

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 30 June 2010 and 2009 together with our unaudited consolidated interim condensed financial information as of and for the three months ended 30 June 2010. The unaudited consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*. This consolidated interim condensed financial information should be read together with the audited consolidated financial statements for the year ended 31 December 2009 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom. In terms of proved natural gas reserves, we are the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System (PRMS) reserve reporting methodology.

Our exploration, development, production and processing of natural gas, gas condensate, crude oil and related oil products have been conducted primarily within the Russian Federation, and we sell our natural gas volumes exclusively in the Russian domestic market. We export our stable gas condensate directly to international markets while our liquefied petroleum gas (LPG) and crude oil are generally delivered to both international (including CIS) and domestic markets. We generally sell oil products produced from our unstable gas condensate on the domestic market.

In 2009, we geographically expanded our sales of stable gas condensate through deliveries to the Asian-Pacific region. The diversification of our stable gas condensate sales provides us with revenue stability, access to new markets and opportunities for higher margins. The ability to market our stable gas condensate to various geographical regions becomes more crucial as we continue to expand the production of wet gas at our fields and increase unstable gas condensate volumes processed at the Purovsky Gas Condensate Processing Plant (Purovsky Plant).

In November 2009, we established a wholly-owned subsidiary in Poland named "Novatek Polska Sp.z.o.o." (Novatek Polska) to expand our LPG trading activities within this country. Novatek Polska commenced commercial operations in January 2010.

In May 2010, we established a wholly-owned subsidiary, OOO "NOVATEK Perm", to support the Group's current natural gas deliveries to the Perm region, as well as to expand potential sales opportunities in the region.

On 1 July 2010, the Group acquired 100 percent of the outstanding ordinary shares of OAO "Tambeyneftegas", an oil and gas company in the early stages of geological exploration for total purchase consideration of USD 10 million. The company holds the license for exploration and development of the Malo-Yamalskoye field (license expiry date 2019) located in the southern part of the Yamal peninsula, in the Yamal-Nenets Autonomous Region (YNAO), with estimated natural gas and gas condensate reserves according to Russian reserve classification categories C1 + C2 of 161 bcm and 14.4 mt, respectively.

On 26 July 2010, we announced the creation of a joint venture, OOO "Yamal Development", with OAO "Gazprom Neft" to jointly develop potential hydrocarbon assets in the YNAO, with each entity holding a 50% equity participation interest in OOO "Yamal Development". The combined experience of the two companies will enable the joint venture to optimize the development of complex multi-layered fields containing natural gas, gas condensate and crude oil in the YNAO and to ensure the rational management of the Region's resources.

On 12 August 2010, we launched the unstable gas condensate de-ethanization facility at our Yurkharovskoye field and commenced the unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant. With the launching of the facility and pipeline, we are now able to process and transport all unstable gas condensate produced at the Yurkharovskoye field to the Purovsky Plant without utilizing third party facilities.

SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Three months ended 30 June:		Change %
	2010	2009	
Financial results			
Total revenues (net of VAT and export duties)	25,706	23,148	11.1%
Operating expenses	(15,717)	(15,038)	4.5%
Profit attributable to NOVATEK shareholders	7,139	7,178	(0.5%)
EBITDA ⁽¹⁾	11,690	9,334	25.2%
EBITDAX ⁽²⁾	12,025	9,565	25.7%
Earnings per share (in Russian roubles)	2.35	2.37	(0.5%)
Operating results			
Natural gas sales volumes (mmcm)	7,909	7,704	2.7%
Stable gas condensate sales volumes (thousand tons)	539	658	(18.1%)
Liquefied petroleum gas sales volumes (thousand tons)	231	188	22.9%
Crude oil sales volumes (thousand tons)	48	45	6.7%
Oil product sales volumes (thousand tons)	3	3	0.0%
Cash flow results			
Net cash provided by operating activities	6,340	8,448	(25.0%)
Capital expenditures	6,052	4,794	26.2%
Free cash flow ⁽³⁾	288	3,654	(92.1%)

⁽¹⁾ EBITDA represents net income before finance income (expense) and income taxes from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

⁽²⁾ EBITDAX represents EBITDA as defined above excluding exploration expenses.

⁽³⁾ Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate of Russian rouble to US dollar</i>	Three months ended 30 June:		Change
	2010	2009	%
At the beginning of the period	29.36	34.01	(13.7%)
At the end of the period	31.20	31.29	(0.3%)
Average for the period	30.24	32.21	(6.1%)

<i>Crude oil prices, USD / bbl</i>	Three months ended 30 June:		Change
	2010	2009	%
WTI ⁽¹⁾			
At the end of the period	75.6	69.9	8.2%
Average for the period	78.1	59.8	30.6%
Brent ⁽²⁾			
At the end of the period	75.0	68.1	10.1%
Average for the period	78.2	59.1	32.3%
Urals ⁽²⁾			
At the end of the period	74.3	68.0	9.3%
Average for the period	76.9	58.5	31.5%

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

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

<i>Export duties, USD / ton ⁽¹⁾</i>	Three months ended 30 June:		Change
	2010	2009	%
Crude oil, stable gas condensate			
At the end of the period	292.1	152.8	91.2%
Average for the period	281.7	133.5	111.0%
LPG			
At the end of the period	27.3	0.0	n/a
Average for the period	48.4	0.0	n/a

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

The adverse financial situation in Greece and several European countries and the risk of contagion to other regional economies has resulted in a tight funding market and a potential prolongation of the economic downturn in the EURO zone during the period. As a result, this situation may continue to negatively affect all borrowers by limiting access to capital markets, despite signs of the financial markets willingness to price recent transactions. Even though expectations of a prolonged economic downturn have somewhat receded, the events in Greece and the fears of contagion in other economies has resulted in the possibility of a continuing period of tight credit market conditions and increasing margin spreads, although there is a willingness in the capital markets to continue considering quality grade issuers to access funds as recent placements have demonstrated. Furthermore, there is a heightened awareness over excess borrowings, potential liquidity problems and the ability of a company's balance sheet to withstand a period of prolonged market turbulence.

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

We have reviewed our capital expenditure program for the remainder of 2010 and have concluded that we have sufficient liquidity, through current internal cash flows and short-term borrowing facilities, to adequately fund our core natural gas business operations and planned capital expenditure program. As a result of this assessment, we have not made any major adjustments to our capital expenditure program as of the 30 June 2010.

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

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian government's regulation of natural gas prices. 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 on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency, and present market conditions. In the three months ended 30 June 2010, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 530 per mcm, or 30.2%, to RR 2,285 per mcm compared to RR 1,755 per mcm in the corresponding 2009 period.

The specific terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses. Historically, we have realized higher prices and net margins for natural gas volumes sold directly to end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. However, the recent shift in our sales mix has demonstrated that the historical norm may or may not prevail in the present or future market situations.

In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011. As part of the liberalization plan, the FTS approved four quarterly increases in the regulated price for natural gas in 2009, rising by 5% in the first quarter, 7% in the second quarter, 7% in the third quarter and 6.2% in the fourth quarter. Moreover, in December 2009, the FTS approved an increase in the regulated price for natural gas by 15% compared to the fourth quarter 2009 regulated prices effective from 1 January 2010. We expect further increases in the regulated price for natural gas as part of the Russian Federation government's efforts to liberalize the price of natural gas on the Russian domestic market. The FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published as well as potentially prolong the timetable toward market price liberalization based on market conditions and other factors.

In the three months ended 30 June 2010, our natural gas sales volumes to end-customers (excluding traders in remote points) increased by 72.7% (see “Natural gas sales volumes” below) due to the commencement of deliveries to new end-customers located in remote regions. These new deliveries together with the growth of natural gas transportation tariffs, also set by FTS, resulted in a 34.2% increase in our average natural gas transportation expense. Our average natural gas price to end-customers (excluding traders in remote points) and ex-field price increased by 18.5% and 19.1%, respectively, whereas our average natural gas netback price on end-customer sales increased by 7.1%, compared to the respective prices in the corresponding period in 2009. Our pricing strategy for natural gas is consistent with our commercial marketing strategy to enter new and more remote regions to maintain and grow our share of natural gas deliveries to the domestic market, as well as maintaining our production growth.

As a result of the factors discussed above, as well as the suspension of natural gas sales to traders in remote points effective the 1 January 2010, our average netback price on end-customers sales (including traders in remote points) increased by 32.7%, while our total average natural gas price excluding transportation expense increased by 29.1% compared to respective prices in the 2009 period.

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 30 June 2010 and 2009:

<i>Russian roubles per mcm</i>	Three months ended 30 June:		Change %
	2010	2009	
Average natural gas price ⁽¹⁾:			
<i>End-customers</i>	2,289	1,932	18.5%
<i>Traders in remote points</i>	-	1,836	n/a
Average natural gas price to end-customers	2,289	1,886	21.4%
Average natural gas transportation expense:			
<i>End-customers</i>	(1,091)	(813)	34.2%
<i>Traders in remote points</i>	-	(1,169)	n/a
Average natural gas transportation expense for sales to end-customers	(1,091)	(983)	11.0%
Average natural gas netback price:			
<i>End-customers</i>	1,198	1,119	7.1%
<i>Traders in remote points</i>	-	667	n/a
Average natural gas netback price on end-customer sales	1,198	903	32.7%
Average natural gas price ex-field (wholesale traders)	1,223	1,027	19.1%
Total average natural gas price excluding transportation expense	1,206	934	29.1%

⁽¹⁾ Includes cost of transportation.

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

Crude oil, stable gas condensate, liquefied petroleum gas (“LPG”) and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, the ability and willingness of oil producing countries to sustain or change production levels to meet changes in global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters. Crude oil, stable gas condensate, LPG and oil products prices on the domestic market also fluctuate depending on supply and demand fundamentals amongst other factors. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as “Urals blend”, which normally (or historically) trades at a discount to the international benchmark Brent crude oil. The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management.

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our liquid volumes sold on both the domestic and international markets, amongst many other factors. In the three months ended 30 June 2010, the average benchmark crude oil prices were more than 30% higher than in the corresponding period in 2009.

Our stable gas condensate, LPG (excluding obligatory domestic deliveries at regulated prices), crude oil and oil products prices on both international and domestic markets include transportation expense in accordance with the specific terms of delivery.

In the three months ended 30 June 2010, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost, insurance and freight (CIF), while in the corresponding period in 2009 our delivery terms were either DES or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in the three months ended 30 June 2010 was approximately USD 678 per ton compared to approximately USD 483 per ton in the corresponding period in 2009.

In the three months ended 30 June 2010, as well as in the corresponding period in 2009, our crude oil export delivery terms were delivery at frontier (DAF Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 546 per ton compared to USD 423 per ton in the 2009 period.

The following table shows our average realized stable gas condensate and crude oil sales prices (net of VAT and export duties, where applicable) for the three months ended 30 June 2010 and 2009 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Three months ended 30 June:		Change
	2010	2009	%
Stable gas condensate			
Net export price, RR per ton	11,936	11,441	4.3%
Net export price, USD per ton	394.7	355.2	11.1%
Domestic price, RR per ton	9,915	8,217	20.7%
Crude oil			
Net export price, RR per ton	7,719	8,989	(14.1%)
Net export price, USD per ton	255.2	279.0	(8.5%)
Domestic price, RR per ton	7,262	6,503	11.7%

Our LPG export delivery terms during the three months ended 30 June 2010, were delivery at frontier (DAF) at the border of the customer’s country, carriage paid to (CPT) the Port of Temryuk, southern Russia, or at the border of the customer’s country, and priced free carrier (FCA) at the terminal points in Poland, compared to DAF and CPT in the corresponding period in 2009. In the three months ended 30 June 2010, our average export LPG contract price, including export duties, was approximately USD 583 per ton compared to USD 322 per ton in the corresponding period in 2009. In the three months ended 30 June 2010, we had no sales of LPG to CIS markets. In the three months ended 30 June 2009, our LPG CIS delivery terms were DAF at the border of the customer’s country.

We were obliged to sell a portion of our LPG sales volumes on the domestic market at regulated prices and in the three months ended 30 June 2010 we sold a total of 14 thousand tons at the regulated price of RR 6,613 per ton. In the 2009 period, we were not obliged to sell LPG volumes at regulated prices. In the three months ended 30 June 2010, we sold 92 thousand tons at an average commercial price of RR 10,648 per ton compared to 80 thousand tons at an average commercial price of RR 6,660 per ton in the corresponding period in 2009. In addition, in the 2010 period, we sold 10 thousand tons of LPG produced at the Purovsky Plant through our wholly-owned subsidiary OOO “NOVATEK-Refuelling Complexes” at an average price of RR 11,654 per ton.

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

In the three months ended 30 June 2010, our wholly-owned subsidiary, OOO “NOVATEK-Refuelling Complexes” purchased 1,106 tons of diesel fuel and petrol from third parties and subsequently resold 1,073 tons through its retail stations for approximately RR 22,959 per ton compared to sales of 252 tons for approximately RR 20,095 per ton in the corresponding period in 2009. In addition, in the three months ended 30 June 2009, we sold 405 tons of liquefied petroleum gas, previously purchased for resale, for approximately RR 12,505 per ton.

The following table shows our average realized liquefied petroleum gas and oil products sales prices excluding trading activities with oil products (net of VAT and export duties, where applicable) for the three months ended 30 June 2010 and 2009 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Three months ended 30 June:		Change %
	2010	2009	
LPG			
Net export price, RR per ton	15,905	10,293	54.5%
Net export price, USD per ton	525.9	319.5	64.6%
CIS price, RR per ton	-	8,644	n/a
Domestic price, RR per ton	10,119	6,660	51.9%
Domestic price (retail and small wholesale stations), RR per ton	11,654	-	n/a
Oil products			
Domestic price, RR per ton	6,893	3,849	79.1%

Transportation tariffs

The methodology of calculating transportation tariffs for natural gas produced in the Russian Federation for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan) consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 kilometers (km). The rate for utilization of the trunk pipeline is based on an “input/output” function, which is determined by where natural gas enters and exits the trunk pipeline and includes a constant rate for end-customers using Gazprom’s gas distribution systems. The constant rate is deducted from the utilization rate for end-customers using non-Gazprom gas distribution systems.

In December 2008, the FTS approved four quarterly increases in the transportation tariff for natural gas in 2009 for an average total increase of 15.7% for the year, in line with the increases in natural gas prices.

In December 2009, the FTS approved a 12.3% average increase for the 2010 transportation tariff for natural gas effective 1 January 2010 compared to the fourth quarter 2009 tariffs. The increase is applicable to both the rate for utilization of the trunk pipeline and transportation rate per mcm per 100 km, the former had a range of RR 29.21 to RR 1,630.97 (excluding VAT) per mcm and the latter was RR 9.15 (excluding VAT) per mcm per 100 km, as at 31 December 2009. Effective from 1 January 2010, the rate for utilization of the trunk pipeline has a range of RR 32.92 to RR 1,818.37 (excluding VAT) per mcm and a transportation rate of RR 10.27 (excluding VAT) per mcm per 100 km. The increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts.

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

Our stable gas condensate (to the Port of Vitino on the White Sea), LPG and oil products are transported by rail which is owned and operated by Russian Railways, Russia's state-owned monopoly railway operator. Our transportation tariffs for transport by rail are also set by the FTS and vary depending on product and length of transport route. On 27 March 2009, the FTS announced specific discount co-efficients to be applied to the existing rail road transportation tariffs related to export deliveries of LPG and stable gas condensate shipped from the Limbey rail station, located in close proximity to our Purovsky Plant. We applied a co-efficient of 0.72 to the existing rail tariff for our stable gas condensate volumes shipped to export markets from 7 April 2009 and a co-efficient of 0.35 for our LPG export deliveries at the Russian Federation cross-border points for volumes in excess of 90 thousand tons which we reached in the middle of April 2009. The specific discount co-efficients remained in effect throughout 2009.

In January 2010, the FTS approved the discount co-efficients to existing rail road transportation tariffs related to export deliveries of LPG and stable gas condensate shipped from the Limbey rail station. The discount co-efficient for stable gas condensate is set at 0.89 for annual shipped volumes of more than 2,235 thousand tons and the discount co-efficient for LPG is set at 0.35 for export volumes in excess of 105 thousand tons which we reached in the middle of April 2010. The discount co-efficients will remain in effect throughout 2010.

We deliver our stable gas condensate and oil products produced from our unstable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and tankers for transportation to US, European, South American and countries of the Asian-Pacific region. The costs associated with tanker transportation are determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

Transportation transactions with related parties

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

Our tax burden

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

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax, significant taxes to which we are subject include VAT, unified natural resources production tax (UPT), export duties, property tax, social taxes and contributions.

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to an increase in our production. Liquids sales volumes decreased due to an increase in liquids inventory balances despite an increase in our unstable gas condensate production.

Natural gas sales volumes

<i>millions of cubic meters</i>	Three months ended 30 June:		Change %
	2010	2009	
Production from:			
Yurkharovskoye field	5,723	4,260	34.3%
East-Tarkosalinskoye field	1,783	2,515	(29.1%)
Khancheyskoye field	752	766	(1.8%)
Other fields	18	22	(18.2%)
Total natural gas production	8,276	7,563	9.4%
Purchases from:			
Third parties	-	159	n/a
Total natural gas purchases	-	159	n/a
Total production and purchases	8,276	7,722	7.2%
Purovsky Plant and own usage	(10)	(10)	0.0%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	(357)	(8)	n/m
Total natural gas sales volumes	7,909	7,704	2.7%
<i>Sold to end-customers</i>	<i>5,196</i>	<i>3,009</i>	<i>72.7%</i>
<i>Sold to traders in remote points</i>	<i>-</i>	<i>2,764</i>	<i>n/a</i>
Subtotal sold to end-customers	5,196	5,773	(10.0%)
Sold ex-field	2,713	1,931	40.5%

In the three months ended 30 June 2010, our total consolidated natural gas production increased by 713 mmcm, or 9.4%, compared to the 2009 period primarily due to an increase in production at our Yurkharovskoye field resulting from the launch of the second stage of the field's second phase development in October 2009. The decrease in natural gas production at our East-Tarkosalinskoye field in the 2010 period was the direct result of our decision to continue optimizing unstable gas condensate production at the Yurkharovskoye field.

In the three months ended 30 June 2010, we did not purchase natural gas from third parties due to our ability to meet domestic market demand from our own production.

Liquids sales volumes

<i>thousands of tons</i>	Three months ended 30 June:		Change %
	2010	2009	
Production from:			
Yurkharovskoye field	493	355	38.9%
East-Tarkosalinskoye field	215	234	(8.1%)
Khancheyskoye field	163	160	1.9%
Other fields	8	10	(20.0%)
Total liquids production	879	759	15.8%
Purchases from:			
Third parties	1	0	n/a
Total liquids purchases	1	0	n/a
Total production and purchases	880	759	15.9%
Losses and own usage ⁽¹⁾	(9)	(5)	80.0%
Decrease in liquids inventory balance due to disposal of interest in subsidiaries	-	(4)	n/a
Decreases (increases) in liquids inventory balances	(50)	144	n/a
Total liquids sales volumes	821	894	(8.2%)
<i>Stable gas condensate export</i>	536	650	(17.5%)
<i>Stable gas condensate domestic</i>	3	8	(62.5%)
Subtotal stable gas condensate	539	658	(18.1%)
<i>LPG export</i>	115	107	7.5%
<i>LPG CIS</i>	-	1	n/a
<i>LPG domestic</i>	106	80	32.5%
<i>LPG sold through domestic retail and small wholesale stations</i>	10	-	n/a
Subtotal LPG	231	188	22.9%
<i>Crude oil export</i>	15	19	(21.1%)
<i>Crude oil domestic</i>	33	26	26.9%
Subtotal crude oil	48	45	6.7%
<i>Oil products domestic</i>	3	3	0.0%
Subtotal oil products	3	3	0.0%

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

In the three months ended 30 June 2010, our liquids production increased by 120 thousand tons, or 15.8%, to 879 thousand tons compared to 759 thousand tons in the 2009 period, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the second stage of the field's second phase development in October 2009. The decrease in liquids production at the East-Tarkosalinskoye field was the result of natural declines in the concentration of gas condensate due to decreasing reservoir pressure at the current gas condensate producing horizons.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 JUNE 2010 COMPARED TO THE CORRESPONDING PERIOD IN 2009

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2010 and 2009. Each line item is also shown as a percentage of our total revenues.

<i>Millions of Russian roubles</i>	Three months ended 30 June:			
	2010	% of total revenues	2009	% of total revenues
Total revenues (net of VAT and export duties)	25,706	100.0%	23,148	100.0%
<i>including:</i>				
natural gas sales	15,209	59.2%	12,868	55.6%
liquids sales	9,842	38.3%	9,508	41.1%
Operating expenses	(15,717)	(61.1%)	(15,038)	(65.0%)
Other operating income (loss)	29	0.1%	(158)	(0.7%)
Profit from operations	10,018	39.0%	7,952	34.4%
Finance income (expense)	(1,078)	(4.2%)	1,103	4.8%
Share of income (loss) of associated companies	(9)	0.0%	11	0.0%
Profit before income tax	8,931	34.7%	9,066	39.2%
Total income tax expense	(1,865)	(7.3%)	(1,903)	(8.2%)
Profit (loss)	7,066	27.5 %	7,163	30.9%
Non-controlling interest	73	0.3%	15	0.1%
Profit attributable to NOVATEK shareholders	7,139	27.8%	7,178	31.0%

Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the three months ended 30 June 2010 and 2009:

<i>Millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Natural gas sales	15,209	12,868	18.2%
<i>End-customer</i>	11,891	5,811	104.6%
<i>Traders in remote points</i>	-	5,073	n/a
Subtotal of end-customers sales	11,891	10,884	9.3%
Ex-field sales	3,318	1,984	67.2%
Stable gas condensate sales	6,424	7,500	(14.3%)
<i>Export</i>	6,398	7,440	(14.0%)
<i>Domestic</i>	26	60	(56.7%)
Liquefied petroleum gas sales	3,024	1,649	83.4%
<i>Export</i>	1,831	1,104	65.9%
<i>CIS</i>	-	11	n/a
<i>Domestic</i>	1,193	534	123.4%
Crude oil sales	354	341	3.8%
<i>Export</i>	116	173	(32.9%)
<i>Domestic</i>	238	168	41.7%
Oil products sales	40	18	122.2%
<i>Domestic</i>	40	18	122.2%
Total oil and gas sales	25,051	22,376	12.0%
Sales of polymer and insulation tape	611	501	22.0%
Other revenues	44	271	(83.8%)
Total revenues	25,706	23,148	11.1%

Natural gas sales

In the three months ended 30 June 2010, our revenues from sales of natural gas increased by RR 2,341 million, or 18.2%, compared to the corresponding period in 2009 largely due to an increase in natural gas prices and, to a lesser extent, an increase in sales volumes. Revenues from the sale of natural gas accounted for 59.2% and 55.6% of our total revenues in the three months ended 30 June 2010 and 2009, respectively. The increase in natural gas sales as a percentage of total revenues was primarily due to a decrease in liquids sales volumes.

In the three months ended 30 June 2010, our average realized natural gas price per mcm increased by RR 253 per mcm, or 15.1%, to RR 1,923 per mcm from RR 1,670 per mcm in the corresponding period in 2009. Our proportion of natural gas sold to end-customers to total natural gas sales volumes, decreased from 74.9% in the reporting period in 2009 to 65.7% in the three months ended 30 June 2010 primarily due to the cessation of natural gas deliveries to traders in remote points, previously classified as end-customers' sales, effective as of the 1 January 2010. The average realized prices of our natural gas sold directly to end-customers (including transportation expense) and sold ex-field were higher by 21.4% and 19.1%, respectively, in the three months ended 30 June 2010 compared to the same period in 2009. In the three months ended 30 June 2010, as well as in the corresponding period in 2009 our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies.

Stable gas condensate sales

In the three months ended 30 June 2010, our revenues from sales of stable gas condensate decreased by RR 1,076 million, or 14.3%, compared to the corresponding period in 2009, primarily due to a decrease in volumes sold as a result of an increase in inventory in transit. The decrease in revenues from stable gas condensate was partially offset by an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation.

In the three months ended 30 June 2010, our total stable gas condensate sales volumes decreased by 119 thousand tons, or 18.1%, due to an increase in stable gas condensate inventory balances despite an increase in our unstable gas condensate production. In the three months ended 30 June 2010, we exported 536 thousand tons of stable gas condensate, or 99.4% of our total sales volumes, to the United States, South America and Asian-Pacific region, with the remaining three thousand tons sold domestically. In the three months ended 30 June 2009, we exported 650 thousand tons of stable gas condensate, or 98.8% of our total sales volumes, to markets in the United States, Europe and Asian-Pacific region, with the remaining eight thousand tons sold domestically.

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

In the three months ended 30 June 2010, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 39.5 per ton, or 11.1%, to USD 394.7 per ton (DES and CIF) from USD 355.2 per ton (DES and CFR) in the 2009 period due to a 40.2% increase in our average export contract price that was partially offset by a 132.7% increase in our average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in the 2010 period compared to the corresponding period in 2009.

Liquefied petroleum gas sales

In the three months ended 30 June 2010, our revenues from the sales of LPG increased by RR 1,375 million, or 83.4%, compared to the corresponding period in 2009, primarily due to an increase in our average realized prices and, to a lesser extent, an increase in volumes sold. In the three months ended 30 June 2010, our total LPG sales volumes increased by 43 thousand tons, or 22.9%, to 231 thousand tons from 188 thousand tons in the corresponding period in 2009. The growth in LPG sales was mainly due to an increase in unstable gas condensate throughput at the Purovsky Plant and the corresponding increase in LPG output.

In the three months ended 30 June 2010, we sold 115 thousand tons of LPG, or 49.8% of our total LPG sales volumes, to the export markets for an average price of USD 525.9 per ton (DAF, CPT and FCA excluding export duties), representing an increase of USD 206.4 per ton, or 64.6%, compared to the corresponding period in 2009. The increase in our average realized export prices (excluding export duties) was primarily due to a 81.1% increase in our average contract price that was partially offset by an increase in our average export duty per ton as a result of the cancellation of the zero export duty rate from 1 December 2009 (a zero export duty rate for LPG was effective from 1 January to 1 December 2009).

The remaining volumes of LPG were sold domestically at an average price of RR 10,256 per ton (FCA, excluding VAT) representing an increase of RR 3,596 per ton, or 54.0%, compared to the 2009 period.

In the three months ended 30 June 2009, we sold 56.9% of our LPG volumes to the export markets, 42.6% was sold to the domestic markets, and 0.5% was sold to the CIS markets.

Crude oil sales

In the three months ended 30 June 2010, our revenues from the sales of crude oil increased by RR 13 million, or 3.8%, compared to the 2009 period, primarily due to an increase in our sales volumes.

In the three months ended 30 June 2010, our crude oil sales volumes increased by three thousand tons, or 6.7%, to 48 thousand tons from 45 thousand tons in the corresponding period in 2009 due to a decrease in inventory balances. In the three months ended 30 June 2010, 68.8% of our crude oil volumes were sold domestically at an average price of RR 7,262 per ton (excluding VAT) representing an increase of RR 759 per ton, or 11.7%, compared to the corresponding period in 2009. The increase in our average realized price was due to the overall increase in crude oil prices in the domestic market in the 2010 period. The remaining 31.2% of our crude oil volumes were sold to the export markets at an average price of USD 255.2 per ton (DAF, excluding export

duties) representing a decrease of USD 23.8 per ton, or 8.5%, compared to the 2009 period. The decrease in the average realized export price (excluding export duties) was the result of a 114.6% increase in our average export duty per ton that was partially offset by a 29.2% increase in our average export contract price. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in the 2010 period compared to the corresponding period in 2009.

Oil products sales

In the three months ended 30 June 2010, our revenue from the sales of oil products increased by RR 22 million, or 122.2%, compared to the 2009 period, primarily due to an increase in our average realized prices.

In the three months ended 30 June 2010, our revenues from oil products produced at the Surgutsky refinery increased to RR 15 million from RR eight million in the 2009 period. Oil products sales volumes produced from our unstable gas condensate amounted to two thousand tons in both periods. Our average oil products sales price increased by RR 3,044 per ton, or 79.1 %, to RR 6,893 per ton in the 2010 period from RR 3,849 per ton in the corresponding period in 2009 due to a greater proportion of high-priced products we received from the output at the Surgutsky refinery and an overall increase in oil products prices in the domestic market in the 2010 period.

In the three months ended 30 June 2010, our revenues from oil products trading operations sold through our retail stations on the domestic market amounted to RR 25 million compared to RR 10 million in the corresponding period in 2009. In the three months ended 30 June 2010, we sold 1,073 tons of oil products (diesel fuel and petrol) for an average price of RR 22,959 per ton through our retail stations compared to 657 tons for an average price of RR 15,514 per ton in the corresponding period in 2009.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 110 million, or 22.0%, to RR 611 million in the three months ended 30 June 2010 compared to RR 501 million in the 2009 period due to an increase in average realized prices.

Revenues from our sales of BOPP film wrap increased by RR 103 million, or 29.9%, from RR 345 million in the three months ended 30 June 2009 to RR 448 million in the 2010 period due to an increase in average realized prices. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 4.4% to 73.3% in the three months ended 30 June 2010 compared to 68.9% in the 2009 period.

Our revenues from pipe insulation product sales increased by RR 20 million, or 20.0%, from RR 100 million in the 2009 period to RR 120 million in the three months ended 30 June 2010 due to an increase in average realized prices. Revenues from polymer pipes sales decreased by RR 6 million, or 12.5%, from RR 48 million in the 2009 period to RR 42 million in the 2010 period due to a decrease in volumes sold. The remaining RR 1 million and RR 8 million in the three months ended 30 June 2010 and 2009, respectively, related to sales of other polymer products.

Other revenues

Other revenues include geological and geophysical research services, rent and other services sales. In the three months ended 30 June 2010, other revenues decreased by RR 227 million, or 83.8%, to RR 44 million from RR 271 million in the corresponding period in 2009. The decrease in other revenues was primarily related to a RR 179 million, or 100.0%, decrease in revenues from geological and geophysical research services provided to our associates. The decrease was due to the acquisition in February 2010 of a controlling interest in our associated companies and the subsequent consolidation of their activities and elimination of intercompany operations. In addition, rent services sales decreased by RR 55 million, or 70.7%, to RR 23 million in the three months ended 30 June 2010. The remaining increase of RR 7 million in other revenues was composed of various immaterial items.

Operating expenses

In the three months ended 30 June 2010, our total operating expenses increased by RR 679 million, or 4.5%, to RR 15,717 million compared to RR 15,038 million in the 2009 period, due to increases in different expense categories: general and administrative expenses, taxes other than income tax, depreciation, depletion and amortization, and materials services and other. These increases were partially offset by a decrease in purchases of natural gas and liquid hydrocarbons, and a significant reversal of operating expenses due to an increase in inventory balances. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased marginally between the reporting periods to 68.1% in the three months ended 30 June 2010 compared to 68.0% in the corresponding period in 2009. Total operating expenses decreased as a percentage of total revenues to 61.1% in the three months ended 30 June 2010 compared to 65.0% in the corresponding period in 2009, as shown in the table below. The decrease in our operating expenses as a percent of total revenues was primarily due to an increase in our natural gas sales.

<i>millions of Russian roubles</i>	Three months ended 30 June:			
	2010	% of total revenues	2009	% of total revenues
Transportation expenses	8,436	32.8%	8,295	35.8%
Taxes other than income tax	2,260	8.8%	1,935	8.4%
Subtotal non-controllable expenses	10,696	41.6%	10,230	44.2%
Materials, services and other	1,740	6.8%	1,469	6.3%
General and administrative expenses	1,631	6.3%	1,281	5.5%
Depreciation, depletion and amortization	1,549	6.0%	1,274	5.5%
Exploration expenses	335	1.3%	231	1.0%
Purchases of natural gas and liquid hydrocarbons	21	0.1%	161	0.7%
Net impairment expense	9	n/m	71	n/m
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(264)	n/m	321	n/m
Total operating expenses	15,717	61.1%	15,038	65.0%

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In the three months ended 30 June 2010, non-controllable expenses of transportation and taxes other than income tax increased by RR 466 million, or 4.6%, to RR 10,696 million from RR 10,230 million in the corresponding period in 2009. The change in transportation expenses was primarily due to an increase in regulated rail tariffs to transport our liquid products. Taxes other than income tax increased primarily due to higher liquids and natural gas production volumes and the corresponding impact on unified natural resources production tax. As a percentage of total revenues our non-controllable expenses decreased by 2.6% to 41.6% in the three months ended 30 June 2010 compared to 44.2% in the corresponding period in 2009.

Transportation expenses

In the three months ended 30 June 2010, our total transportation expenses increased by RR 141 million, or 1.7%, compared to the corresponding period in 2009.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Natural gas transportation to customers	5,669	5,674	(0.1%)
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	1,811	1,646	10.0%
Stable gas condensate transported by tankers	785	853	(8.0%)
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	124	81	53.1%
Crude oil transportation to customers	45	40	12.5%
Other transportation costs	2	1	100.0%
Total transportation expenses	8,436	8,295	1.7%

In the three months ended 30 June 2010, our transportation expenses for natural gas decreased marginally by RR 5 million, or 0.1%, to RR 5,669 million from RR 5,674 million in the corresponding period in 2009. The change was due to a 10.0% decrease in our sales volumes of natural gas delivered directly to end-customers, where the cost of transportation is included in the sales price, and a decrease in our average delivery distance due to the cessation of deliveries to traders in remote points in 2010. The decrease in natural gas volumes delivered and the average delivery distance was offset by an increase in the natural gas transportation tariff (see “Transportation tariffs” above). Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

Total expenses for transportation by rail increased by RR 165 million, or 10.0%, primarily due to higher rail transportation tariffs that was partially offset by a decrease in liquids volumes sold. In the three months ended 30 June 2010, our combined volumes of stable gas condensate, LPG and oil products sold and transported via rail decreased by 89 thousand tons, or 10.5%, to 757 thousand tons from 846 thousand tons in the corresponding period in 2009.

Our expense for stable gas condensate transported by rail to export markets decreased by RR 19 million, or 1.9% to RR 966 million from RR 985 million in the three months ended 30 June 2009 due to a 17.5% decrease in volumes sold that was partially offset by an increase in the rail tariff. In the three months ended 30 June 2010, our average transportation rate per ton for stable gas condensate transported by rail to export markets increased by 18.9% to RR 1,802 from RR 1,515 in the corresponding period in 2009, primarily due to increases in rail tariffs by 5.7% effective 1 July 2009 and by a further 9.4% effective 1 January 2010. The increases in the rail tariff were partially offset by the application of a co-efficient of 0.89 to the existing rail tariff for stable gas condensate deliveries to export markets from February 2010 compared to co-efficient of 0.72 applicable from 7 April 2009 and throughout 2009 (see “Transportation tariffs” above).

In the three months ended 30 June 2010, our expense for LPG transported by rail increased by RR 188 million, or 28.9%, due to increases in both rail tariffs and volumes sold. In the three months ended 30 June 2010, our expense for LPG transported by rail amounted to RR 839 million, of which RR 520 million was related to export sales and RR 319 million to domestic sales, or RR 4,517 per ton and RR 3,116 per ton, respectively. In the three months ended 30 June 2009, transportation expenses for LPG transported by rail amounted to RR 651 million, of which RR 453 million was related to export sales, RR 4 million to CIS sales, and RR 194 million to domestic sales, or RR 4,222 per ton, RR 3,070 per ton and RR 2,421 per ton, respectively. We began applying a co-efficient of 0.35 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation for volumes in excess of 105 thousand tons in 2010 and 90 thousand tons in 2009 which we reached in the middle of April in both years (see “Transportation tariffs” above).

In the three months ended 30 June 2010, we incurred RR 1 million of railroad transportation expenses related to the domestic sales of stable gas condensate compared to RR 7 million in the 2009 period. The remaining RR 5 and RR 3 million of transportation expenses by rail in the 2010 and 2009 periods, respectively, were related to the transportation of oil products sold on the domestic market and other railroad services not allocated between products.

Total transportation expense for delivery of stable gas condensate by tanker to international markets decreased by RR 68 million, or 8.0%, to RR 785 million in the three months ended 30 June 2010 from RR 853 million in the 2009 period. The change was primarily due to a 17.5% decrease in volumes sold that was partially offset by an increase in average freight rates.

Starting from August 2010, we will not incur expenses related to unstable gas condensate transportation from the field to the our processing facility through third party pipelines as we commenced operation of our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant (see “Overview” above).

Taxes other than income tax

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Unified natural resources production tax (UPT)	1,805	1,588	13.7%
Property tax	348	315	10.5%
Excise and fuel taxes	56	-	n/a
Other taxes	51	32	59.4%
Total taxes other than income tax	2,260	1,935	16.8%

In the three months ended 30 June 2010, taxes other than income tax increased by RR 325 million, or 16.8%, primarily due to an increase in unified natural resources production tax expense.

In the three months ended 30 June 2010, our UPT for natural gas and gas condensate increased by RR 104 million, or 9.3%, and RR 79 million, or 20.6%, respectively, due to an increase in production volumes. The increase in our UPT for crude oil of RR 34 million was due primarily to an increase in our average crude oil production tax rate, which is linked to the Urals benchmark crude oil price, and a marginal increase in our crude oil production. Our average UPT rate for crude oil increased from RR 2,199 per ton in the three months ended 30 June 2009 to RR 2,982 per ton in the 2010 period. The natural gas production tax rate in the 2010 and 2009 periods remained unchanged at RR 147 per mcm.

In the three months ended 30 June 2010, our property tax expense increased by RR 33 million, or 10.5%, to RR 348 million from RR 315 million in the corresponding period in 2009, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In the three months ended 30 June 2010, we expensed RR 56 million of excise and fuel taxes in respect of LPG sales through our subsidiary Novatek Polska, which commenced commercial operations in January 2010. The excise and fuel taxes are payable when LPG enters the territory of Poland.

Materials, services and other

In the three months ended 30 June 2010, our materials, services and other expenses increased by RR 271 million, or 18.4%, to RR 1,740 million compared to RR 1,469 million in the 2009 period. The main components of this expense category were employee compensation and materials and supplies, which comprised 39.7% and 27.8%, respectively, of total materials, services and other expenses in the 2010 period.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Employee compensation	691	633	9.2%
Materials and supplies	484	364	33.0%
Tolling and processing fees	213	127	67.7%
Repair and maintenance services	138	22	527.3%
Electricity and fuel	98	78	25.6%
Fire safety and security expense	40	45	(11.1%)
Other	76	87	(12.6%)
Subtotal materials, services and other	1,740	1,356	28.3%
Operator services expense	-	113	n/a
Total materials, services and other	1,740	1,469	18.4%

In the three months ended 30 June 2010, our materials, services and other expenses, excluding operator services expense, increased by RR 384 million, or 28.3%, to RR 1,740 million compared to RR 1,356 million in the corresponding period in 2009.

Our employee compensation increased by RR 58 million, or 9.2%, to RR 691 million compared to RR 633 million in the 2009 period due to higher costs to maintain employee housing at our field locations.

Materials and supplies expense increased by RR 120 million, or 33.0%, mainly due to an increase in production of polymers and insulation tape products and the associated increase in purchases of raw materials, which accounted for RR 108 million, or 90.0%, of the total increase in materials and supplies expense.

Tolling and processing fees increased by RR 86 million, or 67.7%, of which RR 58 million related to de-ethanization of unstable gas condensate. The increase in de-ethanization costs was primarily due to a 38.9% increase in volumes of unstable gas condensate produced at the Yurkharovskoye field. We expect a significant decrease in tolling and processing fees starting from the third quarter 2010 due to a launch of the unstable gas condensate de-ethanization facility at our Yurksharovskoye field in August 2010 (see “Overview” above). In addition, in the three months ended 30 June 2010, we incurred RR 27 million in costs related to the preparation of crude oil produced at our East-Tarkosalinskoye field for transportation. Tolling and processing fees at the Surgutsky refinery increased by RR 1 million.

Repair and maintenance services increased by RR 116 million, or by 5.3 times, to RR 138 million in the three months ended 30 June 2010 compared to RR 22 million in the corresponding period in 2009. The increase was primarily related to the current repair works at our production assets and was consistent with our ongoing maintenance schedules.

Electricity and fuel expenses increased by RR 20 million, or 25.6%, from RR 78 million in the three months ended 30 June 2009 to RR 98 million in the 2010 period primarily due to an increase in energy consumption at the Yurkharovskoye field resulting from the commencement in operation of new production assets.

Our fire safety and security expenses decreased by RR 5 million, or 11.1%, to RR 40 million from RR 45 million in the three months ended 30 June 2009, primarily due to a reduction in fire safety services provided by third parties at our production subsidiary OOO “NOVATEK-Yurkharovneftegas”, which completed the organization of its own fire safety department at the end of 2009 to meet overall fire safety requirements as well as to optimize costs by providing these services in-house.

Operator services expenses mainly refer to the geological and geophysical research provided to our associated companies. In the three months ended 30 June 2010, operator services expenses decreased by RR 113 million, or 100.0%, due to the acquisition in February 2010 of a controlling interest in our associates OOO “Oiltechproduct-Invest”, OOO “Petra Invest-M” and OOO “Tailiksneftegas” and the subsequent consolidation of these companies activities.

General and administrative expenses

In the three months ended 30 June 2010, our general and administrative expenses increased by RR 350 million, or 27.3%, to RR 1,631 million compared to RR 1,281 million in the corresponding period in 2009. The main components of these expenses were employee compensation and legal, audit and consulting services, which, on aggregate, comprised 67.7% and 64.7% of total general and administrative expenses in the three months ended 30 June 2010 and 2009, respectively.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Employee compensation	1,001	721	38.8%
Legal, audit, and consulting services	104	108	(3.7%)
Charitable contributions	92	84	9.5%
Business trip expenses	78	68	14.7%
Rent expense	59	59	0.0%
Fire safety and security expense	37	36	2.8%
Depreciation – administrative buildings	35	39	(10.3%)
Concession management services	21	71	(70.4%)
Insurance expense	15	17	(11.8%)
Other	189	78	142.3%
Total general and administrative expenses	1,631	1,281	27.3%

Our employee compensation increased by RR 280 million, or 38.8%, to RR 1,001 million in the three months ended 30 June 2010 as compared to RR 721 million in the corresponding period in 2009 primarily due to an increase in bonus accruals by RR 183 million related to the performance achieved in 2009. The bonus accrual was consistent with the Group's Concept of the Long-Term Incentive of Senior Employees and the financial and operational results achieved in 2009. In addition, in the three months ended 30 June 2010, we recognized RR 86 million to employee compensation as a result of the initiation of NOVATEK's share-based compensation program for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee.

Legal, audit, and consulting services expenses decreased by RR 4 million, or 3.7%, to RR 104 million compared to RR 108 million in the 2009 period. The decrease was primarily related to information technology system support and maintenance.

In the three months ended 30 June 2010, our charitable contributions increased by RR eight million, or 9.5%, to RR 92 million compared to RR 84 million in the corresponding period in 2009, and were primarily related to our donations to sport clubs and activities as well as continued support for charities and social programs in the regions where we operate. Charitable contributions will continue to fluctuate period-on-period depending on the funding needs and the implementation schedule of specific programs we support.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El Arish concession area located in Egypt). In the three months ended 30 June 2010, our expenses related to concession management services decreased by RR 50 million, or 70.4%, compared to the 2009 period. The decrease in costs associated with concession management services in the 2010 period is consistent with our approved business plan for this project.

In the three months ended 30 June 2010, other general and administrative expenses increased by RR 111 million, or 142.3%, compared to the corresponding period in 2009, of which RR 59 million of the increase related to the remuneration of the Board of Directors and payment to members of the Company's revision committee. The remaining increase of RR 52 million was allocated amongst different expense categories within other general and administrative expenses which, taken individually, changed immaterially.

Depreciation, depletion and amortization

In the three months ended 30 June 2010, our depreciation, depletion and amortization (“DDA”) expense increased by RR 275 million, or 21.6%, compared to the corresponding period in 2009 as a result of an increase in our depletable cost base, as well as a 10.2% increase in our hydrocarbon production in barrels of oil equivalent (boe). The Company accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for processing facilities.

In the three months ended 30 June 2010, our DDA per boe was RR 22.0 compared to RR 19.0 in the corresponding period in 2009. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the second stage of the second phase development at the Yurkharovskoye field in October 2009, as well as costs capitalized during the first half of 2010.

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

Purchases of natural gas and liquid hydrocarbons

Purchases of natural gas and liquid hydrocarbons decreased by RR 140 million, or 87.0%, to RR 21 million in the three months ended 30 June 2010, from RR 161 million in the corresponding period in 2009, primarily due to a decrease in natural gas purchases from third parties by RR 153 million, or 100.0%. The decrease was partially offset by an increase in oil products purchases by RR 13 million.

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

In the three months ended 30 June 2010, we recorded a reversal of RR 264 million to change in inventory expense as compared to a charge of RR 321 million in the corresponding period in 2009:

<i>millions of Russian roubles</i>	Three months ended 30 June:	
	2010	2009
Natural gas	(126)	-
Stable gas condensate	(154)	291
Polymer and insulation tape	(41)	31
Other	57	(1)
Increase (decrease) in operating expenses due to change in inventory balances	(264)	321

In the three months ended 30 June 2010, we recorded a reversal to our operating expenses of RR 126 million due to an increase in our natural gas inventory balance by 357 mmcm. Our volumes of natural gas injected into Gazprom’s underground gas storage facilities (UGSF) fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in the three months ended 30 June 2010, we recorded a reversal of RR 154 million to our operating expenses due to an increase in our inventory balance of stable gas condensate in transit and storage by 55 thousand tons.

The following table highlights movements in our inventory balances:

<i>Inventory balances in transit or in storage</i>	2010			2009		
	At 30 June	At 31 March	Increase / (decrease)	At 30 June	At 31 March	Increase / (decrease)
Natural gas (millions of cubic meters)	829	472	357	267	259	8
<i>including Gazprom’s UGSF</i>	<i>800</i>	<i>405</i>	<i>395</i>	<i>207</i>	<i>137</i>	<i>70</i>
Liquid hydrocarbons (thousand tons)	388	338	50	224	368	(144)
<i>including stable gas condensate</i>	<i>332</i>	<i>277</i>	<i>55</i>	<i>172</i>	<i>313</i>	<i>(141)</i>

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

In the three months ended 30 June 2010, we realized other operating income of RR 29 million related to different immaterial items.

In the three months ended 30 June 2009, we realized other operating loss of RR 158 million, of which RR 212 million was related to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). In addition, in the 2009 period, we recognized other income of RR 52 million and RR 10 million due to the disposal of our production subsidiary OOO "Purneft" in April 2009 and for penalties from our customers due to non-compliance of their contractual obligations, respectively. The remaining other loss of RR 8 million was primarily related to the disposal of fixed assets, equipment and materials.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 2,066 million, or 26.0%, to RR 10,018 million in the three months ended 30 June 2010, compared to RR 7,952 million in the corresponding period in 2009. In the three months ended 30 June 2010, our profit from operations as a percentage of total revenues increased to 39.0% compared to 34.4% in the 2009 period due to higher natural gas and liquids prices and was partially offset by a decrease in liquids sales volumes.

Finance income (expense)

In the three months ended 30 June 2010, we recorded net finance expense of RR 1,078 million due primarily to a foreign exchange loss from the depreciation of the Russian rouble relative to the US dollar compared to recording net finance income of RR 1,103 million in the corresponding period in 2009 due to a foreign exchange gain from the appreciation of the Russian rouble relative to the US dollar.

In the three months ended 30 June 2010, our total accrued interest expense increased to RR 643 million compared to RR 420 million in the corresponding period in 2009 as a result of an increase in our average borrowings and higher average financing rates on Russian rouble denominated borrowings. During the 2010 and 2009 periods, we capitalized RR 560 and RR 234 million, respectively, of interest expense to cost of additions in our property, plant and equipment account in accordance with the Group's accounting policy.

Interest income increased by RR 13 million, or 11.8%, to RR 123 million in the three months ended 30 June 2010 from RR 110 million in the corresponding period in 2009 primarily due to interest income on loans issued to our employees and on long-term receivables.

In the three months ended 30 June 2010, we recorded a net foreign exchange loss of RR 1,118 million as compared to a net gain RR 1,179 million in the corresponding period in 2009 due to a 6.3% depreciation and 8.0% appreciation of the Russian rouble against the US dollar in the 2010 and 2009 periods, respectively, and its effect on our foreign currency denominated borrowings. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the composition of our debt position.

Share of income (loss) of associated companies

In the three months ended 30 June 2010, our proportionate share in the loss of associated companies amounted to RR 9 million compared to a gain of RR 11 million recorded in the 2009 period. The loss recognized by our associated companies was due to the expensing of geological and geophysical research expenditures under the successful efforts accounting policy.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 20.9% and 21.0% for the three months ended 30 June 2010 and 2009, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 21.3% and 22.1% in the 2010 and 2009 periods, respectively. The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the period decreased by RR 97 million, or 1.4%, to RR 7,066 million in the three months ended 30 June 2010 from RR 7,163 million in the corresponding period in 2009. The profit attributable to NOVATEK shareholders decreased by RR 39 million, or 0.5%, to RR 7,139 million in the three months ended 30 June 2010 from RR 7,178 million in the corresponding period in 2009.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to NOVATEK shareholders, decreased by approximately RR 0.02 per share, or 0.5%, to RR 2.35 per share in the 2010 period from RR 2.37 per share in corresponding period in 2009.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 30 June 2010 and 2009:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Net cash provided by operating activities	6,340	8,448	(25.0%)
Net cash used in investing activities	(5,009)	(10,109)	(50.5%)
Net cash provided by (used in) financing activities	3,258	(1,806)	n/m

<i>Liquidity ratios</i>	30 June 2010	31 December 2009	Change, %
Current ratio	1.24	1.14	8.8%
Total debt to equity	0.35	0.33	6.1%
Long-term debt to long-term debt and equity	0.16	0.17	(5.9%)
Net debt to total capitalization ⁽¹⁾	0.15	0.17	(11.8%)

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

Net cash provided by operating activities

In the three months ended 30 June 2010, our net cash provided by operating activities decreased by RR 2,108 million, or 25.0%, to RR 6,340 million compared to RR 8,448 million in the corresponding period in 2009. The change in our net cash provided by operating activity was due primarily to an increase in income tax paid.

Net cash used in investing activities

In the three months ended 30 June 2010, our net cash used in investing activities decreased by RR 5,100 million, or 50.5%, to RR 5,009 million as compared to RR 10,109 million in the corresponding period in 2009. The decrease was primarily due to a cash payment of RR 6,103 million in the second quarter 2009 for the acquired equity interest in OAO "Yamal LNG".

Net cash provided by (used in) financing activities

In the three months ended 30 June 2010, net cash provided by financing activities amounted to RR 3,258 million compared to net cash used in financing activities of RR 1,806 million in the corresponding period in 2009. The change was primarily due to an increase in proceeds from long-term borrowings that was partially offset by an increase in repayments of long-term and short-term debt and dividends.

Working capital

Our net working capital position (current assets less current liabilities) at 30 June 2010 increased to RR 6,848 million compared to RR 3,274 million at 31 December 2009. The net change was mainly due to an increase in our balance of cash and cash equivalents and a decrease in accounts payable and accrued liabilities that was partially offset by an increase in the current portion of long-term debt.

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

Capital expenditures

Total capital expenditures on property, plant and equipment for the three months ended 30 June 2010 and 2009 were as follows:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2010	2009	
Exploration, production and marketing	5,959	4,791	24.4%
Polymer production and marketing	93	3	n/m
Total	6,052	4,794	26.2%

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. During both reporting periods, the majority of our capital expenditures related to ongoing development and exploration activities at our three core fields and at our Purovsky Plant. In the three months ended 30 June 2010, we spent RR 23 million, RR 186 million and RR 5,205 million for further field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 275 million on further construction work at the Purovsky Plant.

In the three months ended 30 June 2010, we increased our capital expenditure to polymer production and marketing by RR 90 million compared to the corresponding period in 2009, as part of our advanced payments to contractors for the future construction of additional film wrapping production assets.

Debt obligations

At 30 June 2010, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 3,254 million (USD 104 million) on either fixed or variable interest rates subject to the specific type of credit facility.

The Group also has funds available under agreements with ZAO "BNP PARIBAS Bank" in the amount of USD 100 million until May 2012 and Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2011, with the interest rates under both agreements to be negotiated at the time of each withdrawal, and with Gazprombank in the amount of RR 2,394 million until November 2012 with an annual interest rate of 9 percent.

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates and interest rates. We are exposed to commodity price risk as our prices for crude oil and stable gas condensate destined for export sales are linked to international crude oil prices. We are exposed to foreign exchange risk to the extent that a portion of our sales revenues, costs, receivables, loans and debt are denominated in currencies other than Russian roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. From time to time we may use derivative instruments, such as commodity forward contracts, commodity price swaps, commodity options, foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks, and we may hold or issue derivative or other financial instruments for trading purposes.

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 30 June 2010, RR 6,222 million, or 13.8%, of our long-term debt was denominated in US dollars (out of RR 44,988 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, approximately 32.5% in the three months ended 30 June 2010, is denominated in US dollars. As of 30 June 2010, the Russian rouble had depreciated by approximately 3.1% against the US dollar since 1 January 2010.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 30 June 2010 would have resulted in an estimated foreign exchange gain of approximately RR 2,249 million on foreign currency denominated borrowings held at that date.

Commodity risk

Substantially all of our crude oil, stable gas condensate and LPG export sales are sold under spot contracts. Our export prices are linked to international crude oil prices. External factors such as geopolitical developments, natural disasters and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

The weather is another factor affecting demand for and, therefore, the price of natural gas. Changes in weather conditions from year to year can influence demand for natural gas and to some extent gas condensate and oil products.

From time to time we may employ derivative instruments to mitigate the price risk of our sales activities. In our consolidated financial statements all derivative instruments are recorded at their fair values. Unrealized gains or losses on derivative instruments are recognized within other operating income (loss), unless the underlying arrangement qualifies as a hedge.

Pipeline access

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

Ability to reinvest

Our business requires significant ongoing capital expenditures in order to grow our production. An extended period of reduced demand for our hydrocarbons available for sale and the corresponding revenues generated from these sales would limit our ability to maintain an adequate level of capital expenditures, which in turn could limit our ability to increase or maintain current levels of production and deliveries of natural gas, gas condensate, crude oil and other associated products; thereby, adversely affecting our financial and operating results.

Off balance sheet activities

As of 30 June 2010, 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.