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 for the three months ended 30 June 2012 and 2011 together with our unaudited consolidated interim condensed financial information as of and for the three and six months ended 30 June 2012. The unaudited consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*. This consolidated interim condensed financial information should be read together with the audited consolidated financial statements for the year ended 31 December 2011 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom, in each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for the six months ended 30 June 2012. In terms of proved natural gas reserves, we are 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 April 2012, the Group and OAO Gazprom (the "Parties") signed a Memorandum of Cooperation, whereby the Parties are considering the possibility to establish a joint venture to increase liquefied natural gas production capacity on the Yamal peninsula as well as jointly developing hydrocarbon resources on the Gydan peninsula.

In April 2012, our joint venture OOO SeverEnergia ("SeverEnergia") launched the first phase of the Samburgskoye field with an annual natural gas production capacity of approximately 2.3 billion cubic meters and approximately 550 thousand tons of gas condensate. Subsidiaries of SeverEnergia hold licenses for the development of oil and gas condensate fields (Samburgskoye, Yaro-Yakhinskoye, North-Chaselskoye, Urengoiskoye and other fields) in the Yamal Nenets Autonomous Region ("YNAO"). SeverEnergia's proved reserves as appraised by DeGolyer and MacNaughton ("D&M") under the Securities and Exchange Commission ("SEC") reserves methodology, as of 31 December 2011, totaled approximately 340 billion cubic meters of natural gas and 59 million tons of liquid hydrocarbons.

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 30 June: 2012	2011	Change %
Financial results			
Total revenues (net of VAT and export duties)	45,145	40,626	11.1%
Operating expenses	(26,780)	(22,474)	19.2%
Profit attributable to shareholders of OAO NOVATEK	9,663	14,336	(32.6%)
EBITDA [(1)]	20,414	19,759	3.3%
EBITDAX [(2)]	20,565	20,032	2.7%
Earnings per share (in Russian roubles)	3.18	4.73	(32.6%)
Operating results			
Natural gas sales volumes (million cubic meters)	13,447	11,830	13.7%
Stable gas condensate sales volumes (thousand tons)	794	755	5.2%
Liquefied petroleum gas sales volumes (thousand tons)	224	217	3.2%
Crude oil sales volumes (thousand tons)	101	53	90.6%
Total hydrocarbons production (million barrels of oil equivalent) [(3)]	99.3	87.3	13.8%
Total daily production (thousand barrels of oil equivalent per day) [(3)]	1,091	959	13.8%
Cash flow results			
Net cash provided by operating activities	9,874	15,118	(34.7%)
Capital expenditures	12,270	7,611	61.2%
Free cash flow [(4)]	(2,396)	7,507	n/a

(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 from the Consolidated Statement of Cash Flows.

(2) EBITDAX represents EBITDA as adjusted for the addback of exploration expenses.

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

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

Reconciliation of EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO NOVATEK is as follows:

millions of Russian roubles	Three months ended 30 June: 2012	2011
Profit (loss) attributable to shareholders of OAO NOVATEK	**9,663**	**14,336**
Depreciation, depletion and amortization	2,561	2,023
Net impairment expense	39	619
Total finance expense (income)	5,597	(1,073)
Total income tax expense	2,554	3,854
EBITDA	**20,414**	**19,759**
Exploration expenses	151	273
EBITDAX	**20,565**	**20,032**

SELECTED MACRO-ECONOMIC DATA

Exchange rate of Russian rouble to US dollar	Three months ended 30 June: 2012	2011	Change %
At the beginning of the period	29.33	28.43	3.2%
At the end of the period	32.82	28.08	16.9%
Average for the period	31.01	27.99	10.8%
Change of RR to US dollar exchange rate for the period	11.9%	(1.2%)	n/a

Crude oil prices, USD / bbl	Three months ended 30 June: 2012	2011	Change %
WTI [(1)]			
At the end of the period	85.0	95.4	(10.9%)
Average for the period	92.1	102.3	(10.0%)
Brent [(2)]			
At the end of the period	94.5	111.5	(15.2%)
Average for the period	108.3	117.0	(7.4%)
Urals [(2)]			
At the end of the period	94.2	110.1	(14.4%)
Average for the period	106.6	113.7	(6.2%)

[(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)]	Three months ended 30 June: 2012	2011	Change %
Crude oil, stable gas condensate			
At the end of the period	419.8	462.1	(9.2%)
Average for the period	443.0	446.5	(0.8%)
LPG			
At the end of the period	237.1	189.8	24.9%
Average for the period	197.4	137.0	44.1%

[(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 as well as changes in the political landscape with the results of the recent elections. The Greek bailout package, the looming debt crisis in Spain, the proposed "austerity programs" in the Euro-Zone 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 continues 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 remainder of 2012 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.

Exchange rate volatility between the Russian rouble and the US dollar exchange rate may significantly influence the Group's reporting financial results due to the fact that a significant portion of our long-term debt is denominated in US dollars (see "Profit attributable to shareholders and earnings per share" below).

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian Government's regulation of natural gas prices, except for those volumes delivered to residential customers, 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 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. 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. As part of the liberalization plan, the FTS approved the increases in the regulated price for natural gas by 15% effective from 1 January 2011 and 1 July 2012. According to the revised Forecast of Socio-economic Development of the Russian Federation for 2012 announced by Economic Development Ministry of the Russian Federation in September 2011, the regulated natural gas prices will be increased by 15% effective from 1 July 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 to potentially prolong the timetable toward market price liberalization based on market conditions and other factors.

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 December 2011, we commenced natural gas sales to residential customers at regulated prices in the Chelyabinsk region as a result of the acquisition of a regional gas trader Gazprom mezhregiongas Chelyabinsk. We disclose such sales within our end-customers category.

In the three months ended 30 June 2012, our average natural gas price to end-customers and ex-field price increased by 1.4% and 0.9%, respectively, whereas our average transportation expense for the delivery of natural gas to end-customers decreased by 0.8%. As a result, our average netback price on end-customers sales increased by 3.2%, while our total average natural gas price excluding transportation expense increased by 2.4% compared to respective prices in the corresponding period in 2011.

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 30 June 2012 and 2011, excluding volumes purchased for resale in the location of our end-customers:

Russian roubles per mcm	**Three months ended 30 June: 2012**	**2011**	**Change %**
Average natural gas price to end-customers [(1)]	2,652	2,615	1.4%
Average natural gas transportation expense for sales to end-customers	(1,175)	(1,184)	(0.8%)
Average natural gas netback price on end-customer sales	1,477	1,431	3.2%
Average natural gas price ex-field (wholesale traders)	1,399	1,387	0.9%
Total average natural gas price excluding transportation expense	**1,445**	**1,411**	**2.4%**

[(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 liquids volumes sold on both the domestic and international markets, among many other factors. In the three months ended 30 June 2012, the average benchmark crude oil prices were approximately 10% lower than in the corresponding period in 2011.

Our stable gas condensate, LPG, crude oil and oil products’ prices on both international and domestic markets include transportation expense in accordance with the specific terms of delivery.

In the three months ended 30 June 2012, our stable gas condensate export delivery terms were cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF), while in the corresponding period in 2011 our delivery terms were either DAP, CIF or CFR. Our average stable gas condensate export contract price, including export duties, in the three months ended 30 June 2012, was approximately USD 882 per ton compared to approximately USD 977 per ton in the corresponding period in 2011.

In the three months ended 30 June 2012, as well as in the corresponding period in 2011, our crude oil export delivery terms were DAP (Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 757 per ton compared to USD 821 per ton in the corresponding period in 2011.

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 three months ended 30 June 2012 and 2011 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	Three months ended 30 June: 2012	2011	Change %
Stable gas condensate			
Net export price, RR per ton	13,387	15,708	(14.8%)
Net export price, USD per ton	431.7	561.3	(23.1%)
Domestic price, RR per ton	12,335	13,818	(10.7%)
Crude oil			
Net export price, RR per ton	9,916	10,321	(3.9%)
Net export price, USD per ton	319.8	368.8	(13.3%)
Domestic price, RR per ton	10,313	9,822	5.0%

Our LPG export delivery terms during the three months ended 30 June 2012 and 2011, 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. In the three months ended 30 June 2012, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 874 per ton compared to USD 904 per ton in the corresponding period in 2011.

In the three months ended 30 June 2012, we sold 108 thousand tons of our LPG on the domestic market at an average price of RR 13,698 per ton (FCA), including volumes sold through our wholly owned subsidiary OOO NOVATEK-Refueling Complexes, compared to 103 thousand tons at an average price of RR 12,279 per ton in the corresponding period in 2011.

In the three months ended 30 June 2012, we sold approximately 4.0 thousand tons of methanol produced by our production subsidiaries to our joint ventures and third parties at an average price of RR 10,896 per ton compared to approximately 1.1 thousand tons at an average price of RR 10,000 per ton in the corresponding period in 2011.

The following table shows our average realized LPG and methanol sales prices, excluding LPG trading activities, (net of VAT and export duties, where applicable) for the three months ended 30 June 2012 and 2011 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	Three months ended 30 June: 2012	2011	Change %
LPG			
Net export price, RR per ton	21,263	21,965	(3.2%)
Net export price, USD per ton	685.6	784.9	(12.7%)
Domestic price, RR per ton	13,704	12,279	11.6%
Methanol			
Domestic price, RR per ton	10,896	10,000	9.0%

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.

Effective from 1 January 2011, the FTS approved a 9.3% average increase of the transportation tariff for natural gas and the rate for utilization of the trunk pipeline ranked between 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.

Effective from 1 July 2012, the FTS approved a 7.0% average increase of the transportation tariff for natural gas and the rate for utilization of the trunk pipeline ranked between RR 50.78 to RR 1,995.44 (excluding VAT) per mcm and the transportation rate was RR 12.02 (excluding VAT) per mcm per 100 km.

According to the revised Forecast of Socio-economic Development of the Russian Federation for 2012 announced in September 2011 by the Economic Development Ministry of the Russian Federation, the transportation tariff for natural gas produced by independent producers will be increased in 2013 and 2014 as of the same date as the increase in the regulated natural gas prices and will not exceed the forecasted inflation rate.

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. The FTS also sets tariffs for transportation of crude oil through Transneft's pipeline network, which includes transport, dispatch, pumping, loading, charge-discharge, transshipment and other services. The FTS sets tariffs for each separate route of the pipeline network, so 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, transportation direction and other factors.

Crude oil transportation tariffs were increased in September and November 2011 on average by approximately 2.9% and 5.0%, respectively.

Stable gas condensate and LPG

Our stable gas condensate (to the Port of Vitino on the White Sea) and LPG 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 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 was set at 0.89 for companies with annual shipped volumes of 2,600 thousand tons or more, and the discount co-efficient for LPG was 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, and countries of the APR. The cost of tanker transportation is generally determined by the distance to the final destination, the availability of tankers, the seasonality of deliveries and standard shipping terms, all in accordance with general industry practice.

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 and other contributions.

Effective from 1 January 2012, the social insurance tax rate for contributions to the Pension Fund of Russia decreased from 26% to 22%, but the maximum taxable base per each employee was increased from RR 463 thousand to RR 512 thousand. In addition, a new tax rate of 10% was implemented for amounts above the maximum taxable base of RR 512 thousand.

According to the Russian Tax Code, the UPT rate for natural gas was set at RR 237, RR 251 and RR 265 per mcm for 2011, 2012 and 2013, respectively. During 2012, the Government of the Russian Federation announced possible increases in the UPT rate for natural gas, but no decisions were made during the reporting period. Any change to the UPT rates would be a subject to approval by the State Duma of the Russian Federation.

In 2011, the UPT rate for gas condensate was set at 17.5% of gas condensate revenues recognized by the producing entities. According to the 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.

The UPT rate for crude oil is linked to the Urals benchmark crude oil price and changes every month. It is calculated in US dollar and enacted to Russian roubles using the monthly average exchange rate established by the Central Bank of Russia.

The Russian tax code provides for reduced or zero UPT rate for crude oil produced in certain geographical areas. We did not use the reduced or zero UPT rates from the production of crude oil prior to 1 January 2012. According to the amendments to the Russian Tax Code, effective from 1 January 2012, a zero UPT rate is set for crude oil produced at fields located in the YNAO to the north of the 65th degree of the northern latitude. Our East-Tarkosalinskoye and Khancheyskoye fields are located in the mentioned geographical area; therefore, we applied the allowed zero UPT rate for crude oil produced at these fields effective from 1 January 2012.

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.

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to a combination of increased production at our core producing fields and purchases, that was partially offset by an increase in natural gas volumes injected into Underground Gas Storage Facilities. Liquids sales volumes increased due to the initiation of purchases from the Group's joint venture as well as a decrease in liquids inventory balances in the three months ended 30 June 2012. Our liquids inventory balances tend to fluctuate periodically due to loading schedules and final destinations of stable gas condensate shipments.

Natural gas sales volumes

millions of cubic meters	**Three months ended 30 June: 2012**	**2011**	**Change %**
Production from:			
Yurkharovskoye field	8,267	7,903	4.6%
East-Tarkosalinskoye field	3,241	2,149	50.8%
Khancheyskoye field	934	626	49.2%
Other fields	16	18	(11.1%)
Total natural gas production	**12,458**	**10,696**	**16.5%**
Purchases from the Group's joint venture	1,268	1,313	(3.4%)
Total production and purchases from Group's joint ventures	**13,726**	**12,009**	**14.3%**
Other purchases	800	-	n/a
Total production and purchases	**14,526**	**12,009**	**21.0%**
Purovsky Plant and own usage	(29)	(22)	31.8%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	(1,050)	(157)	n/m
Total natural gas sales volumes	**13,447**	**11,830**	**13.7%**
Sold to end-customers	*8,361*	*6,448*	*29.7%*
Sold ex-field	*5,086*	*5,382*	*(5.5%)*

In the three months ended 30 June 2012, our total natural gas production (including our pro-rata share in production of our joint venture Sibneftegas) increased by 1,717 mmcm, or 14.3%, to 13,726 mmcm from 12,009 mmcm in the corresponding period in 2011, primarily due to increases in production at our core producing fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye). The increase in production at the East-Tarkosalinskoye and Khancheyskoye fields was due to the increased demand for natural gas that required a greater utilization of the fields' production capacity. The increase in natural gas production at the Yurkharovskoye field was due to the field's ongoing development activities.

In January 2012, we commenced purchasing natural gas from ZAO SIBUR Holding ("SIBUR"), a related party, which are disclosed as "Other purchases" in the table above.

In the three months ended 30 June 2012, we used 19 mmcm of natural gas as feedstock for the production of methanol compared to 12 mmcm in the corresponding period in 2011. 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	Three months ended 30 June: 2012	2011	Change %
Production from:			
Yurkharovskoye field	660	679	(2.8%)
East-Tarkosalinskoye field	232	199	16.6%
Khancheyskoye field	130	152	(14.5%)
Other fields	5	6	(16.7%)
Total liquids production	**1,027**	**1,036**	**(0.9%)**
Purchases from:			
The Group's joint venture	58	-	n/a
Other	3	2	50.0%
Total production and purchases	**1,088**	**1,038**	**4.8%**
Losses and own usage [(1)]	(14)	(11)	27.3%
Decreases (increases) in liquids inventory balances	47	0	n/a
Total liquids sales volumes	**1,121**	**1,027**	**9.2%**
Stable gas condensate export	*785*	*752*	*4.4%*
Stable gas condensate domestic	*9*	*3*	*200.0%*
Subtotal stable gas condensate	***794***	***755***	***5.2%***
LPG export	*116*	*114*	*1.8%*
LPG domestic	*80*	*83*	*(3.6%)*
LPG sold through domestic retail and small wholesale stations	*28*	*20*	*40.0%*
Subtotal LPG	***224***	***217***	***3.2%***
Crude oil export	*37*	*24*	*54.2%*
Crude oil domestic	*64*	*29*	*120.7%*
Subtotal crude oil	***101***	***53***	***90.6%***
Oil products domestic	*2*	*2*	*0.0%*
Subtotal oil products	***2***	***2***	***0.0%***

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

In the three months ended 30 June 2012, our liquids production decreased by nine thousand tons, or 0.9%, primarily due to a decrease in gas condensate production at our core producing fields that was partially offset by an increase in crude oil production at the East-Tarkosalinskoye and Khancheyskoye fields. Natural declines in the concentration of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

In April 2012, we commenced purchasing unstable gas condensate from our joint venture, SeverEnergia, after the launch of the first phase of its Samburgskoye field.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 JUNE 2012 COMPARED TO THE CORRESPONDING PERIOD IN 2011

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2012 and 2011. Each line item is also shown as a percentage of our total revenues.

	Three months ended 30 June:			
millions of Russian roubles	**2012**	**% of total revenues**	**2011**	**% of total revenues**
Total revenues **(net of VAT and export duties)**	**45,145**	***100.0%***	**40,626**	***100.0%***
including:				
natural gas sales	29,272	*64.8%*	24,325	*59.9%*
liquids sales	15,712	*34.8%*	16,226	*39.9%*
Operating expenses	(26,780)	*(59.3%)*	(22,474)	*(55.3%)*
Other operating income (loss)	(36)	*(0.1%)*	(80)	*(0.2%)*
Profit from operations	**18,329**	***40.6%***	**18,072**	***44.5%***
Finance income (expense)	(5,597)	*(12.4%)*	1,073	*2.6%*
Share of profit (loss) of equity investments, net of income tax	(521)	*(1.2%)*	(1,076)	*(2.6%)*
Profit before income tax	**12,211**	***27.0%***	**18,069**	***44.5%***
Total income tax expense	(2,554)	*(5.6%)*	(3,854)	*(9.5%)*
Profit (loss)	**9,657**	***21.4%***	**14,215**	***35.0%***
Non-controlling interest	6	*0.0%*	121	*0.3%*
Profit attributable to shareholders of OAO NOVATEK	**9,663**	***21.4%***	**14,336**	***35.3%***

Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the three months ended 30 June 2012 and 2011:

millions of Russian roubles	**Three months ended 30 June: 2012**	**2011**	**Change %**
Natural gas sales	**29,272**	**24,325**	**20.3%**
End-customers	*22,158*	*16,859*	*31.4%*
Ex-field sales	*7,114*	*7,466*	*(4.7%)*
Stable gas condensate sales	**10,623**	**11,868**	**(10.5%)**
Export	*10,509*	*11,822*	*(11.1%)*
Domestic	*114*	*46*	*147.8%*
Liquefied petroleum gas sales	**3,955**	**3,775**	**4.8%**
Export	*2,473*	*2,516*	*(1.7%)*
Domestic	*1,482*	*1,259*	*17.7%*
Crude oil sales	**1,027**	**530**	**93.8%**
Export	*366*	*244*	*50.0%*
Domestic	*661*	*286*	*131.1%*
Oil and gas products sales	**107**	**53**	**101.9%**
Domestic	*107*	*53*	*101.9%*
Total oil and gas sales	**44,984**	**40,551**	**10.9%**
Other revenues	161	75	114.7%
Total revenues	**45,145**	**40,626**	**11.1%**

Natural gas sales

In the three months ended 30 June 2012, our revenues from sales of natural gas increased by RR 4,947 million, or 20.3%, compared to the corresponding period in 2011 due primarily to an increase in total sales volumes, as well as an increase in our average realized natural gas price resulting from an increase in our proportion of end-customer sales to total natural gas sales volumes.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes increased to 62.2% in the three months ended 30 June 2012 as compared to 54.5% in the corresponding period in 2011. The increase was due to higher natural gas deliveries to the Chelyabinsk region through our regional natural gas trader acquired in November 2011. In the three months ended 30 June 2012, our natural gas sales volumes representing greater than 10% of total end-customers sales volumes were to the Chelyabinsk, Perm and Orenburg regions. In the corresponding period in 2011, our major natural gas sales representing greater than 10% of the end-customer sales volumes were to the Perm, Chelyabinsk, Orenburg and Moscow regions.

In the three months ended 30 June 2012, our average netback price on end-customers sales increased by 3.2% compared to the corresponding period in 2011, while our average realized end-customers sales price increased by 1.4%. The increase in our average realized end-customers sales netback price was primarily due to an increase in natural gas deliveries to regions closer to our producing fields. Our average realized ex-field price was higher by 0.9% than in the corresponding period in 2011.

In the three months ended 30 June 2012, as well as in the corresponding period in 2011, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies, representing 58.4% and 34.8% of total natural gas sales volumes to end-customers in the reporting period in 2012, respectively.

Stable gas condensate sales

In the three months ended 30 June 2012, our revenues from sales of stable gas condensate decreased by RR 1,245 million, or 10.5%, compared to the corresponding period in 2011 primarily due to a decrease in our average realized prices resulting from a decrease in the underlying benchmark crude oil prices used in the price formulation that was partially offset by an increase in volumes sold.

Our total stable gas condensate sales volumes increased by 39 thousand tons, or 5.2%, due to a combination of gas condensate purchases from our joint venture and a decrease in the stable gas condensate inventory balance in the three months ended 30 June 2012 as compared to a slight decrease in the corresponding period in 2011 (see "Change in natural gas, liquid hydrocarbons and work-in-progress" below), that was partially offset by a decrease in gas condensate production. In the three months ended 30 June 2012, we exported 785 thousand tons of stable gas condensate, or 98.9% of our total sales volumes, to the APR, Europe and the United States with the remaining nine thousand tons sold domestically. In the corresponding period in 2011, we exported 752 thousand tons of stable gas condensate, or 99.6% of our total sales volumes, to Europe, the United States and the APR.

In the three months ended 30 June 2012, our average realized price, excluding export duties, for stable gas condensate sold on the export market decreased by USD 129.6 per ton, or 23.1%, to USD 431.7 per ton (CFR, DES, DAP and CIF) from USD 561.3 per ton (DAP, CIF, and CFR) in the corresponding period in 2011 due to a 9.7% decrease in our average export contract price, as well as a 3.8% increase in our average export duty per ton. The decrease in our average realized contract price was due to an overall decrease in crude oil and related commodity prices on the international markets in the three months ended 30 June 2012 as compared to the corresponding period in 2011.

Liquefied petroleum gas sales

In the three months ended 30 June 2012, our revenues from sales of LPG increased by RR 180 million, or 4.8%, compared to the corresponding period in 2011 primarily due to an increase in volumes sold, which was offset by a decline in our average realized export prices.

In the three months ended 30 June 2012, we sold 116 thousand tons of LPG, or 51.8% of our total LPG sales volumes, to export markets as compared to 114 thousand tons, or 52.5%, in the corresponding period in 2011. In the three months ended 30 June 2012, as well as in the corresponding period in 2011, our export sales volumes of LPG representing greater than 20% of total LPG export volumes were to Poland and Finland.

Our average realized LPG export price, excluding export duties, decreased by USD 99.3 per ton, or 12.7%, to USD 685.6 per ton in the three months ended 30 June 2012 (DAP, CPT and FCA) compared to USD 784.9 per ton in the corresponding period in 2011 primarily due to an increase in our average export duty per ton by 57.2%, as well as a 3.3% decrease in average contract price. The reduction in our average contract price was due to an overall decrease in benchmark prices on international markets in the three months ended 30 June 2012 compared to the corresponding period in 2011.

In the three months ended 30 June 2012, we sold 108 thousand tons of LPG, or 48.2% of our total LPG sales volumes, on the domestic market at an average price of RR 13,698 per ton (FCA, excluding VAT) representing an increase of RR 1,419 per ton, or 11.6%, compared to the corresponding period in 2011.

Crude oil sales

In the three months ended 30 June 2012, our revenues from sales of crude oil increased by RR 497 million, or 93.8%, compared to the corresponding period in 2011 primarily due to an increase in sales volumes. Our crude oil sales volumes increased by 48 thousand tons, or 90.6%, to 101 thousand tons from 53 thousand tons in the corresponding period in 2011 due primarily to an increase in crude oil production at our East-Tarkosalinskoye and Khancheyskoye fields.

The majority of our crude oil sales volumes, representing 63.4% in the three months ended 30 June 2012, was sold domestically at an average price of RR 10,313 per ton (excluding VAT) representing an increase of RR 491 per ton, or 5.0%, compared to the corresponding period in 2011. The remaining 36.6% of our crude oil volumes were sold to export markets at an average price of USD 319.8 per ton (DAP, excluding export duties) representing a decrease of USD 49.0 per ton, or 13.3%, compared to the corresponding period in 2011.

The decrease in the average realized export price (excluding export duties) was the result of a 7.8% decrease in our average export contract price that was partially offset by a 1.4% decrease in the average export duty per ton. The decrease in our average realized contract price was due to an overall decrease in benchmark crude oil prices on international markets in the three months ended 30 June 2012 compared to the corresponding period in 2011.

Oil and gas products sales

In the three months ended 30 June 2012, our revenue from sales of oil and gas products increased by RR 54 million, or 101.9%, to RR 107 million from RR 53 million in the corresponding period in 2011.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 22 million to RR 64 million in the three months ended 30 June 2012 compared to RR 42 million in the corresponding period in 2011 due to both an increase in sales prices and volumes sold. In the three months ended 30 June 2012 and 2011, we sold approximately 2.3 thousand and 1.6 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 28,291 and RR 26,637 per ton, respectively.

In the three months ended 30 June 2012, our revenue from methanol sales increased by RR 33 million, or three-fold, to RR 44 million from RR 11 million in the corresponding period in 2011 primarily due to an increase in volumes sold.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In the three months ended 30 June 2012, other revenues increased by RR 86 million, or 114.7%, to RR 161 million from RR 75 million in the corresponding period in 2011. The increase was primarily comprised of a RR 37 million increase in revenue from transportation, handling and storage services, as well as RR 25 million increase in revenues from geological and geophysical research services provided primarily to our joint ventures. In addition, in the three months ended 30 June 2012, we recognized RR 12 million of revenue by subletting leased icebreaker under contract to third parties. The remaining increase of RR 12 million in other revenues was made up of various immaterial items.

Operating expenses

In the three months ended 30 June 2012, our total operating expenses increased by RR 4,306 million, or 19.2%, to RR 26,780 million compared to RR 22,474 million in the corresponding period in 2011 primarily due to an increase in purchases of natural gas and liquid hydrocarbons as well as transportation expenses. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased to 65.0% in the three months ended 30 June 2012 compared to 67.3% in the corresponding period in 2011.

In the three months ended 30 June 2012, total operating expenses as a percentage of total revenues increased to 59.3% in the three months ended 30 June 2012 compared to 55.3% in the corresponding period in 2011, as shown in the table below. The increase in our operating expenses as a percentage of total revenues was caused by two main reasons. In January 2012, we commenced purchasing natural gas, which included the cost of transportation, for subsequent resale to the regions where our end-customers are located as such, received a lower margins for these volumes sold. The second reason was the increase in the UPT rate for natural gas effective 1 January 2012, while the regulated price for natural gas was increased effective 1 July 2012.

	Three months ended 30 June:			
millions of Russian roubles	**2012**	**% of total revenues**	**2011**	**% of total revenues**
Transportation expenses	13,035	*28.9%*	11,088	*27.3%*
Taxes other than income tax	4,375	*9.7%*	4,046	*10.0%*
Subtotal non-controllable expenses	**17,410**	***38.6%***	**15,134**	***37.3%***
Purchases of natural gas and liquid hydrocarbons	3,423	*7.6%*	932	*2.3%*
General and administrative expenses	2,594	*5.7%*	2,117	*5.2%*
Depreciation, depletion and amortization	2,483	*5.5%*	1,987	*4.9%*
Materials, services and other	1,836	*4.1%*	1,540	*3.8%*
Net impairment expense	39	*n/m*	619	*1.5%*
Exploration expenses	(597)	*n/m*	273	*0.7%*
Change in natural gas, liquid hydrocarbons and work-in-progress	(408)	*n/m*	(128)	*n/m*
Total operating expenses	**26,780**	***59.3%***	**22,474**	***55.3%***

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 the three months ended 30 June 2012, non-controllable expenses of transportation and taxes other than income tax increased by RR 2,276 million, or 15.0%, to RR 17,410 million from RR 15,134 million in the corresponding period in 2011. The change in transportation expenses was primarily due to an increase in natural gas volumes sold to end-customers in which we incurred transportation expenses, and excluded volumes of natural gas purchased for resale in the location of our end-customers. Taxes other than income tax increased primarily due to an increase in natural gas production volumes, as well as a 5.9% increase in the natural gas production tax rate effective from 1 January 2012 that was partially offset by the application of zero UPT rate for crude oil from 1 January 2012 (see “Our tax burden” above). As a percentage of total revenues, our non-controllable expenses increased to 38.6% in the three months ended 30 June 2012 from 37.3% in the corresponding period in 2011.

Transportation expenses

In the three months ended 30 June 2012, our total transportation expenses increased by RR 1,947 million, or 17.6%, compared to the corresponding period in 2011.

million of Russian roubles	Three months ended 30 June: 2012	2011	Change %
Natural gas transportation to customers	8,883	7,633	16.4%
Liquid hydrocarbons transportation by rail	2,837	2,437	16.4%
Liquid hydrocarbons transportation by tankers	1,152	940	22.6%
Crude oil transportation to customers	122	63	93.7%
Other	41	15	173.3%
Total transportation expenses	**13,035**	**11,088**	**17.6%**

In the three months ended 30 June 2012, our transportation expenses for natural gas increased by RR 1,250 million, or 16.4%, to RR 8,883 million from RR 7,633 million in the corresponding period in 2011. The change was mainly due to a 17.3% increase in our sales volumes of natural gas to end-customers, for which we incurred transportation expense, and excluded volumes of natural gas purchased for resale in the location of our end-customers. We do not incur transportation expenses in respect of natural gas volumes purchased for resale in the location of our end-customers, as the purchase price includes the cost of transportation. 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 the three months ended 30 June 2012, total expenses for liquids transportation by rail increased by RR 400 million, or 16.4%, to RR 2,837 million from RR 2,437 million in the corresponding period in 2011 due to higher average liquids transportation tariffs and, to a lesser extent, an increase in our liquids volumes sold and transported via rail. In the three months ended 30 June 2012, our combined liquids volumes sold and transported via rail increased by 45 thousand tons, or 4.6%, to 1,017 thousand tons from 972 thousand tons in the corresponding period in 2011 due primarily to a decrease in stable gas condensate inventory balance. The transportation costs incurred in respect of liquids volumes recognized as part of our inventory balance or in transit are capitalized as part of current assets until the recognition of such volumes as sold.

In the three months ended 30 June 2012, our weighted average transportation tariff for liquids delivered by rail increased by 11.3% to RR 2,788 per ton from RR 2,504 per ton in the corresponding period in 2011 primarily due to a 6.0% increase in rail tariffs for the domestic market set by the FTS effective 1 January 2012, as well as an increase in rail tariffs for LPG transportation on the territory of Commonwealth of Independent States to export markets. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-to-period and depends on products type and the geography of deliveries.

Total transportation expense for liquids delivered by tankers to international markets increased by RR 212 million, or 22.6%, to RR 1,152 million in the three months ended 30 June 2012 from RR 940 million in the corresponding period in 2011. The increase was primarily due to a change in the mix in geographical regions where we sold our stable gas condensate and, to a lesser extent, an 4.4% increase in volumes sold as a result of inventory movements. In the three months ended 30 June 2012, we sold 53.7% of our total stable gas condensate export volumes to APR, 38.7% to Europe and 7.6% to the United States, whereas in the corresponding period in 2011, we sold 51.7% to Europe, 32.2% to APR and 16.1% to the United States.

Taxes other than income tax

millions of Russian roubles	Three months ended 30 June: 2012	2011	Change %
Unified natural resources production tax	3,656	3,333	9.7%
Property tax	436	429	1.6%
Excise and fuel taxes	221	235	(6.0%)
Other taxes	62	49	26.5%
Total taxes other than income tax	**4,375**	**4,046**	**8.1%**

In the three months ended 30 June 2012, taxes other than income tax increased by RR 329 million, or 8.1%, primarily due to an increase in the unified natural resources production tax expense.

In the three months ended 30 June 2012, our UPT expense for natural gas increased by RR 597 million, or 23.4%, primarily due to an increase in our natural gas production volumes and, to a lesser extent, a 5.9% increase in the natural gas production tax rate effective 1 January 2012 (RR 251 per mcm in the three months ended 30 June 2012 versus RR 237 per mcm in the corresponding period in 2011). In addition, our UPT for gas condensate increased by RR 17 million, or 3.5%, due primarily to a change in the UPT rate (see "Our tax burden" above).

In the three months ended 30 June 2012, we applied a zero UPT rate for crude oil produced at our East-Tarkosalinskoye and Khancheyskoye fields due to changes in the Russian Tax Code effective 1 January 2012 (see "Our tax burden" above). In the corresponding period in 2011, we incurred RR 291 million of UPT expense for crude oil.

In the three months ended 30 June 2012, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska decreased by RR 14 million, or 6.0%. The decrease was due to an increase in the proportion of sales volumes which are not subject to excise and fuel taxation, as well as the depreciation of the Polish zloty against the Russian rouble.

Purchases of natural gas and liquid hydrocarbons

In the three months ended 30 June 2012, our purchases of natural gas and liquid hydrocarbons increased by RR 2,491 million, or 267.3%, to RR 3,423 million from RR 932 million in the corresponding period in 2011. The increase of RR 2,061 million was related to purchases of natural gas, of which RR 1,990 million related to purchases of natural gas from SIBUR, a related party, commencing from 1 January 2012.

In April 2012, we commenced purchasing unstable gas condensate from SeverEnergia, a Group joint venture, which accounts for RR 393 million of the increase as compared to the corresponding period in 2011. The remaining balance of RR 37 million related to oil products (diesel fuel and petrol) and LPG, which were subsequently resold on the domestic market through our wholly owned subsidiary NOVATEK-Refueling complexes.

General and administrative expenses

In the three months ended 30 June 2012, our general and administrative expenses increased by RR 477 million, or 22.5%, to RR 2,594 million compared to RR 2,117 million in the corresponding period in 2011. The main components of these expenses were employee compensation, social expenses and compensatory payments and legal, audit and consulting services, which, on aggregate, comprised 82.0% and 82.1% of total general and administrative expenses in the three months ended 30 June 2012 and 2011, respectively.

millions of Russian roubles	**Three months ended 30 June: 2012**	**2011**	**Change %**
Employee compensation	1,653	1,373	20.4%
Social expenses and compensatory payments	287	201	42.8%
Legal, audit, and consulting services	187	165	13.3%
Depreciation – administrative buildings	78	36	116.7%
Business trip expenses	70	53	32.1%
Fire safety and security expenses	50	44	13.6%
Rent expense	27	37	(27.0%)
Bank charges	21	16	31.3%
Insurance expense	19	9	111.1%
Other	202	183	10.4%
Total general and administrative expenses	**2,594**	**2,117**	**22.5%**

Employee compensation increased by RR 280 million, or 20.4%, to RR 1,653 million in the three months ended 30 June 2012 as compared to RR 1,373 million in the corresponding period in 2011. The increase of RR 124 million was due to an increase in average number of employees resulting from an acquisition of regional gas trader in November 2011 and an indexation of base salaries by 9.6% from 1 July 2011. In addition, our insurance contributions to the non-budget funds increased by RR 140 million due to the change from 1 January 2012 in taxable base and rates to the Pension Fund of Russia (see “Our tax burden” above). In the three months ended 30 June 2012, employee compensation expense decreased by RR 55 million due to a change in fair value of the liability related to share-based compensation program compared to an increase of RR 41 million in the corresponding period in 2011.

In the three months ended 30 June 2012, our social expenses and compensatory payments increased by RR 86 million, or 42.8%, to RR 287 million compared to RR 201 million in the corresponding period in 2011, and were primarily related to our donations to sport clubs and activities, educational schools, as well as continued support for charities and social programs in the regions where we operate. 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 22 million, or 13.3%, to RR 187 million compared to RR 165 million in the corresponding period in 2011 largely due to an increase in services to prolong and acquire software solutions for our core subsidiaries.

In the three months ended 30 June 2012, depreciation of administrative buildings increased by RR 42 million, or 116.7%, 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 six million, or 13.6%, to RR 50 million in the three months ended 30 June 2012 from RR 44 million in the corresponding period in 2011 as a result of the opening of our new Moscow head-office in May 2011.

In the three months ended 30 June 2012, our rent expense decreased by RR 10 million, or 27.0%, to RR 27 million from RR 37 million in the corresponding period in 2011 due to the relocation of Moscow head-office employees to our new office building in May 2011.

Insurance expenses increased by RR 10 million, or 111.1%, to RR 19 million in the three months ended 30 June 2012 from RR nine million in the corresponding period in 2011 due to insurance of recently launched fixed assets at our production subsidiaries.

In the three months ended 30 June 2012, other general and administrative expenses increased by RR 19 million, or 10.4%, to RR 202 million from RR 183 million in the corresponding period in 2011 primarily due to the increase in expenses related to our participation in international economic forums and exhibitions, advertising and other immaterial expense items of an administrative nature, which was partially offset by the decrease in expenses related to the termination at the end of 2011 of the concession agreement at El-Arish concession area located in Egypt.

Depreciation, depletion and amortization

In the three months ended 30 June 2012, our depreciation, depletion and amortization ("DDA") expense increased by RR 496 million, or 25.0%, to RR 2,483 million from RR 1,987 million in the corresponding period in 2011 as a result of a 14.5% increase in our total hydrocarbon production (excluding our proportionate share in the production of joint ventures) in barrels of oil equivalent (boe), as well as an increase in our depletable cost base. The Group accrues depreciation and depletion using the "units of production" method for producing assets and straight-line method for other facilities.

In the three months ended 30 June 2012, our DDA per boe was RR 23.3 compared to RR 21.6 in the corresponding period in 2011. The increase in our DDA charge calculated on a boe basis was due to capitalization of costs related to ongoing development at our Yurkharovskoye field, as well as a decrease in our proved reserves estimates as of 31 December 2011, used as the denominator in the calculation of the DDA under the "units of production" method, at our core producing fields.

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.

Materials, services and other

In the three months ended 30 June 2012, our materials, services and other expenses increased by RR 296 million, or 19.2%, to RR 1,836 million compared to RR 1,540 million in the corresponding period in 2011. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 55.0% and 21.8%, respectively, of total materials, services and other expenses in the three months ended 30 June 2012.

millions of Russian roubles	**Three months ended 30 June:** **2012**	**2011**	**Change %**
Employee compensation	1,010	829	21.8%
Repair and maintenance services	401	345	16.2%
Electricity and fuel	115	113	1.8%
Materials and supplies	89	43	107.0%
Security expenses	69	59	16.9%
Transportation expenses	44	42	4.8%
Processing fees	25	25	0.0%
Rent expenses	11	6	83.3%
Other	72	78	(7.7%)
Total materials, services and other	**1,836**	**1,540**	**19.2%**

In the three months ended 30 June 2012, our employee compensation increased by RR 181 million, or 21.8%, to RR 1,010 million compared to RR 829 million in the corresponding period in 2011 due to a 9.6% indexation of base salaries effective 1 July 2011, an increase in average number of employees resulting from an acquisition of a regional gas trader in November 2011, and additional bonuses paid for the results achieved in 2011.

Repair and maintenance services increased by RR 56 million, or 16.2%, to RR 401 million in the three months ended 30 June 2012 compared to RR 345 million in the corresponding period in 2011. The increase was primarily related to on-going repair works at our wholly owned production subsidiary NOVATEK-Tarkosaleneftegas and was consistent with our maintenance schedules.

In the three months ended 30 June 2012, electricity and fuel expenses marginally increased by RR two million, or 1.8%, to RR 115 million from RR 113 million in the corresponding period in 2011.

Security expenses increased by RR 10 million, or 16.9%, to RR 69 million in the three months ended 30 June 2012 from RR 59 million in the corresponding period in 2011 largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

Materials and supplies expense increased by RR 46 million, or 107.0%, mainly due to an increase in our production assets repair works.

Transportation expenses related to the delivery of materials and equipment to our fields increased by RR two million, or 4.8%, to RR 44 million in the three months ended 30 June 2012 from RR 42 million in the corresponding period in 2011.

Processing fees were consistent between reporting periods and related to the preparation of crude oil for the transportation through pipeline network in both periods.

In the three months ended 30 June 2012, rent expenses increased by RR five million, or 83.3%, to RR 11 million from RR six million in the corresponding period in 2011 primarily due to the rental of storage facilities for LPG inventory balances held by our subsidiary Novatek Polska as a result of increased LPG export sales through this subsidiary.

Net impairment expense

In the three months ended 30 June 2012, our net impairment expense amounted to RR 39 million compared to a net impairment expense of RR 619 million in the corresponding period in 2011. During the 2011 reporting period, we wrote off assets at the Sredne-Chaselskiy license area in the amount of RR 499 million due to negative future cash flows expected to be derived from those assets, and RR 119 million related to the impairment of our investment at the El-Arish project.

Exploration expenses

million of Russian roubles	**Three months ended 30 June: 2012**	**2011**	**Change %**
Exploration expenses	151	273	(44.7%)
Less capitalized 3-D seismic surveys for the three months ended 31 March 2012	(748)	-	n/a
Total exploration expenses	**(597)**	**273**	**n/a**

In the three months ended 30 June 2012, we recorded a reversal to our exploration expenses of RR 597 million due to the initiation of a new accounting policy to capitalize 3-D seismic surveys. Three-dimensional seismic surveys are performed to maintain our production levels, increase total recoverability of our reserves, as well as to increase the effectiveness of development wells drilled at the Group's proved reserve areas. We capitalized RR 1,479 million of 3-D seismic surveys for the six months ended 30 June 2012, of which RR 748 million related to the three months ended 31 March 2012.

In the corresponding period in 2011, our exploration expenses amounted to RR 273 million primarily due to seismic activities at our fields in early stages of development.

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

In the three months ended 30 June 2012, we recorded a reversal of RR 408 million to change in inventory expense as compared to a reversal of RR 128 million in the corresponding period in 2011:

	Three months ended 30 June:	
millions of Russian roubles	**2012**	**2011**
Natural gas	(513)	(81)
Stable gas condensate	97	4
Other	8	(51)
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	**(408)**	**(128)**

In the three months ended 30 June 2012, we recorded a reversal to our operating expenses of RR 513 million primarily due to a 1,050 mmcm increase 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 the three months ended 30 June 2012, we recorded a charge of RR 97 million to our operating expenses due to a 57 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage.

The following table highlights movements in our inventory balances:

	2012			**2011**		
Inventory balances in transit or in storage	**At 30 June**	**At 31 March**	**Increase / (decrease)**	**At 30 June**	**At 31 March**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**1,082**	**32**	**1,050**	**234**	**77**	**157**
including Gazprom's UGSF	*1,050*	-	*1,050*	*203*	*48*	*155*
Liquid hydrocarbons (thousand tons)	**402**	**449**	**(47)**	**371**	**371**	**0**
including stable gas condensate	*295*	*352*	*(57)*	*274*	*282*	*(8)*

Other operating income (loss)

In the three months ended 30 June 2012, we recognized other operating loss of RR 36 million compared to other operating loss of RR 80 million in the corresponding period in 2011, both of which were primarily related to different immaterial items, including profit (loss) on disposal of materials, fixed assets, equipment and other similar transactions.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 257 million, or 1.4%, to RR 18,329 million in the three months ended 30 June 2012, compared to RR 18,072 million in the corresponding period in 2011. In the three months ended 30 June 2012, our profit from operations as a percentage of total revenues decreased to 40.6% compared to 44.5% in the corresponding period in 2011 primarily due to the commencement in January 2012 of natural gas purchases for resale in the regions where our end-customers are located and the lower margins we received for these volumes as well as a decrease in our liquids export sales prices.

In addition, our operating expenses exceeded the growth rate of our total revenues due to the fact that the UPT rate for natural gas was increased effective from 1 January 2012, while the regulated price for natural gas was increased effective from 1 July 2012.

Finance income (expense)

In the three months ended 30 June 2012, we recorded net finance expense of RR 5,597 million compared to a net finance income of RR 1,073 million in the corresponding period in 2011 due primarily to a foreign exchange loss from the depreciation of the Russian rouble relative to the US dollar in the 2012 reporting period.

In the three months ended 30 June 2012, our total accrued interest expense on loans obtained amounted to RR 1,193 million compared to RR 1,365 million in the corresponding period in 2011. In the three months ended 30 June 2012 and 2011, we capitalized RR 590 and RR 920 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 60 million and RR 58 million related to the unwinding of the present value discount related to provisions of asset retirement obligations as part of interest expense in the three months ended 30 June 2012 and 2011, respectively.

Interest income decreased by RR 445 million, or 54.9%, to RR 365 million in the three months ended 30 June 2012 from RR 810 million in the corresponding period in 2011 due to a decrease in accrued interest on loans provided to our joint ventures. In February 2012, the loan provided to our joint venture OOO Yamal Development ("Yamal Development"), as well as accrued interest for this loan, were converted to charter capital.

In the three months ended 30 June 2012, we recorded a net foreign exchange loss of RR 5,299 million compared to a net foreign exchange gain of RR 766 million in the corresponding period in 2011 due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble depreciated by 11.9% against the US dollar during the three months ended 30 June 2012 compared to the appreciation of Russian rouble by 1.2% in the corresponding period in 2011. 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

In the three months ended 30 June 2012, our proportionate share in loss of equity investments decreased to RR 521 million compared to RR 1,076 million in the corresponding period in 2011 primarily due to a decrease in losses recognized by our joint venture Yamal Development. The decrease in losses recognized in Yamal Development was due to conversion of loans obtained from its participants to charter capital in February 2012 resulting to a decrease in interest expense.

In the three months ended 30 June 2012, we recognized a share of losses in our joint venture OAO Yamal LNG ("Yamal LNG") of RR 175 million compared to RR nil million in the corresponding period in 2011.

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 20.9% and 21.3% for the three months ended 30 June 2012 and 2011, 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 decreased by RR 4,558 million, or 32.1%, to RR 9,657 million in the three months ended 30 June 2012 from RR 14,215 million in the corresponding period in 2011. The profit attributable to shareholders of OAO NOVATEK decreased by RR 4,673 million, or 32.6%, to RR 9,663 million in the three months ended 30 June 2012 from RR 14,336 million in the corresponding period in 2011.

Excluding the effect of foreign gains and losses, the profit attributable to shareholders of OAO NOVATEK increased by RR 1,392 million, or 10.3%, to RR 14,962 million in the three months ended 30 June 2012 from RR 13,570 million in the corresponding period in 2011.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, decreased by approximately RR 1.55 per share, or 32.6%, to RR 3.18 per share in the three months ended 30 June 2012 from RR 4.73 per share in the corresponding period in 2011.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 30 June 2012 and 2011:

millions of Russian roubles	Three months ended 30 June: 2012	2011	Change %
Net cash provided by operating activities	9,874	15,118	(34.7%)
Net cash provided by (used in) investing activities	(10,167)	(14,012)	(27.4%)
Net cash provided by (used in) financing activities	(17,684)	(2,395)	n/m

Liquidity and credit ratios	30 June 2012	31 December 2011	Change, %
Current ratio	1.26	1.16	8.6%
Total debt to equity	0.36	0.40	(10.0%)
Long-term debt to long-term debt and equity	0.21	0.24	(12.5%)
Net debt to total capitalization [(1)]	0.21	0.20	5.0%
Net debt to EBITDA [(2)]	0.89	0.84	6.0%

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

(2) Net debt to EBITDA ratio is calculated as Net debt divided by EBITDA for the last twelve months adjusted for the net gain on disposal of interest in subsidiaries.

Net cash provided by operating activities

In the three months ended 30 June 2012, our net cash provided by operating activities decreased by RR 5,244 million, or 34.7%, to RR 9,874 million compared to RR 15,118 million in the corresponding period in 2011 mainly due to significant current income tax payments made during the second quarter 2012. Current income tax paid in the three months ended 30 June 2012 amounted to RR 10,709 million and increased by RR 4,976 million, or 86.8%, compared to RR 5,733 million in the corresponding period in 2011 due to a decrease in current tax payables during the second quarter 2012 and prepayments based on high first quarter 2012 results.

Net cash provided by (used in) investing activities

In the three months ended 30 June 2012, our net cash used in investing activities decreased by RR 3,845 million, or 27.4%, to RR 10,167 million compared to RR 14,012 million in the corresponding period in 2011 due primarily to prepayments made by the Group in May 2011 to participate in a tender for new exploration and production licenses in the YNAO in the amount of RR 6.9 billion. Our cash used for purchases of property, plant and equipment and development of our fields increased by RR 3,626 million.

Net cash provided by (used in) financing activities

In the three months ended 30 June 2012, our net cash used in financing activities increased by RR 15,289 million to RR 17,684 million compared to RR 2,395 million in the corresponding period in 2011 primarily due to the repayment of the remaining balance of RR 16.3 billion for the 49 percent equity stake in Yamal LNG acquired in September 2011.

Working capital

Our net working capital position (current assets less current liabilities) at 30 June 2012 was a positive RR 9,387 million compared to RR 8,202 million at 31 December 2011. The strengthening of our net working capital position was primarily due to the repayment of accounts payable related to our acquisition of Yamal LNG in September 2011, that was partially offset by a decrease in cash and cash equivalents.

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

Our total capital expenditures (including capitalized 3-D seismic surveys) 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 three months ended 30 June 2012 and 2011:

	Three months ended 30 June:	
millions of Russian roubles	**2012**	**2011**
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga)	3,160	827
Yurkharovskoye field	3,071	2,659
East-Tarkosalinskoye field	1,967	562
Khancheyskoye field	416	166
Salmanovskoye (Utrenneye) field	382	-
North-Russkiy license area	324	154
Purovsky Plant	251	259
Geofizicheskoye field	241	-
North-Yamsoveiskiy license area	198	6
Other	2,260	2,978
Exploration, production and marketing	**12,270**	**7,611**

Total capital expenditures on property, plant and equipment in the three months ended 30 June 2012 increased by RR 4,659 million, or 61.2%, to RR 12,270 million from RR 7,611 million in the corresponding period in 2011. The increase was primarily related to the construction of processing assets at Ust-Luga as well as further field development on the crude oil layers at the East-Tarkosalinskoye and Khancheyskoye fields.

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 decreased from RR 95,478 million at 31 December 2011 to RR 93,667 million at 30 June 2012, or by RR 1,811 million. We utilize credit facilities to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields and to construct and/or expand 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 30 June 2012 and 31 December 2011 was as follows:

Facility	Amount	Maturity	Interest rate	At 30 June 2012	At 31 December 2011
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	21,188	20,776
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	19,592	19,206
Sberbank	RR 15 billion	December 2013	7.5%	14,975	14,966
Sberbank	RR 10 billion	December 2014	8.9%	9,851	-
Gazprombank [(1)]	RR 10 billion	November 2012	8%	-	10,000
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,980	9,971
Sumitomo Mitsui Banking Corporation Europe Limited	USD 300 million	December 2013	LIBOR+1.45%	5,883	7,685
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9%	6,563	6,439
UniCredit Bank	USD 200 million	October 2012	LIBOR+3.25%	2,624	6,435
Bank overdrafts	USD 92 million	July 2012	2.57%	3,011	-
Total				**93,667**	**95,478**

[(1)] The loan from Gazprombank was repaid ahead of maturity schedule in January 2012.

Maturities of long-term loans

Scheduled maturities of our long-term debt outstanding (net of unamortized transaction costs) at 30 June 2012 were as follows:

Maturity schedule:	**RR million**
1 July 2013 to 30 June 2014	20,185
1 July 2014 to 30 June 2015	9,851
1 July 2015 to 30 June 2016	19,592
1 July 2016 to 30 June 2017	-
After 30 June 2017	21,188
Total long-term debt	**70,816**

Available credit facilities

At 30 June 2012, 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 4,797 million (USD 83 million and EUR 50 million) at 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 30 billion until December 2012, Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2013, ZAO UniCredit Bank in the amount of USD 270 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 30 June 2012, total amount of our long-term debt denominated in US dollars was RR 46,010 million, or 49.1% 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 26.3% in the three months ended 30 June 2012, is denominated in US dollars. As of 30 June 2012, the Russian rouble depreciated by approximately 1.9% against the US dollar since 31 December 2011.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 30 June 2012 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 5,886 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 available that is 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 30 June 2012, 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.