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 September 2011 and 2010 together with our unaudited consolidated interim condensed financial information as of and for the three and nine months ended 30 September 2011. 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 2010 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom, in each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for the respective 2011 and 2010 reporting periods. In terms of proved natural gas reserves, we are the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

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

RECENT DEVELOPMENTS

In September 2011, the Group increased its equity interest in Yamal LNG to 100% by exercising the two call options of 23.9% and 25.1% purchased in July 2009 and February 2011, respectively. In October 2011, the Group disposed of a 20% interest in Yamal LNG to TOTAL E&P YAMAL SAS, an affiliate of TOTAL S.A.

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

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

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

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

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

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

In July 2010, we created a 50/50 joint venture, OOO "Yamal Development" ("Yamal Development"), with OAO "Gazprom Neft" to jointly develop potential hydrocarbon assets in the YNAO. In November 2010, Yamal Development acquired a 51 percent participation interest in OOO "SeverEnergia" ("SeverEnergia"). SeverEnergia holds 100% of the shares of OAO "Arctic Gas", ZAO "Urengoil Inc." and OAO "Neftegaztechnologia", which hold licenses for the development of oil and gas condensate fields in the YNAO. SeverEnergia's proved reserves as appraised by D&M under the SEC and PRMS reserves methodologies, as of 31 December 2010, totaled approximately 224 and 245 billion cubic meters of natural gas and 39 and 42 million tons of liquid hydrocarbons, respectively.

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

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

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

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

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

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 30 September: 2011	2010	Change %
Financial results			
Total revenues (net of VAT and export duties)	39,980	29,441	35.8%
Operating expenses	(22,881)	(17,587)	30.1%
Profit attributable to shareholders of OAO “NOVATEK”	8,406	10,105	(16.8%)
EBITDA [(1)]	18,961	14,017	35.3%
EBITDAX [(2)]	19,601	14,161	38.4%
Earnings per share (in Russian roubles)	2.77	3.33	(16.8%)
Operating results			
Natural gas sales volumes (million cubic meters)	12,266	8,123	51.0%
Stable gas condensate sales volumes (thousand tons)	658	723	(9.0%)
Liquefied petroleum gas sales volumes (thousand tons)	208	206	1.0%
Crude oil sales volumes (thousand tons)	66	42	57.1%
Oil product sales volumes (thousand tons)	1	2	(50.0%)
Total hydrocarbons production (million barrels of oil equivalent) [(3)]	95.2	62.2	53.1%
Total daily production (thousand barrels of oil equivalent per day) [(3)]	1,035	676	53.1%
Cash flow results			
Net cash provided by operating activities	12,560	12,085	3.9%
Capital expenditures	7,527	7,174	4.9%
Free cash flow [(4)]	5,033	4,911	2.5%

[(1)] EBITDA represents profit (loss) attributable to shareholders of OAO “NOVATEK” adjusted for the addback of net impairment expense, income tax expense and finance income (expense) from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

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

[(3)] Total hydrocarbons production and total daily production are calculated based on net production, including our proportionate share in the production of associated companies.

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

Reconciliation of EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO “NOVATEK” is as follows for the three months ended 30 September 2011 and 2010:

millions of Russian roubles	Three months ended 30 September: 2011	2010
Profit (loss) attributable to shareholders of OAO “NOVATEK”	**8,406**	**10,105**
Depreciation, depletion and amortization	2,352	1,818
Net impairment expense	51	154
Total finance income (expense)	5,890	(482)
Total income tax expense	2,262	2,422
EBITDA	**18,961**	**14,017**
Exploration expenses	640	144
EBITDAX	**19,601**	**14,161**

SELECTED MACRO-ECONOMIC DATA

Exchange rate of Russian rouble to US dollar	**Three months ended 30 September: 2011**	**2010**	**Change %**
At the beginning of the period	28.08	31.20	(10.0%)
At the end of the period	31.88	30.40	4.9%
Average for the period	29.05	30.62	(5.1%)

Crude oil prices, USD / bbl	**Three months ended 30 September: 2011**	**2010**	**Change %**
WTI [1]			
At the end of the period	79.2	80.0	(1.0%)
Average for the period	89.5	76.2	17.5%
Brent [2]			
At the end of the period	105.2	81.0	29.9%
Average for the period	113.4	76.9	47.5%
Urals [2]			
At the end of the period	102.3	79.9	28.0%
Average for the period	111.5	75.6	47.5%

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

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

Export duties, USD / ton [1]	**Three months ended 30 September: 2011**	**2010**	**Change %**
Crude oil, stable gas condensate			
At the end of the period	444.1	273.5	62.4%
Average for the period	442.5	262.0	68.9%
LPG			
At the end of the period	192.0	45.2	324.8%
Average for the period	182.6	34.3	432.4%

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

We continue to witness signs of economic instability in the Euro-Zone that has prolonged the period of market volatility. The rapid deterioration in the Greek debt crisis and the potential threat to the European banking community of a Greek debt default has led the European Central Bank, the International Monetary Fund and other Non-OECD countries to consider arranging a package of emergency stabilization funds to prevent a contagion in the European Union, most notably Italy, Spain, Portugal and Belgium, and to further support and preserve the Euro. The recent wave of market uncertainty may continue to negatively impact all borrowers by limiting access to the capital markets as well as causing continued volatility in the equity and currency markets, especially for those companies operating in the so-called “emerging markets”.

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

We have reviewed our capital expenditure program for the fourth quarter 2011 and have concluded that we have sufficient liquidity, through current internal cash flows and short-term borrowing facilities, to adequately fund our core natural gas business operations and planned capital expenditure program.

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

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian government’s regulation of natural gas prices. 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 September 2011, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 329 per mcm, or 14.3%, to RR 2,625 per mcm compared to RR 2,296 per mcm in the 2010 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 historical norm may or may not prevail in the present or future market situations.

In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011. As part of the liberalization plan, the FTS approved the increases in the regulated price for natural gas by 15% effective from 1 January 2010 and 2011.

In February 2011, the government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015 but there are various Governmental discussions indicating that this program may be further extended. The regulation of the domestic natural gas price prior to 2015 will be based on the netback parity of natural gas prices on the domestic and export markets. 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. We expect that the FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published, as well as potentially prolong the timetable toward market price liberalization based on market conditions and other factors.

In the three months ended 30 September 2011, our average natural gas price to end-customers and ex-field price increased by 14.2% and 13.5%, respectively, whereas our average transportation expense for the delivery of natural gas to end-customers increased by 10.1% primarily due to a 9.3% increase in the average transportation tariff set by the FTS (see “Transportation tariffs” below). As a result, our average netback price on end-customers sales increased by 18.1%, while our total average natural gas price excluding transportation expense increased by 16.8%, compared to respective prices in the corresponding period in 2010.

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

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 30 September 2011 and 2010:

	Three months ended 30 September:		Change
Russian roubles per mcm	**2011**	**2010**	**%**
Average natural gas price to end-customers [(1)]	2,637	2,309	14.2%
Average natural gas transportation expense for sales to end-customers	(1,237)	(1,124)	10.1%
Average natural gas netback price on end-customer sales	1,400	1,185	18.1%
Average natural gas price ex-field (wholesale traders)	1,390	1,225	13.5%
Total average natural gas price excluding transportation expense	**1,396**	**1,195**	**16.8%**

[(1)] Includes cost of transportation.

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

Crude oil, stable gas condensate, LPG and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, the ability and willingness of oil producing countries to sustain or change production levels to meet changes in global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters.

The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management, such as movements in international benchmark crude oil prices. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as “Urals blend”, which normally (or historically) trades at a discount to the international benchmark Brent crude oil.

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our liquid volumes sold on both the domestic and international markets, among many other factors. In the three months ended 30 September 2011, the average benchmark crude oil prices were more than 40% higher than in the corresponding period in 2010.

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

In the three months ended 30 September 2011, our stable gas condensate export delivery terms were delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF) or cost and freight (CFR), while in the corresponding period in 2010 our delivery terms were either delivery to the port of destination ex-ship (DES) or CIF. Our average stable gas condensate export contract price, including export duties, in the three months ended 30 September 2011 was approximately USD 935 per ton compared to approximately USD 660 per ton in the corresponding period in 2010.

In the three months ended 30 September 2011, our crude oil export delivery terms were DAP Feneshlitke, Hungary, while in the corresponding period in 2010 our delivery terms were delivery at frontier (DAF, Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 808 per ton compared to USD 541 per ton in the 2010 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 September 2011 and 2010 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Three months ended 30 September: 2011**	**2010**	**Change %**
Stable gas condensate			
Net export price, RR per ton	14,817	12,249	21.0%
Net export price, USD per ton	510.1	400.0	27.5%
Domestic price, RR per ton	-	10,633	n/a
Crude oil			
Net export price, RR per ton	10,707	8,623	24.2%
Net export price, USD per ton	368.6	281.6	30.9%
Domestic price, RR per ton	9,046	7,480	20.9%

Our LPG export delivery terms during the three months ended 30 September 2011, were DAP at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and free carrier (FCA) at terminal points in Poland, compared to DAF (at the border of the customer's country), CPT (the Port of Temryuk) and FCA (terminal points in Poland) in the corresponding period in 2010. In the three months ended 30 September 2011, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 917 per ton compared to USD 645 per ton the corresponding period in 2010.

In the three months ended 30 September 2011, as well as in the corresponding period in 2010, we were obliged to sell a portion of our LPG sales volumes on the domestic market at regulated prices, while the remaining portion of our sales was sold under commercial terms. In the three months ended 30 September 2011, we sold a total of 14 thousand tons of LPG on the domestic market at the regulated price of RR 7,605 per ton, while in the corresponding period in 2010, we sold 16 thousand tons at the regulated price of RR 6,613 per ton. In the three months ended 30 September 2011, we sold 81 thousand tons at an average commercial price of RR 14,668 per ton, including volumes sold through our wholly-owned subsidiary OOO "NOVATEK-Refueling Complexes", compared to 87 thousand tons at an average commercial price of RR 11,409 per ton in the corresponding period in 2010.

The following table shows our average realized LPG and oil products sales prices excluding trading activities (net of VAT and export duties, where applicable) for the three months ended 30 September 2011 and 2010 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Three months ended 30 September: 2011**	**2010**	**Change %**
LPG			
Net export price, RR per ton	21,148	18,683	13.2%
Net export price, USD per ton	728.1	610.2	19.3%
CIS price, RR per ton	-	17,351	n/a
Domestic commercial price, RR per ton	14,668	11,409	28.6%
Domestic regulated price, RR per ton	7,605	6,613	15.0%
Oil products			
Domestic price, RR per ton	-	4,125	n/a

Transportation tariffs

Natural gas

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

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

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

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

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

Crude oil

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

Stable gas condensate, LPG and oil products

Our stable gas condensate (to the Port of Vitino on the White Sea), LPG and oil products are transported by rail which is owned and operated by Russian Railways, Russia's state-owned monopoly railway operator. Our transportation tariffs for transport by rail are also set by the FTS and vary depending on product and length of transport route.

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

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

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

Our tax burden

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

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to a combination of increased production at our core producing fields and purchases from our associated company, Sibneftegas, which were slightly offset by a buildup of natural gas volumes in underground storage. Our liquids production increased by 12.3% during the 2011 reporting period largely due to an increase in unstable gas condensate production at the Yurkharovskoye field; however, our overall liquids sales volumes decreased by 4.1% primarily due to a buildup in liquids inventory balances in the 2011 period; our inventory balances tend to fluctuate period-on-period due to loading schedules and final destinations of stable gas condensate shipments.

Natural gas sales volumes

millions of cubic meters	**Three months ended 30 September: 2011**	**2010**	**Change %**
Production from:			
Yurkharovskoye field	7,759	6,035	28.6%
East-Tarkosalinskoye field	3,239	1,647	96.7%
Khancheyskoye field	932	672	38.7%
Other fields	20	20	0.0%
Total natural gas production	**11,950**	**8,374**	**42.7%**
Purchases from:			
Sibneftegas, the Group’s associate	1,329	-	n/a
Total production and purchases	**13,279**	**8,374**	**58.6%**
Purovsky Plant and own usage	(22)	(22)	0.0%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	(991)	(229)	332.8%
Total natural gas sales volumes	**12,266**	**8,123**	**51.0%**
Sold to end-customers	*6,966*	*6,077*	*14.6%*
Sold ex-field	*5,300*	*2,046*	*159.0%*

In the three months ended 30 September 2011, our total natural gas production (including our share in production of our associate Sibneftegas) increased by 4,905 mmcm, or 58.6%, compared to the 2010 period primarily due to an increase in production at our Yurkharovskoye and East-Tarkosalinskoye fields, as well as the consolidation of our share in production of the Group’s associate. We were able to increase natural gas production at the Yurkharovskoye field due to the launch of the third stage of the field’s second phase development in October 2010. The increase in natural gas production at the East-Tarkosalinskoye field was due to increased demand in the 2011 period resulting in greater utilization of the field’s production capacity.

In the three months ended 30 September 2011, we used 13 mmcm of natural gas as feedstock for the production of methanol compared to 14 mmcm in the corresponding period in 2010. A significant portion of the methanol we produce is used for our own internal purposes.

Liquids sales volumes

thousands of tons	Three months ended 30 September: 2011	2010	Change %
Production from:			
Yurkharovskoye field	650	513	26.7%
East-Tarkosalinskoye field	200	207	(3.4%)
Khancheyskoye field	136	156	(12.8%)
Other fields	7	8	(12.5%)
Total liquids production	**993**	**884**	**12.3%**
Purchases from:			
Third parties	1	5	(80.0%)
Total production and purchases	**994**	**889**	**11.8%**
Losses and own usage [1]	(10)	(8)	25.0%
Gas condensate pipeline fill and de-ethanization	-	(36)	n/a
Decreases (increases) in liquids inventory balances	(51)	128	n/a
Total liquids sales volumes	**933**	**973**	**(4.1%)**
Stable gas condensate export	*658*	*722*	*(8.9%)*
Stable gas condensate domestic	*-*	*1*	*n/a*
Subtotal stable gas condensate	***658***	***723***	***(9.0%)***
LPG export	*113*	*103*	*9.7%*
LPG CIS	*-*	*0*	*n/a*
LPG domestic	*66*	*91*	*(27.5%)*
LPG sold through domestic retail and small wholesale stations	*29*	*12*	*141.7%*
Subtotal LPG	***208***	***206***	***1.0%***
Crude oil export	*23*	*17*	*35.3%*
Crude oil domestic	*43*	*25*	*72.0%*
Subtotal crude oil	***66***	***42***	***57.1%***
Oil products domestic	*1*	*2*	*(50.0%)*
Subtotal oil products	***1***	***2***	***(50.0%)***

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

In the three months ended 30 September 2011, our liquids production increased by 109 thousand tons, or 12.3%, to 993 thousand tons compared to 884 thousand tons in the 2010 period, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the third stage of the field's second phase development in October 2010. The decrease in liquids production at the Khancheyskoye and East-Tarkosalinskoye fields was due to lower concentration of gas condensate in the extracted gas. Natural declines in the concentration of gas condensate at mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 SEPTEMBER 2011 COMPARED TO THE CORRESPONDING PERIOD IN 2010

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 September 2011 and 2010. Each line item is also shown as a percentage of our total revenues.

	Three months ended 30 September:			
millions of Russian roubles	**2011**	**% of total revenues**	**2010**	**% of total revenues**
Total revenues **(net of VAT and export duties)**	**39,980**	***100.0%***	**29,441**	***100.0%***
including:				
natural gas sales	25,735	*64.4%*	16,539	*56.2%*
liquids sales	14,100	*35.3%*	12,247	*41.6%*
Operating expenses	(22,881)	*(57.2%)*	(17,587)	*(59.7%)*
Other operating income (loss)	31	*0.0%*	154	*0.5%*
Profit from operations	**17,130**	***42.8%***	**12,008**	***40.8%***
Finance income (expense)	(5,890)	*(14.7%)*	482	*1.6%*
Share of profit (loss) of equity investments, net of income tax	(751)	*(1.9%)*	(7)	*(0.0%)*
Profit before income tax	**10,489**	***26.2%***	**12,483**	***42.4%***
Total income tax expense	(2,262)	*(5.6%)*	(2,422)	*(8.2%)*
Profit (loss)	**8,227**	***20.6%***	**10,061**	***34.2%***
Non-controlling interest	179	*0.4%*	44	*0.1%*
Profit attributable to shareholders of OAO “NOVATEK”	**8,406**	***21.0%***	**10,105**	***34.3%***

Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the three months ended 30 September 2011 and 2010:

millions of Russian roubles	**Three months ended 30 September: 2011**	**2010**	**Change %**
Natural gas sales	**25,735**	**16,539**	**55.6%**
End-customers	*18,371*	*14,032*	*30.9%*
Ex-field sales	*7,364*	*2,507*	*193.7%*
Stable gas condensate sales	**9,741**	**8,848**	**10.1%**
Export	*9,741*	*8,841*	*10.2%*
Domestic	-	*7*	*n/a*
Liquefied petroleum gas sales	**3,675**	**3,034**	**21.1%**
Export	*2,376*	*1,931*	*23.0%*
CIS	-	*9*	*n/a*
Domestic	*1,299*	*1,094*	*18.7%*
Crude oil sales	**637**	**327**	**94.8%**
Export	*244*	*143*	*70.6%*
Domestic	*393*	*184*	*113.6%*
Oil and gas products sales	**47**	**38**	**23.7%**
Domestic	*47*	*38*	*23.7%*
Total oil and gas sales	**39,835**	**28,786**	**38.4%**
Sales of polymer and insulation tape	-	619	n/a
Other revenues	145	36	302.8%
Total revenues	**39,980**	**29,441**	**35.8%**

Natural gas sales

In the three months ended 30 September 2011, our revenues from sales of natural gas increased by RR 9,196 million, or 55.6%, compared to the corresponding period in 2010 largely due to an increase in sales volumes and, to a lesser extent, an increase in natural gas prices.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased from 74.8% in the 2010 reporting period to 56.8% in the three months ended 30 September 2011. The decrease was due to the increase of sales volumes to one of our main gas traders and the commencement from January 2011 of natural gas sales, ex-field, to “ITERA”, a Russian oil and gas company, under a long-term contract signed in April 2010 for annual volumes of approximately four billion cubic meters. There were no corresponding sales of natural gas to “ITERA” in the 2010 reporting period.

The average realized prices of our natural gas sold directly to end-customers (including transportation expense) and sold ex-field were higher by 14.2% and 13.5%, respectively, in the three months ended 30 September 2011 compared to the same period in 2010. In the three months ended 30 September 2011, as well as in the corresponding period in 2010, 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 September 2011, our revenues from sales of stable gas condensate increased by RR 893 million, or 10.1%, compared to the corresponding period in 2010 due to an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation, that was partially offset by a decrease in volumes sold.

In the three months ended 30 September 2011, our total stable gas condensate sales volumes decreased by 65 thousand tons, or 9.0%, due to an increase in the stable gas condensate inventory balance in the 2011 period compared to a decrease in the 2010 period (see “Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress” below), that was partially offset by an increase in our unstable gas condensate production. In the three months ended 30 September 2011, we exported 658 thousand tons of stable gas condensate, or 100.0% of our total sales volumes, to Europe, the United States and APR. In the three months ended 30 September 2010, we sold 723 thousand tons of stable gas condensate, of which approximately 99.9% were exported to the United States, APR and South America.

In the three months ended 30 September 2011, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 110.1 per ton, or 27.5%, to USD 510.1 per ton (DAP, CFR and CIF) from USD 400.0 per ton (DES and CIF) in the 2010 period due to a 41.7% increase in our average export contract price that was partially offset by an 80.2% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in the 2011 period compared to the corresponding period in 2010.

Liquefied petroleum gas sales

In the three months ended 30 September 2011, our revenues from sales of LPG increased by RR 641 million, or 21.1%, compared to the corresponding period in 2010, primarily due to an increase in our average realized prices.

In the three months ended 30 September 2011, we sold 113 thousand tons of LPG, or 54.3% of our total LPG sales volumes, to the export markets for an average price of USD 728.1 per ton (DAP, CPT and FCA excluding export duties), representing an increase of USD 117.9 per ton, or 19.3%, compared to the corresponding period in 2010. The increase in our average realized export prices (excluding export duties) was primarily due to a 42.2% increase in our average contract price that was partially offset by a four-fold increase in the average export duty per ton.

In the three months ended 30 September 2011, we sold 95 thousand tons of LPG, or 45.7% of our total LPG sales volumes, on the domestic market at an average price of RR 13,614 per ton (FCA, excluding VAT) representing an increase of RR 2,940 per ton, or 27.5%, compared to the 2010 period.

In the three months ended 30 September 2010, we sold 50.0% of our LPG volumes to the export markets and 50.0% to the domestic markets.

Crude oil sales

In the three months ended 30 September 2011, our revenues from sales of crude oil increased by RR 310 million, or 94.8%, compared to the 2010 period, due to an increase in sales volumes and, to a lesser extent, an increase in our average realized prices.

In the three months ended 30 September 2011, our crude oil sales volumes increased by 24 thousand tons, or 57.1%, to 66 thousand tons from 42 thousand tons in the corresponding period in 2010 due primarily to an increase in crude oil production.

In the three months ended 30 September 2011, 65.2% of our crude oil volumes were sold domestically at an average price of RR 9,046 per ton (excluding VAT) representing an increase of RR 1,566 per ton, or 20.9%, compared to the corresponding period in 2010.

The remaining 34.8% of our crude oil volumes were sold to the export markets at an average price of USD 368.6 per ton (DAP, excluding export duties) representing an increase of USD 87.0 per ton, or 30.9%, compared to the corresponding period in 2010. The increase in the average realized export price (excluding export duties) was the result of a 49.4% increase in our average export contract price that was partially offset by a 69.2% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in benchmark crude oil prices on the international markets in the 2011 period compared to the corresponding period in 2010.

Oil and gas products sales

In the three months ended 30 September 2011, our revenue from the sales of oil and gas products increased by RR nine million, or 23.7%, to RR 47 million from RR 38 million in corresponding period in 2010.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR four million to RR 39 million in the three months ended 30 September 2011, compared to RR 35 million in the 2010 period due to an increase in sales prices. In the three months ended 30 September 2011 and 2010, we sold approximately 1.4 thousand tons and 1.5 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 29,068 per ton and RR 22,991 per ton, respectively.

In the three months ended 30 September 2011, we had no revenues from domestic sales of oil products produced at the Surgutsky refinery, compared to revenues of RR three million in the corresponding period in 2010, due to the cessation of deliveries of our unstable gas condensate to the Surgutsky refinery starting in September 2010. In August 2010, we launched our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant eliminating the need for third-party processing.

In the three months ended 30 September 2011, we sold approximately one thousand tons of methanol to our associated company, Sibneftegas, and recorded revenues of RR eight million from such sale.

Sales of polymer and insulation tape

In the three months ended 30 September 2011, we had no revenues from the sales of polymer and insulation tape, compared to revenues of RR 619 million in the corresponding period in 2010, due to the disposal of our polymer and insulation tape production subsidiary OOO "NOVATEK–Polymer" in September 2010.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In the three months ended 30 September 2011, other revenues increased by RR 109 million, or 302.8%, to RR 145 million from RR 36 million in the corresponding period in 2010. The increase was primarily comprised of RR 70 million in other revenue for the sublet of a leased tanker as well as a RR 16 million increase in revenue from transportation, handling and storage services. The remaining increase of RR 23 million in other revenues was made up of various immaterial items.

Operating expenses

In the three months ended 30 September 2011, our total operating expenses increased by RR 5,294 million, or 30.1%, to RR 22,881 million compared to RR 17,587 million in the 2010 period, primarily due to an increase in taxes other than income tax and transportation expenses. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased to 70.8% in the three months ended 30 September 2011 compared to 68.8% in the corresponding period in 2010. Total operating expenses decreased as a percentage of total revenues to 57.2% in the three months ended 30 September 2011 compared to 59.7% in the corresponding period in 2010, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas sales volumes and liquids prices, as well as cost optimization due to the launch of our own transport and processing infrastructure in August 2010, and a change in inventory balances due to the buildup of inventories in transit or storage during the period.

	Three months ended 30 September:			
millions of Russian roubles	**2011**	**% of total revenues**	**2010**	**% of total revenues**
Transportation expenses	11,755	*29.4%*	9,761	*33.2%*
Taxes other than income tax	4,443	*11.1 %*	2,334	*7.9 %*
Subtotal non-controllable expenses	**16,198**	***40.5%***	**12,095**	***41.1%***
Depreciation, depletion and amortization	2,291	*5.7%*	1,783	*6.1%*
General and administrative expenses	1,760	*4.4%*	1,656	*5.6%*
Materials, services and other	1,572	*3.9%*	1,641	*5.6%*
Purchases of natural gas and liquid hydrocarbons	938	*2.3%*	67	*0.2%*
Exploration expenses	640	*1.6%*	144	*0.5%*
Net impairment expense	51	*0.1%*	154	*0.5%*
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(569)	*n/m*	47	*n/m*
Total operating expenses	**22,881**	***57.2%***	**17,587**	***59.7%***

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 September 2011, non-controllable expenses of transportation and taxes other than income tax increased by RR 4,103 million, or 33.9%, to RR 16,198 million from RR 12,095 million in the corresponding period in 2010. The change in transportation expenses was primarily due to an increase in natural gas sales volumes, as well as the increase in the natural gas and liquids transportation tariffs. Taxes other than income tax increased primarily due to a 61.2% increase in the natural gas production tax rate effective from 1 January 2011, as well as higher natural gas and liquids production volumes. As a percentage of total revenues, our non-controllable expenses decreased to 40.5% in the three months ended 30 September 2011 from 41.1% in the corresponding period in 2010.

Transportation expenses

In the three months ended 30 September 2011, our total transportation expenses increased by RR 1,994 million, or 20.4%, compared to the corresponding period in 2010.

millions of Russian roubles	**Three months ended 30 September:** 2011	2010	**Change %**
Natural gas transportation to customers	8,618	6,832	26.1%
Liquids transportation by rail	2,200	1,971	11.6%
Liquids transportation by tankers	788	845	(6.7%)
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	-	64	n/a
Crude oil transportation to customers	74	43	72.1%
Other transportation costs	75	6	n/m
Total transportation expenses	**11,755**	**9,761**	**20.4%**

In the three months ended 30 September 2011, our transportation expenses for natural gas increased by RR 1,786 million, or 26.1%, to RR 8,618 million from RR 6,832 million in the corresponding period in 2010. The change was due to a 14.6% increase in our sales volumes of natural gas delivered directly to end-customers, where the cost of transportation is included in the sales price, as well as 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.

In the three months ended 30 September 2011, total expenses for liquids transportation by rail increased by RR 229 million, or 11.6%, to RR 2,200 million from RR 1,971 million in the corresponding period in 2010 due to an increase in the average liquids transportation tariffs. The increase in the average liquids transportation tariffs was partially offset by a decrease in our combined liquids volumes sold and transported via rail. In the three months ended 30 September 2011, our combined liquids volumes sold and transported via rail decreased by 60 thousand tons, or 6.6%, to 852 thousand tons from 912 thousand tons in the corresponding period in 2010.

In the three months ended 30 September 2011, our weighted average transportation tariff for liquids delivered by rail increased by 19.7% to RR 2,586 per ton from RR 2,161 per ton in the corresponding period in 2010 primarily due to an 8.0% increase in rail tariffs set by the FTS effective 1 January 2011 and a decrease in the share of stable gas condensate volumes in our combined liquids volumes sold and transported via rail. The change in the share of stable gas condensate volumes in our total liquids volumes delivered by rail affects our weighted average rail tariff due to the relatively low transportation expense for stable gas condensate compared to other liquids.

In the three months ended 30 September 2011, as well as in the corresponding period in 2010, we applied a co-efficient of 0.89 to the existing rail tariff for stable gas condensate deliveries to export markets. In addition, in the three months ended 30 September 2011, we applied a co-efficient of 0.68 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation compared to a co-efficient of 0.35 in the corresponding period in 2010, applicable from the middle of April 2010 (see “Transportation tariffs” above).

Total transportation expense for liquids delivered by tankers to international markets decreased by RR 57 million, or 6.7%, to RR 788 million in the three months ended 30 September 2011 from RR 845 million in the 2010 period. The change was due to an 8.9% decrease in volumes sold that was partially offset by a slight increase in average freight rates. In the three months ended 30 September 2011, we delivered 54.4% of our total stable gas condensate export volumes to the APR, 27.5% to the United States and 18.1% to Europe, whereas in the corresponding period in 2010, we exported 48.9% to the United States, 42.8% to the APR and 8.3% to South America.

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

Taxes other than income tax

millions of Russian roubles	**Three months ended 30 September:** 2011	2010	**Change** %
Unified natural resources production tax (UPT)	3,656	1,798	103.3%
Property tax	435	350	24.3%
Excise and fuel taxes	276	142	94.4%
Other taxes	76	44	72.7%
Total taxes other than income tax	**4,443**	**2,334**	**90.4%**

In the three months ended 30 September 2011, taxes other than income tax increased by RR 2,109 million, or 90.4%, primarily due to an increase in the unified natural resources production tax expense.

In the three months ended 30 September 2011, our UPT for natural gas increased by RR 1,618 million, or 130.9%, due to a 61.2% increase in the natural gas production tax rate effective 1 January 2011 (from RR 147 to RR 237 per mcm), and an increase in our natural gas production volumes. The remaining increase in UPT expenses of RR 240 million related to the UPT for gas condensate and crude oil and was primarily due to an increase in the crude oil tax rate and production volumes. Our average UPT rate for crude oil is linked to the Urals benchmark crude oil price and increased to RR 4,545 per ton in the three months ended 30 September 2011 from RR 2,987 per ton in the corresponding period in 2010.

In the three months ended 30 September 2011, our property tax expense increased by RR 85 million, or 24.3%, to RR 435 million from RR 350 million in the corresponding period in 2010, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In the three months ended 30 September 2011, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska increased by RR 134 million, or 94.4%, due to an increase in our LPG export sales through Novatek Polska. The excise and fuel taxes are payable when LPG enters Polish territory.

Depreciation, depletion and amortization

In the three months ended 30 September 2011, our depreciation, depletion and amortization ("DDA") expense increased by RR 508 million, or 28.5%, to RR 2,291 million from RR 1,783 million in the corresponding period in 2010 as a result of an increase in our depletable cost base, as well as a 39.1% increase in our total hydrocarbon production (excluding our proportionate share in the production of associated companies) in barrels of oil equivalent (boe). The Group accrues depreciation and depletion using the "units of production" method for producing assets and straight-line method for other facilities.

In the three months ended 30 September 2011, our DDA per boe was RR 23.0 compared to RR 23.9 in the corresponding period in 2010. The decrease in our DDA charge calculated on a boe basis was primarily due to an increase in our proved developed reserves as of 31 December 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 as of 31 December and does not fluctuate during the year, whereas our depletable cost base does change each quarter due to the ongoing capitalization of our costs throughout the year.

General and administrative expenses

In the three months ended 30 September 2011, our general and administrative expenses increased by RR 104 million, or 6.3%, to RR 1,760 million compared to RR 1,656 million in the 2010 period. The main components of these expenses were employee compensation, charitable contributions and social programs and legal, audit and consulting services, which, on aggregate, comprised 79.1% and 76.0% of total general and administrative expenses in the three months ended 30 September 2011 and 2010, respectively.

millions of Russian roubles	Three months ended 30 September: 2011	2010	Change %
Employee compensation	667	863	(22.7%)
Charitable contributions and social programs	597	297	101.0%
Legal, audit, and consulting services	129	99	30.3%
Depreciation – administrative buildings	61	36	69.4%
Business trip expenses	57	67	(14.9%)
Security services	44	37	18.9%
Concession management services	22	34	(35.3%)
Rent expense	14	65	(78.5%)
Other	169	158	7.0%
Total general and administrative expenses	**1,760**	**1,656**	**6.3%**

Employee compensation decreased by RR 196 million, or 22.7%, to RR 667 million in the three months ended 30 September 2011 as compared to RR 863 million in the corresponding period in 2010 primarily due to a RR 247 million decrease in bonuses accrued to key management for the results achieved for the first half 2011, that was partially offset by an indexation of base salaries by 9.6% from 1 July 2011.

In the three months ended September 2011, our charitable contributions and social programs increased by RR 300 million, or 101.0%, to RR 597 million compared to RR 297 million in the corresponding period in 2010. During the quarter we commenced direct payments to the YNAO government to undertake new social programs related to the Yamal LNG project. Charitable contributions and social programs will continue to fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 30 million, or 30.3%, to RR 129 million compared to RR 99 million in the 2010 period largely due to an increase in services connected with the development of the Yamal LNG project.

In the three months ended 30 September 2011, depreciation of administrative buildings increased by RR 25 million, or 69.4%, due to the completion and opening of our new Moscow head-office in the second quarter 2011. Administrative buildings are depreciated on a straight-line basis over their estimated useful lives.

Security services expense increased by RR seven million, or 18.9%, to RR 44 million in the three months ended 30 September 2011 from RR 37 million in the corresponding period in 2010 as a result of the opening of our new Moscow head-office in May 2011.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El-Arish concession area located in Egypt). In the three months ended 30 September 2011, our expenses related to concession management services decreased by RR 12 million, or 35.3%, compared the corresponding period in 2010.

In the three months ended 30 September 2011, our rent expense decreased by RR 51 million, or 78.5%, to RR 14 million from RR 65 million in the 2010 period due to the relocation of Moscow head-office employees to our new office building in May 2011.

In the three months ended 30 September 2011, other general and administrative expenses increased by RR 11 million, or 7.0%, compared to the corresponding 2010 period. The increase was allocated amongst different expense categories within other general and administrative expenses which, taken individually, changed immaterially.

Materials, services and other

In the three months ended 30 September 2011, our materials, services and other expenses decreased by RR 69 million, or 4.2%, to RR 1,572 million compared to RR 1,641 million in the 2010 period. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 45.6% and 22.5%, respectively, of total materials, services and other expenses in the 2011 period.

millions of Russian roubles	**Three months ended 30 September: 2011**	**2010**	**Change %**
Employee compensation	717	665	7.8%
Repair and maintenance services	353	133	165.4%
Materials and supplies	144	483	(70.2%)
Electricity and fuel	93	93	0.0%
Security services	61	49	24.5%
Transportation costs	50	41	22.0%
Processing fees	24	122	(80.3%)
Other	130	55	136.4%
Total materials, services and other	**1,572**	**1,641**	**(4.2%)**

Our employee compensation increased by RR 52 million, or 7.8%, to RR 717 million compared to R 665 million in the 2010 period due primarily to a 9.6% indexation of base salaries effective 1 July 2011.

Repair and maintenance services increased by RR 220 million, or 165.4%, to RR 353 million in the three months ended 30 September 2011 compared to RR 133 million in the 2010 period. The increase was primarily related to current repair works at our production assets and was consistent with our on-going maintenance schedules.

Materials and supplies expense decreased by RR 339 million, or 70.2%, mainly due to a cessation of purchases of raw materials required for the production of polymer and insulation tape products as a result of the disposal of OOO “NOVATEK-Polymer” in September 2010, which accounted for RR 393 million of the total decrease in materials and supplies expense.

Security services expense increased by RR 12 million, or 24.5%, to RR 61 million in the three months ended 30 September 2011 from RR 49 million in the corresponding period in 2010 largely due to additional security related to recently completed infrastructure projects at our production subsidiaries.

In the three months ended 30 September 2011, our transportation costs related to the delivery of materials and goods to our fields increased by RR nine million, or 22.0%, to RR 50 million compared to RR 41 million in the corresponding period in 2010 primarily due to an increase in third party services provided to our production subsidiaries.

Processing fees decreased by RR 98 million, or 80.3%, to RR 24 million in the three months ended 30 September 2011, from RR 122 million in the 2010 period due primarily to the launch of our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010, which resulted in savings of approximately RR 94 million on third-party processing fees in the 2011 period.

Purchases of natural gas and liquid hydrocarbons

Purchases of natural gas and liquid hydrocarbons increased by RR 871 million to RR 938 million in the three months ended 30 September 2011, from RR 67 million in the corresponding period in 2010, of which RR 903 million of the increase related to the purchases of natural gas from our associated company Sibneftegas which was partially offset by a decrease of RR 32 million related to oil products and LPG purchases from third parties for resale.

Exploration expenses

In the three months ended 30 September 2011, our exploration expenses increased by RR 496 million, or 344.4%, to RR 640 million from RR 144 million in the corresponding period in 2010. In the 2011 period, we expensed the capitalized cost of three exploratory wells in accordance with our accounting policy in the total amount of RR 414 million at the Raduzhny and Yarudeiskiy licence areas.

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

In the three months ended 30 September 2011, we recorded a reversal of RR 569 million to change in inventory expense as compared to a charge of RR 47 million in the corresponding period in 2010:

millions of Russian roubles	**Three months ended 30 September: 2011**	**2010**
Natural gas	(433)	(107)
Stable gas condensate	(131)	222
Other	(5)	(68)
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	**(569)**	**47**

In the three months ended 30 September 2011, we recorded a reversal to our operating expenses of RR 433 million due to a 991 mmcm increase in our natural gas inventory balance. Our volumes of natural gas injected into Gazprom's underground gas storage facilities fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in the three months ended 30 September 2011, we recorded a reversal of RR 131 million to our operating expenses due to a 51 thousand tons increase in our inventory balance of stable gas condensate in transit and storage.

The following table highlights movements in our inventory balances:

Inventory balances in transit or in storage	**2011** At 30 September	At 30 June	Increase / (decrease)	**2010** At 30 September	At 30 June	Increase / (decrease)
Natural gas (millions of cubic meters)	**1,225**	**234**	**991**	**1,058**	**829**	**229**
including Gazprom's UGSF	*1,194*	*203*	*991*	*1,010*	*800*	*210*
Liquid hydrocarbons (thousand tons)	**422**	**371**	**51**	**296**	**388**	**(92)**
including stable gas condensate	*325*	*274*	*51*	*206*	*332*	*(126)*

Other operating income (loss)

In the three months ended 30 September 2011, we recognized other operating income of RR 31 million which was primarily related to different immaterial items, including profit (loss) on disposal of materials, fixed assets, equipment and other transactions.

In the three months ended 30 September 2010, we recognized a net loss on the disposal of our non-core, wholly-owned subsidiary, OOO "NOVATEK-Polymer" in amount of RR 254 million. In addition, we recognized other operating income of RR 408 million, of which RR 317 million related to the depositary services provided to the holders of our GDRs.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 5,122 million, or 42.7%, to RR 17,130 million in the three months ended 30 September 2011, compared to RR 12,008 million in the corresponding period in 2010. In the three months ended 30 September 2011, our profit from operations as a percentage of total revenues increased to 42.8% compared to 40.8% in the 2010 period primarily due to higher natural gas sales volumes and liquids prices.

Finance income (expense)

In the three months ended 30 September 2011, we recorded net finance expense of RR 5,890 million due primarily to an increase in a foreign exchange loss from the depreciation of the Russian rouble relative to the US dollar compared to a net finance gain of RR 482 million in the corresponding period in 2010 due to a foreign exchange gain from the appreciation of the Russian rouble relative to the US dollar.

In the three months ended 30 September 2011, our total accrued interest expense increased to RR 1,448 million compared to RR 665 million in the corresponding period in 2010 as a result of an increase in our average borrowings. In the three months ended 30 September 2011 and 2010, we capitalized RR 1,072 and RR 568 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with the Group's accounting policy.

Interest income increased to RR 801 million in the three months ended 30 September 2011 from RR eight million in the corresponding period in 2010 primarily due to an increase in interest income on loans provided to our associated companies.

In the three months ended 30 September 2011, we recorded a net foreign exchange loss of RR 6,315 million compared to a net foreign exchange gain of RR 571 million in the 2010 period due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble depreciated by 13.5% against the US dollar during the three months ended 30 September 2011 compared to Russian rouble appreciation of 2.6% in the corresponding period in 2010. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio.

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

Our proportionate share in loss of equity investments increased from RR seven million in the three months ended 30 September 2010 to RR 751 million in the 2011 period, of which a significant portion was related to Sibneftegas and Yamal Development. The losses we recognized in Sibneftegas were primarily due to the revaluation of oil and gas properties acquired to fair value and the subsequent amortization of those costs under IFRS. The share of loss related to Yamal Development resulted from the recognition of interest expense on loans obtained.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 20.1% and 19.4% for the three months ended 30 September 2011 and 2010, respectively. Our effective income tax rate, excluding the effect of foreign subsidiaries, was 20.3% and 20.5% in the 2011 and 2010 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 1,834 million, or 18.2%, to RR 8,227 million in the three months ended 30 September 2011 from RR 10,061 million in the corresponding period in 2010. The profit attributable to shareholders of OAO "NOVATEK" decreased by RR 1,699 million, or 16.8%, to RR 8,406 million in the three months ended 30 September 2011 from RR 10,105 million in the corresponding period in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO "NOVATEK", decreased by approximately RR 0.56 per share, or 16.8%, to RR 2.77 per share in the 2011 period from RR 3.33 per share in corresponding period in 2010.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 30 September 2011 and 2010:

millions of Russian roubles	Three months ended 30 September: 2011	2010	Change %
Net cash provided by operating activities	12,560	12,085	3.9%
Net cash used in investing activities	(8,237)	(6,373)	29.2%
Net cash provided by (used in) financing activities	(2,037)	(9,253)	(78.0%)

Liquidity ratios	30 September 2011	31 December 2010	Change, %
Current ratio	0.88	0.51	72.5%
Total debt to equity	0.56	0.49	14.3%
Long-term debt to long-term debt and equity	0.32	0.24	33.3%
Net debt to total capitalization (1)	0.28	0.25	12.0%

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

Net cash provided by operating activities

In the three months ended 30 September 2011, our net cash provided by operating activities increased by RR 475 million, or 3.9%, to RR 12,560 million compared to RR 12,085 million in the corresponding period in 2010. The increase was primarily due to an increase in natural gas sales volumes and liquids prices, that was partially offset by an increase in accounts receivable and prepayments and an increase in income tax paid.

Net cash used in investing activities

In the three months ended 30 September 2011, our net cash used in investing activities increased by RR 1,864 million, or 29.2%, to RR 8,237 million as compared to RR 6,373 million in the corresponding period in 2010 due primarily to an increase in loans provided to our associated companies.

Net cash provided by (used in) financing activities

In the three months ended 30 September 2011, our net cash used in financing activities decreased by RR 7,216 million, or 78.0%, to RR 2,037 million from RR 9,253 million in the corresponding period in 2010 due to a decrease in repayment of long-term borrowings.

Working capital

Our net working capital position (current assets less current liabilities) at 30 September 2011 was negative RR 7,022 million compared to a negative RR 27,876 million at 31 December 2010.

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

In September 2011, the Group increased its equity stake in Yamal LNG from 51% to 100% through the execution of the two call options. The options' strike price will be paid in instalments with the final payment due by 30 June 2012. As a result, RR 30,632 million (USD 961 million) was disclosed as part of accounts payable and accrued liabilities at 30 September 2011, of which USD 456 million were paid in October 2011. The remaining balance of USD 505 million will be repaid from the proceeds of the 29% shares in Yamal LNG sold to the potential partners.

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

Capital expenditures

Total capital expenditures on property, plant and equipment for the three months ended 30 September 2011 and 2010 were as follows:

millions of Russian roubles	Three months ended 30 September: 2011	2010	Change %
Exploration, production and marketing	7,527	7,027	7.1%
Polymer production and marketing	-	147	n/a
Total	**7,527**	**7,174**	**4.9%**

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities for the three months ended 30 September 2011 and 2010:

millions of Russian roubles	Three months ended 30 September: 2011	2010
Yurkharovskoye field	2,796	2,635
South-Tambeyskoye field	1,034	850
East-Tarkosalinskoye field	835	221
Purovsky Plant	506	587
Gas Condensate Fractionation Complex and Transshipment facilities (Ust-Luga)	474	358
Olimpiyskiy license area	138	144
West-Urengoiskiy license area	129	19
Khancheyskoye field	21	21
Other	1,594	2,192
Exploration, production and marketing	**7,527**	**7,027**

Debt obligations

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

Our total debt increased from RR 72,226 million at 31 December 2010 to RR 95,795 million at 30 September 2011, or by RR 23,569 million, in order to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields and investments in related assets such as the Purovsky Plant, as well as the acquisition of new oil and gas assets.

Our total debt position (net of unamortized transaction costs) at 30 September 2011 and 31 December 2010 was as follows:

Facility	Amount	Maturity	Interest rate	At 30 September 2011	At 31 December 2010
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	20,564	-
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	19,007	-
Sberbank	RR 15 billion	December 2013	7.5%	14,962	14,948
Gazprombank	RR 10 billion	November 2012	8% (1)	10,000	10,000
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,965	9,949
Sumitomo Mitsui Banking Corporation Europe Limited	USD 300 million	December 2013	LIBOR+1.45%	8,554	-
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9%	6,375	6,095
UniCredit Bank	USD 200 million	October 2012	LIBOR+3.25% (1)	6,368	6,082
Bridge loan facility (2)	USD 600 million	November 2011	LIBOR+1%	-	18,200
Syndicated term loan facility	USD 800 million	April 2011	LIBOR+1.5%	-	6,952
Total				**95,795**	**72,226**

(1) – interest rates were changed during the periods.
(2) – bridge loan repaid in February 2011 ahead of maturity schedule.

Scheduled maturities of our long-term debt outstanding (net of unamortized transaction costs) at 30 September 2011 were as follows:

Maturity schedule:	**RR million**
1 October 2012 to 30 September 2013	21,702
1 October 2013 to 30 September 2014	17,459
1 October 2014 to 30 September 2015	-
1 October 2015 to 30 September 2016	19,007
After 30 September 2016	20,564
Total long-term debt	**78,732**

At 30 September 2011, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 6,216 million (USD 195 million) at either fixed or variable interest rates subject to the specific type of credit facility.

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

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 30 September 2011, total amount of our long-term debt denominated in US dollars was RR 51,305 million, or 53.6% of our total borrowings at that date. Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms, as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, approximately 27.6% in the three months ended 30 September 2011, is denominated in US dollars. As of 30 September 2011, the Russian rouble depreciated by approximately 4.6% against the US dollar since 31 December 2010.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 30 September 2011 would have resulted in an estimated foreign exchange loss of approximately RR 6,087 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 September 2011, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.