NOVATEK

Annual Review 07

NOVATEK is Russia's largest independent gas producer and the second-largest natural gas producer

annual review

2007

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Financial and operating highlights

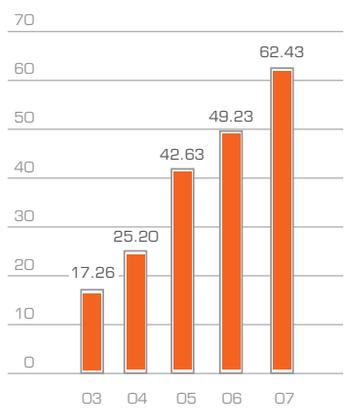
millions of Russian roubles except per share amounts and ratios	Year ended 31 December 2007	Year ended 31 December 2006	Change %
Financial results			
Total revenues and other income [1]	62,431	49,234	26.8%
Total revenues	62,321	49,373	26.2%
Operating expenses	37,066	30,081	23.2%
Net income	18,728	14,007	33.7%
EBITDA [2]	29,283	23,129	26.6%
Earnings per share (EPS), Russian roubles	6,17	4,64	33.0%
Operating results			
Total proved reserves (SEC), million boe (mmboe)	4,678	4,664	0.3%
Natural gas sales volumes by consolidated subsidiaries, billion cubic meters (bcm)	32.054	30.308	5.8%
Hydrocarbon liquids sales volumes by consolidated subsidiaries, thousand tons (mt)	2,404	2,249	6.9%
Incl. stable gas condensate sales volumes from Purovsky Processing Plant, mt	1,508	1,358	11.0%
Equity and liquidity			
Net cash provided by operating activities	21,384	16,938	26.2%
Capital expenditures	19,466	4,703	313.9%
Net debt [3]	2,620	(2,560)	–
Total debt to Total shareholders equity, %	8.1%	4.5%	80.0%

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

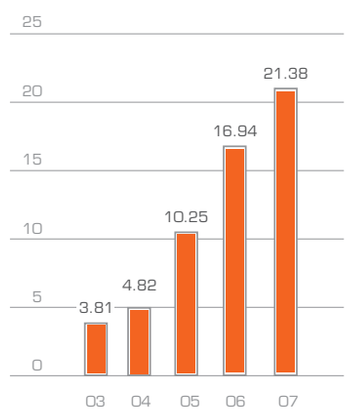
[2] EBITDA represents net income before finance income (expense) and income taxes from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

[3] Net debt calculated as total debt less cash and cash equivalents

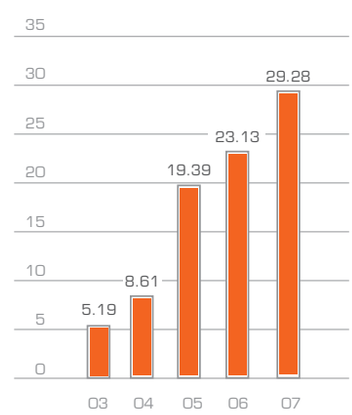
Total Revenues and Other Income, RR billion



Operating Cash Flow, RR billion

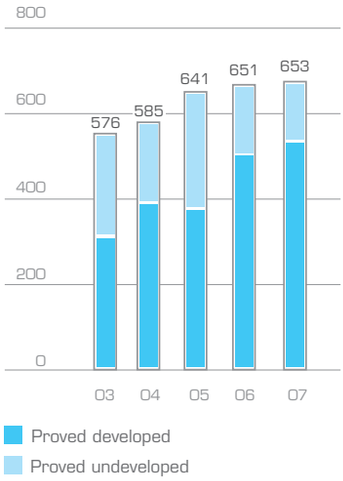


EBITDA[4], RR billion

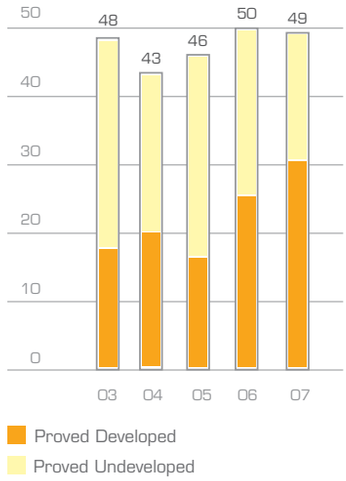


[4] 2005 EBITDA is normalized and does not include one-time effect from disposal of investments. Inclusive of the disposal of investments effect, EBITDA amounted to 23.02 billion roubles.

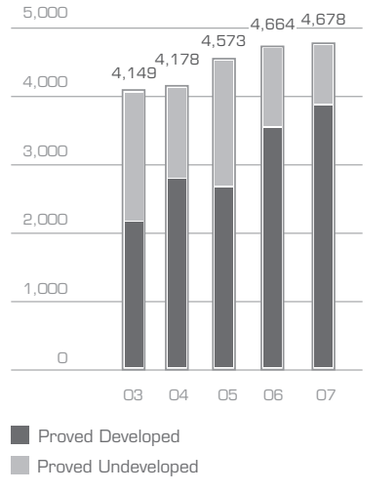
Natural Gas Reserves (SEC), bcm



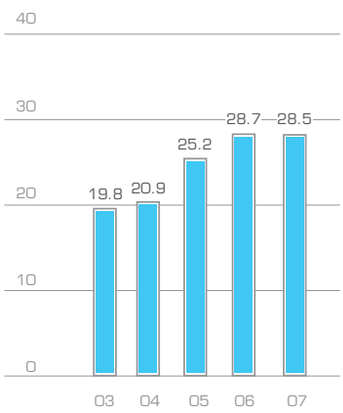
Liquids Reserves (SEC), mmt



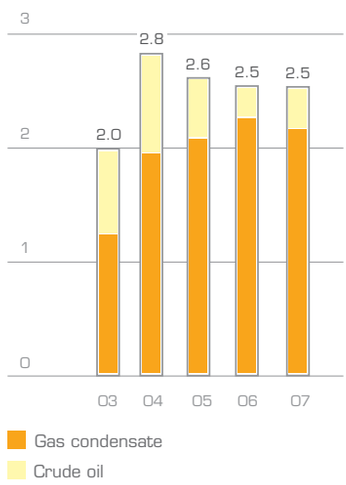
Total reserves (SEC), mmboe



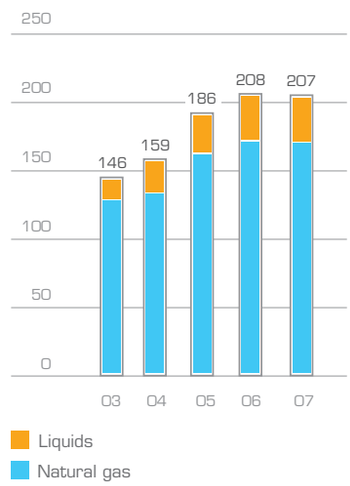
Natural Gas Production, bcm



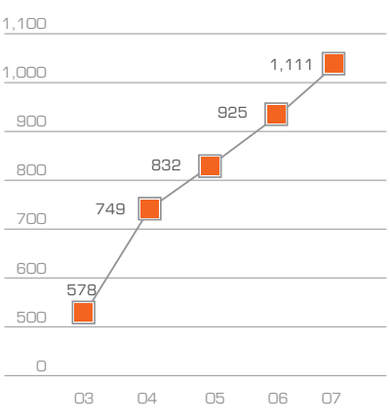
Liquids Production, mmt



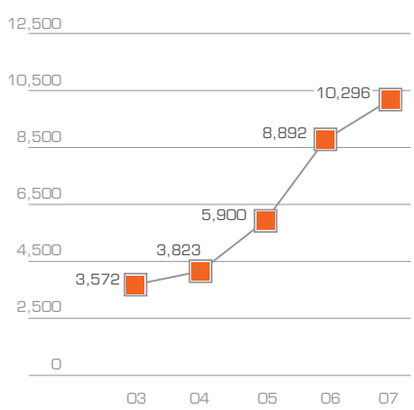
Total Production, mmboe



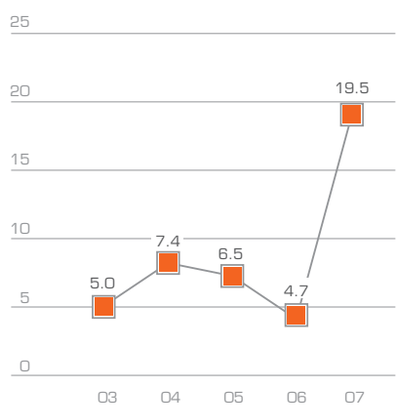
Average Natural Gas Prices[1], RR per mcm



Average Liquids Prices[1], RR per ton



Total Capital Expenditures, RR billion



[1]Net of VAT, excise taxes and export duties, where applicable

Our Strategy in Motion

Dear shareholders,

TWO THOUSAND AND SEVEN was a difficult market environment for natural gas producers in Russia as we experienced an unseasonable warm winter this past year – the warmest in 126 years. Despite the weather, 2007 proved to be a very rewarding year for NOVATEK and our valued shareholders as we continued to achieve record financial and operational results.

Throughout 2007, our business environment was challenged by events beyond our control yet we continued to make significant capital investments to expand our present infrastructure and processing capabilities and to ensure the successful exploitation of our large resource base in the future. By remaining steadfast to our strategic goals and objectives we grew our resource base, albeit at a slower pace, diversified into complimentary and value-accretive projects and continued optimizing our core marketing channels for both natural gas and liquids.

OUR STRATEGY IN MOTION proved its resiliency in this dynamic market environment. Even though our natural gas production was flat year-on-year due solely to the warm winter weather, we made enormous strides toward fulfilling our long-term production targets by investing capital into our production facilities and continuing our commitment toward exploratory activities. During 2007, our capital expenditures aggregated approximately RR 20 billion, a three-fold increase over the prior year and the largest single year expenditures in our corporate history. We will continue to make the appropriate capital investments in our portfolio of assets, particularly our Yukharovskoye field, to ensure adequate productive capacity in the future.

During 2007, our total hydrocarbon production aggregated approximately 207 million barrels of oil equivalent (boe), or roughly 570 thousands boe per day. Revenues from sales of natural gas increased to RR 36 billion, or by 27%, as compared to 2006, while our revenues from sales of liquids grew to RR 25 billion, or by 24%. Our earnings before interest tax and depreciation, or EBITDA, increased to RR 29 billion, or by 27% over the corresponding 2006 period, while our profit attributable to NOVATEK's shareholders increased to RR 19 billion. Our record financial results allowed us to increase our full year dividend payment to RR 2.35 per ordinary share (or RR 23.5 per GDR).

We rank amongst the top ten companies globally in terms of proven natural gas reserves and are considered one of the fastest growing producers of natural gas amongst our peers. Our core portfolio of assets is concentrated in the prolific Yamal-Nenets Autonomous Region, which is considered the world's largest natural gas producing area. We aim to continuously increase our reserve base by efficiently applying state-of-the-art technology and through our focused exploration activities. As a result, we have successfully replaced our reserves over the past five years at an average rate of 158%, while preserving our reserve to production ratio at 23 years.

During the past year, we paid special attention to growing our resource base and geographically diversifying our core activities to create a long-term platform for future production growth. At the same time, we maintained our primary focus on cost control despite the spiralling cost inflation experienced in the oil and gas industry.

In 2007, we acquired a 25% participation interest in three companies holding six license areas located in close proximity to our existing assets and the transportation infrastructure. The six exploration license areas hold a combined resource base of approximately 9 billion boe under the Russian reserves classification system, more than 60% of which is natural gas. We retained the right to purchase an additional 25% participation interest in each of these companies if we are successful in our exploratory activities and deem the field's to be commercially producing assets.

We also acquired a working interest in the Concession Agreement for Gas and Crude Oil Exploration and Exploitation in the El Arish Offshore Area located in the Arab Republic of Egypt. Our participation is this concession is considered one of our major events in 2007

as the El Arish Offshore project is our first foray into the international markets. We view the Egyptian gas market to be highly attractive and see significant upside opportunities in this hydrocarbon rich region. The Arab Republic of Egypt ranks third in proven natural gas reserves in Africa after Algeria and Nigeria and is strategically located to supply natural gas to the European and Middle Eastern markets.

Our ability to explore for new natural gas and gas condensate fields resulted in discovering three brand new fields – North Khancheyskoye, Raduzhnoye and Yarudeyskoye – holding potential C1 and C2 reserves of 331 million boe under the Russian reserves classification system. These are promising new natural gas and gas condensate fields which offers potential future incremental production for the Company.

The uninterrupted delivery of natural gas and liquids to our customers is vital to our commercial activities. Over the past year, we expanded our deliveries of natural gas to 39 regions in Russia as well as continuing our sales of stable gas condensate to the United States and Western European markets. The Purovsky processing plant is an integral part of our gas condensate value chain and has provided us with the capacity to sell our liquids to the export markets at improved margins. With the commencement of the second phase of the Purovsky processing plant currently under construction, we plan to more than double our existing processing capacity which allows us to better exploit our wet gas fields. We also made the strategic decision to migrate further downstream by announcing our plans to construct a condensate fractionation unit and related terminal transhipment facilities in Ust-Luga, located in the North-West region of Russia to produce value-added refined products.

Our full year results were an impressive achievement for our Company and an attribution to the dedication, commitment and professionalism of our highly valued employees. The successful implementation of NOVATEK's business strategy, combined with the dynamic development of our Company is directly related to the efforts of all of our employees. Our motivated and talented team of professionals are vital to the continued development of our Company and the creation of shareholder value. We sincerely thank each and every one of them for their contributions toward achieving our vision.

Our outstanding performance has been recognized by the investment community. By the end of 2007 our market capitalization exceeded USD 23 billion, representing a growth in our share price by more than 21%. We will continue to execute our business strategy and make the appropriate capital investments with the aim of increasing shareholder value in an environmentally and socially responsible manner.

Despite the challenges we faced in 2007 we are proud of the results we have achieved and the platform that we have built for the future. We are committed to building a world class company that can prosper in any market environment. On behalf of the Board of Directors and the Management Board, we are pleased to present NOVATEK's 2007 Annual Review. We would like to express our gratitude for your continued confidence and support of NOVATEK.

Alexander Natalenko
Chairman of the Board

Leonid Mikhelson
Chief Executive Officer

Mark Gyetvay
Chief Financial Officer

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Strategy in Motion

Overview

As an energy source, natural gas is clean, abundant and increasingly becoming the fuel of choice in the 21st century. The demand for natural gas is projected to grow at an increasing rate over the next decade, outstripping the demand growth for other primary sources of energy.

Our proved natural gas reserves (SEC) totaled 653 bcm as of 31 December 2007

We achieved average daily natural gas production of 78 mmcm

Overview

OAO NOVATEK is Russia's largest independent gas producer and its second-largest producer of natural gas after OAO Gazprom. NOVATEK's production and processing operations are located in the Yamal-Nenets Autonomous Region whereas our industrial facilities are located in the Samara Region. With many years of experience in exploration and production, we have continued to demonstrate stable operational and record financial results, which have been achieved through a successful strategy of expanding our hydrocarbons reserves base, while at the same time maintaining our low-cost competitive advantage.

In 2007, we produced approximately 207 million boe, 90% of which was natural gas. As of 31 December 2007, our natural gas, gas condensate and crude oil proved reserve base[1] (SEC) was appraised at 4,678 mm boe, 91% of which is natural gas. Our proved natural gas reserves place us among the largest oil and gas companies globally and make us the fourth largest oil and gas company in Russia, after Gazprom, LUKOIL, and Rosneft.

Highlights for 2007 include:

- Record financial and operational results that reflect our successful efforts add value via products and market diversification. Revenues from our sales of hydrocarbons and other income increased by 27% to RR 62.4 billion as compared to 2006. Profit distributions to shareholders increased by 33% to RR 18.7 billion.
- Upgraded corporate ratings – Moody's Corporate Family Ratings of NOVATEK was upgraded to Baa3 (stable outlook); S&P's – to BB (positive outlook).
- Respectable reserve replacement statistics for the year – 107% (SEC case) on a boe basis, with our reserve-to-production ratio registering at 23 years. Our proved developed natural gas reserves increased by 7% and now comprise 84% of our total proved natural gas reserves.
- Discovery of three new fields with total reserves of 331 mm boe[2].
- Acquisition by NOVATEK from Tharwa Petroleum S.A.E. of a 50% working interest in a concession agreement for oil and gas exploration and development at the El-Arish offshore block in Egypt.
- Acquisition by NOVATEK of a 25% participation interest in projects to conduct exploration in six license areas in the Yamal Nenets Autonomous Region, which possess a combined resource base of approximately 9 billion boe[3].
- Increase of production at the Khancheyskoye field by 28% due to the commissioning of the second phase development of the gas condensate field.
- Commissioning of a pilot methanol production unit with a throughput capacity of 12,500 metric tons per annum at the Yurkharovskoye field. The on-site methanol production unit will minimize the environmental risks associated with transporting methanol while reducing costs and ensuring operational stability.
- Receipt by NOVATEK of the «National Environmental Prize» in the category «Sustainable Development Reporting».

[1] As per DeGolyer & MacNaughton's Reserve Appraisal Report as of 31 December 2007

[2] Under C1 + C2 Russian classification of reserves

[3] Under C3 + D Russian classification of reserves

Strategy

In 2015, NOVATEK plans to reach a production level of 65 bcm of natural gas and between 8 to 9 mmt of liquids per annum

Our strategy is to expand our hydrocarbons production on a sustainable and profitable basis, while efficiently increasing our resource base and operating in a socially and environmentally responsible manner. Specifically, we intend to:

• **Substantially increase our production of natural gas and associated hydrocarbons.** Industry experts estimate that, in 2010, demand for natural gas in Russia will comprise about 500 bcm, of which by 200 bcm will be supplied by independent natural gas producers and oil companies. We believe we are well positioned to capture a 30% share of the domestic consumption growth by increasing our production and maximizing sales volumes, reflecting the increase in demand. In 2007, our fields produced 28.5 bcm of natural gas and 2.5 mmt of gas condensate and crude oil. In 2010, we plan to produce annually 45 bcm of natural gas and 4.6 mmt of liquids; in 2015, we anticipate 65 bcm of gas and 8 to 9 mmt of liquids.

• **Maintain our low cost structure.** Through the continued use of modern technology and production techniques across our prolific hydrocarbon resource base, we intend to maintain our low cost track record. In 2007, our weighted average lifting cost and our finding and exploration costs were among the lowest in the industry. The geographic concentration of our resource base and the resulting economies of scale will continue to be a major factor in helping us maintain our low cost structure. Moreover, we strive to maintain consistently low costs in all other areas of our business.

• **Capture maximum margins on natural gas and liquids sales.** Our marketing and sales team continues to optimize our product distribution among customer and market segments to realize superior risk adjusted margins. Today, we supply gas to 39 regions of the Russian Federation. We intend to maintain our leadership among independent gas producers by penetrating new regional markets and entering into long-term supplies agreements with end users, to whom we supplied 45% of our gas sales in 2007. In addition, as we market our liquid hydrocarbons, we intend to continue to take advantage of the increased flexibility of our Purovsky processing plant and the related infrastructure at the Port of Vitino. We export a substantial amount of our gas condensate production, which results in improved margins based on current international prices.

• **Increase our resource base and manage reserves effectively.** We intend to continue to manage our resource base in order to grow our proved reserves as we develop our fields. We believe the concentration of our resource base in the gas-rich Yamal-Nenets Autonomous Region, along with the proximity of our fields to gas transportation infrastructure in the Nadym-Pur-Taz Region, will facilitate cost-effective reserves growth.













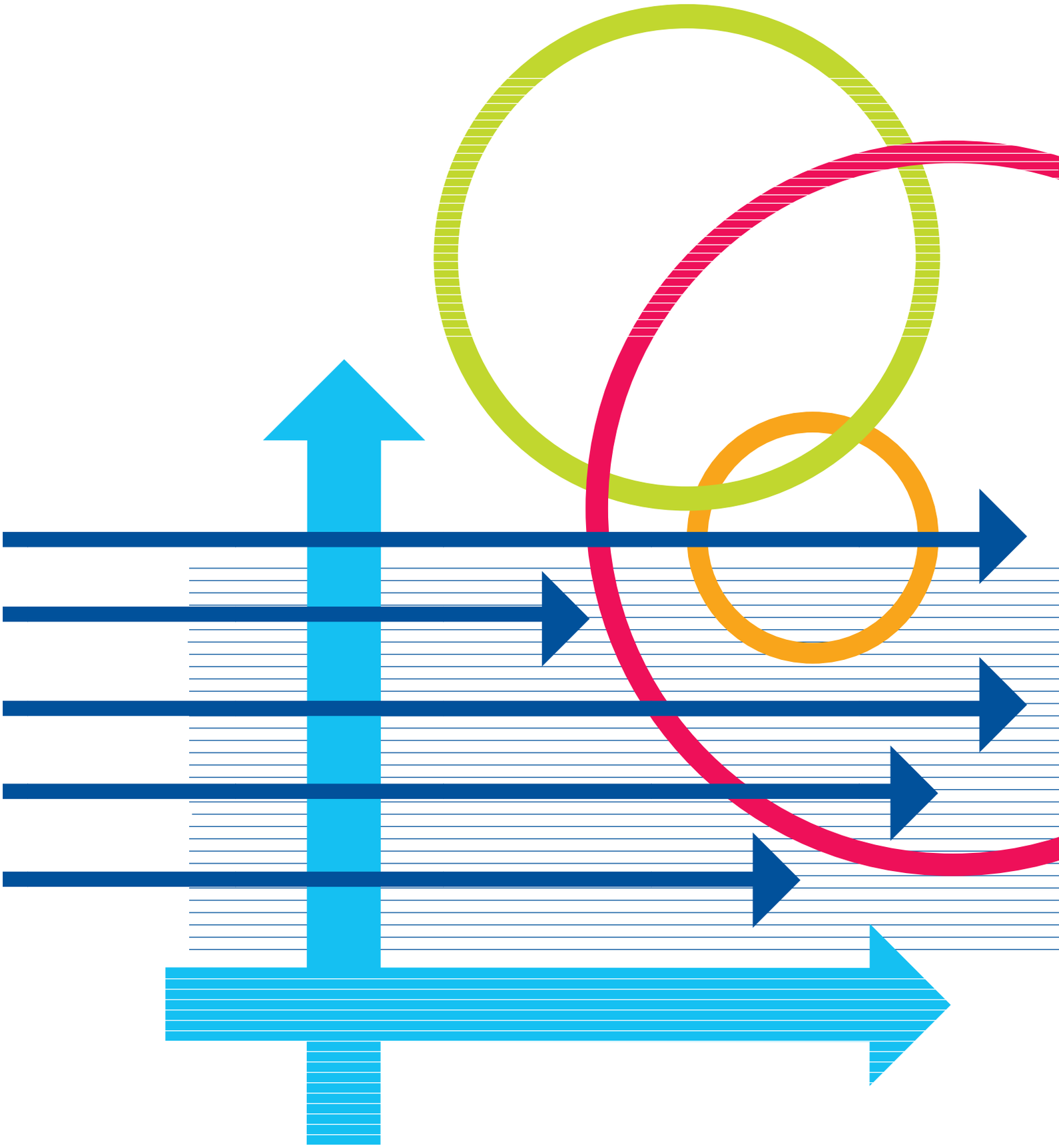



Strategy in Motion

Exploration and Production

NOVATEK

Our core focus on the gas-rich Yamal-Nenets Autonomous Region provides us with the best opportunity to increase shareholder value through low-risk, low-cost production and effective reserve replacement.



2007 Operations in Review

NOVATEK's reserves-to-production ratio is 23 years, while the volume of proved developed natural gas reserves comprised 84% of our total proved natural gas reserves

Exploration and Production

Our core fields and license areas are located in the Yamal-Nenets Autonomous Region, the world's largest natural gas producing region, which accounts for over 90% of Russia's natural gas production and approximately 20% of the world's. The geographical location of our fields in this gas-rich hydrocarbon basin offers vast opportunities for increasing shareholder value through low-risk, low-cost production and effective reserve replacement. With more than thirteen years of operational history in this region, we are in an optimal position to capitalize on these opportunities.

Based on our 2007 results, we have maintained our position as Russia's second-largest gas producer. In 2007, we accounted for 4.4% of Russia's total natural gas output and supplied approximately 8% of the nation's domestic demand.

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

Our efforts to find and develop natural gas and gas condensate fields have produced exceptional results, as evidenced by the fact that our reserves grew faster than production.

In 2007, our costs incurred for exploration and development activities amounted to RR 20.5 billion, resulting in revisions and additions of approximately 220 mm boe of proved natural gas, gas condesate and crude oil reserves, before production, for a reserve replacement cost of RR 94.5 per boe ($3.70 per boe).

During 2007 we continued our efforts to find new resources through ongoing exploratory activities and spent approximately RR 1.6 billion on our fields. We ran 580 square kilometer of three-dimensional (3D) seismic as well as completed 31,000 meters of drilling.

As of 31 December 2007, our proved natural gas reserves under the Securities and Exchange Commission (SEC) reserve definitions totaled 653 bcm (23.1 tcf), while our proved liquid reserves (gas condensate and crude oil) constituted 49.2 mmt (406 mm boe). There has been a gradual change in the structure of our proved natural gas reserves: the proportion of our proved developed reserves increased by 7% and now comprises 84% of our total proved natural gas reserves. In 2007, we successfully replaced 107% of our production volumes on a boe basis from our appraised fields, and achieved a cumulative five-year (2003 to 2007) reserve replacement rate (RRR) of 158%.

As of 31 December 2007, our proved and probable natural gas reserves under the new PRMS reserve reporting standard totalled 1,029 bcm, while our proved and probable liquids reserves were 102 mmt.

In 2007, our fields produced a total of 28.5 bcm (1.006 tcf) of natural gas and 2.5 mmt (20.5 mm bbls) of liquids. Our total gross natural gas production during the period was consistent with our 2007 production targets, which were revised due to a reduction in natural gas volumes injected into underground storage as a result of reduced off-take from the underground storage system because of an unseasonably warm winter in Russia and Europe.

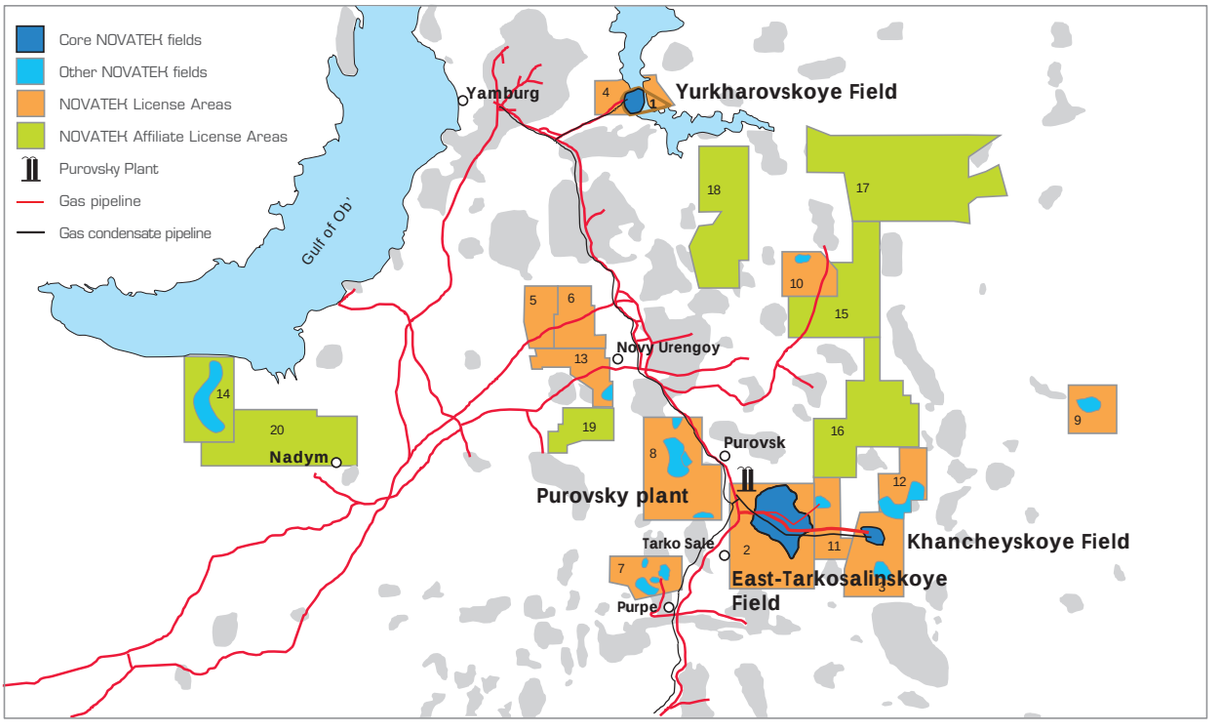
In 2007, through our exploratory efforts three new fields were discovered – North Khancheyskoye, Raduzhnoye, and Yarudeyskoye – that collectively hold 331 mm boe[1]. The estimation of reserves for the North Khancheyskoye field under both the SEC and PRMS reserve standards was performed in 2007, whereas the reserve estimation of the Yarudeyskoye and Raduzhnoye fields will be carried out later.

In 2007, we completed a number of acquisitions to create a long-term basis for production growth. We acquired the West-Urengoisky license area in the Yamal-Nenets Autonomous District at an auction, as well as acquiring a 25% participation interests in projects to

[1]Under C1 + C2 Russian classification of reserves

The Yurkharovskoye field is the cornerstone of our mid-term strategy of growing our production and reserves

NOVATEK License Areas



1 Yurkharovskiy
2 East-Tarkosalinskiy
3 Khancheiskiy
4 Novo-Yurkharovskiy
5 North-Yubileiniy
6 Tabyakha-Tarkinskiy
7 Ust-Purpeyskiy
8 Olimpiyskiy
9 Termokarsktoviy
10 Raduzhny
11 Yumantilskiy
12 North-Khancheyskiy
13 West-Urengoiskiy
14 Yarudeyskiy
15 South-Zapolyarniy
16 Sredne-Chaselskiy
17 North-Russkiy
18 Zapadno-Tazovskiy
19 North-Yamsoveiskiy
20 Anomalniy

conduct exploration in six license areas with combined resources of approximately 9 billion boe[1].

More notably, we also acquired from Tharwa Petroleum S.A.E., a 50% working interest in a concession agreement for hydrocarbons exploration and development at the El-Arish offshore block in Egypt. This acquisition is our first foray into the international market, and our ability to access the Egyptian market is consistent with NOVATEK's long-term strategy of expanding its resource base and geographically diversifying its core activities.

Core Fields

In 2007, our three core fields produced 99% of our natural gas and liquids on a boe basis and, at year's end, accounted for 94% of our total proved reserves. All three fields are located in close proximity to the world's largest gas transportation infrastructure, the Unified Gas Supply System (UGSS), which is owned and operated by Gazprom. Continued development of our core fields is the primary focus of our

[1]Under C3 + D Russian classification of reserves

mid-term strategy of growing production and reserves.

Yurkharovskoye. Discovered in 1970, the Yurkharovskoye field is located within the Polar Circle southeast of the Tazovsky peninsula, The field is licensed to our wholly-owned subsidiary OOO NOVATEK-YURKHAROVNEFTEGAS, and has been producing natural gas and gas condensate since 2003. It is the largest of our core fields in terms of reserves, and the second-largest in terms of production. The Yurkharovskoye field is the cornerstone of our mid-term strategy of growing our production and reserves. During the year, our exploration efforts yielded positive results on this field as we discovered six new deposits.

In 2007, we commissioned a pilot methanol production unit with throughput capacity of 12,500 metric tons per annum at the Yurkharovskoye field. The methanol production unit is integrated into the field's Complex Gas Preparation Plant and is the world's only low-tonnage methanol facility of this kind at a gas condensate field. The on-site methanol production unit will minimize the environmental risks involved in transporting methanol to the field, while correspondingly reducing production costs and improving operational stability.

We are planning to launch additional phases of the Yurkharovskoye field by the end of 2010, which will increase production at that field by more than 150%.

East-Tarkosalinskoye. Discovered in 1971, the East-Tarkosalinskoye field is located 40 kilometers east of the town of Tarko-Sale and is licensed to our wholly-owned subsidiary OOO NOVATEK-TARKOSALENEFTEGAS. It is currently our largest producing field, and has been producing crude oil since 1994, natural gas since 1998, and gas condensate since 2001. The production of stable gas condensate at the East-Tarkosalinskoye field has reached its expected plateau and will remain flat in the near term. Future development activities include the development of crude oil reserves in the northern part of the license area.

Khancheyskoye. Discovered in 1990, the Khancheyskoye field is 65 kilometers east of East-Tarkosalinskoye and is licensed to our wholly-owned subsidiary OOO NOVATEK-TARKOSALENEFTEGAS. The license was reissued in May 2005, when OOO NOVATEK-TARKOSALENEFTEGAS merged with our wholly-owned subsidiary OOO Khancheyneftegas in order to take advantage of the fields close proximity to improve operating efficiencies and enhance economies of scale. The Khancheyskoye field has been producing natural gas and gas condensate since 2003 and 2002, respectively. As a result of further exploration activities at the Khancheysky license area in 2007, we successfully discovered three new gas condensate horizons, conducted 3D seismic prospecting to clarify the geological structure of the field's southern part and define an exploratory drilling program. In 2007, we increased production by 28% year-on-year after the successful commissioning of the second phase development at the gas condensate field.

Other Appraised Fields and Licences

We remain focused on growing our natural gas and gas condensate reserves organically through our exploratory efforts on additional twelve license areas we hold in the Yamal-Nenets Autonomous Region. We consider these license areas an integral part of our long-term reserve and production growth strategy. In 2007, three new fields were discovered due to our geological exploration: North Khancheyskoye, Yaryudeyskoye, and Radyuzhnoe. We will continue to spend capital on various geological and geophysical research as well as drilling exploration wells on our other license areas.

The Sterkhovoye field and the southern part of the Urengoiskoye field, which fall within the territory of the Olympiyskiy license area, have been appraised. In 2007, we accumulated 240 square kilometers of 3D seismic and improved the field's geological model based on the seismic results.

The Termokarstovoye field is currently in the early stages of development and holds reserves of natural gas and gas condensate. Commercial gas condensate production is slated to begin in 2011, and our first delivery of natural gas is scheduled to commence in 2015. With the development of a geological model and revised estimation of the field's natural gas reserves, we were able to increase the proved natural gas reserves at the Termokarstovoye field by 25%

The Termokarstovoye and the North Khancheyskoye fields, as well as the fields in the Olympiyskiy and the West Urengoisky license areas are strategic medium-term contributors to our organic production and reserves growth.

Yurkharovskoye

2007 total production:

Natural gas: 9.63 bcm (340 bcf)

Liquids: 750 mt (6.452 mmboe)

Total: 69 mm boe

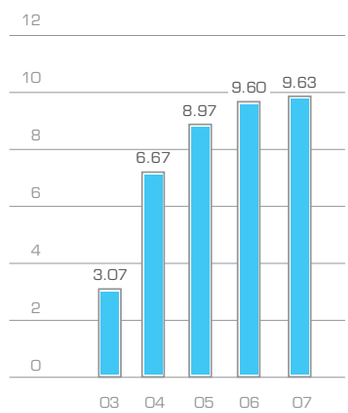
Proved reserves (SEC) as of 31 December 2007:

Natural gas: 312 bcm (11.003 tcf)

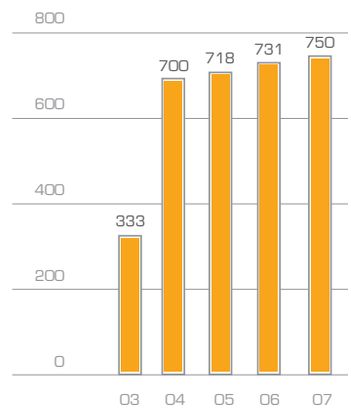
Liquids: 15 mmt (129 mmboe)

Total: 2,167 mm boe

Yurkharovskoye Field Natural Gas Production, bcm



Yurkharovskoye Field Gas Condensate Production, mt



East-Tarkosalinskoye

2007 total production:

Natural gas: 14.61 bcm (516 bcf)

Liquids: 906 mt (7.349 mmboe)

Total: 103 mmboe

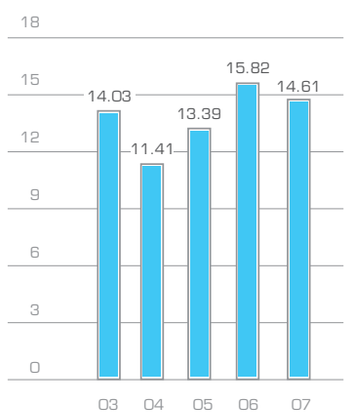
Proved reserves (SEC) as of 31 December 2007:

Natural gas: 267 bcm (9.425 tcf)

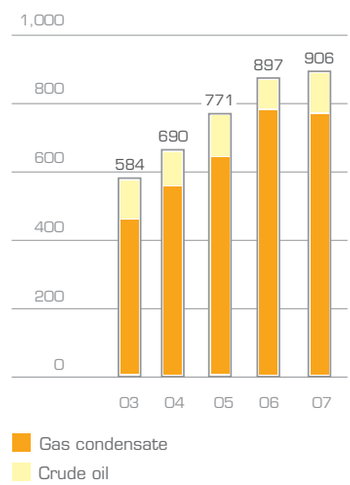
Liquids: 21 mmt (165 mmboe)

Total: 1,910 mmboe

East-Tarkosalinskoye Field Natural Gas Production, bcm



East-Tarkosalinskoye Field Liquids Production, mt



Khancheyskoye

2007 total production:

Natural gas: 4.23 bcm (149 bcf)

Liquids: 727 mt (5.924 mmboe)

Total: 34 mmboe

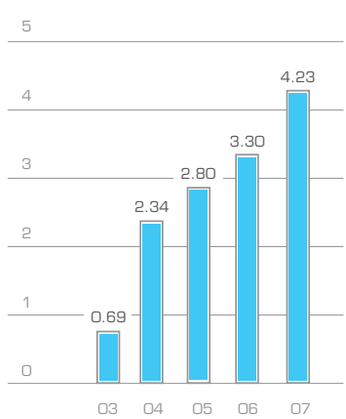
Proved reserves (SEC) as of 31 December 2007:

Natural gas: 41 bcm (1.441 tcf)

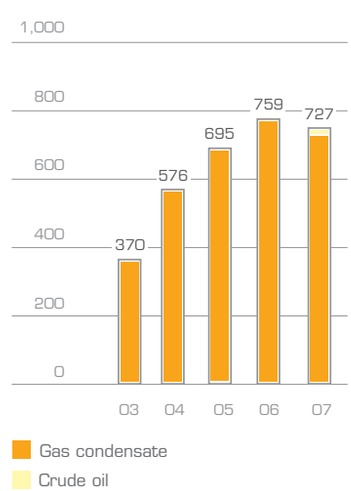
Liquids: 6.6 mmt (54 mmboe)

Total: 321 mmboe

Khancheyskoye Field Natural Gas Production, bcm



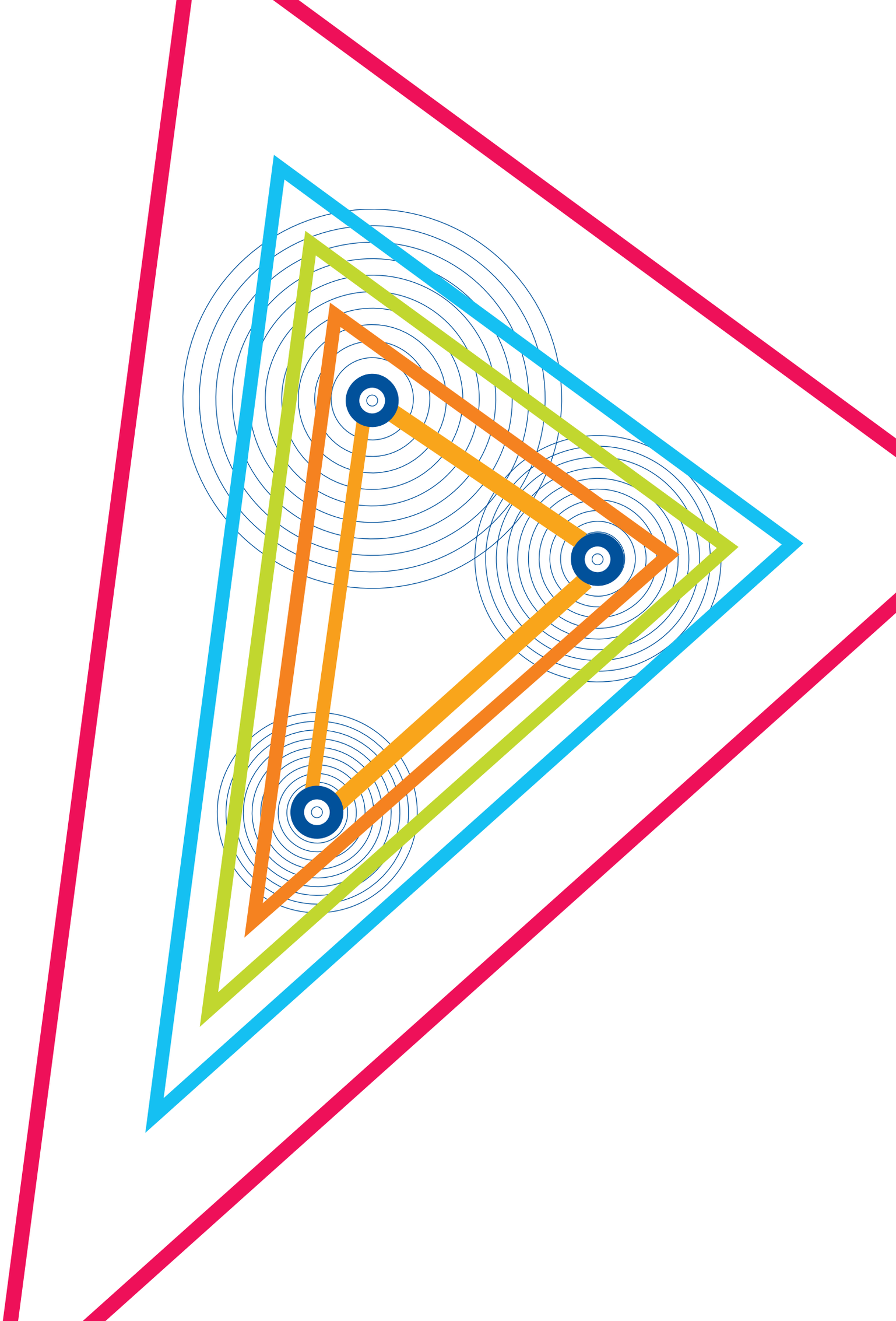
Khancheyskoye Field Liquids production, mt



Strategy in Motion

Processing and Marketing

By owning our processing facility, we lessen our reliance on third parties thus improving our ability to control the product slate and its quality. This accords us greater control over the development of our fields by removing processing capacity constraints and logistical bottlenecks.



Processing and Marketing

The Purovsky processing plant is a vital link in our mid-stream operational chain

We have ambitious plans to continually diversify our business model by becoming more active in deeper conversion of hydrocarbons into refined products. Our present plans include further expansion of our processing capacity at our Purovsky processing plant for stable gas condensate and liquefied petroleum gas (LPG).

Processing

In June 2005, we commenced the first phase of our wholly-owned Purovsky processing plant, which enabled us to process 100% of our unstable gas condensate production into stable gas condensate and LPG. The Purovsky processing plant is a vital link in our mid-stream operational chain allowing us full control over our processing needs and providing access to the high-yielding marketing channels for our gas condensate production.

In 2007, the Purovsky Plant processed approximately 2.1 mmt of unstable gas condensate and produced more than 1.5 mmt of stable gas condensate and 554 mt of LPG.

The commencement of the second phase expansion in late 2008 will increase our processing capacity from 2 mmt to 5 mmt per annum to accommodate future production increases from our fields. The migration further down the value chain will allow us to refine raw materials into value-added products thus capturing additional products margins.

In 2007, we began the engineering design of a terminal facility at Ust-Luga, located on the Baltic Sea, for the transshipment and fractionation of stable gas condensate produced by our Purovsky Plant, which has an estimated throughput capacity of up 6 million tons per annum.

Gas sales

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

Russia ranks third in the world in natural gas consumption, utilizing approximately 415 bcm in 2007. As a result of Russia's economic development and growth, preliminary estimates indicate that natural gas usage grew by roughly 2.8% in 2007, compared to 2006. In Russia's energy balance, natural gas currently accounts for over 50% of the primary energy supply and, in some regions, is as high as 80%.

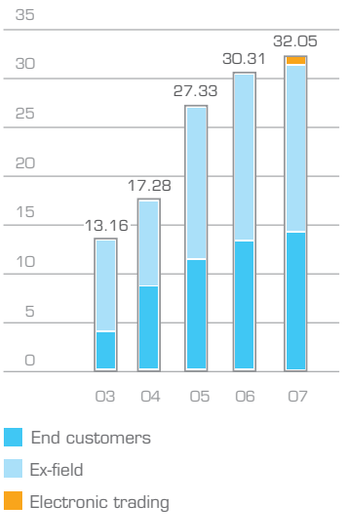
In 2007, our natural gas sales volumes increased by 6% and totaled 32.05 bcm (30.31 bcm in 2006), of which 14.28 bcm was delivered to end users and 17.12 bcm was sold to traders at the UGSS entry-point. Our share of total natural gas deliveries to consumers in Russia was approximately 8%. We sold 661 mmcm, or 2% of our total natural gas sales, on the electronic gas exchange operated by ООО «Mezhregiongaz». Increasing volumes of gas sold the electronic trading exchange as well as higher average realized prices for gas trades is one of the many signs of eventual liberalization of the Russian gas market and an additional indicator for the market prices for gas.

In 2007, we expanded our deliveries of natural gas to more than 39 regions of the Russian Federation. The largest recipients were the Chelyabinsk, Samara, Moscow, Kirovsk, Tyumen, Kurgan regions and the Perm Territory. We delivered natural gas primarily to the following industrial users: power generation companies, metallurgical plants, and regional natural gas distributors.

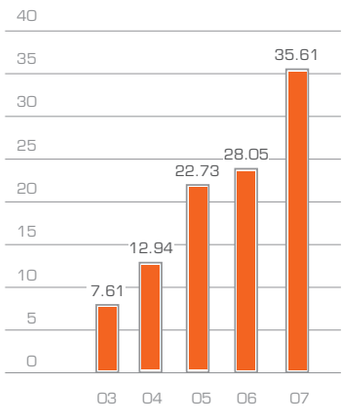
Our natural gas sales are subject to seasonal fluctuations in demand. To mitigate their effect we have entered into a service agreement with Gazprom to utilize the spare capacity in their underground natural gas storage reservoirs. In periods of low demand we store gas in the underground reservoirs and later extract it in periods of peak demand to supplement our production.

In 2007, NOVATEK's share of total natural gas deliveries to consumers within Russia amounted to 8%. We expanded our deliveries of natural gas to 39 regions of the Russian Federation

Natural Gas Sales Volumes, bcm



Natural Gas Sales Revenue,[1] RR billion



[1]Net of VAT

The future construction of a transshipment complex in Ust-Luga combined with a gas condensate fractionation unit will allow NOVATEK to export high quality refined products rather than raw commodities

Liquids sales

Our liquids sales highlight our efforts to add value through the diversification of our product line and customer base. In 2007, we realized record liquids revenues by optimizing our sales of liquid hydrocarbons (crude oil, stable gas condensate, LPG and oil products) to consumers in Russia and abroad. Utilizing our flexible marketing channels we were able to capture the highest margin per product by capitalizing on market demand and pricing conditions where they were most favorable.

During 2007, our overall volumes of liquids sold totaled 2,404 thousand tons, representing a 7% increase versus 2006. Throughout the year, we exported 28 tankers of stable condensate, including 20 tankers to the United States, 7 tankers to European markets and 1 tanker to South America. We sold 99% of our stable gas condensate produced at the Purovsky processing plant to export markets, whereas our LPG exports, including exports to the CIS countries, represented 24% of our total LPG production.

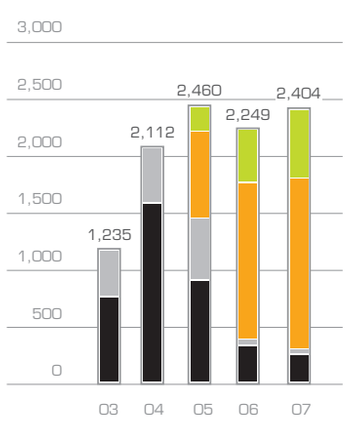
With our Purovsky Plant becoming operational, we have significantly increased our flexibility in marketing liquid hydrocarbons, resulting in better profitability of our stable gas condensate sales. The Purovsky stable gas condensate enjoys robust demand and tends to sell at a premium to crude oil.

In 2007, we used 3,000 rail tank cars to transport liquids, of which 1,200 transported LPG (420 are owned by NOVATEK) and 1,800 rail tanks, contracted from OAO «Russian Railways», delivered stable gas condensate.

Exports of our stable gas condensate go via the all-season White Sea port Vitino, where NOVATEK constructed LPG storage and transshipment facilities in partnership with OAO «Belomorskaya Neftebaza». In 2007, the volume of transshipments of stable gas condensate through these facilities totaled 1,554 thousand tons.

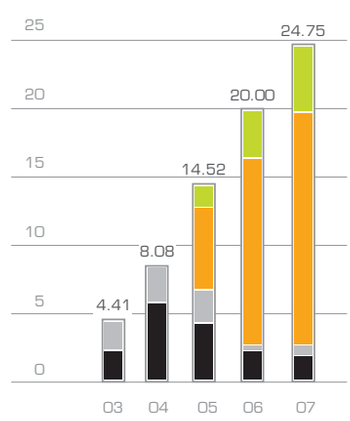
NOVATEK's plan to increase the processing capacity of Purovsky Plant requires the optimization of the liquids logistics infrastructure. Therefore, engineering design of additional storage capacities in Vitino and a transshipment complex in Ust-Luga has been initiated. The construction of a fractionation unit within the new complex will allow NOVATEK to export high quality refined products rather than raw materials, to diversify its markets and increase margins on liquids sales.

Liquids Sales Volumes, mt



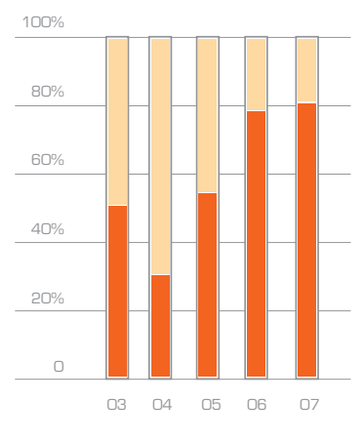
Oil
Oil products
Stable condensate
LPG

Liquids Sales Revenue,[1] RR billion



Oil
Oil products
Stable condensate
LPG

Liquids Sales Revenue[1] Market Distribution, %



Export
Domestic

[1] Net of VAT, excise taxes and export duties

Successful optimization of the sales of polymers helped increase our production by 42% per annum

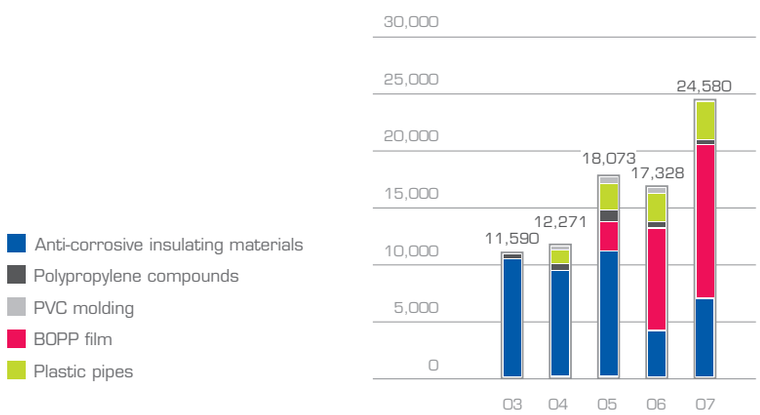
Industrial

NOVATEK-Polimer is the core subsidiary in our industrial manufacturing business segment. Headquartered in the city of Novokuybyshevsk in the Samara Region, it is the largest Russian producer of anti-corrosive insulating materials used on underground pipelines in the oil and gas industry. It produces more than a dozen types of polyethylene based insulating tape, including polymer tape and wrap, heat-shrinkable tape and sleeves to protect welded pipe joints. Successful optimization of the sales of anti-corrosive insulating materials helped increase our production in 2007 by 69% as compared to 2006.

In June 2005, we commissioned a modern BOPP (Biaxially Oriented Polypropylene Film) plant for the production of film wrap, which is widely used as a packaging material in the food, tobacco, perfume, pharmaceutical, and textile industries. In 2007, growing demand for BOPP film wrap enabled us to increase our output at the plant by 54%.

Although film wrap production is not our core business, we continued to expand its production and reached exceptional growth in both revenues and volumes. We see our diversification into film wrap production as complementary and value-additive to our overall strategy in the industrial manufacturing sector and a way of offsetting possible decrease in demand for insulation materials.

Polymer Production Volumes, tons

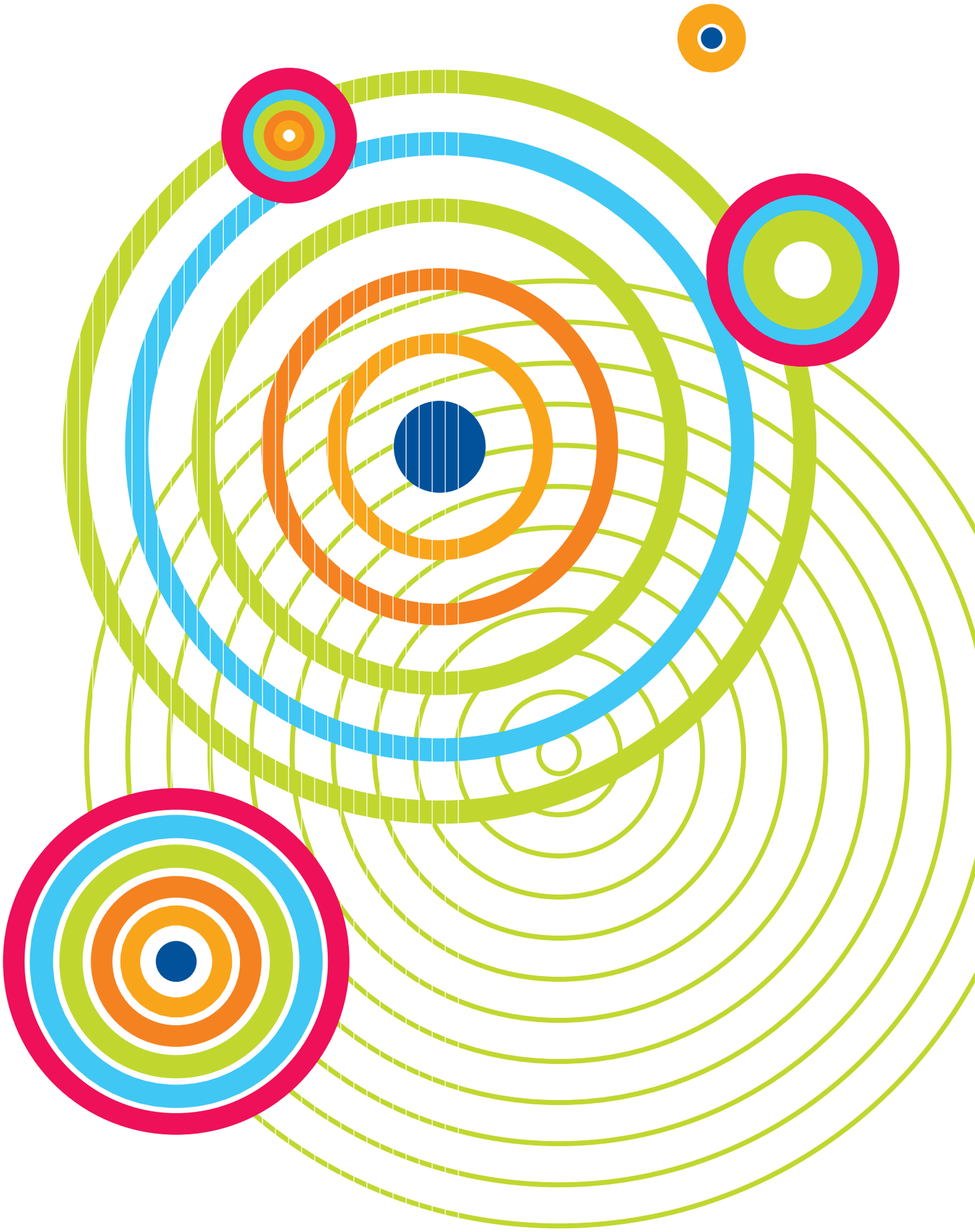


Strategy in Motion

Social and Environmental Responsibility

NOVATEK

Since commencing operations, we have been building a strong reputation as a responsible corporate citizen by adhering to applicable domestic and global standards, including our own guiding principles and values to employ sustainable business practices throughout our operations.



Social and Environmental Responsibility

In 2007, NOVATEK received the «National Environmental Prize» in the category of «Sustainable Development Reporting»

OAO NOVATEK, together with all of its operating subsidiaries and affiliates, aims to conduct all operations in a socially responsible manner. We have made ecological, social and safety matters a strategic priority for the Company, which is reflected by our environmental, health and safety (EHS) policy. Wherever possible, we prevent, or otherwise minimize, mitigate and remediate, harmful effects of our operations on the environment, and employ sustainable business practices throughout our operations.

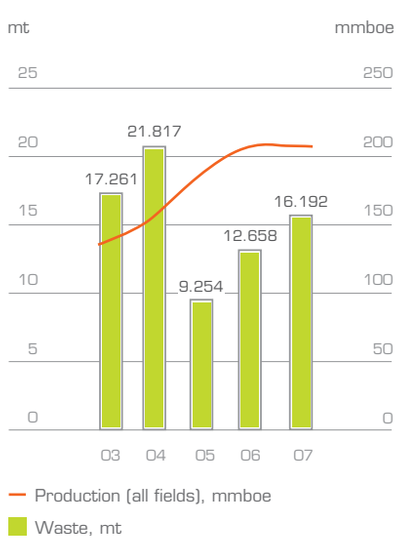
Environment

We continually develop and improve the EHS management system for the oversight and implementation of the EHS Policy through internal audits and results monitoring, regular external audits and periodic analysis of the system's efficiency. The results of our internal environmental audits (soil, air, snow, surface and groundwater sampling) have demonstrated the effectiveness of the Policy and indicate that the environmental situation in NOVATEK's intense infrastructure buildup areas is favorable.

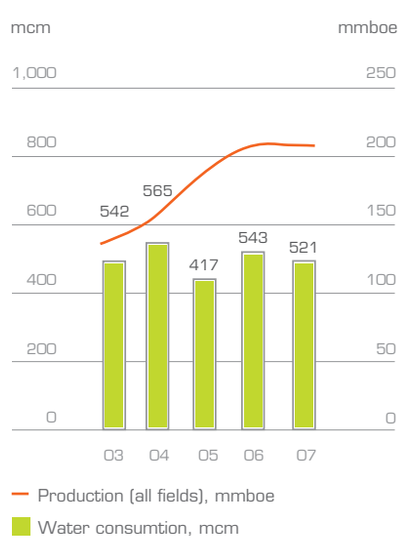
In 2007, the following initiatives were implemented to mitigate our impact on the environment and to continuously improve on our environmental performance:

- Modernized the technology of off-gas recycling at the gas condensate field of the East-Tarkosalinskoye field, which significantly reduced emissions of pollutants into the environment
- Optimized the gas transportation pattern at the Khancheyskoye and East-Tarkosalinskoye fields, resulting in reduced emissions from our gas compressor units
- Commissioned a pilot methanol production unit at the Yurkharovskoye field. The methanol production unit is able to meet the field's current methanol requirements and has eliminated the environmental risks associated with transporting methanol via northern rivers. The methanol production unit's design incorporates a state-of-the-art automated control system which minimizes any potential negative impact on the environment
- Commenced development of an information and analysis system based on the SoFi software system to help automate the organizational, technical and informational decision-making process related to our EHS policy
- Defined perspective projects complying with the Joint Implementation, one of the project-based mechanisms of the Kyoto Protocol that is used to meet the Kyoto targets.

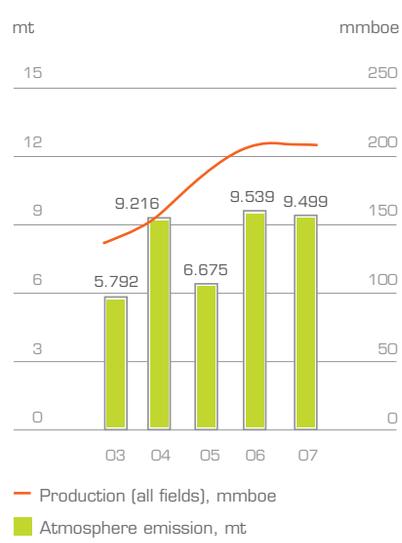
Waste generation of NOVATEK E&P Companies



Water consumption of NOVATEK E&P Companies



Air pollution of NOVATEK E&P Companies



NOVATEK has maintained its commitments to achieve certification under the international standards ISO 14001:2004 and OHSAS 18001:2007

Despite the temporary increase in waste generation over the past year the Company's environmental and operational personnel are closely monitoring the situation.

In October 2007, a group of NOVATEK's managers and employees were awarded certificates of honor for rational and efficient forest management by the Federal Forestry Agency (an arm of the Ministry of Natural Resources of the Russian Federation). It was the first time such recognition was awarded in Russia.

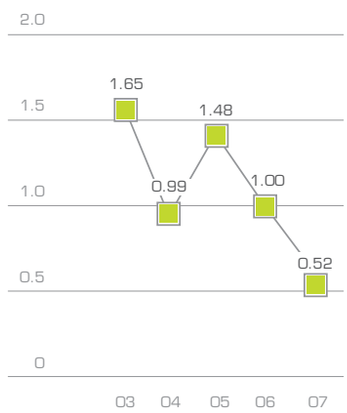
In 2007 OAO NOVATEK was recognized for its achievements and efforts for our sustainable business development philosophy and was among the winners in the Russian «National Environmental Prize» contest where we were nominated in the category of «Sustainable Development Reporting». NOVATEK's excellent record in environmental efficiency and environmental reporting transparency earned it a high position in the social and environmental corporate citizen rating.

Health & Safety

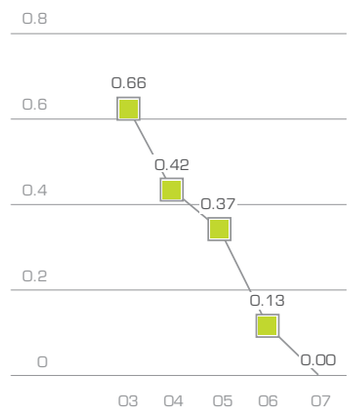
NOVATEK is in the process of implementing an environmental health and safety management system for all of its operating subsidiaries in accordance with the ISO 14001 and the OHSAS 18001 standards. Based on the results of a 2007 preliminary independent audit, the Company's management system was recommended for certification under the said standards.

We employed approximately 3,850 personnel during the year, of whom 50% were engaged in exploration and production, and 38% in refining and marketing. We continuously place special emphasis on the professional development of our employees, enhancing the safety of our work environments and providing the requisite levels of training in health and safety matters. More than 49% of our total workforce has completed certified occupational health and safety training and approximately 30% of our engineers and specialists have received advanced training. A group of our top managers was certified for compliance with ISO 14001:2004 and OHSAS 18001:2007 to conduct internal audit of the integrated management systems.

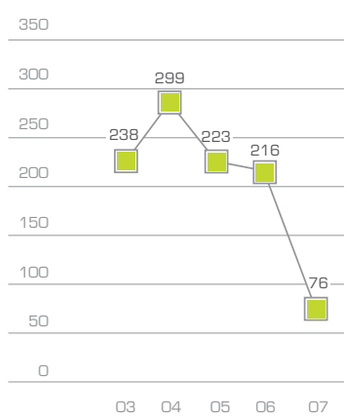
Injury Frequency Rate (no. of injuries / million working hrs)



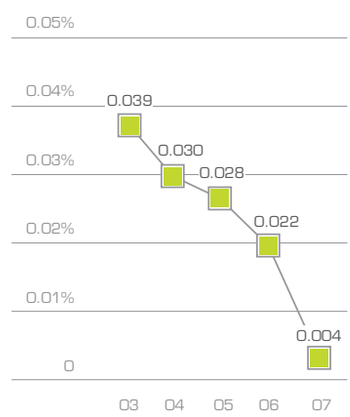
Serious Injury Frequency (no. of serious injuries/ million working hrs)



Accident Severity Rate (total no. of employee working hrs lost per accident / no. of accidents)



Percentage of Time Lost Due to Injuries (number of hrs lost / total working hrs)


















Socio – Economic and Community Development

NOVATEK is committed to making a positive impact on the social and economic development of the communities surrounding our operations. Our partnerships with these communities take many forms and in 2007 included direct contributions through community development programs, including education programs, social infrastructure development, revival and preservation of cultural tradition, and support and promotion for cultural events.

In 2007, we invested in construction projects and infrastructure improvements in various settlements of primarily indigenous peoples in the Yamal-Nenets Autonomous Region. We supported housing, kindergartens, boiler plants, sauna-laundry facilities and the renovation and equipping of schools and hospitals. We operate a services center in our most remote field, which provides medical assistance, recreational facilities and food to the indigenous population. We also made contributions to the quality of life of the indigenous peoples in the form of transportation programs and the provision of modern equipment.

In 2007, we continued implementing a program to train young professionals, sponsored several classes comprising 'gifted' children in Tarko-Sale and Novokuibyshevsk, and devised a grant program aimed at excellence in learning for the students of the Purovsky District. We also continued our interaction with leading Russian universities whose curricula offer training in our core areas. Additionally, we supported the arts through contributions to programs at the Russian State Museum and the Samara Artistic Museum, which promote Russian arts abroad.

During 2007, we provided RR 558 million in charitable contributions and community development investments for educational and cultural support programs for ethnic minorities in the Far North of Russia.

NOVATEK is a socially responsible company that contributes to the social and economic progress in the areas within its operational footprint

Board of Directors and Management Committee

BOARD OF DIRECTORS

Alexander Natalenko (Chairman)

Andrei Akimov*

Ruben Vardanian*

Mark Gyetvay

Ilya Yuzhanov*

Leonid Mikhelson

Kirill Seleznev*

Vladimir Dmitriev

* non-executive

MANAGEMENT COMMITTEE

Leonid Mikhelson (Chairman)

Vladimir Baskov

Victor Girya

Mark Gyetvay

Tatyana Kuznetsova

Mikhail Popov

Sergei Protosenya

Vladimir Smirnov

Nikolai Titarenko

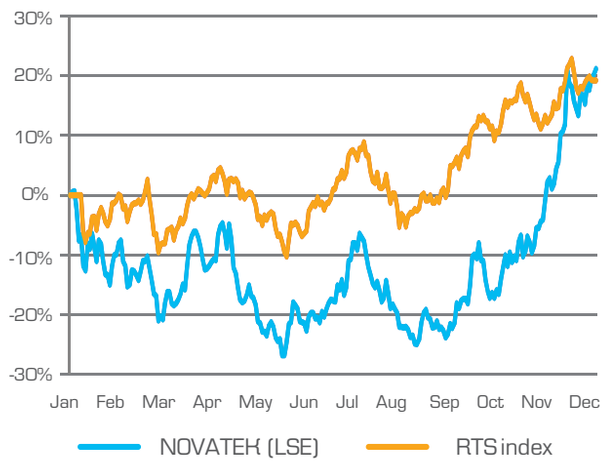
Alexander Fridman

Kirill Yanovskiy

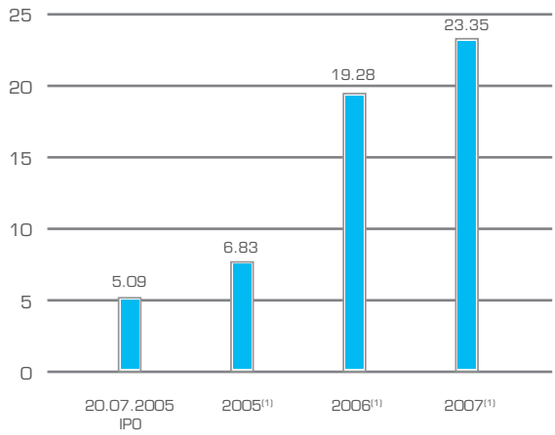
Market information

Our share capital is RR 303,603,600 and consists of 3,036,306,000 ordinary shares, each with a nominal value of RR 0.1. In July 2006, we executed a 1:1000 share split, which considerably increased the trading transactions involving the Company's ordinary shares.
Our shares have traded in US dollars on the RTS Stock Exchange (symbol: NVTK) since December 2004, and in Russian roubles on the MICEX Stock Exchange (symbol: NOTK) since October 2004 and on the RTS Stock Exchange (symbol: NVTKG) since April 2005.
In 2005, we listed Global Depositary Receipts (GDR) on the London Stock Exchange (symbol: NVTK). Each GDR represents 10 ordinary shares. The GDRs are also traded in the United States on NASDAQ PORTAL (symbol: NVATY) under Rule 144A and on the Frankfurt Stock Exchange (symbol: N 10).

NOVATEK share price and RTS index (2007), %



NOVATEK market capitalization since IPO (LSE, closing, billion USD)



(1) As for the last trading day of the year, closing, LSE

Share and GDR price range in 2007

	Ordinary Shares (MICEX), RR		GDR (LSE), USD	
	min	max	min	max
First Quarter	132.03	159.00	50.20	63.90
Second Quarter	120.49	155.58	46.50	60.50
Third Quarter	122.50	151.05	47.70	59.40
Fourth Quarter	128.00	186.00	52.00	76.90

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

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

You should read the following discussion and analysis of our financial condition and results of operations as of 31 December 2007 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2007 and 2006. The consolidated financial statements and the related notes thereto have been 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 fourth largest holder of natural gas resources in Russia after Gazprom, Rosneft and LUKOIL.

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. We sell our natural gas volumes exclusively in the Russian domestic market. We export our stable gas condensate directly to international markets while liquefied petroleum gas and crude oil are generally delivered to both international (including CIS) and domestic markets. We generally sell our oil products produced from our unstable gas condensate on the domestic market. We began limited commercial trading operations in September 2007 through our wholly-owned Swiss-based trading subsidiary, RUNITEK, by primarily purchasing and reselling refined products, on the international markets.

In September 2007, we acquired a 50 percent working interest in the Concession Agreement for Gas and Crude Oil Exploration and Exploitation in El Arish Offshore Area (hereinafter referred to as the "Concession Agreement") in the Arab Republic of Egypt. The remaining working interest is held by Tharwa Petroleum S.A.E. Pursuant to the Concession Agreement, we are committed to spend a minimum of USD 40 million on various exploration activities during the initial exploration period of four years. We will continue to evaluate exploration and production opportunities outside of the Russian Federation as a way to diversify our business operations.

During the year, we discovered three new fields – North Khancheyskoye, Yarudeyskoye, and Radyzhnoye.

SELECTED DATA

millions of Russian roubles except as stated	Year ended 31 December: 2007	2006	Change %
Financial results			
Total revenues (net of VAT and export duties)	62,321	49,373	26.2%
Operating expenses	(37,066)	(30,081)	23.2%
Profit attributable to NOVATEK shareholders	18,736	14,079	33.1%
EBITDA [1]	29,283	23,129	26.6%
Earnings per share (in Russian roubles)	6.17	4.64	33.0%
Operating results			
Natural gas sales volumes (mmcm)	32,054	30,308	5.8%
Stable gas condensate sales volumes (thousand tons)	1,508	1,358	11.0%
Liquefied petroleum gas sales volumes (thousand tons)	554	505	9.7%
Crude oil sales volumes (thousand tons)	269	305	(11.8%)
Oil product sales volumes (thousand tons)	73	81	(9.9%)
Cash flow results			
Net cash provided by operating activities	21,383	16,938	26.2%
Capital expenditures	19,466	4,703	313.9%

[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.

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Natural gas prices

As an independent natural gas producer, we are not subject to the government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In 2007, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 164 per mcm, or 14.8%, to RR 1,274 per mcm compared to RR 1,110 per mcm in 2006. The terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale traders allow us to diversify our gas sales without incurring additional commercial expenses. However, we realize higher prices and net margins for natural gas volumes sold directly to the end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. During 2007, the average netback margin differential we received on end-customer sales compared to ex-field sales (average end-customer netback less average ex-field price) increased by RR 22 per mcm, or 30.1%, compared to 2006 as a result of higher average realized prices to end-customers (see "Natural gas sales" below).

In November 2006, the FTS published it guidelines for raising the regulated natural gas prices in Russia for the years 2008, 2009 and 2010 based on an approved governmental protocol. Effective 1 January 2008, the FTS approved a 25% increase in the regulated price of natural gas for the year 2008. As part of this program, the FTS announced the expected percentage increases in the regulated natural prices for 2009 and 2010 at 13% and 13%, respectively, on the 1 January and 1 July of each year. The FTS approves the effective increase on an annual basis and reserves the right to modify the percentages published based on market conditions and other factors.

The following table shows our average realized natural gas sales prices (net of VAT) for the years ended 31 December 2007 and 2006:

	Year ended 31 December:		Change
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to end-customers [1]	1,505	1,253	20.1%
Gas transportation expense for sales to end-customers	631	516	22.3%
Average natural gas netback price on end-customer sales	874	737	18.6%
Average natural gas price ex-field (wholesale traders)	779	664	17.3%
Average netback margin differential	95	73	30.1%

[1] Includes cost of transportation.

In November 2006, we started participating in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. Our average natural gas netback price on electronic trading (e-trading) sales exceeded the average natural gas netback price on end-customers sales by 24.3% in 2007 and 22.0% in 2006 as shown in the table below:

	Year ended 31 December:		Change
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to customers on e-trading sales [1]	1,193	991	20.4%
Gas transportation expense on e-trading sales	107	92	16.3%
Average natural gas netback on e-trading sales	1,086	899	20.8%

[1] Includes cost of transportation.

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

Crude oil, stable gas condensate, liquefied petroleum gas ("LPG") and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, and the ability and willingness of oil producing countries to sustain production levels to meet increasing 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. Crude oil prices in Russia have generally remained below prices in the international market primarily due to constraints on the

ability of many Russian oil companies to transport their crude oil, whereas certain oil products and LPG prices in Russia have more closely followed prices on international markets. This has occasionally led to crude oil surpluses in key consuming regions in Russia driving down the price in the domestic market. Moreover, there is no independent or uniform benchmark price for crude oil in Russia because the majority of all crude oil destined for sale in Russia is produced and refined by the same vertically integrated Russian oil companies. Crude oil that is not exported from Russia or refined by the producer is offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as "Urals blend", which normally trades at a discount to the international benchmark Brent crude oil.

Our stable gas condensate, LPG (excluding obligatory domestic deliveries at regulated prices) and oil products prices at both international and domestic markets, as well as crude oil prices at international markets include transportation expense in accordance with the terms of delivery. Delivery terms for our crude oil and obligatory LPG domestic sales are such that the buyer takes ownership at the point of loading or at the entrance to the trunk pipeline and is responsible for the transportation expense to the final destination.

In 2007, as well as in 2006, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in 2007 was approximately USD 646 per ton compared to approximately USD 573 per ton in 2006.

In 2007, as well as in 2006, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany). In 2007, our average crude oil export contract price, including export duties, was approximately USD 491 per ton compared to USD 414 per ton in 2006. In addition, in 2006, our foreign subsidiary purchased and resold 27 thousand tons of crude oil under delivery terms priced at cost, insurance and freight (CIF) at the port of Porvoo, Finland, at an average contract price of USD 364 per ton.

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 years ended 31 December 2007 and 2006:

	Year ended 31 December:		**Change**
Russian roubles (RR) or US dollars (USD) per ton	**2007**	**2006**	**%**
Stable gas condensate			
Net export price, RR per ton	11,353	10,143	11.9%
Net export price, USD per ton	443.9	373.1	19.0%
Domestic price, RR per ton	8,464	8,182	3.4%
Crude oil			
Net export price, RR per ton	7,225	7,107	1.7%
Net export price, USD per ton	282.5	261.4	8.1%
Domestic price, RR per ton [(1)]	6,039	5,993	0.8%

[(1)] Net of transportation costs.

Our LPG export and CIS delivery terms during 2007 were delivery at frontier (DAF) at the border of the customer's country. In 2007, our average export LPG contract price, including export duties, was approximately USD 605 per ton compared to USD 548 per ton in 2006. We are obliged to sell a portion of our LPG volumes at regulated prices while the remaining portion of our sales are sold under commercial terms. In 2007, we sold 42 thousand tons at the regulated price of RR 3,500 per ton and 380 thousand tons at a commercial price of RR 8,750 per ton in the domestic market, compared to 40 thousand tons at RR 1,697 per ton and 370 thousand tons at RR 7,592 per ton, respectively, in 2006.

Domestic sales of oil products associated with our own production were priced free carrier (FCA) at the Surgut railroad station (located in the Khanty-Mansiysk Autonomous Region). In 2007, our foreign trading subsidiary purchased from third parties approximately 33 thousand tons of naphtha which were resold to the US and European markets at an average contract price USD 819 per ton. The delivery terms for these volumes were delivery to the port of destination ex-ship (DES Houston, USA) and free on board (FOB, Vitino). There were no applicable export duties on these sales.

The following table shows our average realized liquefied petroleum gas and oil products sales prices (net of VAT and export duties, where applicable) for the years ended 31 December 2007 and 2006 (excluding foreign trading activities):

Russian roubles (RR) or US dollars (USD) per ton	Year ended 31 December: 2007	2006	Change %
LPG			
Net export price, RR per ton	11,535	10,970	5.2%
Net export price, USD per ton	451.0	403.5	11.8%
CIS price, RR per ton	10,264	8,538	20.2%
Domestic price, RR per ton	8,231	7,014	17.4%
Oil products			
Domestic price, RR per ton	7,358	6,174	19.2%

Transportation tariffs

In the first seven months of 2006, the transportation tariff set by the FTS (effective from 1 October 2005) for the transport of natural gas produced in Russia for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan) was RR 23.84 (excluding VAT) per mcm per 100 km.

Starting from 1 August 2006, the general methodology for calculating transportation tariffs for natural gas produced in the Russian Federation was changed by the FTS. Under the new methodology the transportation tariff consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 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 (the maximum “input/output” rate effective from 1 March 2007 is RR 1,061.51 (excluding VAT) per mcm) and includes a constant rate of RR 13.8 (excluding VAT) per mcm 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. The second component of the transportation rate for natural gas delivered within the customs territory of the Russian Federation and the member states of the Customs Union Agreement was set at RR 6.07 (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. There is no set timetable for reviews or changes in transportation tariffs set by the FTS, and thus changes in transportation tariffs occur on an irregular basis.

We transport most of our crude oil through the pipeline network owned and operated by Transneft, Russia’s 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, 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.

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 South American markets. The costs associated with the transportation of stable gas condensate by tanker are determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

Transactions with related parties

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

Our tax burden

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

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

In practice, Russian tax authorities often have their own interpretation of tax laws that rarely favors taxpayers, who have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to an inspection of their activities for a period of three calendar years which immediately precedes 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

Oil and gas production costs

Our oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the unaudited supplemental oil and gas disclosures in our consolidated financial statements as of and for the years ended 31 December 2007 and 2006. Oil and gas production costs do not include general corporate overheads or its associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the years presented in millions of Russian roubles and in US dollars and Russian roubles per boe:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	3,057	2,518	21.4%
Long-term supply purchases	3,242	1,805	79.6%
Taxes other than income tax	6,222	6,019	3.4%
Transportation expenses	14,358	11,342	26.6%
Total production costs before DD&A	**26,879**	**21,684**	**24.0%**
Depreciation, depletion and amortization (DD&A)	3,446	3,466	(0.6%)
Total production costs	**30,325**	**25,150**	**20.6%**

USD/boe	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	0.58	0.45	28.9%
Long-term supply purchases	6.03	3.74	61.2%
Taxes other than income tax	1.19	1.07	11.2%
Transportation expenses	2.49	1.86	33.9%
Total production costs before DD&A	**4.66**	**3.56**	**30.9%**
Depreciation, depletion and amortization (DD&A)	0.66	0.62	6.5%
Total production costs	**5.26**	**4.13**	**27.4%**

RR/boe	Year ended 31 December: 2007	2006	Change %
Production costs:			
Lifting cost	14.9	12.2	22.1%
Long-term supply purchases	154.2	101.7	51.6%
Taxes other than income tax	30.4	29.2	4.1%
Transportation expenses	63.7	50.6	25.9%
Total production costs before DD&A	**119.2**	**96.8**	**23.1%**
Depreciation, depletion and amortization (DD&A)	16.8	16.8	0.0%
Total production costs	**134.4**	**112.3**	**19.7%**

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

Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to an increase in purchases from the third parties and natural gas withdrawal from the underground gas storage facilities. Our liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) also increased in 2007 primarily due to a one-time stable gas condensate inventory buildup in 2006 which was related to a change in export delivery terms for this product.

Natural gas sales volumes

millions of cubic meters	Year ended 31 December: 2007	2006	Change %
Production from:			
Yurkharovskoye field	9,554	9,538	0.2%
East-Tarkosalinskoye field	14,468	15,735	(8.1%)
Khancheyskoye field	4,196	3,277	28.0%
Other fields	32	28	14.3%
Total natural gas production	**28,250**	**28,578**	**(1.1%)**
Purchases from:			
Gazprom	1,973	2,054	(3.9%)
Other	1,166	529	120.4%
Total natural gas purchases	**3,139**	**2,583**	**21.5%**
Total production and purchases	**31,389**	**31,161**	**0.7%**
Purovsky Plant and own usage	(34)	(36)	(5.6%)
Decrease (increase) in pipeline and underground gas storage facilities	699	(817)	n/m
Total natural gas sales volumes	**32,054**	**30,308**	**5.8%**
sold to end-customers	*14,277*	*13,433*	*6.3%*
e-trading sales	*661*	*10*	*n/m*
Subtotal sales treated as to end-customers	*14,938*	*13,443*	*11.1%*
Sold ex-field	*17,116*	*16,865*	*1.5%*

In 2007, our total consolidated natural gas production decreased by 328 mmcm, or 1.1%, compared to 2006. The decrease in production was due to a temporary reduction in production of dry Cenomanian gas mainly at our East-Tarkosalinskoye field as a result of our inability to inject natural gas into storage due to the lack of available capacity at Gazprom's underground gas storage facilities. During the year, however, we increased our natural gas production capacity at the Khancheyskoye field due to the commissioning of the field's second phase of development.

The unseasonably warm winter weather in Western, Central and Eastern Europe resulted in decreased export deliveries of natural gas from Gazprom, which directly affected the normal seasonal withdrawal of natural gas from underground storage facilities. As a result, due to the overfilled underground storage system we did not have the ability to produce and inject our planned natural gas volumes in the 2007.

At 31 December 2007, our cumulative natural gas volumes stored in Gazprom's underground gas storage facilities totaled 40 mmcm compared to 1,000 mmcm at 31 December 2006. We expect our volumes of natural gas injected into underground gas storage facilities to continue fluctuating period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

Despite the warmest winter in Russia over the past 126 years, base natural gas demand on the domestic market remained reasonably robust. In 2007, we increased our purchases of natural gas from "other" suppliers by 556 mmcm, or 21.5%, as compared to 2006 largely due to meet increased market demand.

Liquids sales volumes

thousands of tons	Year ended 31 December: 2007	2006	Change %
Production from:			
Yurkharovskoye field	698	671	4.0%
East-Tarkosalinskoye field	892	853	4.6%
Khancheyskoye field	710	712	(0.3%)
Other fields	100	108	(7.4%)
Total liquids production	**2,400**	**2,344**	**2.4%**
Purchases from:			
Purgazdobycha	16	78	(79.5%)
Other	40	27	48.1%
Total liquids purchases	**56**	**105**	**(46.7%)**
Total production and purchases	**2,456**	**2,449**	**0.3%**
Losses [1]	(20)	(21)	(4.8%)
Decreases (increases) in liquids inventory balances	(32)	(179)	(82.1%)
Total liquids sales volumes	**2,404**	**2,249**	**6.9%**
Stable gas condensate export	*1,505*	*1,355*	*11.1%*
Stable gas condensate domestic	*3*	*3*	*0.0%*
LPG export	*77*	*41*	*87.8%*
LPG CIS	*55*	*54*	*1.9%*
LPG domestic	*422*	*410*	*2.9%*
Crude oil export	*109*	*98*	*11.2%*
Crude oil domestic	*160*	*207*	*(22.7%)*
Oil products export	*33*	*-*	*n/m*
Oil products domestic	*40*	*81*	*(50.6%)*

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

In 2007, our gas condensate and crude oil production increased by 56 thousand tons, or 2.4%, to 2,400 thousand tons compared to 2,344 thousand tons in 2006. The higher gas condensate yields from the East-Tarkosalinskoye field were due to changes in the technical parameters of the gas separation process resulting from the start-up of a new compressor station on the field as well as organic growth in gas condensate production combined with a higher proportion liquid concentration in the gas production at the Yurkharovskoye field.

At 31 December 2007, we had 224 thousand tons of stable gas condensate in transit or storage and recognized as inventory until such time as it is delivered to the port of destination as compared to 190 thousand tons as of 31 December 2006. Our stable gas condensate in transit or storage and recognized as inventory was increased by 34 thousand tons as at 31 December 2007 as compared to the inventory balance at 1 January 2007. At 31 December 2006, our inventory balance of stable gas condensate increased by 179 thousand tons. The remaining change in liquids inventory balances related to changes in other liquid products.

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2007 COMPARED TO THE YEAR ENDED 31 DECEMBER 2006

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2007 and 2006. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Total revenues (net of VAT and export duties)	62,321	*100.0%*	49,373	*100.0%*
including:				
natural gas sales	35,605	*57.1%*	28,048	*56.8%*
liquids sales	24,752	*39.7%*	19,999	*40.5%*
Other income (loss)	110	*0.2%*	(139)	*(0.3%)*
Total revenues and other income	**62,431**	***100.2%***	**49,234**	***99.7%***
Operating expenses	(37,066)	*(59.5%)*	(30,081)	*(60.9%)*
Profit from operations	**25,365**	***40.7%***	**19,153**	***38.8%***
Finance income (expense)	124	*0.2%*	(31)	*(0.1%)*
Profit before income tax and minority interest	**25,489**	***40.9%***	**19,122**	***38.7%***
Total income tax expense	(6,761)	*(10.8%)*	(5,115)	*(10.4%)*
Profit for the period	**18,728**	***30.1%***	**14,007**	***28.4%***
Minority interest	8	*n/m*	72	*0.1%*
Profit attributable to NOVATEK shareholders	**18,736**	***30.1%***	**14,079**	***28.5%***

Total revenues and other income

The following table sets forth our sales (net of VAT and export duties where applicable) and other income for the years ended 31 December 2007 and 2006:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Natural gas sales	**35,605**	**28,048**	**26.9%**
End-customer	*21,483*	*16,838*	*27.6%*
E-trading	*788*	*10*	*n/m*
Ex-field	*13,334*	*11,200*	*19.1%*
Stable gas condensate sales	**17,106**	**13,768**	**24.2%**
Export	*17,082*	*13,742*	*24.3%*
Domestic	*24*	*26*	*(7.7%)*
Liquefied petroleum gas sales	**4,926**	**3,804**	**29.5%**
Export	*884*	*455*	*94.3%*
CIS	*569*	*465*	*22.4%*
Domestic	*3,473*	*2,884*	*20.4%*
Crude oil sales	**1,753**	**1,928**	**(9.1%)**
Export	*784*	*695*	*12.8%*
Domestic	*969*	*1,233*	*(21.4%)*
Oil products sales	**967**	**499**	**93.8%**
Export	*674*	*-*	*n/m*
Domestic	*293*	*499*	*(41.3%)*
Total oil and gas sales	**60,357**	**48,047**	**25.6%**
Sales of polymer and insulation tape	1,602	1,109	44.5%
Other revenues	362	217	66.8%
Total revenues	**62,321**	**49,373**	**26.2%**
Other income (loss)	110	(139)	n/m
Total revenues and other income	**62,431**	**49,234**	**26.8%**

Natural gas sales

In 2007, our revenues from sales of natural gas increased by RR 7,557 million, or 26.9%, compared to 2006. The increase in natural gas revenues was primarily attributable to an overall increase in prices and to a lesser extent an increase in sales volumes. Revenues from the sale of natural gas accounted for 57.1% and 56.8% of our total revenues in 2007 and 2006, respectively. The marginal increase in natural gas sales as a percentage of total revenues was primarily due to a decrease in crude oil volumes sold.

In 2007, our average realized natural gas price per mcm increased by RR 186 per mcm, or 20.1%, to RR 1,111 per mcm from RR 925 per mcm in 2006. Our proportion of natural gas sold to end-customers, including e-trading sales, on a volume basis, increased from 44.4% in 2006 to 46.6% in 2007 due to an increase in sales at electronic trading system. The average realized prices of our natural gas sold directly to end-customers, at the electronic trading system and natural gas sold ex-field were higher by 20.1%, 20.4% and 17.3%, respectively, in 2007 compared to 2006. Our sales of natural gas to end-customers were primarily to energy utilities and large industrial companies in both periods.

In November 2006, we started participating in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. In 2007, we sold 661 mmcm of natural gas at an average price of RR 1,193 per mcm (netback price RR 1,086 per mcm). These sales were primarily to energy utility companies and are recorded in our end-customer volumes and average end-customer price.

Effective 1 January 2008, the expected volumes to be sold on the electronic gas exchange will be increased from five billion cubic meters each (Independent gas producers and Gazprom) to 7.5 billion cubic meters each. We continue to view the success of electronic trading of natural gas as a positive development in the domestic natural gas market.

Stable gas condensate sales

In 2007, our revenues from sales of stable gas condensate increased by RR 3,338 million, or 24.2%, compared to 2006 due to an increase in both export contract prices and export sales volumes.

In 2007, we increased our export sales volumes of stable gas condensate to the US, European and South American markets by 150 thousand tons, or 11.1%, to 1,505 thousand tons as compared to 1,355 thousand tons exported in 2006. We deliver stable gas condensate to the international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers. The increase was due to sales of stable gas condensate balance in transit or storage recognized as inventory at 31 December 2006. In 2007, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market increased by USD 70.8 per ton, or 19.0%, to USD 443.9 per ton (DES and CFR) from USD 373.1 per ton (DES and CFR) in 2006. The increase in the average realized export price was the result of a 12.7% increase in our average export contract price that was partially offset by a 1.9% increase in our average export duty per ton. The increase in our average realized contract prices was due to the overall increase in prices on international markets in 2007. The average domestic price for stable gas condensate increased by RR 282 per ton, or 3.4%, in 2007 compared to 2006 due to the strengthening of prices on the domestic market.

Liquefied petroleum gas sales

In 2007, our revenues from the sales of LPG increased by RR 1,122 million, or 29.5%, compared to 2006, primarily due to an increase in domestic prices and to a lesser extent an increase in export volumes.

In 2007, we increased our sales volumes of LPG by 49 thousand tons, or 9.1%, to 554 thousand tons mainly due to an increase in throughput at our Purovsky Plant, of which 76.2% of LPG volumes was sold domestically for an average price of RR 8,231 per ton (FCA excluding VAT); an increase of RR 1,217 per ton, or 17.4%, compared to 2006. The remaining volumes of LPG were sold as follows: 13.9% was sold to the export market for an average price of USD 451.0 per ton (DAF excluding export duties) representing an increase of USD 47.5 per ton, or 11.8%, compared to 2006; and 9.9% was sold in the CIS for an average price of RR 10,264 per ton (DAF excluding VAT) representing an increase of RR 1,726 per ton, or 20.2%, compared to 2006. The increase in our average realized export prices (excluding export duties) was primarily due to an increase in our average contract prices by 10.3% that was partially offset by a 4.6% increase in our average export duty per ton in the 2007.

In 2006, 81.2%, 8.1% and 10.7% of LPG volumes were sold on domestic markets, export markets and in the CIS, respectively. LPG volumes sold on the export market was primarily due to a better pricing market on the international markets during 2007.

Crude oil sales

In 2007, our revenues from the sales of crude oil decreased by RR 175 million, or 9.1%, compared to 2006, due to a reduction in volumes sold on the domestic market. The decrease in crude oil volumes available for sale by 36 thousand tons from 305 thousand tons in 2006 to 269 thousand tons in 2007, or 11.8%, was mainly attributable to a decrease in unstable gas condensate deliveries to the Surgutsky refinery due to the migration of processing of our unstable gas condensate from the Surgutsky refinery to the Purovsky Plant (a portion of gas condensate processed at the Surgutsky refinery is sold as crude oil).

Our average realized export sales price for crude oil produced by our production subsidiaries and those volumes purchased by our trading subsidiary and resold on international markets (which are not subject to export duties) translated into US dollars increased by USD 21.1 per ton, or 8.1%, to USD 282.5 per ton (DAF) in 2007 compared to USD 261.4 per ton (DAF) in 2006. If we exclude the effect from sales of crude oil by our foreign trading subsidiary in 2006, our average realized sales price for sales volumes produced by our production subsidiaries, excluding export duties, translated into US dollars for crude oil exported to international markets increased by USD 58.2 per ton, or 25.9%, to USD 282.5 per ton (DAF) in 2007 compared to USD 224.3 per ton (DAF) in 2006. The increase in the average realized export price was the result of a 13.4% increase in our average export contract price and to a lesser extent due to a 0.7% decrease in our average export duty per ton. The increase in our average realized contract prices was due to the overall increase in prices on international markets in 2007.

Our average realized crude oil domestic sales price (excluding VAT) marginally increased by RR 46 per ton, or 0.8%, to RR 6,039 per ton in 2007, compared to RR 5,993 per ton in 2006.

Oil products sales

In 2007, our revenue from the sales of oil products increased by RR 468 million, or 93.8%, compared to 2006, primarily due to the initiation of oil products trading on international markets by our foreign trading subsidiary.

During the year we purchased 37 thousand tons of oil products and resold 33 thousand tons to customers in the US and Europe for an average contract price of USD 819 per ton (terms DES and FOB). The remaining 4 thousand tons were recorded as "goods in transit" in inventories until such time as they are delivered to the port of destination.

Our domestic oil products sales volumes decreased by 41 thousand tons, or 50.6%, to 40 thousand tons in 2007 from 81 thousand tons in 2006. The decrease was mainly due to the migration of processing of our unstable gas condensate from the Surgutsky refinery to the Purovsky Plant, which resulted in a decrease in the output of oil products available for sale.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 493 million, or 44.5%, to RR 1,602 million in 2007, compared to RR 1,109 million in 2006 due to an increase in BOPP film wrap and certain pipes insulation products. Revenues from our sales of BOPP film wrap increased by RR 276 million from RR 491 million in 2006 to RR 767 million in 2007 due to a more efficient utilization of the facilities which increased the volumes available for sale. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 3.6% to 47.9% in 2007 compared to 44.3% in 2006.

Our revenues from pipe insulation products sales increased by RR 181 million from RR 369 million in 2006 to RR 550 million in 2007 mainly due to an increase in new regional customers and a corresponding increase in volumes sold.

Other revenues

Other revenues include rent, polymer tolling, transportation, handling, storage and other services. In 2007, other revenues increased by RR 145 million, or 66.8%, to RR 362 million from RR 217 million in 2006. The increase in other revenues was primarily due to an increase in transportation, handling and storage services which accounted for RR 128 million of other revenues in 2007 compared to RR 37 million in 2006 and an increase in geological and geophysical research provided to our associates from RR 32 million in 2006 to RR 56 million in 2007. In 2007, revenues from tolling and rent services increased marginally by RR 5 million and RR 7 million to RR 82 million and RR 57 million, respectively.

Other income (loss)

In 2007, we realized other income of RR 110 million, of which RR 95 million related to sale of our non-core subsidiary, Geolog Yamala. In 2006, we realized other loss of RR 83 million relating to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). The remaining other loss of RR 56 million related to disposals of fixed assets, equipment and materials.

Operating expenses

In 2007, total operating expenses increased by RR 6,985 million, or 23.2%, to RR 37,066 million compared to RR 30,081 million in 2006, largely due to increases in transportation costs, purchases of oil, gas condensate and natural gas, and an increase in materials, services and other. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased in 2007 by 2.5% to 56.0% compared to 58.5% in 2006. Total operating expenses decreased as a percentage of total revenues to 59.5% in the 2007 compared to 60.9% in 2006, as shown in the table below.

	Year ended 31 December:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Transportation expenses	14,372	*23.1%*	11,362	*23.0%*
Taxes other than income tax	6,379	*10.2%*	6,223	*12.6%*
Materials, services and other	4,924	*7.9%*	3,893	*7.9%*
General and administrative expenses	3,873	*6.2%*	3,165	*6.4%*
Depreciation, depletion and amortization	3,668	*5.9%*	3,671	*7.4%*
Purchases of oil, gas condensate and natural gas	3,242	*5.2%*	1,805	*3.7%*
Exploration expenses	486	*0.8%*	459	*0.9%*
Net impairment expense	153	*0.2%*	100	*0.2%*
Change in inventory	(31)	*0.0%*	(597)	*(1.2%)*
Total operating expenses	**37,066**	***59.5%***	**30,081**	***60.9%***

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 2007, non-controllable expenses of transportation and taxes other than income tax increased by RR 3,166 million, or 18.0%, to RR 20,751 million from RR 17,585 million in 2006. The increase was primarily due to an increase in the transportation tariff for natural gas and a combined increase in the transportation tariffs and volumes sold for liquids. There were marginal changes in taxes other than income between the reporting dates. As a percentage of total revenues, our non-controllable expenses decreased by 2.3% to 33.3% in the 2007 compared to 35.6% in 2006.

Transportation expenses

Our total transportation expenses in 2007 increased by RR 3,010 million, or 26.5%, compared to 2006.

	Year ended 31 December:		Change
millions of Russian roubles	**2007**	**2006**	**%**
Natural gas transportation to customers	9,077	6,934	30.9%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	3,376	2,753	22.6%
Stable gas condensate transported by tankers	1,690	1,484	13.9%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	115	78	47.4%
Crude oil transportation to customers	78	93	(16.1%)
Other transportation costs	36	20	80.0%
Total transportation expenses	**14,372**	**11,362**	**26.5%**

In 2007, our transportation expense for natural gas increased by RR 2,143 million, or 30.9% to RR 9,077 million from RR 6,934 million in 2006. The increase was mainly due to higher transportation tariffs effective from 1 March 2007 (see “Transportation tariffs” above) and to a lesser extent due an 11.1% increase in our sales volumes of natural gas sold directly to end-customers and via the electronic trading system, where the cost of transportation is included in the sales price. We are not able to influence the transportation route of natural gas sold to end-customers and therefore we have no control over our average delivery distance. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period.

In 2007, our total expenses for transportation by rail increased by RR 623 million, or 22.6%, due to higher railroad transportation tariffs and volumes sold during the year. During 2007, our combined volumes of stable

gas condensate, LPG and oil products sold and transported via rail increased by 158 thousand tons, or 8.1%, to 2,102 thousand tons from 1,944 thousand tons in 2006.

Our expense for stable gas condensate transported by rail to international markets increased by RR 366 million, or 21.1%, from RR 1,737 million to RR 2,103 million, or from RR 1,282 per ton in 2006 to RR 1,398 per ton in 2007. The increase in the transportation rate per ton was primarily due to a tariff increase of approximately 12.7% in January 2007.

In 2007, our expense for LPG transported by rail amounted to RR 1,250 million, of which RR 381 million was related to export sales, RR 133 million to CIS sales, and RR 736 million to domestic sales, or RR 4,971 per ton, RR 2,391 per ton, and RR 1,745 per ton, respectively. In 2006, transportation expenses for LPG amounted to RR 989 million, of which RR 225 million was related to export sales, RR 121 million to CIS sales, and RR 643 million to domestic sales, or RR 5,432 per ton, RR 2,220 per ton and RR 1,564 per ton, respectively. Our LPG rail transportation expense in 2007 was also affected by an increase in transportation tariffs which was partially offset by shorter distances for deliveries of LPG to export markets.

The remaining RR 23 million of the transportation expenses by rail in 2007 and RR 27 million in 2006 were related to the transportation of oil products 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 206 million, or 13.9%, from RR 1,484 million in 2006 to RR 1,690 million in 2007. The change was primarily due to an 11.1% increase in stable gas condensate volumes sold and higher average freight rates primarily due to an increase in the average delivery distance to international markets. In 2007, the percentage of stable gas condensate export volumes delivered to the US market increased by 6.2% to 70.8% of total volumes delivered compared to 64.6% in 2006.

Taxes other than income tax

millions of Russian roubles	**Year ended 31 December:**		**Change**
	2007	**2006**	**%**
Unified natural resources production tax (UPT)	5,703	5,556	2.6%
Property tax	544	483	12.6%
Other taxes	132	184	(28.3%)
Total taxes other than income tax	**6,379**	**6,223**	**2.5%**

In 2007, taxes other than income tax increased by RR 156 million, or 2.5%, of which RR 147 million and RR 61 million was due to UPT and property tax increase, respectively, that was partially offset by a decrease in other taxes.

Our increase in UPT of 2.6%, or RR 147 million, was largely attributable to higher mineral production taxes for crude oil of RR 110 million. During the year, we increased our volumes of crude oil produced by 11.3% and also incurred an increase in our crude oil production tax rate by 10.4%. The remaining balance related to an increase in our gas condensate UPT expense of RR 77 million, which was partially offset by a decrease in natural gas UPT expense for RR 40 million. The reduction in our natural gas UPT expense resulted from a decrease in natural gas production.

In 2007, our property tax expense increased by RR 61 million, or 12.6%, to RR 544 million compared to RR 483 million in 2006. The increase was primarily due to additions of property, plant and equipment ("PPE") at NOVATEK-YURKHAROVNEFTEGAS, which accounted for RR 42 million of the tax increase, and additions of PPE at other companies in the Group, resulting in an additional RR 19 million in property tax increase.

Materials, services and other

In 2007, our materials, services and other expenses increased by RR 1,031 million, or 26.5%, to RR 4,924 million compared to RR 3,893 million in 2006. The main components of this expense were employee compensation and materials and supplies expense, which comprised 38.5% and 30.9%, respectively, of total materials, services and other expenses in 2007.

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Employee compensation	1,897	1,351	40.4%
Materials and supplies	1,521	1,219	24.8%
Repair and maintenance services	367	333	10.2%
Fire safety and security expense	263	254	3.5%
Electricity and fuel	216	192	12.5%
Tolling and processing fees	213	226	(5.8%)
Other	447	318	40.6%
Total materials, services and other	**4,924**	**3,893**	**26.5%**

Employee compensation increased by RR 546 million, or 40.4%, to RR 1,897 million compared to RR 1,351 million in 2006. The increase was due to additional bonuses and an increase in wages at our production entities, which resulted in an additional RR 364 million in employee compensation in 2007. In 2007, we increased staff at NOVATEK-YURKHAROVNEFTEGAS, our production subsidiary, resulting in an employee compensation increase of RR 75 million. We also recorded an additional RR 106 million of employee compensation related to the accrual of pension obligations due to the implementation of a post-employment benefit program in February 2007.

Materials and supplies expense increased by RR 302 million, or 24.8%, mainly due to an increase in production of polymers and insulation tape products and the associated increase in purchases of raw materials.

Our increase in repair and maintenance expenses by RR 34 million, or 10.2%, from RR 333 million in 2006 to RR 367 million in 2007 was primarily related to repair works at the Purovsky Plant. Fire safety and security expenses increased by RR 9 million, or 3.5%, to RR 263 million from RR 254 million in 2006, and was primarily related to ongoing fire safety activities at our field sites.

We incurred an increase in our average electricity tariff mainly at our production entities which increased our electricity and fuel expenses by RR 24 million, or 12.5%, during 2007. Our tolling and processing services expense decreased by RR 37 million due to reduced volumes of unstable gas condensate sent to the Surgutsky refinery in 2007. The decrease was partially offset by an increase in services related to the de-ethanization of unstable gas condensate produced at the Yurkharovskoye field by RR 24 million due to an increase in both processing tariffs and volumes processed.

Other expenses include rent expenses, transport of raw materials, telecommunication services, and miscellaneous operating expenses. Other expenses increased by RR 129 million, or 40.6%, in 2007 compared to 2006 mainly due to increases in transport and rent expenses of RR 46 million and RR 24 million, respectively.

General and administrative expenses

In 2007, our general and administrative expenses increased by RR 708 million, or 22.4%, to RR 3,873 million compared to RR 3,165 million in 2006. The main components of these expenses were employee compensation, maintenance of social infrastructure and charitable contributions, legal, audit, and consulting services which, on aggregate comprised 75.5% and 70.2% of total general and administrative expenses for the 2007 and 2006, respectively.

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Employee compensation	1,961	1,476	32.9%
Maintenance of social infrastructure and charitable contributions	559	491	13.8%
Legal, audit, and consulting services	404	256	57.8%
Rent expense	146	123	18.7%
Insurance expense	117	225	(48.0%)
Other	686	594	15.5%
Total general and administrative expenses	**3,873**	**3,165**	**22.4%**

Employee compensation increased by RR 485 million, or 32.9%, to RR 1,961 million compared to RR 1,476 million in 2006. Additional employees' wages and staff at NOVATEK accounted for RR 219 million, or 45.2%, of the total increase in employee compensation, of which RR 88 million related to increases in staff wages and RR 131 million related to staff additions. In 2006, we initiated an independent review of our employee compensation levels in an effort to bring the Group's total remuneration packages in line with domestic and international peers as part of a broader human resources initiative to attract, retain and motivate employees. The review process is ongoing and will affect payroll expenses in future periods. In 2007, we accrued pension obligations in the amount of RR 110 million.

Maintenance of social infrastructure and charitable contributions increased by RR 68 million, or 13.8%, to RR 559 million compared to RR 491 million in 2006, and were primarily related to our continued support for charities and social programs in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 148 million, or 57.8%, to RR 404 million compared to RR 256 million in 2006. The increase was primarily due to consulting services related to our information technology systems updates and management efficiency programs improvements.

Throughout the year, we engaged our external independent auditors, ZAO "PricewaterhouseCoopers Audit" ("PwC"), to provide various types of professional services to the Group. Audit related fees paid to PwC for the audit of the Group's consolidated financial statements and the statutory audit of the Parent company totaled RR 28 million in both 2007 and 2006. In addition, we paid fees to PwC for non-audit services, mainly tax related work, in the amount of RR 3 million in 2007 and RR 1 million in 2006.

In 2007, rent expense increased by RR 23 million, or 18.7%, to RR 146 million as compared to RR 123 million in 2006. The increase in rent expense was mainly attributable to a general increase in rental rates and additional office space rented in Moscow.

Insurance expense decreased by RR 108 million, or 48.0%, to RR 117 million compared to RR 225 million in 2006. The decrease was primarily due to lower Group insurance rates due to a reduction in claims for accidents and a re-assessment of items to be insured.

Other general and administrative expenses increased by RR 92 million, or 15.5%, in 2007 as compared to 2006 mostly due to an increase in fire safety and security expenses and business trips expenses, which accounted for RR 38 million and RR 33 million, respectively, of the increase.

Depreciation, depletion and amortization

In 2007, our depreciation, depletion and amortization ("DDA") expense decreased by RR 3 million, or 0.1%, compared to 2006. The decrease was primarily due to lower production levels which decreased depletion of our oil and gas properties. Associated depletion of oil and gas properties decreased by RR 19 million, or 0.6%, compared to 2006. In 2007 as well as in 2006, our DDA per barrel of oil equivalent (boe) was RR 15.7 per boe. The decrease in our depreciation expense accrued using the "units of production" method was partially offset by

an increase in straight-line depreciation for assets at Purovsky Plant by RR 10 million and an increase in straight-line depreciation for other assets by RR 6 million.

Purchases of oil, gas condensate and natural gas

Our purchases of hydrocarbons increased by RR 1,437 million, or 79.6%, to RR 3,242 million in 2007 from RR 1,805 million in the corresponding period in 2006 primarily due to an increase in natural gas volumes purchased from third parties to maximize end-customer sales during the period and our purchases of oil products on international markets for resale which, amounted to RR 730 million in 2007.

Change in inventory

We reduced our operating expenses by recording credit amounts to our change in inventory of RR 31 million and RR 597 million in 2007 and 2006, respectively. The credits represent an adjustment to our operating expenses for "goods in transit" and volumes held in storage at the end of the period. At 31 December 2006, we increased our volumes of natural gas stored in underground gas facilities and stable gas condensate in transit as compared to 1 January 2006. During 2007, we withdrew nearly all natural gas volumes from underground gas storage facilities and increased the balance of liquids by volumes of oil products purchased on international markets.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 6,212 million, or 32.4%, to RR 25,365 million in 2007 compared to RR 19,153 million in 2006. In 2007, our profit from operations as a percentage of total revenues increased to 40.7% as compared to 38.8% in 2006.

Finance income (expense)

We reversed our position from net finance expense of RR 31 million in 2006 to net finance income of RR 124 million in 2007. The reversal was mainly due to reduced interest expenses and higher interest income received which was partially offset by a decrease in foreign exchange gains in 2007.

In 2007, interest expense decreased by RR 253 million, or 49.0%, due to a reduction in our weighted average debt balances while interest income increased by RR 102 million, or 37.2%, due to an increase in interest income on funds held on account as bank deposits. In 2007, we recorded a net foreign exchange gain of RR 11 million compared to RR 211 million in 2006. The decrease of foreign exchange gain was due to the combination of a higher proportion of US dollar denominated assets than liabilities and the strengthening of the Russian rouble against US dollar in 2007.

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 26.5% and 26.7% for the years ended 31 December 2007 and 2006, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 27.0% and 27.2% in 2007 and 2006, respectively. Russian statutory income tax rate for both periods was 24%. 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 year increased by 4,721 million, or 33.7%, to RR 18,728 million in 2007 from RR 14,007 million in 2006. The profit attributable to NOVATEK shareholders increased by RR 4,657 million, or 33.1%, to RR 18,736 million in 2006 from RR 14,079 million in 2006.

We increased our weighted average basic and diluted earnings per share by RR 1.53 per share, or 33.0%, from RR 4.64 per share in 2006 to RR 6.17 per share in 2007 based on the profits attributable to NOVATEK's shareholders.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2007 and 2006:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Net cash provided by operating activities	21,383	16,938	26.2%
Net cash used in investing activities	(20,747)	(5,041)	311.6%
Net cash used in financing activities	(3,678)	(9,037)	(59.3%)

Liquidity ratios	31 December 2007	31 December 2006	Change %
Current ratio	1.41	3.04	(53.6%)
Total debt to equity	0.08	0.05	60.0%
Long-term debt to long term debt and equity	0.001	0.008	(87.5%)
Net debt to total capitalization [(1)]	0.03	(0.03)	n/m

[(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

Net cash provided by operating activities increased by RR 4,445 million, or 26.2%, to RR 21,383 million in 2007 compared to RR 16,938 million in 2006. The increase was mainly attributable to higher operating income from our oil and gas sales as a result of increase in our natural gas and liquids realized prices that were partially offset by an increase in trade receivables and prepayments.

Net cash used in investing activities

Net cash used in investing activities increased by RR 15,706 million to RR 20,747 million in 2007 compared to RR 5,041 million in 2006. The increase in 2007 was primarily due to an increase in capital expenditures related to further development of our three core fields, the construction activities for the second phase of the Purovsky Processing Plant and the payment for the acquisition of the license for the West-Urengoiskoye field.

Net cash used in financing activities

Net cash used for financing activities decreased by RR 5,359 million, or 59.3 %, to RR 3,678 million in 2007 compared to RR 9,037 million in 2006. The decrease was primarily due to significant repayments of short-term and long-term debt in 2006 compared to 2007 that was partially offset by an increase in dividends paid.

Working capital

At 31 December 2007, our net working capital position (current assets less current liabilities) was RR 4,963 million compared to RR 10,389 million at 31 December 2006. The decrease by RR 5,426 million was mainly due to increases in short-term debts, trade payables and accrued liabilities at 31 December 2007.

Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2007 and 2006 are as follows:

millions of Russian roubles	Year ended 31 December: 2007	2006	Change %
Exploration and production	18,638	4,347	328.8%
Other	828	356	132.6%
Total	**19,466**	**4,703**	**313.9%**

Exploration and production 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. In addition, in February 2007 we acquired and obtained the license to exploration and production of hydrocarbons at the West-Urengoiskoye field for RR 1,710 million. During 2007, we spent RR 951 million, RR 2,208 million and RR 10,759 million for field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 1,758 million on construction of the second phase at the Purovsky Processing Plant.

Debt obligations

At 31 December 2007, the Group repaid RR 1,975 million (USD 75 million) of long-term debt to BNP PARIBAS Bank ahead of its maturity schedule and received additional short-term debt in the amount of RR 2,455 million (USD 100 million) repayable in August and September 2008.

In 2007 the Group additionally borrowed from CALYON S.A. and CALYON RUSBANK Corporate and Investment Bank short-term USD denominated loans of RR 2,455 million (USD 100 million) that are repayable in May 2008.

At 31 December 2007, the Group had unused short-term credit facilities in the aggregate amount of RR 4,148 million (USD 169 million) on either fixed or variable interest rates subject to the specific type of credit facility. In addition, in November 2007, the Group obtained a two-year credit line facility with International Moscow Bank (from December 2007 – “UniCredit Bank”) up to the maximum amount of RR 2,455 million (USD 100 million) with interest rates negotiated at each withdrawal date.

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 and Euro. As of 31 December 2007, RR 54 million, or 0.8%, of our long-term debt was denominated in US dollars (out of RR 6,602 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 partially mitigated by the fact that a portion of our total revenues, approximately 31.2% in 2007, is denominated in US dollars. As of 31 December 2007, the Russian rouble had appreciated by approximately 7% against the US dollar since 1 January 2007.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 31 December 2007 would have resulted in an estimated foreign exchange gain of approximately RR 633 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 interim condensed financial information all derivative instruments are recorded at their fair values. Unrealized gains or losses on derivative instruments are recognized within other 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 low natural gas prices or high transportation tariffs would limit our ability to maintain an adequate level of capital expenditures, which in turn could limit our ability to increase or maintain current levels of production and deliveries of natural gas, gas condensate, crude oil and other associated products, adversely affecting our results.

Off balance sheet activities

As of 31 December 2007, 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.

IFRS Consolidated Financial Statements and Independent Auditor's Report for the Years ended 31 December 2007 and 2006

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INDEPENDENT AUDITOR'S REPORT

To the shareholders and directors of OAO NOVATEK

1 We have audited the accompanying consolidated financial statements of OAO NOVATEK and its subsidiaries (the "Group") set out on pages 4 to 48 which comprise the consolidated balance sheet as at 31 December 2007 and the consolidated statement of income, consolidated statement of cash flows and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation
18 April 2008

OAO NOVATEK
Consolidated Balance Sheet
(in millions of Russian roubles)

	Notes	At 31 December: 2007	2006
ASSETS			
Non-current assets			
Property, plant and equipment	6	82,669	66,734
Investments in associates		1,125	-
Long-term loans and receivables		681	331
Other non-current assets		2,462	1,774
Total non-current assets		**86,937**	**68,839**
Current assets			
Inventories	7	1,794	1,815
Current income tax prepayments		335	940
Trade and other receivables	8	3,267	2,213
Prepayments and other current assets	9	7,660	4,851
Cash and cash equivalents	10	3,982	5,668
Total current assets		**17,038**	**15,487**
Total assets		**103,975**	**84,326**
LIABILITIES AND EQUITY			
Non-current liabilities			
Long-term debt	11	42	543
Deferred income tax liabilities	21	8,083	8,412
Other non-current liabilities		905	816
Asset retirement obligations		1,058	781
Total non-current liabilities		**10,088**	**10,552**
Current liabilities			
Short-term debt and current portion of long-term debt	13	6,560	2,565
Trade payables and accrued liabilities	14	3,599	1,801
Current income tax payable		645	48
Other taxes payable		1,271	684
Total current liabilities		**12,075**	**5,098**
Total liabilities		**22,163**	**15,650**
Equity attributable to NOVATEK shareholders			
Ordinary share capital		393	393
Additional paid-in capital		30,257	30,081
Asset revaluation surplus on acquisitions		5,617	5,617
Retained earnings		45,068	32,229
Total equity attributable to NOVATEK shareholders	15	**81,335**	**68,320**
Minority interest		**477**	**356**
Total equity		**81,812**	**68,676**
Total liabilities and equity		**103,975**	**84,326**

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

Approved for issue and signed on behalf of the Board of Directors on 18 April 2008:

L. Mikhelson
General Director

M. Gyetvay
Financial Director

OAO NOVATEK

Consolidated Statement of Income

(in millions of Russian roubles, except for share and per share amounts)

	Notes	Year ended 31 December: 2007	2006
Revenues			
Oil and gas sales	16	60,357	48,047
Sales of polymer and insulation tape		1,602	1,109
Other revenues		362	217
Total revenues		**62,321**	**49,373**
Net gain on disposal of interest in subsidiaries	5	95	9
Other income (loss)		15	(148)
Total revenues and other income		**62,431**	**49,234**
Operating expenses			
Transportation expenses	17	(14,372)	(11,362)
Taxes other than income tax	18	(6,379)	(6,223)
Materials, services and other	19	(4,924)	(3,893)
Depreciation, depletion and amortization	6	(3,668)	(3,671)
General and administrative expenses	20	(3,873)	(3,165)
Purchases of oil, gas condensate and natural gas		(3,242)	(1,805)
Exploration expenses		(486)	(459)
Net impairment expense		(153)	(100)
Changes in inventories		31	597
Total operating expenses		**(37,066)**	**(30,081)**
Profit from operations		**25,365**	**19,153**
Finance income (expense)			
Interest expense		(263)	(516)
Interest income		376	274
Foreign exchange gain (loss)		11	211
Total finance income (expense)		**124**	**(31)**
Profit before income tax		**25,489**	**19,122**
Income tax expense			
Current income tax expense		(7,301)	(5,527)
Net deferred income tax benefit		540	412
Total income tax expense	21	**(6,761)**	**(5,115)**
Profit for the year		**18,728**	**14,007**
Profit (loss) attributable to:			
Minority interest		(8)	(72)
Shareholders of OAO NOVATEK		**18,736**	**14,079**
Basic and diluted earnings per share (in Russian roubles)		6.17	4.64
Weighted average number of shares outstanding (in thousands)		*3,036,306*	*3,036,306*

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

OAO NOVATEK
Consolidated Statement of Cash Flows
(in millions of Russian roubles)

	Notes	Year ended 31 December: 2007	2006
Profit before income tax		**25,489**	**19,122**
Adjustments to profit before income tax:			
Depreciation, depletion and amortization		3,734	3,728
Net impairment expense		153	100
Net foreign exchange loss (gain)		(11)	(211)
Net loss (gain) on disposal of assets		(93)	223
Share-based compensation	25	176	176
Interest expense		263	516
Interest income		(376)	(274)
Net change in other non-current assets		(178)	(65)
Other adjustments		24	(91)
Working capital changes			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(4,048)	(506)
Decrease (increase) in inventories		(94)	(409)
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends		1,856	600
Increase (decrease) in other taxes payable		587	(217)
Total effect of working capital changes		**(1,699)**	**(532)**
Income taxes paid		(6,099)	(5,754)
Net cash provided by operating activities		**21,383**	**16,938**
Cash flows from investing activities			
Purchases of property, plant and equipment		(19,043)	(4,439)
Purchases of tangible assets		(623)	(331)
Acquisition of subsidiaries, associates and minority interests, net of cash acquired		(989)	(184)
Proceeds from disposals of subsidiaries, associates and minority interests, net of cash disposed		5	45
Interest paid and capitalized		(139)	(287)
Loans provided		(423)	(153)
Repayments of loans provided		83	39
Interest received		382	269
Net cash (used for) provided by investing activities		**(20,747)**	**(5,041)**
Cash flows from financing activities			
Proceeds from long-term debt		-	2,689
Proceeds from short-term debt		5,448	3,734
Repayments of long-term debt		(2,293)	(7,428)
Repayments of short-term debt		(862)	(4,437)
Interest paid		(111)	(305)
Dividends paid	15	(5,860)	(3,290)
Net cash (used for) provided by financing activities		**(3,678)**	**(9,037)**
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		(12)	(148)
Net increase (decrease) in cash, cash equivalents and bank overdrafts		**(3,054)**	**2,712**
Cash and cash equivalents at beginning of the year		5,668	2,956
Cash, cash equivalents and bank overdrafts at end of the year		**2,614**	**5,668**

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

OAO NOVATEK

Consolidated Statement of Changes in Equity

(in millions of Russian roubles, except for number of shares)

	Number of ordinary shares (in thousands)	Ordinary share capital	Additional paid in capital	Asset revaluation surplus	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Minority interest	Total equity
At 31 December 2005	***3,036,306***	**393**	**29,905**	**5,481**	**21,489**	**57,268**	**281**	**57,549**
Dividends (Note 15)	-	-	-	-	(3,258)	(3,258)	-	(3,258)
Acquisitions of subsidiaries	-	-	-	136	-	136	203	339
Purchase of minority interest	-	-	-	-	(81)	(81)	(197)	(278)
Impact of additional shares subscription in subsidiaries on minority interest	-	-	-	-	-	-	141	141
Share-based compensation funded by shareholders	-	-	176	-	-	176	-	176
Profit (loss) for the year	-	-	-	-	14,079	14,079	(72)	14,007
At 31 December 2006	***3,036,306***	**393**	**30,081**	**5,617**	**32,229**	**68,320**	**356**	**68,676**
Dividends (Note 15)	-	-	-	-	(5,860)	(5,860)	-	(5,860)
Purchase of minority interest	-	-	-	-	(37)	(37)	(111)	(148)
Impact of additional shares subscription in subsidiaries on minority interest	-	-	-	-	-	-	240	240
Share-based compensation funded by shareholders	-	-	176	-	-	176	-	176
Profit (loss) for the year	-	-	-	-	18,736	18,736	(8)	18,728
At 31 December 2007	***3,036,306***	**393**	**30,257**	**5,617**	**45,068**	**81,335**	**477**	**81,812**

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

1 ORGANISATION AND PRINCIPAL ACTIVITIES

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

The Group sells its natural gas on the Russian domestic market at both regulated and unregulated market prices, however the majority of natural gas sold on the domestic market is sold at prices regulated by the Federal Tariff Service, a governmental agency. The Group's stable gas condensate and crude oil sales are sold on both the Russian domestic and international markets, and are subject to fluctuations in benchmark crude oil prices. Additionally, the Group's natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in the winter months of December and January and decreasing in the summer months of July and August. The Group's liquids sales volumes comprising stable gas condensate, crude oil and oil products remain relatively stable from period to period.

2 BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). In the absence of specific IFRS guidance for oil and gas producing companies, the Group has developed accounting policies in accordance with other generally accepted accounting principles for oil and gas producing companies, mainly US GAAP, insofar as they do not conflict with IFRS principles.

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

The consolidated financial statements have been prepared under the historical cost convention and are presented in Russian roubles. The assets and liabilities of the Group entities whose functional currency is not the Russian rouble are remeasured into Russian roubles at the exchange rate at the balance sheet date. The financial results of these entities are remeasured into Russian roubles using average exchange rates for the reporting periods. Exchange adjustments arising on the opening net assets and the profits for the reporting period are taken to a separate component of equity and reported in the consolidated statement of changes in equity.

Exchange rates, restrictions and controls. The official rate of exchange of the Russian rouble to the US dollar ("USD") at 31 December 2007 and 2006 was 24.55 and 26.33 Russian roubles to USD 1.00, respectively. The official rate of exchange of the Russian rouble to the Euro at 31 December 2007 and 2006 was 35.93 and 34.70 Russian roubles to 1.00 Euro, respectively. Any re-measurement of Russian rouble amounts to US dollars or any other currency should not be construed as a representation that such Russian rouble amounts have been, could be, or will in the future be converted into other currencies at these exchange rates.

Through early 2006, the Russian rouble was not a convertible currency in most countries outside of the former Soviet Union and, further, the Group was required to convert 10 percent of its hard currency proceeds into Russian roubles. During the first half of 2006, substantially all restrictions for hard currency transactions were lifted and the rights of the government of the Russian Federation and those of the Central Bank of the Russian Federation to impose such restrictions were waived.

2 BASIS OF PRESENTATION (CONTINUED)

Reclassifications. The following reclassifications have been made to the comparative figures to conform to the current period presentation. Commencing January 2007, liquefied petroleum gas sales and oil products sales are presented gross of rail transportation costs. Accordingly, liquefied petroleum gas sales and oil products sales for the year ended 31 December 2006 were increased by RR 534 million and RR 25 million, respectively. Correspondingly, stable gas condensate, liquefied petroleum gas, and oil products transportation expenses by rail were increased by RR 559 million.

At 31 December 2006, RR 331 million of materials and supplies intended for construction of fixed assets were reclassified from inventories to other non-current assets. Also, RR 664 million of recoverable value-added tax was reclassified from trade and other receivables to prepayments and other current assets. The reclassifications were made to conform to the current year presentation.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

All intercompany transactions, balances and unrealized gains on transactions between the Group entities are eliminated. Unrealized losses are also eliminated upon consolidation, but in the case where an asset is transferred with a loss amongst the Group entities, this event is considered by management as an impairment indicator for that asset.

Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by NOVATEK. Minority interest forms a separate component of the Group's equity.

Acquisition of minority interests. For accounting of acquisitions of non-controlling minority stakes, the difference between the purchase consideration and the carrying amount of minority interests acquired is recognized within retained earnings.

Investments in associates. Associated companies are entities over which the Group has significant influence, but which it does not control. Generally, significant influence exists when the Group has between 20 and 50 percent of voting rights. On acquisition of the associated company the difference between the cost of an acquisition and the share of the fair value of the associate's identifiable net assets represents goodwill. Associated companies are accounted for using the equity method and are initially recognized at cost. After the date of acquisition the carrying amount of the investment is increased or decreased to recognize the Group's share of the profit or loss of the investee. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the post-acquisition profits or losses of associates is recorded in the consolidated statement of income, and its share of post-acquisition movements in reserves is recognized in the consolidated statement of changes in equity. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in other non-current assets and is tested annually for impairment and carried at cost less accumulated impairment losses, if any. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill on an acquisition of an associate is included in the investments in associates and is tested for impairment as part of the overall investment balance.

Goodwill is allocated to the cash-generating units, or Groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or Group of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

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

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

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

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components that extend the life of property, plant and equipment items are capitalized and depreciated over their estimated useful life.

The cost of self-constructed assets includes the cost of direct materials, direct employee related costs, a pro-rata portion of depreciation of assets used for construction and an allocation of the Group's overhead costs.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

At each reporting date management assess whether there is any indication of impairment in respect of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in the consolidated statement of income. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. Gains and losses are recognized in the consolidated statement of income.

Exploration costs. Exploration costs (geological and geophysical expenditures, expenditures associated with the maintenance of non-proven reserves and other expenditures relating to exploration activity), excluding exploratory drilling expenditures and license acquisition costs, are charged to the consolidated statement of income as incurred. License acquisition costs and exploratory drilling costs are recognized as assets until it is determined whether proved reserves justifying their commercial development have been found. If no proved reserves are found, the capitalized drilling costs are charged to the consolidated statement of income. License acquisition costs and exploratory drilling costs recognized as assets are reviewed for impairment on an annual basis.

Depreciation. Depreciation, depletion and amortization of oil and gas properties and equipment (except for processing facilities) is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for costs associated with acquisitions of proved properties. Reserve amounts used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the current license expiry dates.

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

The estimated useful lives of the Group's property, plant and equipment, other than oil and gas properties and equipment, are as follows:

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

Derivative instruments. The Group accounts for derivative instruments in accordance with IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). All derivative instruments are recorded in the balance sheet at their fair values. Under IAS 39, in order to consider these derivative instruments as hedges for accounting purposes, management must formally designate the derivative instrument as a hedge of variability in future cash flows or fair values, normally arising from the Group's exposure to foreign currency exchange rates and oil price fluctuations. Changes in the market values of the derivative instruments treated as cash flow hedges, to the extent that they are effective hedges, are not recognized in income until the hedged item affects income. If the above designation and effectiveness criteria are not met, any unrealized gains and losses on derivative instruments are recorded immediately in the consolidated statement of income.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Adoption of IFRS 7. Effective 1 January 2007, the Group adopted IFRS 7, *Financial Instruments: Disclosures* ("IFRS 7"). IFRS 7 introduced new disclosures to improve the information about financial instruments with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaced IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and some of the requirements in IAS 32, *Financial Instruments: Disclosure and Presentation*. In addition, the Amendments to IAS 1, *Presentation of Financial Statement,* introduced new disclosures about the level of an entity's capital and how it manages capital.

Effective interest method. The effective interest method is a method of calculating the carrying value of a financial asset or a financial liability held at amortized costs and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts future cash payments and receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying value of the financial asset or financial liability.

Financial assets. The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, held-to-maturity, loans and receivables, and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition. Subsequent reclassification of financial assets is made only as a result of a change in intention or ability of management to hold the financial assets. Financial assets are recognized initially at fair value, normally being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs. The subsequent measurement of financial assets depends on their classification.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivative instruments are also categorized as held for trading unless they are designated as hedges. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the consolidated statement of income. Gains or losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are presented in the consolidated statement of income within other income (loss) in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the consolidated statement of income as part of other income when the Group's right to receive payments is established.

Financial assets at fair value through profit or loss are classified as current assets. There were no financial assets designated at fair value through profit or loss held by the Group at the reporting dates.

(b) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and are classified as held-to-maturity when the Group has the positive intention and ability to hold these investments to maturity. After initial measurement held-to-maturity investments are measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the investments are derecognized or impaired, as well as through the amortization process.

Held-to-maturity investments are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. There were no such investments held by the Group at the reporting dates.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Financial assets classified as loans and receivables are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets.

(d) Available-for-sale financial assets

Financial assets classified as available-for-sale are non-derivatives financial assets that are either specially designated in this category or are not classified in any of the other categories. After initial recognition, financial assets classified as available-for-sale are measured at fair value, with gains and loses recognized directly in the consolidated statement of changes in equity until the investment is derecognized or determined to be impaired, at which time the cumulative gain or loss previously recorded in equity is recognized in profit or loss.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale financial assets are analyzed between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognized in profit or loss, while translation differences on non-monetary securities are recognized in equity. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the consolidated statement of income as profit or loss on sales of available-for-sale investments.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss) is removed from equity and recognized in the consolidated statement of income. Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed. There was no available-for-sale investments held by the Group at the reporting dates.

Financial liabilities. Financial liabilities are classified at initial recognition as either financial liabilities at fair value through profit or loss, derivative instruments designated as hedging instruments in an effective hedge or as financial liabilities measured at amortized cost. The measurement of financial liabilities depends on their classification, as follows:

(a) Financial liabilities at fair value through profit or loss

Derivative instruments, other than those designated as effective hedging instruments, are classified as held for trading and are included in this category. These financial liabilities are carried on the balance sheet at fair value with gains or losses recognized in the consolidated statement of income. There were no financial liabilities designated at fair value through profit or loss held by the Group at the reporting dates.

(b) Financial liabilities measured at amortized cost

All other financial liabilities are included in this category and initially recognized at fair value. For interest-bearing debt, the fair value of the liability is the fair value of the proceeds received net of associated issue costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method. This category of financial liabilities includes trade and other payables and debt.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with Russian legislation enacted or substantively enacted as of end of the reporting period. The income tax charge or benefit comprises current tax and deferred tax and is recognized in the consolidated statement of income unless it relates to transactions that are recognized, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the tax authorities in respect of taxable profits or losses for the current and prior periods.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or when the tax loss carry forwards will be utilized. Deferred tax assets and liabilities are netted only with respect to individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilized. The realization if deferred tax assets are assessed based on several interrelated factors. These factors include the Group's expectation to generate sufficient future taxable income and the projected time period over which these deferred tax assets will be realized.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Inventories. Natural gas, gas condensate, crude oil and related products inventories are valued at the lower of cost or net realizable value. The cost of inventories includes applicable purchase costs of raw materials, direct operating costs, and related production overhead expenses and is recorded on a first-in-first-out (FIFO) basis. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Starting from 1 January 2007, the Group changed its accounting policy for accounting of inventories cost from the weighted average method to FIFO. The cumulative effect of the retrospective application of the new policy was not material. Management believes that the new inventory methodology is more precise in transferring costs of inventory purchases to the consolidated statement of income and more fairly presents the reported inventory balances in the consolidated balance sheet of the Group.

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

Trade and other receivables. Trade receivables are represented by amounts due from regular customers in the ordinary course of business (production and marketing of natural gas, gas condensate, crude oil and related products; production and marketing of polymer and insulation tape products). Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method and include value-added taxes. Trade receivables are analyzed for impairment on a debtor by debtor basis. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognized in the consolidated statement of income within operating expenses. Subsequent recoveries of amounts previously written off are credited against amount of the provision in the consolidated statement of income.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents. Cash and cash equivalents comprises cash on hand, cash deposits held with banks, investments which are readily convertible to known amounts of cash and which are not subject to significant risk of change in value and have an original maturity of three months or less. For purposes of the presentation of the statement of cash flows, bank overdrafts are deducted from cash and cash equivalents.

Treasury shares. Repurchased shares of NOVATEK are classified as treasury shares and are presented in the consolidated balance sheet as a deduction from total equity. Treasury shares are recorded at weighted average cost, gains or losses resulting from subsequent sales of shares are recorded in the consolidated statement of changes in equity, net of associated costs including taxation. There were no treasury shares held by the Group at the reporting dates.

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

Value added tax (VAT). Output VAT related to sales is payable to the tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT related to purchases is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which is not settled or recovered at the balance sheet date (VAT payable and VAT recoverable) is recognized on a gross basis and disclosed separately as current asset and current liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

Borrowings. Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statement of income over the period of the borrowings using the effective interest method.

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

Trade and other payables. Trade payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Provisions for liabilities and charges. Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be low.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Provisions are reassessed at each reporting date and changes in the provisions resulting from the passage of time are recognized in the consolidated statement of income as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Foreign currency transactions. Transactions denominated in foreign currencies are converted into the functional currency of each entity of the Group at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency remeasurement into the functional currencies are included in the determination of profit for the reporting period.

Monetary assets and liabilities denominated in foreign currencies are converted into the functional currency of each entity of the Group by applying the year end exchange rate and the effect is stated in the consolidated statement of income. Non-monetary assets and liabilities denominated in foreign currencies valued at cost are converted into the functional currency of each entity of the Group at the initial exchange rate. Non-monetary assets that are remeasured to fair value, recoverable amount or realizable value, are translated at the exchange rate applicable to the date of remeasurement.

Revenue recognition. Revenues represent the amounts receivable for goods and services provided in the normal course of business, net of discounts, value-added tax and export duties.

Revenues from oil and gas sales and sales of polymer and insulation tape are recognized when such products are shipped or delivered to customers in accordance to the contract terms and the title has transferred. Services are recognized in the period in which the services are rendered.

Interest income is recognized as the interest accrues as related to the net carrying amount of the financial asset.

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

Employee benefits. Wages and salaries, bonuses, voluntary medical insurance, paid annual and sick leaves are accrued in the period in which the associated services are rendered by the employees of the Group. Compensation at dismissals, vocational support payments, and other allowances are expensed when incurred.

The Group contributes to the Russian Federation State social insurance fund and State pension plan on behalf of its employees. Mandatory contributions to the State social insurance fund and the State pension plan, which is a defined contribution plan, are expensed when incurred and are included in payroll expenses.

The Group also incurs employee costs related to the provision of benefits such as health and social infrastructure and services, employees meals, transportation, and other services. These amounts principally represent an implicit cost of employing production workers and, accordingly, are charged to payroll expenses in the consolidated statement of income.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Share based compensation. The Group accounts for share-based compensation in accordance with IFRS 2, *Share-based Payment* ("IFRS 2"). The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted measured at the grant date. For share-based compensation made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

Pension obligations. The Group operates a non-contributory post-employment defined benefit plan based on employees' years of service and average salary (Note 12).

The liability recognized in the consolidated balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligations at the balance sheet date, together with adjustments for unrecognized past service costs. The present value of the pension obligations are determined by discounting the estimated future cash outflows. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The discount rate was determined by reference to Russian rouble denominated bonds issued by the Government of the Russian Federation chosen to match the duration of the post-employment benefit obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recorded to the consolidated statement of income in the period in which they arise. Past-service costs are amortized on a straight-line basis over the vesting period.

Earnings per share. Earnings per share are determined by dividing the profit or loss attributable to shareholders of NOVATEK by the weighted average number of shares outstanding during the reporting period.

Segment reporting. A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenues earned from sales to external customers and whose revenues, results or assets are ten percent or more of all the segments are reported separately.

The Group's primary format for reporting segment information is business segments and the secondary format is geographical segments. The risks and returns of the Group's operations are primarily determined by the nature of the different activities that the Group engages in, rather than the geographical location of these operations. This is reflected by the Group's organizational structure.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Consolidated financial statements prepared in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period.

Management reviews these estimates and assumptions on a continuous basis, by reference to past experiences and other factors considered as reasonable which form the basis for assessing the book values of assets and liabilities. Adjustments to accounting estimates are recognized in the period in which the estimate is revised if the change affects only that period or in the period of the revision and subsequent periods, if both periods are affected. Management also makes certain judgments, apart from those involving estimations, in the process of applying the Group's accounting policies. Actual results may differ from such estimates if different assumptions or circumstances apply; however, management considers that the effect of any changes in these estimates would not be significant.

Judgments and estimates that have the most significant effect on the amounts reported in these consolidated financial statements and within the next financial year are described below.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

Useful lives of property, plant and equipment. Management assesses the useful life of an asset by considering the expected usage, estimated technical obsolescence, residual value, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future depreciation rates and expenses for the period.

Fair values of financial assets and liabilities. The fair value of financial assets and liabilities, other than financial instruments that are traded in an active market, is determined by applying various valuation methodologies. Management uses its judgment to make assumptions based on market conditions existing at each balance sheet date. Discounted cash flow analysis is used for various loans and receivables as well as debt instruments that are not traded in active markets. The effective interest rate is determined by reference to the interest rates of instruments available to the Group in active markets. In the absence of such instruments, the effective interest rate is determined by reference to the interest rates of active market instruments available adjusted for the Group's specific risk premium estimated by management.

Deferred income tax asset recognition. Management assesses deferred income tax assets at each balance sheet date and determines the amount recorded to the extent that realization of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments and applies estimation based on prior years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

Estimation of oil and gas reserves. Engineering estimates of oil and gas reserves are inherently uncertain and are subject to future revisions, The Group estimates its oil and gas reserves in accordance with guidelines promulgated by the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) for proved reserves. Accordingly, accounting measures such as depreciation, depletion and amortization charges and asset retirement obligations that are based on the estimates of proved reserves are also subject to change.

Proved reserves are estimated by reference to available reservoir and well information, including production and pressure trends for producing reservoirs. Furthermore, estimates of proved reserves only include volumes for which access to market is assured with reasonable certainty. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are substantially developed and depleted. As those fields are further developed, new information may lead to further revisions in reserve estimates.

Oil and gas reserves have a direct impact on certain amounts reported in the consolidated financial statements, most notably depreciation, depletion and amortization as well as impairment expenses. Depreciation rates on oil and gas assets using the units-of-production method for each field are based on proved developed reserves for development costs, and total proved reserves for costs associated with the acquisition of proved properties. Assuming all variables are held constant, an increase in proved developed reserves for each field decreases depreciation, depletion and amortization expenses. Conversely, a decrease in the estimated proved developed reserves increases depreciation, depletion and amortization expenses. Moreover, estimated proved reserves are used to calculate future cash flows from oil and gas properties, which serve as an indicator in determining whether or not property impairment is present.

Although the possibility exists for changes or revisions in estimated reserves to have a critical effect on depreciation, depletion and amortization charges and, therefore, reported net profit for the year, it is expected that in the normal course of business the diversity of the Group's asset portfolio will mitigate the likelihood of this occurring.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

Impairment of non-financial assets. Management assesses whether there are any indicators of possible impairment of all non-financial assets at each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Such indicators include changes in the Group's business plans, changes in commodity prices leading to unprofitable performances, changes in product mixes, and for oil and gas properties, significant downward revisions of estimated proved reserves. Goodwill and other indefinite life intangibles are tested for impairment annually and at other times when impairment indicators exist. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

Impairment provision for trade receivables. The impairment provision for trade receivables is based on management's assessment of the probability of collection of individual customer accounts receivable. Significant financial difficulties of the customer, probability that the customer will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

When there is no expectation of recovering additional cash for an amount receivable, amount receivable is written off against associated provision.

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

Pension obligations. The cost of defined benefit pension plans and related current service costs are determined using actuarial valuations. The actuarial valuations involve making demographic assumptions (mortality rates, age of retirement, employee turnover and disability) as well as financial assumptions (discount rates, expected rates of return on assets, inflation forecasts, future salary and pension increases). Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

Asset retirement obligations. Management makes provision for the future costs of decommissioning oil and gas production facilities, pipelines and related support equipment based on the best estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future. Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The Group also assesses it liabilities for site restoration at each balance sheet period in accordance with the guidelines of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the balance sheet date based on current legislation where the Group's respective operating assets are located, and is also subject to change because of modifications, revisions and changes in laws and regulations and their interpretation thereof. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of incurring such costs.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

Taxes. Management reduces deferred tax assets to the amount that is more likely than not to be realized. In the event that management determines that it would be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to the deferred tax asset valuation allowance would increase income in the period such determination was made. Likewise, should management determine that it would not be able to realize all or part of Group's deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made. Currently, management expects to generate future taxable income to realize the benefits of the Group's net deferred tax assets.

5 ACQUISITIONS AND DISPOSAL

In July 2007, the Group acquired 25 percent participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas. These entities hold exploration licenses for the Sredniy Chaselskiy, Severo Russkiy, Yuzhno-Zapolyarniy, Zapadno-Tazovskiy, and Anomalniy license areas which expire in 2010 and 2011 and the Severo-Yamsoveskiy license area, which expires in 2009. The cost of these participation interests was RR 1,125 million, of which RR 108 million were payable at 31 December 2007. The Group has an option to purchase an additional 25 percent participation interests in the aforementioned companies after they are granted production licenses and if the license areas are deemed economically viable. Purchase prices for these entities approximate their fair value. The financial and operational activities of the acquirees were not material to the Group's assets, liabilities, revenues and results of operations as at and for the year ended 31 December 2007.

In September 2007, the Group acquired a 50 percent working interest in the Concession Agreement for Gas and Crude Oil Exploration and Exploitation in El Arish Offshore Area (hereinafter referred to as the "Concession Agreement") in the Arab Republic of Egypt. The remaining working interest is held by Tharwa Petroleum S.A.E. Pursuant to the Concession Agreement the Group is committed to spend a minimum of USD 40 million on exploration operations during the initial exploration period of four years.

In November 2007, the Group disposed of its non-core subsidiary, OAO "Geolog Yamala", to third parties for RR 175 million payable in three equal annual installments, recognizing a gain on sale of RR 85 million, net of associated income tax of RR 10 million. The Group included balances and results of the operations of the disposed subsidiary within "other" in the Group's segment information.

6 PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment, for the years ended 31 December 2007 and 2006 are as follows:

	Oil and gas properties and equipment	Assets under construction	Other	Total
Cost	62,341	4,174	3,482	69,997
Accumulated depreciation, depletion and amortization	(4,065)	-	(257)	(4,322)
Net book value at 1 January 2006	**58,276**	**4,174**	**3,225**	**65,675**
Acquisition of subsidiaries	741	-	-	741
Additions	469	4,227	7	4,703
Transfers	3,280	(3,711)	431	-
Depreciation, depletion and amortization	(3,490)	-	(238)	(3,728)
Disposals, net	(250)	(173)	(234)	(657)
Cost	66,555	4,517	3,643	74,715
Accumulated depreciation, depletion and amortization	(7,529)	-	(452)	(7,981)
Net book value at 31 December 2006	**59,026**	**4,517**	**3,191**	**66,734**
Acquisition of subsidiaries	-	-	254	254
Additions	2,136	17,324	6	19,466
Transfers	2,716	(2,999)	283	-
Depreciation, depletion and amortization	(3,478)	-	(260)	(3,738)
Disposal of subsidiaries, net	-	-	(18)	(18)
Disposals, net	(2)	1	(28)	(29)
Cost	71,404	18,843	4,097	94,344
Accumulated depreciation, depletion and amortization	(11,006)	-	(669)	(11,675)
Net book value at 31 December 2007	**60,398**	**18,843**	**3,428**	**82,669**

Included within the oil and gas properties and equipment balance at 31 December 2007 and 2006 are proved properties of RR 28,222 million and RR 28,168 million, net of accumulated depreciation, depletion and amortization of RR 4,908 million and RR 3,225 million, respectively.

Included within general and administrative expenses are RR 66 million and RR 57 million of depreciation of administrative buildings for the years ended 31 December 2007 and 2006, respectively (see Note 20).

Included in additions to property, plant and equipment for the years ending 31 December 2007 and 2006 is capitalized interest of RR 139 million and RR 287 million, respectively. The interest capitalization rates for 2007 and 2006 used for additions were 6.0 percent and 6.2 percent, respectively.

Asset retirement obligations. Estimated costs of dismantling oil and gas production facilities, pipelines and related processing facilities, including abandonment and site restoration costs, amounting to RR 618 million and RR 424 million at 31 December 2007 and 2006, respectively, are included in the cost of oil and gas properties and equipment. The Group has estimated its liability based on current legislation using estimated costs and timing of when the expenses are expected to be incurred between the end of the reporting period and 2051. Governmental authorities are continually reviewing regulations and their enforcement. Consequently, the Group's ultimate liabilities may differ from the recorded amounts.

7 INVENTORIES

	At 31 December:	
	2007	2006
Materials and supplies at net realizable value (net of provisions of RR 45 million and RR 46 million at 31 December 2007 and 2006, respectively)	280	332
Materials and supplies at cost	438	432
Natural gas and hydrocarbon liquids	799	814
Polymer and insulation tape products (net of provisions of RR 10 million and RR 33 million at 31 December 2007 and 2006, respectively)	177	147
Other inventories	100	90
Total inventories	**1,794**	**1,815**

The Group recorded an expense of RR 101 million and RR 64 million during the years ended 31 December 2007 and 2006, respectively, to write-down the carrying value of inventory due to obsolescence.

8 TRADE AND OTHER RECEIVABLES

	At 31 December:	
	2007	2006
Trade receivables (net of provision of RR 8 million and RR 16 million at 31 December 2007 and 2006, respectively)	2,947	1,843
Interest on loans receivable	3	26
Other receivables (net of provision of RR 47 million and RR 59 million at 31 December 2007 and 2006, respectively)	317	344
Total trade and other receivables	**3,267**	**2,213**

The carrying values of trade and other receivables approximate their fair value. The maximum exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above. The Group does not hold any collateral as security for trade and other receivables (see Note 22 for credit risk disclosures).

Trade and other receivables that are less than three months past due are generally not considered for impairment unless other indicators of impairment exist. Trade and other receivables of RR 81 million and RR 69 million at 31 December 2007 and 2006, respectively were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these past due but not impaired trade and other receivables are as follows:

	At 31 December:	
	2007	2006
Up to 90 days past-due	19	15
91 to 360 days past-due	55	39
Over 360 days past-due	7	15
Total past due but not impaired	**81**	**69**

8 TRADE AND OTHER RECEIVABLES (CONTINUED)

Movements on the Group provision for impairment of trade and other receivables are as follows:

	Year ended 31 December:	
	2007	2006
At 1 January	**75**	**121**
Additional provision recorded	23	33
Receivables written off as uncollectible	(43)	(70)
Provision amount reversed into income	-	(9)
At 31 December	**55**	**75**

The provision for impaired receivables has been included in the consolidated statement of income in net impairment expense.

9 PREPAYMENTS AND OTHER CURRENT ASSETS

	At 31 December:	
	2007	2006
Financial assets		
Short-term loans receivables	36	20
Short-term bank deposits	-	50
Non-financial assets		
Recoverable value-added tax	2,668	664
Prepayments and advances to suppliers (net of provision of RR 4 million and RR 11 million at 31 December 2007 and 2006, respectively)	2,413	1,143
Deferred export duties for stable gas condensate	1,069	924
Prepaid taxes other than income tax	974	777
Deferred transportation expense for stable gas condensate	334	306
Deferred transportation expense for natural gas	55	874
Other current assets	111	93
Total prepayments and other current assets	**7,660**	**4,851**

10 CASH AND CASH EQUIVALENTS

	At 31 December:	
	2007	2006
Cash at current bank accounts	1,787	1,522
Russian rouble denominated deposits (average interest rate 3% p.a. and 4% p.a. for 2007 and 2006, respectively)	2,195	3,757
US dollar denominated deposits (average interest rate 5% p.a. for 2006)	-	389
Total cash and cash equivalents	**3,982**	**5,668**

All deposits have original maturities of less than three months (see Note 22 for credit risk disclosures).

Cash, cash equivalents and bank overdrafts include the following for the purposes of the cash flow statement:

	At 31 December:	
	2007	2006
Cash and cash equivalents per the consolidated balance sheet	3,982	5,668
Less: bank overdrafts (Note 13)	(1,368)	-
Cash, cash equivalents and bank overdrafts per the consolidated statement of cash flows	**2,614**	**5,668**

11 LONG-TERM DEBT

	At 31 December:	
	2007	2006
US dollar denominated loans	54	2,153
Euro denominated loans	270	507
Total	324	2,660
Less: current portion of long-term debt	(282)	(2,117)
Total long-term debt	**42**	**543**

At 31 December 2007 and 2006, the Group's long-term debt by facility is as follows:

	At 31 December:	
	2007	2006
BNP PARIBAS Bank	-	1,975
Other loans	324	685
Total	324	2,660
Less: current portion of long-term debt	(282)	(2,117)
Total long-term debt	**42**	**543**

11 LONG-TERM DEBT (CONTINUED)

Other loans. At 31 December 2007 and 2006, other loans included US dollar denominated loans totaling RR 54 million (USD 2.2 million) and RR 178 million (USD 6.8 million), respectively, with a weighted average interest rate of 10.8 percent and 10.3 percent, respectively. These loans mature between 2008 and 2009. At 31 December 2007 and 2006, other loans also included Euro denominated loans totaling RR 270 million (Euro 7.5 million) and RR 507 million (Euro 14.6 million), respectively, with a weighted average effective interest rate of 13.6 percent and 13.5 percent, respectively. These loans mature between 2008 and 2009.

The carrying values of long-term debt approximate their fair value.

12 PENSION OBLIGATIONS

In February 2007, the Group announced the implementation of a post-employment benefit program. Under the pension program, employees who are employed by the Group for more than three years and retire from the Group on or after the statutory retirement age will receive monthly payments from NOVATEK for life unless they are actively employed. The amount of payments to be disbursed depends on the average salary, duration and location of employment. The program is effective from 1 January 2007 and applies to employees who retire after that date.

The program represents an unfunded defined benefit plan and is accounted for as such under provisions of IAS 19, *Employee Benefits*. The impact of the program on the consolidated financial statements is disclosed below.

The amounts recognized in the consolidated balance sheet and included in other non-current liabilities are determined as follows:

	At 31 December 2007
Present value of the defined benefit obligations	492
Unrecognized past service cost	(276)
Defined benefit plan liability recognized in the consolidated balance sheet	**216**

The movements in the present value of the defined benefit obligations are as follows:

	Year ended 31 December 2007
At 1 January	**-**
Past service cost	293
Interest cost	18
Current service cost	60
Actuarial loss	121
At 31 December	**492**

12 PENSION OBLIGATIONS (CONTINUED)

The amounts recognized in the consolidated statement of income are as follows:

	Year ended 31 December 2007
Current service cost	60
Interest cost	18
Actuarial loss	121
Amortization of past service cost	17
Defined benefit plan costs recognized in operating expenses	**216**
of which the following amounts were included as employee compensation in:	
Materials, services and other	106
General and administrative expenses	110

As a result of experience adjustments on plan liabilities the Group recognized a loss of RR 77 million included in actuarial loss.

The principal actuarial assumptions used at 31 December 2007 are as follows:

Weighted average discount rate	6.4%
Projected annual increase in employee compensation	10%
Expected increases to pension benefits occurring every third year	10%

The assumed average salary and pension payment increases for Group employees have been calculated on the basis of inflation forecasts, analysis of increases of past salaries and the general salary policy of the Group. It is assumed that the thresholds for the minimum and maximum amount of monthly pension payments would increase by 10 percent every third year.

Mortality assumptions are based on the Russian mortality tables published by the State Statistics Committee from the years 1986 to 1987, which management believes are the most conservative and prudent Russian whole-population mortality tables available.

Management has assessed that reasonable changes in the most significant actuarial assumptions will not have a significant impact on the consolidated statement of income or the liability recognized in the consolidated balance sheet.

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

	At 31 December:	
	2007	2006
US dollar denominated loans	4,910	448
US dollar denominated bank overdrafts	1,368	-
Total	6,278	448
Add: current portion of long-term debt	282	2,117
Total short-term debt and current portion of long-term debt	**6,560**	**2,565**

US dollar denominated loans. At 31 December 2007, the US dollar denominated loans included a loan from BNP PARIBAS Bank in the amount RR 2,455 million (USD 100 million) with annual interest of LIBOR plus 0.75 percent (5.8 percent at 31 December 2007). The loan is repayable in September 2008.

13 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT (CONTINUED)

At 31 December 2007, the US dollar denominated loans included loans from CALYON S.A. and CALYON RUSBANK Corporate and Investment Bank in the total amount RR 2,455 million (USD 100 million) with annual interest of LIBOR plus 0.85 percent (5.9 percent at 31 December 2007). The loans are repayable in May 2008.

The carrying values of the loans approximate their fair value.

Available credit facilities and bank overdrafts. At 31 December 2007 and 2006, the Group used RR 1,368 million and nil of its credit facilities as bank overdrafts, respectively. Available funds under these short-term credit lines with various international banks were in total RR 4,148 million (USD 169 million) and RR 6,135 million (USD 233 million) at 31 December 2007 and 2006, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

In November 2007, the Group obtained a two year credit line facility with International Moscow Bank (from December 2007 – "UniCredit Bank") up to the maximum amount of RR 2,455 million (USD 100 million) with interest rates negotiated on each withdrawal dates.

14 TRADE PAYABLES AND ACCRUED LIABILITIES

	At 31 December:	
	2007	**2006**
Financial liabilities		
Trade payables	1,327	677
Other payables	375	40
Interest payable	9	7
Non-financial liabilities		
Advances from customers	1,535	961
Salary payables	352	115
Other payables	1	1
Trade payables and accrued liabilities	**3,599**	**1,801**

15 SHAREHOLDERS' EQUITY

Ordinary share capital. Share capital issued and paid-in consisted of 3,036,306,000 ordinary shares at 31 December 2007 and 2006 with a par value of RR 0.1 each. The total authorized number of ordinary shares was 10,593,682,000 shares at both dates.

15 SHAREHOLDERS' EQUITY (CONTINUED)

Dividends. Dividends declared and paid are as follows:

	Year ended 31 December:	
	2007	**2006**
Dividends payable at 1 January	1	33
Total dividends declared	5,860	3,258
Dividends paid	(5,860)	(3,290)
Dividends payable at 31 December	**1**	**1**
Dividends per share declared during the year (in Russian roubles)	1.93	1.07
Dividends per GDR declared during the year (in Russian roubles)	19.3	10.7

The Group declares and pays dividends in Russian roubles. Dividends declared in 2007 and 2006 were as follows:

Final for 2006: RR 1.10 per share or RR 11.0 per GDR declared in May 2007	3,340
Interim for 2007: RR 0.83 per share or RR 8.30 per GDR declared in October 2007	2,520
Total dividends declared in 2007	**5,860**
Final for 2005: RR 0.52 per share or RR 5.20 per GDR declared in June 2006	1,588
Interim for 2006: RR 0.55 per share or RR 5.50 per GDR declared in September 2006	1,670
Total dividends declared in 2006	**3,258**

Share-based compensation. In 2005, certain shareholders provided share-based compensation to key members of the Group's management team. The fair value of the awards of RR 879 million is being recognized as compensation expense evenly over their five year vesting period beginning the second quarter of 2005. A corresponding increase is recorded to additional paid in capital as expense is recognized to reflect the shareholders contribution in providing the award. The fair value of the awards was determined by reference to the fair value of the limited liability company's net assets estimated by its owners.

Distributable retained earnings. In accordance with Russian legislation, NOVATEK distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. Russian legislation identifies the net profit as basis of distribution. For 2007, net statutory profit of NOVATEK as reported in the published annual statutory reporting forms was RR 16,242 million (2006: RR 12,946 million) and the closing balance of the accumulated profit including the current year net statutory profit totalled RR 41,213 million (2006: RR 30,830 million).

16 OIL AND GAS SALES

	Year ended 31 December:	
	2007	**2006**
Natural gas	35,605	28,048
Stable gas condensate	17,106	13,768
Liquefied petroleum gas	4,926	3,804
Crude oil	1,753	1,928
Oil products	967	499
Total oil and gas sales	**60,357**	**48,047**

17 TRANSPORTATION EXPENSES

	Year ended 31 December:	
	2007	2006
Natural gas transportation to customers	9,077	6,934
Stable gas condensate and liquefied petroleum gas transportation by rail	3,376	2,753
Stable gas condensate transportation by tankers	1,690	1,484
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	115	78
Crude oil transportation to customers	78	93
Insurance expense	7	8
Other	29	12
Total transportation expenses	**14,372**	**11,362**

18 TAXES OTHER THAN INCOME TAX

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

	Year ended 31 December:	
	2007	2006
Unified natural resources production tax	5,703	5,556
Property tax	544	483
Excise tax	36	80
Other taxes	96	104
Total taxes other than income tax	**6,379**	**6,223**

In 2007 and 2006, the unified natural resources production tax for natural gas production was fixed at a rate of RR 147 per thousand cubic meters.

The unified natural resources production tax rate for gas condensate is set at 17.5 percent of gas condensate revenues recognized by the producing entities.

Under the Tax Code of the Russian Federation, the tax rate for the unified natural resources production tax for crude oil is calculated by reference to an average price for Urals oil mix and an average exchange rate over the relevant tax period. Beginning 1 January 2005, the base rate was set at RR 419 per metric ton of crude oil.

19 MATERIALS, SERVICES AND OTHER

	Year ended 31 December:	
	2007	2006
Employee compensation	1,897	1,351
Materials and supplies	1,521	1,219
Repair and maintenance services	367	333
Fire safety and security expense	263	254
Tolling and processing fees	213	226
Electricity and fuel	216	192
Other	447	318
Total materials, services and other	**4,924**	**3,893**

20 GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended 31 December:	
	2007	2006
Employee compensation	1,961	1,476
Maintenance of social infrastructure and charitable contributions	559	491
Legal, audit, and consulting services	404	256
Business trips expense	199	166
Rent expense	146	123
Insurance expense	117	225
Depreciation - administrative buildings	66	57
Other	421	371
Total general and administrative expenses	**3,873**	**3,165**

Auditors' fees and services. ZAO PricewaterhouseCoopers Audit has served as the Group's independent external auditors for each of the financial years. The independent external auditors are subject to re-appointment at the Annual General Meeting of shareholders based on the recommendations from the Board of Directors. The following table presents the aggregate fees for professional services and other services rendered by ZAO PricewaterhouseCoopers Audit to the Group included within legal, audit, and consulting services:

	Year ended 31 December:	
	2007	2006
Audit services fee (audit of the Group's consolidated financial statements and the statutory audit of the parent company)	28	28
Non-audit services (tax services and other)	3	1
Total auditors' fees and services	**31**	**29**

21 INCOME TAX

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

	Year ended 31 December:	
	2007	2006
Profit before income tax	25,489	19,122
Theoretical income tax expense at statutory rate of 24 percent	6,117	4,589
Increase (decrease) due to:		
Non-deductible expenses	364	403
Foreign entities' taxation at lower income tax rate	(107)	(65)
Withholding tax on dividends distributed between parent and subsidiaries	193	-
Other non-temporary differences	194	188
Total income tax expense	**6,761**	**5,115**

Effective income tax rate. The Group's Russian statutory income tax rate in 2007 and 2006 was 24.0 percent. For the years ended 31 December 2007 and 2006, the Group's effective income tax rate was 26.5 percent and 26.7 percent, respectively.

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

21 INCOME TAX (CONTINUED)

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

	At 31 December:	
	2007	2006
Long-term deferred income tax asset (other non-current assets)	532	321
Long-term deferred income tax liability	(8,083)	(8,412)
Net deferred income tax liability	**(7,551)**	**(8,091)**

Deferred income tax assets expected to be realized within twelve months of 31 December 2007 and 2006 were RR 608 million and RR 387 million, respectively. Deferred tax liabilities expected to be reversed within twelve months of 31 December 2007 and 2006 were RR 348 million and RR 376 million, respectively.

Movements in deferred income tax assets and liabilities during the years ended 31 December 2007 and 2006 are as follows:

	At 31 December 2007	Statement of Income effect	At 31 December 2006	Statement of Income effect	Acquisitions	At 31 December 2005
Liabilities						
Property, plant and equipment	(8,720)	226	(8,946)	496	(180)	(9,262)
Inventories	(43)	(3)	(40)	(16)	-	(24)
Other current assets	(312)	17	(329)	(329)	-	-
Trade payables and accrued liabilities	(3)	13	(16)	(6)	-	(10)
Total deferred income tax liabilities	(9,078)	253	(9,331)	145	(180)	(9,296)

	At 31 December 2007	Statement of Income effect	At 31 December 2006	Statement of Income effect	Acquisitions	At 31 December 2005
Assets						
Inventories	561	170	391	205	33	153
Trade and other receivables	24	1	23	(13)	-	36
Trade payables and accrued liabilities	585	69	516	(84)	-	600
Tax losses carried forward	319	81	238	143	19	76
Other	38	(34)	72	16	-	56
Total deferred income tax assets	1,527	287	1,240	267	52	921
Net deferred income tax liabilities	**(7,551)**	**540**	**(8,091)**	**412**	**(128)**	**(8,375)**

At 31 December 2007, the Group had recognized deferred income tax assets of RR 319 million (31 December 2006: RR 238 million) in respect of unused tax loss carry forwards of RR 1,329 million (31 December 2006: RR 992 million). Tax losses can be carried forward for relief against taxable profits for 10 years after they are incurred, subject to certain limitations. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments including expectations regarding the Group's ability to generate sufficient future taxable income and the projected time period over which deferred tax benefits will be realized.

At 31 December 2007 and 2006, the Group had not recorded a deferred tax liability in respect of taxable temporary differences of RR 8,614 million and RR 7,577 million, respectively, associated with investments in subsidiaries as the Group is able to control the timing of the reversal of those temporary differences and does not intend to reverse them in the foreseeable future.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

The accounting policies for financial instruments have been applied to the line items below:

Financial assets	*Loans and receivables* At 31 December: 2007	2006
Non-current		
Loans receivable	412	102
Trade and other receivables	269	229
Letters of credit	175	-
Current		
Loans receivable	36	20
Trade and other receivables	3,267	2,213
Short-term bank deposits	-	50
Cash and cash equivalents	3,982	5,668
Total carrying amount	**8,141**	**8,282**

Financial liabilities	*Measured at amortized cost* At 31 December: 2007	2006
Non-current		
Long-term debt	42	543
Current		
Current portion of long-term debt	282	2,117
Short-term debt	6,278	448
Trade and other payables	1,711	724
Total carrying amount	**8,313**	**3,832**

Financial risk management objectives and policies. In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on the degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial results. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position.

The Group's principal risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to these limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

Market risk. Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures, while optimizing the return on risk.

The Group is exposed to market price movements relating to changes in commodity prices such as crude oil, gas condensate, liquefied petroleum products and natural gas (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities or expected future cash flows.

(a) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to the US dollar and the Euro. Foreign exchange risk arises primarily from future commercial transactions, recognized assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. Foreign currency derivative instruments may be utilized to manage the risk exposures associated with fluctuations on certain firm commitments for sales and purchases, debt instruments and other transactions that are denominated in currencies other than the Russian rouble, and certain non-Russian rouble assets and liabilities.

The carrying amounts of the Group's financial instruments are denominated in the following currencies:

At 31 December 2007	Russian rouble	US dollar	Euro	Other	Total
Financial assets					
Non-current					
Loans receivable	412	-	-	-	412
Trade and other receivables	269	-	-	-	269
Letters of credit	169	-	6	-	175
Current					
Loans receivable	36	-	-	-	36
Trade and other receivables	1,913	1,350	-	4	3,267
Cash and cash equivalents	3,763	189	7	23	3,982
Financial liabilities					
Non-current					
Long-term debt	-	(4)	(38)	-	(42)
Current					
Current portion of long-term debt	-	(50)	(232)	-	(282)
Short-term debt	-	(6,278)	-		(6,278)
Trade and other payables	(1,657)	(31)	(16)	(7)	(1,711)
Net exposure at 31 December 2007	**4,905**	**(4,824)**	**(273)**	**20**	**(172)**

At 31 December 2006	Russian rouble	US dollar	Euro	Other	Total
Financial assets					
Non-current					
Loans receivable	102	-	-	-	102
Trade and other receivables	229	-	-	-	229
Current					
Loans receivable	20	-	-	-	20
Short-term bank deposits	50	-	-	-	50
Trade and other receivables	1,272	932	-	9	2,213
Cash and cash equivalents	4,907	748	-	13	5,668
Financial liabilities					
Non-current					
Long-term debt	-	(275)	(268)	-	(543)
Current					
Current portion of long-term debt	-	(1,878)	(239)	-	(2,117)
Short-term debt	-	(448)	-	-	(448)
Trade and other payables	(635)	(34)	(47)	(8)	(724)
Net exposure at 31 December 2006	**5,945**	**(955)**	**(554)**	**14**	**4,450**

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

In accordance with IFRS requirements the Group has chosen to provide information about market risk and potential exposure to hypothetical loss from its use of financial instruments through sensitivity analysis disclosures.

The sensitivity analysis depicted in the table below reflects the hypothetical loss that would occur assuming a 10 percent change in exchange rates and no changes in the portfolio of instruments and other variables at 31 December 2007 and 2006, respectively.

		At 31 December:	
Effect on pre-tax profit	**Increase in exchange rate**	**2007**	**2006**
RUR / USD	10%	(482)	(95)
RUR / EUR	10%	(27)	(55)

The effect of a corresponding 10 percent decrease in exchange rate is approximately equal and opposite.

(b) Commodity price risk

The Group's overall commercial trading strategy in natural gas, stable gas condensate and crude oil and related products is centrally managed. Changes in commodity prices could negatively or positively affect the Group's results of operations. The Group manages the exposure to commodity price risk by optimizing its core activities to achieve stable price margins.

Natural gas. As an independent natural gas producer, the Group is not subject to the government's regulation of natural gas prices. Nevertheless, the Group's prices are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. 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 this program, the FTS approved an annual 25% increase in the regulated price effective 1 January 2008. Management believes it has limited downside commodity price risk for natural gas and does not use commodity derivative instruments for trading purposes. However, to effectively manage the margins achieved through its natural gas trading activities, management has established targets for volumes sold to wholesale traders, end-customers and the natural gas exchange.

Liquid hydrocarbons. The Group sells all its crude oil and related products and gas condensate under spot contracts. Gas condensate volumes sold to the US and European markets are based on benchmark reference crude oil prices of WTI and Brent dated, respectively, plus a margin or discount, depending on current market situation. Crude oil sold internationally are based on benchmark reference crude oil prices of Brent dated, plus a discount and on a transaction-by-transaction basis for volumes sold domestically. As a result, the Group's revenues from the sales of liquid hydrocarbons are subject to commodity price volatility based on fluctuations or changes in the crude oil benchmark reference prices. Presently, the Group does not use commodity derivative instruments for trading purposes to mitigate price volatility.

(c) Cash flow and fair value interest rate risk

The Group is subject to interest rate risk on financial liabilities with variable interest rates. To mitigate this risk, the Group's treasury function performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favorable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favorable over the expected period until maturity.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

	At 31 December:	
	2007	2006
At variable rate	6,278	448
At fixed rate	324	2,660
Total debt	**6,602**	**3,108**

The Group centralizes the cash requirements and surpluses of controlled subsidiaries and the majority of their external financing requirements, and applies, on its consolidated net debt position, a funding policy to optimize its financing costs and manage the impact of interest-rate changes on its financial results in line with market conditions. In this way, the Group is able to ensure that the balance between the floating rate portion of its debt and its cash surpluses has a low level of exposure to any change in interest rates over the short term. This policy makes it possible to significantly limit the Group's sensitivity to interest-rate volatility.

The Group's financial results are sensitive to changes in interest rates on the floating rate portion of the Group's debt portfolio. If the interest rates applicable to floating rate debt were to increase by 100 basis points at the reporting dates, assuming all other variables remain constant, it is estimated that the Group's profit before taxation for 2007 would decrease by the amounts shown below.

	At 31 December:	
Effect on pre-tax profit	2007	2006
Increase by 100 basis points	63	4

The effect of a corresponding 100 basis points decrease in exchange rate is approximately equal and opposite.

Credit risk. Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations.

Credit risk is managed on a Group level and arises from cash and cash equivalents, including short-term deposits with banks, as well as credit exposures to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to minimal risk of default.

The Group's trade and other receivables consist of a large number of customers, spread across diverse industries and geographical areas. Most of the Group's international liquid sales are made to customers with independent external ratings. All domestic sales of liquid hydrocarbons are made on a 100 percent prepayment basis. The Group also requires 100 percent prepayments from small customers for natural gas deliveries and partial advances from others. Although the Group does not require collateral in respect of trade and other receivables, it has developed standard credit payment terms and constantly monitors the status of trade receivables and the creditworthiness of the customers.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

The table below highlights the Group's trade and other receivables to published credit ratings of its counterparties.

	At 31 December:	
Moody's and/or Fitch	**2007**	**2006**
Investment grade rating	499	395
Non-investment grade rating	1,071	859
No external rating	1,697	959
Total trade and other receivables	**3,267**	**2,213**

The table below highlights the Group's cash balances to published credit ratings of its banks.

	At 31 December:	
Moody's and/or Fitch	**2007**	**2006**
Investment grade rating	2,528	4,036
Non-investment grade rating	1,303	1,418
No external rating	151	213
Total cash and cash equivalents	**3,982**	**5,668**

Liquidity risk. Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing its liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows and matches the maturity profiles of financial assets and liabilities.

The Group prepares various financial plans (monthly, quarterly and annually) which ensures that the Group has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. The Group has entered into a number of short-term credit facilities. Such credit lines and overdraft facilities can be drawn down to meet short-term financing needs. To fund cash requirements of a more permanent nature, the Group will normally raise long-term debt in available international and domestic markets.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

All of the Group's financial liabilities represent non-derivative financial instruments. The following tables summarize the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

At 31 December 2007	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
Principal	282	42	-	324
Interest	41	2	-	43
Debt at variable rate				
Principal	6,278	-	-	6,278
Interest	157	-	-	157
Trade and other payables	1,711	-	-	1,711
Total financial liabilities	**8,469**	**44**	**-**	**8,513**

At 31 December 2006	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
Principal	2,117	501	42	2,660
Interest	190	45	2	237
Debt at variable rate				
Principal	448	-	-	448
Interest	26	-	-	26
Trade and other payables	724	-	-	724
Total financial liabilities	**3,505**	**546**	**44**	**4,095**

Capital management. The primary objectives of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain investor, market and creditor confidence to support its business activities.

The Group presently has an investment grade credit rating of Baa3 (stable outlook) by Moody's Investor Services and is rated BB (positive) by Standard & Poors. To maintain its credit rating, the Group has established certain financial targets and coverage ratios that it monitors on a quarterly and annual basis.

The Group manages its liquidity on a corporate-wide basis to ensure adequate funding to sufficiently meet group operational requirements. All external debts are centralized at the Parent level, and all financing to Group entities is facilitated through inter-company loan arrangements.

The Group has a stated dividend policy that distributes at least 30% of its parent company non-consolidated statutory net profit determined according to Russian accounting standards. The dividend for a specific year is determined after taken into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the NOVATEK's shareholders.

There were no changes to the Group's approach to capital management during the year.

23 CONTINGENCIES AND COMMITMENTS

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

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

Commitments. At 31 December 2007, the Group had contractual capital expenditures commitments aggregating approximately RR 21,744 million (at 31 December 2006: RR 5,200 million) for phase two development of the Yurkharovskoye field (through 2009), development of the East-Tarkosalinskoye and Khancheyskoye fields (through 2008 and 2010, respectively) and for continuation of phase two construction of the Purovsky Gas Condensate Plant (through 2008).

Taxation. Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activities of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2007, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued.

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

The Group's oil and gas fields and license areas are situated on land located in the Yamal-Nenets Autonomous Region. Licenses are issued by the Federal Agency for the Use of Natural Resources under the Ministry of Natural Resources and the Group pays unified natural resources production tax to produce oil and gas from these fields and contributions for exploration of license areas. The principal licenses of the Group and their expiry dates are:

Field	License holder	License expiry date
Yurkharovskoye	OOO NOVATEK-YURKHAROVNEFTEGAS	2034
East-Tarkosalinskoye	OOO NOVATEK-TARKOSALENEFTEGAS	2043
Khancheyskoye	OOO NOVATEK-TARKOSALENEFTEGAS	2019
Sterkhovoye (within the Olympinsky license area)	OOO PurNovaGas	2026
Termokarstovoye	OOO Terneftegas	2021

Management believes the Group has the right to extend its licenses beyond the initial expiration date under the existing legislation and intends to exercise this right on all of its fields. In December 2007, the Group was successful in extending the license for the East-Tarkosalinskoye field from 2018 to 2043. The Group has plans to submit the appropriate application with the respective Agency for the Use of Natural Resources for the extension of the terms of the licenses for Khancheyskoye field.

23 CONTINGENCIES AND COMMITMENTS (CONTINUED)

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

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

24 SUBSIDIARIES AND ASSOCIATES

The most important subsidiaries and associates of the Group at 31 December 2007 and respective ownership in the ordinary share capital are set out below.

	Ownership interest at 31 December 2007	Country of incorporation	Principal activities
Subsidiaries			
OOO NOVATEK-YURKHAROVNEFTEGAS	100.0%	Russia	Exploration and production
OOO NOVATEK-TARKOSALENEFTEGAS	100.0%	Russia	Exploration and production
OOO Terneftegaz	100.0%	Russia	Exploration and production
OOO NOVATEK-PUROVSKY ZPK	100.0%	Russia	Gas Condensate Plant
OOO NOVATEK-TRANSERVICE	100.0%	Russia	Transportation services
OOO NOVASIB	100.0%	Russia	Exploration activities
OOO NOVATEK-Refuelling Complexes	100.0%	Russia	Wholesale and retail trading
OOO NOVATEK North-West	100.0%	Russia	Trading and marketing
OOO NOVATEK-Polymer	100.0%	Russia	Production of polymer and insulation tape
OOO PurNovaGaz	100.0%	Russia	Exploration and production
OOO Purneft	100.0%	Russia	Exploration and production
OOO NOVATEK-Ust-Luga	100.0%	Russia	Construction of sea terminal
OOO Purovsky Terminal	83.85%	Russia	Transport / handling services
OOO YARGEO	51.0%	Russia	Exploration activities
Novatek Overseas AG	100.0%	Switzerland	Holding company
Runitek GmbH	100.0%	Switzerland	Trading and marketing
Novatek Overseas Exploration & Production GmbH	100.0%	Switzerland	Exploration and production
Associates			
OOO Oiltechproduct-Invest	25.0%	Russia	Exploration activities
OOO Petra Invest-M	25.0%	Russia	Exploration activities
OOO Tailiksneftegas	25.0%	Russia	Exploration activities

25 RELATED PARTY TRANSACTIONS

For the purposes of these consolidated financial statements, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. Management has used reasonable judgments in considering each possible related party relationship with attention directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be affected on the same terms, conditions and amounts as transactions between unrelated parties. The Group enters into transactions with related parties based on market or regulated prices.

All natural gas producers and wholesalers operating in Russia transport their natural gas volumes through the Unified Gas Supply System (UGSS), which is owned and operated by OAO Gazprom, a State monopoly. As an independent natural gas producer, the Group utilizes the UGSS to transport natural gas to end-consumers at the tariff established by the Federal Tariff Service. Transactions only with Gazprom group parent company – OAO Gazprom, a shareholder of NOVATEK from October 2006, are presented below. The difference with the expenses for natural gas transportation as disclosed in Note 17 relates to volumes sold on electronic trading facilities of Mezhregiongaz, a subsidiary of OAO Gazprom.

	As at and for the year ended 31 December	
Gazprom	**2007**	**2006**
Transactions		
Purchases of natural gas	1,282	237
Natural gas transportation to customers	8,939	1,932
Balances		
Prepayments and other current assets	835	-
Trade and other payables	152	163

	As at and for the year ended 31 December	
Related parties – associates	**2007**	**2006**
Transactions		
Other revenues	22	-
Interest income	16	-
Balances		
Long-term loans receivable	409	-
Interest on long-term loans receivable	16	-
Trade payables and accrued liabilities	324	-

25 RELATED PARTY TRANSACTIONS (CONTINUED)

During 2006, the Group had transactions with entities controlled by the Group's significant shareholders. Starting October 2006, these entities were no longer considered to be related parties of the Group.

	Year ended 31 December	
Related parties - subject to control by significant shareholders	**2007**	**2006**
Transactions		
Sales of inventory and oil products	-	54
Purchases of construction services	-	656
Materials, services and other	-	176
Interest income	-	17

Key management compensation. During 2007 and 2006, the Group paid to the key management personnel (the members of the Board of Directors and the Management Board, some of whom have also direct and indirect interests in the Group) short-term compensation, including salary, bonuses, excluding dividends the total of RR 403 million and RR 364 million in cash, respectively. Such amounts include personal income tax and are net of unified social tax. The remuneration for serving on the Board of Directors is subject to approval by the General Meeting of Shareholders. Key management personnel also receive certain short-term benefits related to healthcare. In addition, during 2007 and 2006, RR 176 million for each year, were recognized as part of the share-based compensation program (Note 15) and included in general and administrative expense.

26 SEGMENT INFORMATION

The Group's primary format for reporting segment information is business segments and the secondary format is geographical segments.

Business Segments. The Group evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Group as a whole. However, the Group's activities are considered by management to comprise the following business segments:

- Exploration and production – acquisitions, exploration, development, production, processing, marketing and transportation of natural gas, gas condensate, crude oil and related products;
- Corporate and other – other activities, including head-office, certain general and administrative services, polymer and tape insulation.

Segment information as at 31 December 2007 and 2006 is as follows:

At 31 December 2007	Exploration and production	Corporate and other	Total
Segment assets	92,965	4,344	97,309
Investment in associates	1,125	-	1,125
Unallocated assets:			
Current and deferred income tax			868
Long-term loans receivable			412
Trade and other receivables			3
Other non-current assets			191
Prepayments and other current assets			85
Cash and cash equivalents			3,982
Total assets			**103,975**
Segment liabilities	6,728	94	6,822
Unallocated liabilities:			
Current and deferred income tax			8,728
Long-term and short term debt			6,602
Trade payable and accrued liabilities			11
Total liabilities			**22,163**

At 31 December 2006	Exploration and production	Corporate and other	Total
Segment assets	73,608	3,545	77,153
Unallocated assets:			
Current and deferred income tax			1,261
Long-term loans receivable			102
Trade and other receivables			29
Prepayments and other current assets			113
Cash and cash equivalents			5,668
Total assets			**84,326**
Segment liabilities	3,968	106	4,074
Unallocated liabilities:			
Current and deferred income tax			8,460
Long-term and short term debt			3,108
Trade payable and accrued liabilities			8
Total liabilities			**15,650**

26 SEGMENT INFORMATION (CONTINUED)

Segment information for the years ended 31 December 2007 and 2006 is as follows:

Year ended 31 December 2007	Exploration and production	Corporate and other	Total
Segment revenues			
External revenues and other income	60,478	1,858	62,336
Inter-segment sales	11	51	62
Total segment revenues	**60,489**	**1,909**	**62,398**
Segment expenses			
External expenses	(32,510)	(4,556)	(37,066)
Inter-segment expenses	(51)	(11)	(62)
Total segment expenses	**(32,561)**	**(4,567)**	**(37,128)**
Segment result	**27,928**	**(2,658)**	**25,270**
Unallocated gains on sales of investments			95
Profit from operations			**25,365**
Finance income (expense), net			124
Profit before income tax			**25,489**
Income tax expense			(6,761)
Profit for the year			**18,728**
Acquisition of subsidiaries	-	254	254
Capital expenditures	18,382	1,084	19,466
Depreciation, depletion and amortization	(3,516)	(218)	(3,734)
Impairment charges	(30)	(123)	(153)

26 SEGMENT INFORMATION (CONTINUED)

Year ended 31 December 2006	Exploration and production	Corporate and other	Total
Segment revenues			
External revenues and other income	47,972	1,251	49,223
Inter-segment sales	10	18	28
Total segment revenues	**47,982**	**1,269**	**49,251**
Segment expenses			
External expenses	(26,413)	(3,668)	(30,081)
Inter-segment expenses	(18)	(10)	(28)
Total segment expenses	**(26,431)**	**(3,678)**	**(30,109)**
Segment result	**21,551**	**(2,409)**	**19,142**
Unallocated gains on sales of investments			11
Profit from operations			**19,153**
Finance income (expense), net			(31)
Profit before income tax			**19,122**
Income tax expense			(5,115)
Profit for the year			**14,007**
Acquisition of subsidiaries	741	-	741
Capital expenditures	4,347	356	4,703
Depreciation, depletion and amortization	(3,565)	(163)	(3,728)
Impairment charges	(32)	(68)	(100)

Capital expenditures include purchases of property, plant, and equipment. Charges for impairment above include impairment provisions for accounts and loans receivable and inventories.

The inter-segment sales mainly consist of:

- Exploration and production – sale of gas and oil products to the other segments, for which prices are based on market prices; and
- Corporate and other – rendering rent services, transportation sales and sales of polymer to the other segments, for which prices are based on market prices.

26 SEGMENT INFORMATION (CONTINUED)

Geographical segments. The Group's two business segments operate in three major geographical areas of the world. In the Russian Federation, its home country, the Group is mainly engaged in the exploration, development, extraction and sales of natural gas, crude oil, gas condensate and related products and sales of polymer and insulation tape. Activities outside the Russian Federation are conducted in the United States (sales of stable gas condensate), in Europe (sales of stable gas condensate, liquefied petroleum gas and crude oil) and other areas (sales of liquefied petroleum gas and sales of polymer and insulation tape). Information for the main geographical segments of the Group is set out below.

At 31 December 2007 and for the year then ended	Russia	Europe	USA	Other	Total
Total segment assets	94,353	1,416	1,540	-	97,309
Investment in associates	1,125	-	-	-	1,125
External revenues and other income	42,201	5,693	13,377	1,065	62,336
Unallocated gain on sales of investments					95
Total revenues and other income as per consolidated statement of income					**62,431**
Acquisition of subsidiaries	254	-	-	-	254
Capital expenditures	19,440	-	-	26	19,466

At 31 December 2006 and for the year then ended	Russia	Europe	USA	Other	Total
Total segment assets	75,260	1,893	-	-	77,153
External revenues and other income	33,790	9,410	5,481	542	49,223
Unallocated gain on sales of investments					11
Total revenues and other income as per consolidated statement of income					**49,234**
Acquisition of subsidiaries	741	-	-	-	741
Capital expenditures	4,699	4	-	-	4,703

Segment revenue from external customers is based on the geographical location of customers. Segment assets are based on the geographical location of the assets. Capital expenditure is based on the geographical location of the Group's assets.

27 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

The amounts included within the consolidated financial statements associated with the exploration for and evaluation of mineral resources for the years ended 31 December 2007 and 2006 is as follows:

	At 31 December and for the year then ended:	
	2007	**2006**
Assets	3,881	1,395
Liabilities	(12)	(23)
Expenses	(486)	(459)
Cash flows used for operating activities	(449)	(335)
Cash flows used for investing activities	(2,463)	(1,309)

Assets include uncompleted cost of drilling and equipping of exploratory wells on unproved reserves and participation payment for the rights to purchase oil and gas exploration and production licenses. Liabilities include unpaid obligations under the contracts for drilling and equipping exploratory wells. Exploration costs include geological and geophysical expenditures, expenditures associated with the maintenance of non-proven reserves and other expenditures relating to exploration activity. Cash flows used for operating activities and for investing activities include cash paid for geological and geophysical studies performed and cash paid for drilling and equipping exploratory wells and acquiring the right for mineral recourses, respectively.

28 SUBSEQUENT EVENTS

On 11 February 2008, the Group's Board of Directors approved the purchase of up to, but not more than, 3.0 percent of NOVATEK's ordinary shares outstanding, in the form of GDR's, as part of a share buy back program. The program will be carried out on a long-term basis. NOVATEK plans to use the buy back program for possible future financing activities and for the Company's ongoing implementation of a compensation and incentive program.

Syndicated ?

29 NEW ACCOUNTING PRONOUNCEMENTS

Beginning 1 January 2007, the Group has adopted the following interpretations:

- IFRIC 7, *Applying the Restatement Approach under IAS 29* (effective for periods beginning on or after 1 March 2006). IFRIC 7 clarifies the requirements under IAS 29, *Financial Reporting in Hyperinflationary Economies* relating to how comparative amounts in financial statements should be restated when an entity identifies the existence of hyperinflation in the economy of the currency in which its financial statements are measured; and how deferred tax items in the opening balance sheet should be restated;

- IFRIC 8, *Scope of IFRS 2* (effective for periods beginning on or after 1 May 2006). IFRIC 8 clarifies that the accounting standard IFRS 2, *Shared-based Payment* applies to arrangements where an entity makes share-based compensation for apparently no or inadequate consideration;

- IFRIC 9, *Reassessment of Embedded Derivatives* (effective for annual periods beginning on or after 1 June 2006). IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required; and

- IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006). IFRIC 10 prohibits the impairment losses recognized in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date.

The adoption of these interpretations, if applicable, had an insignificant effect on the Group's consolidated financial statements.

Recently, the International Accounting Standards Board published the following new standards and interpretations which have not been early adopted by the Group.

- IFRS 8, *Operating Segments* (effective for annual periods beginning on or after 1 January 2009). IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information;

- IAS 1, *Presentation of Financial Statements* (revised September 2007); effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances;

- Amendment to IAS 32 and IAS 1, *Puttable financial instruments and obligations arising on liquidation* (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability;

- IAS 27, *Consolidated and Separate Financial Statements* (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value;

29 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

- IFRS 3, *Business Combinations* (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or on the same basis as US GAAP (at fair value). The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognized as expenses rather than included in goodwill. An acquirer will have to recognize at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognized in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone;

- Amendment to IFRS 2, *Share-based Payment* (issued in January 2008; effective for annual periods beginning on or after 1 January 2008). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment;

- IAS 23 (Revised), *Recognition of Borrowing Costs*. The revision removed the option of immediately recognizing as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. The revised standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009;

- IFRIC 11, *IFRS 2 – Group and Treasury Share Transactions* (effective for annual periods beginning on or after 1 March 2007). IFRIC 11 addresses accounting for certain transactions an entity may enter into to satisfy rights to equity instruments previously granted to employees. Additionally it provides guidance on accounting for rights to equity instruments of a parent company granted for employees of a subsidiary in the subsidiary's separate financial statements;

- IFRIC 12, *Service Concession Arrangements* (effective for annual periods beginning on or after 1 January 2008). IFRIC 12 gives guidance on the accounting by operators for public-to-private service concession arrangements;

- IFRIC 13, *Customer Loyalty Programs* (effective for annual periods beginning on or after 1 July 2008). IFRIC 13 provides guidance on the recognition and measurement of award credits which a company grants to its customers; and

- IFRIC 14, *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective for annual periods beginning on or after 1 January 2008). IFRIC 14 addresses the measurement of defined benefit plan assets and accounting for an obligation under a minimum funding requirement.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's financial statements.

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). In the absence of specific IFRS guidance, the Group has reverted to other relevant disclosure standards, mainly US GAAP, that are consistent with norms established for the oil and gas industry. While not required under IFRS, this section provides unaudited supplemental information on oil and gas exploration and production activities but excludes disclosures regarding the standardized measures of discounted cash flows related to oil and gas activities.

The Group's exploration and production activities are presently exclusively within the Russian Federation; therefore, all of the information provided in this section pertains to this country. The Group operates through various oil and gas production subsidiaries. The Group also has an interest in oil and gas companies that are accounted for under the equity method. These associates have no proved reserves and immaterial capitalized costs.

Oil and Gas Exploration and Development Costs

The following tables set forth information regarding oil and gas acquisition, exploration and development activities. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the years ended 31 December 2007 and 2006 (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2007	2006
Costs incurred in exploration and development activities		
Acquisition cost	2,835	741
Exploration costs	1,605	740
Development costs	16,077	3,883
Total costs incurred in exploration and development activities	**20,517**	**5,364**

	At 31 December:	
	2007	2006
Capitalized costs relating to oil and gas producing activities		
Wells and related equipment and facilities	60,674	56,171
Support equipment and facilities	9,824	9,740
Uncompleted wells, equipment and facilities	18,312	4,165
Total capitalized costs relating to oil and gas producing activities	88,810	70,076
Less: accumulated depreciation, depletion and amortization	(10,909)	(7,471)
Net capitalized costs relating to oil and gas producing activities	**77,901**	**62,605**

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

Results of Operations for Oil and Gas Producing Activities

The Group's results of operations for oil and gas producing activities are shown below. The results of operations for oil and gas producing activities do not include general corporate overhead or its associated tax effects. Income tax is based on statutory rates. In the following table both transportation and processing costs are included in Revenues from oil and gas sales (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2007	**2006**
Revenues from oil and gas sales	60,357	48,047
Production costs	(3,072)	(1,729)
Long-term supply purchases	(3,242)	(1,805)
Transportation expenses	(14,358)	(11,342)
Taxes other than income tax	(6,222)	(6,019)
Depreciation, depletion and amortization	(3,446)	(3,466)
Exploration expenses	(486)	(459)
Results of operations for oil and gas producing activities before income tax	29,531	23,227
Less: related income tax expense	(7,087)	(5,574)
Results of operations for oil and gas producing activities	**22,444**	**17,653**

Proved Oil and Gas Reserves

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

The oil and gas reserve estimates reported below are determined by the Group's independent petroleum reservoir engineers, DeGolyer and MacNaughton ("D&M"), for the Group's fields – Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye, Sterkhovoye, Termokarstovoye, Urengoyskoe and Severo-Khancheyskoye. The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for the reserve determination. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of this process, senior management reviews and approves the final reserve estimates issued by D&M.

The following reserve estimates were prepared using standard geological and engineering methods generally accepted by the petroleum industry. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history.

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2007 and 2006.

Extensions of production licenses are assumed to be at the discretion of the Group. Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. The Group's licenses expire between 2018 and 2043, with the most significant license, Yurkharovskoye field and East-Tarkosalinskoye field, expiring in 2034 and 2043, respectively. Management believes that there is requisite legislation to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the license expiry dates.

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

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

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

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

Net reserves exclude quantities due to others when produced.

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

Additions represent two more fields, Severo-Khancheyskoye and Urengoyskoe, appraised by D&M in 2007. For convenience, volumes are provided both in English and metric units.

Net proved reserves of natural gas are presented below.

	Net proved reserves of natural gas recoverable up to license expiry dates		**Net proved reserves of natural gas recoverable past license expiry dates**		**Total net proved reserves of natural gas**	
	Billions of cubic feet	***Billions of cubic meters***	***Billions of cubic feet***	***Billions of cubic meters***	***Billions of cubic feet***	***Billions of cubic meters***
Reserves at 31 December 2005	**18,949**	**537**	**3,685**	**104**	**22,634**	**641**
Changes attributable to:						
Revisions of previous estimates	1,043	30	321	9	1,364	39
Production	(1,008)	(29)	-	-	(1,008)	(29)
Reserves at 31 December 2006	**18,984**	**538**	**4,006**	**113**	**22,990**	**651**
Changes attributable to:						
Revisions of previous estimates	(3,668)	(105)	4,109	117	441	12
Extension of license	7,521	213	(7,521)	(213)	-	-
Extension and discoveries	446	13	-	-	446	13
Additions	96	3	91	2	187	5
Production	(997)	(28)	-	-	(997)	(28)
Reserves at 31 December 2007	**22,382**	**634**	**685**	**19**	**23,067**	**653**
Net proved developed reserves (included above)						
At 31 December 2005	10,513	298	2,925	83	13,438	381
At 31 December 2006	14,911	422	3,134	89	18,045	511
At 31 December 2007	19,290	546	106	3	19,396	549

UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)

Net proved reserves of crude oil, gas condensate and natural gas liquids are presented below.

	Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable up to license expiry dates		Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable past license expiry dates		Total net proved reserves of crude oil, gas condensate and natural gas liquids	
	Millions of barrels	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*	*Millions of barrels*	*Millions of metric tons*
Reserves at 31 December 2005	**325**	**39**	**56**	**7**	**381**	**46**
Changes attributable to:						
Revisions of previous estimates	30	4	14	2	44	6
Production	(18)	(2)	-	-	(18)	(2)
Reserves at 31 December 2006	**337**	**41**	**70**	**9**	**407**	**50**
Changes attributable to:						
Revisions of previous estimates	(35)	(5)	35	5	-	-
Extension of license	97	13	(97)	(13)	-	-
Extension and discoveries	11	1	-	-	11	1
Additions	6	1	1	-	7	1
Production	(19)	(3)	-	-	(19)	(3)
Reserves at 31 December 2007	**397**	**48**	**9**	**1**	**406**	**49**
Net proved developed reserves (included above)						
At 31 December 2005	123	15	10	1	133	16
At 31 December 2006	199	24	11	1	210	25
At 31 December 2007	259	31	4	1	263	32

OAO NOVATEK was incorporated as a joint stock company in accordance with the Russian law and is domiciled in the Russian Federation. The Group's registered office is:

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NOVATEK's website contains a variety of corporate information including the following:
– Key business and production results
– Press-releases
– Current share prices
– Annual reports
– Information disclosures to regulators
– Investor presentations
– Social and environmental activities
Website: www.novatek.ru (Russian version) and www.novatek.ru/eng (English version)
Mentions in this Annual Review of «OAO NOVATEK», «NOVATEK», «the company», «we» and «our» refer to OAO NOVATEK and/or its subsidiary enterprises, depending upon the context, in which the terms are used.

Abbreviations

barrel	one stock tank barrel, or 42 US gallons of liquid volume
bcm	billion cubic meters
boe	barrels of oil equivalent. For natural gas, we use the conversion factor of one mcm equals 6.54 barrels. Liquid tons are converted to boe according to ratios found in our reserves appraisal report, ranging between 7.3 to 8.87 boe per ton, due to the differing quality of hydrocarbons at the fields, including differences in calorific content
CAGR	Compound Annual Growth Rate
km	kilometer(s)
mbbls	thousand barrels
mboe	thousand boe
mcm	thousand cubic meters
mmbbls	million barrels
mmboe	million boe
mmcf	million cubic feet
mmcm	million cubic meters
mmt	million metric tons
mt/m	thousand metric tons
tcf	trillion cubic feet
tcm	trillion cubic meters
ton	metric ton
SEC	United States Securities and Exchange Commission
PRMS	Petroleum Resources Management System

Forward–looking statements

This Annual Review includes 'forward-looking information' within the meaning of Section 27A of the US Securities Act of 1933, as amended, and Section 21E of the US Securities Exchange Act of 1934, as amended. Certain statements included in this Annual Report and Accounts, including, without limitation, statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words «believe,» «expect,» «anticipate,» «intends,» «estimate,» «forecast,» «project,» «will,» «may,» «should» and similar expressions identify forward-looking statements. Forward-looking statements include statements regarding: strategies, outlook and growth prospects; future plans and potential for future growth; liquidity, capital resources and capital expenditures; growth in demand for our products; economic outlook and industry trends; developments of our markets; the impact of regulatory initiatives; and the strength of our competitors. The forward-looking statements in this Annual Review are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, these assumptions are inherently subject to significant uncertainties and contingencies, which are difficult or impossible to predict and are beyond our control. As a result, we may not achieve or accomplish these expectations, beliefs or projections. In addition, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include:

- changes in the balance of oil and gas supply and demand in Russia and Europe;
- the effects of domestic and international oil and gas price volatility and changes in regulatory conditions, including prices and taxes;
- the effects of competition in the domestic and export oil and gas markets;
- our ability to successfully implement any of our business strategies;
- the impact of our expansion on our revenue potential, cost basis and margins;
- our ability to produce target volumes in the event, among other factors, of restrictions on our access to transportation infrastructure;
- the effects of changes to our capital expenditure projections on the growth of our production;
- potentially lower production levels in the future than currently estimated by our management and/or independent petroleum reservoir engineers;
- inherent uncertainties in interpreting geophysical data;
- changes to project schedules and estimated completion dates;
- our success in identifying and managing risks to our businesses;
- the effects of changes to the Russian legal framework concerning currently held and any newly acquired oil and gas production licenses;
- changes in political, social, legal or economic conditions in Russia and the CIS;
- the effects of technological changes;
- the effects of changes in accounting standards or practices.

This list of important factors is not exhaustive. When relying on forward-looking statements, one should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made. Accordingly, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario. The information and opinions contained in this document are provided as at the date of this review and are subject to change without notice.

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