NOVATEK

2005 Annual Review

NOVATEK

2005 ANNUAL REVIEW

Financial and Operating Highlights

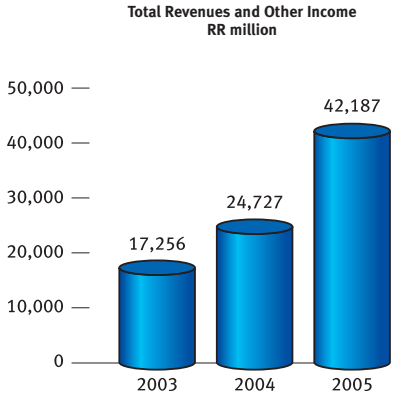
millions of Russian roubles except per share amounts and ratios	Year ended 31 December 2005	2004	Change %
Financial results			
Total revenues and other income[1]	42,187	24,727	71%
Operating expenses	22,861	17,113	34%
Profit attributable to NOVATEK shareholders	13,697	5,694	141%
EBITDA[2]	22,876	8,785	160%
Earnings per share (basic and fully diluted)	4,511	2,510	80%
Operating results			
Total proved reserves[3], mmboe	4,573	4,178	9.5%
Natural gas sales volumes by consolidated subsidiaries, mmcm	27,330	17,277	58%
Liquid sales volumes by consolidated subsidiaries, mt	2,460	2,112	17%
Stable gas condensate sales volumes from Purovsky Processing Plant, mt	762	–	100%
Capital resources and liquidity			
Net cash provided by operating activities	10,246	4,817	113%
Capital expenditures	6,460	7,412	(13%)
Net debt[4]	6,138	20,997	(71%)
Total debt to Total shareholders equity	16%	54%	(70%)

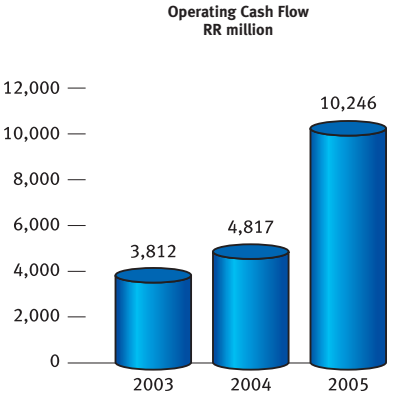
[1] Net of VAT, excise tax and export duties.

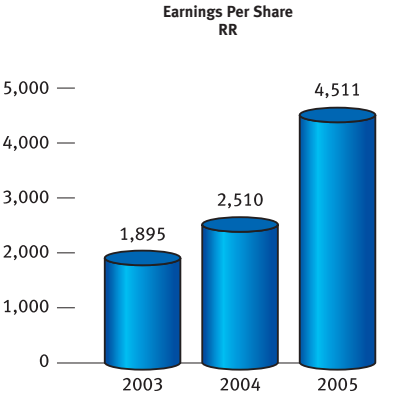
[2] EBITDA represents net income before finance income (expense), income taxes, and depreciation depletion and amortization.

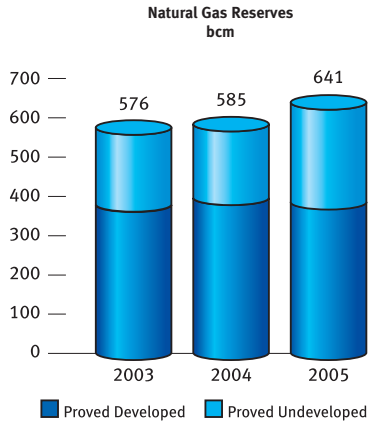
[3] Reserves in this Review include our share of reserves of associates.

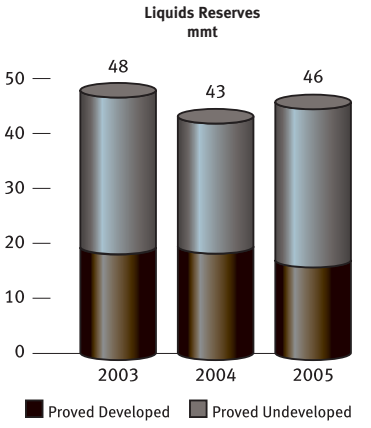
[4] Calculated as total debt less cash and cash equivalents.

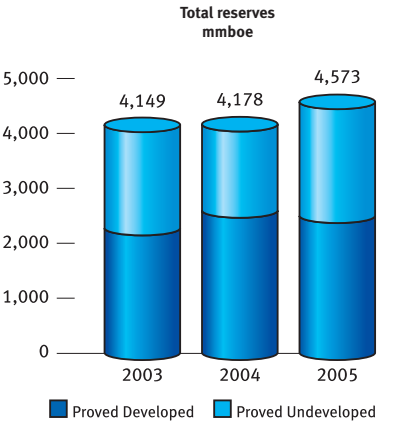


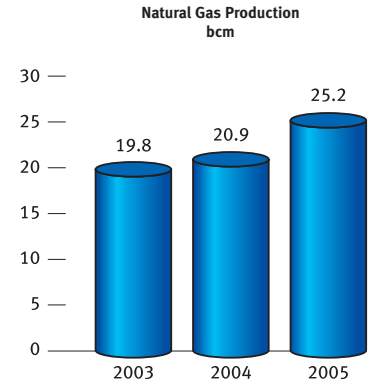


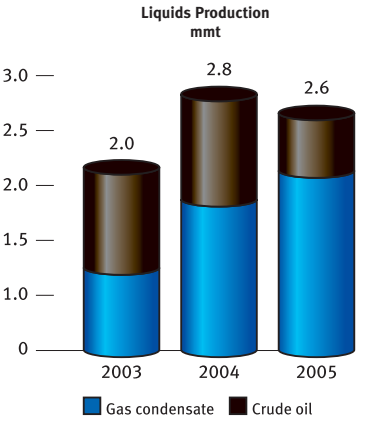


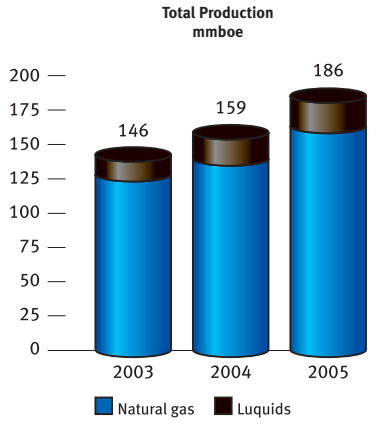

Natural Gas Reserves
bcm
700
600
500
400
300
200
100
0
576
585
641
2003
2004
2005
Proved Developed
Proved Undeveloped

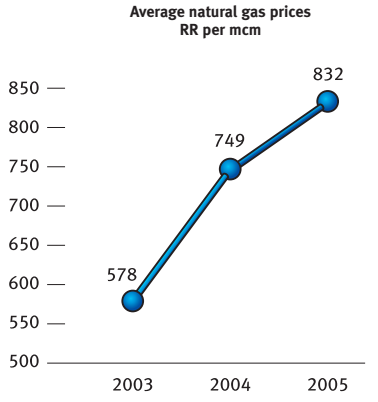

Liquids Reserves
mmt
50
40
30
20
10
0
48
43
46
2003
2004
2005
Proved Developed
Proved Undeveloped

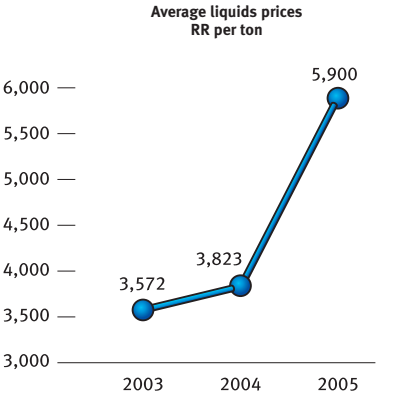

Total reserves
mmboe
5,000
4,000
3,000
2,000
1,000
0
4,149
4,178
4,573
2003
2004
2005
Proved Developed
Proved Undeveloped

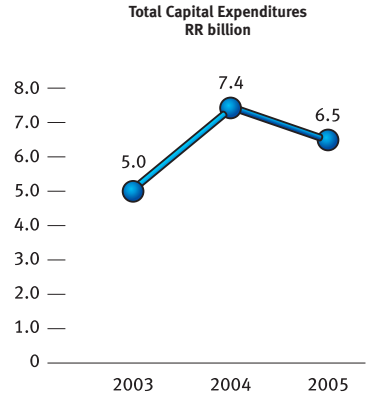

Natural Gas Production
bcm
30
25
20
15
10
5
0
19.8
20.9
25.2
2003
2004
2005


Liquids Production
mmt
3.0
2.5
2.0
1.5
1.0
0
2.0
2.8
2.6
2003
2004
2005
Gas condensate
Crude oil


Total Production
mmboe
200
175
150
125
100
75
50
25
0
146
159
186
2003
2004
2005
Natural gas
Luquids


Average natural gas prices
RR per mcm
850
800
750
700
650
600
550
500
578
749
832
2003
2004
2005


Average liquids prices
RR per ton
6,000
5,500
5,000
4,500
4,000
3,500
3,000
3,572
3,823
5,900
2003
2004
2005


Total Capital Expenditures
RR billion
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0
5.0
7.4
6.5
2003
2004
2005

A Year of Transition

Dear Shareholders,

For NOVATEK, 2005 was a year of transition, our first full year of operational and financial results as a fully consolidated entity. It was a year of immense challenges and great rewards. We achieved a major milestone in our corporate history by listing our shares on the Russian and London stock exchanges. You are holding the first annual report of OAO NOVATEK as a public company. This report is the culmination of our hard work over the past eleven years and sets a new standard for our performance in the future.

We are proud of our accomplishments in 2005. This was the most successful year in the history of the Company. We have a strategy that balances our aim of increasing production at our core producing fields while migrating towards more processing capacity downstream. Our strategy of maximizing returns throughout the energy value chain combined with our success in meeting and exceeding every goal in our ambitious growth plan has created enormous shareholder value.

In 2005, the Company completed several projects in different segments of our business: we restructured the Company to concentrate on our core gas assets; we brought into commercial operation our Purovsky Gas Condensate processing plant; we built facilities for stable gas condensate transshipment at the port of Vitino; we commissioned a brand new consumer packaging manufacturing facility in Novokuybyshevsk; and we made significant progress in attracting, retaining and motivating our valued employees.

The combined production volumes in 2005 of 25.2 billion cubic meters of natural gas and 2.6 million tons of liquids are the highest operational figures in our history. We achieved record total revenues and other income of

RR 42,187 million. Net profits attributable to our shareholders according to IFRS increased more than twofold to RR 13,697 million as compared to the prior year. Our earnings per share grew 80% to RR 4,511 per share. We increased our proven reserve base by 9.5% including reserves of associates, achieved a reserve replacement ratio, net of disposals, of 311% and our reserve-to-production life is 25 years. We are truly poised for future growth.

We are grateful to our investors and the whole investment community for their high appraisal of our corporate activities. Our market capitalization has grown by 100% over its value at the beginning of the year and by 39% since NOVATEK listed its Depository Receipts on the London Stock Exchange in July 2005.

The investors' positive reaction to the Company suggests that many people believe we have a solid strategic platform to continue our growth story. How do we define success? For seven consecutive years we have demonstrated we can increase reserves, production, and cash flow year after year. Since 2002, we have increased our reserves by 5.2% on a compound annual basis, our production on a fully consolidated basis by 22.2%, and our earnings per share by 99.9%.

Building quality prospects is important, but people are even more critical to long-term success. We have a group of highly experienced oil and gas professionals who have worked their entire careers in West Siberia. Teamwork, knowledge and experience are powerful forces in any organization, especially when they are fuelled by an entrepreneurial mindset that is both creative and competitive. It is a privilege to work with the exceptional group of employees we have here at NOVATEK.

It is obvious that we are a different company today than we were even a year ago. All of the changes we made during our corporate restructuring initiatives, including our divestiture program, were designed to strengthen our financial position, focus management's attention on the most attractive assets in our core businesses, and position NOVATEK to succeed in all market conditions. We emerged from 2005 with a solid platform for future growth.

The publication of this annual report opens a new page in our history. Yet as before, we remain true to our principles: to be efficient, socially responsible and to contribute to the prosperity of our country.

On behalf of the Board of Directors and the Management Board, we look forward to continuing our dialogue with the investment community and delivering superior operational and financial results in 2006 and beyond.

Alexander Y. Natalenko
Chairman of the Board

Leonid V. Mikhelson
Chief Executive Officer

Mark A. Gyetvay
Chief Financial Officer

Overview

OAO NOVATEK is Russia's largest independent gas producer, and the second-largest producer of natural gas in Russia after OAO Gazprom, with upstream operations located in the Yamal-Nenets Autonomous Region and downstream facilities located in the Samara Region. Our impressive growth has been achieved through the successful strategy of developing and exploiting our significant hydrocarbon resource base, while maintaining our low-cost competitive advantage.

In 2005, we produced 186 mmboe, 89% of which was natural gas. At year end 2005, our natural gas, gas condensate and crude oil proven reserve base was appraised at 4.6 billion boe, 90% of which is natural gas. Our proved natural gas reserves rank among the largest oil and gas companies globally and third among oil and gas companies in Russia, after OAO Gazprom and OAO NK Lukoil.

Key achievements in 2005 include:

- Record earnings reflecting the first year of operational and financial results after the full consolidation of our core subsidiaries in December 2004. Total revenues and other income increased by 71% to RR 42,187 million and profits attributable to common shareholders grew by 141% to RR 13,697 million
- Record production volumes for natural gas and gas condensate
- Successful replacement of 311% of our proven reserves on an organic basis, while maintaining a reserve-to-production life of 25 years
- Continued strengthening our relationship with Gazprom through the formalization of a strategic framework agreement to participate cooperatively in future projects
- Commenced operations at our wholly-owned Purovsky Gas Condensate processing plant (Purovsky Plant) in June to process a majority of the unstable gas condensate produced by our core fields
- Completed the construction of the loading facilities at the Port of Vitino in May and began transporting our stable gas condensate from the Purovsky Plant through the port facilities for sales to the US and Europe
- Commenced production of biaxial-oriented polypropylene (BOPP) film wrap in June at our industrial products subsidiary, Novatek-Polimer, providing us with the capacity to supply 25% of the domestic market demand
- Successful placement of 19% of our shares on London and Russian exchanges in July representing, at the time, the second largest Russian IPO ever.

STRATEGY

Our strategy is to leverage our competitive strengths to increase hydrocarbon production on a sustainable and profitable basis, while operating in a socially and environmentally responsible manner. Specifically, we intend to:

• Substantially increase our production of hydrocarbons, particularly natural gas. Independent experts estimate that the share of natural gas supplied by independent producers to the domestic market will increase in line with the forecasted increase in total domestic demand as well as increases in exports of Russian gas. We believe we are well positioned to take advantage of the heightened demand by increasing our production and maximizing sales volumes. Our fields produced 25.2 bcm of natural gas and 2.6 mmt of gas condensate and crude oil in 2005. Our target is to increase our natural gas production to approximately 45.0 bcm and our gas condensate and crude oil production to approximately 4.6 mmt in 2010.

• Maintain our low cost structure. Through continued use of modern technology and production techniques across our prolific hydrocarbon resource base, we intend to maintain our low cost track record. In 2005, our weighted average lifting cost and our finding and development cost were among the lowest in the industry. We believe that the geographic concentration of our resource base and the resulting economies of scale will continue to be a major factor in helping us maintain our low cost structure. Moreover, we strive to maintain consistently low costs in all other areas of our business.

• Capture maximum margins on natural gas and liquids sales. Our marketing and sales team continues to optimize our product distribution among customer and market segments to realize superior risk adjusted margins. We intend to maintain our leadership among independent gas producers by penetrating new regional markets and entering into long-term supply agreements with key clients. In addition, we intend to take advantage of our recently commissioned gas condensate processing plant and related infrastructure at the Port of Vitino to enable us to export a substantial amount of our gas condensate production resulting in improved margins based on current prices.

• Prove-up our resource base. We intend to continue to manage our resource base to grow our proved reserves as we expand the development of our fields. We believe the concentration of our resource base in the gas-rich Yamal-Nenets Autonomous Region, along with the proximity of our fields to gas transportation infrastructure in the Nadym-Pur-Taz Region will facilitate cost-effective reserve growth.

2005 Operations in Review

Exploration and Production

All of our fields are located in the Yamal-Nenets Autonomous Region, the world's largest natural gas producing region, accounting for over 90% of Russia's natural gas production and approximately 20% of the world's natural gas production. Our core focus in this prolific region provides the best opportunity to increase shareholder value through low-risk, low-cost production and reserve growth. With more than eleven years of operational history in this region, we are well-positioned to capitalize on these opportunities.

As a result of our 2005 achievements, we have maintained our position as Russia's second largest gas producer and third largest holder of natural gas reserves. In 2005, we produced approximately 4% of Russia's total natural gas output and supplied roughly 7% of the nation's domestic demand.

Yurkharovskoye field

NOVATEK is continuously seeking to increase its hydrocarbon resource base through geological and geophysical exploration activities in close proximity to existing transportation and production infrastructure. By employing modern exploration methods and data processing techniques, we seek to maximize the ultimate recovery of hydrocarbons from our fields, and efficiently exploit our reserves on a cost-effective basis.

Our core focus on developing our natural gas and gas condensate fields delivered exceptional results as evidenced by increases in both the production of natural gas and liquid hydrocarbons and our resource base.

In 2005, our costs incurred in exploration and development activities amounted to RR 5,434 million, resulting in revisions and additions of 646 mmboe of proved natural gas, gas condensate and crude oil reserves, before production and disposals, for a reserve replacement cost of RR 8.4 per boe (USD 0.3 per boe). Our proven natural gas reserves increased by 9.5% to 641 bcm (22.6 tcf), while our proven liquids reserves (gas condensate and crude oil) increased by 7.4% to 46 mmt (381 mmbbls), net of disposals. Reserve replacement for the year was 311% on a boe basis net of disposals. Our three-year average reserve replacement rate is 232%.

Our fields produced 25.2 bcm (889.9 bcf) of natural gas and 2.6 mmt (21.2 mmbbls) of liquids. We are focused on growth through the drill bit and have consistently delivered above average increases in natural gas production through utilization of horizontal and other advanced drilling techniques.

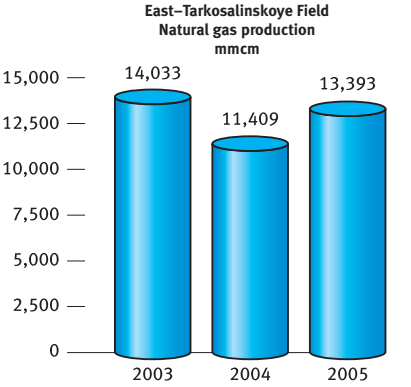
Core Fields

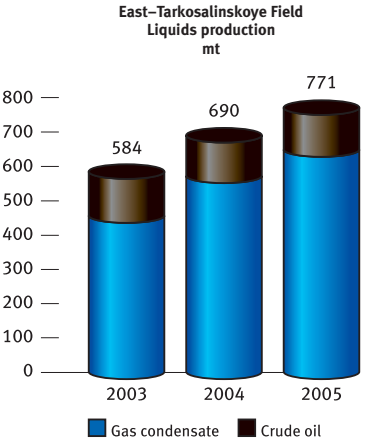
Our three core fields produced 98% of our natural gas and liquids on a boe basis, and accounted for 95% of our total proved reserves in 2005. All three fields are located in close geographic proximity to the world's largest gas transportation infrastructure, the Unified Gas Supply System (UGSS), which is owned and operated by Gazprom. Continued development of our core fields is the primary focus of our near term strategy of growing production and reserves. These fields demonstrate the prolific nature of the hydrocarbon deposits in the area, with 2005 average production rates of 69 mmcm of natural gas and 5.6 mt of gas condensate per day we will be able to reach our production goals with fewer wells drilled and lower overall development costs. In 2005, development activities at these fields resulted in additions of 432 mmboe of proved natural gas and liquid hydrocarbon reserves.

East-Tarkosalinskoye. Initially discovered in 1971, the East-Tarkosalinskoye field is located 40 kilometers east of the city of Tarko-Sale and is licensed to our wholly-owned subsidiary, OOO Tarkosaleneftegas. It is the largest and most mature of our fields with crude oil production beginning in 1994, natural gas production beginning in 1998 and gas condensate production beginning in 2001. Future development activities include exploitation of the undeveloped crude oil reserves in the northern part of the license area.

2005 total production:
Natural gas: 13,393 mmcm (473 bcf)
Liquids: 771 mt (6,174 mbbls)
Total: 93.8 mmboe

2005 proved reserves:
Natural gas: 299 bcm (10.6 tcf)
Liquids: 18 mmt (145 mmbbls)
Total: 2,100 mmboe





YURKHAROVSKOYE. Initially discovered in 1970, the Yurkharovskoye field is located within the Polar Circle to the South-East of the Tazovsky peninsula and is one of the northern most fields to begin operations in Post-Soviet Russia. The field is licensed to our wholly-owned subsidiary, OOO Yurkharovneftegas, and is in the earliest stage of development of our three core fields with production of natural gas and gas condensate commencing in 2003. It is the second largest of our core fields by production and reserves, and the cornerstone of our long-term growth strategy.

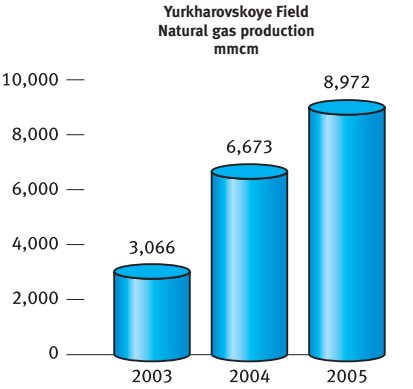
2005 TOTAL PRODUCTION:
Natural gas: 8,972 mmcm (317 bcf)
Liquids: 718 mt (6,368 mbbls)
Total: 65.0 mmboe

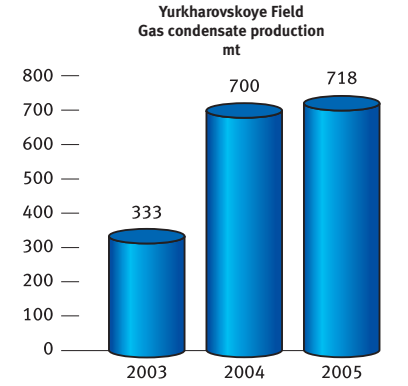
2005 PROVED RESERVES:
Natural gas: 273 bcm (9.6 tcf)
Liquids: 13 mmt (117 mmbbls)
Total: 1,899 mmboe

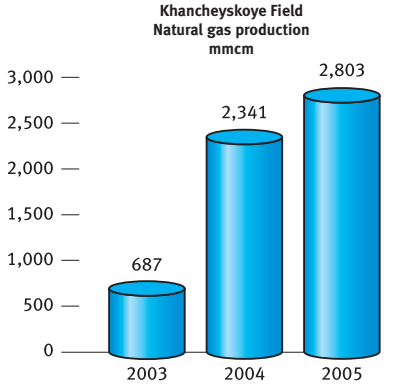
KHANCHEYSKOYE. Initially discovered in 1990, the Khancheyskoye field is located 65 kilometers east of the East-Tarkosalinskoye field, and is licensed to our wholly-owned subsidiary, OOO Tarksosaleneftegas. In May 2005, Tarkosaleneftegas merged with our wholly-owned subsidiary OOO Khancheyneftegas taking advantage of the close proximity of the fields to improve operating efficiencies and enhance economies of scale. The Khancheyskoye field has been producing natural gas and gas condensate since 2003 and 2002, respectively.

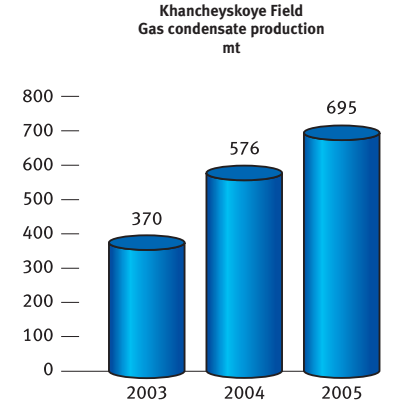
2005 TOTAL PRODUCTION:
Natural gas: 2,803 mmcm (99 bcf)
Liquids: 695 mt (5,667mbbls)
Total: 24.0 mmboe

2005 PROVED RESERVES:
Natural gas: 46 bcm (1.6 tcf)
Liquids: 6.3 mmt (52 mmbbls)
Total: 353 mmboe









Newly Appraised Fields

In 2005, we appraised two new fields under SEC and SPE reserve appraisal standards, the fields are both in the early stages of development. While these fields are currently not as large or developed as our three core fields, we consider them strategic medium term contributors to our organic production and reserve growth. The fields are located in close geographic proximity to our core fields and have similar geological characteristics.

Sterkhovoye. The Sterkhovoye field is part of the Olympiskiy license area which is held by OAO Purneftegasgeologiya, a majority-owned subsidiary. The field commenced production of natural gas and gas condensate in 2004. Currently, there are nine wells at the field and we have accumulated over 800 kilometers of 2D, and 295 square kilometers of 3D, seismic results.

2005 total production:
Natural gas: 16 mmcm (0.6 bcf)
Liquids: 9 mt (72 mbbls)
Total: 176 mboe

2005 proved reserves:
Natural gas: 3.5 bcm (122 bcf)
Liquids: 1.4 mmt (11 mmbbls)
Total: 34 mmboe

Termokarstovoye. The Termokarstovoye field is licensed to our wholly-owned subsidiary, Terneftegas. The field is currently in the development stage and holds reserves of natural gas and gas condensate. Currently, there are eight wells at the field and we have accumulated over 430 kilometers of 2D seismic results. Production is targeted to begin in 2009.

2005 proved reserves:
Natural gas: 20 bcm (699 bcf)
Liquids: 7 mmt (57 mmbbls)
Total: 186 mmboe

Other Licenses

We are currently producing natural gas and liquids from two licenses which are not considered strategic to our asset portfolio and future growth. We remain focused on organically growing our natural gas and gas condensate reserves through our activities at an additional six exploration licenses located in the Yamal-Nenets Autonomous Region. We consider these license areas an integral part of our long term growth strategy. Currently, there are 37 production and 26 exploration wells among these fields and license areas and over 12 thousand kilometers of 2D, and 208 square kilometers of 3D, seismic results.

2005 total production:
Natural gas: 41 mmcm (1.4 bcf)
Liquids: 76 mt (572 mbbls)
Total: 839 mboe

Divestitures

In June 2005, we disposed of our respective interests in the following entities: Geoilbent, Tambeyneftegas and Selkupneftegas. The disposals were the result of our strategy to focus on the development of our upstream natural gas and gas condensate assets and divest assets where we do not exercise operational control over their development.

Processing and Marketing

Currently, Russia has fewer known deposits of easily developed "dry" Cenomanian gas which is almost 100% pure methane and does not require additional processing.
In recent years, there has been an increase in the discovery and development of deeper deposits of so called "wet" gas from Valanginian and Achimov horizons which also yields valuable gas condensate but requires additional processing.

Our new plant removes current and future processing capacity constraints enabling us to optimize the development of our fields.

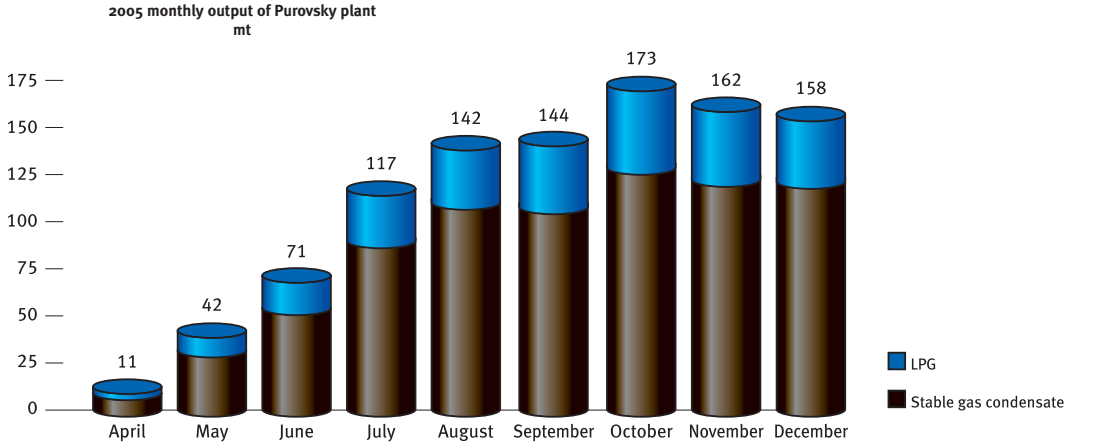
We have ambitious plans to diversify our business by becoming both a leading natural gas producer and an active player in the market of refined products. Our plans include the production of stable gas condensate, liquefied petroleum gas (LPG), propane, butane and finished products, such as plastic pipes, pipe insulation and various types of packing materials for the consumer goods industry.

Processing

In June 2005, we commenced operations at our wholly-owned Purovsky Plant, enabling us to process up to 100% of our unstable gas condensate production into stable gas condensate and LPG. The plant is the first of its kind to be built in Russia in the last 20 years and is an integral part of our gas condensate value chain.

We completed construction of the plant in 18 months at a cost of approximately RR 6 billion (approximately USD 210 million) and reached maximum operating capacity in the fourth quarter 2005. The plant has the capacity to process up to two million tons of unstable gas condensate

Purovsky Plant



per annum into approximately one million six hundred thousand tons of stable gas condensate and 400 thousand tons of LPG. The Purovsky Plant currently has storage facilities for up to 22 thousand tons of gas condensate and 3.5 thousand tons of LPG and fully automated facilities on site for loading stable gas condensate and LPG into rail tank cars. We plan to increase processing capacity to five million tons per annum to accommodate future production increases from our fields.

The commencement of operations at the Purovsky Plant has proved a vital link in our mid-stream operations allowing us full control over our processing needs and providing access to new marketing channels for our gas condensate production. Having our own processing facility lessens our reliance on third party pipelines and processing plants, improves our ability to control the product slate and its quality and gives us greater control over the development of our fields by removing processing capacity constraints.

In 2005, the Purovsky Plant processed approximately one million tons of unstable gas condensate and produced more than 770 thousand tons of stable gas condensate and 240 thousand tons of LPG.

Gas Sales

As an energy source, natural gas is clean, abundant and increasingly becoming the fuel of choice in the 21st century. The demand for natural gas is projected to grow at an increasing rate over the next decade, outstripping the demand growth for other primary sources of energy. This demand growth, combined with the ongoing liberalization of gas markets in Russia and the world, will enable us to leverage our natural gas expertise to become a significant and reliable supplier to the domestic market.

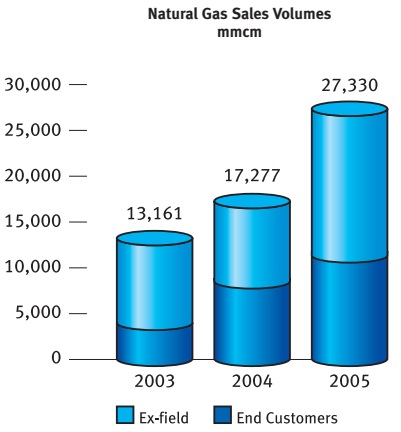
Russia ranks third in the world in natural gas consumption utilizing approximately 390 bcm in 2005. Natural gas usage has grown roughly 2.5% in 2005, compared to 2004, a result of Russia's economic development and growth. In Russia's energy balance, natural gas currently comprises over 50% of the primary energy supply and in some regions it is as high as 80%. The main consumers are the electric power industry, the metals and chemicals industries, public utilities and households.

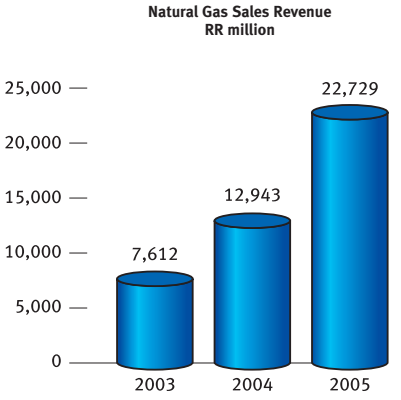
In 2005, our natural gas sales volumes totaled 27,330 mmcm, of which 11,650 mmcm was delivered to end users and 15,680 mmcm was sold ex-field mainly to wholesale traders. In 2005, natural gas sales volumes increased by 58% compared to sales volumes of 17,277 mmcm in 2004. Our share of total natural gas deliveries to consumers in Russia via the UGSS was approximately 8%.

In 2005, we expanded our deliveries of natural gas to more than 30 regions of the Russian Federation, the largest of which are made to industrial consumers in the Chelyabinsk, Samara, Leningrad, Perm, Tyumen and Kurgan regions. We deliver natural gas primarily to the following industrial users: power generation companies, metallurgical plants and regional natural gas distributors.

Our natural gas sales are subject to seasonal fluctuations in demand. To mitigate the effect of these changes we have entered into a service agreement with Gazprom to utilize the spare capacity in their underground natural gas storage reservoirs. In periods of low demand we store gas in the underground reservoirs and later extract it in periods of peak demand to supplement our production. In the third quarter of 2005, we injected 115 mmcm of natural gas into these underground reservoirs, the gas was extracted and sold in the colder months, of fourth quarter 2005 and first quarter 2006, supplementing our production during these periods of increased demand.

We also sell a portion of our natural gas to wholesale trading companies allowing us to manage seasonal fluctuations in production.



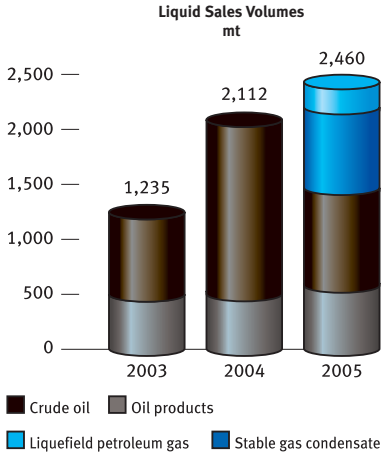


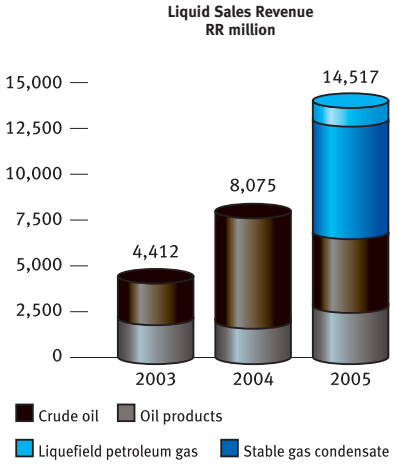
Liquids Sales

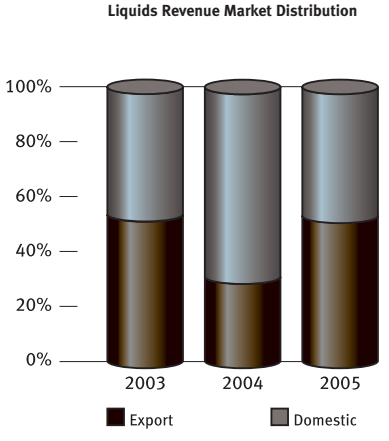
Our liquids sales results in 2005 highlight our efforts to add value through diversification of the products that we sell and the markets that we supply. In 2005, we realized record liquids revenue by optimizing our sales of liquid hydrocarbons (crude oil, stable gas condensate, LPG and oil products) to consumers in Russia and abroad, through flexible marketing channels that enabled us to capture the highest margin depending on where demand and pricing conditions were most favorable. In 2005, 53% of our total liquids revenue was derived from export sales compared to 31% in 2004. Our results in 2005 demonstrate the significant progress we have made in our liquids value chain through the reduction in sales volumes of crude oil and oil products resulting from third party processing of our gas condensate. In 2004, and the first half of 2005, our gas condensate was processed and sold as crude oil and various oil products limiting our ability to realize its full potential.

With the commencement of operations at our Purovsky Plant, we have significantly increased our flexibility in marketing liquid hydrocarbons. This flexibility allowed us to increase the profitability of our stable gas condensate sales through optimization of export and domestic marketing channels. Stable gas condensate and LPG produced at our Purovsky Plant is in high demand and is sold at a quality premium to crude oil and most oil products.

Our stable gas condensate and LPG are transported by railway to both domestic and export markets. We have leased 420 rail tank cars for the transportation of LPG through our wholly-owned subsidiary, NovaTrans, and have entered into a long term contract with Sverdlovsk Railways (an affiliated company of Russian Railways) for delivery of stable gas condensate to the all-season port facilities in Vitino. The combination of this logistical network provides uninterrupted delivery to customers and positions us as a reliable supplier of these products.



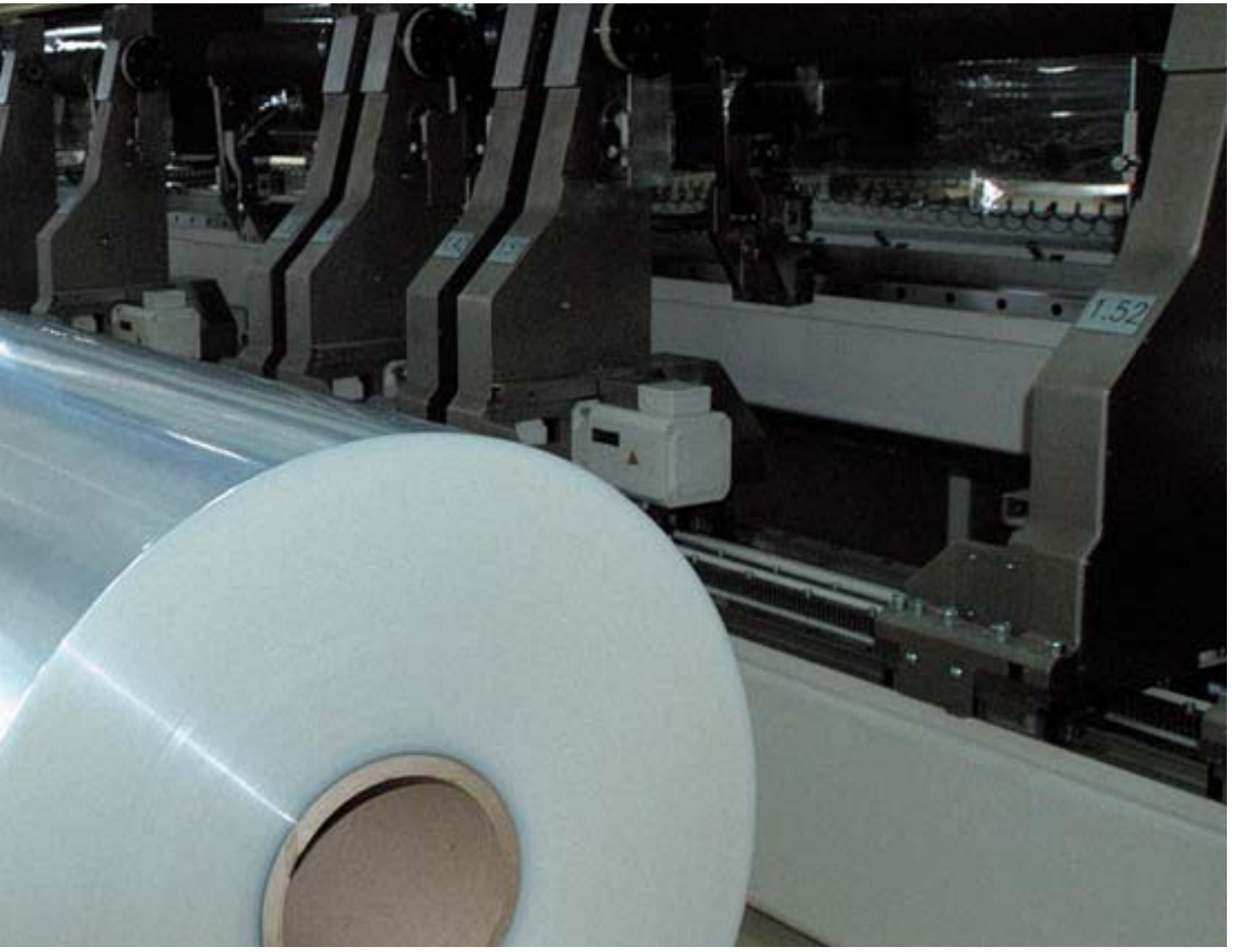




Industrial

Novatek-Polimer is the core subsidiary in our industrial manufacturing business segment. Headquartered in the city of Novokuybyshevsk in the Samara Region, it is the largest Russian producer of anti-corrosive insulating materials used on underground pipelines in the oil and gas industry. It produces more than a dozen types of polyethylene-based insulating tapes, including polymer tapes and wraps, heat-shrinkable tapes and sleeves for the protection of welded pipe joints. Its major customers include Gazprom, LUKOIL, Surgutneftegas, Slavneft, Rosneft, Bashneft, Transneft and Orenburgneft, amongst others.

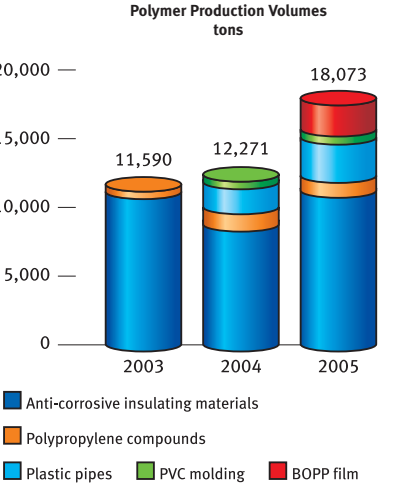
Novatek-Polimer also produces plastic pipes of varying diameters for the oil and gas industry and civil construction, and polypropylene compounds, which are purchased by, among others, Russian automotive parts suppliers.



Testing of BOPP film production line

In June 2005, we commissioned a modern BOPP plant for the production of film wrap which is widely used as a packaging material in the food, tobacco, perfume, pharmaceutical and textile industries. The plant has annual production capacity of 25 thousand tons and we currently estimate that, as a result of import substitution, production from the plant will supply up to one-quarter of the Russian market for consumer packaging film materials.

While not our core business, we have continued to expand our Novatek-Polimer operations and have achieved exceptional growth in both revenues and plant output from this business segment. We see our diversification into film wrap production as complimentary and value additive to our overall strategy in the industrial manufacturing sector.



Social and Environmental Responsibility

Our sustainable success depends on, among other factors, the safety of our employees and the respect we demonstrate for the environment and communities in which we operate. Since the beginning of our operations, eleven years ago, we have been building a strong reputation as a responsible corporate citizen by adhering to applicable domestic and global standards, and our own principles and interests, to employ sustainable business practices throughout our operations.

Environment, Health & Safety

In 2004, we developed our own Environmental, Health and Safety (EHS) Policy (the "Policy") that translates our values and shared principles into clear policy commitments which are applied to the areas and communities where we operate. In these areas and communities, we are active philanthropically and operate in an environmentally responsible manner to produce the most environmentally attractive fuel in the country's energy mix. In 2005, the Policy was amended to comply with the Principles and Practices of the International Finance

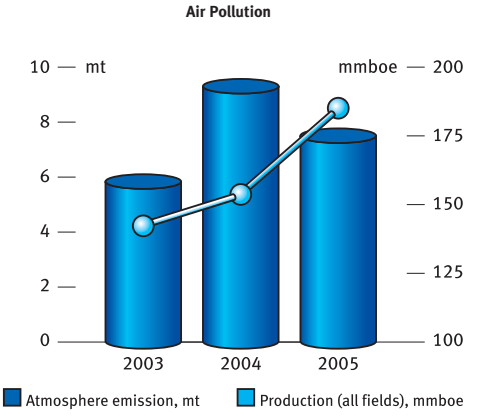
Corporation (a part of the World Bank Group) and international environmental health and safety standards. The new Policy also expands our commitments to partners and subcontractors engaged in activities on our behalf.

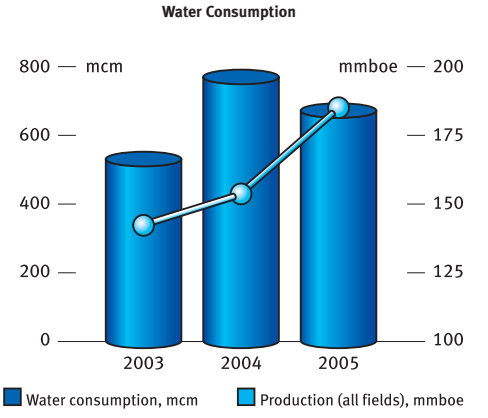
In 2005, we conducted external environmental audits of our main operating subsidiaries and have maintained an ongoing relationship with external consultants in the environmental field. Based on the audit and consultants' recommendations, we have reviewed the management of our Policy and employed an integrated EHS Management Standard to enhance the effectiveness of our Policy. We recognize the advantages of independent assurance and have committed to compliance and certification in accordance with ISO 14001 standards and BSI OHSAS 18001 specifications at and for our main subsidiaries. As part of this effort, in 2005, our major operating subsidiaries began adopting appropriate standards and conducting preliminary audits carried out by a recognized industry leader in the field of EHS.

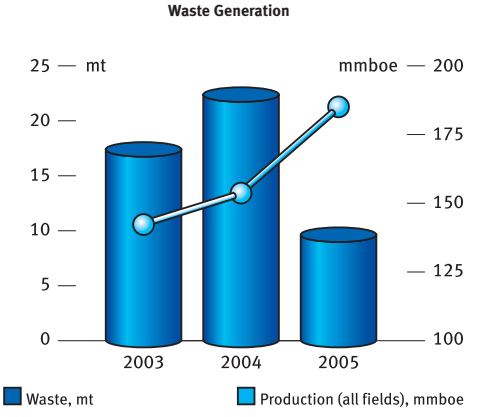
Environment

Wherever possible, we prevent, or otherwise minimize, mitigate and remediate, harmful effects of our operations on the environment. In 2005, we spent more than RR 300 million, almost triple our environmental expenditure in 2004, on several initiatives to improve our environmental performance. The results of these initiatives include the following:

- Reduced atmospheric emissions and increased the effectiveness of our gas turbine power stations through recycling of exhaust gases for heating purposes;
- Re-injected water produced during oil production resulting in a 20% reduction from 2004 of external water usage in the oil production process;
- Conserved material usage and transitioned to resource-saving technologies resulting in a 54% reduction in waste in 2005 over 2004;
- Constructed two waste disposal sites with monitoring wells and waste filtering monitoring systems improving our environmental risk management;
- Continued clean up efforts in 2005 along the shoreline of the Tazov Bay removing 1,732 tons of scrap metal left over from prior use of the license area, five times more than in 2004; and
- Rehabilitated 1,080 acres of land which we returned to the State.







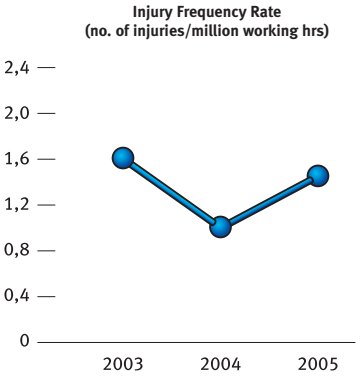
Greenhouse Gases Emission

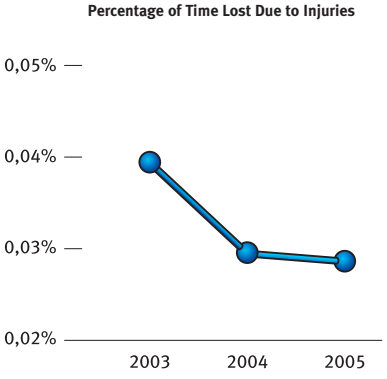
in tons	2005	2004
methane	53	3,784
nitrogen dioxide	777	456
carbon oxide	4,121	3,960
sulfur dioxide	13	15

Health & Safety

We employ approximately 4,000 people, 50% of which are engaged in exploration and production activities and 38% in processing and industrial activities. In 2005, we created more than 350 new jobs, 79% of which are in the Yamal-Nenets Autonomous Region.

In 2005, 24% of our employees were enrolled in occupational health and safety certification and training programs and 20 of our top managers were certified for compliance with oil and gas industry health and safety standards. In 2004 and 2005, our average training rate was 46 hours per employee.





Socio-Economic and Community Development

We are committed to making a positive impact on the social and economic development of the communities surrounding our operations. Our partnerships with these communities take many forms, including: direct contributions through community development programs for education and youth development, social infrastructure improvements and support and promotion for cultural events and the arts.

In 2005, we invested in construction projects and infrastructure improvements in various settlements of primarily indigenous peoples in the Yamal-Nenets Autonomous Region, including; housing, kindergartens, boiler plants, sauna-laundry facilities and the renovation and equipping of schools and hospitals. At our most remote field, we constructed a Service Center where indigenous peoples receive medical aid, food and rest during their migrations. We also made contributions to the quality of life of the indigenous

peoples in the form of transportation programs and provision of modern equipment such as boats and snowmobiles.

In 2005, we continued to contribute to education and youth development through sponsorship of classes for 'gifted' children in Tarko-Sale and Novokuybyshevsk and establishment of a grant program aimed at excellence in learning for the students of the Purovsky District. We also continued our support for several higher educational programs at leading Russian universities and our support of the arts through contributions to programs at the Russian State Museum and the Samara Artistic Museum which promote Russian artists abroad.

During 2005, we provided RR 215 million in charitable contributions and community development investments of which, more than RR 40 million went to educational and cultural support programs.

Market Information

Our share capital is RR 303,603 thousand and consists of 3,036,306 ordinary shares, each with a nominal value of RR 100, which are fully paid, issued and outstanding.

Our shares and GDRs are traded on the following exchanges:

Exchange	*Symbol*	*Security*	*Currency*	*Start of trading*
MICEX	NVTK	Common shares	Russian roubles	October 2004
RTS	NVTK	Common shares	USD	December 2004
RTS	NVTKG	Common shares	Russian roubles	April 2005
LSE	NVTK	GDR (Reg S)	USD	July 2005
NASDAQ PORTAL	NVATY	GDR (144A)	USD	July 2005

In 2005, we listed Global Depositary Receipts (GDR) on the London Stock Exchange.

One hundred GDRs represent one ordinary share. The GDRs were issued pursuant to two separate Deposit agreements, one relating to the Rule 144A GDRs and another relating to the Regulation S GDRs. Pursuant to the Deposit Agreements, the shares represented by the GDRs are held in Russia by Deutsche Bank Ltd., as Custodian, for the benefit of the Deutsche Bank Trust Company Americas, as Depositary, and for the further benefit of the holders and beneficial owners of GDRs.

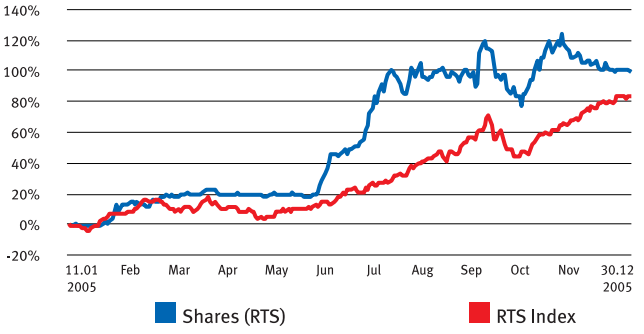
Rule 144A GDRs are traded in the United States on the NASDAQ PORTAL Trading activity in our shares on the MICEX and the RTS Stock Exchanges is not significant.

Share Registrar:
The National Registry Company
GDR program Depositary:
Deutsche Bank Trust Company Americas
60 Wall Street, New York, New York 10005, United States
Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom
GDR program Custodian:
Deutsche Bank Ltd.
4 Shepkina Street, Moscow 129090, Russia

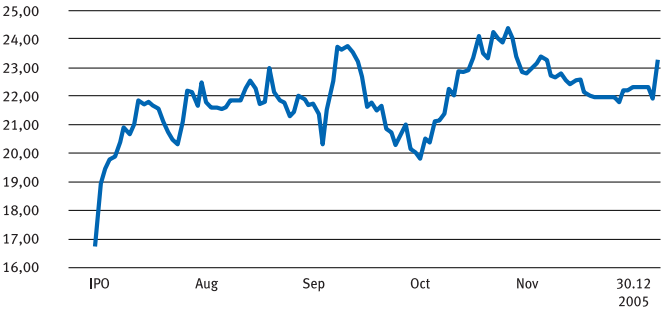
Quarterly price range

	Common Shares, USD		*GDR (LSE), USD*	
	min	max	min	max
First Quarter 2005	1,095	1,320	n/a	n/a
Second Quarter 2005	1,290	1,635	n/a	n/a
Third Quarter 2005	1,590	2,410	16.75	24.25
Fourth Quarter 2005	2,000	2,435	19.45	25.00

NOVATEK share price and RTS index (2005), %



NOVATEK GDR price since IPO (LSE, closing, US Dollars)



Board of Directors and Management Committee

Board of Directors

Alexander Natalenko (Chairman) [7]
Anatoly Brekhuntsov [1] [4] [7]
Vladimir Dmitriev [1] [6]
Victor Girya [3] [5]
Mark Gyetvay [3]
Iosif Levinzon [1] [5]
Leonid Mikhelson
Ruben Vardanian [1] [2]

Management Committee

Leonid Mikhelson (Chairman)
Anatoly Antipin
Vladimir Baskov
Alexander Fridman
Mark Gyetvay
Tatyana Kuznetsova
Mikhail Popov
Sergei Protosenya
Vladimir Smirnov
Nikolai Titarenko
Kirill Yanovskiy

[1] non-executive director
[2] Chairman of the Corporate Governance Committee
[3] Member of the Corporate Governance Committee
[4] Chairman of the Strategy Committee
[5] Member of the Strategy Committee
[6] Chairman of the Audit Committee
[7] Member of the Audit Committee

Management's Discussion and Analysis of Financial Condition and Results of Operations

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 year ended 31 December 2005 and 2004 in conjunction with our consolidated financial statements as of and for the year ended 31 December 2005 and 2004. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS). All Russian rouble amounts have been stated at their nominal value for all periods shown.

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, its consolidated subsidiaries and its share of the results of associates. Accordingly, production volumes in the following discussion and analysis exclude volumes of Tarkosaleneftegas and Khancheyneftegas prior to the consolidation of these entities in December 2004. Prior to that date, sales volumes and revenues include the volumes of Tarkosaleneftegas and Khancheyneftegas only to the extent we purchased such production from Tarkosaleneftegas and Khancheyneftegas. We have, however, been responsible for managing the development and operations of these associates for the periods prior to the consolidation.

In June 2004, we sold our oil and gas construction services business to focus on our core activities of oil and gas exploration and production. Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation.

OVERVIEW

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

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

Recent developments

Significant events occurring subsequent to period ended 31 December 2005 are as follows:

- In November and December 2005, we established Novatek Overseas AG and Runitek GmbH, both registered in Switzerland, to manage the administration, marketing and trading of crude oil, stable gas condensate, liquefied petroleum gas, and other oil products to international markets. Effective 1 January 2006, we commenced export sales through our newly established foreign subsidiaries.

- In February 2006, we were assigned a Ba2/stable outlook Corporate Family Rating from Moody's Investor Service. Concurrently Moody's Interfax Rating Agency (majority-owned by Moody's Investor Service) has assigned us an Aa2.ru long-term national scale rating. This is the first time that we have received credit ratings from Moody's Investor Service. The Corporate Family Rating reflects our global default and loss expectation while the Interfax Rating reflects the standard of our credit quality relative to our domestic peers.

- In February 2006, we were assigned a BB- /stable Corporate Credit Rating from Standard and Poor's. This is the first time that we have received a credit rating from Standard and Poor's. The Corporate Credit Rating reflects our global default and loss expectation.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Consolidation

Since 2002, we have pursued a strategy of increasing our holdings in, and focusing on, our core oil and gas assets and made a number of acquisitions and disposals to further this strategy. Our three core fields are held in our wholly-owned subsidiaries Tarkosaleneftegas and Yurkharovneftegas. With the completion of the December 2004 acquisitions discussed below, we now own 100 percent of Tarkosaleneftegas (in May 2005, Khancheyneftegas was merged into Tarkosaleneftegas). As a result of these acquisitions and our other consolidation and restructuring initiatives over the past three years, we have simplified our holding structure, allowing us to directly manage our core assets and improving the overall transparency of our financial reporting.

Acquisitions

In December 2004, we undertook a series of transactions whereby we acquired a 67.7 percent interest in Tarkosaleneftegas and a 57.0 percent interest in Khancheyneftegas in exchange for the issuance of 789,276 new ordinary shares of OAO NOVATEK, resulting in these companies becoming fully consolidated subsidiaries as at 31 December 2004.

Prior to our acquisitions of additional interests in Tarkosaleneftegas and Khancheyneftegas in December 2004, we purchased approximately 56 percent of Tarkosaleneftegas' hydrocarbon production and 100 percent of Khancheyneftegas' hydrocarbon production and then resold the production to third parties. Subsequent to the acquisitions, Tarkosaleneftegas' and Khancheyneftegas' activities were consolidated into our financial position and results of operations. Accordingly, all purchases from, sales to and balances with Tarkosaleneftegas and Khancheyneftegas have been eliminated in our consolidated balance sheets at 31 December 2005 and 2004 and in our consolidated statement of income for the year ended 31 December 2005, and each line item within our total operating expenses for year ended 31 December 2005 includes the corresponding results of Tarkosaleneftegas and Khancheyneftegas for the periods. Prior to the year ended 31 December 2004, we accounted for Tarkosaleneftegas and Khancheyneftegas under the equity method of accounting as investments in associates, and thus the operating costs of the two acquired entities were effectively included (pro rata to the percentage of volumes purchased) within purchases of crude oil, gas condensate and natural gas in our consolidated statements of income for the year ended 31 December 2004.

As part of the December 2004 acquisitions we have committed to sell a total volume of 37.5 bcm of natural gas over a five year period starting in January 2005 to the Itera Group, and have classified the sales volumes as "ex-field" sales. This contract will have an effect on the relative proportion of "ex-field" sales and "end-customer" sales during that period; however it is currently one of our highest margin contracts. In 2005, we sold 6.9 bcm to the Itera Group in accordance with this commitment.

Divestitures

Historically, our business has included various non-core business activities, including oil and gas construction services, banking and telecommunications. In June 2004, we sold to our shareholders our oil and gas construction services business to focus on our core activities of oil and gas exploration and production. Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation.

In 2004, we sold to Gazprom a subsidiary of Purneftegasgeologiya, which held the mineral license in the West-Tarkosalinskoye field, in return for an 8.34 percent interest in Purneftegasgeologiya. In connection with this transaction, we retained a right to 10 percent of the natural gas extracted from the Cenomanian horizon and 100 percent of the hydrocarbons extracted from the Valanginian horizon, the latter of which we retain 50 percent of based on a joint venture agreement, of the West-Tarkosalinskoye field for the duration of the license.

In 2004, other disposals included the sale of our telecommunication business as well as other non-core businesses. In May 2005, we disposed of our equity interest in NOVA Bank to our shareholder.

In June 2005, we disposed of our 66 percent participation interest in Geoilbent to LUKOIL and one of its subsidiaries for RR 5.1 billion. We accounted for our interest in Geoilbent under the equity method as all significant operating and financing decisions required the consent of the other shareholder, and thus we were not able to control Geoilbent. In June 2005, we disposed of our 25.1 percent share interest in Tambeyneftegas to Gazprombank-Invest for RR 120 million. Also in June 2005, we disposed of our 34 percent interest in Selkupneftegas to Rosneft for RR 573 million. The disposals were the result of our strategy to focus on the development of our upstream natural gas and gas condensate assets and divest assets where we do not exercise operational control over the development of the asset.

Transactions with related parties

Historically, we have had significant transactions with our shareholders, companies related to our shareholders, our associated companies and other related parties. Such transactions have included the purchase and sale of natural gas, gas condensate, crude oil, construction and other related services, the holding of equity securities, and the provision of and receipt of loans, guarantees and other non-cash settlements. Our reported statements of income, balance sheets and statements of cash flows would be different had such transactions been conducted amongst unrelated parties. The production volumes of natural gas, gas condensate and crude oil purchased from Tarkosaleneftegas prior to December 2004 represented a combination of our direct equity interest in the field's production volumes and volumes attributable to the equity interest held by our principal shareholders in an aggregate volume of approximately 56% of Tarkosaleneftegas' total production. We have purchased 100% of the natural gas production volumes from Khancheyneftegas since it commenced commercial production in 2003. In 2004, we began purchasing volumes attributable to our equity interest in Geoilbent. Prior to that period, Geoilbent marketed its volumes independently.

With the consolidation of our key producing assets, as discussed in the "Acquisitions" section above, and the disposal of Geoilbent, as discussed in the "Divestitures" section above, we estimate that the volume of related party transactions that we will conduct in the future will be significantly reduced.

Natural gas prices

As an independent natural gas producer, we are not subject to the government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS). The terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. We generally realize higher prices and net margins for natural gas volumes sold directly to the end-customer, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. Sales to wholesale traders allow us to diversify our gas sales without incurring additional commercial expenses. In 2005, the margin between the end-customer netback price and the ex-field price decreased by RR 29 per mcm, or 29.3%, compared to 2004.

The following table shows our average natural gas sales prices for the years ended 31 December 2005 and 2004:

Average natural gas prices (1)

	Year ended 31 December		
	2005	2004	Change, %
Average natural gas price to end-customers(2)	1,121	958	17%
Gas transportation expense for sales to end-customers	434	331	31%
Average natural gas netback on end-customer sales	687	627	10%
Average natural gas price ex-field (wholesale traders)	617	528	17%

(1) Net of VAT and excise tax. Average RR realized per mcm.

(2) Includes cost of transportation.

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

Our crude oil, stable gas condensate, LPG and oil products export prices include transportation expenses in accordance with the terms of delivery while prices for domestic and CIS sales do not. Our crude oil export price terms are generally free on board (FOB) or delivery at frontier (DAF) at the border of the Russian Federation. Historically, the majority of our sales volumes sold for export are transported by pipeline to Germany or through the shipping ports at Butinge, Lithuania. In 2005, our average crude oil contract price for export sales, including export duties, was approximately USD 319 per ton compared to approximately USD 223 per ton in 2004.

The majority of our stable gas condensate export price terms are carriage paid to (CPT) the Port of Vitino while a small portion are priced at free carrier (FCA) Purovsk railroad station. In 2005, our average stable gas condensate contract price for export sales, including export duties, was approximately USD 450 per ton. Our stable gas condensate domestic sales are priced FCA Purovsk railroad station. Under these agreements, the buyer takes ownership at the named place and responsibility for further transportation of the product to its final destination.

Average crude oil and stable gas condensate prices

	Year ended 31 December		
	2005	2004	Change, %
Crude oil			
Export price, RR per ton (1) (2)	6,102	4,743	29%
Export price, $ per ton (3)	215.7	175.0	23%
Domestic price, RR per ton (1)	4,100	3,353	22%
Stable gas condensate			
Export price, RR per ton (1) (2)	8,339	-	100%
Export price, $ per ton (3)	294.8	-	100%
Domestic price, RR per ton (1)	6,268	-	100%

(1) Net of VAT, excise tax and export duties. Average RR realized per ton.

(2) Includes cost of transportation.

(3) Converted from the average RR realized price using average exchange rates for the period.

Our LPG export and CIS terms of delivery are DAF at the Belarusian-Polish and Russian-Latvian borders. In 2005, our average LPG contract price for export sales, including export duties, was approximately USD 450 per ton. Our domestic sales of LPG are delivered FCA at Purovsk railroad station. Domestic sales of oil products from Surgutsky refinery are priced FCA Surgut railroad station. In 2004, our average oil products contract price for export sales, including export duties, was approximately USD 202 per ton. Under these agreements, the buyer takes ownership at the named place and responsibility for further transportation of the product to its final destination.

Average LPG and oil products prices

	Year ended 31 December		
	2005	2004	Change, %
LPG			
Export price, RR per ton (1) (2)	9,515	-	100%
Export price, $ per ton (3)	336.4	-	100%
Domestic price, RR per ton (1)	5,647	-	100%
Oil products			
Export price, RR per ton (1) (2)	-	4,900	(100%)
Export price, $ per ton (3)	-	170.1	(100%)
Domestic price, RR per ton (1)	4,704	3,879	21%

(1) Net of VAT, excise tax and export duties. Average RR realized per ton.

(2) Includes cost of transportation.

(3) Converted from the average RR realized price using average exchange rates for the period.

Transportation tariffs

Transportation tariffs established by the FTS from 1 October 2005 for the transport of natural gas produced in Russia for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan) are set at RR 23.84 (excluding VAT) per mcm per 100 km. This represents a 23% increase from the tariffs of RR 19.37 (excluding VAT) per mcm per 100 km set on the 1 October 2004 and a 44% increase from the tariffs of RR 16.56 (excluding VAT) per mcm per 100 km effective 1 August 2003. The increases in regulated transportation tariffs may be passed on to end-customers pursuant to contract terms. There is no set timetable for reviews or changes in transportation tariffs set by the FTS, and thus changes in transportation tariffs occur on an irregular basis.

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

Our stable gas condensate, LPG and oil products are transported by rail which is owned and operated by the state-owned company, Russian Railways (RZD). Our tariffs for transportation by rail are set by FTS and vary depending on product and length of transport route. We deliver our stable gas condensate to international markets using the recently commissioned storage and loading facilities at the Port of Vitino on the White Sea. The majority of our LPG and oil products are sold in Russia and the CIS.

Commencement of Purovsky Plant

Our unstable gas condensate has historically been transported through our own pipeline network and pipelines owned by Gazprom to the Surgutsky refinery, where it is processed into stabilized gas condensate and oil products (including diesel fuel, light distillate and naphtha). With the commissioning of our Purovsky Plant in June 2005, we began transporting our unstable gas condensate production volumes from our East-Tarkosalinskoye and Khancheyskoye fields through our own pipeline network directly to the Purovsky Plant. We have an agreement with Gazprom to access its gas condensate pipeline network to deliver the unstable gas condensate produced at our Yurkharovskoye field to the Purovsky Plant through 2006. The crude oil and oil products mix that we receive from the Surgutsky refinery has historically been transported to market using a combination of the Transneft crude oil pipeline network and the Russian Railways system. The commissioning of our Purovsky Plant has changed our distribution channel for delivery of stable gas condensate to the market. We now export the majority of our stable gas condensate to international markets.

We expect our gas condensate revenues and margins to increase since prices for stable gas condensate in international markets have historically exceeded prices for Urals blend crude oil.

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), export duties, property tax, social taxes and contributions.

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

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

OPERATIONAL HIGHLIGHTS

Oil and gas production costs

Our oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the unaudited supplemental oil and gas disclosures for the periods ended 31 December 2005 and 2004. Oil and gas production costs do not include general corporate overheads or its associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the periods presented in Russian roubles and in US dollars per boe:

	Year ended 31 December		
	2005	2004	Change, %
	(millions of RR)		
Production costs:			
Lifting cost	2,552	1,147	122%
Long-term supply purchases	2,065	5,632	(63%)
Taxes other than on income	4,336	1,393	211%
Transportation costs	6,581	3,672	79%
Total production costs before DD&A	**15,534**	**11,844**	**31%**
Depreciation, depletion and amortization (DD&A)	3,255	584	457%
Total production costs	**18,789**	**12,428**	**51%**

	Year ended 31 December		
	2005	2004	Change, %
	($/boe)		
Production costs:			
Lifting cost	0.50	0.61	(18%)
Long-term supply purchases	3.76	2.94	28%
Taxes other than on income	0.85	0.74	14%
Transportation costs	1.16	0.97	20%
Total production costs before DD&A	**2.74**	**3.12**	**(12%)**
Depreciation, depletion and amortization (DD&A)	0.63	0.31	105%
Total production costs	**3.31**	**3.27**	**1%**

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

Hydrocarbon sales volumes

In 2005, we increased our natural gas and liquids (crude oil, stable gas condensate, LPG and oil products) sales volumes due to significant increases in our production of these hydrocarbons in the 2005 period compared to the corresponding period in 2004. Our growth in production was achieved through the efficient exploitation of our existing producing asset base, together with increases in our holdings of core assets such that we could consolidate the production from these assets rather than report them as purchases. As discussed in the section on "Acquisitions" above, in December 2004, we began consolidating the production volumes from core fields licensed to Tarkosaleneftegas and Khancheyneftegas into our results.

We expect our total production volumes to continue growing, primarily as a result of the development activities at our existing producing fields and by exploring and developing other oil and gas fields in our asset portfolio.

Natural gas sales volumes

	Year ended 31 December		
millions of cubic meters	**2005**	**2004**	**Change, %**
Production from: (1)			
Yurkharovskoye field	8,916	6,673	34%
East-Tarkosalinskoye field	13,327	-	100%
Khancheyskoye field	2,767	-	100%
Other fields	26	2,309	(99%)
Total natural gas production	**25,036**	**8,982**	**179%**
Purchases from:			
Tarkosaleneftegas (2)	-	5,738	(100%)
Khancheyneftegas (3)	-	2,297	(100%)
Other	2,518	523	381%
Total natural gas purchases	**2,518**	**8,558**	**(71%)**
Total production and purchases	**27,554**	**17,540**	**57%**
Changes in pipeline and underground storage	(224)	(263)	(15%)
Total natural gas sales volumes	**27,330**	**17,277**	**58%**
Natural gas volumes sold to end-customers	*11,650*	*8,889*	*31%*
Natural gas volumes sold ex-field	*15,680*	*8,388*	*87%*

(1) Net of technical losses.

(2) Represents purchases of gas production at our combined interest of 56%.

(3) Represents purchases of natural gas at our agreed upon contractual rate of 100%.

In 2005, our total consolidated natural gas production, net of technical losses, increased by 16,054 mmcm, or 178.7%, compared to 2004 and accounted for 91.6% of total natural gas sales volumes. The increase in natural gas production was primarily due to the consolidation of production from the East-Tarkosalinskoye and Khancheyskoye fields and organic growth at both the Yurkharovskoye and Khancheyskoye fields. In 2005, natural gas production from the East-Tarkosalinskoye and Khancheyskoye fields was 16,094 mmcm; two times more than the volumes we purchased from these fields in 2004, while organic growth at the Yurkharovskoye field was 2,243 mmcm, or 33.6%.

The decrease in "Other" natural gas production was primarily attributable to the sale of our subsidiary holding the license to the West-Tarkosalinskoye field to Gazprom, after which, we began purchasing our share of natural gas production from the West-Tarkosalinskoye field in accordance with contractual terms and conditions.

In 2005, total natural gas purchases decreased by 6,040 mmcm, or 70.6%, to 2,518 mmcm, compared to 8,558 mmcm in 2004, primarily due to the full consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004. Purchases from "Other" increased by 1,995 mmcm, or 381.4%, in 2005, compared to 2004, primarily due to the divestiture of the West Tarkosalinskoye license. In 2005, we purchased 2,191 mmcm of natural gas from Gazprom under the terms and conditions of the West Tarkosalinskoye agreement.

Liquids sales volumes

	Year ended 31 December		
thousands of tons	**2005**	**2004**	**Change, %**
Production from: (1)			
Yurkharovskoye field	662	554	20%
East-Tarkosalinskoye field	742	-	100%
Khancheyskoye field	644	-	100%
Other fields	83	239	(65%)
Total liquids production	**2,131**	**793**	**169%**
Purchases from:			
Tarkosaleneftegas (2)	-	348	(100%)
Khancheyneftegas (3)	-	520	(100%)
Geoilbent	240	358	(33%)
Other	140	99	41%
Total liquids purchases	**380**	**1,325**	**(71%)**
Total production and purchases	**2,511**	**2,118**	**19%**
Changes in inventory	(51)	(6)	(750%)
Total liquids sales volumes	**2,460**	**2,112**	**17%**
Crude oil export sales volumes	*183*	*502*	*(64%)*
Crude oil domestic sales volumes	*679*	*1,087*	*(38%)*
Stable gas condensate export sales volumes	*760*	-	*100%*
Stable gas condensate domestic sales volumes	*2*	-	*100%*
LPG export sales volumes	*28*	-	*100%*
LPG domestic sales volumes	*213*	-	*100%*
Oil products export sales volumes	-	*20*	*(100%)*
Oil products domestic sales volumes	*595*	*503*	*18%*

(1) Net of technical losses.

(2) Represents purchases of production at our combined interest of 56%.

(2) Represents purchases of production at our agreed upon contractual rate of 100%.

In 2005, crude oil and gas condensate production, net of technical losses, increased by 1,338 thousand tons, or 168.7% to 2,131 thousand tons, compared to 793 thousand tons in 2004. The increase was largely attributable to continued development at our fields and full consolidation of production from the East-Tarkosalinskoye and Khancheyskoye fields. The increase was slightly offset by a decrease in production from "Other" of 156 thousand tons, or 65.3%, due to our divestiture of the West-Tarkosalinskoye license.

In 2005, purchases decreased by 945 thousand tons, or 71.3%, compared to the same period in 2004, primarily due to the consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004 and the divestiture of Geiolbent in June 2005. Following our disposal of Geoilbent we have ceased purchasing its crude oil volumes which amounted to 240 thousand tons in 2005 and 358 thousand tons in 2004.

In 2005, we delivered 1,031 thousand tons and 1,052 thousand tons of unstable de-ethanized gas condensate to the Purovsky Plant and Surgutsky refinery, respectively, compared to nil and 1,333 thousand tons, respectively, in 2004. In 2005, stable gas condensate output comprised 41.7% of the total yield from the Surgutsky refinery compared with 57.9% in 2004. Processed products from the Purovsky Plant are sold separately from the processed products we receive from the Surgutsky refinery. After processing gas condensate at the Surgutsky refinery we receive crude oil and a slate of oil products. The crude oil is sold as Ural's blend crude oil and delivered by the Transneft pipeline network.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2005 COMPARED TO THE YEAR ENDED 31 DECEMBER 2004

The following table and discussion is a summary of our consolidated results of operations (in millions of Russian roubles) for the year ended 31 December 2005 and 2004. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	2005	% of Total revenues	2004	% of Total revenues
Total revenues (1)	**38,523**	**100%**	**24,144**	**100%**
Other income	3,664	9%	583	2%
Total revenues and other income	42,187	109%	24,727	102%
Operating expenses	**(22,861)**	**(59%)**	**(17,113)**	**(71%)**
Income from operations	**19,326**	**50%**	**7,614**	**32%**
Finance expense	(729)	(2%)	(292)	(1%)
Share of income from associates	143	0%	764	3%
Income before income tax and minority interest	18,740	49%	8,086	34%
Total income tax expense	(5,078)	(13%)	(2,118)	(9%)
Profit for the period	13,662	36%	5,968	25%
Minority interest	(35)	0%	274	(1%)
Profit attributable to NOVATEK shareholders	**13,697**	**36%**	**5,694**	**24%**

(1) Net of VAT, excise tax and export duties.

Total revenues and other income

Our total revenues and other income comprise oil and gas sales, sales of polymer and insulation tape, other revenues, disposals and other income. Total revenues increased by RR 14,379 million, or 59.6%, to RR 38,523 million in 2005 compared to RR 24,144 million in 2004 while disposals and other income increased by RR 3,081 million, or 528%, to RR 3,664 million compared to RR 583 million in 2004.

The increase in total revenues was primarily the result of our success in expanding our natural gas production volumes and diversifying our liquid hydrocarbon marketing channels as well as favorable pricing environments in both the export and domestic markets. Our continued efforts in funding exploration and development activities have allowed us to expand our sales volumes annually since our inception. In 2005, our sales volumes of natural gas increased to 27,330 mmcm from 17,277 mmcm in 2004, or 58.2%. Our combined sales volumes of crude oil, stable gas condensate, LPG and oil products increased to 2,460 thousand tons in 2005 from 2,112 thousand tons in 2004, or 16.5%. We expect to continue increasing our sales volumes, but at a more measured pace, due to production growth at our subsidiaries.

The increase in other income was primarily driven by asset disposals of RR 3,631 million in 2005 compared to RR 198 million in 2004. The increase in 2005 was primarily due to the disposals in Geoilbent, Selkupneftegas and Tambeyneftegas.

The following table sets forth our net sales (in millions of Russian roubles, net of VAT, excise tax and export duties), and other income for the year ended 31 December 2005 and 2004:

	Year ended 31 December		
	2005	2004	Change, %
Sales of natural gas			
Net sales	**22,729**	**12,943**	**76%**
Net End-customer sales	*13,056*	*8,515*	*53%*
Net Ex-field sales	*9,673*	*4,429*	*118%*
Sales of stable gas condensate			
Net sales	**6,349**	**-**	**100%**
Net export sales	*6,336*	*-*	*100%*
Net domestic sales	*13*	*-*	*100%*
Sales of liquefied petroleum gas			
Net sales	**1,472**	**-**	**100%**
Net export sales	*271*	*-*	*100%*
Net domestic sales	*1,201*	*-*	*100%*
Sales of oil products			
Net sales	**2,797**	**2,050**	**37%**
Net export sales	*-*	*99*	*(100%)*
Net domestic sales	*2,797*	*1,951*	*43%*
Sales of crude oil			
Net sales	**3,899**	**6,025**	**(35%)**
Net export sales	*1,114*	*2,381*	*(53%)*
Net domestic sales	*2,785*	*3,644*	*(24%)*
Total oil and gas sales	**37,246**	**21,018**	**77%**
Oil and gas construction services	-	2,053	(100%)
Sales of polymer and insulation tape	964	617	56%
Other revenues	313	456	(33%)
Total revenues	**38,523**	**24,144**	**60%**
Net gain (loss) on disposals	**3,631**	**198**	**1,734%**
Net other income (expense)	**33**	**385**	**(91%)**
Total revenues and other income	**42,187**	**24,727**	**71%**

Natural gas sales

In 2005, our revenues from the sale of natural gas increased by RR 9,786 million, or 75.6%, compared to 2004. Revenues from the sale of natural gas accounted for 59.0% and 53.6% of our total revenues in 2005 and 2004, respectively. The increase in natural gas revenues was primarily attributable to an increase in sales volumes and subsequently an increase in new customers. Almost half of our sales in 2005 were made to new customers mainly in power generation and other industries. We sell our natural gas volumes exclusively in the Russian domestic market.

In 2005, our average realized price per mcm increased by RR 83 per mcm, or 11.0%, compared to 2004, due to an overall increase in natural gas prices and an increase in sales volumes to end-customers. The average realized prices of our natural gas sold to end-customers and natural gas sold ex-field were higher by 17.0% and by 16.9%, respectively, in 2005 compared to 2004. The netback margin we received on end-customer sales compared to ex-field sales decreased by RR 29 per mcm, or 29.3%, in 2005 compared to 2004 due to an increase in the transportation tariff per mcm in 2005.

Crude oil sales

In 2005, our revenues from the sales of crude oil decreased by RR 2,126 million, or 35.3%, compared to 2004, due to a reduction in the overall volumes of crude oil sold during the 2005 period, which was offset by higher prices in 2005 for both the export and domestic markets.

Total sales volumes of crude oil decreased in 2005 by 727 thousand tons, or 45.8%, compared to 2004. The decrease in sales volumes of crude oil in 2005 was due to the migration of processing of our unstable de-ethanized gas condensate from the Surgutsky refinery to the Purovsky Plant (stable gas condensate from the Surgutsky refinery is sold as crude oil), lower percentage of stable gas condensate in the product mix received from the Surgutsky refinery in the 2005 period and the divestiture of our participation interest in Geoilbent in June 2005.

Our average realized sales price translated into US dollars for crude oil exported to international markets increased by USD 40.7 per ton, or 23.3%, to USD 215.7 per ton in 2005 compared to USD 175.0 per ton in 2004, primarily due to the higher pricing environment in the international crude oil markets during 2005. Our average realized crude oil domestic sales price increased by RR 747 per ton, or 22.3%, to RR 4,100 per ton in 2005, compared to RR 3,353 per ton in 2004, due to the strengthening of domestic crude oil prices in 2005.

Stable gas condensate sales

In 2005, our revenues from sales of stable gas condensate were RR 6,349 million compared to nil in 2004, and are directly related to the launch of our Purovsky Plant in June 2005. The volumes of stable gas condensate received from the Purovsky Plant are sold separately from the volumes received from the Surgutsky refinery and, as such, are not included in revenues from crude oil sales.

In 2005, we exported substantially all of our stable gas condensate volumes, 760 thousand tons, from the Purovsky Plant to markets in the United States and Europe using the loading and storage facilities at the Port of Vitino on the White Sea. In 2005, our average realized price translated into US dollars for stable gas condensate sold on the export market was USD 294.8 per ton, while prices on the domestic market were RR 6,268 per ton.

Liquefied petroleum gas sales

In 2005, our revenues from the sales of LPG were RR 1,472 million, compared to nil in 2004, and are directly related to the launch of our Purovsky Plant in June 2005. In 2005, we sold 241 thousand tons of LPG, of which, 88.3% was sold domestically for an average price of RR 5,647 per ton and the remaining volumes were sold to the export market for an average price of USD 336.4 per ton.

Oil products sales

In 2005, our revenue from the sales of oil products increased by RR 747 million, or 36.4%, compared to 2004. The increase in oil products revenues was primarily due to an increase in the average domestic price of RR 825 per ton, or 21.2%, to RR 4,704 per ton in 2005, compared to RR 3,879 per ton in 2004, and to a lesser extent a 13.7% increase in sales volumes in 2005 compared to 2004. In 2005, sales volumes from the Surgutsky refinery amounted to 595 thousand tons compared to 523 thousand tons in 2004. The main oil products sold were diesel fuel, light distillate and naphtha. We sold 100% of our oil products' volumes to the domestic market in 2005 as we were able to realize better margins for light distillate and diesel fuel. The domestic market for oil products in 2004 was characterized by generally lower prices across all oil products categories and we received a lower proportion of higher margin processed volumes from the Surgutsky refinery in 2004 compared to 2005.

Sales of polymer and insulation tape

In 2005, our revenues from the sales of polymer and insulation tape increased to RR 964 million compared to RR 617 million in 2004, due to higher sales volumes and prices. In 2005, we commenced production of BOPP film wrap at our subsidiary NOVATEK-Polimer which generated RR 88 million in revenue. In 2005, other polymers sales contributed an additional RR 876 million in revenues compared to RR 617 million in 2004.

Other revenues

Other revenues include rent, polymer tolling, telecommunication and other services. In 2005, other revenues decreased by RR 143 million, or 31.4%, from RR 313 million compared to RR 456 million in 2004. The decrease was due to the divestiture of certain non-core businesses in 2005 and 2004.

Operating expenses

In 2005, operating expenses increased by RR 5,748 million, or 33.6%, to RR 22,861 million compared to RR 17,113 million in 2004. Operating expenses decreased as a percentage of total revenues to 59.3% in 2005 compared to 70.9% in 2004, as shown in the table below.

	Year ended 31 December:			
	2005		2004	
Categories	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Materials, services and other expense	3,473	*9%*	3,795	*16%*
Purchases of natural gas, gas condensate and crude oil	2,065	*5%*	5,708	*24%*
Transportation expenses	6,605	*17%*	3,690	*15%*
Taxes other than income tax	4,494	*12%*	1,569	*6%*
General and administrative expenses	2,417	*6%*	1,605	*7%*
Depreciation, depletion and amortization	3,372	*9%*	681	*3%*
Net impairment expense (benefit)	87	*0%*	(118)	*(1%)*
Exploration expenses	348	*1%*	183	*1%*
Total operating expenses	**22,861**	***59%***	**17,113**	***71%***

Materials, services and other expense

In 2005, our materials, services and other expense decreased by RR 322 million, or 8.5%, to RR 3,473 million compared to RR 3,795 million in 2004. The change in the expense was primarily due to the acquisition of Tarkosaleneftegas and Khancheyneftegas in December 2004 and the launch of the Purovsky Plant in June 2005, which accounted for RR 1,193 million, or 34.3%, and RR 142 million, or 4.1%, of total materials, services and other expense in 2005 compared to nil in 2004. These additional expenses were offset by the divestiture of SNP Nova and Novafininvest in 2004 and a decrease in their expense of RR 3,496 million.

The main components of this expense in 2005 were materials and payroll expenses. Materials expense decreased by RR 382 million, or 24.0%, in 2005 compared to 2004. The divestiture of SNP Nova and Novafininvest resulted in a decrease of RR 1,504 million whereas the consolidation of Tarkosaleneftegas and Khancheyneftegas added RR 237 million and production growth at Novatek-Polimer resulted in an additional increase of RR 441 million.

In 2005, payroll expense increased by RR 486 million mainly due to the consolidation of Tarkosaleneftegas and Khancheyneftegas which added RR 518 million and payroll increases at Yurkharovneftegas and Nova ZPK, operator of the Purovsky Plant, of RR 109 million and RR 107 million, respectively. The increases in 2005 were offset by the divestiture of SNP Nova and Novafininvest in 2004 and a reduction in employees at Purneftegasgeologiya in 2005, resulting in a decrease of RR 152 million and RR 97 million, respectively.

Other factors responsible for the decrease in materials, services and other expense in 2005 compared to 2004 were decreases in construction and extraction services of RR 555 million which were offset by increases to repair and maintenance expense of RR 158 million.

Purchases of natural gas, gas condensate and crude oil

In 2005, our purchases of hydrocarbons decreased significantly due to the acquisition and subsequent consolidation of production from the East-Tarkosalinskoye and Khancheyskoye fields and the sale of Geoilbent in June 2005. In 2005, our purchases of natural gas included production from the West-Tarkosalinskoye field in the amount of 2,191 mmcm. This field was previously owned by us (See "Divestitures" above) and our net production of natural gas from this field in 2004 was 454 mmcm.

Transportation expense

Our total transportation expense in 2005 increased by RR 2,915 million, or 79.0%, compared to 2004. In 2005, transportation expense for natural gas increased by RR 2,114 million, or 72.0%, to RR 5,052 million compared to RR 2,938 million in 2004. The increase was due to a 31.1% increase in our sales volumes of natural gas sold to end-customers, for whom the cost of transportation is included in the sales price, and a 31.2% increase in our average natural gas transportation expense per mcm. The average tariff for transportation of natural gas in 2005 was RR 20.49 per mcm per 100 km compared to RR 17.26 per mcm per 100 km in 2004. The increase in volumes and transportation expense per mcm contributed roughly equally to the increase in natural gas transportation expense.

Transportation expenses for liquids by pipeline and by rail contained only export volumes delivered to customers while domestic transportation expense is recorded on a net basis with the respective revenue.

In 2005, our expense for transportation of crude oil to export markets decreased by RR 144 million, or 52.0%, compared to 2004. The decrease in crude oil transportation expense was primarily due to a reduction in export volumes delivered which was slightly offset by an increase in the expense per ton due to increases in the transportation tariff in 2005.

In 2005, our total expense for transportation of oil products, stable gas condensate and LPG by rail to export markets increased by RR 934 million compared to 2004, primarily due to a 788 thousand ton increase in combined export volumes of stable gas condensate and LPG in 2005.

In 2005, our expense for stable gas condensate and LPG transported by rail to export markets amounted to RR 800 million and RR 96 million, respectively, or approximately RR 1,052 per ton, and RR 3,373 per ton, respectively. The remaining RR 47 million was related to railway infrastructure maintenance and was not allocated between products. Transportation expenses for stable gas condensate and LPG was nil in 2004.

In 2005, we did not have any export sales of oil products whereas, in 2004, we transported 20 thousand tons of oil products at an expense of RR 9 million, or RR 450 per ton.

Taxes other than income tax

Taxes other than income tax expense are comprised of the following: "unified natural resources production tax" (UPT), property tax, excise tax, social taxes and other taxes and contributions. In 2005, taxes other than income tax increased by RR 2,925 million, or 186.4%, compared to 2004. The increase was primarily due to the consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004. Prior to the consolidation, taxes other than income tax attributable to these companies were not included as part of our expenses due to the fact that, as associates, these companies were accounted for under the equity method.

The increase in taxes other than income tax resulted primarily from a RR 3,074 million, or 237.7%, increase in the UPT due to increased hydrocarbon production volumes in 2005 compared to 2004 and an increase in the UPT rate for natural gas from RR 107 per mcm in 2004 to RR 135 per mcm in 2005. The consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004 and the subsequent increase in consolidated production accounted for RR 2,766 million, or 90.0%, of our UPT tax increase and 94.6% of the total increase in taxes other than income in 2005.

Effective 1 January 2005, the base rate for the UPT relating to crude oil increased from RR 347 per metric ton to RR 419 per metric ton.

In 2005, property tax expense increased by RR 221 million, or 208.5%, to RR 327 million compared to RR 106 million in 2004. The increase is related to significant additions of property, plant and equipment at the Yurkharovskoye field combined with the impact of the consolidation of property, plant and equipment of Tarkosaleneftegas and Khancheyneftegas in December 2004.

General and administrative expenses

In 2005, general and administrative expenses increased by RR 812 million, or 50.6%, to RR 2,417 million compared to RR 1,605 million in 2004. The main contributors to the change in the 2005 expense were the consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004 and the divestiture of SNP Nova and Novafininvest, also in 2004. The main components of this expense, comprising 77.9% of the 2005 expense, were payroll, insurance, social and charity and legal, audit and consulting expenses.

In 2005, payroll expenses increased by RR 372 million, or 58.8%, to RR 1,004 million compared to RR 632 million in 2004. The acquisition of Tarkosaleneftegas and Khancheyneftegas, in December 2004, contributed RR 119 million while increases in basic compensation and administrative staff at NOVATEK contributed RR 272 million to the increase in this expense. The launch of the Purovsky Plant and the related payroll expense for an additional 249 employees resulted in an additional increase of RR 36 million. The increases were offset by a reduction in payroll expenses of RR 77 million due to the divestiture of SNP Nova and Novafininvest in 2004.

In 2005, insurance expenses increased by RR 231 million, or 170.8%, to RR 367 million compared to RR 135 million in 2004. The increase was primarily due to the acquisition of Tarkosaleneftegas and Khancheyneftegas, in December 2004, which added RR 155 million, or 67.1%, to the overall increase for insurance on production assets. Additional increases in insurance expenses in 2005 were related to insurance on liquid inventories stored at the Surgutsky refinery, insurance on production assets (primarily Purovsky Plant) and Directors' and Officers' insurance resulting from the IPO in July 2005.

In 2005, social and charity expenses increased by RR 61 million, or 28.1%, compared to 2004, primarily due to continued support of education and other social programs. The acquisition of Tarkosaleneftegas and Khancheyneftegas resulted in an additional RR 23 million in social and charity expense in 2005.

In 2005, legal, audit and consulting services expenses increased by RR 37 million, or 18.8%, to RR 233 million compared to RR 196 million in 2004. The increase was primarily related to expenses incurred to undertake the IPO in July 2005.

In 2005, other general and administrative expenses increased by RR 110 million, or 26.5%, compared to 2004, due to increases in business trip, fire safety and security, rent and other administrative expenses.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expense increased by RR 2,691 million in 2005, or 395.2%, compared to 2004. The increase was primarily due to our calculation of depreciation and depletion on a unit-of-production basis for our oil and gas properties, which increased by RR 2,671 million, or 457.4%. The increase was, largely attributable to growth in our production volumes combined with additions to property, plant and equipment at the Yurkharovskoye field and the impact of the consolidation of Tarkosaleneftegas and Khancheyneftegas in December 2004. The effect of the consolidation of Tarkosaleneftegas and Khancheyneftegas increased our depreciation expense by RR 2,417 million in 2005 while continued development at Yurkharovneftegas added RR 243 million.

Income from operations

As a result of the factors discussed above, our profit from operations increased by RR 11,712 million, or 153.8%, to RR 19,326 million in 2005 from RR 7,614 million in 2004. In 2005, our income from operations as a percentage of our total revenues increased to 50.2% compared to 31.5% in 2004.

Finance income (expense)

Finance expense increased from a net expense of RR 292 million in 2004 to a net expense of RR 729 million in 2005. The increase was the result of higher interest expense of RR 258 million primarily related to the Credit Linked Notes issued in June and December of 2004, which was partly offset by the early repayment of other loans. Foreign exchange loss increased from a net gain of RR 109 million in 2004 to a net loss of RR 280 million in 2005. The increase in foreign exchange loss was primarily due to US dollar denominated debt and the general strengthening of the US dollar in 2005 compared to 2004. The increase in interest expense and foreign exchange loss was partly offset by an increase in interest income of RR 210 million in 2005, compared to 2004, due to the provision of loans to related parties.

Share of income of associated companies

In 2005, our share of the net income of Tarkosaleneftegas and Khancheyneftegas was nil compared to RR 181 million in 2004, as we now consolidate these entities and no longer account for them as associated companies under the equity method of accounting due to the acquisition of the additional interests in these entities in December 2004. Our share of the net income of other associated companies decreased by RR 440 million to RR 143 million in 2005 compared to 2004 primarily due to the divestiture of our participation interest in Geoilbent in June 2005.

Income tax expense

Our overall effective income tax rates (total tax expense calculated as a percentage of our reported IFRS profit before income tax and share of net income from associates) were 27.3% and 28.9% for the years ended 31 December 2005 and 2004, respectively. Our effective income tax rate of 27.3% for the year ended 31 December 2005 is higher than our statutory income tax rate of 24% primarily due to an increase in non-deductible expenses and other non-temporary differences.

Profit for the period and earnings per share

As a result of the factors discussed above, our profit for the period increased by RR 7,694 million, or 128.9%, to RR 13,662 million in 2005 from RR 5,968 million in 2004. The profit attributable to NOVATEK shareholders increased by RR 8,003 million, or 140.6%, to RR 13,697 in 2005 from RR 5,694 million in 2004.

Our weighted average basic and diluted earnings per share increased to RR 4,511 per share in 2005 from RR 2,510 per share in 2004. The weighted average number of ordinary shares outstanding in 2005 and 2004 were 3,036,306 and 2,268,654, respectively. The increase was mainly due to a 140.6% increase in net profit attributable to shareholders of NOVATEK which was partly offset by an increase in the weighted average number of ordinary shares outstanding in 2005 compared to 2004. The weighted average number of shares was higher in the 2005 period due to the issuance of 789,276 new ordinary shares in connection with the acquisitions in December 2004 of the remaining interests in Tarkosaleneftegas and Khancheyneftegas (see "Acquisitions" above).

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are the cash provided from operating activities, debt financing, and access to capital markets. Our plan going forward is to finance our budgeted capital expenditures, interest and dividend payments mainly out of operating cash flows supplemented by additional borrowings and equity, if needed. In addition, we intend to improve our debt profile by retiring a portion of our short-term rouble denominated debt and by refinancing our debt portfolio with long-term borrowings in roubles and other currencies.

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the year ended 31 December 2005 and 2004:

	Year ended 31 December		
millions of Russian roubles except ratios	**2005**	**2004**	**Change, %**
Net cash provided by operating activities	10,246	4,817	113%
Net cash provided by (used for) investing activities	8,983	(12,892)	170%
Net cash provided by (used for) financing activities	(19,280)	9,433	(304%)
Current ratio	114%	64%	78%
Total debt to equity	16%	54%	(70%)
Long-term debt to long term debt and equity	2%	23%	(91%)

Net cash provided by operating activities

Net cash provided by operating activities increased by RR 5,429 million, or 112.7%, to RR 10,246 million in 2005 compared to RR 4,817 million in 2004. The increase was mainly attributable to significantly higher operating income from our oil and gas sales as a result of increases in our sales volumes and realized prices in 2005 compared to 2004. The positive impact on our cash flows due to higher sales volumes and realized prices was partially offset by an increase in income tax payments.

Net cash from investing activities

Net cash from investing activities increased by RR 21,875 million, or 170%, to RR 8,983 million in 2005 compared to net cash used in investing activities of RR 12,892 million in 2004. The increase in 2005 was primarily due to proceeds received from the disposals of Geoilbent, Selkupneftegas and Tambeyneftegas and repayment of a loan made to a related party. In 2005, the net cash used for investment in purchases of property plant and equipment, primarily associated with the continued development of our oil and gas activities, was slightly lower than in 2004 and the provision of short- and long-term loans was significantly lower in 2005 compared to 2004. In 2004, we provided short- and long-term loans to our associates, Tarkosaleneftegas and Khancheyneftegas, for the continued development of their oil and gas activities.

Net cash from financing activities

Net cash from financing activities decreased by RR 28,713 million, or 304%, to net cash used for financing activities of RR 19,280 million in 2005 compared to net cash provided by financing activities of RR 9,433 million in 2004. The decrease was primarily due to repayments of short- and long-term borrowings of RR 21,212 million in 2005 (See "Debt obligations" below).

Working capital

At 31 December 2005, our working capital surplus (current assets less current liabilities) was RR 1,490 million compared to a deficit of RR 5,105 million at 31 December 2004. In 2005, current assets increased by RR 2,788 million compared to 2004 primarily due to increases in prepayments and advances and trade and other receivables of RR 2,780 million, which was partially offset by a decrease in short-term loans receivable of

RR 540 million and cash and cash equivalents of RR 47 million. In 2005, current liabilities decreased by RR 3,807 million compared to 2004 primarily due to a reduction in short-term debt of RR 2,566 million and a reduction in other taxes, income tax and accounts payable of RR 1,241 million in 2005.

Capital expenditures

Total capital expenditures on property, plant and equipment for 2005 and 2004 are as follows:

	Year ended 31 December		
millions of Russian roubles	**2005**	**2004**	**Change, %**
Exploration and production	5,183	7,212	(28%)
Other	1,277	200	539%
Total	**6,460**	**7,412**	**(13%)**

Exploration and production expenditures represent our investments in developing our oil and gas properties. During 2005 and 2004, capital expenditures in exploration and production were mainly attributable to the construction of the Purovsky Plant and the storage and loading facilities at the Port of Vitino as well as further development at our three core fields. During 2005, we accrued and capitalized expenditures aggregating to approximately RR 1,200 million on the construction of the Purovsky Plant and the loading facilities at the Port of Vitino. In 2005, we also capitalized approximately RR 1,047 million for equipment relating to our BOPP facilities at Novatek-Polimer.

Capitalized interest of RR 608 million and RR 446 million was included within capital expenditures for the year ended 31 December 2005 and 2004, respectively.

Debt obligations

Our total debt obligations decreased by RR 14,906 million, or 62.1%, to RR 9,094 million at 31 December 2005 from RR 24,000 million at 31 December 2004. Our borrowings have been used primarily for the financing of capital expenditures related to development of our three core oil and gas fields and investment in related assets such as the construction of the Purovsky Plant and the loading facilities at the Port of Vitino.

Short-term debt

Our short-term debt obligations decreased by RR 4,188 million, or 77.8%, to RR 1,192 million at 31 December 2005 from RR 5,380 million at 31 December 2004.

Long-term debt

In 2005, we were able to repay a major portion of our long-term borrowings ahead of their respective maturity schedules due to an increase in operating cash flow, resulting from our 2005 financial performance, Geoilbent divestiture and the early repayment of a loan made to a related party in the amount of RR 7,755 million (USD 270 million). In 2005, loans repaid ahead of maturity consisted of rouble denominated loans from Sberbank, RR 3,354 million, Finance Department of YNAO, RR 1,130 million, Yamal Regional Fund of Development, RR 1,208 million, and a US dollar denominated loan to Vneshtorgbank, RR 2,834 million (USD 100 million). Also, in 2005, we repaid a US dollar denominated loan to C.R.R. B.V. in the amount of RR 2,856 (USD 100 million) in line with its scheduled maturity.

Our long-term debt at 31 December 2005 included loans from C.R.R. B.V., in the amount of RR 5,757 million (USD 200 million), repayable in June 2006 and bearing interest of 7.75% per annum and Russian rouble denominated bonds in the amount of RR 1,000 million, repayable in November 2006 and bearing interest of 9.4%.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates, and interest rates. We are exposed to commodity price risk as our crude oil destined for export sales are linked to oil product prices. We are exposed to foreign exchange risk to the extent that our sales revenues, costs, receivables, loans and debt are denominated in currencies other than Russian roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. We do not currently use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks and we do not 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. At 31 December 2005, RR 6,116 million, or 67.3%, of our long-term debt was denominated in US dollars (out of approximately RR 9,094 million of our total borrowings, excluding promissory notes, at that date). Decreases in the value of the Russian rouble relative to the US dollar will increase our foreign currency denominated costs and expenses and our debt service obligations for foreign currency denominated borrowings in Russian rouble terms. A depreciation of the Russian rouble relative to the US dollar will also result in an increase in the value of our foreign currency borrowings in Russian rouble terms. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, approximately 20% in 2005, is denominated in US dollars. As of 31 December 2005, the Russian rouble had depreciated against the US dollar by approximately 3.7% since 1 January 2005.

A hypothetical, instantaneous and unfavorable 10% change in currency exchange rates as of 31 December 2005 would have resulted in an estimated foreign exchange loss of approximately RR 680 million on foreign currency denominated borrowings held as of 31 December 2005. A hypothetical, instantaneous and unfavorable 10% change on the average currency exchange rate for 2005 would have resulted in additional interest expense of approximately RR 112 million in 2005, reflecting the hypothetical increased costs in rouble terms of servicing our foreign currency denominated borrowings held during 2005.

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 world crude oil prices. Worldwide political developments, natural disasters and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

We currently do not use any derivative instruments to hedge our production in order to decrease our price risk exposure.

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. We currently do not enter into any significant hedging arrangements to mitigate the price risk of our sales activities.

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

A 31 December 2005, 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.

Critical accounting policies

Our financial statements reflect the selection and application of accounting policies that require management to make significant estimates and assumptions. We believe that the following are some of the most critical accounting policies that currently affect our financial position and results of operations.

Oil and gas exploration and production activities

We follow the successful efforts method of accounting for oil and gas properties which we believe is the most prudent and conservative accounting treatment for our oil and gas operations. Under the successful efforts method property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overhead and all exploration costs other than exploratory drilling are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

We calculate our depreciation, depletion and amortization of capitalized costs of oil and gas properties using the unit-of-production method for each field based upon proved developed reserves for exploration and development costs, and total proved reserves for acquisitions of proved properties. For this purpose, the oil and gas reserves of our fields have been determined based on estimates of mineral reserves prepared by us, and for our three core and newly appraised fields, reserves have been determined in accordance with internationally recognized definitions and were independently appraised by internationally recognized petroleum engineers. The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, and therefore are subject to amortization thereon using the unit-of-production method.

Revenue recognition

Revenues from oil and gas sales and sales of polymer and insulation tape are recognized when such products are delivered to customers and title has transferred. Revenues are stated net of value-added tax, excise tax and export duties.

Revenues from rendering construction services were based on the stage of completion determined by reference to services performed to date as a percentage of total services to be performed.

Related party transactions

The following are considered to be our related parties:

- our associates are entities we do not control but over which we exercise significant influence and therefore we account for them in accordance with IAS No. 28, *Investments in Associates* (IAS 28);
- our major shareholders and their immediate relatives;
- our directors and officers and their immediate relatives;
- enterprises in which principal shareholders, officers and directors and their immediate relatives have control or significant influence; and

- other parties with which we deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

In considering each possible related party relationship, attention is directed to the nature and substance of the relationship, and not merely to its legal form. Our reported statements of income, balance sheets and statements of cash flows would be different had such transactions been carried out amongst unrelated parties. Related parties may enter into transactions that unrelated parties might not, and transactions between related parties may not be executed on the same terms, conditions and amounts as transactions between unrelated parties.

Business combinations

On 31 March 2004, the International Accounting Standards Board (IASB) issued IFRS No. 3, *Business Combinations* (IFRS 3), on accounting for business combinations and revised Standard IAS No. 36, *Impairment of Assets* (IAS 36) and IAS No. 38, *Intangible Assets* (IAS 38). The main features of the new and revised standards are that all business combinations within the scope of IFRS 3 must be accounted for using the purchase method. The previously permitted pooling-of-interest method is prohibited. Identifiable assets acquired, liabilities, and contingent liabilities incurred or assumed must be initially measured at fair value. Intangible items acquired in a business combination must be recognized as assets separately from goodwill if they meet the definition of an asset, are either separable or arise from contractual or other legal rights, and their fair value can be measured reliably. Amortization of goodwill and intangible assets with indefinite useful lives is prohibited. Instead, they must be tested for impairment annually or more frequently if events or changes in circumstances indicate a possible impairment. IFRS 3 allows for the use of provisional values in the initial accounting for a business combination if the fair values of assets and liabilities purchased or the cost of the combination can only be determined provisionally. Adjustments to the provisional values are expected to be finalized within 12 months of the acquisition date. These standards apply to business combinations commencing on or after 31 March 2004. We have accounted for our December 2004 acquisitions of the remaining equity interests in Tarkosaleneftegas and Khancheyneftegas that we did not previously own in accordance with provisions promulgated in IFRS 3, IAS 36 and IAS 38.

We applied the transitional rules of IFRS 3. *Business Combinations*, in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. Consequently, beginning 1 January 2005, previously recognized goodwill was no longer amortized and will be tested for impairment in accordance with IAS 36, *Impairment of Assets*, and on 1 January 2005, previously recognized negative goodwill of RR 762 million was reversed with a corresponding adjustment to the opening balance of retained earnings.

New accounting developments

We prepare our financial statements in accordance with IFRS. As discussed within the Business Combinations section above, we were required to adopt the provisions of IFRS 3, Business Combinations, for all business combinations within the scope of IFRS 3 from 31 March 2004.

In December 2003, the International Accounting Standards Board issued amendments to 15 existing IFRS standards that became effective 1 January 2005. The application of these 15 revised IFRS standards has not had a material effect on our financial position, statements of income or cash flows. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004. Significant changes relevant to us are discussed below.

The revisions to IAS 1, *Presentation of Financial Statements,* clarify certain presentation requirements. Most significantly, the revised standard requires that minority interest be presented within equity.

IAS 24, *Related Party Disclosures,* as revised, requires the disclosure of compensation of key management personnel and clarifies that such personnel include non-executive directors.

Other revised and amended standards effective on 1 January 2005 are as follows: IAS 2, *Inventories;* IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors;* IAS 10, *Events after the Balance Sheet Date;* IAS 16, *Property, Plant and Equipment;* IAS 17, *Leases;* IAS 19, *Employee Benefits;* IAS 21, *The Effects of Changes in Foreign Exchange Rates;* IAS 27, *Consolidated and Separate Financial Statements;* IAS 28, *Investments in Associates;* IAS 31, *Investments in Joint Ventures;* IAS 32, *Financial Instruments: Disclosure and Presentation;* IAS 33, *Earnings per Share;* IAS 36, *Impairment of Assets;* IAS 38, *Intangible Assets;* and IAS 39, *Financial Instruments: Recognition and Measurement*. The adoption of these revised and amended standards has not had a material effect on our financial position, statements of income or of cash flows.

Other new standards and interpretations that we early adopted on 1 January 2005 are as follows: IAS 19 (amended), *Employee Benefits,* IFRS 4, *Insurance Contracts;* IFRIC 3, *Emission Rights;* IFRIC 4, *Determining whether an Arrangement contains a Lease;* IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12. The adoption of these standards did not have a material impact on our financial position, statements of income or of cash flows.

Accounting policies significant to us that were adopted or modified on 1 January 2005 are discussed below.

Share based payments. We account for share-based payments in accordance with IFRS 2, *Share-based Payment* (IFRS 2). The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised. For transactions with parties other than employees, we account for the transaction based upon the fair value of goods or services provided, unless the fair values are not reliably estimable. The adoption of IFRS 2 did not have a material effect on us as we had no outstanding share-based awards at 1 January 2005.

For share-based payments made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

Business combinations. See "Critical accounting policies" above. We account for business combinations in accordance with the provisions of IFRS 3, *Business Combinations* (IFRS 3).

Non-current assets held for sale and discontinued operations. We account for non-current assets held for sale and discontinued operations in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 replaced IAS 35, *Discontinuing Operations*. Assets or disposal groups that are classified as held for sale are presented separately on the balance sheet and are carried at the lower of the carrying amount and fair value less costs to sell. Additionally, the results of discontinued operations are shown separately on the face of the income statement. The adoption of IFRS 5 did not have a material effect on us.

On 1 January 2005, we early adopted IFRS 6, *Exploration for and Evaluation of Mineral Resources*. This standard provides guidance on accounting for costs incurred in the exploration for and evaluation of mineral resources. Adoption of the standard did not have a material effect on us and did not result in changes to our accounting policies.

OAO NOVATEK IFRS Consolidated Financial Statements and Auditors' Report

For the years ended 31 December 2005 and 2004

CONTENTS

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AUDITORS' REPORT

To the shareholders and directors of OAO NOVATEK

1 We have audited the accompanying consolidated balance sheet of OAO NOVATEK and its subsidiaries (the "Group") as at 31 December 2005 and the related consolidated statement of income, of cash flows and of changes in shareholders' equity for the year then ended. These financial statements as set out on pages 4 to 34 are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2 We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2005 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation
14 April 2006

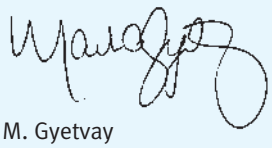
ZAO PricewaterhouseCoopers Audit

	Notes	At 31 December: 2005	2004
ASSETS			
Non-current assets			
Property, plant and equipment, net	6	65,675	62,683
Other non-current assets		1,063	1,090
Investments in associates	7	-	1,945
Long-term loans receivable	20	102	7,832
Total non-current assets		**66,840**	**73,550**
Current assets			
Prepayments and other current assets		2,426	1,039
Inventories	8	1,524	929
Trade and other receivables	9	4,849	3,456
Short-term loans receivable		167	707
Cash and cash equivalents		2,956	3,003
Total current assets		**11,922**	**9,134**
Total assets		**78,762**	**82,684**
LIABILITIES AND EQUITY			
Non-current liabilities			
Long-term debt	10	892	13,232
Deferred income tax liability	17	8,396	8,953
Other non-current liabilities		1,493	1,188
Total non-current liabilities		**10,781**	**23,373**
Current liabilities			
Short-term debt and current portion of long-term debt	11	8,202	10,768
Other taxes payable		923	1,280
Income taxes payable		46	228
Trade payables and accrued liabilities		1,261	1,963
Total current liabilities		**10,432**	**14,239**
Total liabilities		**21,213**	**37,612**
Equity attributable to Group shareholders			
Ordinary share capital		393	393
Additional paid-in capital		29,905	29,797
Asset revaluation surplus		5,481	5,481
Retained earnings		21,489	8,952
Total equity attributable to Group shareholders	12	**57,268**	**44,623**
Minority interest		**281**	**449**
Total equity		**57,549**	**45,072**
Total liabilities and equity		**78,762**	**82,684**

The accompanying notes are an integral part of these consolidated financial statements.

Approved and authorized for issue on 14 April 2006:

L. Mikhelson
General Director



M. Gyetvay
Financial Director

	Notes	Year ended 31 December: 2005	2004
Revenues			
Oil and gas sales	13	37,246	21,018
Oil and gas construction services		-	2,053
Sales of polymer and insulation tape		964	617
Other revenues		313	456
Total revenues		**38,523**	**24,144**
Net gain (loss) on disposal of investments in oil and gas producing subsidiaries and associates		3,611	(12)
Net gain on disposal of construction services and other subsidiaries		20	210
Other income		33	385
Total revenues and other income		**42,187**	**24,727**
Operating expenses			
Materials, services and other	14	(3,473)	(3,795)
Purchases of oil, gas condensate and natural gas		(2,065)	(5,708)
Transportation expenses	15	(6,605)	(3,690)
Taxes other than income tax	16	(4,494)	(1,569)
General and administrative expenses		(2,417)	(1,605)
Depreciation, depletion and amortization	6	(3,372)	(681)
Net impairment (expense) reversal		(87)	118
Exploration expenses		(348)	(183)
Total operating expenses		**(22,861)**	**(17,113)**
Profit from operations		**19,326**	**7,614**
Finance income (expense)			
Foreign exchange (loss) gain		(280)	109
Interest income		672	462
Interest expense		(1,121)	(863)
Total finance expense		**(729)**	**(292)**
Profit before income tax and share of income from associates		**18,597**	**7,322**
Share of income from associates, net of income tax	7	143	764
Profit before income tax		**18,740**	**8,086**
Income tax expense			
Current income tax expense		(5,615)	(1,906)
Deferred income tax benefit (expense)		537	(212)
Total income tax expense	17	**(5,078)**	**(2,118)**
Profit for the period		**13,662**	**5,968**
Profit (loss) attributable to:			
Minority interest		(35)	274
Shareholders of OAO NOVATEK		**13,697**	**5,694**
Basic and diluted earnings per share (in Russian roubles)	22	4,511	2,510
Weighted average shares outstanding		*3,036,306*	*2,268,654*

The accompanying notes are an integral part of these consolidated financial statements.

	Notes	Year ended 31 December: 2005	2004
Profit before income tax		**18,740**	**8,086**
Adjustments to profit before income tax:			
Depreciation, depletion and amortization		3,410	699
Net impairment loss (reversal of impairment)		87	(118)
Net foreign exchange loss (gain)		280	(109)
Net gain on disposal of assets, subsidiaries and associates		(3,664)	(586)
Share-based compensation	20	108	-
Interest expense		1,121	863
Interest income		(672)	(462)
Share of income from associates, net of income tax		(143)	(764)
Working capital changes			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(2,667)	(479)
Decrease (increase) in inventories		(610)	171
Decrease (increase) in trade payables and accrued liabilities, excluding interest and dividends		196	(603)
Increase (decrease) in other taxes payable		467	336
Total effect of working capital changes		**(2,614)**	**(575)**
Income taxes paid		(6,407)	(2,217)
Net cash provided by operating activities		**10,246**	**4,817**
Cash flows from investing activities			
Purchases of property, plant and equipment		(4,433)	(5,362)
Acquisition of subsidiaries and associated companies, net of cash acquired		(52)	298
Proceeds from disposals of subsidiaries and associates	5, 7	5,565	361
Interest paid and capitalized		(608)	(305)
Loans provided		(260)	(11,661)
Repayments of loans provided		8,085	3,289
Dividends and non banking interest received		686	488
Net cash provided by (used in) investing activities		**8,983**	**(12,892)**
Cash flows from financing activities			
Proceeds from long-term borrowings		2,058	11,493
Proceeds from short-term borrowings		2,755	5,633
Repayments of long-term borrowings		(14,102)	(624)
Repayments of short-term borrowings		(7,110)	(4,350)
Interest paid: non-banking		(992)	(709)
Dividends paid	12	(1,889)	(2,010)
Net cash provided by (used in) financing activities		**(19,280)**	**9,433**
Effect of exchange rate on cash and cash equivalents		(12)	(21)
Net change in restricted cash		16	48
Net increase (decrease) in cash and cash equivalents		(47)	1,385
Cash and cash equivalents at beginning of the year		3,003	1,618
Cash and cash equivalents at end of the year		**2,956**	**3,003**

The accompanying notes are an integral part of these consolidated financial statements.

	Number of ordinary share	Ordinary shares capital	Additional paid in capital	Asset revaluation surplus	Retained earnings	Equity attributable to Group shareholders	Minority interest	Total equity
At 31 December 2003	***2,247,030***	**314**	**5,963**	**-**	**5,268**	**11,545**	**468**	**12,013**
Acquisition (see Note 4)	789,276	79	23,849	5,481	-	29,409	-	29,409
Profit for the period	-	-	-	-	5,694	5,694	274	5,968
Dividends	-	-	-	-	(2,010)	(2,010)	-	(2,010)
Distribution to shareholders	-	-	(15)	-	-	(15)	-	(15)
Impact of disposals and acquisitions on minority interest	-	-	-	-	-	-	(293)	(293)
At 31 December 2004	***3,036,306***	**393**	**29,797**	**5,481**	**8,952**	**44,623**	**449**	**45,072**
Cumulative effect of adoption of IFRS 3, Business Combinations (Note 3)	-	-	-	-	762	762	-	762
At 31 December 2004, as restated for adoption of IFRS 3, *Business Combinations*	***3,036,306***	***393***	***29,797***	***5,481***	***9,714***	***45,385***	***449***	***45,834***
Profit (loss) for the period	-	-	-	-	13,697	13,697	(35)	13,662
Dividends	-	-	-	-	(1,922)	(1,922)	-	(1,922)
Share-based compensation funded by shareholders	-	-	108	-	-	108	-	108
Impact of disposals and acquisitions on minority interest	-	-	-	-	-	-	(133)	(133)
At 31 December 2005	***3,036,306***	**393**	**29,905**	**5,481**	**21,489**	**57,268**	**281**	**57,549**

The accompanying notes are an integral part of these consolidated financial statements.

1 ORGANISATION AND PRINCIPAL ACTIVITIES

OAO NOVATEK (hereinafter referred to as "NOVATEK") and its subsidiaries (hereinafter jointly referred to as the "Group") is an independent oil and gas company engaged in the acquisition, exploration, development, production and processing of hydrocarbons with its core operations of oil and gas properties located and incorporated in the Yamal-Nenets Autonomous Region ("YNAO") in the Russian Federation.

In June 2004, the Group sold its subsidiaries that represented substantially all of it's oil and gas construction services segment (the "disposed segment") to focus its activities on oil and gas exploration, production and processing of hydrocarbons (see Note 22).

In December 2004, the Group acquired controlling stakes in two of its primary equity affiliates, OAO NK Tarkosaleneftegas ("Tarkosaleneftegas") and OOO Khancheyneftegas ("Khancheyneftegas") (collectively the "acquired subsidiaries"). Following the acquisition, the Group's ownership in these subsidiaries increased to 100 percent. Prior to December 2004, Tarkosaleneftegas and Khancheyneftegas were accounted for as equity associates (see Note 4).

As a result of the sale of the disposed segment and the purchase of the acquired subsidiaries, the Group's results of operations for the year ended 31 December 2005 differ significantly from those of prior periods. Most notably, prior to the acquisition, a significant proportion of the hydrocarbon production of Tarkosaleneftegas and all of the production of Khancheyneftegas was purchased by the Group and then resold on to third parties. Accordingly, in prior periods, the Group's statements of income included purchases from the acquired subsidiaries. Following the acquisition, the Group consolidated the activities of the acquired subsidiaries and, accordingly, all intragroup transactions have been eliminated.

Moreover, in prior periods, the Group included those activities of the disposed segment to the extent the disposed segment provided services to third parties. Beginning in July 2004, the Group no longer included such operations and any oil and gas drilling and construction services purchased from third parties are either capitalized to property, plant and equipment or expensed within materials, services and other, as deemed appropriate.

In May 2005, the Group disposed of its equity stake in ZAO NOVA Bank, a Group subsidiary, to ZAO Levit ("Levit"), a Group shareholder (see Note 5), and merged Khancheyneftegas into Tarkosaleneftegas, after converting Tarkosaleneftegas from an open joint stock company to a limited liability company.

In June 2005, the Group disposed of its 66 percent participation interest in OOO Geoilbent, its 34 percent interest in OAO Selkupneftegas, and its 25.1 percent interest in OAO Tambeyneftegas, Group associates (see Note 7).

In November and December 2005, the Group established Novatek Overseas AG and Runitek GmbH (both registered in Switzerland) to manage the administration, marketing and trading of crude oil, stable gas condensate, liquefied petroleum gas, and other oil products to international markets.

The Group's natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in the winter months of December and January and dipping in the summer months of July and August.

2 BASIS OF PRESENTATION

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS"), and Interpretations issued by the International Accounting Standards Board ("IASB") and the International Accounting Standards Board's International Financial Reporting Interpretations Committee ("IFRIC"). In the absence of specific IFRS guidance for oil and gas producing companies, the Group has developed accounting policies in accordance with other generally accepted accounting principles for oil and gas producing companies insofar as they do not conflict with IFRS principles.

2 BASIS OF PRESENTATION (CONTINUED)

The Group maintained their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"). The Group's financial statements are based on the statutory records with adjustments and reclassifications recorded in the financial statements for the fair presentation in accordance with IFRS. The principal adjustments primarily relate to (1) depreciation, depletion and amortization, and valuation of property, plant and equipment, (2) consolidation of subsidiaries, (3) business combinations, (4) accounting for income taxes, and (5) valuation of unrecoverable assets, expense recognition and other provisions.

The consolidated financial statements have been prepared under the historical cost convention. The Group's functional currency is the Russian rouble ("RR").

Use of estimates. The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. Estimates have principally been made in respect to fair values of assets and liabilities, impairment provisions, oil and gas reserves and deferred income taxes. Actual results may differ from such estimates.

Exchange rates, restrictions and controls. The official rate of exchange of the Russian rouble to the US dollar ("USD") at 31 December 2005 and 2004 was 28.78 and 27.75 Russian roubles to USD 1.00, respectively. The official Russian inflation rates as per Goskomstat, a Russian official statistical agency, were 10.9 percent and 11.7 percent in 2005 and 2004, respectively. Additionally, exchange restrictions and controls exist relating to converting Russian roubles into other currencies. At present, the Russian rouble is not a convertible currency in most countries outside of the Russian Federation and, further, the Group is required to convert 10 percent (25 percent from July 2003 through December 2004) of its hard currency proceeds into Russian roubles. Any translation of Russian rouble amounts to US dollars or any other hard currency should not be construed as a representation that such Russian rouble amounts have been, could be, or will in the future be converted into hard currency at the exchange rate shown or at any other exchange rate.

Reclassifications. The Group previously disclosed transportation expenses rechargeable to customers with no margin and associated revenue within transportation expenses and oil and gas sales, respectively. Management believes that their presentation on a net basis more appropriately reflects the substance of the transactions. Additionally, certain expenses incurred by the Group's headquarters and administrative functions of the production subsidiaries previously reported within materials, services and other have been reclassified to general and administrative expenses to more appropriately reflect their nature. Comparative amounts for the year ended 31 December 2004 have been adjusted as follows:

	As originally reported	Reclassifications	After reclassifications
Oil and gas sales	21,489	(471)	21,018
Materials, services and other	(4,175)	380	(3,795)
Transportation expenses	(4,234)	544	(3,690)
General and administrative expenses	(1,152)	(453)	(1,605)

Management believes that the current year presentation more accurately represents the Group's activities.

2 BASIS OF PRESENTATION (CONTINUED)

Additionally, certain adjustments were made to 2004 amounts related to the finalization of the Group's purchase accounting for its 2004 acquisitions (see Note 4). The table below discloses the amounts before and after the adjustments.

	As originally reported	Adjustment	After finalization
Property, plant and equipment	62,449	234	62,683
Deferred income tax liability	8,855	98	8,953
Asset revaluation surplus	5,345	136	5,481

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation. The accompanying consolidated financial statements include the operations of all controlled companies in which NOVATEK directly or indirectly owns more than 50 percent of the voting stock or otherwise has the power to govern the financial and operating policies. Subsidiaries are consolidated from the date on which control is obtained unless the acquisition occurred between entities under common control, which are accounted for from the beginning of the earliest period presented, and are no longer consolidated from the date that control ceases. Except for the acquisition of entities under common control, the purchase method of accounting is used to account for the acquisition of subsidiaries.

Upon achieving a controlling interest in an entity in which the Group previously held a non-controlling interest, the acquiree's identifiable assets, liabilities and contingent liabilities are restated to their fair values as of the date of achieving control. The effect of revaluing previously held interests to current fair values is recorded within asset revaluation surplus in the consolidated statement of shareholders' equity.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in other non-current assets. Goodwill on an acquisition of an associate is included in investments in associates.

The Group applied the transitional rules of IFRS 3, Business Combinations, in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. In accordance with IFRS 3, goodwill arising from business combinations for which the agreement date is on or after 31 March 2004 is tested annually for impairment and carried at cost less accumulated impairment losses. Negative goodwill arising from a business combination for which the agreement is on or after 31 March 2004 is recognized directly in the consolidated statement of income. Beginning 1 January 2005, previously recognized goodwill is no longer amortized and is now tested for impairment in accordance with IAS 36, Impairment of Assets. At 31 December 2004, the Group had negative goodwill of RR 762 million recorded within other long-term assets in its consolidated balance sheet. On 1 January 2005, this negative goodwill was derecognized in accordance with IFRS 3 and retained earnings were increased by the same amount.

The gain or loss on disposal of an entity includes the balance of goodwill relating to the disposed entity.

Property, plant and equipment. Property, plant and equipment are carried at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion, amortization and impairment.

The Group follows the successful efforts method of accounting for its oil and gas properties and equipment whereby property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overheads and all exploration costs other than exploratory drilling are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Depreciation, depletion and amortization of oil and gas properties and equipment (except for processing facilities) is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves from acquisitions of proved properties. Reserve amounts used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the current license expiry dates. In February 2005, the Group successfully extended its license on Yurkharovskoye field from 2020 through 2034, which year represents the expected end of the economic life of the field. The cost of license extension was not material.

The Group's principal reserves have been independently estimated by internationally recognized petroleum engineers. Other oil and gas reserves of the Group have been determined based on estimates of mineral reserves prepared by management in accordance with internationally recognized definitions. The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, subject to depletion using the unit-of-production method.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalized during the period of time that is required to complete and prepare the asset for its intended use.

Gains or losses from retirements or sales are included in the determination of net income.

Major renewals and improvements are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of the asset beyond its capability.

Property, plant and equipment, other than oil and gas properties and equipment, are depreciated on a straight-line basis over their estimated useful lives. Assets under construction are not depreciated.

The estimated useful lives of the Group's other assets are as follows:

	Years
Machinery and equipment	5-15
Processing facilities	20-30
Buildings	25-50

Investments in associates. Associated companies are entities over which the Group has significant influence, but which it does not control. Generally, significant influence exists when the Group has between 20 percent and 50 percent of the voting rights. Associated companies are accounted for using the equity method.

The Group's interest in each associated company is carried in the balance sheet at an amount that reflects cost, including goodwill or negative goodwill at acquisition, plus its share of income and losses and other equity movements during the year. Provisions are recorded for any impairment in value. Unrealized gains on transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated companies; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

Inventories. Natural gas, crude oil, gas condensate and natural gas liquids inventories are valued at the lower of cost or net realizable value. The cost of inventories includes applicable purchase costs of raw materials, direct operating costs, and related overhead expenses and is recorded at average cost. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Materials and supplies inventories are recorded at average cost and are carried at amounts which do not exceed their respective amounts recoverable in the normal course of business.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Trade and other receivables. Trade receivables are represented by amounts due from regular customers in the ordinary course of business (production and marketing of natural gas, gas condensate, crude oil, and associated products; production and marketing of polymer and insulation tape products). Trade and other receivables are presented at recoverable amounts and include value-added and excise taxes, which are payable to tax authorities upon collection of such receivables. An estimate is made for impairment of receivables based on a review of all outstanding amounts at year end, and the movement in the estimate is charged or credited to the consolidated statement of income. Bad debts are provided for during the year in which they are identified.

Cash and cash equivalents. Cash and cash equivalents comprises cash on hand, cash deposits held with banks, and investments which are readily convertible to known amounts of cash and which are not subject to significant risk of change in value and have an original maturity of three months or less.

Borrowings. Borrowings received or provided are recognized initially at cost, which is the fair value of the consideration received or provided, net of transaction costs incurred, if any. Borrowings denominated in foreign currencies are re-measured at each period end at the foreign exchange rate as of the balance sheet date. Borrowings received or provided that are originated by the Group are subsequently measured at amortized cost and, for borrowings provided, net of any impairment losses.

Financial instruments. Financial instruments carried on the balance sheet include cash and cash equivalents, receivables, trade payables and debt. The particular recognition methods adopted are disclosed in the individual policies related to each item. Except for long-term debt, the difference, where material, between the fair value at inception of the financial instruments, where these can be estimated reliably, and the nominal amount of financial instruments at their inception are recognized in the consolidated statement of income, consolidated balance sheet, or consolidated statement of changes in shareholders' equity in accordance with the underlying nature of such differences.

Deferred income taxes. Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12, Income Taxes.

The Group uses the balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income nor loss, it is not recognized. A deferred income tax asset is recorded only to the extent that it is probable that taxable income will be available against which the deductible temporary differences can be utilized. Deferred income tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Value-added tax. The tax authorities permit the settlement of sales and purchases value added tax ("VAT") on a net basis.

VAT payable represents VAT related to sales payable to tax authorities upon collection of receivables from customers net of VAT on purchases which have been settled at the balance sheet date. In addition, VAT related to sales which have not been settled at the balance sheet date (deferred VAT) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

VAT recoverable relates to purchases which have not been settled at the balance sheet date and property, plant and equipment not yet put into operation. VAT recoverable is reclaimable against VAT payable upon payment for the purchases and putting property, plant and equipment into operation.

In July 2005, new amendments to the Tax Code of the Russian Federation were adopted changing the tax rules with respect to VAT. Effective 1 January 2006, VAT balances become payable or eligible for recovery on an accrual basis subject to certain transitional provisions. Additionally, the requirement to defer the recovery of VAT recoverable on capital expenditures was withdrawn.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Dividends. Dividends are recognized as a liability and deducted from shareholders' equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are issued.

Revenue recognition. Revenues from oil and gas sales and sales of polymer and insulation tape are recognized when such products are delivered to customers and title has transferred. Revenues are stated net of value-added tax, excise tax and export duties.

Revenues from rendering construction services were based on the stage of completion determined by reference to services performed to date as a percentage of total services to be performed.

General and administrative expenses. General and administrative expenses represent overall corporate management and other expenses related to the general management and administration of the business unit as a whole. They include management and administrative compensation, certain legal and other advisory expenses, insurance of properties, social expenses and other expenses necessary for the administration of the Group.

Impairment of assets. An assessment is made at each balance sheet date to determine whether there is objective evidence that an asset or a group of assets may be impaired. When there is an indication that an asset may be impaired, the asset is measured at its estimated recoverable amount, which is the higher of the net selling price and value in use.

Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment loss is recognized for the difference between the estimated recoverable amount and the carrying value. The carrying amount of the asset is reduced to its estimated recoverable amount either directly or through the use of an allowance accounts and the amount of the loss is included in the consolidated statement of income for the period.

An impairment loss is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

Pension and post-employment benefits. The Group's mandatory contributions to the governmental pension scheme in the Russian Federation are expensed when incurred. Discretionary pension and other post-employment benefits are not material.

Foreign currency transactions. The Russian rouble is the Group's functional currency. Transactions denominated in foreign currencies are converted into Russian roubles at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Provisions. Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are reassessed at each reporting date and changes in the provisions resulting from the passage of time are reflected in the consolidated statement of income within non-operating income and expenses. Other changes in provisions, related to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation or changes in the discount rates, are treated as a change in an accounting estimate in the period of the change and, with the exception of asset retirement obligations, reflected in the consolidated statement of income. Changes in estimated asset retirement obligations are reflected as adjustments to the carrying value of property, plant and equipment.

An asset retirement obligation is recognized when the Group has a present legal or constructive obligation to dismantle, remove and restore items of property, plant and equipment. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation, determined using pre-tax risk free discount rates adjusted for risks specific to the obligation. Changes in the obligation resulting from the passage of time are recognized as interest expense. Changes in the obligation, reassessed at each balance sheet date, related to a change in the expected pattern of settlement of the obligation, or in the estimated amount of the obligation or in the discount rates, are treated as a change in an accounting estimate in the period. Such changes are reflected as adjustments to the carrying value of property, plant and equipment and the corresponding liability.

Share based payments. The Group accounts for share-based payments in accordance with IFRS 2, Share-based Payment ("IFRS 2"). The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and additional paid in capital when awards are exercised. For transactions with parties other than employees, the Group accounts for the transaction based upon the fair value of goods or services provided, unless the fair values are not reliably estimable.

For share-based payments made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

Non-current assets held for sale and discontinued operations. The Group accounts for non-current assets held for sale and discontinued operations in accordance with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations ("IFRS 5"). IFRS 5 replaced IAS 35, Discontinuing Operations. Assets or disposal groups that are classified as held for sale are presented separately on the balance sheet and are carried at the lower of the carrying amount or fair value less costs to sell. Additionally, the results of discontinued operations are shown separately on the face of the consolidated statement of income.

New accounting developments. In December 2003, the IASB released 15 revised International Accounting Standards and withdrew one IAS standard. The revised standards are all mandatory for periods starting on or after 1 January 2005. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued five new interpretations in 2004 and two in 2005. Significant changes relevant to the Group as a result of the new effective or early adopted IFRSs are:

IAS 1 (revised 2003), *Presentation of Financial Statements* ("IAS 1 (revised)"). IAS 1 (revised) requires the classification as current all financial liabilities for which the Group does not have an unconditional right to defer their settlement for at least twelve months after the balance sheet date. Additionally, IAS 1 (revised) requires that minority interest be presented within total equity and that profit or loss for the period is allocated between profit or loss attributable to minority interest and profit or loss attributable to shareholders of the reporting entity on the face of the consolidated statements of income. The revised standard is applied retrospectively in accordance with IAS 8.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IAS 8 (revised 2003), *Accounting Policies, Changes in Accounting Estimates and Errors* ("IAS 8 (revised)"). The Group now applies all voluntary changes in accounting policies retrospectively. Comparatives are amended in accordance with the new policies. All material errors are now corrected retrospectively in the first set of financial statements after their discovery.

IAS 21 (revised 2003), *The Effects of Changes in Foreign Exchange Rates* ("IAS 21 (revised)"). IAS 21 (revised) clarifies the method of translation of foreign currencies to the functional and presentation currency and clarifies that goodwill and fair value adjustments to assets and liabilities resulting from acquisitions are treated as part of the assets and liabilities of the acquired entity and translated at the exchange rate on the balance sheet date.

IAS 24 (revised 2003), *Related Party Disclosures*. The definition of related parties was extended and additional disclosures required by the revised standard were made in these financial statements. The revised standard is applied retrospectively in accordance with IAS 8 (revised).

IAS 36 (revised 2004), *Impairment of Assets* ("IAS 36 (revised)"). The Group now performs impairment tests of goodwill, intangible assets not yet available for use and intangible assets with indefinite useful life at least annually. The 'bottom-up/top-down' approach to testing goodwill was replaced by a simpler method. As applicable, the goodwill is, from the acquisition date, allocated to each of the acquirer's cash-generating units ("CGU"), or groups of CGUs, that are expected to benefit from the synergies of the business combination. Each CGU or group of CGUs to which the goodwill is allocated represents the lowest level at which the goodwill is monitored and is not larger than a segment. Reversals of impairment losses of goodwill are prohibited. Management assesses the reasonableness of the assumptions on which the Group's current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. The IAS 36 (revised) is applied in accordance with the Standard's transitional provisions to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004 and to all other assets prospectively from 1 January 2005.

IAS 38 (revised 2004), *Intangible Assets* ("IAS 38 (revised)"). The IAS 38 (revised) is applied prospectively in accordance with its transitional provisions. The amended accounting policies apply to intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004 and to all other intangible assets acquired on or after 1 January 2005. Intangible assets now include assets that arise from contractual or other legal rights, regardless of whether those rights are transferable or separable. The probability of inflow of economic benefits recognition criterion is now deemed to be always met for intangibles that are acquired separately or in a business combination. The Group's policies were amended to introduce the concept of indefinite life intangible assets which exist when, based on an analysis of all of the relevant factors, management concludes that there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows. Such intangibles are not amortized but tested for impairment at least annually. The Group has reassessed the useful lives of its intangible assets in accordance with the transitional provisions of IAS 38 (revised). No adjustment resulted from this reassessment.

IFRS 3, *Business Combinations*. IFRS 3 requires accounting for all business combinations by applying the purchase method and separate recognition, at the acquisition date, of the acquiree's contingent liabilities if their fair values can be measured reliably. It also requires that the identifiable assets, liabilities and contingent liabilities are measured at their fair values irrespective of the extent of any minority interest. Any resulting goodwill is tested for impairment annually, or when there are indications of impairment. The excess of the Group's interest in the net fair value of an acquiree's identifiable assets, liabilities and contingent liabilities over the cost ("negative goodwill") is recognized immediately in the consolidated statement of income. The Group applied transitional provisions of IFRS 3 and applies it to all business combinations for which the agreement date is on or after 31 March 2004.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IFRS 5 (issued 2005), *Non-current Assets Held for Sale and Discontinued Operations* ("IFRS 5"). The Group applies IFRS 5 prospectively in accordance with its transitional provisions to non-current assets (or disposal groups) that meet the criteria to be classified as 'held for sale' and operations that meet the criteria to be classified as 'discontinued' after 1 January 2005. The Group's accounting policies now describe assets 'held for sale' as those that will be recovered principally through a sales transaction rather than through continuing use. Subject to certain exceptions, assets or disposal groups that are classified as 'held for sale' are measured at the lower of carrying amount and fair value less costs to sell. Such assets cease to be depreciated and are presented separately on the face of the balance sheet.

IFRS 6, *Exploration for and Evaluation of Mineral Resources* ("IFRS 6"). IFRS 6 was early adopted by the Group. IFRS 6 allows an entity to continue using the accounting policies for exploration and evaluation assets applied immediately before adopting the IFRS, subject to certain impairment test requirements. Adoption of the standard did not require changes of the Group's accounting policies.

IAS 21 (Amendment), *Net Investment in a Foreign Operation.* The amendment to IAS 21 was early adopted by the Group. It clarifies treatment of foreign exchange differences on intercompany loans that form part of a net investment in a foreign operation.

Other than the effect of adoption of IFRS 3 discussed above, the adoption of these standards as well as all the other new or revised standards that are effective for 2005 did not have a material impact on the Group's financial position, consolidated statement of income or of cash flows.

New or revised standards not yet effective. Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006 or later periods and which the Group has not early adopted:

IFRIC 4, *Determining whether an Arrangement contains a Lease* (effective from 1 January 2006); IAS 39 (Amendment), *The Fair Value Option* (effective from 1 January 2006); IAS 39 (Amendment), *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (effective from 1 January 2006); IAS 39 (Amendment), *Financial Guarantee Contracts* (effective from 1 January 2006); IFRS 7, *Financial Instruments:* Disclosures and a Complementary Amendment to IAS 1 *Presentation of Financial Statements - Capital Disclosures* (effective from 1 January 2007); IAS 19 (Amendment), *Employee Benefits* (effective from 1 January 2006); IFRS 1 (Amendment), *First-time Adoption of International Financial Reporting Standards* and IFRS 6 (Amendment), *Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006); IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (effective from 1 January 2006); IFRIC 6, *Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment* (effective for periods beginning on or after 1 December 2005); IFRIC 7, *Applying the Restatement Approach under IAS* 29 (effective for periods beginning on or after 1 March 2006); IFRIC 8, *Scope of IFRS 2* (effective for periods beginning on or after 1 May 2006); and IFRIC 9 *Reassessment of Embedded Derivatives* (effective for annual periods beginning on or after 1 June 2006).

These new standards and interpretations are not expected to significantly affect the Group's financial statements when adopted on 1 January 2006 or later.

4 ACQUISITION OF TARKOSALENEFTEGAS AND KHANCHEYNEFTEGAS

Description of the transaction. In December 2004, the Group's interest in Tarkosaleneftegas and Khancheyneftegas was increased to 100 percent as a result of its purchase of an additional 67.7 percent interest in Tarkosaleneftegas and 57.0 percent in Khancheyneftegas. The Group purchased these stakes from its significant shareholders, SWGI Growth Fund (Cyprus) Limited and Levit, by issuing 789,276 new ordinary shares in NOVATEK. Immediately prior to the acquisition, SWGI Growth Fund (Cyprus) Limited and Levit purchased 43.9 percent of Tarkosaleneftegas and 26.8 percent of Khancheyneftegas from the ITERA Group. Also prior to the acquisition, Levit purchased six percent of Khancheneftegas from individuals. The shareholder purchases from the ITERA Group were partially funded through loans from the Group (see Notes 10, 20). As part of the acquisition, the Group agreed to the early repayment of loans from Tarkosaleneftegas to the ITERA Group and entered into a five-year commitment to sell gas to the ITERA Group at negotiated market prices.

4 ACQUISITION OF TARKOSALENEFTEGAS AND KHANCHEYNEFTEGAS (CONTINUED)

The value of the ordinary shares was determined by the market price of OAO NOVATEK shares on the date the transaction was entered into. Accordingly, the total purchase price for 67.7 percent of Tarkosaleneftegas and 57.0 percent of Khancheyneftegas comprises the following:

Issuance of 789,276 new ordinary shares of NOVATEK	23,928
Cost of early repayment of long-term debt by Tarkosaleneftegas	578
Value of five-year natural gas sales contract	701
Total purchase price	**25,207**

At 31 December 2004, management's purchase accounting was preliminary and resulted in no goodwill being recognized. During 2005, management engaged an independent appraiser to assess the fair value of assets and liabilities of the acquired companies, which results are presented in the table below. The net fair values comprise 100 percent of the assets and liabilities of the acquirees, including the stakes in Tarkosaleneftegas and Khancheyneftegas held by the Group prior to the acquisition. Such stakes were also revalued to their fair values at the acquisition date. The results of the preliminary valuation totaled RR 5,345 million, which were recorded as asset revaluation surplus in the consolidated statement of shareholders' equity. This asset revaluation surplus was increased by RR 136 million to RR 5,481 million as a result of the final purchase accounting. There was no goodwill recorded as a result of the acquisition. Differences between the fair values of the acquirees' total net assets and the purchase price include the cost of the early repayment of long-term debt and the value of the five-year gas sales contract.

The table below provides information on IFRS carrying values of the identifiable assets and liabilities of the acquirees immediately before the acquisition in their respective IFRS accounts, and the assessed fair values following purchase accounting adjustments.

	Tarkosaleneftegas		Khancheyneftegas	
	IFRS carrying amounts before the acquisition	Fair values at the acquisition date	IFRS carrying amounts before the acquisition	Fair values at the acquisition date
Current assets	2,165	2,220	654	654
Oil and gas properties and equipment	14,137	35,578	3,166	13,084
Other non-current assets	174	203	25	25
Current liabilities	(4,783)	(4,743)	(1,863)	(1,863)
Non-current liabilities	(722)	(5,990)	(1,297)	(3,675)

Summary combined financial information. The following table sets forth summary combined financial information for the year ended 31 December 2004 that is presented to provide information to evaluate the financial effects of the acquisition of Tarkosaleneftegas and Khancheyneftegas as if it had occurred on 1 January 2004. The following information comprises financial data for the full financial year ended 31 December 2004.

	Group results excluding its share of income from Tarkosaleneftegas and Khancheyneftegas	Tarkosale-neftegas	Khanchey-neftegas	Summary combined
Total revenues	24,144	4,680	2,749	31,573
Net income (loss)	5,513	(104)	421	5,830

The summary combined financial information should not be construed to represent consolidated financial information. Specifically, no adjustments have been made for the following: (a) revenues were not adjusted to conform with the terms of the five-year gas sales contract with the ITERA Group; (b) depreciation, depletion and amortization was not increased to reflect the higher carrying values of property, plant and equipment following fair value adjustments; (c) intercompany eliminations; and (d) income taxes.

5 INVESTMENTS IN SUBSIDIARIES

Acquisition of stakes in NOVATEK-Polymer. In May 2004, the Group acquired an additional 19 percent of the total outstanding shares of NOVATEK-Polymer, a Group subsidiary, from a third party for RR 67 million in cash, and, in August 2004, another 25.5 percent of the total outstanding shares of NOVATEK-Polymer in an auction from the Russian Federal Property Fund for RR 61 million in cash. In addition, in August 2004, the Group also purchased an additional 1.25 percent for RR 4 million.

Acquisition of additional stake in PNGG. During 2004, the Group entered into an agreement with OAO Gazprom, the Russian gas monopoly, whereby the Group exchanged its title to the mineral license in the West-Tarkosalinskoye field, held by OOO Purgazdobycha, a wholly-owned subsidiary of Purneftegasgeologiya (hereinafter "PNGG"), a Group subsidiary, for an 8.34 percent interest in PNGG. The acquisition increased the Group's effective interest in PNGG to 78.0 percent. Within the framework of this agreement, the Group retained its rights to 10 percent of the natural gas extracted from the Cenomanian reservoir and 50 percent of the hydrocarbon liquids from the Neocomian reservoir from the West-Tarkosalinskoye field for the whole period of the license (which expires in 2018). At the same time, the Group leased the gas production assets from the field to OAO Gazprom under a long-term finance lease. The Group recognized a gain of RR 278 million, net of tax of RR 88 million, on the disposal.

Disposals. In June 2004, the Group disposed of substantially all of its oil and gas construction services segment (see Note 22). Also during 2004, the Group disposed of its interest in various non-core business entities to both third and related parties realizing a net gain of RR 480 million; and sold 10 percent of its interest of PNGG for RR 12 million, recognizing a loss of RR 29 million.

In September 2004, NOVA Bank issued an additional six million shares to Levit, a Group shareholder, for total consideration of RR 60 million. As a result, the Group's interest in NOVA Bank decreased from 88.6 percent to 62 percent, and correspondingly, the Group recognized a loss on the transaction of RR 6 million.

In December 2004, the Group disposed of its 66.7 percent interest in OAO Yamaltelecom, a Group telecommunication subsidiary, for total consideration of RR 19 million, recognizing a gain of RR 6 million on the transaction.

In May 2005, the Group disposed of its equity stake in NOVA Bank to Levit, a Group shareholder, for RR 156 million, recognizing a gain on the sale of RR 12 million, net of associated income tax of RR 8 million. The disposal of NOVA Bank did not have a material effect on the Group's financial position and results of operations. NOVA Bank's financial position and results of operations were included within "Other" in the Group's segment information.

6 PROPERTY, PLANT AND EQUIPMENT

	At 31 December:	
	2005	**2004**
Cost		
Oil and gas properties and equipment	62,341	53,708
Assets under construction	4,174	8,728
Other	3,482	1,159
	69,997	63,595
Accumulated depreciation, depletion and amortization		
Oil and gas properties and equipment	(4,065)	(806)
Other	(257)	(106)
	(4,322)	(912)
Property, plant and equipment, net	**65,675**	**62,683**

6 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Movements in property, plant and equipment, for the years ended 31 December 2005 and 2004 were as follows:

	Oil and gas properties and equipment	Assets under construction	Other	Total
At 31 December 2003	**6,462**	**2,553**	**1,042**	**10,057**
Acquisitions	44,677	2,342	431	47,450
Additions	1,062	6,220	130	7,412
Transfers	1,909	(2,105)	196	-
Depreciation, depletion and amortization	(584)	-	(115)	(699)
Disposals, net	(687)	(282)	(680)	(1,649)
Impairments	63	-	49	112
At 31 December 2004	**52,902**	**8,728**	**1,053**	**62,683**
Additions	1,144	4,346	970	6,460
Transfers	7,491	(8,894)	1,403	-
Depreciation, depletion and amortization	(3,255)	-	(155)	(3,410)
Disposals, net	(36)	(6)	(85)	(127)
Impairments	30	-	39	69
At 31 December 2005	**58,276**	**4,174**	**3,225**	**65,675**

Included within oil and gas properties and equipment balance at 31 December 2005 and 2004 are proved properties of RR 29,125 million and RR 30,583 million, net of accumulated depreciation, depletion and amortization and impairment expense of RR 1,527 million and RR 69 million, respectively.

Included within general and administrative expenses are RR 38 million and RR 18 million of depreciation of administrative buildings for the years ended 31 December 2005 and 2004, respectively.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, amounting to RR 398 million and RR 268 million at 31 December 2005 and 2004, respectively, are included in the cost of oil and gas properties and equipment. The Group has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred through 2038. The corresponding obligation is recorded within other non-current liabilities in the Group's consolidated balance sheets. Governmental authorities are continually considering environmental regulations and their enforcement. Consequently, the Group's ultimate environmental liabilities may differ from the recorded amounts.

Included in additions to property, plant and equipment for the years ending 31 December 2005 and 2004 was capitalized interest of RR 608 million and RR 446 million, respectively. The interest capitalization rates for 2005 and 2004 used for additions were 9.14 percent and 10.25 percent, respectively.

During 2005, the transfers and additions to oil and gas property and equipment included the completion of the Purovsky Gas Condensate Plant in the amount of RR 4,862 million. The Group also completed the BOP Plant (Biaxial-Oriented Polypropylene Plant) for RR 1,047 million recorded within other.

7 INVESTMENTS IN ASSOCIATES

	Year ended 31 December:	
	2005	2004
Balance at the beginning of year	**1,945**	**5,291**
Share of income before tax	159	721
Share of income tax (expense) benefit	(16)	43
Net income from associates	143	764
Acquisition of associates	-	35
Disposals of associates	(2,088)	(37)
Acquisition of controlling stakes in associates	-	(4,106)
Other movements	-	(2)
Balance at the end of year	**-**	**1,945**

Acquisition of stakes in Tarkosaleneftegas and Khancheyneftegas. In December 2004, the Group completed an acquisition of two key operating subsidiaries, Tarkosaleneftegas and Khancheyneftegas, resulting in 100 percent ownership of both entities (see Note 4).

Disposals. In June 2005, the Group sold its 66 percent participation interest in Geoilbent to OAO LUKOIL and its subsidiary for RR 5,108 million, recognizing a gain on sale of RR 2,234 million, net of associated income tax of RR 793 million. The Group included its investment in Geoilbent within exploration and production in the Group's segment information.

In June 2005, the Group sold its 34 percent interest in Selkupneftegas, a Group associate, to OAO NK Rosneft for RR 573 million, recognizing a gain on sale of RR 436 million, net of associated income tax of RR 137 million. As the Group's carrying value for its investment in Selkupneftegas was nil, the full amount of the sales proceeds was recognized as a gain.

In June 2005, the Group disposed of its 25.1 percent interest in Tambeyneftegas to OOO Gazprombank-Invest for RR 120 million, recognizing a gain on sales of RR 4 million, net of associated income tax of RR 7 million. The Group included its investment in Tambeyneftegas within exploration and production in the Group's segment information.

8 INVENTORIES

	At 31 December:	
	2005	2004
Materials and supplies at net realizable value (net of provisions of RR 91 million and RR 87 million at 31 December 2005 and 2004, respectively)	565	479
Materials and supplies at cost	416	252
Natural gas and hydrocarbon liquids	284	105
Polymer and insulation tape products	243	66
Other inventories	16	27
Total inventories	**1,524**	**929**

9 TRADE AND OTHER RECEIVABLES

	At 31 December:	
	2005	2004
Trade receivables (net of provision of nil and RR 21 million at 31 December 2005 and 2004, respectively)	654	669
Trade and other receivables – related parties (net of provision of RR 59 million and nil at 31 December 2005 and 2004, respectively)	1,628	606
Recoverable value-added tax	2,415	1,740
Interest on loans receivable – related parties	29	42
Other receivables (net of provision of RR 62 million and RR 47 million at 31 December 2005 and 2004, respectively)	123	399
Total trade and other receivables	**4,849**	**3,456**

10 LONG-TERM DEBT

	At 31 December:	
	2005	2004
US dollar denominated loans	6,116	11,586
Euro denominated loans	786	-
Russian rouble denominated bonds	1,000	1,000
Russian rouble denominated loans	-	4,537
Loans from related parties	-	1,497
Total	7,902	18,620
Less: current portion of long-term debt	(7,010)	(5,388)
Total long-term debt	**892**	**13,232**

At 31 December 2005 and 2004, the Group's long-term debt by facility is as follows:

	At 31 December:	
	2005	2004
C.R.R. B.V.	5,757	8,324
Russian rouble denominated bonds	1,000	1,000
Sberbank	-	3,354
Vneshtorgbank	-	2,775
Finance Department of YNAO	-	1,130
Yamal Regional Fund of Development	-	1,126
Other Russian rouble denominated loans	-	424
Other loans	1,145	487
Total	7,902	18,620
Less: current portion of long-term debt	(7,010)	(5,388)
Total long-term debt	**892**	**13,232**

C.R.R. B.V. At 31 December 2005 and 2004, US dollar denominated loans included a USD 200 million loan (RR 5,757 million and RR 5,549 million, respectively) from C.R.R. B.V. backed by unsecured, 18-month credit-linked notes with an annual coupon rate of 7.75 percent, payable semi-annually. The loan is guaranteed by Group subsidiaries, Yurkharovneftegas and Tarkosaleneftegas, and repayable in June 2006.

10 LONG-TERM DEBT (CONTINUED)

At 31 December 2004, US dollar denominated loans also included a USD 100 million loan (RR 2,775 million) from C.R.R. B.V. backed by unsecured, 18-month credit-linked notes with an annual coupon rate of 9.125 percent. The loan was repaid in October 2005.

Russian rouble denominated bonds. In December 2004, the Group issued one million non-convertible Russian rouble denominated bonds, each with a nominal value of RR 1,000 and an annual coupon rate of 9.4 percent, payable semi-annually. The bonds are guaranteed by Yurkharovneftegas and mature in November 2006.

Sberbank. At 31 December 2004, Russian rouble denominated loans included loans from Sberbank in the aggregated amount of RR 3,354 million with annual interest rates between 10.5 and 13 percent. A portion of these loans in the amount of RR 600 million was collateralized by the Group's 2.5 percent share in Tarkosaleneftegas. During 2005, the loans were fully repaid and the shares pledged were released.

Vneshtorgbank. At 31 December 2004, US dollar denominated loans included a USD 100 million loan (RR 2,775 million) from Vneshtorgbank with annual interest rate of 9.75 percent. The loan was collateralized by 26 percent of the Group's participation interest in Tarkosaleneftegas. In August 2005, the Group fully repaid the loan ahead of its maturity schedule and the participation interest pledged was released.

Finance Department of YNAO. At 31 December 2004, Russian rouble denominated loans included a loan from the Finance Department of YNAO in the amount of RR 1,130 million. The loan bore interest of 11.75 percent per annum and was collateralized by 4.7 percent of the Group's participation interest in Tarkosaleneftegas. In August 2005, the Group fully repaid the loan ahead of its maturity schedule and the participation interest pledged was released.

Yamal Regional Fund of Development. At 31 December 2004, loans from related parties included loans from the Yamal Regional Fund of Development in the aggregated amount of RR 1,126 million with annual interest rates between 10 and 12 percent. A portion of these loans in the amount of RR 971 million was collateralized by 31 percent of the Group's participation interest in Yurkharovneftegas. During 2005, the loans were fully repaid ahead of its maturity schedule and the participation interest pledged was released.

Other Russian rouble denominated loans. At 31 December 2004, loans from related parties included interest free loans from Pur-Land in the total amount of RR 371 million. The loans were fully repaid in January 2005.

Other loans. At 31 December 2005 and 2004, other loans included US dollar denominated loans totaling RR 359 million (USD 12 million) and RR 487 million (USD 17.6 million), respectively, with a weighted average interest rate of 9.6 and 8.3 percent, respectively. The loans mature between 2006 and 2010. At 31 December 2005, other loans also included Euro denominated loans totaling RR 786 million (Euro 23 million) with an implied weighted average interest rate of 12 percent. The loans mature between 2006 and 2009.

Scheduled maturities of long-term debt outstanding are as follows:

	Scheduled maturities at 31 December:	
Year ended 31 December	**2005**	**2004**
2006	-	7,920
2007	375	2,697
2008	360	2,093
2009	141	515
Thereafter	16	7
Total long-term debt	**892**	**13,232**

11 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT

	At 31 December:	
	2005	2004
US dollar denominated loans	1,192	-
Russian rouble denominated loans	-	3,680
Promissory notes	-	1,275
Loans from related parties	-	425
Total	1,192	5,380
Add: current portion of long-term debt	7,010	5,388
Total short-term debt and current portion of long-term debt	**8,202**	**10,768**

US dollar denominated loans. Short-term US dollar denominated loans had a weighted average interest rate of 7.8 percent (interest ranging from 7.6 percent to 7.9 percent) at 31 December 2005.

Russian rouble denominated loans. Short-term Russian rouble denominated loans had a weighted average interest rate of 10.5 percent (interest ranging from 8.8 to 12 percent) at 31 December 2004.

Promissory notes. At 31 December 2004, promissory notes included Tarkosaleneftegas Russian rouble denominated promissory notes repayable within one year of the balance sheet date. During 2005, the promissory notes, which were non interest-bearing, were fully repaid.

Loans from related parties. At 31 December 2004, loans from related parties included US dollar denominated loan from the Yamal Regional Fund of Development, at that time a Group shareholder, in the amount of RR 425 million (USD 15.3 million). The loan bore interest of 10 percent per annum and was fully repaid in February 2005.

12 SHAREHOLDERS' EQUITY

Ordinary share capital. Share capital issued and outstanding consisted of 3,036,306 ordinary shares at 31 December 2005 and 2004 with a par value of RR 100 each. The total authorized number of ordinary shares was 10,593,682 shares at 31 December 2005 and 2004.

Dividends. On 10 June 2005, the Group's shareholders approved final dividends for 2004 totaling RR 777 million (RR 256 per share). On 14 December 2005, the Group's shareholders approved interim dividends for 2005 of RR 1,145 million (RR 377 per share), of which RR 33 million were still payable at the year end.

Share-based compensation. In 2005, certain shareholders provided share-based compensation to the Group's chief financial officer and to the Group's head of exploration and production activities. The share awards comprise shares in a limited liability company that indirectly holds shares of the Group. The fair value of the awards of RR 879 million is being recognized as compensation expense evenly over their five year vesting period beginning the second quarter of 2005. A corresponding increase is recorded to additional paid in capital as expense is recognized to reflect the shareholders contribution in providing the award. The fair value of the awards was determined by reference to the fair value of the limited liability company's net assets estimated by its owners.

Distributable retained earnings. The statutory accounting reports of NOVATEK are the basis for income distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net income calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation. For the years ended 31 December 2005 and 2004, NOVATEK had a statutory net income of RR 15,179 million and RR 5,182 million, respectively, as reported in NOVATEK's statutory accounting reports.

13 OIL AND GAS SALES

	Year ended 31 December:	
	2005	2004
Natural gas	22,729	12,943
Stable gas condensate	6,349	-
Crude oil	3,899	6,025
Oil products	2,797	2,050
Liquefied petroleum gas	1,472	-
Total oil and gas sales	**37,246**	**21,018**

14 MATERIALS, SERVICES AND OTHER

	Year ended 31 December:	
	2005	2004
Materials and supplies	1,212	1,594
Employee compensation	1,161	675
Tolling and processing fees	507	481
Repair and maintenance services	268	110
Electricity and fuel	135	137
Rent expense	30	95
Construction services	-	415
Extraction services	-	140
Other	160	148
Total materials, services and other	**3,473**	**3,795**

15 TRANSPORTATION EXPENSES

	Year ended 31 December:	
	2005	2004
Natural gas transportation to customers	5,052	2,938
Stable gas condensate, liquefied petroleum gas and oil products transported by railroad	943	9
Transportation of unstable gas condensate from the fields to the processing facilities through third party pipelines	163	144
Crude oil transportation to customers	133	277
Insurance expense	290	304
Other transportation costs	24	18
Total transportation expenses	**6,605**	**3,690**

16 TAXES OTHER THAN INCOME

The Group is subject to a number of taxes other than on income, which are detailed as follows:

	Year ended 31 December:	
	2005	**2004**
Unified natural resources production tax	4,367	1,293
Property tax	327	106
Excise tax	102	93
Other taxes	125	77
Subtotal	4,921	1,569
Less: reversal of provision for additional taxes	(427)	-
Total taxes other than income tax	**4,494**	**1,569**

Under the Tax Code of the Russian Federation, the rate for the unified natural resources production tax on natural gas production was RR 107 per thousand cubic meters through 31 December 2004. Beginning 1 January 2005, the unified natural resources production tax for natural gas production was fixed at a rate of RR 135 per thousand cubic meters. Beginning 1 January 2006, the unified natural resources production tax for natural gas production was fixed at a rate of RR 147 per thousand cubic meters.

Under the Tax Code of the Russian Federation, from 1 January 2004, the unified natural resources production tax rate for gas condensate is set at 17.5 percent of gas condensate revenues recognized by the Group.

Under the Tax Code of the Russian Federation, the base rate for the unified natural resources production tax for crude oil was set at RR 347 per metric ton of crude oil produced at 31 December 2004. The rate for crude oil is adjusted depending on the market price of Urals blend and the RR/USD exchange rate. Between 1 January 2005 and 31 December 2006 the base rate is RR 419 per metric ton of crude oil. From 1 January 2007, the tax rate will be 16.5 percent of crude oil revenues recognized by the Group.

Reversal of provision for additional taxes. During 2004, the Russian tax authorities' position on calculating the tax basis for unified natural resources production tax on gas condensate differed from how the Group calculated the tax. As a result, through 31 March 2005, the Group recorded provisions for additional taxes in excess of its declarations submitted to the tax authorities. In July 2005, a revised methodology on calculating the unified natural resources production tax on gas condensate was enacted. The revision supported the Group's methodology and was retroactively effective from 1 January 2004. Accordingly, the Group reversed its previously recorded provisions of RR 427 million as of 1 April 2005.

17 INCOME TAX

At 31 December 2005 and 2004, RR 732 million and RR 109 million of prepaid income tax were included within prepayments and other current assets, respectively.

17 INCOME TAX (CONTINUED)

Reconciliation of income tax. The table below reconciles actual income tax expense and theoretical income tax, determined by applying the statutory tax rate to profit before income tax and share of income in associates.

	Year ended 31 December:	
	2005	2004
Profit before income tax and share of income in associates	18,597	7,322
Theoretical income tax expense at statutory rate of 24 percent	4,463	1,757
Increase (decrease) due to:		
Non-deductible expenses	439	156
Tax losses carried forward	(76)	-
Other non-temporary differences	252	205
Total income tax expense	**5,078**	**2,118**

Effective income tax rate. The Group's statutory income tax rate in 2005 and 2004 was 24 percent. For the years ended 31 December 2005 and 2004, the Group's effective income tax rate was 27.3 percent and 28.9 percent, respectively.

Deferred income tax. Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes.

Deferred income tax balances are presented in the consolidated balance sheets as follows:

	At 31 December:	
	2005	2004
Long-term deferred income tax asset (other non-current assets)	21	41
Long-term deferred income tax liability	(8,396)	(8,953)
Net deferred income tax liability	**(8,375)**	**(8,912)**

Deferred income tax assets expected to be recovered within twelve months of 31 December 2005 and 2004 were RR 275 million and RR 224 million, respectively. Deferred tax liabilities expected to be recovered within twelve months of 31 December 2005 and 2004 were RR 45 million and RR 178 million, respectively.

Movements in deferred income tax assets and liabilities during the years ended 31 December 2005 and 2004 were as follows:

	At 31 December 2005	Income statement effect	At 31 December 2004	Income statement effect	Acquisitions and disposals	At 31 December 2003
Liabilities						
Property, plant and equipment	(9,262)	(187)	(9,075)	(202)	(8,245)	(628)
Investments in associates	-	347	(347)	(175)	859	(1,031)
Inventories	(24)	(18)	(6)	11	-	(17)
Trade payables and accrued liabilities	(10)	168	(178)	(86)	(16)	(76)
Total deferred income tax liabilities	(9,296)	310	(9,606)	(452)	(7,402)	(1,752)

17 INCOME TAX (CONTINUED)

	At 31 December 2005	Income statement effect	At 31 December 2004	Income statement effect	Acquisitions and disposals	At 31 December 2003
Assets						
Inventories	153	46	107	(4)	26	85
Trade and other receivables	36	(132)	168	89	10	69
Trade payables and accrued liabilities	600	218	382	148	190	44
Tax losses carried forward	76	76	-	-	-	-
Other	56	19	37	7	(31)	61
Total deferred income tax assets	921	227	694	240	195	259
Net deferred income tax liabilities	**(8,375)**	**537**	**(8,912)**	**(212)**	**(7,207)**	**(1,493)**

At 31 December 2005 and 2004, the Group had recognized deferred income tax assets of RR 76 million and nil in respect of unused tax loss carry forwards of RR 317 million and RR 337 million, respectively. Tax losses can be carried forward for relief against taxable profits for 10 year after they are incurred, subject to certain limitations.

At 31 December 2005 and 2004, the Group had not recorded a deferred tax liability in respect of taxable temporary differences of RR 7,084 million and RR 7,040 million, respectively, associated with investments in subsidiaries as the Group is able to control the timing of the reversal of those temporary differences and does not intend to reverse them in the foreseeable future.

18 FINANCIAL INSTRUMENTS

Foreign exchange. The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar, and it does not use foreign exchange or forward contracts. At 31 December 2005, cash, trade and other receivables, short-term and long-term debt denominated in US dollars amounted to RR 1,289 million, RR 1,507 million, RR 1,192 million, RR 6,116 million, respectively, translated at the official Russian rouble to US dollar exchange rate used by the Central Bank of the Russian Federation.

Interest rates. The Group obtains funds from and deposits surpluses with banks at current market interest rates, and does not use any hedging instruments to manage its exposure to changes in interest rates. Management does not believe that it has significant exposure to interest rate risk as the majority of its borrowings are at fixed interest rates.

Credit risks. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to have minimal risk of default. The Group does not require collateral or other security to support receivables from customers. Although collection of accounts receivable could be influenced by economic factors affecting these customers, management believes there is no significant risk of loss to the Group beyond the provisions already recorded.

Fair values. The fair value of financial instruments is determined with reference to various market information and other valuation methods as considered appropriate. At 31 December 2005, the fair values, where determinable, of financial instruments held by the Group did not materially differ from their carrying values.

19 CONTINGENCIES AND COMMITMENTS

Operating environment. The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

While there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

Guarantees and pledges. At 31 December 2004, the Group had pledged 32.2 percent of its share in Tarkosaleneftegas and 31 percent of its participation interest in Yurkharovneftegas as collateral for long-term borrowings. During 2005, the respective loans were repaid and the associated pledges were released (see Note 10).

At 31 December 2005 and 2004, the Group had pledged property, plant and equipment of nil and approximately RR 7,839 million, respectively.

Taxation. Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2005, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

Environmental liabilities. The Group and its predecessor entities have operated in the oil and gas industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations and, as obligations are determined, they are recognized immediately, if no current or future benefit is discernible. Potential liabilities which might arise as a result of stricter enforcement of existing regulations, civil litigation or changes in legislation, cannot be estimated. Under existing legislation, management believes that there are no probable liabilities which will have a material adverse effect on the Group’s financial position, consolidated statements of income or of cash flows.

Legal contingencies. During the year, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

Oilfield licenses. The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licenses. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitation, suspension or revocation. The Group’s management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the Group’s financial position, consolidated statements of income or of cash flows.

19 CONTINGENCIES AND COMMITMENTS (CONTINUED)

The Group's oil and gas fields are situated on land belonging to the Regional Administration of Yamal-Nenets. Licenses are issued by the Ministry of Natural Resources and the Group pays unified natural resources production tax to explore and produce oil and gas from these fields. The principal licenses of the Group, including its subsidiaries, and their expiry dates are:

Field	License holder	License expiry date
Yurkharovskoye	Yurkharovneftegas	2034
Khancheyskoye	Tarkosaleneftegas	2019
East-Tarkosalinskoye	Tarkosaleneftegas	2018
Sterkhovoye	Purneftegasgeologiya	2026
Termokarstovoye	Terneftegas	2021

The licenses expire between 2018 and 2034. Management believes the Group has the right to extend its licenses beyond the initial expiration date under the existing legislation and intends to exercise this right. In February 2005, the Group was successful in extending the license for the Yurkharovskoye field from 2020 to 2034. The Group plans to extend the terms of the licenses for its two other core fields, East-Tarkosalinskoye and Khancheyskoye.

Commitments. The Group had entered into commitments aggregating approximately RR 1,010 million to complete the facilities and begin phase two of construction of the Purovsky Gas Condensate Plant in 2006.

20 RELATED PARTY TRANSACTIONS

In 2005 and 2004, the Group had significant activities with companies related to its shareholders in connection with purchases and sales of natural gas, crude oil and gas condensate, construction and other related services, and purchases and sales of equity securities. The Group's reported statements of income, balance sheets and cash flows would be different had such transactions been carried out amongst unrelated parties. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be affected on the same terms, conditions and amounts as transactions between unrelated parties.

The Group had transactions with the following related parties during 2005 and 2004:

Name of related party	Nature of transactions
Shareholders	
Levit	Provision of loans, transactions in shares of Group companies (see Notes 1, 4, 5, 22)
SWGI Growth Fund (Cyprus) Limited	Transactions in shares of Group companies (see Notes 4, 22)
Yamal Regional Fund of Development (through June 2005)	Receipt of loans, transactions in shares of Group companies (see Note 10)
TNG Energy (*)	Crude oil and gas condensate sales, transactions in shares of Group companies. TNG Energy was a shareholder of the Group from December 2004 through January 2005
Associates	
Khancheyneftegas (through December 2004)	Purchases of natural gas and gas condensate, provision of construction services, provision of loans and guarantees
Tarkosaleneftegas (through December 2004)	Purchases of natural gas and gas condensate, provision of construction and well services, provision of loans and guarantees, settlement of receivables and loan payables
Geoilbent (through June 2005)	Purchases of crude oil

20 RELATED PARTY TRANSACTIONS (CONTINUED)

Name of related party	Nature of transactions
Subject to control by significant shareholders	
Kerden Trading Limited (**)	Sales of crude oil and oil products
OOO Novafininvest (from July 2004)	Provision of construction services (see Note 22)
OAO SNP NOVA (from July 2004)	Provision of construction services (see Note 22)
OOO NOVA Energy Services (from July 2004)	Provision of construction services (see Note 22)
OAO Pur-Land (*) (through January 2005)	Receipt of loans

(*) Beginning December 2004, TNG Energy and OAO Pur-Land were subsidiaries of the significant shareholders. From December 2003 to the beginning of December 2004, TNG Energy and OAO Pur-Land were associate investments of the significant shareholders.

(**) Beginning January 2006, the Group commenced export sales through its newly established foreign subsidiaries (see Note 1).

Purchases and sales of crude oil:

	Year ended 31 December:			
	2005		2004	
Name of related party	Sales volumes (thousands of tons)	Russian roubles (millions)	Sales volumes (thousands of tons)	Russian roubles (millions)
Sales to Kerden Trading Limited	97	622	389	1,772
Sales to TNG Energy	86	492	73	395
Purchases from Tarkosaleneftegas	-	-	348	557
Purchases from Khancheyneftegas	-	-	520	832
Purchases from Geoilbent (until June 2005)	219	562	358	920

Purchases of natural gas:

	Year ended 31 December:			
	2005		2004	
Name of related party	Sales volumes (millions of m^3)	Russian roubles (millions)	Sales volumes (millions of m^3)	Russian roubles (millions)
Purchases from Tarkosaleneftegas	-	-	5,738	1,727
Purchases from Khancheyneftegas	-	-	2,297	958

Sales of stable gas condensate and liquefied petroleum gas:

During 2005, the Group sold 760 thousand tons of stable gas condensate and 28 thousand tons of liquefied petroleum gas to Kerden Trading Limited for RR 6,342 million and RR 271 million, respectively. Beginning January 2006, the Group commenced export sales through its newly established foreign subsidiaries (see Note 1).

20 RELATED PARTY TRANSACTIONS (CONTINUED)

Other balances and transactions with related parties:

	As at and for the year ended 31 December:	
	2005	**2004**
Balances		
Prepayments and advances (for construction)	95	235
Other non-current assets	57	70
Long-term loans receivable	102	7,694
Prepayments and advances	15	30
Trade and other receivables	1,628	606
Interest receivable	29	42
Short-term loans receivable	165	251
Cash and cash equivalents	179	-
Long-term debt	-	640
Short-term debt and current portion of long-term debt	-	1,281
Trade and other payables	49	147
Transactions		
Sales of inventory and oil products	40	151
Interest expense	64	85
Interest income	467	425
Construction services sales	-	209
Purchases of construction services	791	486
Other (Notes 4, 22)		

Long-term loans receivable. At 31 December 2004, long-term loans receivable included a US dollar denominated loan to Levit, a Group shareholder, in the amount of USD 270 million (RR 7,492 million). The loan was unsecured, bore annual interest rate of 10 percent and was fully repaid in July 2005 ahead of its maturity schedule.

Key management compensation. During 2005 and 2004, the Group paid to the members of the Board of Directors and the Management Board, some of whom have also direct and indirect interests in the Group, the total of RR 153 million and RR 100 million, respectively, in compensation and directors' fees, excluding dividends. In addition, during 2005, RR 108 million were accrued as part of the share-based compensation scheme and included in general and administrative expense.

21 SEGMENT INFORMATION

The Group operates principally in the oil and gas industry in the Russian Federation. The Group evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Group as a whole. However, the Group's activities are considered by management to comprise the following business segments:

- Exploration and production – acquisitions, exploration, production, processing, marketing and transportation of oil and gas;
- Oil and gas construction services – drilling and construction of oil and gas infrastructure and facilities (discontinued in June 2004);
- Other – other activities, including head office services, polymer and tape insulation, banking and telecommunications.

21 SEGMENT INFORMATION (CONTINUED)

Segment information as at 31 December 2005 and 2004 was as follows:

At 31 December 2005	Exploration and production	Other	Total
Segment assets	72,246	2,505	74,751
Unallocated assets			4,011
Total assets	**72,246**	**2,505**	**78,762**
Segment liabilities	(3,470)	(142)	(3,612)
Unallocated liabilities			(17,601)
Total liabilities	**(3,470)**	**(142)**	**(21,213)**

At 31 December 2004	Exploration and production	Other	Total
Segment assets	68,154	856	69,010
Associated companies	1,945	-	1,945
Unallocated assets			11,729
Total assets	**70,099**	**856**	**82,684**
Segment liabilities	(3,531)	(65)	(3,596)
Unallocated liabilities			(34,016)
Total liabilities	**(3,531)**	**(65)**	**(37,612)**

Segment information for the years ended 31 December 2005 and 2004 was as follows:

Year ended 31 December 2005	Exploration and production	Other	Total
Segment revenues			
External revenues and other income	37,442	1,114	38,556
Inter-segment sales	8	3	11
Total segment revenues	**37,450**	**1,117**	**38,567**
Segment expenses			
External expenses	(19,525)	(918)	(20,443)
Inter-segment expenses	(3)	(8)	(11)
Total segment expenses	**(19,528)**	**(926)**	**(20,454)**
Segment result	**17,922**	**191**	**18,113**
Unallocated gains on sales of investments			3,631
Unallocated operating expenses			(2,418)
Profit from operations			**19,326**
Export revenues	7,732	30	7,762
Income of associated companies, net	143	-	143
Capital expenditures	5,183	1,277	6,460
Depreciation, depletion and amortization	(3,358)	(14)	(3,372)
Charges for impairment	(52)	(35)	(87)

21 SEGMENT INFORMATION (CONTINUED)

Year ended 31 December 2004	Oil and gas construction services	Exploration and production	Other	Total
Segment revenues				
External revenues and other income	2,005	21,250	1,274	24,529
Inter-segment sales	915	12	8	935
Total segment revenues	**2,920**	**21,262**	**1,282**	**25,464**
Segment expenses				
External expenses	(2,773)	(12,736)	(743)	(16,252)
Inter-segment expenses	(16)	-	-	(16)
Total segment expenses	**(2,789)**	**(12,736)**	**(743)**	**(16,268)**
Segment result	**131**	**8,526**	**539**	**9,196**
Unallocated gains on sales of investments				198
Unallocated operating expenses				(1,773)
Unrealized margin in segment assets				(7)
Profit from operations				**7,614**
Export revenues	-	2,480	119	2,599
Income of associated companies, net	-	764	-	764
Acquisitions	-	47,450	-	47,450
Capital expenditures	-	7,212	200	7,412
Depreciation, depletion and amortization	(79)	(594)	(26)	(699)
Charges for impairment	1	184	(67)	118

All of the Group's operating assets are located in the Russian Federation.

At 31 December 2004, external expenses of the oil and gas construction services segment included RR 912 million of costs capitalized by exploration and production segment.

Segment assets consist primarily of property, plant and equipment and current assets. Unallocated assets include other investments and deferred tax assets. Segment liabilities comprise operating liabilities, excluding items such as taxes payable, borrowings and deferred tax liabilities.

Capital expenditures include purchases of property, plant, and equipment, and acquisitions of subsidiaries and associates. Charges for impairment above include impairment provisions for accounts and loans receivable, assets under construction, inventory, and other long-term assets.

The inter-segment revenues mainly consist of:

- Oil and gas construction services – rendering drilling and construction services to the exploration and production segment, for which prices are determined on a cost plus basis; and
- Other – provision of telecommunication and banking services to the other segments, for which prices are based on market prices.

Included within unallocated operating expenses are corporate expenses, including provision for the impairment of other investments.

The Group's segment revenues are generated from sales on domestic and international markets.

22 DISCONTINUED OPERATIONS

In June 2004, NOVATEK's board of directors approved the sale of substantially all of the Group's oil and gas construction services business. The disposal is consistent with the Group's long-term strategy to focus its activities on oil and gas exploration, production, processing and marketing of hydrocarbons, and to divest non-core activities.

The Group's oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation. Contracts were typically signed with customers that allowed for the determination of agreed construction schedules, estimated costs, including a margin over the cost of materials and supplies, customer approval of deliverables, and invoicing.

In June 2004, the Group sold its 99 percent participation interest investment in the share capital of OOO Novafininvest ("Novafininvest") to shareholders of the Group: SWGI Growth Fund (Cyprus) Limited (40.9 percent), a Group shareholder, Levit (53.6 percent), a Group shareholder, and OOO Kopitek (4.5 percent), for total cash consideration of RR 240 million, recognizing a loss of RR 296 million.

During 2004, Novafininvest acted as general contractor for the construction of the Khancheyskoye and Yurkharovskoye fields. As of the date of disposal, Novafininvest also held interests in certain companies, including OAO SNP NOVA, which was the primary provider of construction services to the Group. Such activities represent substantially all of the activities of the oil and gas construction services segment of the Group. The Group expects to continue existing contractual relationships, and may enter into additional contracts, with Novafininvest and its subsidiaries in the future at market terms and conditions.

The table below summarizes the effect of the discontinued operations on the Group's results of operations and of cash flows for the year ended 31 December 2004.

Total revenues and other income	2,186
Total operating expenses	(2,194)
Loss before income tax	(8)
Income tax expense	(31)
Loss after tax	(39)
Loss on disposal, net of tax of nil	(296)
Loss for discontinued operations	(335)
Net cash provided by operating activities	29
Net cash used in investing activities	(701)
Net cash provided by financing activities	1,078
Basic and diluted earnings per share from continuing operations (in Russian roubles)	2,658
Basic and diluted loss per share for discontinued operations (in Russian roubles)	(148)
Basic and diluted earnings per share (in Russian roubles)	2,510
Weighted average shares outstanding	*2,268,654*

As of the date of disposal, total assets and total liabilities of the disposed operations were RR 2,569 million and RR 1,419 million, respectively.

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS"), and Interpretations issued by the International Accounting Standards Board ("IASB") and the International Accounting Standards Board's International Financial Reporting Interpretations Committee ("IFRIC"). In the absence of specific IFRS guidance which establishes a comprehensive set of disclosures for oil and gas producing companies, the Group has reverted to other relevant disclosure standards that are consistent with norms established for the oil and gas industry. While not required under IFRS, this section provides unaudited supplemental information on oil and gas exploration and production activities but excludes disclosures regarding the standardized measures of oil and gas activities.

The Group's exploration and production activities are exclusively within the Russian Federation; therefore, all of the information provided in this section pertains to this country. The Group operates through various oil and gas production subsidiaries. The Group also owned interest in oil and gas producing entities, referred to as Associates that were accounted for under the equity method.

Oil and Gas Exploration and Development Costs

The following tables set forth information regarding oil and gas acquisition, exploration and development activities. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the years ended 31 December 2005 and 2004 (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2005	2004
Costs incurred in property acquisition, exploration and development activities		
Acquisition costs	-	47,019
Exploration costs	348	183
Development costs	5,086	6,391
Total costs incurred in property acquisition, exploration and development activities	**5,434**	**53,593**

	At 31 December:	
	2005	2004
Capitalized costs relating to oil and gas producing activities		
Wells and related equipment and facilities	55,371	47,494
Support equipment and facilities	6,328	5,740
Uncompleted wells, equipment and facilities	3,940	8,331
Total capitalized costs relating to oil and gas producing activities	65,639	61,565
Accumulated depreciation, depletion and amortization	(4,065)	(806)
Net capitalized costs relating to oil and gas producing activities	**61,574**	**60,759**

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

Results of Operations for Oil and Gas Producing Activities

The Group's results of operations for oil and gas producing activities are shown below. The results of operations for oil and gas producing activities do not include general corporate overhead or its associated tax effects. Income tax is based on statutory rates (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2005	2004
Revenues from oil and gas sales	37,246	21,018
Production costs	(2,342)	(1,103)
Long-term supply purchases	(2,065)	(5,632)
Transportation expenses	(6,291)	(3,368)
Taxes other than income tax	(4,336)	(1,393)
Depreciation, depletion and amortization	(3,255)	(584)
Exploration expenses	(348)	(183)
Results of operations for oil and gas producing activities before income tax	18,609	8,755
Related income tax expense	(4,466)	(2,101)
Results of operations for oil and gas producing activities	**14,143**	**6,654**
Share in associates' results of operations for oil and gas producing activities	**143**	**845**

Proved Oil and Gas Reserves

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

The oil and gas reserve estimates reported below are determined by the Group's independent petroleum reservoir engineers, DeGolyer and MacNaughton ("D&M"), for the Group's primary fields – Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye, Sterkhovoye, and Termokarstovoye – as well as other oil and gas producing fields, North Gubkinskoye and South Tarasovskoye, that were appraised by independent consulting firm, Ryder Scott Co. LP as of 31 December 2004. The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for the reserve determination. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of this process, senior management reviews and approves the final reserve estimates issued by D&M.

The following reserve estimates were prepared using standard geological and engineering methods generally accepted by the petroleum industry. 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.

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2005 and 2004.

Extensions of production licenses are assumed to be at the discretion of the Group. Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. The Group's licenses expire between 2018 and 2034, with the most significant license, Yurkharovskoye field, expiring in 2034. Management believes that there is requisite legislation to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the license expiry dates. In February 2005, the Group successfully extended its license on Yurkharovskoye field from 2020 through 2034, which year represents the expected end of the economic life of the field. The cost of license extension was not material. The Group plans to extend the terms of the licenses for its two other core fields, East-Tarkosalinskoye and Khancheyskoye.

The Group has disclosed information on proved oil and gas reserve quantities for periods up to and past the license expiry dates separately.

Proved reserves are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

Proved developed reserves are those reserves which are expected to be recovered through existing wells with existing equipment and operating methods. Undeveloped reserves are those reserves which are expected to be recovered as a result of future investments to drill new wells, to re-complete existing wells and/or install facilities to collect and deliver the production.

"Net" reserves exclude quantities due to others when produced.

The below reserve quantities include 100 percent of the net proved reserve quantities attributable to the Company's consolidated subsidiaries. A portion of the Group's total proved reserves are classified as either developed non-producing or undeveloped. Of the non-producing reserves, a portion represents existing wells which are to be returned to production at a future date.

Additions represent two more fields, Sterkhovoye and Termokarstovoye, appraised by D&M in 2005. For convenience, volumes are provided both in English and metric units.

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

Net proved reserves of natural gas are presented below.

	Net proved reserves of natural gas recoverable up to license expiry dates		Net proved reserves of natural gas recoverable past license expiry dates		Total net proved reserves of natural gas	
	Billions of cubic feet	*Billions of cubic meters*	*Billions of cubic feet*	*Billions of cubic meters*	*Billions of cubic feet*	*Billions of cubic meters*
Reserves at 31 December 2003	**7,356**	**208**	**-**	**-**	**7,356**	**208**
Changes attributable to:						
Revisions of previous estimates	1,178	34	-	-	1,178	34
Acquisitions	8,614	244	3,787	107	12,401	351
Production	(343)	(10)	-	-	(343)	(10)
Reserves at 31 December 2004	**16,805**	**476**	**3,787**	**107**	**20,592**	**583**
Changes attributable to:						
Revisions of previous estimates	2,418	69	(315)	(9)	2,103	60
Additions	609	17	213	6	822	23
Production	(883)	(25)	-	-	(883)	(25)
Reserves at 31 December 2005	**18,949**	**537**	**3,685**	**104**	**22,634**	**641**
Net proved developed (included above)						
At 31 December 2003	736	21	-	-	736	21
At 31 December 2004	11,016	312	2,728	77	13,744	389
At 31 December 2005	10,513	298	2,925	83	13,438	381

The Group's interests in proved developed and undeveloped reserves of associates were not included in the table above and were as follows:

	Net proved reserves of natural gas recoverable up to license expiry dates		Net proved reserves of natural gas recoverable past license expiry dates		Total net proved reserves of natural gas	
	Billions of cubic feet	*Billions of cubic meters*	*Billions of cubic feet*	*Billions of cubic meters*	*Billions of cubic feet*	*Billions of cubic meters*
At 31 December 2003	3,498	99	849	24	4,347	123
At 31 December 2004	-	-	-	-	-	-
At 31 December 2005	-	-	-	-	-	-

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

	Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable up to license expiry dates		Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable past license expiry dates		Total net proved reserves of crude oil, gas condensate and natural gas liquids	
	Millions of barrels	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*
Reserves at 31 December 2003	**106**	**12**	**-**	**-**	**106**	**12**
Changes attributable to:						
Revisions of previous estimates	(8)	(1)	1	1	(7)	-
Acquisitions	151	19	52	6	203	25
Production	(7)	(1)	-	-	(7)	(1)
Reserves at 31 December 2004	**242**	**29**	**53**	**7**	**295**	**36**
Changes attributable to:						
Revisions of previous estimates	46	5	(11)	(1)	35	4
Additions	54	7	14	1	68	8
Production	(17)	(2)	-	-	(17)	(2)
Reserves at 31 December 2005	**325**	**39**	**56**	**7**	**381**	**46**
Net proved developed (included above)						
At 31 December 2003	14	2	-	-	14	2
At 31 December 2004	130	15	8	1	138	16
At 31 December 2005	123	15	10	1	133	16

The Group's interests in proved developed and undeveloped reserves of associates were not included in the table above and were as follows:

	Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable up to license expiry dates		Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable past license expiry dates		Total net proved reserves of crude oil, gas condensate and natural gas liquids	
	Millions of barrels	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*
At 31 December 2003	113	14	16	2	129	16
At 31 December 2004	51	6	2	-	53	6
At 31 December 2005	-	-	-	-	-	-

CONTACT INFORMATION

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INVESTOR INFORMATION

Registrar	The National Registry Company 6 Veresaeva Street, Moscow, Russia 121357 Tel: +7 495 440-6324/25/44 Fax: +7 495 440-6355 E-mail: info@nrcreg.ru
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Independent Auditor	ZAO PricewaterhouseCoopers Audit 52, Kosmodomianskaya Embankment, Bld. 5, Moscow, 115054, Russia Tel: +7 495 967-6000
Independent Qualified Reserve Evaluator	DeGolyer and MacNaughton 5001 Spring Valley Road, Suite 800 East Dallas, Texas 75244, USA Tel: +1 214 368-6391 Fax: +1 214 369-4061 E-mail: degolyer@demac.com

NOVATEK's website contains a variety of corporate and investor information including, among other information, the following:

- Main business and production results
- News releases
- Current stock price
- Annual and Interim Reports
- Regulatory filings
- Investor presentation
- Social and environmental activities

Website:www.novatek.ru (Russian version) and www.novatek.ru/eng (English version)

Mentions in this Annual Review of 'OAO NOVATEK', 'NOVATEK', 'the company', 'we' and 'our' refer to OAO NOVATEK and/or its subsidiary enterprises, depending upon the context, in which the terms are used.

ABBREVIATIONS

barrel	one stock tank barrel, or 42 US gallons of liquid volume
bcm	billion cubic meters
boe[1]	barrels of oil equivalent
km	kilometer(s)
mbbls	thousand barrels
mboe	thousand boe
mcm	thousand cubic meters
mmbbls	million barrels
mmboe	million boe
mmcf	million cubic feet
mmcm	million cubic meters
mmt	million metric ton
mt/m tons	thousand metric ton
tcf	trillion cubic feet
tcm	trillion cubic meters
tonne	metric ton
SEC	United States Securities and Exchange Commission
SPE	Society of Petroleum Engineers

(1) For natural gas, we use the conversion factor of one mcm equals 6.54 barrels. Liquid tons are converted to boe according to the coefficients found in our reserve appraisal report that is in a range of 7.3 to 8.87 boe per one ton due to the differing quality of the hydrocarbons at the fields, including differences in calorific content

FORWARD–LOOKING STATEMENTS

This Annual Review includes 'forward-looking information' within the meaning of Section 27A of the US Securities Act of 1933, as amended, and Section 21E of the US Securities Exchange Act of 1934, as amended. Certain statements included in this Annual Report and Accounts, including without limitation statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "project," "will," "may," "should" and similar expressions identify forward-looking statements. Forward-looking statements include statements regarding: strategies, outlook and growth prospects; future plans and potential for future growth; liquidity, capital resources and capital expenditures; growth in demand for our products; economic outlook and industry trends; developments of our markets; the impact of regulatory initiatives; and the strength of our competitors.

The forward-looking statements in this Annual Review are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control and we may not achieve or accomplish these expectations, beliefs or projections. In addition, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include:

- changes in the balance of oil and gas supply and demand in Russia and Europe;
- the effects of domestic and international oil and gas price volatility and changes in regulatory conditions, including prices and taxes;
- the effects of competition in the domestic and export oil and gas markets;
- our ability to successfully implement any of our business strategies;
- the impact of our expansion on our revenue potential, cost basis and margins;
- our ability to produce target volumes in the face of restrictions on our access to transportation infrastructure;
- the effects of changes to our capital expenditure projections on the growth of our production;
- inherent uncertainties in interpreting geophysical data;
- commercial negotiations regarding oil and gas sales contracts;
- changes to project schedules and estimated completion dates;
- potentially lower production levels in the future than currently estimated by our management and/or independent petroleum reservoir engineers;
- our ability to service our existing indebtedness;
- our ability to fund our future operations and capital needs through borrowing or otherwise;
- our success in identifying and managing risks to our businesses;
- our ability to obtain necessary regulatory approvals for our businesses;
- the effects of changes to the Russian legal framework concerning currently held and any newly acquired oil and gas production licenses;
- changes in political, social, legal or economic conditions in Russia and the CIS;
- the effects of, and changes in, the policies of the government of the Russian Federation, including the President and his administration, the Prime Minister, the Cabinet and the Prosecutor General and his office;
- the effects of international political events;
- the effects of technological changes;
- the effects of changes in accounting standards or practices; and
- inflation, interest rate and exchange rate fluctuations.

This list of important factors is not exhaustive. When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made. Accordingly, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

The information and opinions contained in this document are provided as at the date of this presentation and are subject to change without notice.