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

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom, in each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for 2011. 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

The Group and OAO Gazprom (the "Parties") signed a Memorandum of Cooperation in April 2012, whereby the Parties are considering the possibility to establish a joint venture to increase liquefied natural gas production capacity on the Yamal peninsula as well as jointly developing hydrocarbon resources on the Gydan peninsula. As specified in the Memorandum of Cooperation, the Parties will consider establishing a joint venture (preliminary shareholdings: Gazprom – 75%; NOVATEK – 25%) based on the hydrocarbon resources of Gazprom's wholly owned Tambey fields (West-Tambeyskoye, North-Tambeyskoye and Tasiyskoye fields) to increase liquefied natural gas production on the Yamal peninsula and a joint venture based on NOVATEK's Salmanovskoye (Utrenneye) field to develop the existing assets located on the Gydan peninsula with equal shareholdings (Gazprom - 50% and NOVATEK – 50%). Gazprom and NOVATEK will formulate and approve an integrated program for developing their fields on the Gydan peninsula.

In April 2012, our joint venture OOO SeverEnergia ("SeverEnergia") launched the first phase of the Samburgskoye field with an annual natural gas production capacity of approximately 2.3 billion cubic meters and approximately 550 thousand tons of gas condensate. We anticipate launching the second phase of natural gas and gas condensate in the fourth quarter 2012. Subsidiaries of SeverEnergia hold licenses for the development of oil and gas condensate fields (Samburgskoye, Yaro-Yakhinskoye, North-Chaselskoye, Urengoiskoye and other fields) in the Yamal Nenets Autonomous Region ("YNAO"). SeverEnergia's proved reserves as appraised by DeGolyer and MacNaughton ("D&M") under the Securities and Exchange Commission ("SEC") and PRMS reserves methodologies, as of 31 December 2011, totaled approximately 340 and 429 billion cubic meters of natural gas and 59 and 80 million tons of liquid hydrocarbons, respectively.

In November 2011, the Group acquired OOO Gazprom mezhregiongas Chelyabinsk ("Gazprom mezhregiongas Chelyabinsk") a natural gas trader serving the Chelyabinsk Region of the Russian Federation, to support and expand the Group's regional natural gas sales commercial operations.

In September 2011, the Group increased its equity interest in Yamal LNG from 51% to 100% and subsequently disposed of a 20% interest in the company in October 2011 to TOTAL S.A., the Group's strategic partner in the Yamal LNG project. The project will construct a natural gas liquefaction plant in three trains of five million tons per annum to exploit the resources of the South-Tambeyskoye field, located on the Yamal peninsula.

In August 2011, we received an exploration and production license for the discovered in 2010 Ukrainsko-Yubileynoye field.

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

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

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 31 March: 2012	2011	Change %
Financial results			
Total revenues (net of VAT and export duties)	54,373	44,894	21.1%
Operating expenses	(31,851)	(23,443)	35.9%
Profit attributable to shareholders of OAO NOVATEK	21,245	18,769	13.2%
EBITDA [(1)]	24,217	23,020	5.2%
EBITDAX [(2)]	25,113	23,746	5.8%
Earnings per share (in Russian roubles)	7.00	6.19	13.1%
Operating results			
Natural gas sales volumes (million cubic meters)	16,050	13,992	14.7%
Stable gas condensate sales volumes (thousand tons)	624	724	(13.8%)
Liquefied petroleum gas sales volumes (thousand tons)	238	229	3.9%
Crude oil sales volumes (thousand tons)	84	49	71.4%
Total hydrocarbons production (million barrels of oil equivalent) [(3)]	103.6	95.6	8.4%
Total daily production (thousand barrels of oil equivalent per day) [(3)]	1,139	1,062	7.3%
Cash flow results			
Net cash provided by operating activities	23,949	19,205	24.7%
Capital expenditures	7,519	6,342	18.6%
Free cash flow [(4)]	16,430	12,863	27.7%

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

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

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

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

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

millions of Russian roubles	Three months ended 31 March: 2012	2011
Profit (loss) attributable to shareholders of OAO NOVATEK	**21,245**	**18,769**
Depreciation, depletion and amortization	2,614	2,061
Net impairment expense	25	12
Total finance expense (income)	(5,624)	(2,738)
Total income tax expense	5,957	4,916
EBITDA	**24,217**	**23,020**
Exploration expenses	896	726
EBITDAX	**25,113**	**23,746**

SELECTED MACRO-ECONOMIC DATA

Exchange rate of Russian rouble to US dollar	Three months ended 31 March: 2012	2011	Change %
At the beginning of the period	32.20	30.48	5.6%
At the end of the period	29.33	28.43	3.2%
Average for the period	30.26	29.27	3.4%

Crude oil prices, USD / bbl	Three months ended 31 March: 2012	2011	Change %
WTI [1]			
At the end of the period	103.0	106.7	(3.5%)
Average for the period	103.0	94.6	8.9%
Brent [2]			
At the end of the period	123.5	116.9	5.6%
Average for the period	118.6	105.4	12.5%
Urals [2]			
At the end of the period	120.0	113.1	6.1%
Average for the period	116.9	102.6	13.9%

[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 31 March: 2012	2011	Change %
Crude oil, stable gas condensate			
At the end of the period	411.2	365.0	12.7%
Average for the period	400.8	343.0	16.9%
LPG			
At the end of the period	157.3	150.2	4.7%
Average for the period	180.0	166.1	8.4%

[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 have prolonged a period of market volatility as well as changes in the political landscape with the results of the recent elections. The Greek bailout package, the looming debt crisis in Spain, the proposed “austerity programs” in the Euro-Zone and the potential threat to the European banking community of a sovereign-debt crisis in the European Union has been the main driver of the market volatility. The recent wave of market uncertainty continues to negatively impact all borrowers by limiting access to the capital markets as well as causing continued volatility in the equity and currency markets, especially for those companies operating in the so-called “emerging markets”.

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

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

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

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian Government’s regulation of natural gas prices, except for those volumes delivered to residential customers, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency, and present market conditions.

According to the revised Forecast of Socio-economic Development of the Russian Federation for 2012 announced in September 2011, the regulated natural gas prices will be increased by 15% effective from 1 July 2012, 2013 and 2014. We expect that the FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published, as well as potentially prolong the timetable toward market price liberalization based on market conditions and other factors.

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

In December 2011, we commenced natural gas sales to residential customers at regulated prices in the Chelyabinsk region as a result of the acquisition of a regional gas trader Gazprom mezhregiongas Chelyabinsk. We disclose our sales prices to residential customers separately from other end-customers as natural gas prices to residential customers are regulated by FTS.

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 2011.

In the three months ended 31 March 2012, our average natural gas price to end-customers (excluding residential customers) and ex-field price decreased by 0.2% and increased by 0.8%, respectively, whereas our average transportation expense for the delivery of natural gas to end-customers (excluding residential customers) decreased by 4.8%. As a result, our average netback price on end-customers sales (excluding residential customers) increased by 3.8%, while our total average natural gas price excluding transportation expense increased by 2.3% compared to respective prices in the corresponding period in 2011.

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 31 March 2012 and 2011:

	Three months ended 31 March:		Change
Russian roubles per mcm	**2012**	**2011**	**%**
Average natural gas price [(1)]:			
End-customers	*2,630*	*2,634*	*(0.2%)*
Residential customers	*2,128*	*-*	*n/a*
Average natural gas price to end-customers	**2,616**	**2,634**	**(0.7%)**
Average natural gas transportation expense:			
End-customers	*(1,150)*	*(1,208)*	*(4.8%)*
Residential customers	*(1,415)*	*-*	*n/a*
Average natural gas transportation expense for sales to end-customers	**(1,158)**	**(1,208)**	**(4.1%)**
Average natural gas netback price:			
End-customers	*1,480*	*1,426*	*3.8%*
Residential customers	*713*	*-*	*n/a*
Average natural gas netback price on end-customer sales	**1,458**	**1,426**	**2.2%**
Average natural gas price ex-field (wholesale traders)	**1,409**	**1,398**	**0.8%**
Total average natural gas price excluding transportation expense	**1,444**	**1,412**	**2.3%**

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 31 March 2012, the average benchmark crude oil prices were more than 10% higher than in the corresponding period in 2011.

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

In the three months ended 31 March 2012, our stable gas condensate export delivery terms were cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF), while in the corresponding period in 2011 our delivery terms were either DES, CIF, CFR, DAP, or delivery at terminal (DAT). Our average stable gas condensate export contract price, including export duties, in the three months ended 31 March 2012, was approximately USD 1,020 per ton compared to approximately USD 911 per ton in the corresponding period in 2011.

In the three months ended 31 March 2012, as well as in the corresponding period in 2011, our crude oil export delivery terms were DAP (Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 842 per ton compared to USD 733 per ton in the corresponding period in 2011.

The following table shows our average realized stable gas condensate and crude oil sales prices (net of VAT and export duties, where applicable) for the three months ended 31 March 2012 and 2011 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Three months ended 31 March: 2012**	**2011**	**Change %**
Stable gas condensate			
Net export price, RR per ton	18,633	16,846	10.6%
Net export price, USD per ton	615.8	575.5	7.0%
Domestic price, RR per ton	14,186	-	n/a
Crude oil			
Net export price, RR per ton	13,403	11,285	18.8%
Net export price, USD per ton	442.9	385.6	14.9%
Domestic price, RR per ton	11,576	10,107	14.5%

Our LPG export delivery terms during the three months ended 31 March 2012 and 2011, were DAP at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and free carrier (FCA) at terminal points in Poland. In the three months ended 31 March 2012, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 904 per ton compared to USD 850 per ton in the corresponding period in 2011.

In the three months ended 31 March 2012, we sold 114 thousand tons of our LPG on the domestic market at an average price of RR 13,094 per ton (FCA), including volumes sold through our wholly owned subsidiary OOO NOVATEK-Refueling Complexes, compared to 112 thousand tons at an average price of RR 12,267 per ton in the corresponding period in 2011.

The following table shows our average realized LPG and methanol sales prices excluding LPG trading activities, (net of VAT and export duties, where applicable) for the three months ended 31 March 2012 and the corresponding period in 2011 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

Russian roubles or US dollars per ton	**Three months ended 31 March: 2012**	**2011**	**Change %**
LPG			
Net export price, RR per ton	21,417	20,383	5.1%
Net export price, USD per ton	707.7	696.4	1.6%
Domestic price, RR per ton	13,101	12,267	6.8%
Methanol			
Domestic price, RR per ton	10,004	9,999	0.1%

Transportation tariffs

Natural gas

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

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

Effective from 1 January 2011, the FTS approved a 9.3% average increase of the transportation tariff for natural gas and the rate for utilization of the trunk pipeline had a range of RR 44.97 to RR 1,964.13 (excluding VAT) per mcm and the transportation rate was RR 11.23 (excluding VAT) per mcm per 100 km. According to the announcement from the FTS in September 2011, the transportation tariff for natural gas will be increased as of the same date as the increase in the regulated natural gas prices, effective from 1 July 2012.

Crude oil

We transport most of our crude oil through the pipeline network owned and operated by Transneft, Russia's state-owned monopoly crude oil pipeline operator. The FTS also sets tariffs for transportation of crude oil through Transneft's pipeline network, which includes transport, dispatch, pumping, loading, charge-discharge, transshipment and other services. The FTS sets tariffs for each separate route of the pipeline network, so the overall expense for the transport of crude oil primarily depends on the length of the transport route from the producing field to the ultimate destination, transportation direction and other factors.

In August 2011, the FTS announced the increase in crude oil transportation tariffs from September and November 2011 on average by approximately 2.9% and 5.0%, respectively.

Stable gas condensate and LPG

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

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

We deliver our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and tankers for transportation to US, European, and countries of the APR. The cost of tanker transportation is generally determined by the distance to the final destination, the availability of tankers, the seasonality of deliveries and standard shipping terms, all in accordance with general industry practice.

Our tax burden

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

According to the Russian Tax Code, the UPT rate for natural gas was set at RR 237, RR 251 and RR 265 per mcm for 2011, 2012 and 2013, respectively. The UPT rates for natural gas may be changed from 1 July 2013 subject to the approval by the State Duma of the Russian Federation.

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

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

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to a combination of increased production at our core producing fields and purchases from related parties. Liquids sales volumes increased primarily due to an organic growth at the Yurkharovskoye field as well as an increase in crude oil production at the East-Tarkosalinskoye and Khancheyskoye fields that was partially offset by a buildup in liquids inventory balances in the 2012 reporting period. Our liquids inventory balances tend to fluctuate periodically due to loading schedules and final destinations of stable gas condensate shipments.

Natural gas sales volumes

millions of cubic meters	Three months ended 31 March: 2012	2011	Change %
Production from:			
Yurkharovskoye field	8,703	7,802	11.5%
East-Tarkosalinskoye field	3,406	3,310	2.9%
Khancheyskoye field	920	809	13.7%
Other fields	16	18	(11.1%)
Total natural gas production	**13,045**	**11,939**	**9.3%**
Purchases from the Group's joint venture	1,409	1,371	2.8%
Total production and purchases from Group's joint ventures	**14,454**	**13,310**	**8.6%**
Other purchases	900	-	n/a
Total production and purchases	**15,354**	**13,310**	**15.4%**
Purovsky Plant and own usage	(32)	(31)	3.2%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	728	713	2.1%
Total natural gas sales volumes	**16,050**	**13,992**	**14.7%**
Subtotal sold to end-customers	*12,172*	*7,095*	*71.6%*
Sold ex-field	*3,878*	*6,897*	*(43.8%)*

In the three months ended 31 March 2012, our total natural gas production (including our pro-rata share in production of our joint venture Sibneftegas) increased by 1,144 mmcm, or 8.6%, to 14,454 mmcm from 13,310 mmcm in the corresponding period in 2011 primarily due to an increase in production at our Yurkharovskoye field resulting from the field's ongoing development activities. The increase in natural gas production at the Khancheyskoye and East-Tarkosalinskoye fields was due to increased demand resulting in a greater utilization of the fields' production capacity.

In January 2012, we commenced purchasing natural gas from our related party, ZAO SIBUR Holding.

In the three months ended 31 March 2012, we used 20 mmcm of natural gas as feedstock for the production of methanol compared to 18 mmcm in the corresponding period in 2011. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation (condensation) during the production, preparation and transportation of hydrocarbons.

Liquids sales volumes

thousands of tons	Three months ended 31 March: 2012	2011	Change %
Production from:			
Yurkharovskoye field	710	679	4.6%
East-Tarkosalinskoye field	231	201	14.9%
Khancheyskoye field	134	137	(2.2%)
Other fields	5	7	(28.6%)
Total liquids production	**1,080**	**1,024**	**5.5%**
Purchases	2	1	100.0%
Total production and purchases	**1,082**	**1,025**	**5.6%**
Losses and own usage [(1)]	(10)	(7)	42.9%
Decreases (increases) in liquids inventory balances	(124)	(15)	n/a
Total liquids sales volumes	**948**	**1,003**	**(5.5%)**
Stable gas condensate export	*623*	*724*	*(14.0%)*
Stable gas condensate domestic	*1*	*-*	*n/a*
Subtotal stable gas condensate	***624***	***724***	***(13.8%)***
LPG export	*124*	*116*	*6.9%*
LPG CIS	*-*	*1*	*n/a*
LPG domestic	*94*	*99*	*(5.1%)*
LPG sold through domestic retail and small wholesale stations	*20*	*13*	*53.8%*
Subtotal LPG	***238***	***229***	***3.9%***
Crude oil export	*27*	*21*	*28.6%*
Crude oil domestic	*57*	*28*	*103.6%*
Subtotal crude oil	***84***	***49***	***71.4%***
Oil products domestic	*2*	*1*	*100.0%*
Subtotal oil products	***2***	***1***	***100.0%***

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

In the three months ended 31 March 2012, our liquids production increased by 56 thousand tons, or 5.5%, to 1,080 thousand tons compared to 1,024 thousand tons in the corresponding period in 2011 primarily due to an increase in production at our Yurkharovskoye and East-Tarkosalinskoye fields, with an offsetting decrease from the Khancheyskoye field. The increase in gas condensate production at the Yurkharovskoye field was due to field's ongoing development, whereas the increase in liquids production at the East-Tarkosalinskoye field was primarily related to an increase in crude oil production resulting from the development of crude oil deposits, that was partially offset by a decrease in gas condensate production due to lower concentration of gas condensate in the extracted gas. Natural declines in the concentration of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2012 COMPARED TO THE CORRESPONDING PERIOD IN 2011

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2012 and 2011. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March:			
millions of Russian roubles	**2012**	**% of total revenues**	**2011**	**% of total revenues**
Total revenues **(net of VAT and export duties)**	**54,373**	***100.0%***	**44,894**	***100.0%***
including:				
natural gas sales	37,305	*68.6%*	28,330	*63.1%*
liquids sales	16,847	*31.0%*	16,496	*36.7%*
Operating expenses	(31,851)	*(58.6%)*	(23,443)	*(52.2%)*
Other operating income (loss)	41	*0.1%*	53	*0.1%*
Profit from operations	**22,563**	***41.5%***	**21,504**	***47.9%***
Finance income (expense)	5,624	*10.3%*	2,738	*6.1%*
Share of profit (loss) of equity investments, net of income tax	(991)	*(1.8%)*	(610)	*(1.4%)*
Profit before income tax	**27,196**	***50.0%***	**23,632**	***52.6%***
Total income tax expense	(5,957)	*(10.9%)*	(4,916)	*(10.9%)*
Profit (loss)	**21,239**	***39.1%***	**18,716**	***41.7%***
Non-controlling interest	6	*0.0%*	53	*0.1%*
Profit attributable to shareholders of OAO NOVATEK	**21,245**	***39.1%***	**18,769**	***41.8%***

Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the three months ended 31 March 2012 and 2011:

millions of Russian roubles	Three months ended 31 March: 2012	2011	Change %
Natural gas sales	**37,305**	**28,330**	**31.7%**
End-customers	*31,842*	*18,688*	*70.4%*
Ex-field sales	*5,463*	*9,642*	*(43.3%)*
Stable gas condensate sales	**11,623**	**12,192**	**(4.7%)**
Export	*11,610*	*12,192*	*(4.8%)*
Domestic	*13*	*-*	*n/a*
Liquefied petroleum gas sales	**4,147**	**3,747**	**10.7%**
Export	*2,657*	*2,359*	*12.6%*
CIS	*-*	*10*	*n/a*
Domestic	*1,490*	*1,378*	*8.1%*
Crude oil sales	**1,024**	**515**	**98.8%**
Export	*370*	*231*	*60.2%*
Domestic	*654*	*284*	*130.3%*
Oil and gas products sales	**53**	**42**	**26.2%**
Domestic	*53*	*42*	*26.2%*
Total oil and gas sales	**54,152**	**44,826**	**20.8%**
Other revenues	221	68	225.0%
Total revenues	**54,373**	**44,894**	**21.1%**

Natural gas sales

In the three months ended 31 March 2012, our revenues from sales of natural gas increased by RR 8,975 million, or 31.7%, compared to the corresponding period in 2011 due to an increase in total sales volumes as a result of an increase in natural gas production and purchases, as well as an increase in our average realized natural gas price resulting from an increase in our proportion of end-customer sales to total natural gas sales volumes.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes increased to 75.8% in the three months ended 31 March 2012 from 50.7% in the corresponding period in 2011. The increase was due to higher natural gas deliveries to the Chelyabinsk region through our regional natural gas trader acquired in November 2011. In the three months ended 31 March 2012, our natural gas sales volumes representing greater than 10% of total end-customers sales volumes were to Chelyabinsk and Perm regions. In the corresponding period in 2011, our major natural gas sales representing greater than 10% of the end-customer sales volumes were to Perm, Chelyabinsk, Orenburg and Moscow regions.

In the three months ended 31 March 2012, our average netback price on end-customers sales (excluding residential customers) increased by 3.8% compared to the corresponding period in 2011 despite a 0.2% decrease in our average realized end-customers sales price (excluding residential customers). The decrease in our average realized end-customers sales price (excluding residential customers) was primarily due to an increase in natural gas deliveries to regions closer to our producing fields. Our average realized ex-field price was higher by 0.8% than in the corresponding 2011 period.

In the three months ended 31 March 2012, as well as in the corresponding period in 2011, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies. In the three months ended 31 March 2012, our proportion of natural gas sold to energy utility companies and large industrial companies was 56% and 31%, respectively, of total natural gas volumes sold to end-customers.

Stable gas condensate sales

In the three months ended 31 March 2012, our revenues from sales of stable gas condensate decreased by RR 569 million, or 4.7%, compared to the corresponding period in 2011 due primarily to a decrease in volumes recognized as sold in the period as a result of inventory movements that 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.

Our total stable gas condensate sales volumes decreased by 100 thousand tons, or 13.8%, due to an increase in the stable gas condensate inventory balance in the three months ended 31 March 2012 of 124 thousand tons compared to a slight increase in the corresponding period in 2011 (see “Change in natural gas, liquid hydrocarbons and work-in-progress” below). In the three months ended 31 March 2012, we exported 623 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to Europe, the United States and APR with the remaining one thousand tons sold domestically. In the corresponding period in 2011, we exported 724 thousand tons of stable gas condensate, or 100.0% of our total sales volumes, to APR, Europe and the United States.

In the three months ended 31 March 2012, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 40.3 per ton, or 7.0%, to USD 615.8 per ton (CFR, DES, DAP and CIF) from USD 575.5 per ton (DES, CIF, CFR, DAP and DAT) in the corresponding period in 2011 due to a 12.0% increase in our average export contract price that was partially offset by a 23.9% 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 three months ended 31 March 2012 compared to the corresponding period in 2011.

Liquefied petroleum gas sales

In the three months ended 31 March 2012, our revenues from sales of LPG increased by RR 400 million, or 10.7%, compared to the corresponding period in 2011 primarily due to an increase in our average realized prices as well as an increase in volumes sold.

In the three months ended 31 March 2012, we sold 124 thousand tons of LPG, or 52.1% of our total LPG sales volumes, to export markets as compared to 116 thousand tons, or 50.7%, in the corresponding period in 2011. In the three months ended 31 March 2012, our export sales volumes of LPG representing greater than 10% of total LPG export volumes were to Poland and Finland. In the corresponding period in 2011, our major LPG export sales were to Poland, Finland and Turkey.

Our average realized LPG export price, excluding export duties, increased by USD 11.3 per ton, or 1.6%, to USD 707.7 per ton in the three months ended 31 March 2012 (DAP, CPT and FCA) compared to USD 696.4 per ton in the corresponding period in 2011 primarily due to a 6.4% increase in average contract price that was partially offset by an increase in our average export duty per ton by 27.3%.

In the three months ended 31 March 2012, we sold 114 thousand tons of LPG, or 47.9% of our total LPG sales volumes, on the domestic market at an average price of RR 13,094 per ton (FCA, excluding VAT) representing an increase of RR 827 per ton, or 6.7%, compared to the corresponding period in 2011.

Crude oil sales

In the three months ended 31 March 2012, our revenues from sales of crude oil increased by RR 509 million, or 98.8%, compared to the corresponding period in 2011 primarily due to an increase in sales volumes and, to a lesser extent, an increase in our average realized prices. Our crude oil sales volumes increased by 35 thousand tons, or 71.4%, to 84 thousand tons from 49 thousand tons in the corresponding period in 2011 due primarily to an increase in crude oil production at our East-Tarkosalinskoye and Khancheyskoye fields.

The majority of our crude oil sales volumes, representing 67.9% in the three months ended 31 March 2012, was sold domestically at an average price of RR 11,576 per ton (excluding VAT) representing an increase of RR 1,469 per ton, or 14.5%, compared to the corresponding period in 2011. The remaining 32.1% of our crude oil volumes were sold to export markets at an average price of USD 442.9 per ton (DAP, excluding export duties) representing an increase of USD 57.3 per ton, or 14.9%, compared to the corresponding period in 2011.

The increase in the average realized export price (excluding export duties) was the result of a 14.9% increase in our average export contract price that was partially offset by a 18.1% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in benchmark crude oil prices on international markets in the three months ended 31 March 2012 compared to the corresponding period in 2011.

Oil and gas products sales

In the three months ended 31 March 2012, our revenue from the sales of oil and gas products increased by RR 11 million, or 26.2%, to RR 53 million from RR 42 million in the corresponding period in 2011.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR nine million to RR 41 million in the three months ended 31 March 2012 compared to RR 32 million in the corresponding period in 2011 due to both an increase in sales prices and volumes. In the three months ended 31 March 2012 and 2011, we sold approximately 1.46 thousand and 1.29 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 27,868 and RR 24,695 per ton, respectively.

In the three months ended 31 March 2012 and 2011, we sold approximately 1.24 thousand tons and 1.05 thousand tons of methanol to our joint venture, Sibneftegas, and recorded revenues of RR 12 million and RR 10 million from such sales, respectively.

Other revenues

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In the three months ended 31 March 2012, other revenues increased by RR 153 million, or 225.0%, to RR 221 million from RR 68 million in the corresponding period in 2011. The increase was primarily comprised of a RR 77 million increase in revenue from transportation, handling and storage services, as well as RR 40 million increase in revenues from geological and geophysical research services provided primarily to our joint ventures. In addition, in the three months ended 31 March 2012, we recognized RR 23 million of revenue by subletting leased icebreaker under contract to third parties. The remaining increase of RR 13 million in other revenues was made up of various immaterial items.

Operating expenses

In the three months ended 31 March 2012, our total operating expenses increased by RR 8,408 million, or 35.9%, to RR 31,851 million compared to RR 23,443 million in the corresponding period in 2011 primarily due to an increase in transportation expenses and purchases of natural gas. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased to 65.9% in the three months ended 31 March 2012 compared to 69.2% in the corresponding period in 2011. Total operating expenses increased as a percentage of total revenues to 58.6% in the three months ended 31 March 2012 compared to 52.2% in the corresponding period in 2011, as shown in the table below. The increase in our operating expenses as a percentage of total revenues was primarily due to the initiation in January 2012 of natural gas purchases, which included the cost of transportation, with subsequent resale to the regions where our end-customers are located.

	Three months ended 31 March:			
millions of Russian roubles	**2012**	**% of total revenues**	**2011**	**% of total revenues**
Transportation expenses	16,379	*30.1%*	11,905	*26.5%*
Taxes other than income tax	4,613	*8.5%*	4,320	*9.6%*
Subtotal non-controllable expenses	**20,992**	***38.6%***	**16,225**	***36.1%***
Purchases of natural gas and liquid hydrocarbons	3,351	*6.2%*	963	*2.1%*
Depreciation, depletion and amortization	2,545	*4.7%*	2,029	*4.5%*
General and administrative expenses	2,396	*4.4%*	1,995	*4.4%*
Materials, services and other	1,586	*2.9%*	1,282	*2.9%*
Exploration expenses	896	*1.6%*	726	*1.6%*
Net impairment expense	25	*n/m*	12	*n/m*
Change in natural gas, liquid hydrocarbons and work-in-progress	60	*n/m*	211	*0.5%*
Total operating expenses	**31,851**	***58.6%***	**23,443**	***52.2%***

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 31 March 2012, non-controllable expenses of transportation and taxes other than income tax increased by RR 4,767 million, or 29.4%, to RR 20,992 million from RR 16,225 million in the corresponding period in 2011. The change in transportation expenses was primarily due to an increase in natural gas volumes sold to end-customers in which we incurred transportation expenses, and excluded volumes of natural gas purchased for resale in the location of our end-customers. Taxes other than income tax increased primarily due to an increase in natural gas production volumes, as well as a 5.9% increase in the natural gas production tax rate effective from 1 January 2012 that was partially offset by the application of zero UPT rate for crude oil in the three months ended 31 March 2012 (see “Our tax burden” above). As a percentage of total revenues, our non-controllable expenses increased to 38.6% in the three months ended 31 March 2012 from 36.1% in the corresponding period in 2011.

Transportation expenses

In the three months ended 31 March 2012, our total transportation expenses increased by RR 4,474 million, or 37.6%, compared to the corresponding period in 2011.

million of Russian roubles	Three months ended 31 March: 2012	2011	Change %
Natural gas transportation to customers	13,059	8,568	52.4%
Liquid hydrocarbons transportation by rail	2,410	2,345	2.8%
Liquid hydrocarbons transportation by tankers	781	932	(16.2%)
Crude oil transportation to customers	98	57	71.9%
Other	31	3	n/a
Total transportation expenses	**16,379**	**11,905**	**37.6%**

In the three months ended 31 March 2012, our transportation expenses for natural gas increased by RR 4,491 million, or 52.4%, to RR 13,059 million from RR 8,568 million in the corresponding period in 2011. The change was mainly due to a 58.9% increase in our sales volumes of natural gas to end-customers, for which we incurred transportation expense, and excluded volumes of natural gas purchased for resale in the location of our end-customers. We do not incur transportation expenses in respect of natural gas volumes purchased for resale in the location of our end-customers, as the purchase price included the cost of transportation. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

In the three months ended 31 March 2012, total expenses for liquids transportation by rail increased marginally by RR 65 million, or 2.8%, to RR 2,410 million from RR 2,345 million in the corresponding period in 2011 due to higher average liquids transportation tariffs that was partially offset by a decrease in our stable gas condensate volumes sold and transported via rail. In the three months ended 31 March 2012, our combined liquids volumes sold and transported via rail decreased by 92 thousand tons, or 9.7%, to 861 thousand tons from 953 thousand tons in the corresponding period in 2011 due primarily to an increase in stable gas condensate inventory balance. The transportation costs incurred in respect of liquids volumes recognized as part of our inventory balance or in transit are capitalized as part of current assets until the recognition of such volumes as sold.

In the three months ended 31 March 2012, our weighted average transportation tariff for liquids delivered by rail increased by 13.6% to RR 2,798 per ton from RR 2,462 per ton in the corresponding period in 2011 primarily due to a 6.0% increase in rail tariffs set by the FTS effective 1 January 2012. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-to-period and depends on products type and the geography of deliveries.

In the three months ended 31 March 2012, as well as in the corresponding period in 2011, 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 31 March 2012, we applied a co-efficient of 0.71 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation compared to a co-efficient of 0.68 in the corresponding period in 2011 (see “Transportation tariffs” above).

Total transportation expense for liquids delivered by tankers to international markets decreased by RR 151 million, or 16.2%, to RR 781 million in the three months ended 31 March 2012 from RR 932 million in the corresponding period in 2011. The decrease was primarily due to a 14.0% decrease in volumes sold as a result of inventory movements and, to a lesser extent, a change in the mix in geographical regions where we sold our stable gas condensate. In the three months ended 31 March 2012, we sold 42.3% of our total stable gas condensate export volumes to Europe, 29.0% to the USA and 28.7% to APR, whereas in the corresponding period in 2011, we sold 45.7% to APR, 29.3% to Europe and 25.0% to the United States.

Taxes other than income tax

millions of Russian roubles	Three months ended 31 March: 2012	2011	Change %
Unified natural resources production tax (UPT)	3,845	3,557	8.1%
Property tax	439	434	1.2%
Excise and fuel taxes	276	243	13.6%
Other taxes	53	86	(38.4%)
Total taxes other than income tax	**4,613**	**4,320**	**6.8%**

In the three months ended 31 March 2012, taxes other than income tax increased by RR 293 million, or 6.8%, primarily due to an increase in the unified natural resources production tax expense.

In the three months ended 31 March 2012, our UPT expense for natural gas increased by RR 454 million, or 16.0%, due to an increase in our natural gas production volumes, as well as a 5.9% increase in the natural gas production tax rate effective 1 January 2012 (RR 251 per mcm in the three months ended 31 March 2012 versus RR 237 per mcm in the corresponding period in 2011). In addition, our UPT for gas condensate increased by RR 57 million, or 11.7%, due primarily to a change in the UPT rate (see “Our tax burden” above).

In the three months ended 31 March 2012, we applied zero UPT rate for crude oil produced at our East-Tarkosalinskoye and Khancheyskoye fields due to changes in Russian Tax Code applied starting from 1 January 2012 (see “Our tax burden” above). In the corresponding period in 2011, we incurred RR 223 million of UPT expense for crude oil.

In the three months ended 31 March 2012, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska increased by RR 33 million, or 13.6%, due to an increase in our LPG export sales through this subsidiary, which are payable when LPG enters Polish territory.

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2012, our purchases of natural gas and liquid hydrocarbons increased by RR 2,388 million, or 248.0%, to RR 3,351 million from RR 963 million in the corresponding period in 2011. The increase of RR 2,376 million resulted from the commencement of natural gas purchases from related parties effective 1 January 2012, as well as increased natural gas purchases from our joint venture Sibneftegas. The remaining increase in purchases of RR 12 million related to oil products (diesel fuel and petrol) and LPG, which were subsequently resold through our wholly owned subsidiary NOVATEK-Refueling complexes.

Depreciation, depletion and amortization

In the three months ended 31 March 2012, our depreciation, depletion and amortization (“DDA”) expense increased by RR 516 million, or 25.4%, to RR 2,545 million from RR 2,029 million in the corresponding period in 2011 as a result of an increase in our depletable cost base, as well as a 9.0% increase in our total hydrocarbon production (excluding our proportionate share in the production of joint ventures) in barrels of oil equivalent (boe). The Group accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In the three months ended 31 March 2012, our DDA per boe was RR 23.0 compared to RR 20.1 in the corresponding period in 2011. The increase in our DDA charge calculated on a boe basis was due to capitalization of costs related to ongoing development at our Yurkharovskoye field as well as a decrease in our proved reserves estimates in our producing entities, used as the denominator in the calculation of the DDA under the “units of production” method.

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 31 March 2012, our general and administrative expenses increased by RR 401 million, or 20.1%, to RR 2,396 million compared to RR 1,995 million in the corresponding period in 2011. The main components of these expenses were employee compensation, social expenses and compensatory payments and legal, audit and consulting services, which, on aggregate, comprised 85.6% and 79.0% of total general and administrative expenses in the three months ended 31 March 2012 and 2011, respectively.

millions of Russian roubles	Three months ended 31 March: 2012	2011	Change %
Employee compensation	1,697	1,311	29.4%
Social expenses and compensatory payments	223	153	45.8%
Legal, audit, and consulting services	132	112	17.9%
Depreciation – administrative buildings	69	32	115.6%
Fire safety and security expenses	49	45	8.9%
Business trip expenses	39	45	(13.3%)
Rent expense	26	74	(64.9%)
Insurance expense	19	10	90.0%
Bank charges	16	7	128.6%
Other	126	206	(38.8%)
Total general and administrative expenses	**2,396**	**1,995**	**20.1%**

Employee compensation increased by RR 386 million, or 29.4%, to RR 1,697 million in the three months ended 31 March 2012 as compared to RR 1,311 million in the corresponding period in 2011 primarily due to a RR 188 million increase in bonus accruals for the results we achieved in the three months ended 31 March 2012 compared to the corresponding period in 2011. In addition, an increase of RR 130 million was due to an increase in average number of employees resulting from an acquisition of regional gas trader in November 2011 and an indexation of base salaries by 9.6% from 1 July 2011.

In the three months ended 31 March 2012, our social expenses and compensatory payments increased by RR 70 million, or 45.8%, to RR 223 million compared to RR 153 million in the corresponding period in 2011, 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. Social expenses and compensatory payments will continue to fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 20 million, or 17.9%, to RR 132 million compared to RR 112 million in the corresponding period in 2011 largely due to an increase in consulting services related to the prolongation and acquisition of new software solutions for our core subsidiaries.

In the three months ended 31 March 2012, depreciation of administrative buildings increased by RR 37 million, or 115.6%, due to the completion and opening of our new Moscow head-office in the second quarter 2011. Administrative buildings are depreciated on a straight-line basis over their estimated useful lives.

Fire safety and security expenses increased by RR four million, or 8.9%, to RR 49 million in the three months ended 31 March 2012 from RR 45 million in the corresponding period in 2011 as a result of the opening of our new Moscow head-office in May 2011.

In the three months ended 31 March 2012, our rent expense decreased by RR 48 million, or 64.9%, to RR 26 million from RR 74 million in the corresponding period in 2011 due to the relocation of Moscow head-office employees to our new office building in May 2011.

Insurance expenses increased by RR nine million, or 90.0%, to RR 19 million in the three months ended 31 March 2012 from RR ten million in the corresponding period in 2011 due to insurance of recently launched fixed assets at our production subsidiaries.

In the three months ended 31 March 2012, other general and administrative expenses decreased by RR 80 million, or 38.8%, to RR 126 million from RR 206 million in the corresponding period in 2011. The decrease of RR 24 million related to the termination in September 2011 of the concession agreement at El-Arish concession area located in Egypt. The remaining decrease of RR 56 million related to different immaterial expense items of administrative nature.

Materials, services and other

In the three months ended 31 March 2012, our materials, services and other expenses increased by RR 304 million, or 23.7%, to RR 1,586 million compared to RR 1,282 million in the corresponding period in 2011. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 57.9% and 20.6%, respectively, of total materials, services and other expenses in the three months ended 31 March 2012.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2012**	**2011**	**%**
Employee compensation	918	749	22.6%
Repair and maintenance services	326	243	34.2%
Electricity and fuel	102	94	8.5%
Security expenses	70	60	16.7%
Materials and supplies	42	35	20.0%
Transportation expenses	39	38	2.6%
Processing fees	25	25	0.0%
Rent expenses	14	5	180.0%
Other	50	33	51.5%
Total materials, services and other	**1,586**	**1,282**	**23.7%**

In the three months ended 31 March 2012, our employee compensation increased by RR 169 million, or 22.6%, to RR 918 million compared to RR 749 million in the corresponding period in 2011 due to a 9.6% indexation of base salaries effective 1 July 2011, an increase in average number of employees resulting from an acquisition of a regional gas trader in November 2011, and an increase in accrued bonuses.

Repair and maintenance services increased by RR 83 million, or 34.2%, to RR 326 million in the three months ended 31 March 2012 compared to RR 243 million in the corresponding period in 2011. The increase was primarily related to on-going repair works at our wholly owned production subsidiary NOVATEK-Tarkosaleneftegas and was consistent with our maintenance schedules.

In the three months ended 31 March 2012, electricity and fuel expenses increased by RR eight million, or 8.5%, to RR 102 million from RR 94 million in the corresponding period in 2011. The increase was primarily due to an increase in electricity volumes used by our production subsidiaries resulting from recently completed infrastructure projects.

Security expenses increased by RR ten million, or 16.7%, to RR 70 million in the three months ended 31 March 2012 from RR 60 million in the corresponding period in 2011 largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

Materials and supplies expense increased by RR seven million, or 20.0%, mainly due to an increase in our production assets repair works.

Transportation expenses related to the delivery of materials and equipment to our fields increased by RR one million, or 2.6%, to RR 39 million in the three months ended 31 March 2012 from RR 38 million in the corresponding period in 2011.

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

In the three months ended 31 March 2012, rent expenses increased by RR nine million, or 180.0%, to RR 14 million from RR five million in the corresponding period in 2011 primarily due to the rental of storage facilities for LPG inventory balances held by our subsidiary Novatek Polska as a result of increased LPG export sales through this subsidiary.

Exploration expenses

In the three months ended 31 March 2012, we incurred RR 896 million of exploration expenses, of which the significant portion related to seismic activities at our fields in early stages of development.

In the corresponding period in 2011, RR 407 million of total exploration expenses of RR 726 million, related to the cost of two exploratory wells written off to exploration expenses under the successful efforts accounting policy at the El Arish (Egypt) and Raduzhniy licence areas.

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

In the three months ended 31 March 2012, we recorded a charge of RR 60 million to change in inventory expense compared to a charge of RR 211 million in the corresponding period in 2011:

millions of Russian roubles	**Three months ended 31 March:** 2012	2011
Natural gas	353	227
Stable gas condensate	(336)	(6)
Other	43	(10)
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	**60**	**211**

In the three months ended 31 March 2012, we recorded a charge to our operating expenses of RR 353 million primarily due to a decrease in our natural gas inventory balance by 728 mmcm. 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 31 March 2012, we recorded a reversal of RR 336 million to our operating expenses due to a 124 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	**2012** At 31 March	At 1 January	Increase / (decrease)	**2011** At 31 March	At 1 January	Increase / (decrease)
Natural gas (millions of cubic meters)	**32**	**760**	**(728)**	**77**	**790**	**(713)**
including Gazprom's UGSF	-	*732*	*(732)*	*48*	*761*	*(713)*
Liquid hydrocarbons (thousand tons)	**449**	**325**	**124**	**371**	**356**	**15**
including stable gas condensate	*352*	*228*	*124*	*282*	*264*	*18*

Other operating income (loss)

In the three months ended 31 March 2012, we recognized other operating income of RR 41 million, of which RR 49 million related to profit on disposal of fixed assets at our production subsidiaries and was offset by other operating loss of RR eight million, which was made up of various immaterial items.

In the corresponding period in 2011, we recognized other operating income of RR 53 million from different immaterial items, including profit (loss) on disposal of materials, fixed assets, equipment and other similar transactions.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 1,059 million, or 4.9%, to RR 22,563 million in the three months ended 31 March 2012, compared to RR 21,504 million in the corresponding period in 2011. In the three months ended 31 March 2012, our profit from operations as a percentage of total revenues decreased to 41.5% compared to 47.9% in the corresponding period in 2011 primarily due to an increase in purchases of natural gas for resale in the regions where our end-customers are located and the lower margins we received for these volumes, as well as the increase in the share of natural gas as a proportion of our total revenues as a result of an increase in the stable gas condensate inventories in the reporting period and the timing of revenue recognition.

Finance income (expense)

In the three months ended 31 March 2012, we recorded net finance income of RR 5,624 million compared to a net finance income of RR 2,738 million in the corresponding period in 2011 due primarily to a foreign exchange gain from the appreciation of the Russian rouble relative to the US dollar in both periods.

In the three months ended 31 March 2012, our total accrued interest expense on loans obtained amounted to RR 1,209 million compared to RR 1,253 million in the corresponding period in 2011. In the three months ended 31 March 2012 and 2011, we capitalized RR 475 and RR 863 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with the Group's accounting policy. In addition, we recognized RR 56 million and RR 265 million related to the fair value remeasurement of financial instruments and the unwinding of the present value discount related to provisions of asset retirement obligations as part of interest expense in the three months ended 31 March 2012 and 2011, respectively.

Interest income decreased by RR 385 million, or 41.9%, to RR 534 million in the three months ended 31 March 2012 from RR 919 million in the corresponding period in 2011 due to a decrease in loans provided to our joint ventures. In February 2012, the loans provided to our joint venture Yamal Development by its participants, including the Group, as well as accrued interest for these loans, were converted to charter capital.

In the three months ended 31 March 2012, we recorded a net foreign exchange gain of RR 5,880 million compared to a net foreign exchange gain of RR 2,474 million in the corresponding period in 2011 due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble appreciated by 8.9% and 6.7% against the US dollar during the three months ended 31 March 2012 and 2011, respectively. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio.

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

In the three months ended 31 March 2012, our proportionate share in loss of equity investments increased to RR 991 million compared to RR 610 million in the corresponding period in 2011, of which a significant portion was related to our joint ventures Sibneftegas and Yamal Development. The losses we recognized in Sibneftegas were primarily due to the revaluation of oil and gas properties acquired to fair value and the subsequent amortization of those costs under IFRS. The losses related to Yamal Development resulted from the recognition of interest expense on loans obtained.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 21.9% and 20.8% for the three months ended 31 March 2012 and 2011, respectively.

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

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the period increased by RR 2,523 million, or 13.5%, to RR 21,239 million in the three months ended 31 March 2012 from RR 18,716 million in the corresponding period in 2011. The profit attributable to shareholders of OAO NOVATEK increased by RR 2,476 million, or 13.2%, to RR 21,245 million in the three months ended 31 March 2012 from RR 18,769 million in the corresponding period in 2011.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 0.81 per share, or 13.1%, to RR 7.00 per share in the three months ended 31 March 2012 from RR 6.19 per share in the corresponding period in 2011.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2012 and 2011:

millions of Russian roubles	Three months ended 31 March: 2012	2011	Change %
Net cash provided by operating activities	23,949	19,205	24.7%
Net cash provided by (used in) investing activities	(2,535)	(29,065)	(91.3%)
Net cash provided by (used in) financing activities	(15,669)	15,453	n/a

Liquidity and credit ratios	31 March 2012	31 December 2011	Change, %
Current ratio	1.40	1.16	20.7%
Total debt to equity	0.29	0.40	(27.5%)
Long-term debt to long-term debt and equity	0.21	0.24	(12.5%)
Net debt to total capitalization (1)	0.14	0.20	(30.0%)
Net debt to EBITDA (2)	0.55	0.84	(34.5%)

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

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

Net cash provided by operating activities

In the three months ended 31 March 2012, our net cash provided by operating activities increased by RR 4,744 million, or 24.7%, to RR 23,949 million compared to RR 19,205 million in the corresponding period in 2011. The change was primarily due to higher natural gas volumes sold as well as an increase in share of sales to end-customers, which results in a higher natural gas sales price.

Net cash provided by (used in) investing activities

In the three months ended 31 March 2012, our net cash used in investing activities amounted to RR 2,535 million compared to RR 29,065 million in the corresponding period in 2011. In the three months ended 31 March 2012, we paid RR 5,955 million for purchases of property, plant and equipment and made a capital contribution in cash to our joint venture Yamal LNG in the amount of RR 2,507 million. In addition, in the three months ended 31 March 2012, we received RR 7,184 million in cash due to the repayment of loans provided to our joint ventures. In the corresponding period in 2011, our net cash used in investing activities was primarily comprised of payment for shares of our joint venture Sibneftegas, which was acquired in 2010.

Net cash provided by (used in) financing activities

In the three months ended 31 March 2012, we used RR 15,669 million to repay our debt and interest. In the corresponding period in 2011, our net cash provided was primarily through the receipt of funds from new loans and borrowings that exceeded cash used for repayment of loans, which resulted in a net cash inflow from financing activities of RR 15,453 million.

Working capital

Our net working capital position (current assets less current liabilities) at 31 March 2012 was a positive RR 15,488 million compared to RR 8,202 million at 31 December 2011. The strengthening of our net working capital position was primarily due to a decrease in the current portion of long-term debt.

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

Capital expenditures

Our total capital expenditures 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 31 March 2012 and 2011:

	Three months ended 31 March:	
millions of Russian roubles	**2012**	**2011**
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga)	2,000	551
Yurkharovskoye field	1,850	2,601
East-Tarkosalinskoye field	1,351	304
Khancheyskoye field	432	167
North-Russkiy license area	163	78
Olimpiyskiy license area	112	103
Purovsky Plant	65	291
West-Urengoiskiy license area	81	241
Other	1,465	2,006
Exploration, production and marketing	**7,519**	**6,342**

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2012 increased by RR 1,177 million, or 18.6%, to RR 7,519 million from RR 6,342 million in the corresponding period in 2011. The increase was primarily related to the construction of processing assets at Ust-Luga as well as further field development on the crude oil layers at the East-Tarkosalinskoye and Khancheyskoye fields.

Debt obligations

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

Overview

Our total debt decreased from RR 95,478 million at 31 December 2011 to RR 75,715 million at 31 March 2012, or by RR 19,763 million due primarily to the repayment of a RR 10 billion loan from Gazprombank, USD 120 million of a loan from UniCredit Bank and USD 30 million of a loan from Sumitomo Mitsui Banking Corporation Europe Limited. We receive credit facilities to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields as well as to invest in processing assets such as the Purovsky Plant and Ust-Luga, as well as acquisitions of new oil and gas assets.

Our total debt position (net of unamortized transaction costs) at 31 March 2012 and 31 December 2011 was as follows:

Facility	Amount	Maturity	Interest rate	At 31 March 2012	At 31 December 2011
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	18,931	20,776
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	17,502	19,206
Sberbank	RR 15 billion	December 2013	7.5%	14,971	14,966
Gazprombank [(1)]	RR 10 billion	November 2012	8%	-	10,000
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,975	9,971
Sumitomo Mitsui Banking Corporation Europe Limited	USD 300 million	December 2013	LIBOR+1.45%	6,127	7,685
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9%	5,866	6,439
UniCredit Bank	USD 200 million	October 2012	LIBOR+3.25%	2,343	6,435
Total				**75,715**	**95,478**

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

Maturities of long-term loans

Scheduled maturities of our long-term debt outstanding (net of unamortized transaction costs) at 31 March 2012 were as follows:

Maturity schedule:	RR million
1 April 2013 to 31 March 2014	31,955
1 April 2014 to 31 March 2015	-
1 April 2015 to 31 March 2016	17,502
1 April 2016 to 31 March 2017	-
After 31 March 2017	18,931
Total long-term debt	**68,388**

Available credit facilities

At 31 March 2012, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 3,959 million (USD 135 million) at variable interest rates subject to the specific type of credit facility.

The Group also has funds available under credit facilities with OAO Sberbank in the amount of RR 40 billion until July 2012 with an annual interest rate of 9.2%, Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2012 and ZAO UniCredit Bank in the amount of USD 270 million until August 2012, with the interest rates applicable under the aforementioned credit facilities to be negotiated at the time of each withdrawal, as well as funds available under credit facility with ZAO BNP PARIBAS Bank in the amount of USD 100 million until September 2012 with predetermined interest rate depending on the period of debt.

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 March 2012, total amount of our long-term debt denominated in US dollars was RR 43,442 million, or 57.4% 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 24.0% in the three months ended 31 March 2012, is denominated in US dollars. As of 31 March 2012, the Russian rouble apprececiated by approximately 8.9% against the US dollar since 31 December 2011.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 31 March 2012 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 5,077 million on foreign currency denominated borrowings held at that date.

Commodity risk

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

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

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

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

As of 31 March 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.