

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

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

OVERVIEW

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

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

On 8 November 2010, the Board of Directors of OAO "NOVATEK" approved the following agenda items:

- The acquisition of a 51% participation interest in OOO "SeverEnergia" by OOO "Yamal Development", a 50/50 joint venture between NOVATEK and OAO "Gazprom Neft". OOO "SeverEnergia" holds 100% of the shares of OAO "Arctic Gas", ZAO "Urengoil Inc." and OAO "Neftegaztehnologia", which hold licenses for the development of oil and gas condensate fields in the Yamal-Nenets Autonomous Region (YNAO). As of 1 January 2009, the reserves of OOO "SeverEnergia" under the Russian reserve classification ABC1 + C2, totalled 1.3 trillion cubic meters of natural gas, 154 million tons of gas condensate and 568 million tons of crude oil according to the Russian Federation's State Balance of Reserves.
- The acquisition of 51% of the shares of OAO "Sibneftegas". OAO "Sibneftegas" holds licenses for development of oil and gas condensate fields within the following license areas located in YNAO: Beregoviy license area, Hadyryahinskiy license area, Pyreiniy gas condensate field and Zapadno-Zapolyarnoye gas field. As of 1 January 2009, the reserves of OAO "Sibneftegas" under the Russian reserve classification of ABC1 + C2 totalled 395.53 billion cubic meters of natural gas and 8.44 million tons of gas condensate according to the Russian Federation's State Balance of Reserves.
- The issuance of a Eurobond for an amount of up to USD 1,500 million for a period of up to ten years.

In October 2010, we launched the third stage of the second phase development at our Yurkharovskoye field, which includes 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"), one of the largest LPG traders in the South-East of Poland. The company holds the discharging and transshipment facility at the wide track (Russian) and narrow track (European) rail road junction.

The acquisition of Intergaz-System will enable us to continue development of our commercial activities within Poland and other European countries.

In August 2010, we launched the 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. With the launching of the facility and pipeline, we process and transport all unstable gas condensate produced at the Yurkharovskoye field to the Purovsky Plant without utilizing third party facilities.

In September 2010, we dispatched a consignment of stable gas condensate to China via the Northern Sea Route, which significantly reduced the nautical miles from approximately 12,900 to approximately 7,700. The cargo travelled approximately half the time required by the traditional shipping route through the Suez Canal. We plan to continue using the Northern Sea Route for deliveries of our stable gas condensate to the Asian-Pacific region subject to navigation conditions.

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

In July 2010, the Group acquired 100 percent of the outstanding ordinary shares of OAO "Tambeyneftegas", an oil and gas company in the early stages of geological exploration for total purchase consideration of USD 10 million. The company holds the license for exploration and development of the Malo-Yamalskoye field (license expiry date 2019) located in the southern part of the Yamal peninsula, in the 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.

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

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

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

SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Three months ended 30 September:		Change
	2010	2009	%
Financial results			
Total revenues (net of VAT and export duties)	29,441	21,971	34.0%
Operating expenses	(17,587)	(13,638)	29.0%
Profit attributable to NOVATEK shareholders	10,105	7,353	37.4%
EBITDA ⁽¹⁾	13,863	9,960	39.2%
EBITDAX ⁽²⁾	14,007	9,977	40.4%
Earnings per share (in Russian roubles)	3.33	2.43	37.4%
Operating results			
Natural gas sales volumes (million cubic meters)	8,123	7,763	4.6%
Stable gas condensate sales volumes (thousand tons)	723	467	54.8%
Liquefied petroleum gas sales volumes (thousand tons)	206	189	9.0%
Crude oil sales volumes (thousand tons)	42	48	(12.5%)
Oil product sales volumes (thousand tons)	2	3	(33.3%)
Cash flow results			
Net cash provided by operating activities	12,085	10,523	14.8%
Capital expenditures	7,196	3,933	83.0%
Free cash flow ⁽³⁾	4,889	6,590	(25.8%)

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

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

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

SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate of Russian rouble to US dollar</i>	Three months ended 30 September:		Change %
	2010	2009	
At the beginning of the period	31.20	31.29	(0.3%)
At the end of the period	30.40	30.09	1.0%
Average for the period	30.62	31.33	(2.3%)

<i>Crude oil prices, USD / bbl</i>	Three months ended 30 September:		Change %
	2010	2009	
WTI ⁽¹⁾			
At the end of the period	80.0	70.6	13.3%
Average for the period	76.2	68.2	11.7%
Brent ⁽²⁾			
At the end of the period	81.0	65.7	23.3%
Average for the period	76.9	68.1	12.9%
Urals ⁽²⁾			
At the end of the period	79.9	65.8	21.4%
Average for the period	75.6	67.8	11.5%

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

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

<i>Export duties, USD / ton ⁽¹⁾</i>	Three months ended 30 September:		Change %
	2010	2009	
Crude oil, stable gas condensate			
At the end of the period	273.5	238.6	14.6%
Average for the period	262.0	224.4	16.8%
LPG			
At the end of the period	45.2	0.0	n/a
Average for the period	34.3	0.0	n/a

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

The economic events that have negatively impacted the domestic and global capital markets over the past couple of years have somewhat receded despite isolated economic uncertainties in Greece and several other European countries. As a result, this uncertainty may continue to negatively affect all borrowers by limiting access to capital markets, despite the financial markets willingness to price recent transactions.

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

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

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

Natural gas prices

As an independent natural gas producer, we are not subject to the Russian government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency, and present market conditions. In the three months ended 30 September 2010, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 435 per mcm, or 23.4%, to RR 2,296 per mcm compared to RR 1,861 per mcm in the corresponding 2009 period.

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

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

In the three months ended 30 September 2010, our total natural gas sales volumes to end-customers increased by 3.7% due to the commencement of deliveries to new end-customers, whereas our volumes sold to end-customers, excluding traders in remote regions, increased by 90.2% (see “Natural gas sales volumes” below). Our transportation expense for the delivery of natural gas to end-customers increased by 29.2% as a result of a 18.9% increase in the average transportation tariff set by FTS and an increase in the average distance to market. Our average natural gas price to end-customers (excluding traders in remote points) and ex-field price increased by 15.1% and 13.1%, respectively, whereas our average natural gas netback price on end-customer sales increased by 4.3%, compared to the respective prices in the corresponding period in 2009. Our pricing strategy for natural gas is consistent with our commercial marketing strategy to enter new regions and markets to maintain and grow our share of natural gas deliveries to the domestic market, as well as maintaining our production growth.

As a result of the factors discussed above, as well as the suspension of natural gas sales to traders in remote points effective the 1 January 2010, our average netback price on end-customers sales (including traders in remote points) increased by 19.2%, while our total average natural gas price excluding transportation expense increased by 17.6% compared to respective prices in the 2009 period.

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

<i>Russian roubles per mcm</i>	Three months ended 30 September:		Change %
	2010	2009	
Average natural gas price ⁽¹⁾:			
<i>End-customers</i>	2,309	2,006	15.1%
<i>Traders in remote points</i>	-	1,767	n/a
Average natural gas price to end-customers	2,309	1,897	21.7%
Average natural gas transportation expense:			
<i>End-customers</i>	(1,124)	(870)	29.2%
<i>Traders in remote points</i>	-	(942)	n/a
Average natural gas transportation expense for sales to end-customers	(1,124)	(903)	24.5%
Average natural gas netback price:			
<i>End-customers</i>	1,185	1,136	4.3%
<i>Traders in remote points</i>	-	825	n/a
Average natural gas netback price on end-customer sales	1,185	994	19.2%
Average natural gas price ex-field (wholesale traders)	1,225	1,083	13.1%
Total average natural gas price excluding transportation expense	1,195	1,016	17.6%

⁽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. Crude oil, stable gas condensate, LPG and oil products prices on the domestic market also fluctuate depending on supply and demand fundamentals amongst other factors. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as "Urals blend", which normally (or historically) trades at a discount to the international benchmark Brent crude oil. The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management.

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our liquid volumes sold on both the domestic and international markets, amongst many other factors. In the three months ended 30 September 2010, the average benchmark crude oil prices were more than 10% higher than in the corresponding period in 2009.

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

In the three months ended 30 September 2010, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost, insurance and freight (CIF), while in the corresponding period in 2009 our delivery terms were either DES or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in the three months ended 30 September 2010 was approximately USD 660 per ton compared to approximately USD 571 per ton in the corresponding period in 2009.

In the three months ended 30 September 2010, as well as in the corresponding period in 2009, our crude oil export delivery terms were delivery at frontier (DAF Feneshlitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 541 per ton compared to USD 483 per ton in the 2009 period.

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

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Three months ended 30 September:		Change %
	2010	2009	
Stable gas condensate			
Net export price, RR per ton	12,249	11,224	9.1%
Net export price, USD per ton	400.0	358.2	11.7%
Domestic price, RR per ton	10,633	10,014	6.2%
Crude oil			
Net export price, RR per ton	8,623	8,321	3.6%
Net export price, USD per ton	281.6	265.6	6.0%
Domestic price, RR per ton	7,480	7,705	(2.9%)

Our LPG export delivery terms during the three months ended 30 September 2010, were delivery at frontier (DAF) at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and the station Klyucharki (western Ukraine), or at the border of the customer's country, and priced free carrier (FCA) at the terminal points in Poland, compared to DAF and CPT in the corresponding period in 2009. In the three months ended 30 September 2010, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 645 per ton compared to USD 490 per ton in the corresponding period in 2009. In addition, in the three months ended 30 September 2010, we sold in Poland approximately two thousand tons of LPG purchased for resale from third parties through our wholly-owned subsidiary Intergaz-System.

In the three months ended 30 September 2010, as well as in the corresponding period in 2009, our LPG CIS delivery terms were DAF at the border of the customer's country.

In the three months ended 30 September 2010, as well as in the corresponding period in 2009 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 2010, we sold a total of 16 thousand tons at the regulated price of RR 6,613 per ton, while in the 2009 period, we sold five thousand tons at the regulated price of RR 5,750 per ton in the domestic market. In the three months ended 30 September 2010, we sold 75 thousand tons at an average commercial price of RR 11,342 per ton compared to 74 thousand tons at an average commercial price of RR 9,547 per ton in the corresponding period in 2009. In addition, in the 2010 period, we sold 12 thousand tons of LPG produced at the Purovsky Plant through our wholly-owned subsidiary OOO "NOVATEK-Refuelling Complexes" at an average price of RR 11,848 per ton compared to sales of five thousand tons at an average price of RR 11,415 per ton in the 2009 period.

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

In the three months ended 30 September 2010, our wholly-owned subsidiary, OOO "NOVATEK-Refuelling Complexes", sold approximately 1.5 thousand tons of diesel fuel and petrol purchased for resale from third parties through its retail stations compared to sales of approximately 0.5 thousand tons in the corresponding period in 2009.

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 2010 and 2009 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	Three months ended 30 September:		Change %
	2010	2009	
LPG			
Net export price, RR per ton	18,683	15,292	22.2%
Net export price, USD per ton	610.2	488.1	25.0%
CIS price, RR per ton	17,351	14,285	21.5%
Domestic commercial price, RR per ton	11,342	9,547	18.8%
Domestic regulated price, RR per ton	6,613	5,750	15.0%
Domestic price (retail and small wholesale stations), RR per ton	11,848	11,415	3.8%
Oil products			
Domestic price, RR per ton	4,125	6,199	(33.5%)

Transportation tariffs

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

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

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

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

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

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

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

Transportation transactions with related parties

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

Our tax burden

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to an increase in our production. Liquids sales volumes increased due to an increase in unstable gas condensate production as well as a decrease in liquids inventory balances.

Natural gas sales volumes

<i>millions of cubic meters</i>	Three months ended 30 September:		Change %
	2010	2009	
Production from:			
Yurkharovskoye field	6,021	4,147	45.2%
East-Tarkosalinskoye field	1,647	2,899	(43.2%)
Khancheyskoye field	672	687	(2.2%)
Other fields	20	23	(13.0%)
Total natural gas production	8,360	7,756	7.8%
Purchases from:			
Third parties	-	250	n/a
Total natural gas purchases	-	250	n/a
Total production and purchases	8,360	8,006	4.4%
Purovsky Plant and own usage	(8)	(7)	14.3%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	(229)	(236)	(3.0%)
Total natural gas sales volumes	8,123	7,763	4.6%
<i>Sold to end-customers</i>	<i>6,077</i>	<i>3,195</i>	<i>90.2%</i>
<i>Sold to traders in remote points</i>	<i>-</i>	<i>2,664</i>	<i>n/a</i>
Subtotal sold to end-customers	6,077	5,859	3.7%
Sold ex-field	2,046	1,904	7.5%

In the three months ended 30 September 2010, our total consolidated natural gas production increased by 604 mcm, or 7.8%, compared to the 2009 period primarily due to an increase in production at our Yurkharovskoye field resulting from the launch of the second stage of the field's second phase development in October 2009. The decrease in natural gas production at our East-Tarkosalinskoye field in the 2010 period was the direct result of our decision to continue optimizing unstable gas condensate production at the Yurkharovskoye field.

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

Liquids sales volumes

<i>thousands of tons</i>	Three months ended 30 September:		Change %
	2010	2009	
Production from:			
Yurkharovskoye field	513	356	44.1%
East-Tarkosalinskoye field	207	218	(5.0%)
Khancheyskoye field	156	154	1.3%
Other fields	8	10	(20.0%)
Total liquids production	884	738	19.8%
Purchases from:			
Third parties	5	6	(16.7%)
Total liquids purchases	5	6	(16.7%)
Total production and purchases	889	744	19.5%
Losses and own usage ⁽¹⁾	(8)	(4)	100.0%
Gas condensate pipeline filling	(36)	-	n/a
Decreases (increases) in liquids inventory balances	128	(33)	n/a
Total liquids sales volumes	973	707	37.6%
<i>Stable gas condensate export</i>	722	467	54.6%
<i>Stable gas condensate domestic</i>	1	0	n/a
<i>Subtotal stable gas condensate</i>	723	467	54.8%
<i>LPG export</i>	103	103	0.0%
<i>LPG CIS</i>	0	2	n/a
<i>LPG domestic</i>	91	79	15.2%
<i>LPG sold through domestic retail and small wholesale stations</i>	12	5	140.0%
<i>Subtotal LPG</i>	206	189	9.0%
<i>Crude oil export</i>	17	15	13.3%
<i>Crude oil domestic</i>	25	33	(24.2%)
<i>Subtotal crude oil</i>	42	48	(12.5%)
<i>Oil products domestic</i>	2	3	(33.3%)
<i>Subtotal oil products</i>	2	3	(33.3%)

⁽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 2010, our liquids production increased by 146 thousand tons, or 19.8%, to 884 thousand tons compared to 738 thousand tons in the 2009 period, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the second stage of the field's second phase development in October 2009. The decrease in liquids production at the East-Tarkosalinskoye field was the result of natural declines in the concentration of gas condensate due to decreasing reservoir pressure at the current gas condensate producing horizons.

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

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

<i>Millions of Russian roubles</i>	Three months ended 30 September:			
	2010	% of total revenues	2009	% of total revenues
Total revenues (net of VAT and export duties)	29,441	100.0%	21,971	100.0%
<i>including:</i>				
natural gas sales	16,539	56.2%	13,177	60.0%
liquids sales	12,247	41.6%	8,040	36.6%
Operating expenses	(17,587)	(59.7%)	(13,638)	(62.1%)
Other operating income (loss)	154	0.5%	25	0.1%
Profit from operations	12,008	40.8%	8,358	38.0%
Finance income (expense)	482	1.6%	903	4.1%
Share of income (loss) of associated companies	(7)	(0.0%)	(23)	(0.1%)
Profit before income tax	12,483	42.4%	9,238	42.0%
Total income tax expense	(2,422)	(8.2%)	(1,961)	(8.9%)
Profit (loss)	10,061	34.2 %	7,277	33.1%
Non-controlling interest	44	0.1%	76	0.4%
Profit attributable to NOVATEK shareholders	10,105	34.3%	7,353	33.5%

Total revenues

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

<i>Millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Natural gas sales	16,539	13,177	25.5%
<i>End-customer</i>	14,032	6,410	118.9%
<i>Traders in remote points</i>	-	4,706	n/a
Subtotal of end-customers sales	14,032	11,116	26.2%
Ex-field sales	2,507	2,061	21.6%
Stable gas condensate sales	8,848	5,247	68.6%
<i>Export</i>	8,841	5,244	68.6%
<i>Domestic</i>	7	3	133.3%
Liquefied petroleum gas sales	3,034	2,385	27.2%
<i>Export</i>	1,931	1,575	22.6%
<i>CIS</i>	9	19	(52.6%)
<i>Domestic</i>	1,094	791	38.3%
Crude oil sales	327	381	(14.2%)
<i>Export</i>	143	127	12.6%
<i>Domestic</i>	184	254	(27.6%)
Oil products sales	38	27	40.7%
<i>Domestic</i>	38	27	40.7%
Total oil and gas sales	28,786	21,217	35.7%
Sales of polymer and insulation tape	619	475	30.3%
Other revenues	36	279	(87.1%)
Total revenues	29,441	21,971	34.0%

Natural gas sales

In the three months ended 30 September 2010, our revenues from sales of natural gas increased by RR 3,362 million, or 25.5%, compared to the corresponding period in 2009 largely due to an increase in natural gas prices and, to a lesser extent, an increase in sales volumes. Revenues from the sale of natural gas accounted for 56.2% and 60.0% of our total revenues in the three months ended 30 September 2010 and 2009, respectively. The decrease in natural gas sales as a percentage of total revenues was primarily due to an increase in stable gas condensate sales volumes.

In the three months ended 30 September 2010, our average realized natural gas price per mcm increased by RR 339 per mcm, or 20.0%, to RR 2,036 per mcm from RR 1,697 per mcm in the corresponding period in 2009. Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased marginally from 75.5% in the reporting period in 2009 to 74.8% in the three months ended 30 September 2010. The average realized prices of our natural gas sold directly to end-customers (including transportation expense) and sold ex-field were higher by 21.7% and 13.1%, respectively, in the three months ended 30 September 2010 compared to the same period in 2009. In the three months ended 30 September 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies, while in the corresponding period in 2009 the majority of natural gas volumes sold to end-customers were delivered to energy utility companies and traders in remote points, the latter of which ceased deliveries to effective 1 January 2010.

Stable gas condensate sales

In the three months ended 30 September 2010, our revenues from sales of stable gas condensate increased by RR 3,601 million, or 68.6%, compared to the corresponding period in 2009, primarily due to an increase in volumes sold and, to a lesser extent, an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation.

In the three months ended 30 September 2010, our total stable gas condensate sales volumes increased by 256 thousand tons, or 54.8%, due to an increase in our unstable gas condensate production as well as a decrease in stable gas condensate inventory balance during the period. In the three months ended 30 September 2010, we exported 722 thousand tons of stable gas condensate, or 99.9% of our total sales volumes, to the United States, Asian-Pacific region and South America, with the remaining one thousand tons sold domestically. In the three months ended 30 September 2009, we exported 467 thousand tons of stable gas condensate, or almost 100% of our total sales volumes, to markets in the United States and Asian-Pacific region.

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

In the three months ended 30 September 2010, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 41.8 per ton, or 11.7%, to USD 400.0 per ton (DES and CIF) from USD 358.2 per ton (DES and CFR) in the 2009 period due to a 15.6% increase in our average export contract price that was partially offset by a 25.8% increase in our average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in the 2010 period compared to the corresponding period in 2009.

Liquefied petroleum gas sales

In the three months ended 30 September 2010, our revenues from the sales of LPG increased by RR 649 million, or 27.2%, compared to the corresponding period in 2009, due to an increase in both our average realized prices and volumes sold. In the three months ended 30 September 2010, our total LPG sales volumes increased by 17 thousand tons, or 9.0%, to 206 thousand tons from 189 thousand tons in the corresponding period in 2009. The growth in LPG sales volumes was mainly due to an increase in unstable gas condensate throughput at the Purovsky Plant and the corresponding increase in LPG output.

In the three months ended 30 September 2010, we sold 103 thousand tons of LPG, or 50.0% of our total LPG sales volumes, (including approximately two thousand tons purchased and resold through our wholly-owned subsidiary Intergaz-System), to the export markets for an average price of USD 614.2 per ton (DAF, CPT and FCA excluding export duties), representing an increase of USD 126.1 per ton, or 25.8%, compared to the corresponding period in 2009. The increase in our average realized export prices (excluding export duties) was primarily due to a 32.7% increase in our average contract price that was partially offset by an increase in our average export duty per ton as a result of the cancellation of the zero export duty rate from 1 December 2009 (a zero export duty rate for LPG was effective from 1 January to 1 December 2009).

The remaining 103 thousand tons, or 50.0% of our total LPG sales volumes, were sold domestically at an average price of RR 10,674 per ton (FCA, excluding VAT) representing an increase of RR 1,242 per ton, or 13.2%, compared to the 2009 period.

In the three months ended 30 September 2009, we sold 54.5% of our LPG volumes to the export markets, 44.4% was sold to the domestic markets, and 1.1% was sold to the CIS markets.

Crude oil sales

In the three months ended 30 September 2010, our revenues from the sales of crude oil decreased by RR 54 million, or 14.2%, compared to the 2009 period, primarily due to a decrease in our sales volumes.

In the three months ended 30 September 2010, our crude oil sales volumes decreased by six thousand tons, or 12.5%, to 42 thousand tons from 48 thousand tons in the corresponding period in 2009 due to a decrease in crude oil purchases. In the three months ended 30 September 2010, 59.5% of our crude oil volumes were sold domestically at an average price of RR 7,480 per ton (excluding VAT) representing a marginal decrease of RR 225 per ton, or 2.9%, compared to the corresponding period in 2009. The remaining 40.5% of our crude oil volumes were sold to the export markets at an average price of USD 281.6 per ton (DAF, excluding export duties) representing an increase of USD 16.0 per ton, or 6.0%, compared to the 2009 period. The increase in the

average realized export price (excluding export duties) was the result of a 12.0% increase in our average export contract price that was partially offset by a 16.0% increase in our average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in the 2010 period compared to the corresponding period in 2009.

Oil products sales

In the three months ended 30 September 2010, our revenue from the sales of oil products increased by RR 11 million, or 40.7%, to RR 38 million from RR 27 million in the 2009 period.

In the three months ended 30 September 2010, our revenues from oil products produced at the Surgutsky refinery decreased to RR three million from RR 14 million in the 2009 period. Oil products sales volumes produced from our unstable gas condensate amounted to approximately one thousand and two thousand tons in the 2010 and 2009 periods, respectively. Our average oil products sales price decreased by RR 2,074 per ton, or 33.5 %, to RR 4,125 per ton in the 2010 period from RR 6,199 per ton in the corresponding period in 2009 due primarily to a lower proportion of high-priced products we received from the output at the Surgutsky refinery.

In the three months ended 30 September 2010, our revenues from oil products trading operations sold through our retail stations on the domestic market amounted to RR 35 million compared to RR 13 million in the corresponding period in 2009. In the three months ended 30 September 2010, we sold approximately 1.5 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 22,991 per ton through our retail stations compared to 0.5 thousand tons for an average price of RR 23,506 per ton in the corresponding period in 2009.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 144 million, or 30.3%, to RR 619 million in the three months ended 30 September 2010 compared to RR 475 million in the 2009 period due to an increase in average realized prices.

Revenues from our sales of BOPP film wrap increased by RR 146 million, or 43.5%, from RR 336 million in the three months ended 30 September 2009 to RR 482 million in the 2010 period due primarily to an increase in average realized prices and, to a lesser extent, an increase in volumes sold. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 7.2% to 77.9% in the three months ended 30 September 2010 compared to 70.7% in the 2009 period.

Our revenues from pipe insulation product sales decreased by RR 22 million, or 25.0%, from RR 88 million in the 2009 period to RR 66 million in the three months ended 30 September 2010 due primarily to a decrease in volumes sold by 33.4%. The decrease was partially offset by an increase in our average realized prices by 12.4%. Revenues from polymer pipes sales increased by RR 24 million, or 52.2%, from RR 46 million in the 2009 period to RR 70 million in the 2010 period due to an increase in volumes sold. The remaining RR one million and RR five million in the three months ended 30 September 2010 and 2009, respectively, related to sales of other polymer products.

Other revenues

Other revenues include geological and geophysical research services, rent, transportation, handling, storage and other services. In the three months ended 30 September 2010, other revenues decreased by RR 243 million, or 87.1%, to RR 36 million from RR 279 million in the corresponding period in 2009. The decrease in other revenues was primarily related to a RR 163 million decrease in revenues from geological and geophysical research services provided to our associates. The decrease was due to the acquisition in February 2010 of a controlling interest in our associated companies and the subsequent consolidation of their activities and elimination of intercompany operations. In addition, rent services sales decreased by RR 84 million, or 77.8%, to RR 24 million in the three months ended 30 September 2010. The remaining increase of RR four million in other revenues was composed of various immaterial items.

Operating expenses

In the three months ended 30 September 2010, our total operating expenses increased by RR 3,949 million, or 29.0%, to RR 17,587 million compared to RR 13,638 million in the 2009 period, due primarily to an increase in transportation expenses. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased to 68.8% in the three months ended 30 September 2010 compared to 67.1% in the corresponding period in 2009. Total operating expenses decreased as a percentage of total revenues to 59.7% in the three months ended 30 September 2010 compared to 62.1% in the corresponding period in 2009, as shown in the table below. The decrease in our operating expenses as a percent of total revenues was primarily due to an increase in our stable gas condensate sales volumes and natural gas sales prices.

<i>millions of Russian roubles</i>	Three months ended 30 September:			
	2010	% of total revenues	2009	% of total revenues
Transportation expenses	9,761	33.2%	7,190	32.7%
Taxes other than income tax	2,334	7.9 %	1,955	8.9%
Subtotal non-controllable expenses	12,095	41.1%	9,145	41.6%
Depreciation, depletion and amortization	1,783	6.1%	1,467	6.7%
General and administrative expenses	1,656	5.6%	1,308	6.0%
Materials, services and other	1,641	5.6%	1,594	7.3%
Net impairment expense (reversal)	154	0.5%	(4)	n/m
Exploration expenses	144	0.5%	17	0.1%
Purchases of natural gas and liquid hydrocarbons	67	0.2%	310	1.4 %
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	47	n/m	(199)	n/m
Total operating expenses	17,587	59.7%	13,638	62.1%

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 2010, non-controllable expenses of transportation and taxes other than income tax increased by RR 2,950 million, or 32.3%, to RR 12,095 million from RR 9,145 million in the corresponding period in 2009. The change in transportation expenses was primarily due to an increase in the natural gas transportation tariff and, to a lesser extent, by an increase in our liquids sales volumes. Taxes other than income tax increased primarily due to higher liquids and natural gas production volumes and the corresponding impact on unified natural resources production tax as well as excise and fuel taxes incurred in the 2010 period with the commencement of commercial activities in Poland. As a percentage of total revenues our non-controllable expenses marginally decreased to 41.1% in the three months ended 30 September 2010 compared to 41.6% in the corresponding period in 2009.

Transportation expenses

In the three months ended 30 September 2010, our total transportation expenses increased by RR 2,571 million, or 35.8%, compared to the corresponding period in 2009.

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Natural gas transportation to customers	6,832	5,288	29.2%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	1,971	1,264	55.9%
Stable gas condensate transported by tankers	845	511	65.4%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	64	82	(22.0%)
Crude oil transportation to customers	43	39	10.3%
Other transportation costs	6	6	0.0%
Total transportation expenses	9,761	7,190	35.8%

In the three months ended 30 September 2010, our transportation expenses for natural gas increased by RR 1,544 million, or 29.2%, to RR 6,832 million from RR 5,288 million in the corresponding period in 2009. The change was primarily due to an increase in the natural gas transportation tariff (see “Transportation tariffs” above) and, to a lesser extent, by a 3.7% increase in our sales volumes of natural gas delivered directly to end-customers, where the cost of transportation is included in the sales price. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

Total expenses for transportation by rail increased by RR 707 million, or 55.9%, due primarily to an increase in liquids volumes sold and higher rail transportation tariffs. In the three months ended 30 September 2010, our combined volumes of stable gas condensate, LPG and oil products sold and transported via rail increased by 261 thousand tons, or 40.1%, to 912 thousand tons from 651 thousand tons in the corresponding period in 2009.

Our expense for stable gas condensate transported by rail to export markets increased by RR 650 million, or 101.7% to RR 1,289 million from RR 639 million in the three months ended 30 September 2009 due to a 54.6% increase in volumes sold and an increase in the rail tariff. In the three months ended 30 September 2010, our average transportation rate per ton for stable gas condensate transported by rail to export markets increased by 30.6% to RR 1,786 from RR 1,368 in the corresponding period in 2009, primarily due to an increase in rail tariffs by 9.4% effective 1 January 2010 and an application of a higher co-efficient to the existing rail tariff. In the three months ended 30 September 2010, we applied a co-efficient of 0.89 to the existing rail tariff for stable gas condensate deliveries to export markets compared to co-efficient of 0.72 in the corresponding period in 2009 (see “Transportation tariffs” above).

In the three months ended 30 September 2010, our expense for LPG transported by rail increased by RR 55 million, or 8.8%, due to increases in both rail tariffs and volumes sold. In the three months ended 30 September 2010, our expense for LPG transported by rail amounted to RR 677 million, of which RR 407 million was related to export sales, RR 269 million to domestic sales and RR 1 million to CIS sales, or RR 3,965 per ton, RR 3,095 per ton and RR 2,119 per ton, respectively. In the three months ended 30 September 2009, transportation expenses for LPG transported by rail amounted to RR 622 million, of which RR 399 million was related to export sales, RR 220 million to domestic sales, and RR three million to CIS sales, or RR 3,874 per ton, RR 2,783 per ton and RR 2,238 per ton, respectively.

The increases in our average transportation tariffs for LPG delivered to export and domestic markets were affected by an increase in rail tariffs by 9.4% effective 1 January 2010. We applied a co-efficient of 0.35 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation in both periods (see “Transportation tariffs” above).

The remaining RR five million and RR three million of transportation expenses by rail in the 2010 and 2009 periods, respectively, were related to the transportation of oil products sold on the domestic market and other railroad services not allocated between products.

Total transportation expense for delivery of stable gas condensate by tanker to international markets increased by RR 334 million, or 65.4%, to RR 845 million in the three months ended 30 September 2010 from RR 511 million in the 2009 period. The change was primarily due to a 54.6% increase in volumes sold and an increase in average freight rates.

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

Taxes other than income tax

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change
	2010	2009	%
Unified natural resources production tax (UPT)	1,798	1,633	10.1%
Property tax	350	266	31.6%
Excise and fuel taxes	138	-	n/a
Other taxes	48	56	(14.3%)
Total taxes other than income tax	2,334	1,955	19.4%

In the three months ended 30 September 2010, taxes other than income tax increased by RR 379 million, or 19.4%, primarily due to an increase in the unified natural resources production tax expense and excise and fuel taxes incurred at our trading subsidiaries in Poland.

In the three months ended 30 September 2010, our UPT for natural gas and gas condensate increased by RR 95 million and RR 63 million, respectively, due to an increase in production volumes. The increase in our UPT for crude oil of RR seven million was due primarily to an increase in our average crude oil production tax rate, which is linked to the Urals benchmark crude oil price that was partially offset by a marginal decrease in our crude oil production. Our average UPT rate for crude oil increased from RR 2,663 per ton in the three months ended 30 September 2009 to RR 2,987 per ton in the 2010 period. The natural gas production tax rate in the 2010 and 2009 periods remained unchanged at RR 147 per mcm.

In the three months ended 30 September 2010, our property tax expense increased by RR 84 million, or 31.6%, to RR 350 million from RR 266 million in the corresponding period in 2009, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In the three months ended 30 September 2010, we expensed RR 138 million of excise and fuel taxes in respect of LPG export sales through our subsidiaries Novatek Polska and Intergaz-System. The excise and fuel taxes are payable when LPG enters the territory of Poland.

Depreciation, depletion and amortization

In the three months ended 30 September 2010, our depreciation, depletion and amortization (“DDA”) expense increased by RR 316 million, or 21.5%, compared to the corresponding period in 2009 as a result of an increase in our depletable cost base, as well as a 9.1% increase in our hydrocarbon production in barrels of oil equivalent (boe). The Company accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In the three months ended 30 September 2010, our DDA per boe was RR 23.9 compared to RR 22.1 in the corresponding period in 2009. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the second stage of the second phase development at the Yurkharovskoye field in October 2009, as well as costs capitalized during the nine months of 2010.

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

General and administrative expenses

In the three months ended 30 September 2010, our general and administrative expenses increased by RR 348 million, or 26.6%, to RR 1,656 million compared to RR 1,308 million in the corresponding period in 2009. The main components of these expenses were employee compensation and charitable contributions, which, on aggregate, comprised 70.0% and 64.4% of total general and administrative expenses in the three months ended 30 September 2010 and 2009, respectively.

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Employee compensation	863	705	22.4%
Charitable contributions	297	138	115.2%
Legal, audit, and consulting services	99	66	50.0%
Business trip expenses	67	39	71.8%
Rent expense	65	67	(3.0%)
Fire safety and security expense	37	37	0.0%
Depreciation – administrative buildings	36	38	(5.3%)
Concession management services	34	52	(34.6%)
Insurance expense	23	23	0.0%
Other	135	143	(5.6%)
Total general and administrative expenses	1,656	1,308	26.6%

Our employee compensation increased by RR 158 million, or 22.4%, to RR 863 million in the three months ended 30 September 2010 as compared to RR 705 million in the corresponding period in 2009 primarily due to an indexation of basic salaries by 10% effective 1 July 2010 and an increase by 3.2% in our average number of employees, which, on aggregate, resulted in an additional RR 100 million to payroll expenses. In addition, in the three months ended 30 September 2010, we recognized RR 99 million to employee compensation as a result of the initiation of NOVATEK's share-based compensation program for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee.

In the three months ended 30 September 2010, our charitable contributions increased by RR 159 million, or 115.2%, to RR 297 million compared to RR 138 million in the corresponding period in 2009, and were primarily related to our donations to sport clubs and activities as well as continued support for charities and social programs in the regions where we operate. Charitable contributions will continue to fluctuate period-on-period depending on the funding needs and the implementation schedule of specific programs we support.

Legal, audit, and consulting services expenses increased by RR 33 million, or 50.0%, to RR 99 million compared to RR 66 million in the 2009 period due to an increase in consulting and legal services related to the Group's recent acquisitions as well as legal services connected with the development of the LNG project in relation to the South-Tambeyskoye field.

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 2010, our expenses related to concession management services decreased by RR 18 million, or 34.6%, compared to the 2009 period. The decrease in costs associated with concession management services in the 2010 period is consistent with our approved business plan for this project.

In the three months ended 30 September 2010, other general and administrative expenses decreased by RR 8 million, or 5.6%, compared to the corresponding period in 2009. The decrease 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 2010, our materials, services and other expenses increased by RR 47 million, or 2.9%, to RR 1,641 million compared to RR 1,594 million in the 2009 period. The main components of this expense category were employee compensation and materials and supplies, which comprised 40.5% and 29.4%, respectively, of total materials, services and other expenses in the 2010 period.

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Employee compensation	665	626	6.2%
Materials and supplies	483	388	24.5%
Repair and maintenance services	133	121	9.9%
Tolling and processing fees	122	128	(4.7%)
Electricity and fuel	93	68	36.8%
Fire safety and security expense	49	48	2.1%
Other	96	106	(9.4%)
Subtotal materials, services and other	1,641	1,485	10.5%
Operator services expense	-	109	n/a
Total materials, services and other	1,641	1,594	2.9%

In the three months ended 30 September 2010, our materials, services and other expenses, excluding operator services expense, increased by RR 156 million, or 10.5%, to RR 1,641 million compared to RR 1,485 million in the corresponding period in 2009.

Our employee compensation increased by RR 39 million, or 6.2%, to RR 665 million compared to RR 626 million in the 2009 period primarily due to an indexation of basic salaries by 10% effective 1 July 2010.

Materials and supplies expense increased by RR 95 million, or 24.5%, mainly due to an increase in production of polymers and insulation tape products and the associated increase in purchases of raw materials, which accounted for RR 58 million, or 61.1%, of the total increase in materials and supplies expense.

Repair and maintenance services increased by RR 12 million, or 9.9%, to RR 133 million in the three months ended 30 September 2010 compared to RR 121 million in the corresponding period in 2009. The increase was primarily related to the current repair works at our production assets and was consistent with our on-going maintenance schedules.

Tolling and processing fees decreased by RR six million, or 4.7%, to RR 122 million in the three months ended 30 September 2010 from RR 128 million in the corresponding period in 2009. The decrease was primarily due to a launch of our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010, which resulted in a savings of RR 30 million on external processing fees. In addition, in the three months ended 30 September 2010, we incurred RR 27 million in costs related to the preparation of crude oil produced at our East-Tarkosalinskoye field for transportation. Tolling and processing fees at the Surgutsky refinery decreased by RR three million.

Electricity and fuel expenses increased by RR 25 million, or 36.8%, from RR 68 million in the three months ended 30 September 2009 to RR 93 million in the 2010 period primarily due to an increase in energy consumption at the Yurkharovskoye field resulting from the commencement in operation of new production assets.

Operator services expenses mainly refer to the geological and geophysical research provided to our associated companies. In the three months ended 30 September 2010, operator services expenses decreased by RR 109 million, or 100.0%, due to the acquisition in February 2010 of a controlling interest in our associates OOO "Oiltechproduct-Invest", OOO "Petra Invest-M" and OOO "Tailiksneftegas" and the subsequent consolidation of these companies activities.

Purchases of natural gas and liquid hydrocarbons

Purchases of natural gas and liquid hydrocarbons decreased by RR 243 million, or 78.4%, to RR 67 million in the three months ended 30 September 2010, from RR 310 million in the corresponding period in 2009, primarily due to decreases in purchases of natural gas by RR 256 million and crude oil by RR 40 million. The decrease was partially offset by an increase in oil products and LPG purchases by RR 53 million.

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

In the three months ended 30 September 2010, we recorded a charge of RR 47 million to change in inventory expense as compared to a reversal of RR 199 million in the corresponding period in 2009:

<i>millions of Russian roubles</i>	Three months ended 30 September:	
	2010	2009
Natural gas	(107)	(85)
Stable gas condensate	222	(93)
Polymer and insulation tape	(15)	(24)
Other	(53)	3
Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress	47	(199)

In the three months ended 30 September 2010, we recorded a reversal to our operating expenses of RR 107 million due to an increase in our natural gas inventory balance by 229 mmcm. Our volumes of natural gas injected into Gazprom's underground gas storage facilities (UGSF) fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in the three months ended 30 September 2010, we recorded a charge of RR 222 million to our operating expenses due to a decrease in our inventory balance of stable gas condensate in transit and storage by 126 thousand tons.

The following table highlights movements in our inventory balances:

<i>Inventory balances in transit or in storage</i>	2010			2009		
	At 30 September	At 30 June	Increase / (decrease)	At 30 September	At 30 June	Increase / (decrease)
Natural gas (millions of cubic meters)	1,058	829	229	503	267	236
<i>including Gazprom's UGSF</i>	<i>1,010</i>	<i>800</i>	<i>210</i>	<i>476</i>	<i>207</i>	<i>269</i>
Liquid hydrocarbons (thousand tons)	296	388	(92)	257	224	33
<i>including stable gas condensate</i>	<i>206</i>	<i>332</i>	<i>(126)</i>	<i>202</i>	<i>172</i>	<i>30</i>

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

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.

In the three months ended 30 September 2009, we realized other operating income of RR 25 million, of which RR 15 million was related to penalties to our customers due to non-compliance of their contractual obligations. The remaining other income of RR 10 million was primarily related to the disposal of equipment and materials.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 3,650 million, or 43.7%, to RR 12,008 million in the three months ended 30 September 2010, compared to RR 8,358 million in the corresponding period in 2009. In the three months ended 30 September 2010, our profit from operations as a percentage of total revenues increased to 40.8% compared to 38.0% in the 2009 period due primarily to higher prices for natural gas and liquids and an increase in total sales volumes.

Finance income (expense)

In the three months ended 30 September 2010, we recorded net finance income of RR 482 million compared to RR 903 million in the corresponding period in 2009. The change was mainly due to a decrease in foreign exchange gains in the 2010 period.

In the three months ended 30 September 2010, our total accrued interest expense decreased to RR 673 million compared to RR 711 million in the corresponding period in 2009 as a result of a decrease in our average borrowings. During the 2010 and 2009 periods, we capitalized RR 576 and RR 257 million, respectively, of interest expense to cost of additions in our property, plant and equipment account in accordance with the Group's accounting policy.

Interest income decreased by RR 124 million, or 93.9%, to RR eight million in the three months ended 30 September 2010 from RR 132 million in the corresponding period in 2009 primarily due to a decrease in interest income on loans issued to our associated companies as well as a decrease in interest income on bank deposits.

In the three months ended 30 September 2010, we recorded a net foreign exchange gain of RR 571 million as compared to RR 1,225 million in the corresponding period in 2009 due to a 2.5% and 3.8% appreciation of the Russian rouble against the US dollar in the 2010 and 2009 periods, respectively, and its effect on our foreign currency denominated borrowings. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the composition of our debt position.

Share of income (loss) of associated companies

In the three months ended 30 September 2010, our proportionate share in the loss of associated companies amounted to RR seven million compared to a loss of RR 23 million recorded in the 2009 period. The loss recognized by our associated companies was due to the expensing of geological and geophysical research expenditures under the successful efforts accounting policy.

Income tax expense

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 19.4% and 21.2% for the three months ended 30 September 2010 and 2009, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 20.5% and 21.3% in the 2010 and 2009 periods, respectively. The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the period increased by RR 2,784 million, or 38.3%, to RR 10,061 million in the three months ended 30 September 2010 from RR 7,277 million in the corresponding period in 2009. The profit attributable to NOVATEK shareholders increased by RR 2,752 million, or 37.4%, to RR 10,105 million in the three months ended 30 September 2010 from RR 7,353 million in the corresponding period in 2009.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to NOVATEK shareholders, increased by approximately RR 0.90 per share, or 37.4%, to RR 3.33 per share in the 2010 period from RR 2.43 per share in corresponding period in 2009.

LIQUIDITY AND CAPITAL RESOURCES

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

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Net cash provided by operating activities	12,085	10,523	14.8%
Net cash used in investing activities	(6,373)	(15,925)	(60.0%)
Net cash used in financing activities	(9,253)	(102)	n/m

<i>Liquidity ratios</i>	30 September 2010	31 December 2009	Change, %
Current ratio	1.65	1.14	44.7%
Total debt to equity	0.24	0.33	(27.3%)
Long-term debt to long-term debt and equity	0.15	0.17	(11.8%)
Net debt to total capitalization ⁽¹⁾	0.11	0.15	(26.7%)

⁽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 2010, our net cash provided by operating activities increased by RR 1,562 million, or 14.8%, to RR 12,085 million compared to RR 10,523 million in the corresponding period in 2009. The increase in our net cash provided by operating activity was due primarily to the increase in natural gas prices and liquids sales volumes and prices, which was partially offset by a decrease in accounts payable and accrued liabilities as well as an increase in income tax paid.

Net cash used in investing activities

In the three months ended 30 September 2010, our net cash used in investing activities decreased by RR 9,552 million, or 60.0%, to RR 6,373 million as compared to RR 15,925 million in the corresponding period in 2009. The decrease was primarily due to a cash payment of RR 9,526 million in the third quarter 2009 for the acquisition of our equity interest in OAO "Yamal LNG".

Net cash used in financing activities

In the three months ended 30 September 2010, net cash used in financing activities increased to RR 9,253 million from RR 102 million in the corresponding period in 2009 primarily due to an increase in the repayment of long-term debt as scheduled and ahead of schedule.

Working capital

Our net working capital position (current assets less current liabilities) at 30 September 2010 increased to RR 10,792 million compared to RR 3,274 million at 31 December 2009. The net change was mainly due to a decrease in the current portion of long-term debt, accounts payable and accrued liabilities, and trade and other receivables, as well as an increase in our balance of cash and cash equivalents.

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

Capital expenditures

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

<i>millions of Russian roubles</i>	Three months ended 30 September:		Change %
	2010	2009	
Exploration, production and marketing	7,049	3,916	80.0%
Polymer production and marketing	147	17	n/m
Total	7,196	3,933	83.0%

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. During both reporting periods, the majority of our capital expenditures related to ongoing development and exploration activities at our three core fields and at our Purovsky Plant. In the three months ended 30 September 2010, we spent RR 21 million, RR 221 million and RR 2,635 million for further field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 587 million on further construction work at the Purovsky Plant. In addition, in the three months ended 30 September 2010, we spent RR 850 million on the development of infrastructure at our South-Tambeyskoye field.

Debt obligations

At 30 September 2010, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 5,169 million (USD 170 million) on either fixed or variable interest rates subject to the specific type of credit facility.

The Group also has funds available under the credit facilities with ZAO "BNP PARIBAS Bank" in the amount of USD 100 million until May 2012, Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2011 and ZAO UniCredit Bank in the amount of USD 100 million until August 2012, with the interest rates under the credit facilities to be negotiated at the time of each withdrawal.

In addition, at 30 September 2010, we had available funds under the credit facility with OAO "Gazprombank" in the amount of RR 2,394 million until November 2012 with an annual interest rate of 9 percent. In October 2010, the Group withdrew this amount and reduced the stated interest rate to 8.5 percent per annum.

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 2010, RR 6,065 million, or 17.8%, of our long-term debt was denominated in US dollars (out of RR 34,010 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, approximately 34.8% in the three months ended 30 September 2010, is denominated in US dollars. As of 30 September 2010, the Russian rouble had depreciated by approximately 0.5% against the US dollar since 31 December 2009.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 30 September 2010 would have resulted in an estimated foreign exchange gain of approximately RR 1,646 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 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.