used in repayment of debt and dividends, as well as cash paid to increase the Group’s equity interest in Yamal LNG from 51% to 100%, exceeded cash provided by new loans by RR 11,735 million. In 2010, our cash provided by new loans and borrowings exceeded cash used for repayment of loans and dividends, that resulted in a net cash inflow from financing activities of RR 23,782 million.

Working capital

Our net working capital position (current assets less current liabilities) at 31 December 2011 was positive RR 8,202 million compared to a negative RR 27,876 million at 31 December 2010. The strengthening of our net working capital position was due to a decrease of short-term debt and accounts payable, as well as an increase in balance of cash and cash equivalents and trade and other accounts receivable.

At 31 December 2010, the Group had an outstanding bridge loan facility for the financing of the acquisition by its joint venture, Yamal Development, of a 51% participation interest in SeverEnergia of RR 18,200 million (USD 597 million), as well as an accounts payable to OAO Gazprombank of RR 21,176 million due to the acquisition of a 51% stake in Sibneftegas. The Group successfully refinanced short-term payables through the issuance of long-term Eurobonds in February 2011 (see "Recent developments" above).

The Group's management believes that it presently has and will continue to have the ability to generate sufficient cash flows (from operating and financing activities) to repay all current liabilities and to finance the Group's capital construction programs.

Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2011 and 2010 were as follows:

	Year ended 31 December:		Change
millions of Russian roubles	**2011**	**2010**	**%**
Capital expenditures			
Exploration, production and marketing	31,143	25,701	21.2%
Polymer production and marketing	-	329	n/a
Total capital expenditures	**31,143**	**26,030**	**19.6%**
Acquisition of mineral licenses per Consolidated Statement of Cash Flows	6,888	76	n/m
Total additions to property, plant and equipment per Note 6 "Property, Plant and Equipment" in the Group's IFRS Consolidated Financial Statements	**38,031**	**26,106**	**45.7%**

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities for the years ended 31 December 2011 and 2010:

	Year ended 31 December:	
millions of Russian roubles	**2011**	**2010**
Yurkharovskoye field	11,403	15,375
South-Tambeyskoye field	4,148	1,678
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga)	3,923	664
East-Tarkosalinskoye field	2,430	1,058
Purovsky Plant	1,369	1,292
Khancheyskoye field	612	87
North-Russkiy license area	574	399
West-Urengoiskiy license area	515	33
Olimpiyskiy license area	345	424
Other	5,824	4,691
Exploration, production and marketing	**31,143**	**25,701**

Our capital expenditures to oil and gas properties increased by RR 5,442 million and related primarily to the fields at the early stage of development such as the South-Tambeyskoye field and the West-Urengoiskiy license area, as well as the construction of processing assets such as Ust-Luga. We increased our capital expenditures at the East-Tarkosalinskoye field due to further development of the field's crude oil deposits and at the Khancheyskoye field as a result of capitalized repair works.

In 2011, the Group purchased, through participation in a tender process, exploration and production licenses for the Salmanovskoye (Utrenneye) and Geofizicheskoye fields and geological studies and production for the North-Obskiy and East-Tambeyskiy license areas for a total payment of RR 6,870 million (see “Recent developments” above).

Debt obligations

We utilize a variety of financial instruments to ensure the flexibility of our financing strategy. This includes maintaining a debt portfolio with a balance of short-term and long-term financing, a mix of fixed and floating interest rate instruments and a debt portfolio denominated in either Russian roubles or US dollars.

Overview

Our total debt increased from RR 72,226 million at 31 December 2010 to RR 95,478 million at 31 December 2011, or by RR 23,252 million, in order to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields, investments in processing assets such as the Purovsky Plant and Ust-Luga, as well as acquisitions of new oil and gas assets.

Our total debt position (net of unamortized transaction costs) at 31 December 2011 and 2010 was as follows:

Facility	Amount	Maturity	Interest rate	Year ended 31 December: 2011	2010
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	20,776	-
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	19,206	-
Sberbank	RR 15 billion	December 2013	7.5%	14,966	14,948
Gazprombank [(1)]	RR 10 billion	November 2012	8% [(2)]	10,000	10,000
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,971	9,949
Sumitomo Mitsui Banking Corporation Europe Limited	USD 300 million	December 2013	LIBOR+1.45%	7,685	-
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9%	6,439	6,095
UniCredit Bank	USD 200 million	October 2012	LIBOR+3.25% [(2)]	6,435	6,082
Bridge loan facility [(3)]	USD 600 million	November 2011	LIBOR+1%	-	18,200
Syndicated term loan facility	USD 800 million	April 2011	LIBOR+1.5%	-	6,952
Total				**95,478**	**72,226**

[(1)] – the loan from Gazprombank repaid in January 2012 ahead of maturity schedule.
[(2)] – interest rates were changed during the periods.
[(3)] – bridge loan repaid in February 2011 ahead of maturity schedule.

Maturities of long-term loans

Scheduled maturities of our long-term debt outstanding (net of unamortized transaction costs) at 31 December 2011 were as follows:

Maturity schedule:	RR million
1 January 2013 to 31 December 2013	35,198
1 January 2014 to 31 December 2014	-
1 January 2015 to 31 December 2015	-
1 January 2016 to 31 December 2016	19,206
After 31 December 2016	20,776
Total long-term debt	**75,180**

Available credit facilities

At 31 December 2011, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 6,278 million (USD 195 million) at either fixed or variable interest rates subject to the specific type of credit facility.

The Group also has funds available under credit facilities with OAO Sberbank in the amount of RR 40 billion until July 2012 with an annual interest rate of 9.2%, Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2012 and ZAO UniCredit Bank in the amount of USD 150 million until August 2012, with the interest rates applicable under the aforementioned credit facilities to be negotiated at the time of each withdrawal, as well as funds available under credit facility with ZAO BNP PARIBAS Bank in the amount of USD 100 million until September 2012 with predetermined interest rate depending on the period of debt.

Management believes it has sufficient internally generated cash flows, as well as access to available external borrowings (both short- and long-term) to fund its capital expenditure program, service its existing debt and meet its current obligations as they become due.

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. As of 31 December 2011, total amount of our long-term debt denominated in US dollars was RR 50,243 million, or 52.6% 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 mitigated by the fact that a portion of our total revenues, approximately 29.7% in 2011, is denominated in US dollars. As of 31 December 2011, the Russian rouble depreciated by approximately 5.6% against the US dollar since 31 December 2010.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 31 December 2011 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 6,054 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 operating 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 2011, 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.