



**NOVATEK**



ANNUAL REPORT 2010

**MOVING  
FORWARD!**



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TOTAL  
REVENUES  
2010  
2005

117.0  
38.5  
RR BILLION

« Higher production volumes, combined with increasing domestic natural gas prices and favorable pricing for liquid hydrocarbons, resulted in record high revenues of RR 117 billion »»

# 01 | Overview

## 2010 Financial and Operating Highlights

millions of Russian roubles except per share amounts and ratios	Year ended 31 December		Change
	2010	2009	%
<b>Financial results</b>			
Oil and gas revenues <sup>(1)</sup>	115,162	86,903	32.5%
Total revenues	117,024	89,954	30.1%
Operating expenses	68,518	56,130	22.1%
Net income	40,278	25,722	56.6%
EBITDA <sup>(2)</sup>	56,965	39,566	44.0%
EBITDAX <sup>(3)</sup>	58,560	40,132	45.9%
Earnings per share (EPS), Russian roubles	13.37	8.59	55.6%
<b>Operating results</b>			
Total proved reserves (SEC), mmmboe	8,088	6,853	18.0%
Natural gas sales volumes by consolidated subsidiaries, bcm	37.117	32.937	12.7%
Liquid hydrocarbon sales volumes by consolidated subsidiaries, mt	3,401	3,128	8.7%
Incl. stable gas condensate sales volumes, mt	2,330	2,170	7.4%
<b>Equity and liquidity</b>			
Net cash provided by operating activities	44,863	34,847	28.7%
Capital expenditures	26,106	17,872	46.1%
Net debt <sup>(4)</sup>	61,988	27,171	128.1%
Total debt to total shareholders equity, %	43.0%	28.3%	51.9%

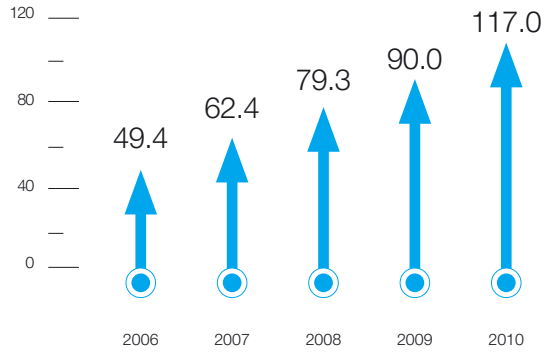
(1) Net of VAT, excise tax and export duties.

(2) EBITDA represents profit (loss) attributable to shareholders of NOVATEK adjusted for the addback of income tax expense and finance income (expense) from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

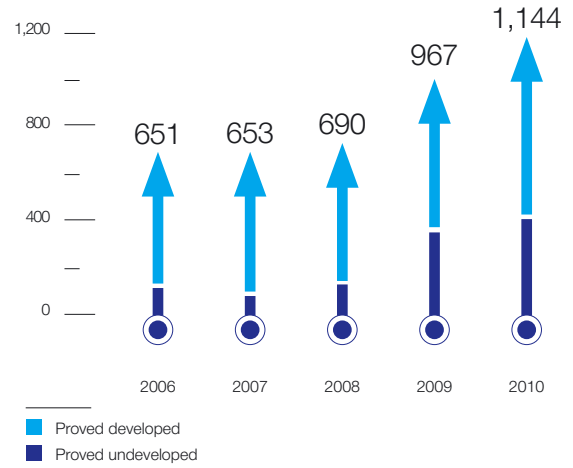
(3) EBITDAX represents EBITDA as adjusted for the addback of exploration expenses.

(4) Net debt calculated as total debt less cash and cash equivalents.

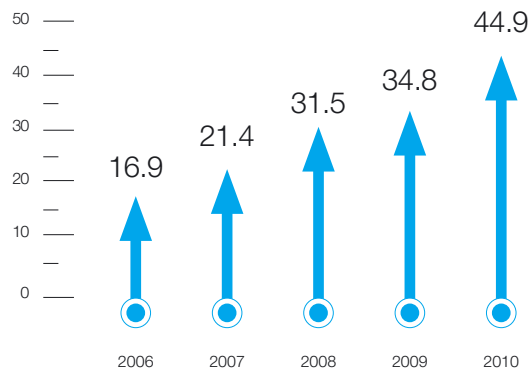
**TOTAL REVENUES,**  
RR billion



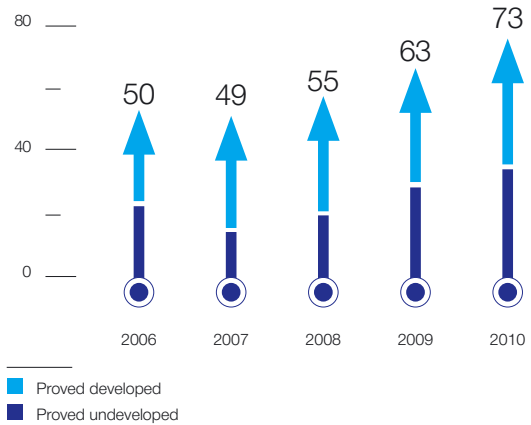
**NATURAL GAS RESERVES (SEC),**  
bcm



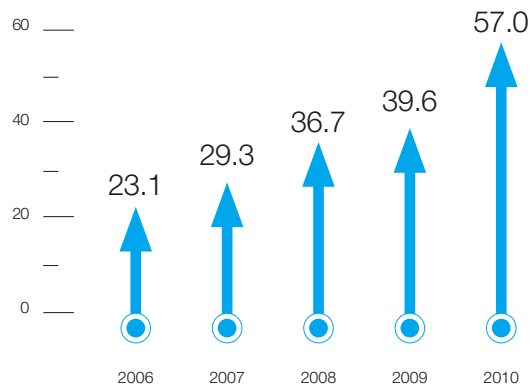
**OPERATING CASH FLOW,**  
RR billion



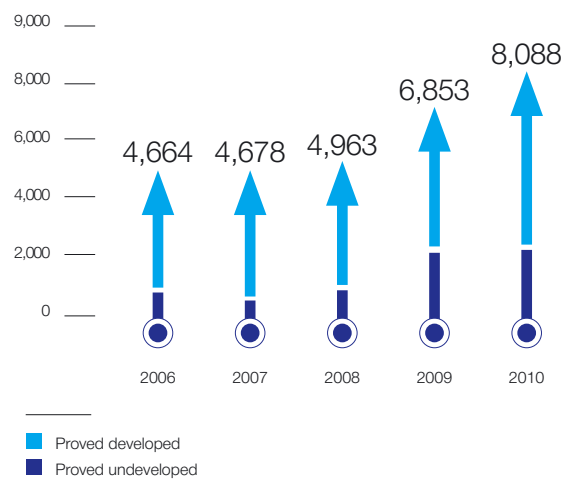
**LIQUIDS RESERVES (SEC),**  
mmt



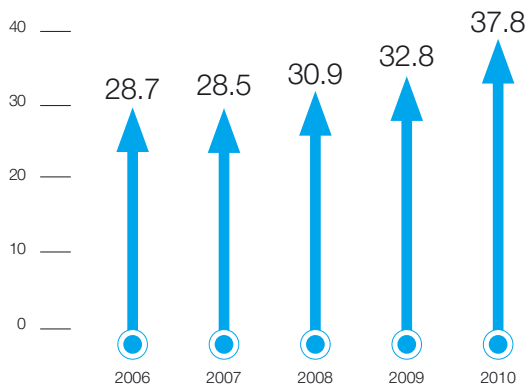
**EBITDA,**  
RR billion



**TOTAL RESERVES (SEC),**  
mmboe



**NATURAL GAS PRODUCTION,**  
bcm

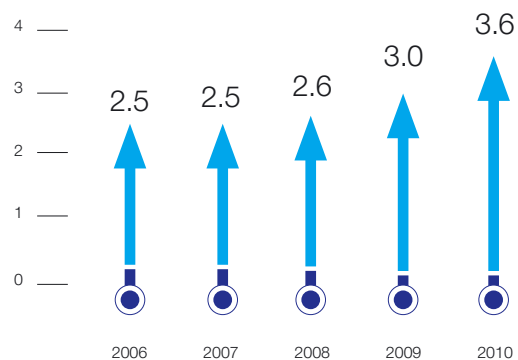


**AVERAGE NATURAL GAS PRICES,**  
RR per mcm\*



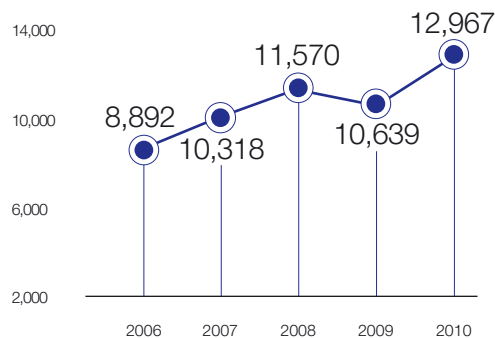
\* Net of VAT

**LIQUIDS PRODUCTION,**  
mmt



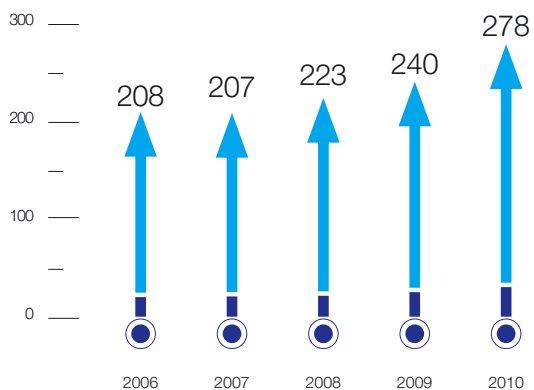
■ Gas condensate  
■ Crude oil

**AVERAGE LIQUIDS PRICES,**  
RR per ton\*



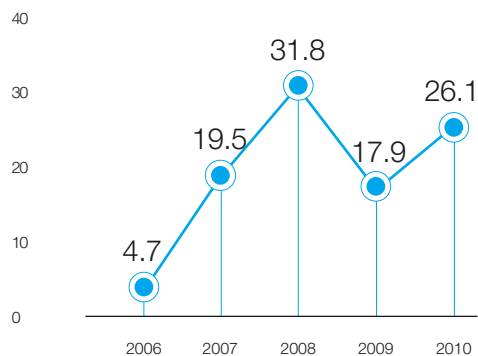
\* Net of VAT, excise tax and export duties

**TOTAL PRODUCTION,**  
mmboe



■ Natural gas  
■ Liquids

**TOTAL CAPITAL EXPENDITURES,**  
RR billion



## Letter to Shareholders

### To our valued shareholders,

**The time is right for natural gas!** The environmental costs and potential hazards of other energy sources solidifies natural gas as the fuel of choice in the 21<sup>st</sup> century. Throughout 2010, we invested capital to ensure that we will be well prepared to capitalize on the many opportunities that this clean burning fuel will provide. With the continued stabilization of the world economy in 2010, we witnessed a correction in the imbalance of supply and demand for natural gas, due to the financial crisis, and a return to traditional market dynamics. This confirmed our views regarding the positive trends during the year in both the international and domestic demand for natural gas and the cyclical rather than structural changes, which occurred during the financial crisis. Correspondingly, we continued to invest in our production and processing capacities and, as a result, we posted double digit growth in our 2010 reserves, production and revenues while maintaining our industry leading position as the lowest cost producer. As we enter a new decade, the capital investments we made this year will ensure our continued growth both domestically and internationally and have established NOVATEK as the global leader among independent gas producers.

**2010 was another record year** for us operationally and financially as the timely and prudent capital investments at our largest core asset, the Yurkharovskoye field, drove production and reserve growth. In 2010, we completed the field's second stage development activities increasing total production capacity to 33 billion cubic meters per annum, as well as completed a gas condensate de-ethanization facility at the field and a pipeline from the field to our Purovsky processing plant, providing us with complete operational control over the gas condensate production cycle and reducing third party expenses and

risks. Our investment focus at the Yurkharovskoye field allowed us to organically increase natural gas and liquids production by 15% and 19%, respectively, while at the same time preserving our five-year average finding and development (F&D) costs at an industry leading \$1.8 per barrel of oil equivalent (boe).

**The higher production volumes** we achieved in 2010 combined with increasing domestic natural gas prices and favorable pricing for liquid hydrocarbons on international markets, resulted in record high revenues of RR 117 billion or 30% higher than in 2009. We are pleased to report that our continued focus on cost control has not waived and for the third consecutive year we have maintained our lifting costs at RR 16 per boe. The combination of strong commodity prices and our focus on cost controls translated into EBITDA and net profit margins of 49% and 35%, respectively, in 2010. We also ended the period in a positive free cash flow position, supporting our Board's recommendation to raise dividends for the seventh consecutive year to RR 4.00 per share, a 45% increase over the previous period.

**MOVING FORWARD, our investment focus is shifting** from core producing assets, like the Yurkharovskoye field, which are, or will soon be, reaching their maintenance capital investment stage, to longer-term plans like our Yamal LNG project. During 2010, we made significant progress on this transformational project in three critical areas – engineering and design work, commercial and marketing activities and definition of a Government sponsored stimulus package. The pre-FEED (front end engineering and design) work, which was conducted by CB&I (Chicago Bridge & Iron) Lummus, was completed and we have signed an export agency agreement with GazpromExport providing us with an export channel for LNG produced by the facility. The export agency agreement was signed in



conjunction with a broader cooperation agreement with Gazprom regarding the joint development of the Yamal peninsula. The execution of the development program underscores the importance of this project not only for NOVATEK but also for the Russian Gas Industry and the development of this hydrocarbon rich region. We currently own 51% of Yamal LNG and have secured the options for the remaining 49%. We plan to exercise these options to attract strategic partners who have the requisite expertise essential for the project's success. In March 2011, we announced that we have selected Total as the strategic partner in the Yamal LNG project with a 20% equity stake, and we expect to announce other partners for the remaining equity stake in due course.

#### **Our prudent and strategic allocation of capital**

consistently ranks us in the top five oil and gas companies globally in F&D and reserve replacement (RR) costs and 2010 was no exception. Throughout 2010, our capital investments targeted organic growth from our legacy assets as well as value accretive acquisitions resulting in a RR cost of \$1.8 per boe, which, although was higher than our industry low five-year RR cost of \$1.2 per boe, demonstrates our ability to replace reserves at attractive industry multiples. Toward the end of 2010, we completed two strategic and value accretive acquisitions, one having an immediate positive effect on our production and cash generation profiles and the other supporting our mid-term growth strategy. The acquisition of a 51% stake in Sibneftegas will contribute over five billion cubic meters of natural gas sales volumes per annum starting in 2011, while the acquisition of a 51% interest in SeverEnergia by Yamal Development, our 50/50 joint venture with Gazprom Neft, is expected to begin initial production in winter 2011/2012. In developing the SeverEnergia assets, we expect to capitalize on our gas condensate infrastructure (pipeline and processing plant), thus achieving

synergies and optimizing our facilities through increased plant and pipeline utilization. We are very excited by the potential these assets hold and the positive contributions they have on our resource base. In 2010, we increased our SEC proved reserves by approximately 18% (net of 2010 production volumes) to 8.1 billion boe and replaced 551% of production volumes, resulting in a reserve to production life of 30 years and a five-year reserve replacement rate of 402%.

#### **The optimization of our marketing channels**

has been a key driver behind the success we achieved in increasing our oil and gas revenues and monetizing our growing production volumes. We continued to invest in our Ust-Luga project for the fractionation and transshipment of stable gas condensate, which will eventually allow us to move further down the hydrocarbon value chain and diversify customer risk by increasing the number of potential off-takers for the facilities product slate. We expect to launch the first phase comprising three million tons per annum in the fourth quarter of 2012. Another marketing milestone in 2010 was the first successful navigation and delivery of a large cargo of stable gas condensate via the Arctic Ocean's Northern Sea Route to the Asian-Pacific region. This historic voyage was completed in approximately half the time required by the traditional navigational route through the Suez Canal and has the potential to facilitate further development of hydrocarbon fields located in the Yamal peninsula.

#### **We are committed to growing our company**

and delivering industry best metrics by focusing on cost control, investing wisely in capital projects and diversifying our commercial activities. Our success in achieving our objectives in 2010 was recognized by the equity markets as our share price increased by 84% since the beginning of the year as compared to 23% for the RTS index, a

proxy of Russia's domestic stock market. Our achievements in 2010 would not have been possible without the commitment and perseverance from our trusted and valued employees. The teamwork and collaboration between our experienced professionals, a corporate culture of success and innovation as well as a coherent and well-executed corporate strategy have been instrumental in delivering the exceptional results we achieved in 2010.

**On behalf of the Board of Directors and our Management Committee,** we would like to sincerely thank

everyone for your continued support of NOVATEK. We remain focused on achieving our Corporate Strategy and are strongly committed to sustainable development principles, the tenets of corporate governance and creating shareholder value. Looking back, the past year represented a clear indication of NOVATEK's ability to continue to positively surprise the market as we found ways to capitalize on the many opportunities the Russian gas market has to offer. As we continue MOVING FORWARD with our operational plans we will provide periodic updates to our shareholders on upcoming activities.



**ALEXANDER NATALENKO**

Chairman of NOVATEK's Board of Directors



**LEONID MIKHELSON**

Chairman of NOVATEK's Management Board



**MARK GYETVAY**

Chief Financial Officer

## Highlights in 2010



- Record financial and operational results including a 32.5% increase in natural gas and liquids sales revenue and a 12.7% and 8.7% increase in sales volumes, respectively.
- Increased total proved reserves according to SEC standards by 18.0% or 1,235 million boe.
- Launch of the unstable gas condensate de-ethanization facility at our Yurkharovskoye field and the unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant.



- Launch of the third and final stage of the Yurkharovskoye field's second phase development increasing the field's production capacity to 33 bcm per annum and NOVATEK's total production capacity to 54 bcm.
- First successful shipment of stable gas condensate to the Asian Pacific Region via the Arctic Ocean's Northern Sea Route.
- Established a 50/50 joint venture, Yamal Development, with Gazprom Neft to jointly develop potential hydrocarbon assets in the YNAO.
- Yamal Development's acquisition of a 51% interest in SeverEnergia, which holds licenses for the development of oil and gas condensate fields in the YNAO through its wholly-owned subsidiaries.



- Acquisition of a 51% interest in Sibneftegas, which holds subsoil exploration and production licenses for fields and license areas located in the YNAO, by our wholly-owned subsidiary NOVATEK Severo-Zapad.
- Signing of a cooperation agreement with Gazprom for LNG production in the Yamal peninsula as well as a long-term agency agreement between OOO GazpromExport and Yamal LNG providing for the export of LNG produced from the South-Tambeyskoye field.
- Placement of RR ten billion in three-year rouble bonds.
- Corporate rating upgraded to BBB-, (stable outlook) by Standard and Poor's, thus securing our third investment grade corporate rating (along with Moody's and Fitch).



TOTAL  
RESERVES  
2010  
2005

8,088  
4,573  
MM BOE

« NOVATEK continued to grow its resource base organically and through strategic acquisitions resulting in a five-year reserve replacement rate of 402% »



# 02 | The Company

## NOVATEK Today

**NOVATEK is the largest Russian** independent natural gas producer and the second largest producer of natural gas in Russia after OAO Gazprom. The Company is ranked among the top five publicly traded companies in terms of natural gas reserves (approximately 1,144 bcm) and is also recognized as one of the lowest cost producers globally. In 2010, the Company accounted for approximately six percent of total Russian natural gas production and 26.5% of natural gas produced by Russian independent producers, as well as playing a significant role in Russia's energy balance providing more than 10% of total 2010 domestic natural gas deliveries through the Unified Gas Supply System (UGSS), according to the Central Dispatch Administration of the Fuel and Energy Complex (CDU-TEK).

**NOVATEK's primary business** activities include exploration and production, processing, transportation and marketing of natural gas and liquid hydrocarbons. The Company's primary production and processing assets are located in the Yamal-Nenets Autonomous Region (YNAO) in Western Siberia and their close proximity to each other and transportation infrastructure has provided the basis for their cost effective development.

**Over the years, NOVATEK** has successfully grown its natural gas and liquid hydrocarbon production and consistently replaced over 100% of its annual production volumes. In 2010, the Company's reserve replacement rate was 551% and its three- and five-year reserve replacement rates were 567% and 402%, respectively.

NOVATEK's total net proved reserves (SEC) as of the 31 December 2010 totaled 8,088 million barrels of oil equivalent (boe), of which approximately 93% was natural gas, and its reserve to production life was 30 years.

**In 2010,** NOVATEK invested Russian rouble (RR) 45,140 million, in exploration and development activities at its fields and license areas (including unproved acquisition costs incurred by NOVATEK's equity investees of RR 13,281 million) resulting in an industry leading finding and development cost of RR 73.16 per boe (\$ 2.41 per boe)\* and a three- and five-year finding and development cost of RR 48.61 per boe (\$ 1.71 per boe) and RR 48.99 per boe (\$1.76 per boe), respectively.

**In 2010,** NOVATEK was able to increase gross natural gas and liquid hydrocarbon production by 15.3% and 19.1%, respectively, compared to respective production volumes in 2009. In 2010, the Company's sales volumes totaled 37.2 bcm of natural gas and 3.4 million tons of liquid hydrocarbons, while total oil and gas revenues reached RR 115.2 billion.

**A large portion of NOVATEK's reserve base** is concentrated in deeper gas condensate bearing layers and requires additional processing capacity to be successfully developed. In order to realize its development strategy, NOVATEK has built a gas condensate processing facility, the Purovsky Gas Condensate Stabilization Plant (Purovsky Plant), near the Company's production assets.

\* Average exchange rate of RR 30.37/USD (\$)

The plant has allowed NOVATEK to more effectively develop its fields and improve the quality of hydrocarbons produced.

**The Purovsky Plant** has the capacity to process up to five million tons of unstable gas condensate per annum and produces both stable gas condensate and liquid petroleum gases (LPG), which meet the highest international quality standards. The Purovsky Plant currently provides NOVATEK with sufficient processing capacity to continue developing its gas condensate fields without having to rely on third party processing facilities.

**NOVATEK** has been able to effectively diversify its hydrocarbon sales both geographically and by customer segment allowing the Company to adapt to changes in market conditions and optimize its marketing channels for natural gas and liquid hydrocarbon sales.

**NOVATEK's fields** are located in close proximity to the UGSS through which the Company delivers natural gas to end-customers, including some of the country's largest energy and industrial companies. In 2010, NOVATEK delivered natural gas to over 33 regions of the Russian Federation, including the Perm territory, Chelyabinsk, Orenburg, Sverdlovsk, Moscow, Kurgan, Kostroma, Kirov and Samara regions, the city of St-Petersburg as well as the YNAO and Khanty-Mansyisk Autonomous Regions.

**NOVATEK's subsidiary**, OOO NOVATEK-TRANSERVICE, operates a fleet of leased and wholly-owned rail tank cars for transporting stable gas condensate and LPG from the Purovsky Plant to export and domestic markets. Stable gas condensate volumes bound for export markets are transported to the Port of Vitino, an all season port, located in the Murmansk Region on the White Sea.

**In September 2010**, we dispatched the first consignment of our own stable gas condensate from the Murmansk Port, which traveled to the Asian-Pacific region via the Arctic Ocean's Northern Sea Route. Transportation of goods via the Northern Sea Route requires less time than traditional routes due to the shorter distances between the North-Western ports of the Russian Federation and the countries of the Asian-Pacific region. The success of NOVATEK's shipment is strategically important and will have a beneficial

impact on the Northern regions of the Russian Federation by facilitating the development of new hydrocarbon fields located in the Yamal peninsula and Arctic shelf.

**In 2010, the Company** was able to continue increasing sales volumes of natural gas and liquid hydrocarbons, which grew by 12.7% and 8.7%, respectively, by taking advantage of the increased production capacity for gas and gas condensate at the Yurkharovskoye field as a result of the launch of the second and third stages of the field's second phase of development in October 2009 and 2010, respectively. The share of NOVATEK's liquid hydrocarbons sold to the export market, as a percentage of total liquid hydrocarbons sold in 2010, was approximately 83% or the same level as in 2009.

**During 2010**, we continued the development of our Yamal LNG project. In June 2010, a long-term agency agreement was signed between Gazprom Export and Yamal LNG, in conjunction with the cooperation agreement we signed in June 2010 with Gazprom, pursuant to which GazpromExport will act as an agent for export sales of LNG between Yamal LNG and Yamal LNG's wholly-owned international sales subsidiary. In October 2010, a Government decree was signed outlining a special privileged taxation and customs incentives system for the Yamal LNG project.

**The Company** has employed a strategy to develop certain projects using joint ventures with strategic partners to mitigate project risk and facilitate knowledge and technology transfers. In February 2010, NOVATEK and Total Termokarstovoye B.V., an affiliate of Total SA, closed the transaction for the establishment of a joint venture for exploration and development of the Termokarstovoye gas condensate field in the YNAO.

**In 2010**, we entered into two significant transactions, which we believe will enhance our position as a leading independent natural gas producer in Russia. In November 2010, Yamal Development, our 50/50 joint venture with Gazprom Neft, acquired a 51% interest in SeverEnergiya from Gazprom. SeverEnergiya, which has not yet commenced commercial production, holds 100% of the shares of Arcticgas, Urengoil Inc. and Neftegaztehnologia, which hold licenses for the development of oil and gas condensate fields in the YNAO.

**In December 2010**, we closed the transaction to acquire a 51% interest in Sibneftegas, by our wholly-owned subsidiary NOVATEK Severo-Zapad from Gazprombank. Sibneftegas holds licenses for the development of hydrocarbons at the following license areas and fields located in the YNAO: Beregovoy license area, Khadyryakhinskiy license area, Pyreinoe gas condensate field and Zapadno-Zapolyarnoye gas field. In 2010, Sibneftegas' gross natural gas production totaled 9.88 bcm.

**In September 2010**, NOVATEK completed the disposal of its 100% subsidiary NOVATEK-Polymer, which historically has accounted for less than 3% of NOVATEK's total revenues. The disposal is consistent with the Company's strategy to focus on its core natural gas and gas condensate production and processing activities.

## Strategy

**The implementation** of NOVATEK's business strategy has increased the Company's core operating and financial results and provided a platform for future growth. Through the efficient development of its existing reserve base and continued cost control NOVATEK has positioned itself as a dynamically developing hydrocarbon producer.

**NOVATEK's long-term strategy** is aimed at profitably exploiting the hydrocarbon value chain – from exploration and production to processing and marketing.

**The Company's success** in realizing this strategy is based on its competitive advantages, industry expertise and favorable operating environment, including:

- Structure of the existing and potential resource base;
- Reserve base geography – proximity of the Company's core fields to the available infrastructure and trunk pipelines;
- Effective geological exploration and development program using state-of-the-art and advanced techniques;
- Full development of the hydrocarbon value chain from production to the Company's own condensate processing facilities;
- Construction and operation of terminals to bring hydrocarbon products to market; and
- Longstanding and successful experience working on the domestic natural gas market, which has and will continue to benefit from the Russian Government's policy to increase domestic wholesale gas prices to achieve full market liberalization by 2015.

**Our strategic objective** is to leverage our competitive strengths to increase our hydrocarbon production on a sustainable and profitable basis, while efficiently increasing our resource base and operating in a socially and environmentally responsible manner. Moreover, we intend to continue to optimize our marketing channels and explore complementary and value added projects. Specifically, we intend to:

- **Substantially Increase Our Production of Hydrocarbons, Particularly Natural Gas**

Despite the recent economic slowdown globally and in Russia, industry experts, including the International Energy Agency, estimate that long-term demand for natural gas will be greater than current supply. We believe we are well positioned to supply a significant portion of the

expected growth in incremental natural gas demand on the Russian domestic market due to the proximity of our core fields to pipeline infrastructure, the successful development of our fields, and our commercial marketing capabilities. We plan to continue making targeted capital investments and prioritize our investment program to focus on expansion of our fields' production capacity. At the same time, we are carefully assessing potential acquisition opportunities of producing assets or assets with a short-and/or mid-term production start, provided that these acquisitions will be value accretive for our business and our security holders.

● **Maintain Our Low Cost Structure**

We intend to maintain our low cost track record through the prudent use of modern technology and production techniques across our hydrocarbon resource base. In the past few years, our three – year weighted average lifting cost, finding and development costs and reserve replacement costs remained among the lowest in the global oil and gas industry based on industry peer reviews and performance metrics. Furthermore, we expect that the geographic concentration of the majority of our resource base, which is in close proximity to the UGSS, the Purovsky Plant and our production infrastructure, and the resulting economies of scale will continue to be a major factor in helping us maintain our low cost structure. Moreover, we currently strive to maintain consistently low costs in all other areas of our business operations and tightly control administrative overhead costs.

● **Maximize Risk-Adjusted Margins on Sales of Natural Gas and Liquids and Expand Our Customer Base**

Our marketing and sales teams continue to optimize our sales of natural gas between end-customers and wholesale traders and our sales of liquid products between export and domestic markets in order to realize superior risk-adjusted margins. We intend to penetrate new regional markets and increase the proportion of our natural gas sales made under long-term contracts as well as maintain our leading position among independent gas producers. In addition, as we increase the production of liquid hydrocarbons, we intend to continue to geographically diversify our stable gas condensate and LPG markets and expand our customer base, while at the same time developing deeper refining capabilities. As a part of this process, we plan on investing capital into the construction of the Ust-Luga transshipment and fractionation facility for processing of our stable gas condensate, allowing us to further enhance refining depth and capture additional margins on end products, as well as expand our marketing capabilities and product offerings. In addition, we expect our participation in the Yamal LNG project will allow us to diversify and expand our customer base across different geographical markets.

● **Increase Our Resource Base and Manage Reserves Effectively**

We intend to manage our resource base in order to grow our proved reserves as we develop and explore for hydrocarbons on our fields and license areas. We believe our established resource base in the Nadym-Pur-Taz region of the YNAO, and its proximity to the Region's existing gas transportation and processing infrastructure, as well as our newly acquired resources in the Yamal peninsula, including, in particular the South-Tambeyskoye field we acquired through our majority interest in Yamal LNG, will en-





able us to leverage our experience in developing complex gas condensate reserves to further expand our resource base both organically and through potential and recent acquisitions. In November 2010, for instance, Yamal Development, our 50/50 joint venture with Gazprom Neft, completed its acquisition of a 51% participation interest in SeverEnergia, which holds licenses for the exploration and development of oil and gas deposits in the YNAO. In addition, in December 2010, we also closed the transaction to acquire a 51% interest in Sibneftegas, which is involved in the exploration and production of oil and gas in the YNAO.

- **Develop Relationships with Strategic Partners**

In view of our strategic objectives to increase production volumes and penetrate new markets we are working to develop relationships with International Energy companies and other strategic partners on a mutually beneficial basis. These relationships will allow NOVATEK to mitigate risks associated with the development of certain projects and provide for the exchange of knowledge and experience.



GROSS  
PRODUCTION  
2010  
2005

278  
186  
MM BOE

« NOVATEK uses state-of-the-art exploration and development technologies to efficiently develop its reserve base and increase the ultimate level of hydrocarbon recovery from its fields »»

# 03 | Operations in Review

## Exploration and Production

### Exploration

**NOVATEK's fields and license areas** are located in the YNAO of the Russian Federation, which, according to Government Statistics and BP's 2009 Statistical Review, is the world's largest natural gas producing region and accounts for approximately 16% of global natural gas production and approximately 83% of Russian natural gas production. The concentration of the Company's producing and prospective fields, license areas and processing facilities in this region combined with the regions overall oil and gas infrastructure have allowed NOVATEK to minimize the risks associated with developing its assets and expanding its resource base. The Company has many years of experience working in this region, which has enabled it to effectively capitalize on the growth opportunities resident there to increase shareholder value.

**NOVATEK** has been able to expand its resource base through geological exploration at fields and license areas in close proximity to existing transportation and production infrastructure. The Company continues to efficiently develop its reserve base and increase the ultimate level of hydrocarbon recovery at its fields as a result of our operational experience in the YNAO and by utilizing state-of-the-art exploration and development technologies.

**As of 31 December 2010**, we and our subsidiaries and equity investments held 31 licenses, of which 24 are classified as either production or combined exploration and production licenses and seven are classified as exploration licenses.

**In 2010**, NOVATEK achieved significant growth in its reserves due to a combination of exploration and development work carried out at the Yurkharovskoye field and the strategic acquisition of Sibneftegas and SeverEnergiya, which hold licenses for the development of oil and gas condensate fields located in the YNAO and in close proximity to NOVATEK's transportation and processing infrastructure as well as the UGSS. The acquisitions increased NOVATEK's net total SEC proved reserves by 1,122 million boe, or 70% of the total increase in 2010 net proved reserves.

**At 31 December 2010**, NOVATEK's net SEC proved natural gas and liquid hydrocarbon reserves amounted to 1,144 bcm and 73 mmt, respectively, while total net proved reserves (natural gas and liquid hydrocarbons) on a boe basis increased by 18% or by 1,235 mm boe, to 8,088 mm boe, excluding production.

**The Company's 2010** reserve to production ratio was 30 years for all hydrocarbons and approximately 31 years for natural gas. NOVATEK's total reserves under the Russian reserve classification ABC1 + C2 totaled 2,698 mmcm of natural gas and 449.8 mmt of liquid hydrocarbons.

**NOVATEK** continued to deliver low cost reserve growth in 2010 through strategically investing capital in acquisitions and exploration and development activities which enabled the Company to maintain its position as one of the lowest cost producers in the industry. The Company's

total 2010 consolidated investments in exploration, development and acquisition activities totaled RR 101.15 billion which resulted in a reserve replacement cost of RR 55.02 per boe (\$1.81 per boe) while our three- and five-year reserve replacement costs amounted to RR 32.94 per boe (\$ 1.11 per boe) and RR 34.37 per boe (\$ 1.18 per boe), respectively.

**In November 2010**, Yamal Development, our 50/50 joint venture with Gazprom Neft, completed its acquisition of SeverEnergiya which, through its subsidiaries, holds licenses for the exploration and development of oil and gas deposits in the YNAO at the following license areas: Samburgskiy, Yaro-Yakhinskiy, Yevo-Yakhinskiy and Severo-Chaselskiy. SeverEnergiya's fields and license areas are in close proximity to the license areas of our subsidiaries and our existing transportation and processing infrastructure and the infrastructure of the Purovsky Plant.

**In December 2010**, our wholly-owned subsidiary NOVATEK Severo-Zapad\* acquired a 51% interest in Sibneftegas, which is involved in the exploration and production of oil and gas in the YNAO. Sibneftegas holds subsoil exploration and production licenses for the Beregovoy and Khadyryakhinskiy license areas and the Pyreinoye and Zapandno-Zapolyarnoye fields. Sibneftegas is currently engaged in commercial production at the Beregovoye and Pyreinoye fields, while the remaining fields and license areas are in the early stages of geological exploration. Sibneftegas fields are in close proximity to the fields and license areas of our subsidiaries and our existing transportation and processing infrastructure. Sibneftegas is a producing asset and its acquisition will enable us to immediately increase our sales volumes.

**As part of the field** development process, NOVATEK relies on the experience and expertise of the specialists in its geology department, and the Company's Scientific and Technical Center, and uses the latest meth-

#### SEC PROVED RESERVES AS AT 31 DECEMBER 2010 AND 2009

	2010	2009
Natural gas, bcm	1,144	967
Liquid hydrocarbons, mmt	73	63
Total proved reserves, mm boe	8,088	6,853

The Company's 2010 net proved reserves are based on appraisal reports for the East-Tarkosalinskoye, Khancheyskoye, North Khancheyskoye, Severo-Russkoye, Yurkharovskoye, West Yurkharovskoye and Olimpiyskiy fields and license areas based on NOVATEK's 100% ownership interest, as well as the South-Tambeyskoye, Termokarstovoye, Yarudeyskoye, Beregovoy, Khadyryakhinskiy, Pyreinoye, Severo-Chaselskoye, Yaro-Yakhinskiy and Samburgskiy fields and license areas, according to NOVATEK's shareholding in the respective fields and license areas. The appraisal reports were conducted under the reserves estimation, reporting and disclosures rules promulgated by the U.S. Securities and Exchange ("SEC") reserves reporting methodology provided that due to a lack of clear and definitive SEC guidance, D&M has relied on management representations that we intend to (i) extend the term of our licenses to the end of the economic lives of the fields, where applicable, and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. The appraisal reports under the SEC reserves standards do not include estimates for probable and possible reserves.

Conversion ratio: 1000 m<sup>3</sup> = 6.54 boe. To convert crude oil and gas condensate reserves from tons to barrels we used various coefficients depending on the liquid density at each field according to D&M's appraisal of our reserves as of 31 December 2010 and 2009.

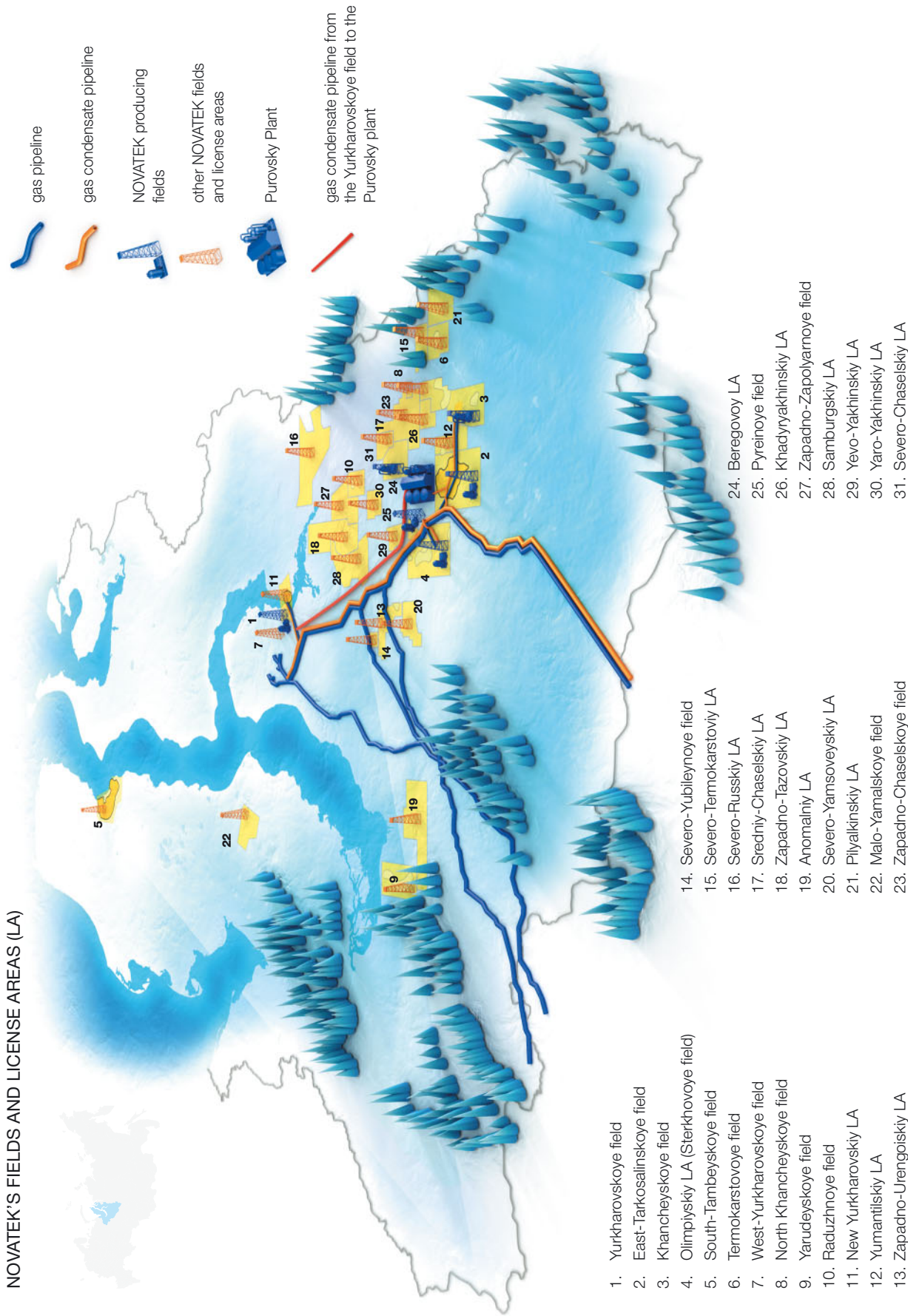
#### GROSS HYDROCARBON PRODUCTION

	Units	2010	2009	Change, %
Natural gas	bcm	37.8	32.8	15.3%
	mm boe	247.1	214.4	
Liquid hydrocarbons	mmt	3,632	3,049	19.1%
	mm boe	30.5	25.5	
Total production	mm boe	278	240	15.8%

Total gross production by OAO NOVATEK and its subsidiaries, excluding acquisitions of 2010

\* As of February 2011, the 51% interest in Sibneftegas is directly held by OAO NOVATEK

## NOVATEK'S FIELDS AND LICENSE AREAS (LA)







ods and technology to model and study the geological structure of NOVATEK's fields and license areas as well as the physical processes of development, production and processing of their hydrocarbons. The Company's geologists use a systematic approach to exploration and development of new fields, beginning with the collection and interpretation of seismic data to the creation of dynamic field models for the placement of exploration and production wells. We employ modern geological and hydrodynamic modeling as well as new well drilling and completion techniques in an attempt to maximize the ultimate recovery of hydrocarbons in a cost effective manner.

**In 2010**, NOVATEK invested approximately RR 2,042 million in exploration activities at consolidated subsidiaries which, included 15.2 thousand meters of exploration drilling and the running and processing of 522 square kilometers of 3D seismic and 322 kilometers of 2D seismic. The exploration activities at our fields targeted gas condensate and crude oil bearing Lower Cretaceous and Jurassic deposits at depths of between 2,000 to 4,400 meters.

## Production

**In 2010**, NOVATEK's gross production from all fields amounted to 278 mm boe of which, approximately 89% was natural gas.

**In 2010**, total gross production amounted to 37.8 bcm of natural gas and 3,632 mt of liquid hydrocarbons. Natural gas production increased by 5.01 bcm, or 15.3 %, while liquids production increased by 583 mt, or 19.1%, compared to the respective production volumes in 2009. In 2010, NOVATEK's lifting costs increased by 0.6% to RR 16.1 per boe on a Russian rouble basis and by 6% to \$0.53 per boe on a dollar basis. The Company's total gas production capacity as of 1 January 2011 aggregated to approximately 167 mmcm per day (including our share in Sibneftegas' production capacity) or approximately 60 bcm per annum.

## Core Producing Fields

**Our three core producing fields** — Yurkharovskoye, East-Tarkosalinskoye and Khancheyevskoye — accounted for 99.7% of our natural gas and liquid hydrocarbons production in 2010 and more than 64% of our total 2010 proved reserves, as appraised by D&M, under the SEC's reserve methodology. Each of these important fields is located in close proximity to the UGSS and production and processing infrastructure and form the foundation for our current production and mid-term production growth targets.

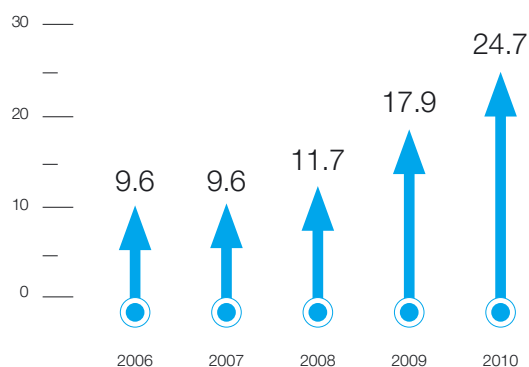
### The Yurkharovskoye Field

**The field** was discovered in 1970 and is located within the polar circle on the southeast shore of the Tazov peninsula. The Company's wholly-owned subsidiary OOO NOVATEK-Yurkharovneftegas (Yurkharovneftegas) holds the license for exploration and production of hydrocarbons at the field which is valid until 2034. The field has been producing natural gas and gas condensate since 2003 and, in 2009, became the largest of NOVATEK's fields in terms of reserves and production. The successful development of this field is the main driver for our near-term production growth as well as the cornerstone of our current strategy to meet growing demand for natural gas in the Russian domestic market.

**The field is connected** to the UGSS via our own pipeline infrastructure, which enables the transport of up to 34 bcm of natural gas per annum. We arrange for further transportation to end-customers through transportation contracts we enter into with Gazprom.

**In April 2010**, we launched a 40 mt per annum methanol plant located on the territory of the Yurkharovskoye field, thus eliminating the need to transport methanol to the field and decreasing our operating costs and the potential environmental risks related to its transportation. We have used the experience gained from the launch in September 2007 of the 12.5 mt per annum pilot methanol

### YURKHAROVSKOYE FIELD NATURAL GAS PRODUCTION, bcm

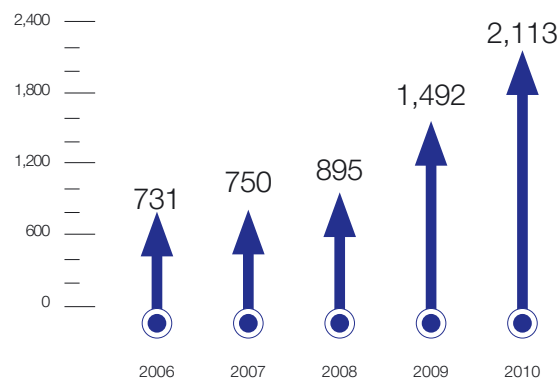


production plant to improve the design of our new plant. Our new plant uses higher quality anti-corrosive steel as well as a more efficient gas compressor unit.

**In August 2010**, we launched our unstable gas condensate de-ethanization unit at the field and a 326 kilometer unstable gas condensate pipeline connecting the field with our Purovsky Plant, both have capacities of three mmt per annum. The construction and launching of these new facilities enabled us to improve the quality of our gas condensate and reduce third party expenses for de-ethanized gas condensate processing and transportation.

**In October 2010**, we completed the third stage of the second phase of development at the field, increasing our total productive capacity by seven bcm of natural gas and 600 mt of unstable gas condensate per annum thus increasing total field production capacity to approximately 33 bcm of natural gas and approximately three mmt of unstable gas condensate.

### YURKHAROVSKOYE FIELD GAS CONDENSATE PRODUCTION, mt



#### Total marketable (sales) production in 2010:

Natural gas:	24.4 bcm (861.1 bcf)
Liquid hydrocarbons:	2,100 mt (18.1 mm bbl)

#### Proved reserves (SEC) at 31 December 2010:

Natural gas:	460.0 bcm (16,244.1 billion cubic feet (bcf))
Liquid hydrocarbons:	23.0 mmt (197.8 mm bbl)

## East-Tarkosalinskoye Field

**The field's license** for exploration and production of hydrocarbons is held by NOVATEK's wholly-owned subsidiary OOO NOVATEK-Tarkosaleneftegaz (Tarkosaleneftegaz) and is valid until 2043. The field began producing crude oil in 1994 and natural gas and gas condensate in 1998 and 2001, respectively.

**The East-Tarkosalinskoye field**, discovered in 1971 is located in the northern central area of the West Siberian lowlands, a territory known locally as the Purovsky district of the Nadym-Pur-Taz region. Development drilling in the Cenomanian horizon commenced in May 1998 and commercial production of natural gas began in December 1998. Development drilling in the Valanginian horizon commenced in May 2000 and commercial production of gas condensate began in February 2001.

**The East-Tarkosalinskoye field** is our most mature field and has reached its respective plateau levels in terms of natural gas and gas condensate production. We expect the field's production profile to remain relatively flat in the near-term.

**The field is connected** to the UGSS via our own pipeline, which enables the transport of up to 20 bcm of natural gas from the East-Tarkosalinskoye and the Khancheykoye fields per annum. Unstable gas condensate is de-ethanized

at the field and is transported via our 2.4 mmt per annum pipeline to our Purovsky Plant.

**Crude oil is transported** via our pipeline collection system to our complex gathering station for further processing. After processing the crude oil is transported via our crude oil pipeline to the metering station of Transneft's oil pumping station and injected into the pipeline system operated by Transneft.

**In April 2010**, we commissioned the first stage compressor booster station at the field's Valanginian layer, with a capacity of eight MW, to maintain the field's hydrocarbon production levels as the reservoir pressure decreases.

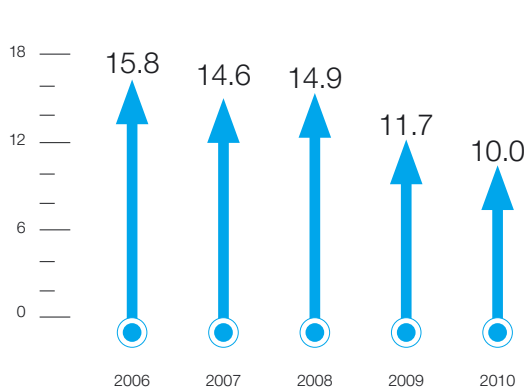
### Total marketable (sales) production in 2010:

Natural gas:	9.7 bcm (343.8 bcf)
Liquid hydrocarbons:	852 mt (6.9 mmbbl)

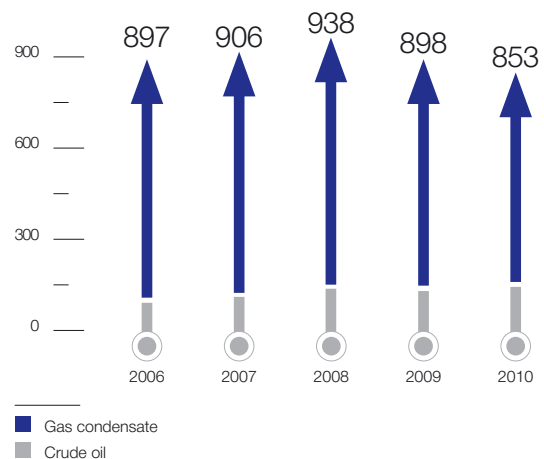
### Proved reserves (SEC) at 31 December 2010:

Natural gas:	236.1 bcm (8,337.3 bcf)
Liquid hydrocarbons:	18.6 mmt (148.3 mm bbl)

### EAST-TARKOSALINSKOYE FIELD NATURAL GAS PRODUCTION, bcm



### EAST-TARKOSALINSKOYE FIELD LIQUIDS PRODUCTION, mt





## Khancheyskoye Field

**The Khancheyskoye field** was discovered in 1990 and is located 65 kilometers to the east of the East-Tarkosalinksoye field. The license for exploration and production of hydrocarbons at the Khancheyskoye field is held by Tarkosalneftegas and is valid until 2044. The field began producing natural gas and gas condensate in 2001 and crude oil in 2007.

**All of the field's natural gas production** is transported via our pipeline to our East-Tarkosalinskoye field, and then further transported to customers using the East-Tarkosalinskoye field's connection to the UGSS. The pipeline's current capacity is 7.5 bcm per annum.

**The field's unstable gas condensate production** is transported via our pipeline to our East-Tarkosalinskoye field, where it is de-ethanized and further transported to our Purovsky Plant using the East-Tarkosalinskoye field's unstable gas condensate pipeline. The intra-field unstable gas condensate pipeline's capacity is 1.1 mmt per annum.

**Crude oil is loaded** on to tanker trucks for further transportation to the oil collection system of the East-Tarkosalinskoye field where it is processed and transported to Transneft's oil pumping station and injected into the pipeline system operated by Transneft.

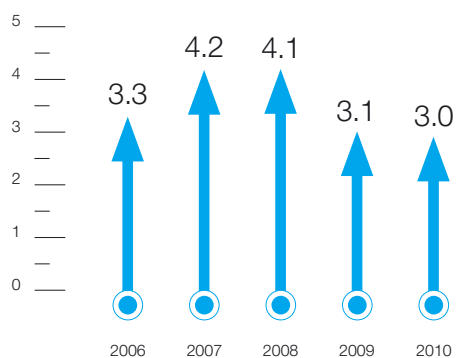
### Total marketable (sales) production in 2010:

Natural gas:	3.0 bcm (106.4 bcf)
Liquid hydrocarbons:	635 mt (5.2 mm bbl)

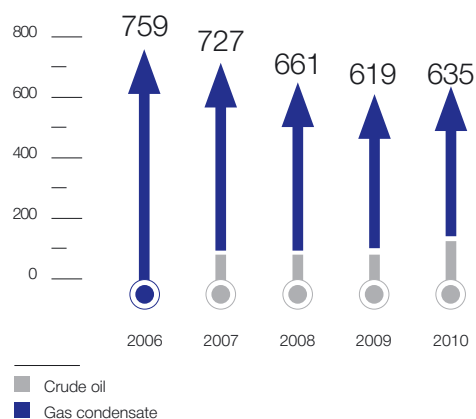
### Proved reserves (SEC) at 31 December 2010:

Natural gas:	37.1 bcm (1,310.7 bcf)
Liquid hydrocarbons:	4.6 mm tons (37.4 mm bbl)

### KHANCHEYSKOYE FIELD NATURAL GAS PRODUCTION, bcm



### KHANCHEYSKOYE FIELD LIQUIDS PRODUCTION, mt



## Other Producing Fields

### Beregovoy License Area

**Sibneftegas holds** the exploration and development license for the Beregovoy license area. This license area encompasses the Beregovoye field, Sibneftegas' largest field according to the Russian Federation's State Balance of Reserves. The field is connected to the UGSS by way of a 32.8 kilometer natural gas pipeline and commercial production of natural gas began in 2007.

**Currently, Sibneftegas** is completing the interpretation of 3D seismic results to update the existing geological model in order to determine the field's future development plans.

#### Total marketable (sales) production in 2010\*:

Natural gas:	9.0 bcm (317 bcf)
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#### Net proved reserves (SEC) at 31 December 2010:

Natural gas:	86.4 bcm (3,052.7 bcf)
Liquid hydrocarbons:	0.4 mmt (3.0 mm bbl)

### Pyreinoye Field

**Sibneftegas also holds a license** for the development of hydrocarbons and geological exploration at the Pyreinoye gas condensate field. Commercial production of natural gas began in 2009. The field is connected to the UGSS by way of a 36 kilometer natural gas pipeline.

**Currently, Sibneftegas** is completing 3D seismic exploration work at the field to update the existing geological model and the field's geological reserves.

#### Total marketable (sales) production in 2010\*:

Natural gas:	0.9 bcm (30.5 bcf)
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#### Net proved reserves (SEC) at 31 December 2010:

Natural gas:	8.9 bcm (312.8 bcf)
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### Sterkhovoye Field

**The Sterkhovoye field** is located within the Olimpiyskiy license area. The license for exploration and production of hydrocarbons at the Olimpiyskiy license area is held by Tarkosaleneftegas. We are currently interpreting seismic data from the northern portion of the license area, where the field is located, and plan to increase development drilling over the next two years.

**We commenced exploratory drilling** at the Sterkhovoye field in 2000, and commercial production began in April 2009.

**The field is connected** to the UGSS by a 14 kilometer natural gas pipeline with transportation capacity of 3.1 bcm per annum. De-ethanized gas condensate from the Sterkhovoye field is sent to the Purovsky Plant via a 12 kilometer portion of the gas condensate pipeline connecting the Yurkharovskoye field with the Purovsky Plant.

**We constructed and launched** a complex gas preparation unit at the Sterkhovoye field in 2009 with annual capacity of 0.7 bcm, which enabled commercial production at the field to commence.

#### Total marketable (sales) production in 2010:

Natural gas:	77.2 mmcm (2.7 bcf)
Liquid hydrocarbons:	31 mt (0.3 mm bbl)

#### Proved reserves (SEC) at 31 December 2010:

Natural gas:	10.5 bcm (371.8 bcf)
Liquid hydrocarbons:	3.5 mm tons (28.6 mm bbl)

\* NOVATEK's subsidiary acquired 51% of the shares of OAO Sibneftegas in December 2010. The production volumes at the Beregovoy license area and Pyreinoye field are given for reference only and are excluded from the Company's total production volumes calculations. 100% of the field's production volumes are shown.

## Development Projects

**NOVATEK continued exploration work** at its other fields and license areas located within the territory of the YNAO. Currently, the most prospective of these assets are the South-Tambeyskoye field, the other fields and license areas of Sibneftegas and SeverEnergiya as well as the Termokarstovoye field and Olimpiyskiy license area.

### South-Tambeyskoye Field

**The license for exploration and production** at the field is held by NOVATEK's subsidiary Yamal LNG.

**In June 2010**, we entered into a cooperation agreement with Gazprom setting out the key parameters for joint activity between our companies in implementing and developing a pilot LNG project on the Yamal peninsula based on the resources of the South-Tambeyskoye field. The terms of our agreement with Gazprom set out the scope of construction, development and subsequent utilization of related infrastructure, including energy and transportation systems and LNG production facilities.

**Within the project's framework** we are planning further exploration and development activities at the South-Tambeyskoye field including production drilling and infrastructure development. Infrastructure plans are expected to include the construction of a gas gathering system, a gas complex processing facility, a gas condensate processing unit, an LNG plant, pipelines which enable gas transportation from the field to the plant, an offshore shipping terminal and other transportation infrastructure (including an airport, port terminal and highways).

**In October 2010**, the Russian Government officially outlined its position on tax concessions for the development of LNG projects in the Yamal peninsula. Following this announcement and the completion of our feasibility and engineering studies, we plan to finalize our total capital expenditure plans, including construction expenses for the Yamal LNG plant.

#### Net proved reserves (SEC) at 31 December 2010:

Natural gas:	213.0 bcm (7,522.1 bcf)
Liquid hydrocarbons:	7.6 mm tons (65.5 mm bbl)

### Samburgskiy License Area

**The Samburgskiy license** area comprises the reserves of Samburgskoye, Severo-Yesetinskoye+Vostochno-Urengoiskoye and Severo-Purovskoye fields and part of the Urengoiskoye field. The license for exploration and development is owned by OAO Arcticgas, a wholly owned subsidiary of SeverEnergiya. We are currently reviewing the development plans for the license area in order to optimize the recovery of hydrocarbons.

#### Net proved reserves (SEC) at 31 December 2010:

Natural gas:	32.5 bcm (1,146.5 bcf)
Liquid hydrocarbons:	6.7 mm tons (53.6 mm boe)

### Termokarstovoye Field

**The license for exploration and production** of gas and gas condensate at the Termokarstovoye field is held by NOVATEK's associated company ZAO Terneftegas, our joint venture with TOTAL Termokarstovoye B.V. In June 2009, we signed a framework agreement with TOTAL S.A. establishing the framework for joint cooperation in exploring and developing the Termokarstovoye gas condensate field. In December 2009, we signed a subscription agreement, a sales and purchase agreement and a shareholders agreement with TOTAL Termokarstovoye B.V., which reduced our share in Terneftegas to 51% in 2010. TOTAL Termokarstovoye B.V. holds the remaining 49% of shares.

**In 2010**, we drilled a horizontal well to assess the potential reservoir productivity in the Jurassic layers. A final investment decision will be taken in 2011.

#### Net proved reserves (SEC) at 31 December 2010:

Natural gas:	12.6 bcm (443.9 bcf)
Liquid hydrocarbons:	2.4 mm tons (20.2 mm bbl)

## Urengoiskoye Field

The **Urengoiskoye field** is part of the Olimpiyskiy license area and is included in our 2010 annual independent reserve appraisals.

**To date**, we are reviewing 2D seismic data from the field.

### Proved reserves (SEC) at 31 December 2010:

Natural gas:	3.3 bcm (118.1 bcf)
Liquid hydrocarbons:	0.9 mm tons (7.1 mm bbl)

## Other Fields and License Areas

**At the end of 2010**, NOVATEK held 15 licenses for exploration and production as well as seven licenses for exploration. The total reserves under the Russian reserve classification ABC1 + C2 at these fields totaled 527 bcm of natural gas and 130.7 mmt of liquid hydrocarbons as of 31 December 2010.

**In 2010**, the following other fields and license areas were also included in our independent reserve appraisal; North Khancheykoye, Severo-Russkoye, West Yurkharovskoye, Yarudeyskoye and Severo-Chaselskoye fields as well as Khadyryakhinskiy and Yaro-Yakhinskiy license areas and the total combined SEC proved reserves, according to NOVATEK's shareholding, amounted to 44.0 bcm of natural gas and 5.2 mmt of liquid hydrocarbons.

**In addition to the Samburgskiy license area**, SeverEnergia, through its subsidiaries, holds licenses for exploration and development at the following fields and license areas:

- The Yevo-Yakhinskiy license area consists of the Yevo-Yakhinskoye field, parts of the Urengoiskoye and Severo-Yesetinskoye + Vostochno-Urengoiskoye fields. The license for exploration and development is owned by OAO Arcticgas.
- Yaro-Yakhinskiy license area includes the Yaro-Yakhinskoye field and its surrounding territories. The license for exploration and development is owned by ZAO Urengoil Inc.
- The Severo-Chaselskiy license area, which includes the Severo-Chaselskoye field and its surrounding area. The license for exploration and development is owned by OAO Neftegaztehnologiya.

**SeverEnergia's fields** are in close proximity to the license areas of our subsidiaries and our existing transportation and processing infrastructure and the infrastructure of the Purovsky Plant. We are currently working with the joint venture partners to refine the development plans for these fields and license areas.

**In addition to the licenses** for the Beregovoy license area and Pyreinoye field, Sibneftegas, holds geological exploration and development licenses for the Khadyryakhinskiy license area and Zapadno-Zapolyarnoye field which are in the early stages of geological exploration. Sibneftegas is currently planning to conduct further drilling and 3D seismic exploration works at the Khadyryakhinskiy license area in order to determine the geological structure of the deposits and identify any potential additional reserves that may be ready for development. Sibneftegas's fields are in close proximity to the license areas of our subsidiaries and our existing transportation and processing infrastructure.

**In 2010**, we increased our participation interest to 100% in companies holding exploration licenses to the Sredniy-Chaselskiy, Severo-Russkiy, Zapadno-Tazovski, Anomalniy and Severo-Yamsoveyskiy license areas, as well as the exploration and production license at the Zapadno-Chaselskoye field.

**In 2010**, the license for the Severo-Russkiy license area was reissued to Tarkosaleneftegas and at the end of 2010 the licenses for the Sredniy-Chaselskiy license area and the Zapadno-Chaselskoye field were in the process of being reissued to Tarkosaleneftegas as a result of the merger of Oiltechproduct-Invest into Tarkosaleneftegas. In order to reduce costs and more effectively carry out development plans, our wholly-owned subsidiaries, Tarkosaleneftegas and Yurkharovneftegas, act as operators for the exploration works at these fields and license areas.

**In 2010**, we discovered one gas condensate field at the Severo-Russkiy license area containing five productive formations. Four of these productive formations were discovered as a result of drilling tests and one on the basis of geophysical data. In 2010, we also discovered the Ukrainsko-Yubileynoye field, which has three gas condensate layers, and is included as part of the Severo-Yamsoveyskiy license area.

**In 2010**, we acquired a 100% interest in Tambeyneftegas, the holder of the exploration and production license to the Malo-Yamalskoye natural gas and gas condensate

field whose total reserves under the Russian reserve classification ABC1 + C2 amount to 161 bcm of natural gas and 14.4 mmt of gas condensate, according to the Russian Federation's State Balance of Reserves at 31 December 2010.

**NOVATEK owns** a 50% participation interest in the concession agreement for exploration and production of hydrocarbons at the El-Arish off-shore block. The off-shore block, comprising an area of approximately 2,300 square kilometers, is located along the Mediterranean Sea coast, adjacent to the north coast of the Sinai Peninsula and close to developed fields. The concession agreement provides for a minimum exploration period of four years, which will include performing geophysical studies of the block as well as drilling two exploration wells.

**In compliance** with the respective license terms, we have conducted 3D exploration works and drilled one exploration well, which was subsequently expensed during the fourth quarter. We are in the process of assessing the geological and geophysical information with our partners, as well as the current economic situation, and will make a decision regarding our future plans in the first quarter of 2011.

**We will continue** to conduct exploration works at our remaining license areas in compliance with the respective license terms, with the strategic aim of furthering our reserves growth as a result of the discovery of new deposits.

## Processing

**Gas condensate** is produced from our fields in an unstable form and requires further processing before it can be delivered to our customers. Our primary gas condensate processing asset is the Purovsky Plant, which has total processing capacity of five mmt of de-ethanized gas condensate per annum, that allows us to produce approximately 3.7 mmt of stable gas condensate and approximately 1.3 mmt of LPG per annum. The Purovsky Plant is located in the YNAO and in close proximity to the East-Tarkosalinskoye field.

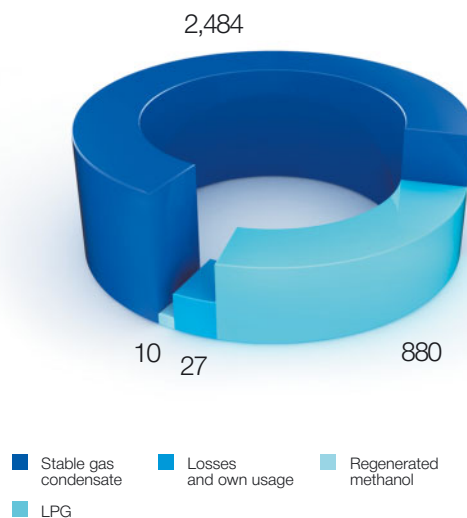
**The Purovsky Plant** is an important link in our mid-stream value chain that provides us complete operational control over our processing needs and access to higher-yielding marketing channels for our stable gas condensate.

Our ability to control the processing function allows us to produce stabilized gas condensate and LPG that are of higher-quality than the output that would result from a third-party processor.

**The Purovsky Plant receives feedstock** from two sources; through our unstable gas condensate pipelines from the East-Tarkosalinskoye and Khancheyevskoye fields, and our unstable gas condensate pipeline from the Yurkharovskoye and Sterkhovoye fields. In August 2010, we launched a 326 kilometer, three mmt per annum unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant. The commissioning of this pipeline allows us to increase the quality of our processed products by eliminating the quality dilution, which occurred when gas condensate from the Yurkharovskoye field was mixed with other producers' gas condensate, during delivery to the Purovsky Plant using Gazprom's trunk pipeline.

**In 2010**, the Purovsky Plant processed 3.4 mmt of de-ethanized unstable gas condensate, or 19.5% more than in 2009, resulting in the commercial production of 2.5 mmt of stable gas condensate and 880 mt of LPG as well as 10 mt of methanol produced during the LPG scrubbing process. In 2010, the Purovsky Plant operated at approximately 68% of full capacity, providing us with the ability to continue developing our gas condensate fields.

**PUROVSKY PLANT OUTPUT 2010,**  
mt



**Substantially all of the stabilized gas condensate produced** at our Purovsky Plant is delivered by rail to the Port of Vitino where it is loaded onto ocean tankers for further transportation to international markets. In November 2010, we commissioned 9.6 mcm of raw material storage facilities for our de-ethanized gas condensate at the plant. In total, the Purovsky Plant has storage facilities for stable condensate (90.0 mcm), LPG (15.6 mcm) and raw materials (13.6 mcm). The Purovsky Plant also has facilities for loading stable condensate and LPG into rail tank cars. Our own railway line connects the plant to the Russian railway network at the Limbey rail station.

**As part of our goal** to increase processing depth, we continued the engineering design work for a new terminal facility at Ust-Luga, located on the Baltic Sea, for the transshipment and fractionation of stable gas condensate produced at the Purovsky Plant. A portion of the stable gas condensate supplied to the facility by rail transport will be loaded onto tankers for delivery to export markets while the remaining volumes will be used as feedstock to the fractionation unit for further processing into naphtha, jet fuel and diesel/gas oil which will be sold to both domestic and international export markets. The estimated fractionation capacity of the Ust-Luga terminal is up to six mmt per annum, and will be constructed in two phases.

**The project** is currently in the early infrastructure development stage. Our subsidiary, NOVATEK-Ust-Luga, is engaged in the engineering design works and has simultaneously started construction works at the site and, upon completion will be the operator of the terminal.

## Marketing

**During 2010**, NOVATEK supplied natural gas to 33 regions of the Russian Federation, successfully navigated the Northern Sea Route to deliver stable gas condensate to China and acquired a Polish LPG distribution company to support export sales and distribution.

### Natural Gas Sales

**According to the CDU-TEK**, total Russian natural gas production increased by 11.6% in 2010 and Russia remained the second largest consumer of natural gas in

the world consuming approximately 414 bcm. The largest Russian consumer of natural gas is the power generation sector where over 50% of its primary energy supply comes from natural gas. In 2010, NOVATEK accounted for more than 10% of the total natural gas deliveries to the domestic market through the UGSS.

**In 2010**, NOVATEK's natural gas sales volumes amounted to 37.1 bcm, an increase of 12.7% compared to 2009 sales volumes of 32.9 bcm, of which 23.7 bcm was sold to the end-customer segment and 13.4 bcm was sold ex-field to the wholesale trader segment.

**In 2010**, our customers were located primarily in the Perm territory, Chelyabinsk, Orenburg, Sverdlovsk, Moscow, Kurgan, Kirov, Samara and Kostroma regions, the city of St-Petersburg as well as the YNAO and Khanty-Mansyisk Autonomous Region. During the period, NOVATEK acquired a gas trader, OOO Yamalgazresurs-Chelyabinsk, and established OOO NOVATEK Perm to support and expand current and future natural gas sales opportunities in the respective region and territory.

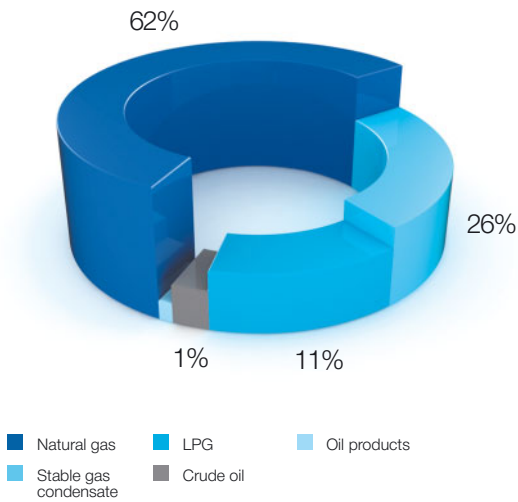
**In the beginning of 2010**, we entered into new arrangements with Gazprom whereby we sell 10.3 bcm of natural gas per annum directly to Gazprom. In April 2010, we entered into a new five-year sales contract with the Itera Group providing for the sale of 24 bcm of natural gas over the period from 2011 through 2015, at prices based on the gas price set by the FTS for the Sverdlovsk region less transportation costs. The Itera Group then sells this gas to end-customers in the Sverdlovsk region.

**Total revenues from natural gas sales increased** to RR 71.1 billion or by 32.5%, in 2010 as compared to 2009.

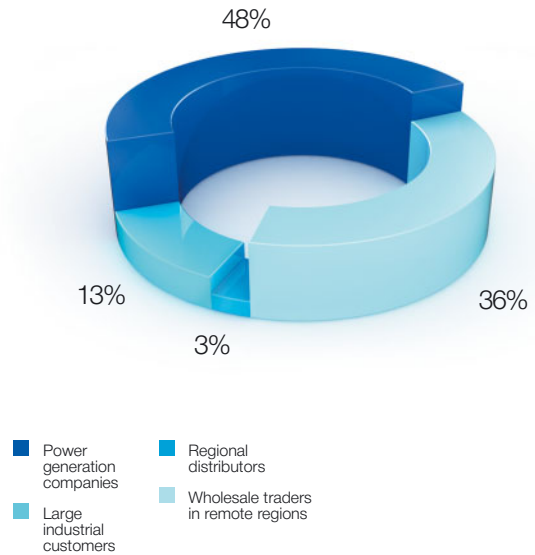
**In order to maintain production levels** during periods of seasonality in demand NOVATEK has entered into an agreement with OAO Gazprom for the use of the latter's underground storage facilities on a space available basis. Historically, natural gas is injected into underground storage facilities during warmer periods when demand is lower and later withdrawn during periods of colder weather and increased demand.

**In 2010**, NOVATEK withdrew 428 mmcm of natural gas from underground storage facilities during periods of high demand and injected 605 mmcm when space was avail-

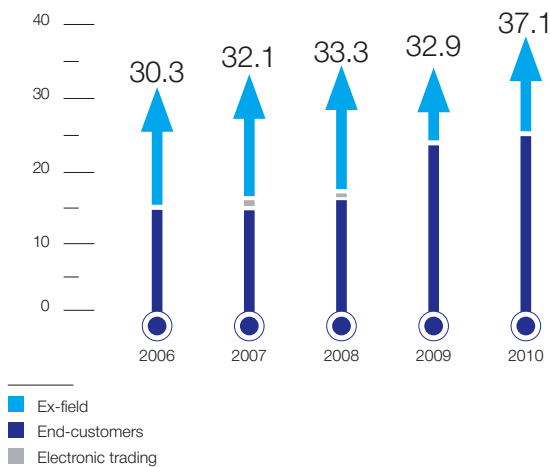
**2010 BREAKDOWN OF OIL&GAS SALES, %**



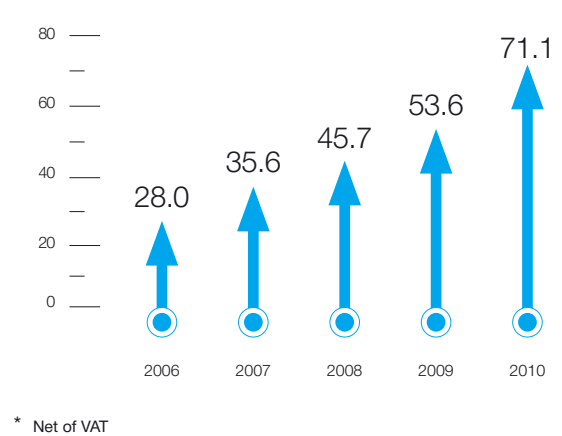
**2010 BREAKDOWN OF NATURAL GAS SALES VOLUMES, %**



**NATURAL GAS SALES VOLUMES, bcm**



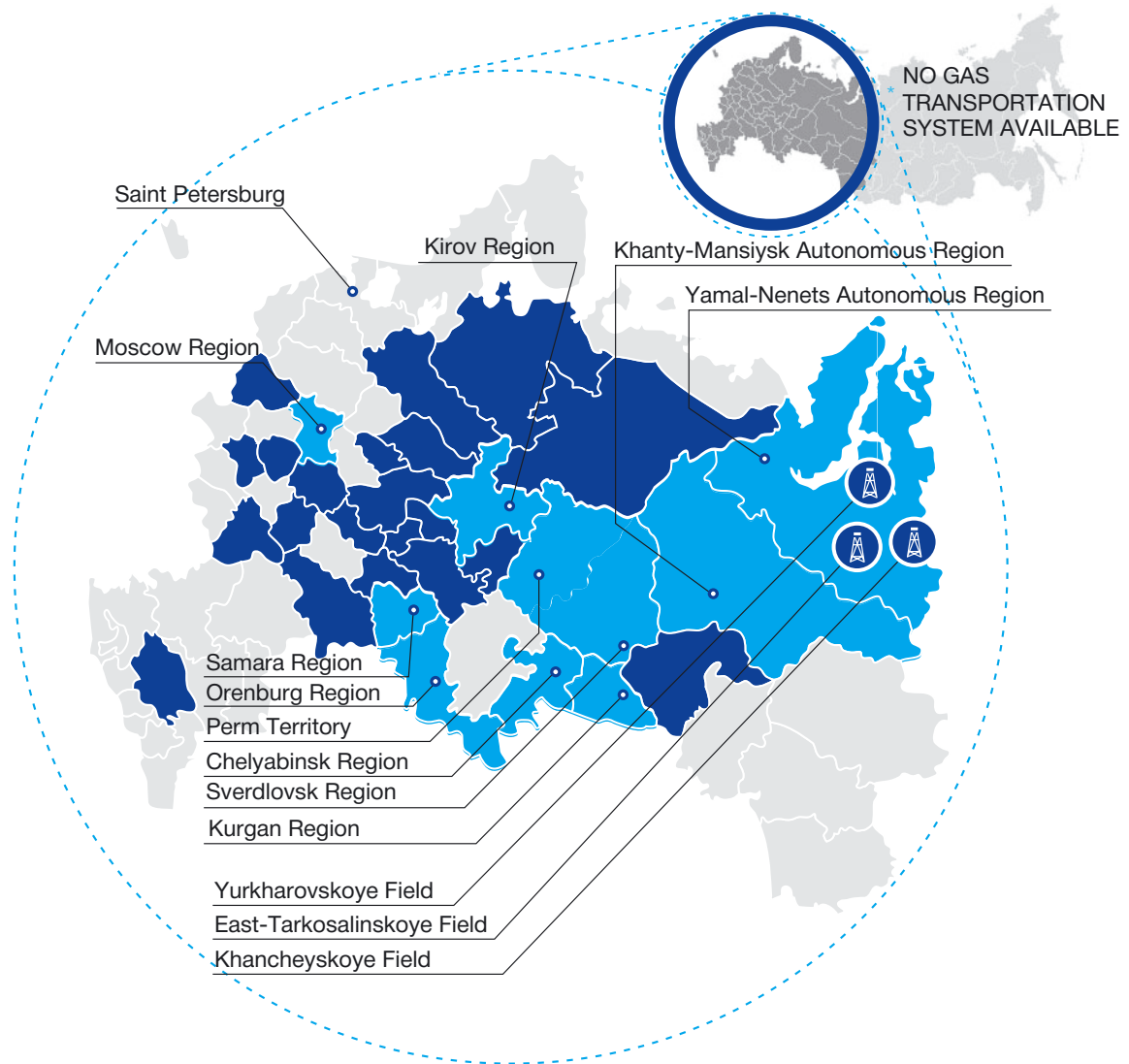
**NATURAL GAS SALES REVENUE, RR billion\***




\* Net of VAT



## DOMESTIC GAS DELIVERIES



- Main regions
- Other regions

 NOVATEK's core producing fields

○ Capitals of the main regions



able. At the end of 2010, the Company had 761 mmcm of natural gas in storage and available for withdraw in future periods.

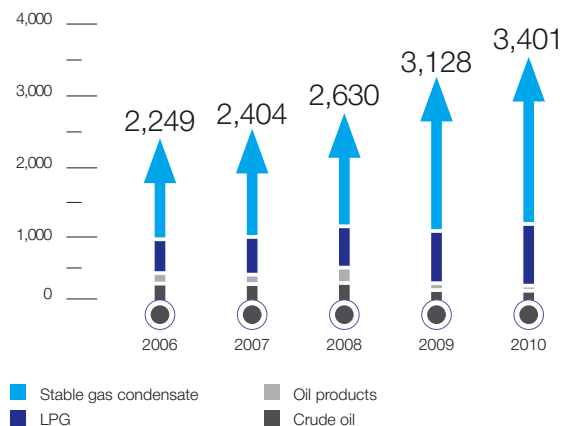
### Liquid Hydrocarbon Sales

The Company's primary liquid hydrocarbon sales volumes are comprised of stable gas condensate and liquefied petroleum gases (LPG). The stable gas condensate is primarily used in the petrochemical and oil refining industries as an alternative to naphtha and light crude oil, respectively. Our LPG is sold to both the chemical processing industry, as a feedstock, and the retail and wholesale fuel markets where its high energy content, environmental safety and ease of storage and transportation make it an attractive fuel source for automobiles and residential usage.

The Company's liquid hydrocarbon sales results demonstrate our success in diversifying both the product slate, to higher value added products, and geographic markets. The initial launch and subsequent expansion of the Purovsky Plant has enabled NOVATEK to optimize its marketing strategy based on the reliable supply of high quality processed hydrocarbons to both the domestic and export markets.

Total sales volumes of liquid hydrocarbons in 2010 amounted to 3,401 mt, an 8.7% increase over 2009

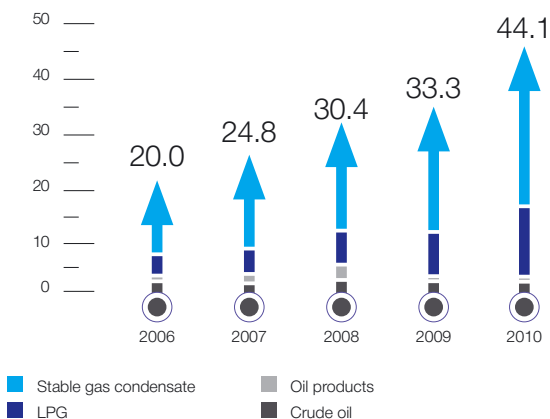
### LIQUIDS SALES VOLUMES, mt



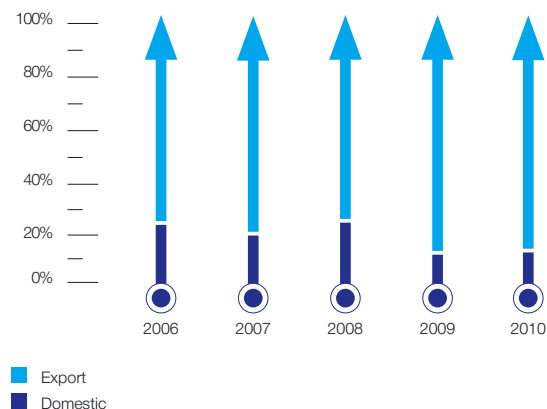
volumes, while total revenues from liquids sales increased to RR 44.1 billion, or by 32.5%, in 2010 as compared to 2009.

During 2010, we dispatched 41 tankers of stable gas condensate from the Port of Vitino and sold 39, of which 53% were sold to markets in the USA, 26% to countries in the Asian-Pacific region, 13% to markets in Europe and 8% to markets in other countries. We had two tankers in transit at year-end. Over 99% of our 2010 stable gas condensate sales volumes were sold to the export market.

### LIQUIDS SALES REVENUE, RR billion\*

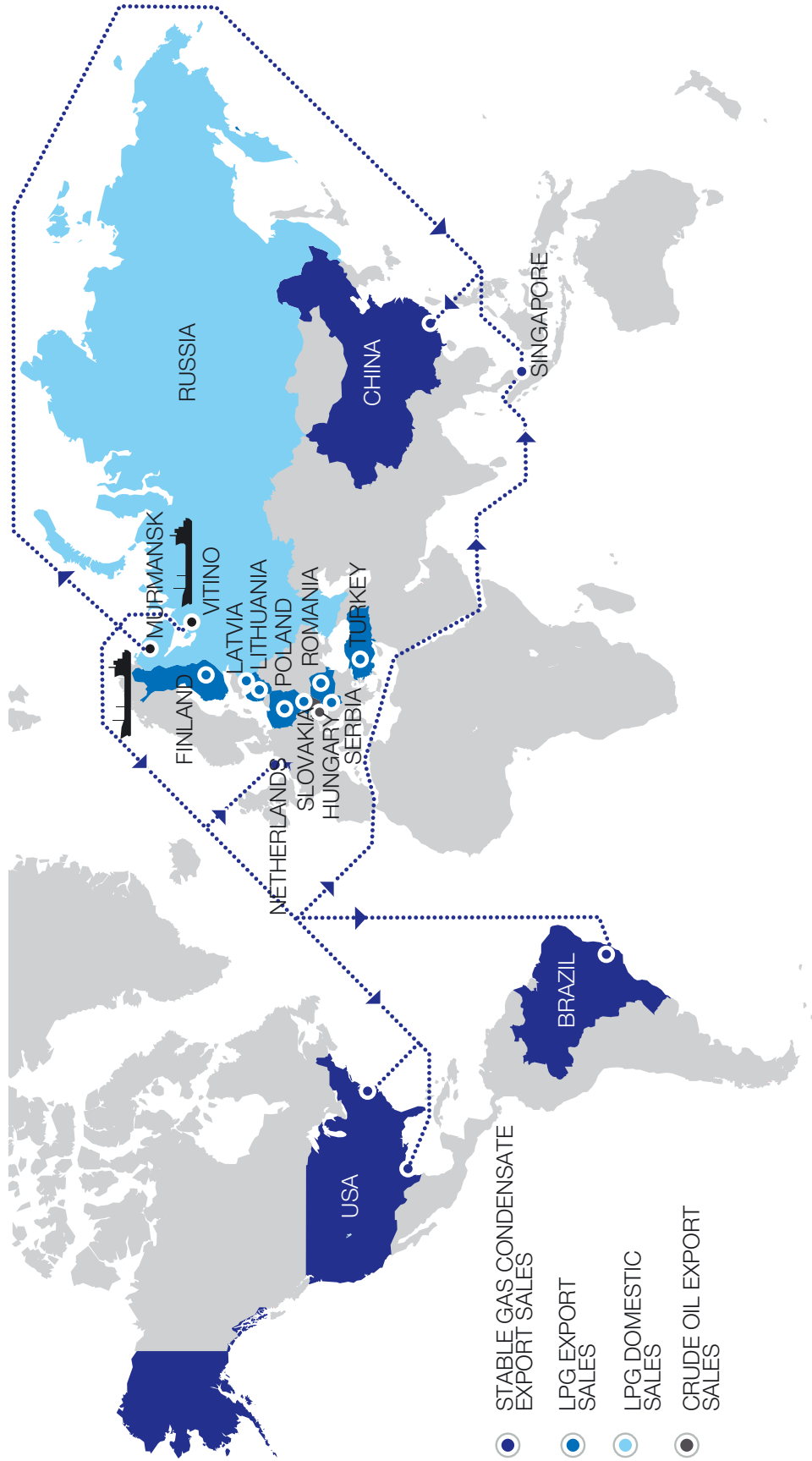


### LIQUIDS SALES REVENUE MARKET DISTRIBUTION, %



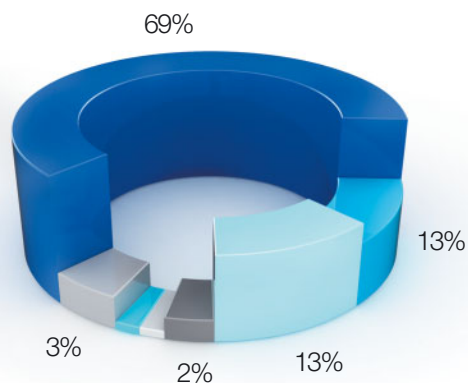
\* Net of VAT, excise tax and export duties.

LIQUID HYDROCARBON SALES



**BREAKDOWN OF LIQUIDS SALES VOLUMES, %**

- Stable gas condensate (export)
- Stable gas condensate (domestic)
- LPG (export)
- LPG (domestic)
- Crude oil (domestic)
- Crude oil (export)
- Oil products



**The Company sells its LPG volumes** to both the export and domestic markets. In November 2009, we established Novatek Polska, a wholly-owned LPG trading company in Poland, to expand our LPG sales network there and support our export sales. Novatek Polska began commercial activities in January 2010. In 2010, export sales volumes of LPG accounted for 50% of total LPG sales volumes. NOVATEK's LPG sales through its network of retail and small wholesale stations in the Chelyabinsk and Volgograd regions increased by more than three times in 2010 compared to 2009. Sales of LPG and oil products through NOVATEK's owned and leased stations amounted to 45 mt in 2010.

**At the end of 2010** the Company's owned and leased rolling stock, for transportation of liquid hydrocarbons from the Purovsky Plant, totaled 5.6 thousand rail cisterns.

**Stable gas condensate** is transported by rail from the Purovsky Plant to the loading and storage facilities we have constructed, together with OAO Belomorskaya Neftebaza, at the all season Port of Vitino. In 2010, we loaded 2,445 mt at the port or 19% more than in 2009.



« NOVATEK considers its employees as the Company's most valuable resource »»

# 04 | Environmental and Social Responsibility

## Human Resources

**In assessing** its current activities and future development plans, NOVATEK considers its employees as the Company's most valuable resource. The Company's human resource management system is based on the principles of fairness, respect, equal opportunity and provides for an open dialogue between management and personnel. NOVATEK also provides continuous, comprehensive training and professional development opportunities for the Company's employees at all levels.

**As of the end of 2010**, NOVATEK had 4,019 employees, 54% of whom work in exploration and production and 33% in plant operations, processing, transportation and sales.

### Personnel Training and Development

**In an environment** of rapidly developing technologies, our multilevel training and professional development program enables NOVATEK's workers to maintain the Company's high degree of competitiveness. In 2010, the primary training and professional development goals included the following:

- Realization of the "Leadership Horizons" program for developing future managers;

- Involvement of young specialists in NOVATEK's "Research-to-Practice Conferences" and the "Fuel and Energy Complex (FEC) Competitions"; and
- Training and professional development for the Company's employees to specific requirements of Division Heads.

**NOVATEK continued** its efforts to increase employee training, improve working conditions and ensure a safe environment at its production facilities. In 2010, 34.6% of the Company's engineers and technicians completed employee certification and industrial safety courses and 40.2% of our specialists and line workers have upgraded their respective qualifications.

**NOVATEK continued** the implementation of the "Leadership Horizons" program for developing future managers and 110 employees underwent training in the "Leadership in Communications", "Human Resource Management" and "Business Case Decisions" modules and 55 employees, who entered the Program in 2010, underwent training in two modules: "Task Management" and "Leadership in Communication".

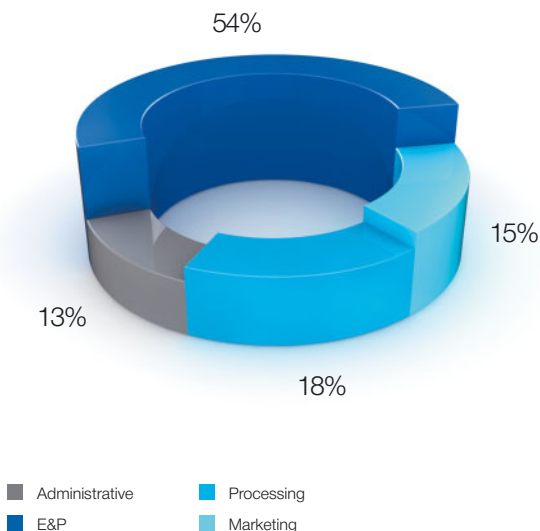
**The "5th Interregional Research-to-Practice Conference"** for NOVATEK's young specialists was held in Moscow in September 2010, and 43 of the Com-

pany's employees participated. Based on the results of the competition, 11 winners were awarded a trip to an oil and gas training center in the USA and the second- and third-place winners were awarded cash prizes. The top projects advanced to the "FEC 2010 Competition of Youth Projects" sponsored by the Ministry of Energy of the Russian Federation.

**In 2010**, two of NOVATEK's young specialists who were winners of the "FEC 2009 Competition of Youth Projects" received commendations from the Ministry of Energy of the Russian Federation.

**In 2010**, we hired an independent specialist to carry out a research study to measure the level of employee involvement in the Company's operations. The study involved 2,348 of the Company's core subsidiaries' employees, which is more than 72% of the total number of employees and a statistically significant representation. The result showed that 68% of our employees felt actively involved in our results and success, which is well above the corresponding levels in a majority of Russian and European companies which participated in similar studies.

#### 2010 BREAKDOWN OF PERSONNEL AS AT 31 DECEMBER 2010



## Social Programs

**The central feature of NOVATEK's social policy** is a systematic approach to solving social problems and supporting workers and their families. According to the Core Concept of the Company's Social Policy which was adopted in 2006, the social benefits package for employees includes the following programs:

- Voluntary medical insurance for employees;
- Therapeutic resort and spa treatment for employees and members of their families;
- Provision of special-purpose short-term loans;
- Special-purpose compensation and social support payments;
- Provision of special-purpose interest-free loans to purchase housing; and
- Pension program.

## Social Policy and Charity

**NOVATEK continued** to implement its socio-economic development strategy in the regions where it operates throughout 2010. Special priority was given to the performance of our long-term agreements with municipalities of the YNAO and the Samara region for financing programs targeting education and youths, development and modernization of social infrastructure and preservation of the cultural heritage of the indigenous peoples of the Far North and Russia as a whole. In 2010, NOVATEK invested approximately RR 774 million on projects and activities related to the support of indigenous peoples, charitable contributions and educational programs.

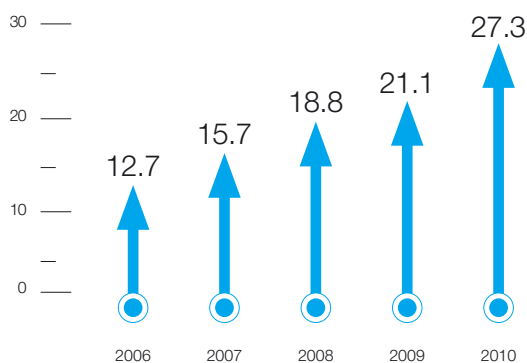
### Cooperation With Indigenous Peoples of the Far North

**During 2010**, NOVATEK financed projects aimed at preserving the culture of indigenous peoples of the Far North and developing community infrastructure, including medical treatment facilities as well as the construction of housing, social and cultural facilities.

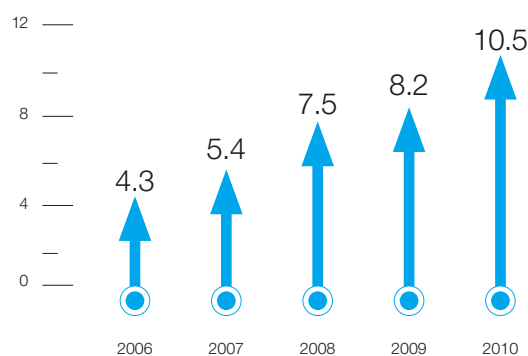
**Throughout the year the Company provided** sponsorship assistance to the following organizations:

- The Yamal for Descendants Association and its district branches to support an Adaptation Center for students from the population centers of the indigenous peoples of the Far North;

**TOTAL REVENUES PER EMPLOYEE,**  
RR million



**NET CASH PROVIDED BY OPERATING  
ACTIVITIES PER EMPLOYEE,**  
RR million



- The Ilebc Territorial Agricultural Community and Tam-bey Territory (Yamal District) in order to develop local land, purchase fuel and provide aviation services; and
- The Kutopyugan Village (Nadym district) for the construction of roads, the installation of a boiler and other infrastructure facilities.

### Educational Programs

**NOVATEK continues** to develop the Company’s continuing education program which provides opportunities to gifted students from the regions where we operate to further their education in top rated Universities, participate in NOVATEK internships and, upon completion of their studies, possible employment with the Company.

**Under the “Gifted Children” program** initiated by NOVATEK in 1999, special classes are formed on a competitive basis from the most talented students in the cities of Tarko-Sale and Novokuybyshevsk. The program is designed for students in grades 10 and 11 who have above-average test scores.

**The Company continued** to operate the “Grants” program for schoolchildren and teachers in the Novokuybyshevsk and Purovsky Districts of the YNAO.

**The “Grants” program** for schoolchildren is an educational support program which we have been administering since 2004. Under the program, students in grades 5 through 11

living in the districts are awarded grants from the Company to support their academic and creative development and to encourage a responsible attitude towards their studies. Since the launch of the program, 1,186 grants have been awarded.

**The “Grants” program** for the teachers of the districts was launched in 2007 and awards grants to highly effective teachers to raise the prestige of the teaching profession and create favorable conditions for developing new and talented teachers. Since the launch of the program 63 grants have been awarded.

**In an effort** to create conditions for more effective use of university and college resources in preparing students for future professional activities, the Company has developed and successfully implemented the NOVATEK-VUZ program in cooperation with the St. Petersburg State Mining Institute, the Gubkin Russian State University of Oil and Gas and the Tyumen Oil and Gas University. The NOVATEK-VUZ program operates on the basis of mutually beneficial cooperation agreements that include support for pre-university preparation of students, subject competitions and professional orientation. Students, who have passed their exams with good and excellent results, receive additional monthly payments together with the State sponsored grants and compensation of travel expenses to internships. During their studies, the students have the opportunity to participate in industrial, technological and pre-degree paid internships with the Company or its subsidiaries.





## Support of Cultural Traditions

**The strengthening** of partnership relations between the Company and Russia's leading cultural and educational institutions, creative groups and charity funds has continued during 2010.

**NOVATEK remains** a General Partner of the Moscow Soloists Chamber Ensemble under the direction of soloist and conductor Yuri Bashmet. The Company also continued its long-term cooperation with the Russian State Museum (St. Petersburg), the Samara Regional Art Museum, the Moscow Kremlin Museum, the Tsaritsyno Estate Museum, the Moscow House of Photography Museum and Exhibition Complex, the Moscow Museum of Modern Art and the State Tretyakov Gallery.

**In 2010**, the Company organized and sponsored a number of exhibitions jointly with the Moscow Kremlin Museum, the Russian State Museum, the Moscow House of Photography and the Moscow Museum of Modern Art and Samara Regional Art Museum. In 2010, NOVATEK worked on the Company's first project with the State Tretyakov Gallery, an exhibition of Alexander Deineka, which was organized in conjunction with the 110th anniversary of the artist.

## Sports Projects

**NOVATEK** has continued its support for semi-professional and high-level amateur sports programs. The Company is the General Partner of the Dinamo Hockey Club (Moscow), the Kryliya Sovetov Football Club (Samara), the Spartak Basketball Club (St. Petersburg) and the NOVA Volleyball Team (Novokuybyshevsk).

## Charitable Activities

**The Company** is expanding its cooperation with the "Gift of Life" charity fund, founded by Chulpan Khamatova, which raises funds to purchase modern medical equipment for children's hospitals.

**In 2010**, NOVATEK also continued its active support of the fund's blood donor movement whereby twice a year the Company's Moscow office hosts blood donor sessions to benefit patients of the Russian Children's Clinical Hospital. By the end of 2010, 250 participants donated more than 100 liters of blood.

## Volunteer Work

**In 2010**, the Company continued its support for the volunteer movement "All Together" in which NOVATEK's employees take part in charitable events and projects. The movement has been active in a number of causes including; supporting orphans and children with various illnesses as well as supporting the blood donor sessions and the organization of various other charitable programs. Since the beginning of 2008, the volunteer movement has been a regular supporter of an orphanage in the Tver region and it has been a regular supporter of orphaned animals and veteran's programs since 2009 and 2010, respectively.



# Environment, Health and Safety (EHS)

**The Company's strategic approach** to ensuring the environmental safety of the Company and subsidiaries' operations are defined in NOVATEK's EHS Policy which provides for the following:

- Regular ecological monitoring in license areas, ecological supervision at production facilities and carrying out environmental impact assessments before commencing work;
- Upgrading equipment and technologies to comply with environmental protection and industrial safety requirements;
- Conformance with the requirements of Russian EHS legislation;
- Rational use and conservation of natural resources and energy; and
- Introduction of non-waste and low-waste technologies.

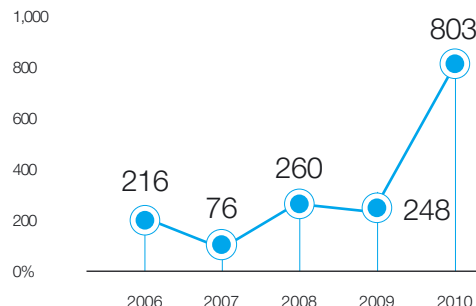
**In August 2010**, NOVATEK launched a 326 kilometer unstable gas condensate pipeline connecting the Yurkharovskoye field with the Purovsky Plant. The Company was able to optimize the capital expenditures required to complete the pipeline by incorporating solar and wind power generation units to provide the necessary electricity to operate the pipeline's tele-mechanic system and valves, instead of using a fixed electrical line. In the future, this process solution will also be used at remote well clusters.

**The Company uses hydrocarbon-based drilling mud** when drilling horizontal wells, providing for the high-precision penetration of production horizons with effectively no pollution. Furthermore, the drilling mud is recovered from cuttings brought to the surface and sent for recycling.

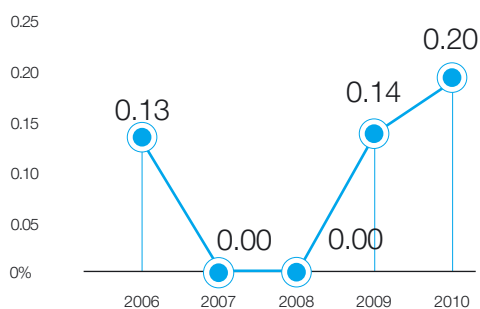
**INJURY FREQUENCY RATE**  
(no. of injuries / million working hrs)



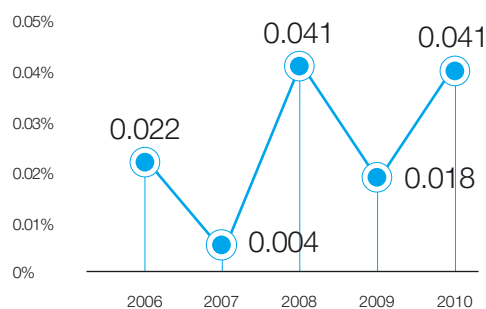
**ACCIDENT SEVERITY RATE**  
(total no. of employee working hrs lost per accident / no. of accidents)



**SERIOUS INJURY FREQUENCY**  
(no. of serious injuries / million working hrs)



**PERCENTAGE OF TIME LOST DUE TO INJURIES**  
(number of hrs lost / total working hrs)



**NOVATEK** is concerned about the environmental and economic issues related to the use of associated petroleum gas and has made the necessary investments in order to achieve a 95% level of associated gas usage.

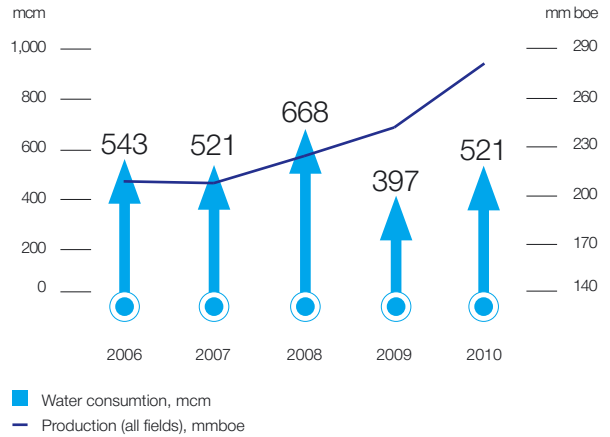
**In October 2010**, we completed the construction of a preliminary gas discharge unit and gas pipeline connecting to the gas and gas condensate preparation unit of the East-Tarkosalinskoe field, providing for the efficient recovery of associated petroleum gas (APG) in an amount of approximately 100 mcm/day.

**In 2010**, NOVATEK continued its participation in the Carbon Disclosure Project (CDP) which discloses information on greenhouse gas emissions and the energy efficiency of production. Despite a continuous increase in hydrocarbon production, greenhouse gas emissions from NOVATEK's production facilities have increased only slightly compared with the previous year.

**In 2010**, NOVATEK and all our core subsidiaries passed compliance and recertification audits of their environmental management systems in accordance with ISO 14001-2004 and OHSAS 18001-2007 international standards.

**The Company's activities** with respect to environmentally safe production have earned the community's appreciation as well as national recognition. In 2010, NOVATEK won an award at the "100 Best Organizations in Russia. Ecology and Indus-

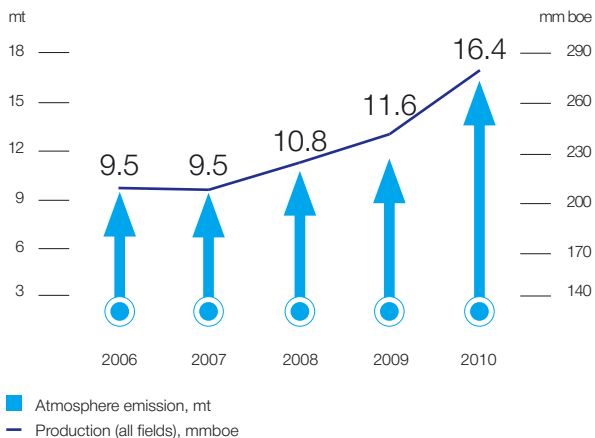
**WATER CONSUMPTION OF NOVATEK E&P COMPANIES**



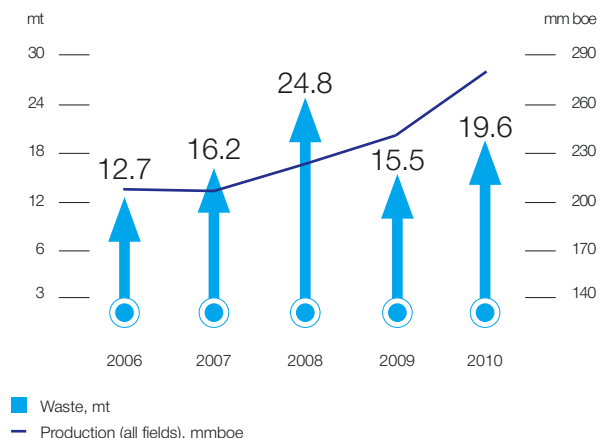
trial Safety" competition (St. Petersburg) and was the winner of the Sixth Russian National Competition "Russian Nature Conservation Leader – 2010" (Kremlin, Moscow), where the CEO of OAO NOVATEK was awarded the Medal of Honor for Environmental Safety.

**A key component** of the Company's health and safety policy is implicit recognition that society, the State, our business partners, shareholders and our other stakeholders have the right to

**AIR POLLUTION OF NOVATEK E&P COMPANIES**



**WASTE GENERATION OF NOVATEK E&P COMPANIES**



**ENERGY RESOURCES CONSUMPTION IN 2010\***

	Volume	Thousands of Russian roubles, net of VAT
Natural gas, mcm	229,432.56	241,662.75
Electricity, MWh	189,608.00	559,192.93
Heating energy, Gcal	236,963.66	139,972.53
Oil, tons	—	—
Motor gasoline, tons	544.56	14,746.21
Diesel fuel, tons	18,679.81	75,950.11
Other, tons	10.90	807.00

\* Company data

obtain full and reliable information on the state of “Health and Safety” at the Company’s production sites.

**In 2010**, the Company developed and approved plans and measures to improve working conditions and ensure safety in the workplace. The plans provide for regulatory, procedural and technical support of safe working conditions and for the organization of an occupational health training system.

**During the implementation** of these plans in 2010, we made a study of the working conditions and hazardous production factors in the workplace. Based on this, we are systematically certifying employees’ workplaces for conformance with international labor organization standards and the requirements of Russian legislation.

**Following a dialog between** the Company’s managers, unions and employees in 2010, a series of collective agreements were signed ensuring that Company employees are provided with personal and group protective equipment and compensation for harm caused to an employee by an occupational disease or other damage to health associated with performance of his or her duties.

**In 2010**, the number of specialists undergoing industrial safety training and certification doubled. Employees are trained in safe work methods under specially developed programs, regardless of the nature of work, the employees’ work experience, education or qualifications. Training is provided both within the Company and at specialized educational institutions.

**In order to identify shortcomings** in managing health and safety practices, and promptly eliminate them at

NOVATEK’s facilities, supervisory committees have been set up at the facilities to carry out internal audits of working conditions and to determine compliance with work safety standards and regulations.

**Despite all our efforts**, we did record accidents in 2010. To prevent similar incidents, unscheduled audits of the emergency response and preparedness of facilities and operating personnel have been carried out. Our efforts to ensure industrial safety are based on the results of an assessment and analysis of risks caused by the multi-variable effect of process operations during hydrocarbon production and processing. In 2010, we worked to improve the quantitative assessment of risks associated with our production activities, prepare declarations of industrial safety, conduct expert examinations of hazardous production facilities, create manufacturing risk identification systems, and implement health and safety inspection methods.

**In recognizing the Company’s liabilities associated** with operating hazardous production facilities in areas of extreme natural conditions and difficult access, we are planning to increase efforts toward reducing the risks of accidents and minimizing their consequences. Plans for accident and emergency response and containment at gas and gas condensate production, storage and transportation facilities were analyzed and revised during the reporting period. NOVATEK’s goal is to develop uniform approaches to organizing emergency response and containment methods and coordinate the actions of all departments and divisions. The emergency response and containment plans call for organizing and carrying out accident prevention measures and developing an action algorithm for operating personnel to eliminate potential accidents.



DIVIDENDS  
2010  
2005

4.0  
0.9\*

DIVIDENDS PER SHARE, RR  
\*AMOUNT REFLECTS THE SHARE  
SPLIT (1:1000) IN JULY 2006

« NOVATEK's dividend policy is aimed at keeping the balance between the Company's business goals and shareholders' interests »»

# 05 | Management and Corporate Governance

## Corporate Governance

**NOVATEK and its Board of Directors** are committed to the highest standards of corporate governance. We believe that such standards are essential to business integrity and performance and provide a framework for transparent and responsible management which in turn enables us to create value for our shareholders. This section sets out the policies and practices of the Company, more information on our corporate governance practices can be found on our website at [www.novatek.ru/eng](http://www.novatek.ru/eng).

**NOVATEK** is committed to the principles and standards of the Corporate Governance Code promulgated by the Russian Federation's Federal Commission for Securities Markets.

**The Board of Directors** (Minutes No. 60 of 15 December 2005) has approved the Corporate Governance Code of NOVATEK. The Code is in full compliance with the laws of the Russian Federation and has been elaborated on in accordance with international best practices, generally accepted principles of corporate governance, the Corporate Governance Code promulgated by the Russian Federation's Federal Commission for Securities Markets and the Company's Articles of Association.

**In order** to ensure that the highest standards of corporate governance are observed we have adopted an internal NOVATEK Corporate Governance Code which

provides a framework that governs the execution of our business activities. We expect all of our employees to conduct business in a socially responsible manner, adhere to our corporate governance and transparency commitments, and strive to identify ways to improve the efficiency of our work in each of our respective roles. The NOVATEK Code of Corporate Governance is also available on the Company's website.

**We are incorporated in the Russian Federation** and our shares are listed on the Russian Trading System and MICEX exchanges. As such, we are required to comply with the laws and regulations promulgated under the Russian Federation's Corporate Governance Code, approved 28 November 2001 (minutes No. 49). The NOVATEK Corporate Governance Code is in full compliance with the provisions of the Russian Federation's Corporate Governance Code. Our shares are also listed on the London Stock Exchange (LSE) in the form of Global Depository Receipts (GDR's) and we recognize the value of the UK Financial Reporting Council's Combined Code on Corporate Governance and have applied the recommendations in so far as it is practicable and appropriate, and does not contradict those of the Russian Federation. We support high standards of corporate governance and will progressively adopt best practices in line with the Combined Code on Corporate Governance.

## Board of Directors

DIRECTOR	COMMITTEE MEMBERSHIP
Alexander Y. Natalenko <sup>1,2</sup>	Strategy and Investments Committee, Corporate Governance and Remuneration Committee
Leonid V. Mikhelson	
Andrei I. Akimov <sup>2</sup>	Audit Committee
Burckhard Bergmann <sup>2</sup>	Corporate Governance and Remuneration Committee, Strategy and Investments Committee, Sub-committee for LNG projects (chairman)
Mark A. Gyetvay	Strategy and Investments Committee (chairman) Sub-committee for LNG projects
Vladimir A. Dmitriev <sup>1,2</sup>	Audit Committee (chairman)
Kirill G. Seleznev <sup>2</sup>	Strategy and Investments Committee
Ruben Vardanian <sup>1,2</sup>	Corporate Governance and Remuneration Committee (chairman), Audit Committee
Gennady N. Timchenko <sup>2</sup>	Strategy and Investments Committee Sub-committee for LNG projects

<sup>1</sup> Denotes independent Board Member according to the definition contained in the UKLA Combined Code

<sup>2</sup> Denotes independent Board Member according to the definition contained in the Russian Federal "Law on Joint-Stock Companies"

**NOVATEK's Board of Directors** (the Board) is responsible for directing and managing the business activities of the Company under the provisions stipulated by the Federal Law on Joint Stock Companies and NOVATEK's charter documents. The Board is accountable to NOVATEK's shareholders for creating and delivering sustainable shareholder value by executing its managerial responsibilities in an effective and efficient manner.

**As well as oversight responsibility** for financial performance, internal controls and risk management, the Board has a formal schedule of matters specifically reserved to it for decision. These matters include, but are not limited to; defining the Company's strategy and ensuring that capital and human resources are properly allocated in order to execute it, optimization of corporate and capital structure, review of significant contracts, approval of long-term and yearly business plans and investment projects, recommendations on dividends and the convening of Annual and Extraordinary General Meetings of Shareholders. The full list of matters reserved to the Board for decision is available on the Company's website.

**The Board consists** of nine members. NOVATEK's Board is chaired by Mr. Alexander Natalenko. The Chair-

man is responsible for leading the Board and its effectiveness. The Board has a strong independent element and currently comprises, in addition to the Chairman, two executive directors and six non-executive directors who together with the Chairman are considered independent according to the definition contained in the Corporate Governance Code of the Russian Federation.

**NOVATEK's Directors** have a wide range of expertise as well as significant experience in strategic, financial, commercial and oil and gas activities. Following appointment to the Board, Directors receive a comprehensive induction tailored to their individual needs. This includes meetings with senior management to enable them to acquire a detailed understanding of NOVATEK's business activities and strategy, and the key risks and issues that we face as a business. In addition to these formal processes Directors have access to the Company's senior executives for both formal and informal discussions to ensure regular exchange of information between non-executive directors and management. Directors receive timely, regular and necessary management and other information to enable them to fulfill their duties and have access to the services and advice of the Board's secretary.



**BOARD AND COMMITTEE MEETINGS ATTENDANCE**

Member	Board of Directors	Audit Committee	Corporate Governance and Remuneration Committee	Strategy and Investments Committee
Alexander Y. Natalenko	10/10		3/3	5/5
Leonid V. Mikhelson	10/10			
Andrei I. Akimov	10/10	5/6		
Burckhard Bergmann	10/10		3/3	2/5
Mark A. Gyetvay*	10/10			5/5
Vladimir A. Dmitriev	9/10	6/6		
Kirill G. Seleznev	7/10			2/5
Ruben Vardanian	9/10	6/6	3/3	
Gennady N. Timchenko	10/10			5/5

\* Mr. Gyetvay was elected to the Chairman of the Strategy and Investments Committee on 28 April 2010

**To ensure an efficient process the Board meets regularly**, but not less than once every two months, and in 2010, held 10 meetings, eight of which were by proxy.

**Board Activities During the Year**

**The Board met 10 times during 2010** where the following key issues were discussed and respective decisions made.

**Operating and Financial Performance**

**The Board reviewed and approved the Company's** 2009 full year operating and financial results, and amended the 2010 business plan accordingly. The Board also reviewed and approved NOVATEK's business plan for 2011.

**Transactions****The Board approved:**

- The acquisition of an additional 25.1% of the shares in OAO Yamal LNG, which holds the license for exploration and production at the South Tambeyskoye field;
- The acquisition of 100% of the shares in OAO Tambeynftegas, which holds the license for exploration and production at the Malo-Yamalskoye natural gas and gas condensate field;

- The acquisition of 51% of the shares in OAO Sibneftegas, which holds the license for subsoil exploration and production at the Beregovoye, Pyreinoye, and Zapadno-Zapolyaroye fields and the Khadyryakhinskiy license area;
- The disposal of the Company's 100% equity interest in OOO NOVATEK-Polymer. The disposal is consistent with NOVATEK's strategy to focus on its core natural gas and gas condensate production and processing activities; and
- The issuance of a Eurobond for an amount of up to 1,500 million US dollars for a period of up to ten years.

**Dividends**

**The Board recommended** a full year dividend for 2009, based on fully year financial results, and an interim dividend for first half 2010, based on interim financial results for that period.

**Board Committees**

**On 25 March 2005**, NOVATEK's Board of Directors approved the implementation and establishment of three Board Committees: Audit; Strategy and Investment; and Corporate Governance and Remuneration, in accordance with corporate governance best practices and standards.

**On 4 December 2009**, the Board approved the establishment of a sub-committee within the Strategy and Investments Committee to oversee the development of LNG projects and natural gas markets.

**The committees play** a vital role in ensuring that the high standards of corporate governance are maintained throughout the Company and that specific decisions are analyzed prior to general Board discussions. The specific terms of reference for each of the Board Committees are available on our website. The minutes of the committee meetings are circulated to the Board and are accompanied by oral reports.

### Strategy and Investments Committee

**The Strategy and Investments Committee** is governed by a Charter which has been approved by the Board. The Charter is available on the Company's website and is summarized below.

**The primary function of the Strategy and Investments Committee** is to give recommendations to the Board for determining priorities of the Company's operations and assessing the effectiveness of investment projects proposed to the Board for consideration.

**The main objectives** of the Strategy and Investment Committee are as follows:

- Determine strategic priorities for the Company's operations; and
- Assess the effectiveness of prospective investment projects and consider how these investments increase shareholder value of the Company

**In carrying** out its responsibilities and assisting the members of the Board in discharging their duties the

Strategy and Investment Committee is responsible for but not limited to

- Analyzing concepts, programs and plans of the Company's strategic development and giving recommendations to the Board;
- Developing recommendations to the Board with respect to any transactions with assets the value of which exceeds five percent of the Company's assets' book value, as calculated in accordance with the accounting data as of the last reporting date;
- Developing recommendations to the Board following the consideration of investment projects proposed by the Company's executive bodies for implementation; and
- Developing recommendations to the Board for utilization of the Company's reserves and provisions.

**In order to carry out** its duties the Strategy and Investment Committee may request information or documents from members of the Company's executive bodies, or heads of the Company's relevant departments, which it requires to efficiently discharge their duties. For the purpose of considering any issues being within the Committee's powers, the Strategy and Investment Committee may engage experts or other specialists having necessary professional knowledge and skills. The manner and terms and conditions of engaging such experts or specialists are to be stipulated in agreements between the Company and such persons.

**At year-end 2009** a LNG sub-committee was established within the Strategy and Investments Committee. The Board members on the sub-committee are Burckhard Bergmann (Chairman), Mark Gyetvay and Gennady Timchenko.

**To ensure the Committee discharges** its responsibilities, it meets not less than four times per year and in 2010, the Strategy and Investment Committee met five times.

### COMMITTEE MEMBERSHIP AS OF 31 DECEMBER 2010

	Audit Committee	Corporate Governance and Remuneration Committee	Strategy and Investment Committee	Strategy and Investment Sub-committee for LNG projects
Chairman	Vladimir Dmitriev	Ruben Vardanian	Mark Gyetvay	Burckhard Bergmann
Members	Ruben Vardanian	Alexander Natalenko	Alexander Natalenko	Mark Gyetvay
	Andrei Akimov	Burckhard Bergmann	Burckhard Bergmann	Gennady Timchenko
			Gennady Timchenko	
			Kirill Seleznev	

## Corporate Governance and Remuneration Committee

**The primary function** of the Corporate Governance and Remuneration Committee is to review practices and policies of the Company to ensure compliance with applicable standards of corporate governance and best practices. The Corporate Governance and Remuneration Committee is also responsible for determining the policy for executive remuneration and for the remuneration and benefits of individual executive directors and senior executives as well.

**The main objectives** of the Corporate Governance and Remuneration Committee are as follows:

- Develop and regularly review our corporate governance documents and documents regulating corporate conflicts;
- Develop recommendations with respect to our dividend policy and distribution;
- Evaluate the Company's Investor Relations and Shareholder communications policies;
- Develop procedures for and perform an annual evaluation of the work performed by the Board; and
- Determine the annual compensation for the Board and Revision Commission members.

**In the 2010 corporate year**, the Corporate Governance and Remuneration Committee met four times.

### Audit Committee

**The Audit Committee** is governed by a Charter which has been approved by the Board. The Charter is available on the Company's website and is summarized below.

**The primary function** of the Audit Committee is to assist the Board in exercising effective control by assessing:

- The accuracy, transparency, and completeness of the Company's financial statements prepared in accordance with the Russian and International accounting standards;
- The candidature of the Company's external auditor;
- The independent auditor's report which is presented at the Company's Annual General Meeting of Shareholders (AGM);
- The efficiency of the Company's internal control procedures and proposals for their improvement; and
- The Company's compliance with applicable laws of the Russian Federation.

**In carrying out** its responsibilities the Audit Committee has full authority to investigate all matters that fall within its Charter. Accordingly, the Audit Committee may:

- Obtain independent professional advice in the satisfaction of its duties within the Committee's budget;
- Request and receive information from Company managers and senior executives; and
- Review reports and conduct meetings from the Company's external auditors.

**The Audit Committee** develops recommendations to the Board with respect to the candidature of the Company's auditor and the cost of its services. On the basis of the Committee's recommendations, the Board proposes the candidate auditor company to NOVATEK's AGM for approval. In selecting proposed candidates, the Audit Committee takes into account a prospective auditor's expertise and independence, the risk of conflicts of interest, contract terms and conditions and remuneration. The Audit Committee exercises control over the independence and objectiveness of the external auditor and the efficiency and quality of the audit. The Audit Committee annually informs the Board regarding its appraisal of the independent auditor's report.

**The Audit Committee meets** with representatives of the external auditor no less than once a year.

**To ensure the Audit Committee discharges** its responsibilities, it meets not less than four times per year and in 2010, the Audit Committee met six times. The Company's Chief Financial Officer and other senior financial management are available to attend the meetings.

**The Audit Committee reviews** the Company's Annual Report and develops recommendations to the Board with respect to preliminary approval of the report by the Board.

**NOVATEK's management acknowledges and recognizes the requirement** to uphold the independence of the Company's principal external auditors by limiting their engagement to provide a wide range of non audit services. The remuneration of the Company's principal auditors for audit services and other services has been set out in disclosure note 23 to the Company's 2010 IFRS consolidated financial statements.

## Internal Audit

**NOVATEK's Internal Audit Division**, in cooperation with the Board of Directors and the Company's management, takes part in providing objective assurance on the adequacy and effectiveness of the Company's systems for risk management and internal control and provides recommendations to improve those systems. The Internal Audit Division has adopted the Company's internal Code of Ethics as well as international auditing standards and international professional standards of internal audit.

**In performing its functions**, the Internal Audit Division is guided by the principles of independence and objectiveness. NOVATEK's internal standards envisage full access of the Internal Audit Division employees to all functions, records, property and personnel of the Company in implementing their audit tasks. The Division's employees regularly update their qualifications and professional development as an integral part of the internal audit quality assurance.

**A risk based approach** is used to plan the internal audits. In preparing reports on performance of audit tasks, the principles of accuracy, objectiveness, completeness and timeliness are observed.

**The head** of the Internal Audit Division annually provides reports on the Company's internal audit performance to the Audit Committee members.

**In August 2009**, the Board approved the new Regulations on NOVATEK's Internal Control, which provides a wider disclosure of the functions and procedure of the Company's internal control activities. According to the new Regulations, the number and organizational structure of the Internal Audit Division is to be approved by the Chairman of the Management Committee as agreed upon with the Audit Committee.

## Revision Commission

**In compliance** with the Russian Federation Law on Joint Stock Companies N 208-FZ and the Company's Charter, the Company's Revision Commission is elected at the AGM. The Revision Commission is governed by a Charter which has been approved by resolution of the shareholders at the Company's AGM. The Charter is available on the Company's website and is summarized below.

**The Revision Commission** consists of four persons and is an internal control body responsible for oversight of the Company's financial and business activities, officers, divisions, departments, branches, and representative offices. The Revision Commission audits the Company's financial and business performance for the year, as well as for any other period as may be decided by its members or other persons authorized to do so in accordance with Russian Federation law and the Revision Commission's Charter, and presents the review (revisions) results in the form of an opinion.

**The Revision Commission shall**, no later than 40 days prior to the AGM, present to the Board its report on the internal audit (review) of the Company's financial and business performance for the year, and its internal audit opinion confirming or denying the reliability of data contained in the Company's Annual Report and Annual Accounting Statement.

## Internal Control Framework

**The corporate governance section** of the Company's website contains a description of the main features of NOVATEK's internal control and risk management systems in relation to the financial reporting process and preparation of consolidated accounts.

## Management Committee

**NOVATEK's Management Committee** is responsible for the day-to-day management of the Company's operations within agreed limits set by the Board. More information regarding the general policies governing the Management Committee is available on the Company's website. The Management Committee is comprised of the Executive Directors and the following senior managers of the Company.

**In December 2009, NOVATEK** increased the size of its Management Committee to 15 members to better reflect the current scale and diversity of NOVATEK's operating activities; previously the Committee consisted of eleven members.

### Management Committee Members

- Leonid Mikhelson (Chairman)
- Vladimir Baskov
- Victor Girya
- Mark Gyetvay
- Evgeny Kot\*
- Tatyana Kuznetsova
- Iosif Levinzon\*
- Mikhail Popov
- Sergei Protosenya
- Valery Retivov\*
- Vladimir Smirnov
- Nikolai Titarenko
- Lev Feodosiev\*
- Alexander Fridman
- Kirill Yanovskiy

### Shareholder Communications

**The Company maintains** an active dialogue with its key financial audiences, including institutional shareholders and sell- and buy-side analysts to ensure that trading in its securities takes place in an informed market. The main channels of communication with the investment community are through the Chairman of the Management Committee and the Chief Financial Officer. The Investor Relations and Corporate Affairs departments manage the ongoing dialogue with these audiences.

**Regular presentations and press releases** take place at the time of interim and final results as well as dur-

ing the rest of the year. The Company also discloses all material facts to shareholders through a Regulatory Information Service, as well through press releases and on its website, in compliance with both Russian and UK listing requirements.

**In addition to material facts and statutory documents** the Company provides in depth information on the health, safety and environmental impact of its operations and activities on its website. The website also contains general investor information, publications and Company policies as well as presentation material from major Company events and investor seminars and conferences.

**The Board recognizes the importance** of communicating with its shareholders and, as well as giving a balanced report of results and progress at each AGM, the Company regularly meets with, and responds to questions and issues raised by shareholders and the analyst community. Information for NOVATEK's shareholders and contact information is available on the Company website.

\* Members of Management Committee were elected in December 2009

# NOVATEK Corporate Culture, Brand and Media Relations

In 2010, NOVATEK continued improving internal corporate communication channels to further develop the Company's corporate culture in order to give employees a sense of involvement in the Company's activities, and promote a creative and proactive attitude to their work.

## Corporate Media

The main objectives of NOVATEK's corporate media in 2010 were to provide employees and their family members with in-depth, reliable information about the Company's activities and involve NOVATEK employees in corporate, cultural, sporting and charitable activities.

NOVATEK's corporate newspaper, including its new supplement "NOVATEK-Family", became an effective means of disseminating this information in 2010. In November 2010, the newspaper was recognized as the "Best Corporate Newspaper in the Oil and Gas Industry" in the "Best Corporate Media" competition sponsored by the Energy Ministry of the Russian Federation.

In 2010, the Company initiated work on the design and preparation of a corporate magazine, "NOVATEK+" to increase the number of communication channels with stakeholders.

Currently, NOVATEK is developing a social website "NOVATEKPLUS.RU" to provide employees with online information on social activities, Company achievements and information on outstanding employees of NOVATEK and its subsidiaries.

## Employee Access to Senior Management

During 2010, the Company continued to provide opportunities for employees to meet directly with NOVATEK's senior management. These meetings were attended by the Chairman, Deputy Chairmen and members of the Management Board.

## Corporate Events: Sports, Culture and Education

In 2010, NOVATEK continued to provide employees with opportunities to participate in recreational and sporting activities, including competitions and social events. The number of employees who took part in corporate events in 2010 increased by more than 15% compared to 2009.

More than 3,500 employees and their family members enjoyed exhibitions at Russia's national museums, classical music and jazz concerts, and professional hockey, basketball and soccer matches.

## NOVATEK Brand and Media Relations

NOVATEK has positioned itself as a transparent Company through the timely disclosure of information on socially significant and relevant topics, as well as by providing prompt answers to questions of interest to the media in order to raise awareness of the NOVATEK brand.

## Image and Publications

NOVATEK's image is based on five key attributes that characterize the Company and how it conducts its operations, which include: confidence in its capabilities, use of innovative and proprietary technologies, focused and clear strategy, business integrity and respect for people and the environment.

During 2010, NOVATEK produced or updated the following promotional materials to highlight these attributes:

- Company booklet;
- Video clips "Ahead of the Times" and "We produce gas in Russia";
- Company book "People who are ahead of their time" in Russian; and
- Brochure on social support projects.



## Exhibitions and Conferences

**During 2010**, NOVATEK managers and employees represented the Company at more than 16 exhibitions, conferences and round tables and gave eight presentations on key industry issues. The most important event was the 21st World Energy Conference held in September in Montreal, Canada which was attended by a NOVATEK delegation. The conference organizers nominated the Company's stand as the best in the "Most Original Conceptualization" category. It harmoniously combined elements of advanced technologies and actual flora of the Yamal tundra, which the Company treats with great care.

## Media Relations

**NOVATEK adheres** to the principles of openness and transparency in its relationship with media outlets, and the Company maintains a regular dialog with the press in keeping with NOVATEK's approved information policy.

**The information disclosed** to the media covers all aspects of NOVATEK's activities including financial and operating results, project implementation and social and environmental information.

**Press tours** have been organized for influential Russian and foreign media to highlight the Company's most important events. These events include:

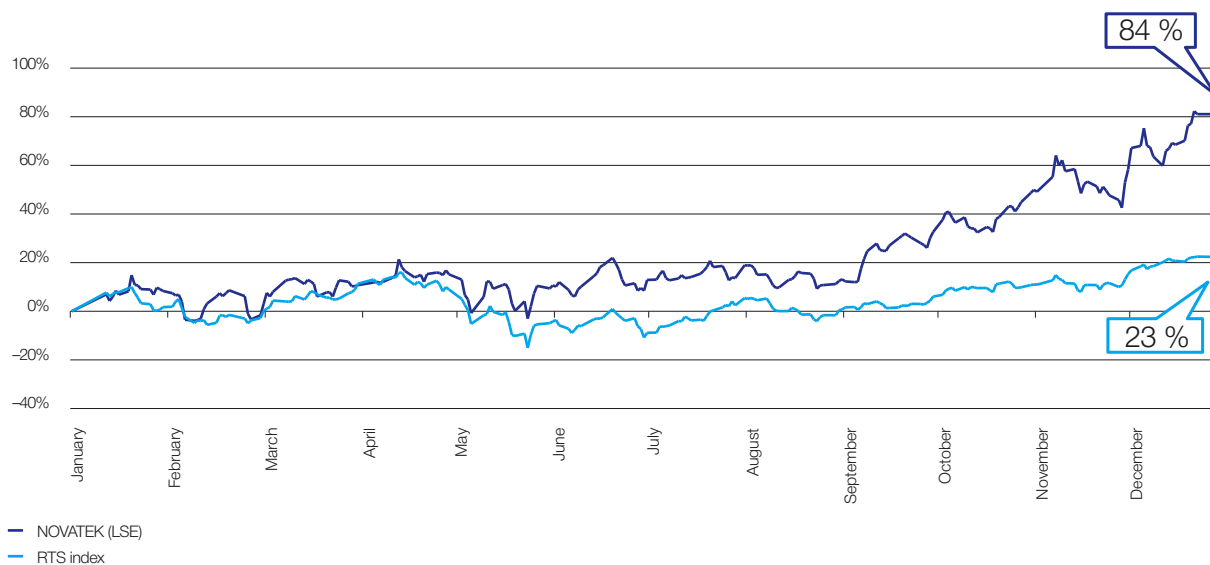
- Launch of commercial production from the third stage of the second phase development at the Yurkharovskoye field which was attended by Russian Prime Minister Vladimir Putin; and
- Inaugural voyage of a supertanker of stable gas condensate from Murmansk to China via the Arctic Ocean's Northern Sea Route.

## Securities

**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 stock.

**Our shares are traded** in US dollars on the RTS Stock Exchange (symbol: NVTK), and in Russian roubles on the MICEX Stock Exchange (symbol: NOTK) and on the RTS Stock Exchange (symbol: NVTKG).

### NOVATEK SHARE PRICE AND RTS INDEX 2010



### NOVATEK GDR PRICE SINCE IPO (LSE, closing, US dollars)



**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).

**Registrar CJSC “Computershare Registrar”**

8 Ivana Franko Street, Moscow  
Russia 121108

**Tel:** +7-495-926-81-60

**Fax:** +7-495-926-81-78

**E-mail:** info@nrcreg.ru

**GDR program Administration Deutsche Bank Trust Company Americas**

60 Wall Street, New York, New York  
100056, United States

**London** +44 20 7547 6500

**New York** +1 212 250 9100

**Moscow** +7 495 797 5209

**The amount of dividends accrued and paid** for the years 2006 to 2009, and for the first six months of 2010, is reported as of 31 December 2010. Partial payment of the accrued dividends was made due to:

- Provision by shareholders (nominee holders) of incorrect postal and/or banking details; and
- Insufficient information regarding banking or postal details of shareholders.

**On 24 March 2011**, the Board of Directors of OAO NOVATEK recommended to the Annual General Meeting of Shareholders to pay dividends for FY 2010 in the amount of 2.5 Russian roubles per ordinary share, exclusive of 1.5 Russian roubles of interim dividends per ordinary share for the first six months of 2010.

**Thus, should the General Meeting** of Shareholders approve the above recommended dividend, the dividends for 2010 will total 4.0 Russian roubles per ordinary share, and the total amount of dividends payable for 2010 will be 12,145,224,000 Russian roubles.

## Dividends

**NOVATEK’s dividend policy** is aimed at keeping the balance between the Company’s business goals and shareholder’s interests. A decision to pay dividends as well as the size, payout time and form of the dividend is passed by the General Meeting of Shareholders according to the recommendation of the Board of Directors. Dividends are paid twice a year, their size depends on market conditions, cash flow and the Company’s capital structure.

**ACCRUED AND PAID DIVIDENDS** on NOVATEK Shares for the period 2005 to 2010

Dividend Accrual Period	Amount of Dividends, RR per Share	Total Amount of Dividends Accrued, RR	Total Amount of Dividends Paid, RR
2005	900.00	2,732,675,400	2,732,675,400
2006*	1.65	5,009,904,900	5,009,904,900
2007	2.35	7,135,319,100	7,135,293,833
2008	2.52	7,651,491,120	7,651,310,957
2009	2.75	8,349,841,500	8,349,681,894
First 6 months of 2010	1.50	4,554,459,000	4,553,316,587

\* In July 2006 the Company executed a share split in proportion of 1:1000.

## Major Risk Factors Associated with the Company's Operations

**The risks provided herein** are by no means exhaustive and only reflect the Company's own opinions and estimates.

**Industry Risks.** The major risks associated with the Russian domestic gas market are largely attributable to the extensive government regulation of prices for natural gas sold on the domestic market as well as Gazprom's dominant position in the industry. The Russian Federation's Gas Balance has a large portion of natural gas supplied to the export market. With the decrease of natural gas consumption in European markets the companies of Gazprom Group could potentially increase natural gas supplies to the domestic market.

The following factors may adversely affect the Company's operations, or its financial and economic performance:

- Government regulation of natural gas sales prices on the domestic market for Gazprom companies;
- Dependence on throughput capacity of trunk pipelines;
- Potential increases in government-regulated tariffs for gas transportation;
- Decline in world prices for liquid hydrocarbons;
- The Company's dependence on OAO AK Transneft and OAO Russian Railways for the use of liquid hydrocarbons' distribution networks; and
- Increasing competition in the Russian natural gas industry from independent natural gas producers and vertically integrated companies.

NOVATEK implements specific measures to minimize the potential impact of industry risks. In particular, the Com-

pany is actively building productive partnerships with key service suppliers, expanding its customer base, actively searching for purchasers of natural gas at agreed prices and entering into long-term contracts with them.

In addition, NOVATEK strives to diversify its marketed product line to include gas condensate, crude oil and petroleum derivatives, along with the marketing of natural gas.

**Country and Regional Risks.** NOVATEK is a Russian company operating in a number of Russian regions.

Country risk is defined by the fact that Russia is still an emerging economy. Despite the positive trend in the Russian economy; strong GDP growth, political stability, improving living standards, etc., the country's economy is still developing.

The Russian economy is commodity-based and oriented towards export of raw materials which explains the dependence of the country's industrial output on the demand for raw materials in world markets.

The Company produces and processes hydrocarbons on the territory of Western Siberia, a region with a challenging climate. The Company's vulnerability to region specific impacts is insignificant and is completely accounted for through the management of the Company's financial and economic operations. The Company has built an efficient system of interaction between its production and marketing units and its principal production

facilities are concentrated in close proximity to the transportation networks in use.

Risks related to possible military conflicts, state of emergency announcements, or strikes, are non-existent, as the Company operates in economically and socially stable regions.

**Financial Risks.** NOVATEK's financial performance is subject to financial risks associated with the fluctuation of foreign currency exchange rates, as the Company borrows funds in foreign denominated currencies and markets a portion of its products internationally.

With respect to the fluctuation of the Russian rouble in relation to other currencies, the marketing of products internationally substantially reduces this risk and balances out the adverse effects of the national currency's exchange value fluctuations. The inflow of export profits will secure payment of outstanding amounts due therefore, currency risks will not substantially impact the Company's operations.

In the case of an interest rate decline, repayment of outstanding amounts on existing loans and credits may become less attractive in comparison with current offers in the loan market. In this event, the Company will undertake to replace existing debt facilities with current market offers on better terms and conditions, including borrowing costs.

Overall interest rate growth may affect the Company's borrower liabilities, subject to change under specific conditions. The resulting dynamic behavior in the borrowed funds value restricts their use as a source of funds throughout "expensive loan" periods.

Interest rate shifts in specific sectors of the debt market will result in the Company diversifying its funding sources and switching to market sectors with more attractive financial resources.

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

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. However, to effectively manage the margins achieved through its natural gas trading activities, management has established targets for volumes sold to wholesale traders and end-customers.

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

**Credit Risk.** Credit risk refers to the risk exposure of the Company to a potential financial loss due to the default of counterparties on their contractual obligations. NOVATEK mitigates credit risk through the management of its cash and cash equivalents, including short-term deposits with banks, as well as credit exposure to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Company at the time of deposit to have minimal risk of default.

The Company's trade and other receivables consist of a large number of customers, spread across diverse industries and geographical areas. Most of NOVATEK'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 Company also requires 100 percent prepayments from small customers for natural gas deliveries and partial advances from others. Although the Company 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.

**Liquidity Risk.** Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk 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 Company's reputation. In managing its liquidity risk, NOVATEK maintains adequate cash reserves and debt facilities, continuously monitors forecasted and actual cash flows and matches the maturity profiles of financial assets and liabilities. The Company prepares various financial plans (monthly, quarterly and annually) which ensures that the Company has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. The Company has also entered into a number of short-term credit facilities, such as credit lines and overdraft facilities, which can be drawn down to meet short-term financing needs. To fund cash requirements of a more permanent nature, the Company will normally raise long-term debt in international and domestic markets.

**Inflation Risks.** The change in the consumer price index has an impact on NOVATEK's profitability and as a consequence, its financial standing and ability to pay on liabilities and securities.

However, this factor is not of great significance due to the fact, that the tariff policy of the Russian Federation contemplates a gradual increase in the domestic gas prices commensurate with the growth in inflation rates.

NOVATEK may not be able to predict the inflation level, since apart from the consumer price level it is necessary to take into account the change in real purchasing power of the Russian rouble, the pricing conditions in liquid hydrocarbon export markets and the government policy in relation to tariffs for natural gas.

NOVATEK monitors the consumer price index and takes this factor into account when determining its selling prices.

**Risks related to the impact of the global financial crisis.** The main risks relating to the impact of the global financial crisis are rouble devaluation and a decrease in demand for natural gas as a result of a decline in Russian industrial output.

A staged increase of the regulated domestic price for natural gas planned by the Russian government, combined with foreign currency denominated revenue received from export sales of liquids and cost reduction due to the decrease of domestic prices for materials and services, mitigate the consequences of potential rouble devaluation for NOVATEK.

The search for new customers along with provision of more flexible terms and conditions to existing contracts and stable demand from our main end-customer segment, public utilities, enable the Company to compensate for the slump in the domestic demand for natural gas from industrial consumers. To increase the competitiveness of its supplies the Company is developing a pricing strategy allowing it to switch to buyers who are less dependent on the external economic factors.

**Legal Risks.** The Company's operations are susceptible to risks resulting from changes in the statutory regulation of the following spheres:

- Currency laws (in areas concerning borrowings and export/import operations);
- Tax laws (in areas regulating taxation systems and rates applicable to companies in general, and to companies marketing natural gas and liquid hydrocarbons, specifically);
- Customs laws (in areas concerning the export of liquid hydrocarbons and their derivatives); and
- Licensing requirements for natural resource extraction.

**Operational Risks.** The Company is not involved in any significant litigation and the risks pertaining to such litigation are minor.

The Company and its affiliates hold long-term field development licenses.

Certain risks exist for the Company's operations associated with field exploration and development. Exploration drilling incorporates multiple risks, including the risk of non-availability of commercial reserves. Information on the Company's fields' reserves is provided as estimated, subject to certain factors and assumptions. Actual production volumes across fields, along with the cost-effectiveness of reserve exploitation may deviate from estimated figures.



The Company's operations require substantial investment into field exploration and development, followed by the production, transportation, and processing of natural gas, oil, and gas condensate. Insufficient funding for these and other expenditures may affect the Company's financial standing and performance results.

## Major Transactions and Interested Party Transactions

**In 2010**, the Company has consummated the following transactions where the scope of the issuer's obligations total 10 or more percent of the issuer's assets' book value as of the end date of the accounting period (quarter) preceding the transaction date:

**Loan Agreement** between OAO NOVATEK (the "Borrower") and BNP PARIBAS S.A., CITIBANK, N.A., LONDON BRANCH and THE ROYAL BANK OF SCOTLAND, NV, (the "Mandated Lead Arrangers"); BNP Paribas S.A., Citibank International plc, The Royal Bank Of Scotland, NV (the "Lenders"); BNP PARIBAS (SUISSE) S.A. (the "Agent")».

**The transaction's material terms and conditions:**

- The term of performance of obligations under the transaction: 15.11.2011;
- Transaction size in money terms: 600,000,000 USD;
- The transaction amount comprises 13.18% of the issuer's assets.

**The transaction** has been approved by NOVATEK's Board of Directors (Minutes № 129 of 08.11.2010).

**Loan Agreement** between OAO NOVATEK (the "Lender") and OOO "Yamal Development" (the "Borrower").

**The transaction's material terms and conditions:**

- The term of performance of obligations under the transaction: 29.11.2011;
- Transaction size in money terms: RR 28,123,305 thousand;
- The transaction amount comprises 19.67% of the issuer's assets.

**The transaction** has been approved by NOVATEK's Board of Directors (Minutes № 129 of 08.11.2010).

**Loan Agreement** between OAO NOVATEK (the "Borrower") and OAO "Sberbank of Russia" (the "Lender").

**The transaction's material terms and conditions:**

- The term of performance of obligations under the transaction: 05.12.2013;
- Transaction size in money terms: RR 15 000 000 thousand;
- The transaction amount comprises 10.49% of the issuer's assets.

**The transaction** has been approved by NOVATEK's Board of Directors (Minutes № 130 of 10.12.2010).

In 2010, the Company consummated eight related party transactions, the size of which does not exceed two percent of the Company's assets' book value as of the end date of the accounting period preceding the transaction date, and the following transactions the size of which exceeds two percent of the Company's assets book value as of the end date of the accounting period preceding the transaction date.

Gas Supply Contract between OAO NOVATEK (the "Supplier") and OAO "OGK-1" (the "Buyer").

The related party in the transaction: member of the Board of Directors of OAO NOVATEK, K.G. Seleznev, is simultaneously represented on the Board of Directors of OAO INTER RAO UES, which in its turn is the managing company of OAO "OGK-1".

**The transaction's material terms and conditions:**

- Natural gas delivery to the border line of the gas transportation system of OOO Gazprom Transgas Ekaterinburg including the gas distribution station of OOO Gazprom Transgas Ekaterinburg, with pipelines of the gas distribution organization ZAO GAZEKS;
- Supply volume: 9,600 mmcm;
- Transaction size in money terms: RR 25,567,296 thousand including VAT;
- The transaction amount comprises 19.35% of the issuer's assets.

**The transaction** has been approved by the decision of the Extraordinary General Meeting of NOVATEK's Shareholders (Minutes № 109 of 25.11.2009).

**Gas Supply Contract** between OAO NOVATEK (the “Supplier”) and OAO “OGK-1” (the “Buyer”).

**The related party** in the transaction: member of the Board of Directors of OAO NOVATEK, K.G. Seleznev, is simultaneously represented on the Board of Directors of OAO INTER RAO UES, which in its turn is the managing company of OAO “OGK-1”.

**The transaction’s material terms and conditions:**

- Natural gas delivery to the border line of the gas transportation system of OOO Gazprom Transgas Ekaterinburg including the gas distribution station of Dombarovskoye LPUMG Gas Distribution Station №5 of Energetik residential camp with gas pipelines of the gas distribution organization OOO “Orenburgoblgas”;
- Gas supply volume: 16,836 mmcm;
- Transaction size in money terms: RR 44,322,122 thousand including VAT;
- The transaction amount comprises 33.54% of the issuer’s assets.

**The transaction** has been approved by the decision of the Extraordinary General Meeting of NOVATEK’s Shareholders (Minutes № 109 of 25.11.2009).

**Gas Supply Contract** between OAO NOVATEK (the “Supplier”) and OAO “OGK-1” (the “Buyer”).

**The related party** in the transaction: member of the Board of Directors of OAO NOVATEK, K.G. Seleznev, is simultaneously represented on the Board of Directors of OAO INTER RAO UES, which in its turn is the managing company of OAO “OGK-1”.

**The transaction’s material terms and conditions:**

- Natural gas delivery to the border line of the gas transportation system of OOO Gazprom Transgas Moscow, including the gas distribution station GRS Kashira (CS-19), with gas pipelines of the of the gas distribution organization GUP MO Mosoblgas;
- Gas supply volume: 8,400 mmcm;
- Transaction size in money terms: RR 26,415,480 thousand including VAT;
- The transaction amount comprises 19.99% of the issuer’s assets.

**The transaction** has been approved by the decision of the Extraordinary General Meeting of NOVATEK’s Shareholders (Minutes № 109 of 25.11.2009).

**Gas Supply Contract** between OAO NOVATEK (the “Supplier”) and OAO “OGK-1” (the “Buyer”).

The related party in the transaction: member of the Board of Directors of OAO NOVATEK, K.G. Seleznev, is simultaneously represented on the Board of Directors of OAO INTER RAO UES, which in its turn is the managing company of OAO “OGK-1”.

**The transaction’s material terms and conditions:**

- Natural gas supply to the point in which the title to the gas passes from the Supplier to the Buyer on the border line of the gas transportation system of OOO Gazprom Transgas Chaikovsky, including the gas distribution station GRS Dobryanka-2;
- Gas supply volume: 22,150 mmcm;
- Transaction size in money terms: RR 57,579,811 thousand subject to VAT;
- The transaction amount comprises 43.57% of the issuer’s assets.

**The transaction** has been approved by the decision of extraordinary general meeting of NOVATEK’s shareholders (Minutes № 109 of 25.11.2009).

**Gas Supply Contract** between OAO NOVATEK (the “Supplier”) and OAO INTER RAO UES (the “Buyer”).

**The related party** in the transaction: member of the Board of Directors of OAO NOVATEK, K.G. Seleznev, is simultaneously represented on the Board of Directors of OAO INTER RAO UES.

**The transaction’s material terms and conditions:**

- Natural gas delivery to the point in which the title to the gas passes from the Supplier to the Buyer at the Gas Distribution Station «North-West Heat Power Station»;
- Gas supply volume: 7,694.33 mmcm;
- Transaction size in money terms: RR 23,324,741 thousand including VAT;
- The transaction amount comprises 17.65% of the issuer’s assets.

**The transaction** has been approved by the decision of the Extraordinary General Meeting of NOVATEK’s Shareholders (Minutes № 109 of 25.11.2009).

## Information on Members of NOVATEK's Board of Directors

### MR. ALEXANDER Y. NATALENKO

**Born in** 1946

Chairman of NOVATEK's Board of Directors and Member of its Strategy and Investments Committee

Mr. Natalenko completed his studies at the Irkutsk State University in 1969 with a primary focus in Geological Engineering. Subsequently, he worked with the Yagodinskaya, Bagdarinskaya, Berelekhskaya, Anadirskaya and East-Chukotskaya geological expeditions. In 1986, Mr. Natalenko headed the North-East Industrial and Geological Association and, in 1992, he was elected president of AO «Magadan Gold & Silver Company». He subsequently held various executive positions in Russian and foreign geological organizations. From 1996 to 2001, Mr. Natalenko held the position of Deputy Minister of Natural Resources of the Russian Federation. He is a member of the Board of Directors of ZAO GC VERTEX.

Currently, Mr. Natalenko is Chairman of NOVATEK's Board of Directors. He is also a member of the Strategy and Investments Committee of NOVATEK's Board of Directors. Mr. Natalenko is the recipient of the State Prize of the Russian Federation and an Honored Geologist of Russia.

### MR. ANDREI I. AKIMOV

**Born in** 1953

Chairman of the Management Board of "Gazprombank" (OAO), Member of NOVATEK's Board of Directors and its Audit Committee

Mr. Akimov graduated from the Moscow Financial Institute in 1975 where he specialized in international economics. Between 1974 and 1987, Mr. Akimov held various executive positions in the Bank of Foreign Trade ("Vneshtorgbank") of the USSR. From 1985 to 1987, he served as Deputy General Director of Vneshtorgbank's branch in Zurich (Switzerland) and between 1987 and 1990, Mr. Akimov headed Donau Bank in Vienna (Austria). From January 1991 to November 2002, he was Managing Director of financial company, IMAG GmbH Vienna (Austria) and, at the same time, served as an Advisor to the Chairman of Vneshtorgbank. Since 2003, Mr. Akimov has been the Chairman of the Management Committee of Gazprombank (OAO). He is Chairman of the Supervisory Board of Gazprombank (Switzerland) Ltd and a member of the Board of Directors of ZAO Gerosgaz, Carbon Trade & Finance SICAR S.E. Since December 2006, he has been a member of NOVATEK's Board of Directors and its Audit Committee.

### DR. BURCKHARD BERGMANN

**Born in** 1943

Member of NOVATEK's Board of Directors, its Corporate Governance and Remuneration Committee and its Strategy and Investments Committee, Member of the Council Presidium of the German-Russian Chamber of Foreign Trade, Member of the Advisory Board of the Union of German Science Funds

Dr. Bergmann studied physics at the Freiburg and Aachen Universities from 1962 to 1968 and was awarded a Doctorate in Engineering by Aachen University of Technology in 1970. From 1968 to 1969, Dr. Bergmann worked at the German Federal Ministry for Research and Technology and from 1969 to 1972 – at the Jlich Nuclear Research Center. In 1972, Dr. Bergmann joined Ruhrgas AG (from 1 July 2004 – E.ON Ruhrgas AG), heading the LNG Purchasing Department. In 1978, he became Head of the Gas Purchasing Division responsible for gas purchasing, commercial aspects of gas transmission and storage, as well as gas billing. In 1980, he was elected as a member of the Management Board of E.ON Ruhrgas AG, serving from June 1996 as its Vice-Chairman and from June 2001 to February 2008 as its Chairman. From March 2003 to February 2008 he was also a member of the Management Board of E.ON AG.

Dr. Bergmann is also a member of the Board of Directors (Supervisory Board) of: Allianz Lebensversicherungs-AG, OAO Gazprom, Commerzbank AG, E.ON Energie AG, Contilia GmbH and Telenor ASA. In addition, he is a member of the Advisory Boards for Dana Gas International, Akkumulatorenwerke Hoppecke Carl Zoeellner & Sohn GmbH and IVG Immobilien AG. He has been elected as Chairman of the Advisory Board of Jaeger Beteiligungsgesellschaft mbH & Co KG and is represented on the Shareholders Committee of Nord Stream AG.

Dr. Bergmann holds the following distinctions: Commander of the Royal Norwegian Order of Merit (1997); a Foreign Member of the Academy of Technological Sciences of the Russian Federation (2003); Order of Merit of the State of North Rhine-Westphalia (2004) as well as a winner of Director of the Year, Moscow (2007).

**MR. RUBEN VARDANIAN****Born in 1968**

Chairman of the Board of Directors of Troika Dialog Group, Member of NOVATEK's Board of Directors, Chairman of its Corporate Governance and Remuneration Committee and member of its Audit Committee

Ruben Vardanian is Troika Dialog's Board Chairman. An employee at Troika Dialog since the company's establishment, Mr. Vardanian became head of the company in 1992. Mr. Vardanian is one of the leading figures on Russia's capital markets, having played a key role in developing almost all segments of the country's stock market. He is a member of the Russian Union of Industrialists and Entrepreneurs, where he sits on the Management Committee. He also serves as Chairman of the Corporate Governance Committee of the Russian Union of Industrialists and Entrepreneurs, as well as Arbitrator of its United Committee on Corporate Ethics.

Mr. Vardanian is Board Chairman of AmeriaBank. He is a Board member of AvtoVAZ, KAMAZ, AK BARS Bank, OAO NOVATEK, Standard Bank Plc. and Joule Unlimited Inc. Mr. Vardanian has been a Chairman of the Human Resources and Compensations Committee of AvtoVAZ and Chairman of the Corporate Governance and Remuneration Committee of OAO NOVATEK. Between 2002 and 2004, Mr. Vardanian served as General Director of Rosgosstrakh and from April 2004 to July 2005, he was Chairman of its Board of Directors. Mr. Vardanian is President of the Moscow Skolkovo School of Management and is a member of its Coordinating Council. He is also a member of the President's Council on Implementation of National Projects and Demographic Policy, a member of the Government's Competition and Entrepreneurship Council of the Russian Federation, a member of the South Korea President's Advisory Council on Education and a member of the Guardian Council of the Specialized Endowment Fund at the Russian Economic School. Mr. Vardanian is also a member of the Coordinating Council of Armenia 2020 project and a member of Guardian Council of Armenia's National Competitiveness Fund, a member of the International Advisory Council of Guanghua (China), a member of the International Advisory Council of FDC Business School (Brazil) and a member of the Supreme Religious Council of the Armenian Apostolic Church.

The American Trade Chamber named Mr. Vardanian as "Businessperson of the Year" for "a considerable contribution to Russia's business development and abiding by high norms of professional ethics". He became a laureate of the

"Person 2003" national award and in 2001, Mr. Vardanian was included in the Fortune's prestigious list "25 Rising Stars of the New Generation".

The World Economic Forum (Davos) included Mr. Vardanian in a list of "100 future world leaders". He was also included in the Top 22 Business Leaders of Russia (rating by the "Commersant" newspaper and Managers Association).

Mr. Vardanian was a winner of Ernst & Young Entrepreneur of the Year 2004 Award. He was recognized as the Best Investment Banker of 2004 in a competition named "Stock Market Elite" conducted by NAUFOR (National Association of Stock Market Participants). Mr. Vardanian is a laureate of the prestigious "ARISTOS" business award by the Association of Russia's Managers and Publishing House Commersant in the nomination "For special merits in the Russian business development 2006". In 2008, he received the "Finance" magazine award "For reputation in the financial market". Mr. Vardanian graduated with honors from Moscow State University with a degree in Economics and received post graduate training at BANCA CRT (1992, Italy) and at Merrill Lynch (1992, New York, USA). In 2000, he also completed executive management courses at INSEAD (Fontainebleau, France) and, in 2001 and 2005, he received training from Harvard Business School (USA).

**MR. MARK A. GYETVAY****Born in 1957**

Member of NOVATEK's Board of Directors and Chairman of its Strategy and Investments Committee, Member and Deputy Chairman of NOVATEK's Management Board

Mr. Gyetvay studied at Arizona State University (Bachelor of Science, Accounting, 1981) and later at Pace University, New York (Graduate Studies in Strategic Management, 1995). After graduation, Mr. Gyetvay worked in various capacities at a number of independent oil and gas companies (Champlin Petroleum Co., Texas, Ensource Inc. and MAG Enterprises, Colorado, and Amerada Hess Corporation, New Jersey) where he specialized in financial and economic analysis for both upstream and downstream segments of the petroleum industry.

In 1994, Mr. Gyetvay began his work at Coopers and Lybrand, New York, as Director, Strategic Energy Advisory Services working for oil and gas companies in the USA and abroad. He subsequently moved to Moscow in 1995 with Coopers & Lybrand to lead the oil and gas practice. He was admitted as a partner of PricewaterhouseCoopers Global Energy where he assumed the role of client service

engagement partner, Utilities and Mining practice, based in Russia (Moscow office). Mr. Gyetvay was an engagement partner on various energy and mining clients providing overall project management, financial and operational expertise, maintaining and supporting client service relationships as well as serving as concurring partner on transaction services to the petroleum sector.

Mr. Gyetvay is a Certified Public Accountant, a member of the American Institute of Certified Public Accountants and an associate member of the Society of Petroleum Engineers.

In 2003, Mr. Gyetvay became a member of NOVATEK's Board of Directors and is also Chairman of the Strategy and Investments Committee of NOVATEK's Board of Directors. Between 2004 and 2008, he has been Chief Financial Officer of NOVATEK. In 2005 Mr. Gyetvay was elected to NOVATEK's Management Board and in July 2010 he became Deputy Director of NOVATEK's Management Board.

#### **MR. VLADIMIR A. DMITRIEV**

**Born in 1953**

Chairman of the Board of Directors, Bank for Development and Foreign Economic Activities ("Vnesheconombank"), Member of NOVATEK's Board of Directors and Chairman of its Audit Committee

Mr. Dmitriev graduated from the Moscow Financial Institute in 1975 where he specialized in International Economic Relations. From 1975 to 1979, Mr. Dmitriev began his professional career as an engineer at the State Committee for Foreign Economic Relations. From 1979 to 1986, he worked as an attache and Third Secretary of a department at the Ministry of Foreign Affairs. From 1986 to 1987, he was a research officer at the Institute of World Economy and International Relations of the Russian Academy of Sciences. From 1987 to 1993, Mr. Dmitriev was appointed Second Secretary and subsequently First Secretary of the USSR's and Russian Federation's ("RF") Embassy in Sweden.

Between 1993 and 1995, Mr. Dmitriev served as the Deputy Head of the Currency Department of the RF Finance Ministry, and later from February 1995 through August 1997 as Deputy Head of Foreign Credits and External Debt Department of the RF Finance Ministry. Between 1997 and 2002, Mr. Dmitriev was appointed as First Deputy CEO of Vnesheconombank and between 2002 and 2004 he served as Deputy Chairman of Vneshtorgbank. In May 2004, Mr. Dmitriev was appointed Chairman of Vnesheconombank and in June 2007, by a Presidential Decree of the RF, Mr.

Dmitriev was appointed Chairman of the State Corporation "Bank for Development and Foreign Economic Activities (Vnesheconombank)". Mr. Dmitriev is a Candidate of Economic Sciences and a correspondent member of the Russian Academy of Natural Sciences.

Mr. Dmitriev is Chairman of the Board of Directors (Supervisory Board) of: OOO VEB Capital, ZAO Globexbank, PAO Joint-Stock Commercial Industrial and Investment Bank, Ukraine, as well as a member of the Board of Directors (Supervisory Board) of: OAO Aeroflot – Russian Airlines, OAO KAMAZ, OAO United Ship Building Company, OAO INTER RAO UES.

#### **MR. LEONID V. MIKHELSON**

**Born in 1955**

Member of NOVATEK's Board of Directors, Chairman of NOVATEK's Management Board

Mr. Mikhelson received his primary degree from the Samara Institute of Civil Engineering in 1977, where he specialized in Industrial Civil Engineering. That same year, Mr. Mikhelson began his career as foreman of a construction and assembling company in Surgut, Tyumen region, where he worked on the construction of the first section of Urengoi-Chelyabinsk gas pipeline. In 1985, Mr. Mikhelson was appointed Chief Engineer of Ryazantruboprovodstroy. In 1987, he became General Director of Kuibishevtruboprovodstroy, which in 1991, was the first company in the region to sell its shares and became private company, AO SNP NOVA. Mr. Mikhelson remained SNP NOVA's Managing Director from August 1987 through October 1994. Subsequently, he became a General Director of the management company "Novafininvest", the holding and finance structure which included SNP NOVA as an asset, amongst others, and is the predecessor to NOVATEK.

Since 2002, Mr. Mikhelson has served as a member of the Board of Directors and Chairman of the Management Board of NOVATEK. From March 2008 to December 2010, he has been a member of the Board of Directors of OAO Sroytransgas and since 2008 a member of the Board of Directors of OOO Art Finance. Mr Mikhelson is the recipient of the Russian Federation's Order of the Badge of Honor.



**MR. KIRILL G. SELEZNEV****Born in 1974**

Member of the Management Board, Director of Gas and Liquid Hydrocarbons Marketing and Processing Department of OAO "Gazprom", General Director of OOO Gazprom Mezhrefiongaz, Member of NOVATEK's Board of Directors and its Strategy and Investments Committee

Mr. Seleznev, graduated from the D.F. Ustinov Baltic State Institute of Technology in 1997 and, in 2002, received a degree in Finance and Credit from the St. Petersburg State University. Upon completion of his university studies, Mr. Seleznev managed OOO «Baltic Finance Company», OAO Investment and Financial Group «Management Investments Development» and OAO «St. Petersburg Sea Port», all of which are located in St. Petersburg, Russia. In 2000, Mr. Seleznev was appointed as Chief of the Tax Group at OAO «Baltic Pipeline System», St. Petersburg, Russia. Between 2001 and 2002, Mr. Seleznev held the position of Deputy Chief of Staff of the Management Board and Assistant to Chief Executive Officer of OAO Gazprom, in Moscow, Russia. Since 2002, he has been the head of the Gas and Liquid Hydrocarbons Marketing and Processing Department of OAO Gazprom and a Member of the OAO Gazprom Management Board. Since 2003, Mr. Seleznev has been the General Director of OOO Gazprom Mezhrefiongaz.

Mr. Seleznev is also a member of the Board of Directors and Supervisory Board of several other entities. Since 2006, Mr. Seleznev has been a member of NOVATEK's Board of Directors.

**MR. GENNADY TIMCHENKO****Born in 1952**

Member of NOVATEK's Board of Directors and its Strategy and Investments Committee

In 1976, Mr. Timchenko graduated with a Masters of Science from the Mechanical University in Leningrad. He began his career at the Izjorskii Factory in Leningrad, an industrial plant which made components for the energy industry. Between 1982 and 1988, he was a Senior Engineer at the Ministry of Foreign Trade. Mr. Timchenko has more than 20 years of experience in Russian and International energy sectors and he has built interests in trading, logistics and transportation related companies.

In 1988, Mr. Timchenko became a vice president of Kirishineftekhimexport, the export and trading arm of the Kirishi refinery in the Leningrad region. In 1991, he worked for Urals Finland which specialized in oil and petrochemical trading. Between 1994 and 2001, Mr. Timchenko was managing Director of IPP OY Finland and IPP AB Sweden. In 1997, he co-founded Gunvor, a leading independent oil-trading company. Mr. Timchenko has been a member of the Board of Directors of OOO Transoil and OOO BalttransService. Since 2009, he has been a member of NOVATEK's Board of Directors.

**SHARES IN NOVATEK'S EQUITY CAPITAL HELD BY MEMBERS OF THE COMPANY'S BOARD OF DIRECTORS\***

	Share in equity capital as of 31 December 2010, %
Natalenko A.Y.	—
Akimov A.I.	—
Bergmann B.	0,0007
Vardanian R.K.	—
Gyetvay M.	—
Dmitriev V.A.	—
Mikhelson L.V.	0,4686
Seleznev K.G.	—
Timchenko G.N.	—

\* Share information is based on NOVATEK's shareholder register in compliance with Russian law.



## Information on Members of NOVATEK's Management Committee

### MR. LEONID V. MIKHELSON

**Born in:** 1955:

Chairman of NOVATEK's Management Committee, Member of NOVATEK's Board of Directors

Details on Mr. Leonid V. Mikhelson are available in the "Information on Members of NOVATEK's Board of Directors" section.

### MR. VLADIMIR A. BASKOV

**Born in:** 1960

Deputy Chairman of NOVATEK's Management Committee

In 1986, Mr. Baskov graduated from the Moscow Higher Police School of the USSR. In 2000, he completed courses at the Management Academy at the Russian Ministry for Internal Affairs. From 1981 to 2003, he served in various departments within the Russian Ministry for Internal Affairs. From 2001 to 2003, Mr. Baskov held managerial positions within the aforementioned Ministry's organizational structures. In August 2003, he accepted the position as Director of NOVATEK's Project Supervision Department, and was elected as a Member of NOVATEK's Management Committee. Since 2005, Mr. Baskov has been Deputy Chairman of NOVATEK's Management Committee.

### MR. VIKTOR I. GUIRIA

**Born in:** 1959

Director of NOVATEK Overseas Exploration & Production GmbH in Cairo (Egypt) – NOVATEK subsidiary

Mr. Guiria graduated from the Tyumen Industrial Institute and began his career in the oil and gas industry in 1978 as an assistant-driller for the Karskaya geological expedition. Subsequently he worked as a foreman in the Urengoy oil and gas exploration expedition and was later promoted to Head of the Regional Engineering and Technical Service. From 1994 to 2006, Mr. Guiria has been General Director of "NOVATEK-TARKOSALENEFTEGAS". Since March 2006 to 2009, he has been Deputy Chairman of NOVATEK's Management Committee and Director for Resource Base Development and Drilling Operations. In 2010, he was appointed a Director of NOVATEK subsidiary, Novatek Overseas Exploration & Production GmbH in Cairo (Egypt). Mr. Guiria is the recipient of the Honorable Oilman of Russia award and was elected as a deputy of the State Duma representing the Yamal-Nenets Autonomous Region.

### MR. MARK A. GYETVAY

**Born in:** 1957

Deputy Chairman of NOVATEK's Management Committee, Member of NOVATEK's Board of Directors and its Strategy and Investments Committee

Details on Mr. Mark A. Gyetvay are available in the "Information on Members of NOVATEK's Board of Directors" section.

### MR. EVGENY A. KOT

**Born in:** 1974

Deputy Chairman of NOVATEK's Management Committee, Director of NOVATEK's LNG Project Department

Mr. Kot graduated from Tyumen State Academy of Architecture and Construction and St. Petersburg State University of Engineering and Economics and is a Candidate of Economics Science. From 1997 to 2001, he worked at the Tyumen branch of "GAZPROMBANK", the commercial bank for the Russian natural gas industry. From 2001 to 2002, he held the position of Deputy Head of the Financial Department at SNP Nova which subsequently became OAO Pur-Land and later merged with OAO NGK ITERA. Since 2002, Mr. Kot held various positions in NOVATEK including, Chief Specialist, Chief of Division, Deputy Director and Director of Corporate Finance Department. In August 2009, Mr. Kot was appointed to the position of Deputy Chairman of the Management Board of NOVATEK and became the Director of NOVATEK's LNG Project Department. Since December 2009, he has also been a Member of NOVATEK's Management Committee.

### MS. TATYANA S. KUZNETSOVA

**Born in:** 1960

Deputy Chairman of NOVATEK's Management Committee, Director of NOVATEK's Legal Department

Ms. Kuznetsova graduated from the Far East State University with a degree in Law. From 1986, she was Senior Legal Advisor for a legal bureau. In 1993, Ms. Kuznetsova became Deputy General Director for Legal Issues and from 1996, Marketing Director for OAO Purneftegasgeologiya. In 1998, she was appointed Deputy General Director General of OAO Nordpipes. Since 2002, she has been Director of the Legal Department for NOVATEK. Since 2003, Ms. Kuznetsova has been a member of NOVATEK's Management Committee and since 2005 Deputy Chairman of NOVATEK's Management Committee.

**MR. IOSIF L. LEVINZON****Born in:** 1956

Deputy Chairman of NOVATEK's Management Committee

Mr. Levinzon graduated from the Tyumen Industrial Institute specializing in geology and is a Candidate of Geological and Mineralogical Science. He continued postgraduate studies in Perm State Technical University. From 1978 to 1987, he was the Head of the Urengoy oil expedition and from 1987 to 1996, he was the General Director of Purneftegasgeologiya. From 1996 to 2005, Mr. Levinzon was the Deputy Governor, 1st Deputy Governor and Vice-Governor of the Yamal-Nenets Autonomous Region. From 2005 to 2006, Mr. Levinzon has been an Advisor to the Chairman of the Federation Council of the Federal Assembly of the Russian Federation. From 2006 to 2009, Mr. Levinzon has been an Advisor on Corporate and Strategic Development at ZAO OSTER and also at ZAO Investgeoservis. Since August 2009, Mr. Levinzon has held the position of Deputy Chairman of NOVATEK's Management Committee and in December 2009 he was elected a member of NOVATEK's Management Committee. Mr. Levinzon is a recipient of the Honored Geologist of Russia, the Order of the Badge of Honor and the Order of the Friendship of Peoples awards and has been awarded the Certificate of Merit from the Governor of the Yamal-Nenets Autonomous Region.

**MR. MIKHAIL V. POPOV****Born in:** 1969

First Deputy Chairman of NOVATEK's Management Committee

Mr. Popov studied at the Gubkin State Academy of Oil and Gas until 1992 and in 1994, graduated from the Kiev Institute of National Economy. In 1992, he held the position of Deputy Chairman of AO Bankomsvyaz's Managing Committee (Kiev). In 2002, he was appointed Director of the Capital Construction Department and Deputy General Director of OAO Novafininvest. Since 2003, he has been Director of NOVATEK's Oil and Oil Products Department and in March 2003, Mr. Popov was elected to NOVATEK's Management Committee. In 2004, Mr. Popov became First Deputy Chairman of NOVATEK's Management Committee.

**MR. SERGEI V. PROTOSENYA****Born in:** 1966

Member and Deputy Chairman of NOVATEK's Management Committee, NOVATEK Chief Accountant

In 1991, Mr. Protosenya graduated from the Kuybyshev Institute of Engineering and Construction in Moscow, with a degree in Engineering and Economics. From 1995 to 1997, he was Deputy General Director General at SNP NOVA. From 1997 to 2001, he was head of the Finance Department at OAO NK Tarkosaleneftegas. In 2001, he became Director of OAO Pur-Land's Accounting Department. Since 2002, Mr. Protosenya has been NOVATEK's Chief Accountant, and in 2005 he was elected to NOVATEK's Management Committee. In 2009, Mr. Protosenya became Deputy Chairman of NOVATEK's Management Committee.

**MR. VALERY N. RETIVOV****Born in:** 1962

Deputy Chairman of NOVATEK's Management Committee

Mr. Retivov received his degree from the Moscow Institute of Steel and Alloys in 1984. From 1984 to 1991, Mr. Retivov worked as an engineer at the Almaty (Kazakhstan) Hydro-mash experimental-mechanical plant. From 1991 to 1999, he held the position of Director at the following industrial and commercial companies: Suncar, TOO FIRMA VIN and AOOT Taganrog motor-transport passenger enterprise. In 1999, Mr. Retivov joined the NOVATEK Group. He worked as Gas Sales Manager and Head of Foreign-Economic Activity and Transportation for the Liquid Hydrocarbons Department in the Commercial Division of ITERA. Since 2002, Mr. Retivov has been head of Division, Deputy Commercial Director and Director of NOVATEK's Liquid Hydrocarbons Sales and Marketing Department. In December 2009, Mr. Retivov was elected Deputy Chairman of NOVATEK's Management Committee.

**MR. VLADIMIR A. SMIRNOV****Born in:** 1967

Deputy Chairman of NOVATEK's Management Committee

In 1991, Mr. Smirnov graduated from the Gubkin Institute of Oil and Gas in Moscow with a degree in Offshore Oil and Gas Structures. In 1994, he was employed as a Front Office Engineer by OAO SNP NOVA. From 1995 to 2002, he was Deputy General Director and later General Director for OAO Novafininvest FIC and from 2002 to 2005 he was General Director of OOO Novafininvest. In February 2004, Mr. Smirnov was elected to NOVATEK's Management Committee and since 2005 he has been a Deputy Chairman of the Management Committee.

**MR. NIKOLAI N. TITARENKO****Born in:** 1958

Deputy Chairman of NOVATEK's Management Committee, NOVATEK Chief Commercial Officer

In 1981, Mr. Titarenko graduated from the Azizbekov Institute of Oil and Chemistry in Azerbaijan. He was a member of the Krasnoselkupsкая Oil and Gas Prospecting Expedition in the Yamal-Nenets Autonomous Region. From 1991 to 1994, Mr. Titarenko was the First Deputy to the Administration Head of Krasnoselkup District in the Tyumen Region. From 1994 to 1998, he held various managerial positions in different companies. From 1999 to 2002, Mr. Titarenko was Deputy Director General with OAO ITERA-Rus TEC. In 2002, he became Deputy General Director with OAO Novafininvest FIC. In March 2003, Mr. Titarenko was elected as Deputy Chairman of NOVATEK's Management Committee and became NOVATEK's Chief Commercial Officer.

**MR. LEV V. FEODOSIEV****Born in:** 1979

Member of NOVATEK's Management Committee, Director of Strategic Planning and Development

Mr. Feodosiev received his degree from the Moscow State Technical University's Bauman School. From 2002 to 2003, he was a Senior Specialist at the Russian Federation's Ministry of Energy. From 2003 to 2007, Mr. Feodosiev worked as a Leading Specialist and Deputy Director of the Department for Government Regulation of Tariffs and Infra-

structure Reforms of the Russian Federation's Ministry of Economic Development and Trade. Mr. Feodosiev joined NOVATEK in 2007 as Director of Strategic Planning and Development and in December 2009 he was elected to the Management Committee.

**MR. ALEXANDER M. FRIDMAN****Born in:** 1951

Deputy Chairman of NOVATEK's Management Committee

In 1973, Mr. Fridman graduated from the Gubkin Institute of Oil and Gas in Moscow, with a degree in Oil and Gas Fields Development and Exploitation. Since 1984, he was employed by various Gazprom companies: as Chief Engineer of Nadymgazprom, Head of the Production and Technical Department of the Industrial Association, and Chief Engineer of Mostransgaz's Kaluga Department for Gas Transportation and Underground Storage. From 1992 to 2003, he was First Deputy General Director of a joint venture established by OAO Gazprom and DKG-EAST (Hungary). Since 2003, Mr. Fridman was the Deputy General Director of Novafininvest. In March 2003, Mr. Fridman was elected to NOVATEK's Management Committee and since 2004 he has been Deputy Chairman of the Management Committee.

**MR. KIRILL N. YANOVSKIY****Born in:** 1967

Member of NOVATEK's Management Committee, Deputy Director for NOVATEK Finance and Development Strategy Department

In 1991, Mr. Yanovskiy graduated from the Gubkin Institute of Oil and Gas in Moscow. From 1992, he headed a department of the Yugorsky Joint-Stock Bank. From 1995, he headed the Securities Department at the Neftek Joint-Stock Commercial Bank. Since 2002, he has been Director of NOVATEK's Financial Planning, Analysis and Control Department. In May 2004, Mr. Yanovskiy was elected to NOVATEK's Management Committee and in 2007 he was appointed Deputy Director for Finance and Development Strategy Department.

SHARES IN NOVATEK'S EQUITY CAPITAL HELD BY MEMBERS  
OF THE COMPANY'S MANAGEMENT COMMITTEE\*

	Share in equity capital as of 31 December 2010, %
Mikhelson L.V.	*information is given in the section on the Board of Directors
Baskov V.A.	0,0288
Guiria V.I.	0,1230
Gyetvay M.	—
Kot E.A.	—
Kuznetsova T.S.	0,1944
Levinzon I.L.	—
Popov M.V.	0,1440
Protosenya S.V.	0,0765
Retivov V.N.	—
Smirnov V.A.	0,5006
Titarenko N.N.	0,0408
Feodosiev L.V.	—
Fridman A.M.	0,0720
Yanovskiy K.N.	0,1051

\* Share information is based on NOVATEK's shareholder register in compliance with Russian law.

**The procedure and criteria** for determining fees payable and expenses reimbursable to NOVATEK's Chairman of the Management Committee and Members of the Management Committee are set forth in the Company's Regulations on the Management Committee and employment agreements entered into between the Company and the individual committee members.

**The procedure and criteria** for determining fees payable and expenses reimbursable to NOVATEK's Members of the Board of Directors are set forth in NOVATEK's Articles of Association and the Regulations for Board of Directors.

INFORMATION ON REMUNERATION OF MEMBERS  
OF THE COMPANY'S BOARD OF DIRECTORS AND MANAGEMENT COMMITTEE IN 2010

Type of remuneration	Board of Directors**	Management Committee
Total paid, RR including:	93,114,354	1,049,185,356
Salaries, RR		369,567,259
Bonuses, RR		677,210,007
Fees, RR	93,000,000	—
Other property advancements, RR	114 354	2,408,090

\*\* Some Members of OAO NOVATEK's Board of Directors are also Members of the Company's Management Committee. Payments made to such persons, as compensation for their activities as Members of the Management Committee, are included in the total amount paid to the Management Committee's members.



# 07 | 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 2010 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2010 and 2009. 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 each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for 2010. In terms of proved natural gas reserves, we are the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

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

In 2009, we have expanded our sales of stable gas condensate to the Asian-Pacific region, in particular to South Korea, China and Singapore. Further diversification of our stable gas condensate sales is one of our strategic goals as we continue to expand the production of wet gas at our fields and increase the processing of unstable gas condensate at the Purovsky Gas Condensate Plant ("Purovsky Plant").

### **RECENT DEVELOPMENTS**

In March 2011, NOVATEK and TOTAL S.A. ("TOTAL") have signed a Memorandum of Cooperation which provides for TOTAL to acquire a 20% participation interest in the development of Yamal LNG project. The memorandum stipulates that both parties have defined the parameters of the project's strategic partnership and shall take steps to close the deal by the end of the first half of 2011.

On 3 February 2011, the Group issued two tranches of Eurobonds in an aggregate amount of USD 1,250 million. The bonds were issued at par and include a five-year tranche of USD 600 million bonds with a coupon rate of 5.326 percent per annum and a ten-year tranche of USD 650 million bonds with a coupon rate of 6.604 percent per annum. The proceeds from the Eurobonds were used to repay a bridge facility and to finance the acquisition of OAO "Sibneftegas" ("Sibneftegas").

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

In December 2010, the Group acquired 100 percent of the outstanding ordinary shares of OOO "Yamalgasresource-Chelyabinsk", a regional gas trader, to expand natural gas sales opportunities in the Chelyabinsk Region.

In July 2010, we created a joint venture, OOO "Yamal Development" ("Yamal Development"), with OAO "Gazprom Neft" to jointly develop potential hydrocarbon assets in YNAO, with each entity holding a 50% equity participation interest in Yamal Development. In November 2010, Yamal Development acquired a 51 percent participation interest in OOO "SeverEnergia" ("SeverEnergia"). SeverEnergia holds 100% of the

shares of OAO “Arctic Gas”, ZAO “Urengoil Inc.” and OAO “Neftegaztechnologia”, which hold licenses for the development of oil and gas condensate fields in the YNAO. SeverEnergia’s proved reserves as appraised by D&M under the PRMS and SEC reserves methodologies as of 31 December 2010 totaled approximately 245 and 224 billion cubic meters of natural gas and 42 and 39 million tons of liquid hydrocarbons, respectively.

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

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

In September 2010, we dispatched a consignment of stable gas condensate to China via the Arctic Ocean’s Northern Sea Route, which significantly reduced the traditional delivery distance from approximately 12,900 nautical miles to approximately 7,700 nautical miles. The cargo was delivered in 22 days, approximately half the time required by the traditional shipping route through the Suez Canal. We plan to continue using the Northern Sea Route for deliveries of our stable gas condensate to the Asian-Pacific region subject to the routes navigability.

In August 2010, we acquired 100 percent of the outstanding ordinary shares of “Intergaz-System Sp.z.o.o.” (“Intergaz-System”), an LPG trader in the South-East of Poland. The company owns and operates a discharging and transshipment facility at the wide track (Russian) and narrow track (European) rail road junction. The acquisition of Intergaz-System enables us to continue developing our commercial activities within Poland and other European countries.

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

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

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

Our ongoing exploration work at existing fields in 2010 resulted in the discovery of three new gas condensate deposits at the Ukrainsko-Yubileyniy field, four gas condensate and one natural gas deposits at the Severo-Russkiy license area, and one gas condensate deposit at the Yumantylskiy field. We also performed the appraisal of reserves at the Severo-Russkiy and Ukrainsko-Yubileyniy fields in accordance with the Russian reserve classification standards. In addition, our reserves at the Severo-Russkiy license area were appraised by D&M under the US Securities and Exchange Commission (SEC) and PRMS reserves methodology at 31 December 2010. Natural gas and gas condensate SEC proved reserves at the Severo-Russkiy license area at 31 December 2010 were 9.3 billion cubic meters and 1.5 million tons, respectively.

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

In May 2009, we acquired 51% of the outstanding ordinary shares of OAO “Yamal LNG”, the license holder for the exploration and development of the South-Tambeyskoye field, with natural gas and gas condensate proved reserves of 418 billion cubic meters and 15 million tons, respectively, under the SEC reserve methodology as of 31 December 2010. The acquisition of the South-Tambeyskoye field significantly increases the Group’s resource base consistent with our long-term business strategy as well as serving as a platform for future production growth and diversification of our natural gas sales.

## SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Financial results</b>			
Total revenues (net of VAT and export duties)	117,024	89,954	30.1%
Operating expenses	(68,518)	(56,130)	22.1%
Profit attributable to NOVATEK shareholders	40,533	26,043	55.6%
EBITDA <sup>(1)</sup>	56,965	39,566	44.0%
Normalized EBITDA <sup>(2)</sup>	55,635	39,514	40.8%
EBITDAX <sup>(3)</sup>	58,560	40,132	45.9%
EBITDA margin <sup>(4)</sup>	48.7	44.0	n/a
Earnings per share (in Russian roubles)	13.37	8.59	55.6%
<b>Operating results</b>			
Natural gas sales volumes (million cubic meters)	37,117	32,937	12.7%
Stable gas condensate sales volumes (thousand tons)	2,330	2,170	7.4%
Liquefied petroleum gas sales volumes (thousand tons)	876	749	17.0%
Crude oil sales volumes (thousand tons)	185	198	(6.6%)
Oil product sales volumes (thousand tons)	10	11	(9.1%)
Total hydrocarbons production (million barrels of oil equivalent)	274	237	15.6%
Total daily production (thousand barrels of oil equivalent per day)	751	649	15.7%
<b>Cash flow results</b>			
Net cash provided by operating activities	44,863	34,847	28.7%
Capital expenditures	26,106	17,872	46.1%
Free cash flow <sup>(5)</sup>	18,757	16,975	10.5%

<sup>(1)</sup> EBITDA represents profit (loss) attributable to shareholders of NOVATEK adjusted for the addback of income tax expense and finance income (expense) from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows.

<sup>(2)</sup> Normalized EBITDA excludes one-time effect from disposal of investments.

<sup>(3)</sup> EBITDAX represents EBITDA as adjusted for the addback of exploration expenses.

<sup>(4)</sup> EBITDA margin is calculated as EBITDA divided by total revenues and is shown as a percentage of total revenues.

<sup>(5)</sup> Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

Reconciliation of EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO NOVATEK is as follows for the years ended 31 December 2010 and 2009:

<i>millions of Russian roubles</i>	Year ended 31 December:	
	2010	2009
<b>Profit (loss) attributable to shareholders of OAO NOVATEK</b>	<b>40,533</b>	<b>26,043</b>
Depreciation, depletion and amortization	6,757	5,738
Total finance income (expense)	(1,197)	831
Total income tax expense	10,804	6,778
Share-based compensation	68	176
<b>EBITDA</b>	<b>56,965</b>	<b>39,566</b>
Exploration expenses	1,595	566
<b>EBITDAX</b>	<b>58,560</b>	<b>40,132</b>

### SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate of Russian rouble to US dollar</i>	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change Y-o-Y, %
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	
At the beginning of the period	30.24	29.38	29.36	34.01	31.20	31.29	30.40	30.09	30.24	29.38	2.9%
At the end of the period	29.36	34.01	31.20	31.29	30.40	30.09	30.48	30.24	30.48	30.24	0.8%
Average for the period	29.89	33.93	30.24	32.21	30.62	31.33	30.71	29.47	30.37	31.72	(4.3%)

<i>Crude oil prices, USD / bbl</i>	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change Y-o-Y, %
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	
<b>WTI <sup>(1)</sup></b>											
At the end of the period	83.8	49.7	75.6	69.9	80.0	70.6	91.4	79.4	91.4	79.4	15.1%
Average for the period	78.9	43.3	78.1	59.8	76.2	68.2	85.2	76.1	79.6	62.1	28.2%
<b>Brent <sup>(2)</sup></b>											
At the end of the period	80.3	46.5	75.0	68.1	81.0	65.7	92.5	77.7	92.5	77.7	19.0%
Average for the period	76.4	44.5	78.2	59.1	76.9	68.1	86.4	74.5	79.5	61.7	28.8%
<b>Urals <sup>(2)</sup></b>											
At the end of the period	78.2	45.5	74.3	68.0	79.9	65.8	90.3	77.0	90.3	77.0	17.3%
Average for the period	75.4	43.7	76.9	58.5	75.6	67.8	85.1	74.2	78.3	61.2	27.9%

<sup>(1)</sup> Based on prices quoted by New York Mercantile Exchange (NYMEX).

<sup>(2)</sup> Based on prices quoted by Intercontinental Exchange (ICE).

<i>Export duties, USD / ton <sup>(1)</sup></i>	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change Y-o-Y, %
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	
<b>Crude oil, stable gas condensate</b>											
At the end of the period	253.6	115.3	292.1	152.8	273.5	238.6	303.8	271.0	303.8	271.0	12.1%
Average for the period	263.8	111.8	281.7	133.5	262.0	224.4	287.0	247.6	273.6	179.3	52.6%
<b>LPG</b>											
At the end of the period	80.0	0.0	27.3	0.0	45.2	0.0	118.1	105.0	118.1	105.0	12.5%
Average for the period	63.7	0.0	48.4	0.0	34.3	0.0	98.5	35.0	61.2	8.8	n/m

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

## **CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS**

### **Current financial market conditions**

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

The adverse financial situation in Greece and several European countries in April and May 2010, and the risk of contagion to other regional economies resulted in a tight funding market and a potential prolongation of the economic downturn in the euro area during the period. This led the governments of European countries to continue injections of liquidity into the financial system and resulted in, among other things, the establishment of a large emergency stabilization package by the euro area member states and the IMF, the European Financial Stability Facility, that would be available to guarantee the sovereign debt of euro area member states. In September 2010, the Irish Minister of Finance announced the planned restructuring of the Irish banking system and the anticipated total costs of such restructuring. There can be no certainty regarding the success of those plans and its impact on Ireland's ability to service its external debt. Subsequently, in November 2010, the European Union's Central Bank finalized a bailout aid package to Ireland as part of the emergency stabilization package mentioned above. As a result, Ireland as well as certain other euro area member states have experienced significant yield pressure on their sovereign bonds, which may continue to negatively affect all borrowers by limiting access to capital markets, despite increased new issuances of debt securities in 2010. Furthermore, there appears to be heightened reluctance on the part of lenders to lend to borrowers which have high debt levels, potential liquidity problems or weak balance sheets.

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

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

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

### **Natural gas prices**

As an independent natural gas producer, we are not subject to the Russian government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency, and present market conditions. In 2010, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 523 per mcm, or 29.4%, to RR 2,299 per mcm compared to RR 1,776 per mcm in 2009.

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

In 2009, we renegotiated the sales terms for natural gas volumes sold to one of our largest wholesale gas traders. Under the new sales terms, natural gas sales volumes are purchased by the trader on a delivered basis to the regions where the natural gas is to be consumed. These volumes were classified as end-customers' sales under a separate category, "traders in remote points". The new terms contributed to an overall decrease in our total average natural gas netback price (excluding transportation expense) in 2009 compared to 2008, and was primarily due to additional transportation expense incurred for these volumes and distances delivered. In an environment of economic uncertainty and its affect on the demand for natural gas, the change in the terms for this classification of sales allowed us to continue growing our natural gas production volumes during 2009 over the 2008 production levels, and also enabled us to correspondingly increase our stable gas condensate and LPG sales volumes. The renegotiated terms were valid from April until December 2009.

In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011. As part of the liberalization plan, the FTS approved four quarterly increases in the regulated price for natural gas in 2009, rising by 5% in the first quarter, 7% in the second quarter, 7% in the third quarter and 6.2% in the fourth quarter. In December 2009, the FTS approved an increase in the regulated price for natural gas by 15% compared to the fourth quarter 2009 regulated prices effective from 1 January 2010. In December 2010, the FTS approved a further increase in the regulated price for natural gas sold on the domestic market by 15% effective from 1 January 2011.

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015. The regulation of the domestic natural gas price prior to 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets while taking into account the cost of alternative fuels. We expect further increases in the regulated price for natural gas as part of the Russian Federation government's efforts to liberalize the price of natural gas on the Russian domestic market. We expect that the FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published as well as potentially prolong the timetable toward market price liberalization based on market conditions and other factors.

In 2010, our total natural gas sales volumes to end-customers increased by 5.9% due to the commencement of deliveries to new end-customers, whereas our volumes sold to end-customers, excluding traders in remote regions, increased by 61.0% (see "Natural gas sales volumes" below). Our average transportation expense for the delivery of natural gas to end-customers increased by 38.3% primarily due to an increase in the average transportation tariff set by FTS in 2010 by 22.9% compared to average tariffs in 2009 (see "Transportation tariffs" below) as well as an increase in our average delivery distance. Our average natural gas price to end-customers (excluding traders in remote points) and ex-field price increased by 19.5% and 15.4%, respectively, whereas our average natural gas netback price on end-customer sales increased by 6.0%, compared to the respective prices in 2009. Our pricing strategy for natural gas is consistent with our commercial marketing strategy to enter new regions and markets to maintain and grow our share of natural gas deliveries to the domestic market, as well as maintaining our production growth.

As a result of the factors discussed above, as well as the suspension of natural gas sales to traders in remote points effective the 1 January 2010, our average netback price on end-customers sales (including traders in remote points) increased by 18.3%, while our total average natural gas price excluding transportation expense increased by 17.5% compared to respective prices in 2009.



The following table shows our average realized natural gas sales prices (net of VAT) for the years ended 31 December 2010 and 2009:

<i>Russian roubles per mcm</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
<b>Average natural gas price <sup>(1)</sup>:</b>			
<i>End-customers</i>	2,310	1,933	19.5%
<i>Traders in remote points</i>	-	1,836	n/a
<b>Average natural gas price to end-customers</b>	<b>2,310</b>	<b>1,900</b>	<b>21.6%</b>
<b>Average natural gas transportation expense:</b>			
<i>End-customers</i>	(1,119)	(809)	38.3%
<i>Traders in remote points</i>	-	(1,054)	n/a
<b>Average natural gas transportation expense for sales to end-customers</b>	<b>(1,119)</b>	<b>(893)</b>	<b>25.3%</b>
<b>Average natural gas netback price:</b>			
<i>End-customers</i>	1,191	1,124	6.0%
<i>Traders in remote points</i>	-	782	n/a
<b>Average natural gas netback price on end-customer sales</b>	<b>1,191</b>	<b>1,007</b>	<b>18.3%</b>
<b>Average natural gas price ex-field (wholesale traders)</b>	<b>1,211</b>	<b>1,049</b>	<b>15.4%</b>
<b>Total average natural gas price excluding transportation expense</b>	<b>1,199</b>	<b>1,020</b>	<b>17.5%</b>

<sup>(1)</sup> Includes cost of transportation.

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

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

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

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our liquid volumes sold on both the domestic and international markets, among many other factors. During 2010, the average benchmark crude oil prices were more than 25% higher than in 2009.

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

In 2010, as well as in 2009, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost, insurance and freight (CIF), or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in 2010 was approximately USD 692 per ton compared to approximately USD 530 per ton in 2009.

In 2010 our crude oil export delivery terms were delivery at frontier (DAF Feneshlitke, Hungary), while in 2009 our delivery terms were either DAF Adamova Zastava, Germany or DAF Feneshlitke, Hungary. Our average crude oil export contract price, including export duties, was approximately USD 557 per ton compared to USD 441 per ton in 2009.

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

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
<b>Stable gas condensate</b>			
Net export price, RR per ton	12,778	10,989	16.3%
Net export price, USD per ton	420.8	346.4	21.5%
Domestic price, RR per ton	10,022	6,483	54.6%
<b>Crude oil</b>			
Net export price, RR per ton	8,538	8,093	5.5%
Net export price, USD per ton	281.2	255.1	10.2%
Domestic price, RR per ton	7,523	6,051	24.3%

Our LPG export delivery terms during 2010 were delivery at frontier (DAF) at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and the station Klyucharki (western Ukraine), and priced free carrier (FCA) at the terminal points in Poland, compared to DAF and CPT in 2009. In 2010, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 619 per ton compared to USD 439 per ton in 2009. In 2010, as well as in 2009, our LPG CIS delivery terms were DAF at the border of the customer's country.

In 2010, as well as in 2009, we were obliged to sell a portion of our LPG sales volumes on the domestic market at regulated prices while the remaining portion of our sales was sold under commercial terms. In 2010, we sold a total of 53 thousand tons at the regulated price of RR 5,750 per ton in January and RR 6,613 per ton from February until December. In 2009, we sold 20 thousand tons of LPG at the regulated price of RR 5,750 per ton in the domestic market. In 2010, we sold 344 thousand tons at an average commercial price of RR 11,057 per ton compared to 301 thousand tons at an average commercial price of RR 8,112 per ton in 2009. In addition, in 2010, we sold 45 thousand tons of LPG produced at the Purovsky Plant through our wholly-owned subsidiary OOO "NOVATEK-Refuelling Complexes" at an average price of RR 12,006 per ton compared to sales of 14 thousand tons at an average price of RR 11,745 per ton in 2009.

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

In 2010, our wholly-owned subsidiary, OOO "NOVATEK-Refuelling Complexes", sold approximately five thousand tons of diesel fuel and petrol, purchased for resale from third parties, through its retail stations compared to sales of approximately two thousand tons in 2009.

The following table shows our average realized LPG and oil products sales prices excluding trading activities (net of VAT and export duties, where applicable) for the years ended 31 December 2010 and 2009 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

<i>Russian roubles (RR) or US dollars (USD) per ton</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
<b>LPG</b>			
Net export price, RR per ton	18,433	13,416	37.4%
Net export price, USD per ton	606.9	422.9	43.5%
CIS price, RR per ton	17,351	10,694	62.2%
Domestic commercial price, RR per ton	11,057	8,112	36.3%
Domestic regulated price, RR per ton	6,557	5,750	14.0%
Domestic price (retail and small wholesale stations), RR per ton	12,006	11,745	2.2%
<b>Oil products</b>			
Net export price, RR per ton	-	9,498	n/a
Net export price, USD per ton	-	299.4	n/a
Domestic price, RR per ton	6,773	5,419	25.0%

## **Transportation tariffs**

### *Natural gas*

We transport our natural gas through our pipelines into the Unified Gas Supply System (“UGSS”), which transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. Transportation tariffs for the use of the UGSS by independent producers are set by the FTS.

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

In December 2008, the FTS approved four quarterly increases in the transportation tariff for natural gas in 2009 for an average total increase of 15.7% for the year, in line with the increases in natural gas prices. As a result, the rate for utilization of the trunk pipeline had a range of RR 29.21 to RR 1,630.97 (excluding VAT) per mcm and the transportation rate per mcm per 100 km was RR 9.15 (excluding VAT) per mcm per 100 km, as at 31 December 2009.

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

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

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

### *Crude oil*

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

### *Stable gas condensate, LPG and oil products*

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

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

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

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

### **Transportation transactions with related parties**

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

### **Our tax burden**

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

According to amendments to the Russian Tax Code the UPT rate for natural gas was increased from RR 147 to RR 237 per mcm effective from 1 January 2011. In addition, effective from 1 January 2012 and 1 January 2013 the UPT rate for natural gas will be increased by 5.9% and by 5.6% respectively.

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

an inspection of their activities for a period of three calendar years immediately preceding the year in which the audit is conducted. Previous audits do not completely exclude subsequent claims relating to the audited period. In addition, in some instances, new tax regulations have been given retroactive effect.

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

## **OIL AND GAS RESERVES**

In December 2008, the US Securities and Exchange Commission released the Final Rule for the *Modernization of Oil and Gas Reporting*, which requires the disclosure of oil and gas proved reserves by significant geographic area, using a 12 month average beginning-of-the-month price for the year, rather than year-end prices, and allows the use of reliable technologies to estimate proved oil and gas reserves, if the technologies have demonstrated reliable estimates about reserves. Furthermore, companies are required to report on the independence and qualifications of its reserve preparer or auditor, and file reports when a third party is relied upon to prepare reserve estimates or conduct an audit of the company's reserves.

OAO NOVATEK does not file with the SEC nor is obliged to report its reserves in compliance with these standards. However, we have consistently disclosed proved oil and gas reserves as unaudited supplemental information in the Group's IFRS audited consolidated financial statements. As part of management's continued efforts to improve investor confidence and provide transparency regarding the Group's oil and gas reserves, we have provided additional information about our hydrocarbon reserves based on the widely-industry accepted PRMS reserves reporting classification, which in addition to total proved reserves discloses information on the Group's probable and possible reserves.

Our proved reserves estimates are appraised by the Group's independent petroleum engineers, "DeGolyer and MacNaughton". The Group's total proved reserves, comprised of proved developed and proved undeveloped reserves as of 31 December 2010 and 2009, were appraised using both reporting and disclosure requirements promulgated by the SEC and the PRMS reserves reporting classification. Proved reserves disclosed in the *Unaudited Supplemental Oil and Gas Disclosures* in the Group's IFRS consolidated financial statements are presented under the SEC reserve reporting methodology, which requires that 100% of the reserves attributable to all consolidated subsidiaries (whether or not wholly owned) shall be included for the reporting year as well as our proportionate share of proved reserves accounted for by the equity method.

The tables below provide the comparison of the Group's estimated reserves under SEC and PRMS classifications attributable to all consolidated subsidiaries and associated companies based on the Group's equity ownership interest in the respective fields and do not reconcile to the proved reserves disclosed under the SEC reserve reporting methodology as noted above.

	Natural gas			
	SEC		PRMS	
	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>
<i>Based on our equity ownership interest in the fields</i>				
<b>Total proved reserves at 31 December 2008 <sup>(1)</sup></b>	<b>24,357</b>	<b>690</b>	<b>25,937</b>	<b>734</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	4,091	115	2,778	79
Acquisitions	6,844	194	10,551	299
Production	(1,142)	(32)	(1,142)	(32)
<b>Total proved reserves at 31 December 2009</b>	<b>34,150</b>	<b>967</b>	<b>38,124</b>	<b>1,080</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	2,392	68	2,579	73
Disposals <sup>(2)</sup>	(870)	(25)	(870)	(25)
Production	(1,314)	(37)	(1,314)	(37)
<b>Total proved reserves at 31 December 2010 (subsidiaries)</b>	<b>34,358</b>	<b>973</b>	<b>38,519</b>	<b>1,091</b>
<i>Total proved reserves at 31 December 2010 (associated companies)</i>	<i>6,057</i>	<i>171</i>	<i>7,726</i>	<i>219</i>
<b>Grand total proved reserves at 31 December 2010</b>	<b>40,415</b>	<b>1,144</b>	<b>46,245</b>	<b>1,310</b>

<sup>(1)</sup> Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

<sup>(2)</sup> Disposals represent reserves attributable to the sale of an equity stake in a subsidiary and the loss of control.



<i>Based on our equity ownership interest in the fields</i>	<b>Crude oil, gas condensate and natural gas liquids</b>			
	<b>SEC</b>		<b>PRMS</b>	
	<i>Millions of barrels</i>	<i>Millions of metric tons</i>	<i>Millions of barrels</i>	<i>Millions of metric tons</i>
<b>Total proved reserves at 31 December 2008 <sup>(1)</sup></b>	<b>452</b>	<b>55</b>	<b>551</b>	<b>67</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	42	4	33	4
Acquisitions	60	7	91	11
Production	(25)	(3)	(25)	(3)
<b>Total proved reserves at 31 December 2009</b>	<b>529</b>	<b>63</b>	<b>650</b>	<b>79</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	43	6	66	9
Disposals <sup>(2)</sup>	(40)	(5)	(40)	(5)
Production	(31)	(4)	(31)	(4)
<b>Proved reserves at 31 December 2010 (subsidiaries)</b>	<b>501</b>	<b>60</b>	<b>645</b>	<b>79</b>
<i>Total proved reserves at 31 December 2010 (associated companies)</i>	<i>103</i>	<i>13</i>	<i>116</i>	<i>14</i>
<b>Grand total proved reserves at 31 December 2010</b>	<b>604</b>	<b>73</b>	<b>761</b>	<b>93</b>

<sup>(1)</sup> Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

<sup>(2)</sup> Disposals represent reserves attributable to the sale of an equity stake in a subsidiary and the loss of control.

The following table provides for our combined SEC and PRMS proved reserves on a total boe basis.

<i>Based on our equity ownership interest in the fields</i>	<b>Combined natural gas, crude oil, gas condensate and natural gas liquids in millions of barrels of oil equivalent</b>	
	<b>SEC</b>	<b>PRMS</b>
<b>Total proved reserves:</b>		
At 31 December 2008 <sup>(1)</sup>	4,963	5,354
At 31 December 2009	6,853	7,711
At 31 December 2010	8,088	9,325
<i>including subsidiaries</i>	<i>6,863</i>	<i>7,779</i>
<i>including associated companies</i>	<i>1,225</i>	<i>1,546</i>

<sup>(1)</sup> Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

The PRMS reserve classification standards allows for the reporting of reserves estimates for probable and possible reserves as presented in the following table:

<i>Under PRMS classification (based on our equity ownership interest in the fields)</i>	<b>Natural gas</b>		<b>Crude oil, gas condensate and natural gas liquids</b>	
	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>	<i>Millions of barrels</i>	<i>Millions of metric tons</i>
<b>Probable reserves:</b>				
At 31 December 2008	9,969	282	298	36
At 31 December 2009	13,520	383	375	46
At 31 December 2010	18,748	531	587	73
<i>including subsidiaries</i>	<i>13,152</i>	<i>372</i>	<i>343</i>	<i>42</i>
<i>including associated companies</i>	<i>5,596</i>	<i>159</i>	<i>244</i>	<i>31</i>
<b>Possible reserves:</b>				
At 31 December 2008	8,958	254	612	78
At 31 December 2009	9,416	267	696	89
At 31 December 2010	14,867	421	915	117
<i>including subsidiaries</i>	<i>7,995</i>	<i>226</i>	<i>674</i>	<i>86</i>
<i>including associated companies</i>	<i>6,872</i>	<i>195</i>	<i>241</i>	<i>31</i>

The Group's PRMS proved reserves attributable to the consolidated subsidiaries and associated companies based on the Group's equity ownership interest in the respective fields aggregated approximately 1.31 trillion cubic meters (tcm) of natural gas and 93 million tons of gas condensate and crude oil as of 31 December 2010. Combined, these proved reserves represent approximately 9.3 billion barrels of oil equivalent.

Our total PRMS proved reserves attributable to consolidated subsidiaries and associated companies based on the Group's equity ownership interest in their respective fields have increased by 20.9% during 2010 due to the acquisition, by the Group's joint venture Yamal Development, of a 51 percent participation interest in SeverEnergia in November 2010, the acquisition of 51 percent of the outstanding ordinary shares of Sibneftegas in December 2010, and organic growth at our core fields. As we continue to invest capital into the development of our fields, we anticipate that we will increase our resource base as well as migrate reserves among the reserve categories.

The increase in the Group's PRMS probable and possible reserves during 2010 was also primarily due to acquisitions of participation interests in SeverEnergia and Sibneftegas in November and December 2010, respectively.

The Group's reserves are all located in the Russian Federation, in the Yamal-Nenets Autonomous Region (Western Siberia), thereby representing one geographical area.

The below table contains information about reserve/production ratios for the years ended 31 December 2010 and 2009 under both reserves reporting methodologies based on our equity ownership interest, rather than 100% of the reserves attributable to all consolidated subsidiaries and associated companies:

<i>Number of years (based on our equity ownership interest in the fields)</i>	<b>SEC</b>		<b>PRMS</b>	
	<b>At 31 December: 2010</b>	<b>2009</b>	<b>At 31 December: 2010</b>	<b>2009</b>
Total proved reserves to production	30	29	34	33
Total proved and probable reserves to production	-	-	49	45
Total proved, probable and possible reserves to production	-	-	62	55

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

The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for reserve determinations. 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. Our reserves estimates were prepared using standard geological and engineering methods generally accepted in the petroleum industry. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of the process, senior management reviews and approves the final reserves estimates issued by D&M.

The Reserves Management and Assessment Group (RMAG) is comprised of qualified technical staff from various departments – geological and geophysical, gas and liquids commercial operations, capital construction, production, financial planning and analysis and includes technical and financial representatives from the Group's subsidiaries, which are the principal holders of the mineral licenses. The person responsible for overseeing the work of the RMAG is a member of the Management Board.

The approval of the final reserves estimates is the sole responsibility of senior management.

## 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 for the years ended 31 December 2010 and 2009. Oil and gas production costs do not include general corporate overheads or their 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 on a barrel of oil equivalent (boe) basis in Russian roubles and US dollars:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Production costs:</b>			
Lifting cost	4,401	3,797	15.9%
Taxes other than income tax	9,363	7,840	19.4%
Transportation expenses	37,187	28,482	30.6%
<b>Total production costs before DD&amp;A</b>	<b>50,951</b>	<b>40,119</b>	<b>27.0%</b>
Depreciation, depletion and amortization (DD&A)	6,384	5,139	24.2%
<b>Total production costs</b>	<b>57,335</b>	<b>45,258</b>	<b>26.7%</b>

<i>RR per boe</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Production costs:</b>			
Lifting cost	16.1	16.0	0.6%
Taxes other than income tax	34.2	33.1	3.3%
Transportation expenses	135.8	120.1	13.1%
<b>Total production costs before DD&amp;A</b>	<b>186.1</b>	<b>169.2</b>	<b>10.0%</b>
Depreciation, depletion and amortization (DD&A)	23.3	21.7	7.4%
<b>Total production costs</b>	<b>209.4</b>	<b>190.9</b>	<b>9.7%</b>

<i>USD per boe</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Production costs:</b>			
Lifting cost	0.53	0.50	6.0%
Taxes other than income tax	1.12	1.04	7.7%
Transportation expenses	4.46	3.78	18.0%
<b>Total production costs before DD&amp;A</b>	<b>6.11</b>	<b>5.32</b>	<b>14.8%</b>
Depreciation, depletion and amortization (DD&A)	0.76	0.68	11.8%
<b>Total production costs</b>	<b>6.87</b>	<b>6.00</b>	<b>14.5%</b>

Production costs consist of amounts directly related to the extraction of natural gas, gas condensate and crude oil from the reservoir and other related costs; including production expenses, taxes other than income tax (production taxes), insurance expenses and shipping/transportation/handling costs to end-customers. The average production cost on a boe basis is calculated by dividing the applicable costs by the respective barrel of oil equivalent of our hydrocarbons produced during the year. Natural gas, gas condensate and crude oil volumes produced by our fields are converted to a barrel of oil equivalent based on the relative energy content of each fields' hydrocarbons.

Our lifting costs, as presented in the tables above, differ from lifting costs as reflected in the *Unaudited Supplemental Oil and Gas Disclosures* in NOVATEK's Financial Statements, in that the lifting costs as presented in NOVATEK's Financial Statements includes changes in balances of natural gas and hydrocarbon liquids to more appropriately match costs incurred to revenues under the IFRS matching principles. A reconciliation of lifting costs as reflected in the *Unaudited Supplemental Oil and Gas Disclosures* in NOVATEK's Financial Statements is set forth below:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Lifting costs presented in "Oil and Gas Production Costs" above	4,401	3,797	15.9%
Change in balances of natural gas and hydrocarbon liquids stated at cost in the consolidated statement of financial position	385	(151)	n/a
<b>Lifting costs per "Unaudited Supplemental Oil and Gas Disclosures"</b>	<b>4,786</b>	<b>3,646</b>	<b>31.3%</b>

## Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to an increase in our production. Liquids sales volumes increased due to an increase in unstable gas condensate production that was partially offset by an increase in liquids inventory balances.

### *Natural gas sales volumes*

<i>millions of cubic meters</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Production from:</b>			
Yurkharovskoye field	24,383	17,731	37.5%
East-Tarkosalinskoye field	9,735	11,509	(15.4%)
Khancheyevskoye field	3,013	3,043	(1.0%)
Other fields	77	70	10.0%
<b>Total natural gas production</b>	<b>37,208</b>	<b>32,353</b>	<b>15.0%</b>
<b>Purchases from:</b>			
Third parties	-	1,000	n/a
<b>Total natural gas purchases</b>	<b>-</b>	<b>1,000</b>	<b>n/a</b>
<b>Total production and purchases</b>	<b>37,208</b>	<b>33,353</b>	<b>11.6%</b>
Purovsky Plant and own usage	(45)	(44)	2.3%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	(46)	(372)	(87.6%)
<b>Total natural gas sales volumes</b>	<b>37,117</b>	<b>32,937</b>	<b>12.7%</b>
<i>Sold to end-customers</i>	<i>23,745</i>	<i>14,751</i>	<i>61.0%</i>
<i>Sold to traders in remote points</i>	<i>-</i>	<i>7,668</i>	<i>n/a</i>
<b>Subtotal sold to end-customers</b>	<b>23,745</b>	<b>22,419</b>	<b>5.9%</b>
<b>Sold ex-field</b>	<b>13,372</b>	<b>10,518</b>	<b>27.1%</b>

In 2010, our total consolidated natural gas production increased by 4,855 mmcm, or 15.0%, compared to 2009 due to an increase in production at our Yurkharovskoye field resulting from the launches of the second and third stages of the field's second phase development in October 2009 and October 2010, respectively. The decrease in natural gas production at our East-Tarkosalinskoye field in 2010 was the direct result of our decision to continue optimizing unstable gas condensate production at the Yurkharovskoye field.

In 2010, we did not purchase natural gas from third parties due to our ability to meet domestic market demand from our own production.



*Liquids sales volumes*

<i>thousands of tons</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
<b>Production from:</b>			
Yurkharovskoye field	2,099	1,484	41.4%
East-Tarkosalinskoye field	852	896	(4.9%)
Khancheyevskoye field	635	618	2.8%
Other fields	31	40	(22.5%)
<b>Total liquids production</b>	<b>3,617</b>	<b>3,038</b>	<b>19.1%</b>
<b>Purchases from:</b>			
Third parties	12	13	(7.7%)
<b>Total liquids purchases</b>	<b>12</b>	<b>13</b>	<b>(7.7%)</b>
<b>Total production and purchases</b>	<b>3,629</b>	<b>3,051</b>	<b>18.9%</b>
Losses and own usage <sup>(1)</sup>	(39)	(26)	50.0%
Gas condensate pipeline line fill and de-ethanization	(36)	-	n/a
Decreases (increases) in liquids inventory balances	(153)	103	n/a
<b>Total liquids sales volumes</b>	<b>3,401</b>	<b>3,128</b>	<b>8.7%</b>
<i>Stable gas condensate export</i>	2,326	2,115	10.0%
<i>Stable gas condensate domestic</i>	4	55	(92.7%)
<b><i>Subtotal stable gas condensate</i></b>	<b>2,330</b>	<b>2,170</b>	<b>7.4%</b>
<i>LPG export</i>	434	405	7.2%
<i>LPG CIS</i>	0	9	n/a
<i>LPG domestic</i>	397	321	23.7%
<i>LPG sold through domestic retail and small wholesale stations</i>	45	14	221.4%
<b><i>Subtotal LPG</i></b>	<b>876</b>	<b>749</b>	<b>17.0%</b>
<i>Crude oil export</i>	71	69	2.9%
<i>Crude oil domestic</i>	114	129	(11.6%)
<b><i>Subtotal crude oil</i></b>	<b>185</b>	<b>198</b>	<b>(6.6%)</b>
<i>Oil products export</i>	-	1	n/a
<i>Oil products domestic</i>	10	10	0.0%
<b><i>Subtotal oil products</i></b>	<b>10</b>	<b>11</b>	<b>(9.1%)</b>

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

In 2010, our liquids production increased by 579 thousand tons, or 19.1%, to 3,617 thousand tons compared to 3,038 thousand tons in 2009, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the second and third stages of the field's second phase development in October 2009 and October 2010, respectively. The decrease in liquids production at the East-Tarkosalinskoye field was the result of natural declines in the concentration of gas condensate in the extracted gas due to decreasing reservoir pressure at the current gas condensate producing horizons.

**RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2010 COMPARED TO THE YEAR ENDED 31 DECEMBER 2009**

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2010 and 2009. Each line item is also shown as a percentage of our total revenues.

<i>Millions of Russian roubles</i>	<b>Year ended 31 December:</b>			
	<b>2010</b>	<b>% of total revenues</b>	<b>2009</b>	<b>% of total revenues</b>
<b>Total revenues (net of VAT and export duties)</b>	<b>117,024</b>	<b>100.0%</b>	<b>89,954</b>	<b>100.0%</b>
<i>including:</i>				
natural gas sales	71,060	60.7%	53,623	59.6%
liquids sales	44,102	37.7%	33,280	37.0%
Operating expenses	(68,518)	(58.6%)	(56,130)	(62.4%)
Net gain on disposal of interest in subsidiaries	1,329	1.1%	52	0.1%
Other operating income (loss)	396	0.4%	(343)	(0.4%)
<b>Profit from operations</b>	<b>50,231</b>	<b>42.9%</b>	<b>33,533</b>	<b>37.3%</b>
Finance income (expense)	1,197	1.0%	(831)	(0.9%)
Share of income (loss) of associated companies	(346)	(0.2%)	(202)	(0.3%)
<b>Profit before income tax</b>	<b>51,082</b>	<b>43.7%</b>	<b>32,500</b>	<b>36.1%</b>
Total income tax expense	(10,804)	(9.3%)	(6,778)	(7.5%)
<b>Profit (loss)</b>	<b>40,278</b>	<b>34.4 %</b>	<b>25,722</b>	<b>28.6%</b>
Non-controlling interest	255	0.2%	321	0.4%
<b>Profit attributable to shareholders of OAO NOVATEK</b>	<b>40,533</b>	<b>34.6%</b>	<b>26,043</b>	<b>29.0%</b>

## Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the years ended 31 December 2010 and 2009:

<i>Millions of Russian roubles</i>	Year ended 31 December:		Change %
	2010	2009	
<b>Natural gas sales</b>	<b>71,060</b>	<b>53,623</b>	<b>32.5%</b>
<i>End-customer</i>	54,860	28,513	92.4%
<i>Traders in remote points</i>	-	14,080	n/a
<b>Subtotal of end-customers sales</b>	<b>54,860</b>	<b>42,593</b>	<b>28.8%</b>
<b>Ex-field sales</b>	<b>16,200</b>	<b>11,030</b>	<b>46.9%</b>
<b>Stable gas condensate sales</b>	<b>29,754</b>	<b>23,599</b>	<b>26.1%</b>
<i>Export</i>	29,720	23,245	27.9%
<i>Domestic</i>	34	354	(90.4%)
<b>Liquefied petroleum gas sales</b>	<b>12,747</b>	<b>8,253</b>	<b>54.5%</b>
<i>Export</i>	8,052	5,429	48.3%
<i>CIS</i>	9	99	(90.9%)
<i>Domestic</i>	4,686	2,725	72.0%
<b>Crude oil sales</b>	<b>1,458</b>	<b>1,335</b>	<b>9.2%</b>
<i>Export</i>	603	554	8.8%
<i>Domestic</i>	855	781	9.5%
<b>Oil products sales</b>	<b>143</b>	<b>93</b>	<b>53.8%</b>
<i>Export</i>	-	10	(100.0%)
<i>Domestic</i>	143	83	72.3%
<b>Total oil and gas sales</b>	<b>115,162</b>	<b>86,903</b>	<b>32.5%</b>
Sales of polymer and insulation tape	1,699	1,873	(9.3%)
Other revenues	163	1,178	(86.2%)
<b>Total revenues</b>	<b>117,024</b>	<b>89,954</b>	<b>30.1%</b>

### *Natural gas sales*

In 2010, our revenues from sales of natural gas increased by RR 17,437 million, or 32.5%, compared to 2009 largely due to an increase in natural gas prices and, to a lesser extent, an increase in sales volumes. Revenues from the sale of natural gas accounted for 60.7% and 59.6% of our total revenues in 2010 and 2009, respectively.

In 2010, our average realized natural gas price per mcm increased by RR 286 per mcm, or 17.6%, to RR 1,914 per mcm from RR 1,628 per mcm in 2009. Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased from 68.1% in 2009 (including traders in remote points) to 64.0% in 2010. The average realized prices of our natural gas sold directly to end-customers and traders in remote points (including transportation expense) and sold ex-field were higher by 21.6% and 15.4%, respectively, in 2010 compared to 2009. In 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies, while in 2009 the majority of natural gas volumes sold to end-customers were delivered to energy utility companies and traders in remote points, the latter of which we ceased deliveries to effective 1 January 2010.

### *Stable gas condensate sales*

In 2010, our revenues from sales of stable gas condensate increased by RR 6,155 million, or 26.1%, compared to 2009, primarily due to an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation and, to a lesser extent, an increase in volumes sold.

In 2010, our total stable gas condensate sales volumes increased by 160 thousand tons, or 7.4%, due to an increase in our unstable gas condensate production that was partially offset by an increase in stable gas condensate inventory balance during the period. In 2010, we exported 2,326 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to the United States, Asian-Pacific region, Europe and South America, with the remaining four thousand tons sold domestically. In 2009, we exported 2,115 thousand tons of stable gas condensate, or 97.5% of our total sales volumes, to markets in the United States, Asian-Pacific region and Europe, and the remaining 55 thousand tons were sold domestically.

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

In 2010, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 74.4 per ton, or 21.5%, to USD 420.8 per ton (DES, CFR and CIF) from USD 346.4 per ton (DES, CFR and CIF) in 2009 due to a 30.6% increase in our average export contract price that was partially offset by a 51.5% increase in our average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in 2010 compared to 2009.

### *Liquefied petroleum gas sales*

In 2010, our revenues from the sales of LPG increased by RR 4,494 million, or 54.5%, compared to 2009, due to an increase in both our average realized prices and volumes sold. In 2010, our total LPG sales volumes increased by 127 thousand tons, or 17.0%, to 876 thousand tons from 749 thousand tons in 2009. The growth in LPG sales volumes was mainly due to an increase in unstable gas condensate throughput at the Purovsky Plant and the corresponding increase in LPG output.

In 2010, we sold 434 thousand tons of LPG, or 49.5% of our total LPG sales volumes, (including approximately three thousand tons purchased and resold through our wholly-owned subsidiary Intergaz-System), to the export markets for an average price of USD 611.0 per ton (DAF, CPT and FCA excluding export duties), representing an increase of USD 188.1 per ton, or 44.5%, compared to 2009. The increase in our average realized export prices (excluding export duties) was primarily due to a 41.0% increase in our average contract price that was partially offset by an increase in our average export duty per ton as a result of the cancellation of the zero export duty rate from 1 December 2009 (a zero export duty rate for LPG was effective from 1 January to 1 December 2009).

In 2010, we sold 442 thousand tons of LPG, or 50.5% of our total LPG sales volumes on the domestic market at an average price of RR 10,609 per ton (FCA, excluding VAT) representing an increase of RR 2,484 per ton, or 30.6%, compared to 2009.

In 2009, we sold 54.1% of our LPG volumes to the export markets, 44.7% was sold to the domestic markets, and 1.2% was sold to the CIS markets.

### *Crude oil sales*

In 2010, our revenues from the sales of crude oil increased by RR 123 million, or 9.2%, compared to 2009, due to an increase in our average realized prices that was partially offset by a decrease in sales volumes.

In 2010, our crude oil sales volumes decreased by 13 thousand tons, or 6.6%, to 185 thousand tons from 198 thousand tons in 2009 due primarily to a decrease in crude oil purchases. In 2010, 61.6% of our crude oil volumes were sold domestically at an average price of RR 7,523 per ton (excluding VAT) representing an increase of RR 1,472 per ton, or 24.3%, compared to 2009. The remaining 38.4% of our crude oil volumes were sold to the export markets at an average price of USD 281.2 per ton (DAF, excluding export duties) representing an increase of USD 26.1 per ton, or 10.2%, compared to 2009. The increase in the average realized export price (excluding export duties) was the result of a 26.3% increase in our average export contract price that was partially offset by a 48.6% increase in our average export duty per ton. The increase in our average realized

contract price was due to an overall increase in crude oil and related commodity prices on international markets in 2010 compared to 2009.

#### *Oil products sales*

In 2010, our revenue from the sales of oil products increased by RR 50 million, or 53.8%, to RR 143 million from RR 93 million in 2009 due primarily to an increase in oil products trading operations through our retail stations on the domestic market.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 73 million to RR 110 million in 2010 compared to RR 37 million in 2009. In 2010, we sold approximately five thousand tons of oil products (diesel fuel and petrol) for an average price of RR 22,951 per ton compared to two thousand tons for an average price of RR 22,356 per ton in 2009.

In 2010, our revenues from oil products produced at the Surgutsky refinery and sold on the domestic market decreased to RR 33 million from RR 46 million in 2009 due to a decrease in volumes sold. In 2010, we sold five thousand tons of oil products produced from our unstable gas condensate at the Surgutsky Refinery at an average price of RR 6,773 per ton compared to eight thousand tons at RR 5,419 per ton in 2009. The decrease in volumes sold was due to the cessation of deliveries of our unstable gas condensate to the refinery starting in September 2010 as a result of the launch of our own gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant in August 2010.

In 2009, we sold one thousand tons of oil products (light distillate) produced from our unstable gas condensate at the Surgutsky Refinery to the international market through our foreign trading subsidiary at an average realized price (excluding export duties, FOB Vitino) of USD 299.4 per ton.

#### *Sales of polymer and insulation tape*

Our revenues from the sales of polymer and insulation tape decreased by RR 174 million, or 9.3%, to RR 1,699 million in 2010 compared to RR 1,873 million in 2009 due to the disposal of our polymer and insulation tape production subsidiary OOO “NOVATEK–Polymer” in September 2010.

#### *Other revenues*

Other revenues include geological and geophysical research services, rent, transportation, handling, storage and other services. In 2010, other revenues decreased by RR 1,015 million, or 86.2%, to RR 163 million from RR 1,178 million in 2009. The decrease in other revenues was primarily related to a RR 779 million decrease in revenues from geological and geophysical research services provided primarily to our associates. The decrease was due to the acquisition in February 2010 of a controlling interest in our associated companies and the subsequent consolidation of their activities and elimination of intercompany operations. In addition, rent services sales decreased by RR 258 million, or 74.8%, to RR 87 million in 2010. The remaining increase of RR 22 million in other revenues was composed of various immaterial items.

## Operating expenses

In 2010, our total operating expenses increased by RR 12,388 million, or 22.1%, to RR 68,518 million compared to RR 56,130 million in 2009, due primarily to an increase in transportation expenses and taxes other than income tax. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased to 69.0% in 2010 compared to 66.0% in 2009. Total operating expenses decreased as a percentage of total revenues to 58.6% in 2010 compared to 62.4% in 2009, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas sales prices and volumes, as well as liquids sales prices.

<i>millions of Russian roubles</i>	Year ended 31 December:			
	2010	% of total revenues	2009	% of total revenues
Transportation expenses	37,200	31.8%	29,026	32.3%
Taxes other than income tax	10,077	8.6 %	8,042	8.9%
<b>Subtotal non-controllable expenses</b>	<b>47,277</b>	<b>40.4%</b>	<b>37,068</b>	<b>41.2%</b>
General and administrative expenses	6,733	5.8%	5,126	5.7%
Depreciation, depletion and amortization	6,616	5.7%	5,588	6.2%
Materials, services and other	6,072	5.2%	6,259	7.0%
Exploration expenses	1,595	1.4%	566	0.6%
Net impairment expense	541	0.5%	125	0.1%
Purchases of natural gas and liquid hydrocarbons	154	0.1%	1,143	1.3%
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(470)	n/m	255	n/m
<b>Total operating expenses</b>	<b>68,518</b>	<b>58.6%</b>	<b>56,130</b>	<b>62.4%</b>

### *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 2010, non-controllable expenses of transportation and taxes other than income tax increased by RR 10,209 million, or 27.5%, to RR 47,277 million from RR 37,068 million in 2009. The change in transportation expenses was primarily due to an increase in the natural gas transportation tariff and sales volumes. Taxes other than income tax increased primarily due to higher liquids and natural gas production volumes and the corresponding impact on unified natural resources production tax as well as excise and fuel taxes incurred in 2010 with the commencement of commercial activities in Poland. As a percentage of total revenues, our non-controllable expenses marginally decreased to 40.4% in 2010 compared to 41.2% in 2009.



### *Transportation expenses*

In 2010, our total transportation expenses increased by RR 8,174 million, or 28.2%, compared to 2009.

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Natural gas transportation to customers	26,569	20,019	32.7%
Liquids transportation by rail	7,350	5,820	26.3%
Liquids transportation by tankers	2,771	2,675	3.6%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	307	340	(9.7%)
Crude oil transportation to customers	190	160	18.8%
Other transportation costs	13	12	8.3%
<b>Total transportation expenses</b>	<b>37,200</b>	<b>29,026</b>	<b>28.2%</b>

In 2010, our transportation expenses for natural gas increased by RR 6,550 million, or 32.7%, to RR 26,569 million from RR 20,019 million in 2009. The change was primarily due to an increase in the natural gas transportation tariff (see “Transportation tariffs” above) and, to a lesser extent, by a 5.9% increase in our sales volumes of natural gas delivered directly to end-customers, where the cost of transportation is included in the sales price. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

Total expenses for liquids transportation by rail increased by RR 1,530 million, or 26.3%, from RR 5,820 million in 2009 to RR 7,350 million in 2010 due primarily to an increase in liquids volumes sold and higher rail transportation tariffs. In 2010, our combined liquids volumes sold and transported via rail increased by 251 thousand tons, or 8.6%, to 3,153 thousand tons from 2,902 thousand tons in 2009.

Our weighted average transportation tariff for liquids delivered by rail increased by 16.2% to RR 2,331 per ton from RR 2,006 per ton in 2009 primarily due to an increase in rail tariffs by 9.4% effective 1 January 2010 and an application of a higher co-efficient to the existing rail tariff for stable gas condensate deliveries to export markets. In 2010, we applied a co-efficient of 0.89 to the existing rail tariff for stable gas condensate deliveries to export markets compared to a co-efficient of 0.72 in 2009. In addition, we applied a co-efficient of 0.35 to the existing rail tariff for LPG export deliveries at the cross-border points of the Russian Federation in both periods (see “Transportation tariffs” above).

Total transportation expense for liquids delivered by tankers to international markets increased by RR 96 million, or 3.6%, to RR 2,771 million in 2010 from RR 2,675 million in 2009. The change was due to a 10.0% increase in volumes sold that was partially offset by a slight decrease in average freight rates. In 2010, we delivered 53.4% of our stable gas condensate export volumes to United States markets compared to 66.5% in 2009.

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

*Taxes other than income tax*

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Unified natural resources production tax (UPT)	7,861	6,699	17.3%
Property tax	1,482	1,155	28.3%
Excise and fuel taxes	454	-	n/a
Other taxes	280	188	48.9%
<b>Total taxes other than income tax</b>	<b>10,077</b>	<b>8,042</b>	<b>25.3%</b>

In 2010, taxes other than income tax increased by RR 2,035 million, or 25.3%, primarily due to an increase in the unified natural resources production tax expense and excise and fuel taxes incurred at our trading subsidiaries in Poland.

In 2010, our UPT for natural gas and gas condensate increased by RR 730 million and RR 275 million, respectively, due to an increase in production volumes. The increase in our UPT for crude oil of RR 157 million was due primarily to an increase in our average crude oil production tax rate, which is linked to the Urals benchmark crude oil price. Our average UPT rate for crude oil increased from RR 2,255 per ton in 2009 to RR 3,099 per ton in 2010. The natural gas production tax rate in 2010 and 2009 remained unchanged at RR 147 per mcm.

In 2010, our property tax expense increased by RR 327 million, or 28.3%, to RR 1,482 million from RR 1,155 million in 2009, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In 2010, we expensed RR 454 million of excise and fuel taxes in respect of LPG export sales through our subsidiaries Novatek Polska and Intergaz-System. The excise and fuel taxes are payable when LPG enters the territory of Poland.

*General and administrative expenses*

In 2010, our general and administrative expenses increased by RR 1,607 million, or 31.3%, to RR 6,733 million compared to RR 5,126 million in 2009. The main components of these expenses were employee compensation and charitable contributions, which, on aggregate, comprised 69.0% and 65.8% of total general and administrative expenses in 2010 and 2009, respectively.

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Employee compensation	3,874	2,840	36.4%
Charitable contributions	774	533	45.2%
Legal, audit, and consulting services	504	301	67.4%
Rent expense	270	245	10.2%
Business trip expenses	265	207	28.0%
Fire safety and security expense	149	143	4.2%
Depreciation – administrative buildings	141	150	(6.0%)
Concession management services	125	225	(44.4%)
Insurance expense	73	90	(18.9%)
Other	558	392	42.3%
<b>Total general and administrative expenses</b>	<b>6,733</b>	<b>5,126</b>	<b>31.3 %</b>

Our employee compensation increased by RR 1,034 million, or 36.4%, to RR 3,874 million in 2010 as compared to RR 2,840 million in 2009 primarily due to an increase in bonus accruals by RR 480 million related to the performance achieved. In addition, we performed an indexation of basic salaries by 10% effective 1 July 2010 resulting in an additional RR 225 million in payroll expenses. Moreover, in 2010, we recognized RR 400 million in employee compensation due to the initiation of NOVATEK's share-based compensation program for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee.

In 2010, our charitable contributions increased by RR 241 million, or 45.2%, to RR 774 million compared to RR 533 million in 2009, and were primarily related to our donations to sport clubs and activities as well as continued support for charities and social programs in the regions where we operate. Charitable contributions will continue to fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support.

Legal, audit, and consulting services expenses increased by RR 203 million, or 67.4%, to RR 504 million compared to RR 301 million in 2009 due to an increase in consulting and legal services related to the Group's recent acquisitions as well as legal services connected with the development of the Yamal LNG project.

In 2010, our rent expense increased by RR 25 million, or 10.2%, to RR 270 million from RR 245 million in 2009 due to the rent of additional office space in Moscow.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El Arish concession area located in Egypt). In 2010, our expenses related to concession management services decreased by RR 100 million, or 44.4%, compared to 2009. The decrease in costs associated with concession management services in 2010 is consistent with our approved business plan for this project.

In 2010, other general and administrative expenses increased by RR 166 million, or 42.3%, compared to 2009, of which RR 55 million related to the remuneration of the Board of Directors and payments to members of the Company's revision committee. In addition, our administrative staff training expenses increased by RR 22 million. The remaining increase of RR 89 million was allocated amongst different expense categories within other general and administrative expenses which, taken individually, changed immaterially.

#### *Depreciation, depletion and amortization*

In 2010, our depreciation, depletion and amortization ("DDA") expense increased by RR 1,028 million, or 18.4%, compared to 2009 as a result of an increase in our depletable cost base, as well as a 15.5% increase in our hydrocarbon production in barrels of oil equivalent (boe). The Company accrues depreciation and depletion using the "units of production" method for producing assets and straight-line method for other facilities.

In 2010, our DDA per boe was RR 20.5 compared to RR 19.4 in 2009. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the second and third stages of the second phase development at the Yurkharovskoye field in October 2009 and October 2010, respectively, as well as costs capitalized during 2010.

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

### *Materials, services and other*

In 2010, our materials, services and other expenses decreased by RR 187 million, or 3.0%, to RR 6,072 million compared to RR 6,259 million in 2009. The main components of this expense category were employee compensation and materials and supplies, which comprised 42.4% and 22.8%, respectively, of total materials, services and other expenses in 2010.

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Employee compensation	2,572	2,457	4.7%
Materials and supplies	1,386	1,455	(4.7%)
Repair and maintenance services	640	396	61.6%
Tolling and processing fees	566	556	1.8%
Electricity and fuel	388	331	17.2%
Fire safety and security expense	179	186	(3.8%)
Other	340	254	33.9%
<b>Subtotal materials, services and other</b>	<b>6,071</b>	<b>5,635</b>	<b>7.7%</b>
Operator services expense	1	624	(99.8%)
<b>Total materials, services and other</b>	<b>6,072</b>	<b>6,259</b>	<b>(3.0%)</b>

In 2010, our materials, services and other expenses, excluding operator services expense, increased by RR 436 million, or 7.7%, to RR 6,071 million compared to RR 5,635 million in 2009.

Our employee compensation increased by RR 115 million, or 4.7%, to RR 2,572 million compared to RR 2,457 million in 2009 primarily due to an indexation of basic salaries by 10% effective 1 July 2010.

Materials and supplies expense decreased by RR 69 million, or 4.7%, mainly due to a decrease in purchases of raw materials required for the production of polymers and insulation tape products as a result of the disposal of OOO “NOVATEK-Polymer”, which accounted for RR 56 million, or 81.2%, of the total decrease in materials and supplies expense.

Repair and maintenance services increased by RR 244 million, or 61.6%, to RR 640 million in 2010 compared to RR 396 million in 2009. The increase was primarily related to the current repair works at our production assets and was consistent with our on-going maintenance schedules.

Tolling and processing fees increased by RR 10 million, or 1.8%, to RR 566 million in 2010 from RR 556 million in 2009. In 2010, our costs related to the preparation of crude oil produced at our East-Tarkosalinskoye field for transportation increased by RR 84 million due to the initiation of such services starting from the fourth quarter 2009. In addition, we launched our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010, which resulted in a savings of RR 70 million on external processing fees. Tolling and processing fees at the Surgutsky refinery decreased by RR 4 million.

Electricity and fuel expenses increased by RR 57 million, or 17.2%, from RR 331 million in 2009 to RR 388 million in 2010 primarily due to an increase in energy consumption at the Yurkharovskoye field resulting from the commencement in operation of new production assets.

Operator services expenses mainly refer to the geological and geophysical research provided to our associated companies. In 2010, operator services expenses decreased by RR 623 million, or 99.8%, due to the acquisition in February 2010 of a controlling interest in our associates OOO “Oiltechproduct-Invest”, OOO “Petra Invest-M” and OOO “Tailiksneftegas” and the subsequent consolidation of these companies activities.

### *Exploration expenses*

In 2010, our exploration expenses increased by RR 1,029 million, or 181.8%, to RR 1,595 million from RR 566 million in 2009. In 2010, we wrote off the capitalized cost of two exploratory wells in accordance with our accounting policy in the total amount of RR 821 million at the El Arish (Egypt) and Anomalny licence areas.

### *Purchases of natural gas and liquid hydrocarbons*

Purchases of natural gas and liquid hydrocarbons decreased by RR 989 million, or 86.5%, to RR 154 million in 2010, from RR 1,143 million in 2009, primarily due to decreases in purchases of natural gas from third parties by RR 1,021 million and crude oil by RR 61 million. The decrease was partially offset by an increase in oil products and LPG purchases by RR 93 million.

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

In 2010, we recorded a reversal of RR 470 million to change in inventory expense as compared to a charge of RR 255 million in 2009:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Natural gas	2	(127)
Stable gas condensate	(379)	281
Polymer and insulation tape	(56)	82
Other	(37)	19
<b>Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress</b>	<b>(470)</b>	<b>255</b>

In 2010, we recorded a reversal of RR 379 million to our operating expenses due to an increase in our inventory balance of stable gas condensate in transit and storage by 153 thousand tons.

The following table highlights movements in our inventory balances:

<i>Inventory balances in transit or in storage</i>	<b>2010</b>			<b>2009</b>		
	<b>At 31 December</b>	<b>At 1 January</b>	<b>Increase / (decrease)</b>	<b>At 31 December</b>	<b>At 1 January</b>	<b>Increase / (decrease)</b>
<b>Natural gas (millions of cubic meters)</b>	<b>790</b>	<b>744</b>	<b>46</b>	<b>744</b>	<b>372</b>	<b>372</b>
<i>including Gazprom's UGSF</i>	<i>761</i>	<i>584</i>	<i>177</i>	<i>584</i>	<i>300</i>	<i>284</i>
<b>Liquid hydrocarbons (thousand tons)</b>	<b>356</b>	<b>167</b>	<b>189</b>	<b>167</b>	<b>270</b>	<b>(103)</b>
<i>including stable gas condensate</i>	<i>264</i>	<i>111</i>	<i>153</i>	<i>111</i>	<i>220</i>	<i>(109)</i>

Our volumes of natural gas injected into Gazprom's underground gas storage facilities (UGSF) fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

### **Net gain on disposal of interest in subsidiaries**

In 2010, we realized a net gain of RR 1,583 million on the disposal of a 49 percent participation interest in our subsidiary ZAO "Terneftegas" to TOTAL Termokarstovoye B.V., which is comprised by a net income on disposal of RR 776 million and a gain of RR 807 million due to revaluation to fair value of the remaining 51 percent participation interest. In 2010, we recognized a net loss on the disposal of our non-core, wholly-owned subsidiary, OOO "NOVATEK-Polymer" in amount of RR 254 million largely due to the discounting of future payments.

In 2009, we recognized other income of RR 52 million due to the disposal of our subsidiary OOO "Purneft" in April 2009.

### **Other operating income (loss)**

In 2010, we recognized other operating income of RR 396 million, of which RR 317 million resulted from the contribution from the depositary under our GDR program.

In 2009, we realized other operating loss of RR 343 million, of which RR 190 million was related to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") and RR 303 million was related to disposal of assets under construction, primarily at our subsidiary JSC "Energy Northern Company". The remaining other operating

income of RR 150 million was primarily related to penalties from our customers due to non-compliance of their contractual obligations and other profit and loss items.

### **Profit from operations**

As a result of the factors discussed above, our profit from operations increased by RR 16,698 million, or 49.8%, to RR 50,231 million in 2010, compared to RR 33,533 million in 2009. In 2010, our profit from operations as a percentage of total revenues increased to 42.9% compared to 37.3% in 2009 due primarily to higher prices for natural gas and liquids and an increase in natural gas sales volumes.

### **Finance income (expense)**

In 2010, we recorded net finance income of RR 1,197 million which was due primarily to foreign exchange gains compared to net finance loss of RR 831 million in 2009 due to significant foreign exchange loss.

In 2010, our total accrued interest expense increased to RR 2,603 million compared to RR 2,099 million in 2009 as a result of an increase in our average borrowings. During 2010 and 2009, we capitalized RR 2,166 and RR 1,280 million, respectively, of interest expense to cost of additions in our property, plant and equipment account in accordance with the Group's accounting policy.

Interest income increased by RR 71 million, or 13.5%, to RR 598 million in 2010 from RR 527 million 2009 primarily due to an increase in interest income on loans issued to our associated companies that was partially offset by a decrease in interest income on bank deposits.

In 2010, we recorded a net foreign exchange gain of RR 1,036 million compared to a net foreign exchange loss of RR 539 million in 2009 due to the revaluation of our foreign currency denominated borrowings. The Russian rouble had depreciated by 0.8% and 2.9% during 2010 and 2009, respectively. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the composition of our debt position.

### **Share of income (loss) of associated companies**

In 2010, our proportionate share in the loss of associated companies increased by RR 144 million, or 71.3%, to RR 346 million compared to RR 202 million recorded in 2009 due to expensing in our associated companies of finance costs on external debts as well as geological and geophysical research expenditures under the successful efforts accounting policy.

### **Income tax expense**

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 21.0% and 20.7% for 2010 and 2009, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 21.3% in 2010 and 2009. The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

### **Profit attributable to shareholders and earnings per share**

As a result of the factors discussed above, profit for the period increased by RR 14,556 million, or 56.6%, to RR 40,278 million in 2010 from RR 25,722 million in 2009. The profit attributable to NOVATEK shareholders increased by RR 14,490 million, or 55.6%, to RR 40,533 million in 2010 from RR 26,043 million in 2009.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to NOVATEK shareholders, increased by approximately RR 4.78 per share, or 55.6%, to RR 13.37 per share in 2010 from RR 8.59 per share in 2009.



## LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for 2010 and 2009:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2010</b>	<b>2009</b>	
Net cash provided by operating activities	44,863	34,847	28.7%
Net cash used in investing activities	(68,842)	(36,185)	90.3%
Net cash provided by financing activities	23,782	761	n/m

<i>Liquidity ratios</i>	<b>31 December 2010</b>	<b>31 December 2009</b>	<b>Change, %</b>
Current ratio	0.51	1.14	(55.3%)
Total debt to equity	0.49	0.33	48.5%
Long-term debt to long-term debt and equity	0.24	0.17	41.2%
Net debt to total capitalization <sup>(4)</sup>	0.25	0.15	66.7%

<sup>(4)</sup> Net debt represents total debt less cash and cash equivalents. Total capitalization represents total debt, total equity and deferred income tax liability.

### *Net cash provided by operating activities*

In 2010, our net cash provided by operating activities increased by RR 10,016 million, or 28.7%, to RR 44,863 million compared to RR 34,847 million in 2009. The increase in our net cash provided by operating activities was due primarily to the increase in natural gas and liquids prices and natural gas sales volumes, which was partially offset by an increase in income tax paid.

### *Net cash used in investing activities*

In 2010, our net cash used in investing activities increased by RR 32,657 million, or 90.3%, to RR 68,842 million as compared to RR 36,185 million in 2009 primarily due to significant increase in long-term loans provided to our associated companies Yamal Development and Sibneftegas.

### *Net cash provided by financing activities*

In 2010, our net cash provided by financing activities amounted to RR 23,782 million, of which the most significant portion was related to a bridge loan facility which was used to finance the acquisition, by our joint venture Yamal Development, of a 51 percent participation interest in SeverEnergia. In 2009, the net cash provided by financing activities was related to our proceeds we received from long-term and short-term borrowings, as well as contributions from minority shareholders, which, in aggregate, exceeded the repayments of borrowings throughout the year as well as our payments of dividends.

## **Working capital**

Our net working capital position (current assets less current liabilities) at 31 December 2010 was negative RR 27,876 million compared to positive RR 3,274 million at 31 December 2009. The change in our net working capital position was mainly due to a significant increase in our short-term debt, accounts payable resulted from the acquisitions of oil and gas companies in the fourth quarter 2010.

At 31 December 2010, the Group had an outstanding bridge loan facility for the financing of the acquisition by its joint venture, Yamal Development, of a 51 percent participation interest in SeverEnergia of RR 18,201 million (USD 597 million). In February 2011, the bridge facility was fully repaid ahead of its maturity schedule. In addition, at 31 December 2010, the Group had a balance of accounts payable to OAO "Gazprombank" of RR 21,176 million due to the acquisition of a 51 percent stake in Sibneftegas, of which RR 16,000 million was repaid in February 2011 and the remaining RR 5,176 million is planned to be repaid by 31 March 2011. We improved our net working capital position by the issuance of long-term Eurobonds in February 2011 (see "Recent developments" above).

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



## Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2010 and 2009 were as follows:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2010	2009	
Exploration, production and marketing	25,777	17,823	44.6%
Polymer production and marketing	329	49	n/m
<b>Total</b>	<b>26,106</b>	<b>17,872</b>	<b>46.1%</b>

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. The majority of our capital expenditures related to ongoing development and exploration activities at our three core fields and at the Purovsky Plant. The following table shows our expenditure on our main fields for the years ended 31 December 2010 and 2009:

<i>millions of Russian roubles</i>	Year ended 31 December:	
	2010	2009
Yurkharovskoye field	15,375	11,401
East-Tarkosalinskoye field	1,058	2,024
Khancheyevskoye field	87	432
South-Tambeyevskoye field	1,678	-
Purovsky Plant	1,292	1,168
Other	6,287	2,798
<b>Exploration, production and marketing</b>	<b>25,777</b>	<b>17,823</b>

## Debt obligations

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

### *Recent developments*

In February 2011, we fully repaid our bridge loan facility ahead of its maturity schedule.

In February 2011, the Group issued two tranches of Eurobonds in an aggregate amount of USD 1,250 million, a portion of which was used to repay the bridge loan facility.

In January 2011, we repaid USD 114 million of our USD 800 million syndicated term loan facility as per the maturity schedule of the facility.

### *Overview*

Our total debt increased from RR 37,703 million at 31 December 2009 to RR 72,226 million at 31 December 2010, or by RR 34,523 million, to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our three core fields and investment in related assets such as the Purovsky Plant, as well as acquisition of new oil and gas assets.

Our debt position (net of transaction costs) at 31 December 2010 and 2009 was as follows:

Facility	Amount	Maturity	Interest rate	At 31 December:	
				2010	2009
Bridge loan facility <sup>(2)</sup>	USD 600 million	November 2011	LIBOR+1%	18,200	-
Sberbank	RR 15 billion	December 2013	7.5%	14,948	-
Gazprombank	RR 10 billion	November 2012	8.5% <sup>(1)</sup>	10,000	6,106
Bonds	RR 10 billion	June 2013	7.5%	9,949	-
BNP PARIBAS	USD 800 million	April 2011	LIBOR+1.5%	6,952	20,646
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9% <sup>(1)</sup>	6,095	-
UniCredit Bank	USD 200 million	October 2012	LIBOR+4.65% <sup>(1)</sup>	6,082	6,027
Sberbank <sup>(3)</sup>	RR 5 billion	February 2011	8.5% <sup>(1)</sup>	-	4,924
<b>Total debt</b>				<b>72,226</b>	<b>37,703</b>

<sup>(1)</sup> – interest rates were changed during the periods

<sup>(2)</sup> – Bridge loan repaid in February 2011 ahead of maturity schedule

<sup>(3)</sup> – Sberbank loan repaid in July 2010 ahead of maturity schedule

#### *Maturities*

Scheduled maturities of our long-term debt outstanding (net of transaction costs) as at the dates indicated were as follows:

<i>millions of Russian roubles</i>	At 31 December:	
	2010	2009
1 January 2011 to 31 December 2011	-	11,726
1 January 2012 to 31 December 2012	16,082	12,150
1 January 2013 to 31 December 2013	30,992	-
<b>Total long-term debt</b>	<b>47,074</b>	<b>23,876</b>

#### *Available credit facilities*

At 31 December 2010, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 5,943 million (USD 195 million) on either fixed or variable interest rates subject to the specific type of credit facility.

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

In addition, at 31 December 2010, we had funds available under a credit facility with Sumitomo Mitsui Banking Corporation Europe Limited in the amount of USD 200 million until December 2013 with an annual interest rate of LIBOR plus 1.45 percent. The availability period ends 90 days after 30 December 2010.

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

## **QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS**

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

### **Foreign currency risk**

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 December 2010, RR 12,177 million, or 25.9%, of our long-term debt was denominated in US dollars (out of RR 72,226 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, approximately 31.0% in 2010, is denominated in US dollars. As of 31 December 2010, the Russian rouble had depreciated by approximately 0.8% against the US dollar since 31 December 2009.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 31 December 2010 would have resulted in an estimated foreign exchange gain of approximately RR 3,733 million on foreign currency denominated borrowings held at that date.

### **Commodity risk**

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

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

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

### **Pipeline access**

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

### **Ability to reinvest**

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

**Off balance sheet activities**

As of 31 December 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

IFRS Consolidated  
Financial Statements  
and Independent  
Auditor's Report  
for years ended  
31 December 2010  
and 2009

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## *Independent Auditor's Report*

To the shareholders and Board of 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 70 which comprise the consolidated statement of financial position as at 31 December 2010 and the consolidated statement of income, consolidated statement of cash flows, consolidated statement of comprehensive income 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 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
11 March 2011

ZAO PricewaterhouseCoopers Audit, White Square Office Center, 10 Butyrsky Val, Moscow, Russia, 125047  
T: +7 (495) 967 6000, F: +7 (495) 967 6001, www.pwc.ru



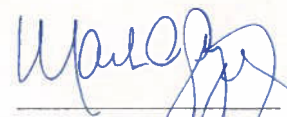
**OAQ NOVATEK**  
**Consolidated Statement of Financial Position**  
(in millions of Russian roubles)

	Notes	At 31 December:	
		2010	2009
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	6	185,573	161,448
Investments in associates and joint ventures	7	27,026	1,214
Long-term loans and receivables	8	40,151	933
Other non-current assets	9	2,858	2,669
<b>Total non-current assets</b>		<b>255,608</b>	<b>166,264</b>
<b>Current assets</b>			
Inventories	10	1,868	1,790
Current income tax prepayments		285	241
Trade and other receivables	11	8,670	8,504
Prepayments and other current assets	12	8,504	5,800
Cash and cash equivalents	13	10,238	10,532
<b>Total current assets</b>		<b>29,565</b>	<b>26,867</b>
<b>Assets held for sale</b>		<b>-</b>	<b>508</b>
<b>Total assets</b>		<b>285,173</b>	<b>193,639</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Non-current liabilities</b>			
Long-term debt	14	47,074	23,876
Deferred income tax liabilities	26	9,473	7,460
Other non-current liabilities		917	3,034
Asset retirement obligations		2,482	2,232
<b>Total non-current liabilities</b>		<b>59,946</b>	<b>36,602</b>
<b>Current liabilities</b>			
Short-term debt and current portion of long-term debt	16	25,152	13,827
Trade payables and accrued liabilities	17	28,479	7,335
Current income tax payable		1,212	386
Other taxes payable		2,598	2,045
<b>Total current liabilities</b>		<b>57,441</b>	<b>23,593</b>
<b>Liabilities associated with assets held for sale</b>		<b>-</b>	<b>4</b>
<b>Total liabilities</b>		<b>117,387</b>	<b>60,199</b>
<b>Equity attributable to OAO NOVATEK shareholders</b>			
Ordinary share capital		393	393
Treasury shares		(446)	(599)
Additional paid-in capital		30,865	30,609
Currency translation differences		(120)	(112)
Asset revaluation surplus on acquisitions		5,617	5,617
Retained earnings		110,810	78,393
<b>Total equity attributable to OAO NOVATEK shareholders</b>	18	<b>147,119</b>	<b>114,301</b>
<b>Non-controlling interest</b>		<b>20,667</b>	<b>19,139</b>
<b>Total equity</b>		<b>167,786</b>	<b>133,440</b>
<b>Total liabilities and equity</b>		<b>285,173</b>	<b>193,639</b>

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 10 March 2011:

  
L. Mikhelson  
General Director

  
M. Gyetvay  
Financial Director

**OAQ NOVATEK**
**Consolidated Statement of Income**

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

	Notes	Year ended 31 December:	
		2010	2009
<b>Revenues</b>			
Oil and gas sales	20	115,162	86,903
Sales of polymer and insulation tape		1,699	1,873
Other revenues		163	1,178
<b>Total revenues</b>		<b>117,024</b>	<b>89,954</b>
<b>Operating expenses</b>			
Transportation expenses	21	(37,200)	(29,026)
Taxes other than income tax	22	(10,077)	(8,042)
General and administrative expenses	23	(6,733)	(5,126)
Depreciation, depletion and amortization	6	(6,616)	(5,588)
Materials, services and other	24	(6,072)	(6,259)
Exploration expenses		(1,595)	(566)
Net impairment expense		(541)	(125)
Purchases of natural gas and liquid hydrocarbons		(154)	(1,143)
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress		470	(255)
<b>Total operating expenses</b>		<b>(68,518)</b>	<b>(56,130)</b>
Net gain on disposal of interest in subsidiaries		1,329	52
Other operating income (loss)		396	(343)
<b>Profit from operations</b>		<b>50,231</b>	<b>33,533</b>
<b>Finance income (expense)</b>			
Interest expense	25	(437)	(819)
Interest income	25	598	527
Foreign exchange gain (loss)		1,036	(539)
<b>Total finance income (expense)</b>		<b>1,197</b>	<b>(831)</b>
Share of profit (loss) of associates and joint ventures, net of income tax		(346)	(202)
<b>Profit before income tax</b>		<b>51,082</b>	<b>32,500</b>
<b>Income tax expense</b>			
Current income tax expense		(9,405)	(5,896)
Net deferred income tax (expense) benefit		(1,399)	(882)
<b>Total income tax expense</b>	26	<b>(10,804)</b>	<b>(6,778)</b>
<b>Profit (loss)</b>		<b>40,278</b>	<b>25,722</b>
Profit (loss) attributable to:			
Non-controlling interest		(255)	(321)
<b>Shareholders of OAO NOVATEK</b>		<b>40,533</b>	<b>26,043</b>
Basic and diluted earnings per share (in Russian roubles)		13.37	8.59
<i>Weighted average number of shares outstanding (in thousands)</i>		<i>3,032,218</i>	<i>3,032,114</i>

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:	
		2010	2009
<b>Profit before income tax</b>		<b>51,082</b>	<b>32,500</b>
<b>Adjustments to profit before income tax:</b>			
Depreciation, depletion and amortization		6,757	5,738
Net impairment expense		541	125
Net foreign exchange loss (gain)		(1,036)	539
Net loss (gain) on disposal of assets		(1,253)	233
Interest expense		437	819
Interest income		(598)	(527)
Share of loss (profit) in associates, net of income tax		346	202
Net change in other non-current assets and long-term receivables		1,063	399
Share-based compensation	18	68	176
Other adjustments		241	(238)
<b>Working capital changes</b>			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(2,675)	(1,298)
Decrease (increase) in inventories		(479)	334
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends		(1,821)	(615)
Increase (decrease) in other taxes payable		765	724
<b>Total effect of working capital changes</b>		<b>(4,210)</b>	<b>(855)</b>
Income taxes paid		(8,575)	(4,264)
<b>Net cash provided by operating activities</b>		<b>44,863</b>	<b>34,847</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(21,436)	(16,218)
Purchases of inventories intended for construction		(1,200)	(20)
Acquisition of subsidiaries net of cash acquired		(1,718)	(19,034)
Investments in associates and joint ventures		(4,660)	-
Proceeds from disposals of subsidiaries net of cash disposed		1,173	419
Interest paid and capitalized		(2,002)	(1,280)
Loans provided		(39,402)	(427)
Repayments of loans provided		219	80
Interest received		184	295
<b>Net cash (used for) provided by investing activities</b>		<b>(68,842)</b>	<b>(36,185)</b>
<b>Cash flows from financing activities</b>			
Proceeds from long-term debt		35,018	16,926
Proceeds from short-term debt		20,331	5,385
Repayments of long-term debt		(18,718)	(6,758)
Repayments of short-term debt		(2,729)	(8,348)
Interest paid		(301)	(583)
Dividends paid	18	(9,868)	(7,628)
Acquisition of non-controlling interest	5	(629)	-
Additional capital contribution into subsidiaries	5	337	1,767
Proceeds from sale of treasury shares	18	341	-
<b>Net cash (used for) provided by financing activities</b>		<b>23,782</b>	<b>761</b>

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

	Notes	Year ended 31 December:	
		2010	2009
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		(45)	141
<b>Net increase (decrease) in cash, cash equivalents and bank overdrafts</b>		<b>(242)</b>	<b>(436)</b>
Cash and cash equivalents at beginning of the year		10,532	10,991
Cash and cash equivalents reclassified as assets classified as held for sale		-	(52)
Net decrease (increase) in cash and cash equivalents reclassified to assets classified as held for sale		(52)	(23)
<b>Cash, cash equivalents and bank overdrafts at end of the year</b>		<b>10,238</b>	<b>10,532</b>

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

**ОАО NOVATEK**  
**Consolidated Statement of Comprehensive Income**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2010	2009
<b>Other comprehensive income (loss) after income tax:</b>			
Currency translation differences		(8)	(21)
<b>Other comprehensive income (loss)</b>		<b>(8)</b>	<b>(21)</b>
<b>Profit (loss)</b>		<b>40,278</b>	<b>25,722</b>
<b>Total comprehensive income</b>		<b>40,270</b>	<b>25,701</b>
Total comprehensive income (loss) attributable to:			
Non-controlling interest		(255)	(321)
<b>Shareholders of ОАО NOVATEK</b>		<b>40,525</b>	<b>26,022</b>

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

**OAQ NOVATEK**

**Consolidated Statement of Changes in Equity**

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

	<i>Number of ordinary shares (in thousands)</i>	<b>Ordinary share capital</b>	<b>Treasury shares</b>	<b>Additional paid-in capital</b>	<b>Currency translation differences</b>	<b>Asset revaluation surplus on acquisitions</b>	<b>Retained earnings</b>	<b>Equity attributable to OAQ NOVATEK shareholders</b>	<b>Non- controlling interest</b>	<b>Total equity</b>
<b>31 December 2008</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,433</b>	<b>(91)</b>	<b>5,617</b>	<b>60,316</b>	<b>96,069</b>	<b>571</b>	<b>96,640</b>
Currency translation differences	-	-	-	-	(21)	-	-	(21)	-	(21)
Profit (loss)	-	-	-	-	-	-	26,043	26,043	(321)	25,722
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(21)</b>	<b>-</b>	<b>26,043</b>	<b>26,022</b>	<b>(321)</b>	<b>25,701</b>
Dividends (Note 18)	-	-	-	-	-	-	(7,641)	(7,641)	-	(7,641)
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	160	160
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	-	-	-	18,729	18,729
Equity call option consideration (Note 5)	-	-	-	-	-	-	(325)	(325)	-	(325)
Share-based compensation funded by shareholders	-	-	-	176	-	-	-	176	-	176
<b>31 December 2009</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>(112)</b>	<b>5,617</b>	<b>78,393</b>	<b>114,301</b>	<b>19,139</b>	<b>133,440</b>

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)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Currency translation differences	Asset revaluation surplus on acquisitions	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b>31 December 2009</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>(112)</b>	<b>5,617</b>	<b>78,393</b>	<b>114,301</b>	<b>19,139</b>	<b>133,440</b>
Currency translation differences	-	-	-	-	(8)	-	-	(8)	-	(8)
Profit (loss)	-	-	-	-	-	-	40,533	40,533	(255)	40,278
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>-</b>	<b>40,533</b>	<b>40,525</b>	<b>(255)</b>	<b>40,270</b>
Dividends (Note 18)	-	-	-	-	-	-	(9,855)	(9,855)	-	(9,855)
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	-	-	-	2,414	2,414
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	1,818	1,818
Acquisition of non-controlling interest (Note 5)	-	-	-	-	-	-	1,739	1,739	(2,368)	(629)
Disposal of subsidiaries	-	-	-	-	-	-	-	-	(81)	(81)
Share-based compensation funded by shareholders	-	-	-	68	-	-	-	68	-	68
Sales of treasury shares (Note 18)	1,070	-	153	188	-	-	-	341	-	341
<b>31 December 2010</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>(120)</b>	<b>5,617</b>	<b>110,810</b>	<b>147,119</b>	<b>20,667</b>	<b>167,786</b>

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 oil and gas operations 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 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 volumes 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 troughing 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.

In December 2010, the Group acquired 100 percent participation interest in OOO Yamalgazresurs-Chelyabinsk, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Chelyabinsk Region in Russian Federation (see Note 5).

In December 2010, the Group acquired 51 percent ownership in OAO Sibneftegas, an oil and gas production company, which owns four licenses for the fields located in YNAO, with total production in 2010 of 9.8 billion cubic meters (see Note 5).

In November 2010, OOO Yamal Development, the Group’s joint venture, acquired a 51 percent participation interest in OOO SeverEnergiya. SeverEnergiya through its three wholly owned subsidiaries holds four exploration and production licenses for the fields located in the YNAO (see Note 5).

In September 2010, the Group disposed of its 100 percent participation interest in OOO NOVATEK-Polymer, its non-core subsidiary to OAO SIBUR Holding (see Note 5).

In August 2010, the Group acquired 100 percent ownership in Intergaz-System Sp.z o.o., domiciled in Poland, to support and extend the wholesale and retail trading of liquefied petroleum gas in Polish market (see Note 5).

In July 2010, NOVATEK and OAO Gazprom Neft, a subsidiary of OAO Gazprom, established a joint venture OOO Yamal Development for the purpose of developing potential hydrocarbon assets in the YNAO (see Note 5).

In May 2010, the Group established OOO NOVATEK Perm, a wholly-owned subsidiary, to support the Group’s current natural gas deliveries to the Perm region, one of the largest industrial centers in the Russian Federation, as well as to expand potential sales opportunities in the territory.

In November 2009, the Group established Novatek Polska, a wholly-owned subsidiary, domiciled in Poland to manage the administration, marketing and trading of liquefied petroleum gas to European markets. Beginning in January 2010, the Group commenced export sales through this subsidiary.

## **2 BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention. 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 preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

## 2 BASIS OF PRESENTATION (CONTINUED)

Most of the Group entities prepare 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.

**Functional and presentation currency.** The consolidated financial statements are presented in Russian roubles, the Group’s reporting (presentation) currency and the functional currency for the majority of entities. The assets and liabilities (both monetary and non-monetary) of the Group entities whose functional currency is not the Russian rouble are translated into Russian roubles at the closing exchange rate at each balance sheet date. All items included in the shareholders’ equity, other than profit or loss, are translated at historical exchange rates. The financial results of these entities are translated into Russian roubles using average exchange rates for each reporting period. Exchange adjustments arising on the opening net assets and the profits for the reporting period are taken to a separate component of equity until the disposal of the foreign operation and reported as currency translation differences in the consolidated statement of changes in equity and the consolidated statement of comprehensive income.

Exchange rates used in preparation of this consolidated financial statement for the entities whose functional currency is not the Russian rouble were as follows:

<i>For one currency unit to one Russian rouble</i>	<b>At 31 December:</b>		<b>Average annual rate</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
US dollar (“USD”)	30.48	30.24	30.37	31.72
Polish Zloty (“PLN”)	10.17	10.32	10.09	10.64

**Exchange rates, restrictions and controls.** 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.

## 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Adoption of IFRS 3.** Effective 1 January 2010, the Group adopted 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 acquirer’s identifiable net assets) or 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;

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Adoption of IAS 27.** Effective 1 January 2010, the Group adopted 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. The Group has changed its accounting policy for the accounting for loss of control or significant influence from 1 January 2010. Previously, when the Group ceased to have control or significant influence over an entity, the carrying amount of the investment at the date control or significant influence became its cost for the purposes of subsequently accounting for the retained interests as associates, jointly controlled entity or financial assets. The Group has applied the new accounting policies prospectively to transactions occurring on or after 1 January 2010.

**Adoption of IAS 1.** Effective 1 January 2009, the Group adopted IAS 1, *Presentation of Financial Statements* (revised September 2007) (“IAS 1”). Following the adoption, the Group introduced the statement of financial position instead of the balance sheet, and replaced the income statement by two statements: a separate income statement and a statement of comprehensive income. Also, non-controlling shares in the Group’s subsidiaries’ net assets and financial results are presented as non-controlling interests (previously “minority interests”). The adoption of IAS 1 affects the formal presentation of the Group’s financial statements but has no impact on the recognition or measurement of specific transactions and balances.

**Adoption of IFRS 8.** Effective 1 January 2009, the Group adopted IFRS 8, *Operating Segments* (“IFRS 8”), which replaces IAS 14, *Segment Reporting*. IFRS 8 introduces new requirements and guidelines regarding the disclosures of operating segments. For periods prior to 1 January 2010, a measure of total segment assets was required to be disclosed for all segments regardless of whether those measures were reviewed by the chief operating decision maker. In December 2007, however, the IASB concluded that IFRS 8 should be changed to state that a measure of segment assets should only be disclosed when such information is provided to the chief operating decision maker. This change was included as part of the IASB’s 2009 annual improvement project issued in April 2009 which has been adopted by Group as of 1 January 2009.

Operating segments are defined as components of the Group where separate financial information is available and reported regularly to the chief operating decision maker (hereinafter referred to as “CODM”, represented by the Management Committee of NOVATEK), which decides how to allocate resources and assesses operational and financial performance using the information provided.

The Group conducts its normal course of business through its principal business segment “exploration, production and marketing”. Substantially all of the Group’s business activities are related to the natural gas and gas condensate exploration, production and marketing segment, and includes all headquarter-related costs. To a significantly lesser extent, the Group was engaged in polymer production and marketing activities, which was considered a separately reportable operating segment until its disposal in September 2010.

The CODM assesses reporting segments performance based on income before income taxes, since income taxes are not allocated. No business segment assets or liabilities (except for capital expenditures for the period) are provided to the CODM for decision-making.

**Principles of consolidation.** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Group measures non-controlling interest on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed and reviews appropriateness of their measurement.

The consideration transferred for the acquiree is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed, including fair value of assets or liabilities from contingent consideration arrangements but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity.

**Disposals of subsidiaries, associates or joint ventures.** When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are recycled to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

**Acquisition of non-controlling interests.** The difference between the purchase consideration and the carrying amount of non-controlling interests acquired is recognized within equity to account for acquisitions of non-controlling minority stakes.

**Investments in associates and joint ventures.** Associated companies and joint ventures 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. Associated companies and joint ventures are accounted for using the equity method and are initially recognized at cost. The difference between the cost of an acquisition and the share of the fair value of the associate's identifiable net assets represents goodwill upon acquiring the associated company. Dividends received from associates and joint ventures reduce the carrying value of the investment in associates. The carrying amount of associates and joint ventures includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the associates' post-acquisition profits or losses 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 or joint ventures 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.

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

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

**Non-current assets held for sale.** Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less selling costs. Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment are not depreciated once classified as held for sale.

**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 and license acquisition costs 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 oil and gas reserves have been independently estimated by internationally recognized petroleum engineers whereas 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 the estimated remaining life of the major part or component. All components that are replaced are written off.

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.

At each reporting date management assesses 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 selling costs 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.



**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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. A portion of the reserves used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation and past results (or experience) 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:

	<u>Years</u>
Machinery and equipment	5-15
Processing facilities	20-30
Buildings	25-50

**Derivative instruments.** Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- (i) hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedge); or
- (ii) hedges of a particular risk associated with a recognized asset or liability or a highly probable forecast transaction (cash flow hedge).

At inception, the Group documents the relationship between the hedging instruments and the items hedged, as well as the Group's risk management objectives and strategy for undertaking various hedging activities. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Group enters into commodity derivative instruments with the primary objective of reducing the Group's exposure to fluctuating of oil and gas prices. The Group has not entered into commodity derivative instruments for trading purposes.

During the year ended 31 December 2009, the Group entered into commodity price swap contracts for total notional volume of three million barrels of stable gas condensate. The contractual notional volumes are not physically exchanged, rather they are cash settled on a net basis. None of the contracts executed during this period qualified for hedge treatment under IAS 39, *Financial Instruments: Recognition and Measurement*. All contracts were settled realizing net losses of RR 190 million. The results of the commodity price swap contracts were recorded within other operating income (loss) in the consolidated statement of income.

*(a) Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of income, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The Group only applies fair value hedge accounting for hedging fixed interest risk on borrowings. The gain or loss relating to the effective portion of interest rate swaps hedging fixed rate borrowings is recognized in the consolidated statement of income within finance income (expenses). The gain or loss relating to the ineffective portion is recognized in the consolidated statement of income within other operating income (loss). Changes in the fair value of the hedge fixed rate borrowings attributable to interest rate risk are recognized in the consolidated statement of income within finance income (expenses).

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to profit or loss over the period to maturity. There were no fair value hedges used throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

(b) *Cash flow hedge*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in consolidated statement of changes in equity. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income within other operating income (loss).

Amounts accumulated in equity are recycled in the consolidated statement of income in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognized in the consolidated statement of income within finance income (expenses). The gain or loss relating to the ineffective portion is recognized in the consolidated statement of income within other operating income (loss). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory or fixed assets), the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset. The deferred amounts are ultimately recognized in cost of goods sold in case of inventory or in depreciation in the case of fixed assets.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in the consolidated statement of income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated statement of income within other operating income (loss). No cash flow hedges were used throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

(c) *Derivatives at fair value through profit or loss and accounted for at fair value through profit or loss*

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any these derivative instruments are recognized immediately in the consolidated statement of income within other operating income (loss). No net derivative instruments were recorded at fair value through profit or loss throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

**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.



**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)***(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 operating 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 operating income (loss) 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, the 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.

*(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 losses 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 consolidated statement of income as 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 consolidated statement of income, while translation differences on non-monetary securities are recognized in consolidated statement of changes in equity. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in consolidated statement of changes 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.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 consolidated statement of income) 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 were 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. There were no derivative instruments designated as hedging instruments by the Group at the reporting dates. 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 consolidated statement of financial position 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 in the consolidated statement of financial position.

**Income taxes.** Russian legislation does not contain the concept of a “consolidated tax payer” and, accordingly, the Group is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. 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.

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.

Deferred tax assets and liabilities are recognized in full 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.

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.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**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.

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 the amount of the provision in the consolidated statement of income.

**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. Bank overdrafts are shown within short-term debt in current liabilities on the consolidated statement of financial position.

**Treasury shares.** Where any Group company purchases NOVATEK's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to OAO NOVATEK shareholders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to OAO NOVATEK shareholders. 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.

**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 within current assets and current liabilities. Where a provision has been made for the impairment of receivables, the 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 and foreign exchange losses 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.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**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; 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.

**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.

The Group's exploration, development and production activities involve the use of wells, related equipment and operating sites, oil and gas gathering and treatment facilities and in-field pipelines. Generally, licenses and other regulatory acts require that such assets be decommissioned upon the completion of production, i.e. the Group is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Group's estimates of these obligations are based on current regulatory or license requirements, as well as actual dismantling and related costs.

The Group's management believes that due to the limited history of gas condensate processing and polymer production plants activities, the useful lives of these assets are indeterminable (while certain of the operating components and equipment have definite useful lives). Because of these reasons, and the lack of clear legal requirements as to the recognition of obligations, the fair value of an asset retirement obligation for such processing facilities cannot be reasonably estimated and, therefore, legal or contractual asset retirement obligations related to these assets are not recognized.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

**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.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 fair value of consideration received or receivable for the sale of goods and services 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 with the contract terms, the price is fixed or determinable, 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 based on gross salary payments. 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 in the consolidated statement of income.

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.

**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 15).

The liability recognized in the consolidated statement of financial position 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.



**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

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 OAQ NOVATEK shareholders by the weighted average number of shares outstanding during the reporting period.

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.

Judgments and estimates that have the most significant effect on the amounts reported in these consolidated financial statements and have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are described below.

**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 estimations 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 rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves. Accounting measures such as depreciation, depletion and amortization charges, impairment assessments and asset retirement obligations that are based on the estimates of proved reserves are subject to change based on future changes to estimates of oil and gas reserves.

#### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

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.

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.

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.

**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. 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, the expected amount receivable is written off against the associated provision.



#### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

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 its liabilities for site restoration at each consolidated statement of financial position 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.

#### 5 MERGERS, ACQUISITIONS AND DISPOSALS

##### **Acquisition of OOO Yamalgazresurs-Chelyabinsk**

In December 2010, the Group acquired a 100 percent participation interest in OOO Yamalgazresurs-Chelyabinsk, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Chelyabinsk Region of the Russian Federation for RR 410 million. Management has assessed the fair value of identifiable assets and liabilities and calculated that goodwill RR 82 million arose on the acquisition. The financial and operational activities of Yamalgazresurs-Chelyabinsk would not have had a material impact on the Group's revenues and results if the acquisition occurred in January 2010.

##### **Acquisition of Intergaz-System Sp.z o.o.**

In August 2010, the Group acquired a 100 percent ownership in Intergaz-System Sp.z o.o., domiciled in Poland, for RR 159 million (USD 5 million). Intergaz-System holds a discharging and transshipment facility and was purchased to support and extend the wholesale and retail trading of liquefied petroleum gas in the Polish market. Management has assessed the fair value of identifiable assets and liabilities and calculated that negative goodwill RR 10 million arose on the acquisition which was recognized as other operating profit in the consolidated statement of income. The financial and operational activities of Intergaz-System would not have had a material impact on the Group's revenues and results if the acquisition occurred in January 2010.

In December 2010, the Group merged Intergaz-System into its wholly-owned subsidiary Novatek Polska. The aforementioned merger did not affect the Group's consolidated financial and operational results.

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

*Acquisition of OAO Sibneftegas*

On 17 December 2010, the Group acquired 51 percent of the outstanding ordinary shares of OAO Sibneftegas, an oil and gas company located in the YNAO, for total cash consideration of RR 25,826, of which RR 4,650 million was paid in December 2010 and the remaining RR 21,176 million is payable in February and March 2011. Sibneftegas holds two production licenses: the Beregovoye and Pyreinoye gas condensate fields, which expire in 2023 and in 2021, respectively. Estimated aggregated proved reserves on these two fields as well as the Khadyryahinskoye (expires in 2031) field appraised by DeGolyer and MacNaughton at 31 December 2010 under the PRMS and SEC reserve methodologies totaled approximately 282 and 200 billion cubic meters of natural gas and 2 and 0.7 million tons of hydrocarbon liquids, respectively.

As part of the acquisition, the Group granted a loan in the amount of RR 11,038 million to Sibneftegas, which was used to fully repay its outstanding debt to Gazprombank ahead of its maturity schedule. Subsequent to the acquisition the Group also entered into the purchase contract to buy natural gas from Sibneftegas in proportion to its ownership interest in the company's total production at pre-determined prices.

As described above, the Group acquired 51 percent of the outstanding ordinary shares of Sibneftegas; however, the Charter agreement stipulates that key financial and operational decisions regarding its business activities are subject to approval by nine out of the eleven members of the Board of Directors. As a result, the Group has determined that it has significant influence over the business activities of Sibneftegas and will account for the investment under the equity method.

In accordance with IAS 28 "Investments in Associates", the Group assessed preliminary fair values of the identified assets and liabilities of Sibneftegas. In the consolidated financial statements for the year ended 31 December 2010, the fair value of purchase consideration and the fair value of the identifiable acquired assets and liabilities are preliminary as the Group is in the process of finalizing the fair value estimates for certain assets and liabilities, primarily for property, plant and equipment. Management is required to finalize the fair value determination within 12 months of the date of acquisition. Any revisions to the provisional values will be reflected as of the acquisition date.

The following table represents the preliminary fair values comprising 100 percent of the assets and liabilities of Sibneftegas:

<i>Sibneftegas</i>	<b>Preliminary fair values at the acquisition date</b>
Non-current assets	66,930
Current assets	1,072
Non-current liabilities	(28,199)
Current liabilities	(2,222)
<b>Total identifiable net assets</b>	<b>37,581</b>
Purchase consideration	25,826
Preliminary fair value of the Group's interest in net assets (RR 37,581 million at 51% ownership)	(19,166)
<b>Preliminary goodwill</b>	<b>6,660</b>

In accordance with Russian legislation, the Group issued (via AKB "Bank of Moscow") a bank guarantee for RR 25.8 billion in January 2011 in favor of the minority holders of the ordinary shares of Sibneftegas. The guarantee is provided as financial support in case the minority shareholders tender to sell their stakes to the Group at a pre-determined fixed price. This bank guarantee expires in April 2011. Management does not believe that any of the minority shareholders will tender their shares as a result of this offer.

**OAo NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)*****Acquisition of OOO SeverEnergiya***

On July 2010, NOVATEK and OAO Gazprom Neft, a subsidiary of OAO Gazprom, established a joint venture OOO Yamal Development. The Group owns a 50 percent participation interest in the new entity and accounts for its share of the joint venture using the equity method.

On 30 November 2010, Yamal Development acquired a 51 percent participation interest in OOO SeverEnergiya for total cash consideration of RR 48,715 million paid upon acquisition. The acquisition was financed proportionally by its founders through the provision of loans in the total amount of RR 56,247 million (see Note 8). As part of the acquisition, Yamal Development also provided a loan in the amount of RR 7,532 million to SeverEnergiya, which was used to fully repay the outstanding debt of the company to its previous shareholder ahead of its maturity schedule. NOVATEK financed its part of the loan to Yamal Development through the use of a bridge loan facility (see Note 16).

SeverEnergiya through its three wholly owned subsidiaries holds exploration and production licenses listed below:

<b>Subsidiary of SeverEnergiya</b>	<b>Field</b>	<b>Expiring date</b>
OAo Arkticheskaya gazovaya kompaniya	Samburgskoye, Yevo-Yakhinskoye	2018
ZAO Urengoil Inc.	Yaro-Yakhinskoye	2018
OAo Neftegastehnologiya	North-Chaselskoye	upon full production

Estimated aggregated proved reserves on these fields appraised by DeGolyer and MacNaughton under the PRMS and SEC reserve methodologies at 31 December 2010 totaled approximately 245 and 224 billion cubic meters of natural gas and 42 and 39 million tons of hydrocarbon liquids, respectively.

The transaction provides the Group with an effective interest ownership of 25.5 percent in SeverEnergiya. Since this company is a subsidiary of Yamal Development, the Group's joint venture, the assets and liabilities of SeverEnergiya and its financial results are included in the assets, liabilities and financial results of Yamal Development and its subsidiaries in the disclosure of summarized financial information about the Group's investments in associates and joint ventures (see Note 7).

In accordance with IAS 28 "*Investments in Associates*", the Group assessed preliminary fair values of the identified assets and liabilities of SeverEnergiya. In the consolidated financial statements for the year ended 31 December 2010, the fair value of purchase consideration and the fair value of the identifiable acquired assets and liabilities are preliminary as the Group is in the process of finalizing the fair value estimates for certain assets and liabilities, primarily for property, plant and equipment. Management is required to finalize the fair value determination within 12 months of the date of acquisition. Any revisions to the provisional values will be reflected as of the acquisition date.

The following table represents the preliminary fair values comprising 100 percent of the assets and liabilities of the SeverEnergiya and its subsidiaries.

<b><i>SeverEnergiya and its subsidiaries</i></b>	<b>Preliminary fair values at the acquisition date</b>
Non-current assets	137,228
Current assets	3,810
Non-current liabilities	(22,950)
Current liabilities	(22,568)
<b>Total identifiable net assets</b>	<b>95,520</b>

As a result of the preliminary assessment of fair value of identifiable assets and liabilities management calculated that no goodwill arose on the acquisition.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)*****Disposal of OOO NOVATEK-Polymer***

In September 2010, the Group disposed of its 100 percent participation interest in OOO NOVATEK-Polymer, its non-core subsidiary, to OAO SIBUR Holding for RR 2,400 million (undiscounted) payable throughout September 2013. The Group recognized a loss on the sale of RR 279 million, net of associated income tax of RR 25 million. The Group has 100 percent participation interest in OOO NOVATEK-Polymer as collateral for the receivable until full settlement.

Below is a breakdown of major classes of assets and liabilities disposed:

<i>OOO NOVATEK-Polymer</i>	<b>RR million</b>
Property, plant and equipment	1,617
Deferred tax assets	189
Inventories	440
Financial assets	340
Other non-financial assets	160
Deferred tax liability	(294)
Short-term debt	(113)
Other financial liabilities	(66)
<b>Total net assets</b>	<b>2,273</b>

The following table summarizes the consideration details from the sale of OOO NOVATEK-Polymer:

	<b>RR million</b>
Cash	287
Receivable in respect of the deferred payments (RR 2,113 million discounted at 8 percent per annum)	1,732
<b>Total consideration</b>	<b>2,019</b>
Less: carrying amount of net assets disposed	(2,273)
<b>Loss on disposal</b>	<b>(254)</b>

OOO NOVATEK-Polymer constituted the Group's "polymer products production and marketing" segment (see Note 31).

***Acquisition of OAO Tambeyneftegas***

On 1 July 2010, the Group acquired 100 percent of the outstanding ordinary shares of OAO Tambeyneftegas, an exploration stage oil and gas company located in the southern portion of the Yamal peninsula (YNAO) for total cash consideration of RR 312 million (USD 10 million), of which 75 percent was acquired from related parties for RR 234 million (USD 7 million) (see Note 30). Tambeyneftegas holds the license for exploration and development of the Malo-Yamalskoye field (expires in 2019) with estimated natural gas and gas condensate reserves in accordance with the Russian reserve classification (categories C1 + C2) amounting to 161 bcm and 14.4 mmt, respectively.

Tambeyneftegas had no notable operating activities up to and as at the purchase date, and is considered an entity in the early exploration stage; consequently, this acquisition is outside the definition of business as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the mineral license), and liabilities of the company acquired.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>ОАО Тамбейнефтегаз</i>	<b>RR million</b>
Property, plant and equipment	303
Deferred tax assets	176
Other non-financial assets	23
Financial assets	12
Short-term debt	(641)
Interest on short-term debt	(229)
Assets retirement obligations	(165)
Other non-financial liabilities	(4)
<b>Total identifiable net liabilities</b>	<b>(525)</b>

The following table shows the total cost of the acquired mineral rights:

	<b>RR million</b>
Total purchase consideration	312
Add: identifiable net liabilities	525
<b>Cost of the acquired mineral rights</b>	<b>837</b>

The property, plant and equipment in the amount of RR 303 million combined with the cost of the mineral rights in the amount of RR 837 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6. Short-term debt in the amount of RR 641 million and interest on short-term debt in the amount of RR 229 million represent balances with the Group companies, which are to be settled in the normal course of business.

The financial and operational activities of Тамбейнефтегаз were not material to the Group’s revenues and results of operations for the year ended 31 December 2010.

***Disposal of ownership interest in ZAO Terneftegas***

On 24 June 2009, NOVATEK and TOTAL E&P ACTIVITIES PETROLIERES (“TOTAL”) signed a Heads of Agreement (the “Agreement”) establishing the framework for joint cooperation in exploring and developing the Group’s Termokarstovoye gas condensate field located in the YNAO.

The Agreement provides for the establishment of a joint venture through the acquisition, by TOTAL of a 49 percent ownership interest in ZAO Terneftegas (formerly a limited liability company, ООО Terneftegas), a wholly-owned subsidiary of the Group and holder of the license for exploration and production of natural gas and gas condensate at the Termokarstovoye field. Under the terms and conditions of the Agreement, the joint venture has two years to complete exploration works and prepare a field development plan, with a final investment decision to proceed further to be taken in 2011.

In December 2009, the Group signed a Sales and Purchase contract with Total Termokarstovoye B.V., an affiliate of TOTAL, for:

- the sale of a 28 percent interest in ZAO Terneftegas for total consideration of USD 24.1 million, of which USD 16 million was paid at the date of title transfer and the remaining USD 8.1 million (deferred payment) to be paid upon approval by TOTAL of the final investment decision; and
- a further increase of TOTAL’s equity share in ZAO Terneftegas to 49 percent through a subscription to the entity’s additional shares emission for total consideration of USD 18 million.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

The Group transferred legal ownership of a 28 percent interest in ZAO Terneftegas to Total Termokarstovoye B.V. in February 2010 upon the execution of the first arrangement. In January 2010, ZAO Terneftegas registered with the Federal Service for Financial Markets (FSFM) for an additional shares emission, the acquisition of which was completed by TOTAL in June 2010. In September 2010, the legal implementation of the second arrangement of the transaction was finished and the subscription for the additional shares issued was registered by Total Termokarstovoye B.V. with the FSFM.

Based on the Agreement and the provisions of the Sales and Purchase contract, these two arrangements were accounted as a single transaction and, in February 2010, the Group recorded a disposal of a 49 percent ownership interest in ZAO Terneftegas for total consideration of RR 982 million realizing a gain of RR 1,466 million, net of associated income tax of RR 117 million.

The following table summarizes the consideration details and shows the components of the gain from the sale of the ownership interest in ZAO Terneftegas:

	<b>RR million</b>
Cash	483
Receivable in respect of the deferred payment (USD 8.1 million at exchange rate of RR 30.11 to USD 1.00 discounted at 5.1 percent per annum)	222
The Group's proportion in an additional shares emission proceeds (51 percent of USD 18 million at exchange rate of RR 30.11 to USD 1.00)	277
<b>Total consideration</b>	<b>982</b>
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment in joint venture	807
<b>Gain on the sale of ownership interest</b>	<b>1,583</b>

As described above, the Group retained a 51 percent interest in ZAO Terneftegas; however, the Agreement stipulates that key financial and operational decisions regarding its business shall be subject to unanimous approval by both shareholders and none of the participants have a preferential voting right. In February 2010, all operating bodies of the joint venture were established and the Group's effective control over ZAO Terneftegas ceased. As a result of these changes, the Group's interest in ZAO Terneftegas is accounted for using the equity method.

In accordance with IAS 27 "Consolidated and Separate Financial Statements", the Group remeasured its retained investment in ZAO Terneftegas at fair value at the date of ceasing control, with the change in value of RR 807 million recognized as a part of the gain from disposal.

The following table reconciles the carrying value of ZAO Terneftegas prior to disposal and the carrying value of the retained investment in the entity recorded under the equity method of accounting in these consolidated financial statements:

<i>ZAO Terneftegas</i>	<b>RR million</b>
Carrying value of the net assets at disposal	420
The Group's proportion in an additional shares emission proceeds	277
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment	807
<b>The carrying value of investment in joint venture</b>	<b>1,298</b>

Prior to the disposal, the Group included balances and results of the operations of the disposed subsidiary within "exploration, production and marketing" in the Group's segment information.



5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

*Acquisition of controlling interests in the associates*

On 15 February 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas, entities recorded as associates to 51 percent through the acquisition of an additional 26 percent participation interests in each company for the total cash consideration of RR 1,297 million. These entities are all exploration stage oil and gas companies and hold exploration licenses for the Middle-Chaselskiy, North-Russkiy, West-Tazovski, Anomalniy and North-Yamsoveskiy license areas. These licenses expire between 2012 and 2014. The Group intends to receive production licenses for these fields based on the exploration activities performed to date. Following the acquisition, in February 2010, OOO Oiltechproduct-Invest obtained the production license for the West-Chaselskoe field, which expires in 2030.

All three entities had no notable operating activities up to and as at the purchase date and are all considered to be in their early exploration stage; consequently, this acquisition is outside the definition of “business” as defined in IFRS 3, “Business Combinations”. The acquisition cost has been allocated based on the relative fair values of the assets acquired (largely comprised of their respective mineral licenses), and liabilities assumed.

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Property, plant and equipment	547	370	959	1,876
Other non-financial assets	531	199	314	1,044
Financial assets	190	9	18	217
Short-term debt	(769)	(519)	(862)	(2,150)
Other financial liabilities	(149)	(108)	(203)	(460)
Non-financial liabilities	(146)	(39)	(102)	(287)
<b>Total identifiable net assets (liabilities)</b>	<b>204</b>	<b>(88)</b>	<b>124</b>	<b>240</b>

The following table shows the total cost of the acquired mineral rights:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Carrying value of the 25 percent participation interest	438	369	407	1,214
Purchase consideration for the 26 percent participation interest	502	380	415	1,297
Gross up for total value of the assets acquired	903	720	791	2,414
Less: identifiable net assets (liabilities)	(204)	88	(124)	(240)
<b>Cost of the acquired mineral rights</b>	<b>1,639</b>	<b>1,557</b>	<b>1,489</b>	<b>4,685</b>

The aforementioned property, plant and equipment in the amount of RR 1,876 million combined with the cost of mineral rights in the amount of RR 4,685 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6.

The financial and operational activities of Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas were not material to the Group’s revenues and results of operations for the year ended 31 December 2010.



## OAQ NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### *Acquisition of additional participation interest in subsidiaries*

In April 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas to 82.4 percent, 92.6 percent and 94.2 percent, respectively, through an additional capital contribution to the ordinary share capital of these entities. Furthermore, in May 2010, the Group brought its participation interest in the share capital of each of the above mentioned companies to 100 percent through the acquisition of the remaining ordinary share capital from non-controlling interests. As a consequence of these two transactions the Group paid cash of RR 629 million, reduced non-controlling interests by RR 2,368 million and recorded a difference of RR 1,739 million directly to retained earnings.

In December 2010, the Group merged its wholly-owned subsidiary, OOO Oiltechproduct-Invest, which holds exploration licenses for the Middle-Chaselskiy, West-Chaselskiy and North-Russkiy license areas into its wholly-owned subsidiary OOO NOVATEK-Tarkosaleneftegas. The aforementioned merger did not affect the Group's consolidated financial and operational results.

### *Acquisition of OAO Yamal LNG*

On 26 May 2009, the Group entered into the contract to acquire 51 percent of the outstanding ordinary shares of OAO Yamal LNG, an exploration stage oil and gas company located in the north-eastern part of the Yamal peninsula, YNAO. This company holds the license for exploration and development of the South-Tambeyskoye field (initial license term expired in 2020 but was extended to 2045 in December 2009). The acquisition of the South-Tambeyskoye field significantly increases the Group's resource base ensuring future natural gas and gas condensate production growth.

OAO Yamal LNG had no notable operating activities up to and as at the purchase date, and is considered an entity in the early exploration stage; consequently, this acquisition is outside the definition of "business" as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the mineral license), and liabilities of the company acquired.

The following table summarizes the total purchase consideration for the acquisition of Yamal LNG.

	<u>USD million</u>	<u>Exchange rate</u>	<u>RR million</u>
Cash	250	30.51	7,628
Promissory notes of NOVATEK	300	30.73	9,219
Deferred cash payment	100	30.51	2,546 <sup>(*)</sup>
<b>Total purchase consideration</b>	<b>650</b>		<b>19,393</b>

(\*) – discounted at 7.5 percent per annum.

The contingent consideration arrangement (referred to as the deferred cash payment) requires the Group to pay the former owners of Yamal LNG USD 100 million (undiscounted) upon the conclusion of an agreement between Yamal LNG and OAO Gazprom, defining the main sales terms of the LNG produced from the South-Tambeyskoye field. On 18 September 2010, such Cooperation Agreement, setting out the key parameters for cooperation between Gazprom and NOVATEK in implementing the pilot LNG project including the development and subsequent utilization of related infrastructure facilities on the Yamal peninsula, was signed and in February 2011 the payment was made.

Acquisition-related costs (legal and evaluation services) directly associated with the transaction in the amount of RR 100 million were included in the cost of the asset acquired.

**OAQ NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below.

<i>OAQ Yamal LNG</i>	<b>RR million</b>
Financial assets	886
Property, plant and equipment	818
Other non-financial assets	807
Long-term debt	(2,833)
Other financial liabilities	(271)
Asset retirement obligations	(587)
Other non-financial liabilities	(150)
<b>Total identifiable net liabilities</b>	<b>(1,330)</b>

In November 2009, the Group fully repaid the outstanding long-term debt of Yamal LNG ahead of its maturity schedule.

The following table shows the total cost of the acquired mineral rights:

	<b>RR million</b>
Total purchase consideration	19,393
Gross up for total value of the asset acquired	18,704
Legal and evaluation services	100
Add: identifiable net liabilities	1,330
<b>Cost of the acquired mineral rights</b>	<b>39,527</b>

The aforementioned property, plant and equipment in the amount of RR 818 million combined with the cost of mineral rights in the amount of RR 39,527 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6.

In May 2009, the Group signed a call option agreement with one of the sellers, which provides the Group with the right, but not the obligation, to purchase an additional 23.9 percent of OAO Yamal LNG for USD 450 million within three years following the controlling acquisition. To enter into this call option agreement, the Group paid RR 325 million (USD 10 million) in July 2009, which was recorded as a decrease in retained earnings in the consolidated statement of changes in equity.

In accordance with the Russian legislation, in November 2009, the Group issued (via AKB “Bank of Moscow”) a bank guarantee for RR 19.4 billion in favor of the minority holders of the ordinary shares of OAO Yamal LNG. The guarantee was provided as financial support in the case the minority shareholders tender to sell their stakes to the Group at the pre-determined fixed price. The guarantee expired in August 2010 and no payment was made.

In March 2010, the existing shareholders of Yamal LNG made cash contributions to the company’s ordinary share capital proportionally to their respective ownership interests in the total amount of RR 3,607 million. The resulting increase of RR 1,767 million in non-controlling interest was recorded within consolidated statement of changes in equity.

The financial and operational activities of Yamal LNG were not material to the Group’s revenues and results of operations for the year ended 31 December 2009.

## OA0 NOVATEK

### Notes to the Consolidated Financial Statements

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## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### Acquisition of OOO EkropromStroy

On 19 June 2009, the Group acquired 100 percent of the participation interest in OOO EkropromStroy from several members of key management personnel of the Group for total cash consideration of RR 1,999 million, all paid in 2009. The Group obtained an independent appraisal supporting the purchase price and considers that the amount paid is substantially consistent with the terms that would be agreed in an arm's length transaction. The company manages the construction of the Group's new office building located in Moscow and has no activities other than the management of construction activities and ownership of the constructed building. Accordingly, the purchase is outside the definition of business as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the office building), and liabilities of the company acquired. The property, plant and equipment in the amount of RR 2,263 million was included in the line "acquisition of subsidiaries" as disclosed in Note 6.

The financial and operational activities of EkropromStroy were not material to the Group's revenues and results of operations for the year ended 31 December 2009.

## 6 PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment, for the years ended 31 December 2010 and 2009 are as follows:

	Oil and gas properties and equipment	Assets under construction and advances for construction	Other	Total
Cost	95,242	24,771	4,787	124,800
Accumulated depreciation, depletion and amortization	(15,166)	-	(920)	(16,086)
<b>Net book value at 1 January 2009</b>	<b>80,076</b>	<b>24,771</b>	<b>3,867</b>	<b>108,714</b>
Acquisition of subsidiaries	40,141	2,463	4	42,608
Additions	943	16,927	2	17,872
Transfers	21,650	(23,431)	1,781	-
Depreciation, depletion and amortization	(5,221)	-	(578)	(5,799)
Reclassified as assets held for sale	(65)	(323)	(2)	(390)
Disposals, net	(5)	(522)	(1,030)	(1,557)
Cost	157,955	19,885	5,319	183,159
Accumulated depreciation, depletion and amortization	(20,436)	-	(1,275)	(21,711)
<b>Net book value at 31 December 2009</b>	<b>137,519</b>	<b>19,885</b>	<b>4,044</b>	<b>161,448</b>
Acquisition of subsidiaries	5,960	1,875	70	7,905
Additions	3,265	22,828	13	26,106
Transfers	27,018	(27,722)	704	-
Depreciation, depletion and amortization	(6,461)	-	(367)	(6,828)
Disposal of subsidiaries, net	-	(319)	(1,298)	(1,617)
Impairment	(321)	-	-	(321)
Disposals, net	(495)	(525)	(100)	(1,120)
Cost	193,411	16,022	4,236	213,669
Accumulated depreciation, depletion and amortization	(26,926)	-	(1,170)	(28,096)
<b>Net book value at 31 December 2010</b>	<b>166,485</b>	<b>16,022</b>	<b>3,066</b>	<b>185,573</b>

**6 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

Included within the oil and gas properties and equipment balance at 31 December 2010 and 2009 are proved properties of RR 62,509 million and RR 65,086 million, net of accumulated depreciation, depletion and amortization of RR 8,915 million and RR 7,730 million, respectively.

Oil and gas properties and equipment balance at 31 December 2010 and 2009 include costs to acquire unproved properties in the amount of RR 4,352 million and RR 99 million, respectively. The Group's management believes these costs are recoverable and has plans to explore and develop the respective properties.

Included within assets under construction are advances to suppliers of equipment of RR 2,676 million and RR 1,217 million at 31 December 2010 and 2009, respectively.

Included in additions to property, plant and equipment for the years ending 31 December 2010 and 2009 are capitalized interest and foreign exchange loss of RR 2,621 million and RR 1,481 million, respectively. The interest capitalization rates for 2010 and 2009 used for additions were 5.4 percent and 6.0 percent, respectively.

During 2010, the transfers and additions to oil and gas property include the completion of the second phase of the Purovsky Gas Condensate Plant for RR 1,718 million, completion of the second and third stages of the second phase development at the Yurkharovskoye field in the amount of RR 22,784 million and the completion of the second phase development at the Khancheyskoye field in the amount of the RR 180 million.

During 2009, the transfers and additions to oil and gas property include the completion of the second phase of the Purovsky Gas Condensate Plant for RR 5,268 million, completion of the second stage of the second phase development at the Yurkharovskoye field in the amount of RR 8,390 million and the completion of the second phase development at the Khancheyskoye field in the amount of the RR 2,412 million.

Reconciliation of depreciation, depletion and amortization (DD&A):

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
DD&A included in operating expenses	6,616	5,588
DD&A included in general and administrative expenses (see Note 23)	141	150
DD&A capitalized in the in the course of intra-group construction services	71	61
<b>Total depreciation, depletion and amortization</b>	<b>6,828</b>	<b>5,799</b>

At 31 December 2010 and 2009, no property, plant and equipment were pledged as security for the Group's borrowings. Impairment of RR 321 million and nil was recognized in respect of oil and gas properties and equipment for the years ended 31 December 2010 and 2009, respectively.

Capital commitments are disclosed in Note 28.

**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 1,115 million and RR 1,235 million at 31 December 2010 and 2009, 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.

**OAQ NOVATEK**

**Notes to the Consolidated Financial Statements**

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**7 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES**

	At 31 December:	
	2010	2009
<i>Associates:</i>		
OAQ Sibneftegas	25,758	-
OOO Oiltechproduct-Invest	-	438
OOO Tailiksneftegas	-	407
OOO Petra Invest-M	-	369
<i>Joint ventures:</i>		
ZAO Terneftegaz	1,268	-
<b>Total investments in associates and joint ventures</b>	<b>27,026</b>	<b>1,214</b>

The Group's investment in OOO Yamal Development at 31 December 2010 is valued at nil due to the Group's proportionate share of accumulated losses exceeding the Group's cost of investment. The excess of the accumulated losses over the Group's cost of investment in Yamal Development were allocated to decrease of long-term loans provided by the Group to the joint venture (see Note 8).

The table below summarizes the movement in the carrying amounts of the Group's investments in associates and joint ventures.

	Year ended 31 December:	
	2010	2009
<b>At 1 January</b>	<b>1,214</b>	<b>1,416</b>
Share of profit (loss) of associates and joint ventures before income tax	(412)	(216)
Share of income tax (expense) benefit	66	14
<b>Share of profit (loss) of associates and joint ventures, net of income tax</b>	<b>(346)</b>	<b>(202)</b>
Acquisition of associates and joint ventures	19,176	-
Preliminary goodwill recognized on acquisition of associates	6,660	-
Disposals of subsidiaries resulting in recognition of associates and joint ventures	1,298	-
Acquisition of controlling stake resulting in derecognition of associates	(1,214)	-
Losses recognized in excess of investment in joint ventures, reclassified to long-term loans receivable	238	-
<b>At 31 December</b>	<b>27,026</b>	<b>1,214</b>

At 31 December 2010, the Group's interests in its principal associates and joint ventures and their summarized financial information, including total assets, liabilities, revenues and profit or loss relating to the Group's interest, were as follows:

<i>Associate or joint venture</i>	<i>Total non-current assets</i>	<i>Total current assets</i>	<i>Total non-current liabilities</i>	<i>Total current liabilities</i>	<i>Non-controlling interest</i>	<i>Revenues</i>	<i>Profit (loss)</i>	<i>% interest held</i>
OOO Yamal Development and its subsidiaries	68,567	1,931	39,599	7,782	23,355	-	(248)	50%
OAQ Sibneftegas	34,053	703	14,381	1,277	-	157	(68)	51%
ZAO Terneftegaz	1,543	170	442	3	-	2	(30)	51%
<b>Total</b>	<b>104,163</b>	<b>2,804</b>	<b>54,422</b>	<b>9,062</b>	<b>23,355</b>	<b>159</b>	<b>(346)</b>	

**OAQ NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**8 LONG-TERM LOANS AND RECEIVABLES**

	At 31 December:	
	2010	2009
Russian rouble denominated loans	38,057	-
Long-term receivables	2,063	932
Interest receivable (non-current)	31	1
<b>Total long-term loans and receivables</b>	<b>40,151</b>	<b>933</b>

On 15 December 2010, the Group provided two loans to OAO Sibneftegas, the Group's associate, for RR 7,429 million and RR 3,609 million. The first loan was issued at an annual interest rate of 10 percent and is repayable in November 2014, whereas the second loan was issued at an annual interest rate of 9.5 percent and is repayable by equal parts starting from March 2011 until November 2014. Included in the Russian rouble denominated loans is the long-term parts of the loans in the total amount of RR 10,069 million.

On 29 November 2010, the Group provided a loan to OOO Yamal Development, the Group's joint venture, in the amount of RR 28,123 million. The loan was issued at an annual interest rate of 8 percent and, in accordance with the signed terms and conditions is repayable by 29 November 2011. For the purpose of these financial statements, the loan was treated as part of the Group's net investment in its joint venture and classified as long-term. At 31 December 2010, the loan was recorded net of losses accumulated recognized by Yamal Development in excess of the Group's investment in the joint venture in the amount of RR 238 million (see Note 7).

No provisions for impairment of long-term loans and receivables were recognized in the consolidated statement of financial position at 31 December 2010 and 2009.

**9 OTHER NON-CURRENT ASSETS**

	At 31 December:	
	2010	2009
Deferred tax assets	1,392	499
Materials for construction	953	2,115
Other	513	55
<b>Total other non-current assets</b>	<b>2,858</b>	<b>2,669</b>

**10 INVENTORIES**

	At 31 December:	
	2010	2009
Natural gas and hydrocarbon liquids at cost	1,090	705
Materials and supplies at cost	575	614
Materials and supplies at net realizable value (net of provisions of RR 33 million and RR 29 million at 31 December 2010 and 2009, respectively)	192	236
Polymer and insulation tape products (net of provisions of RR nil million at 31 December 2009)	-	174
Other inventories	11	61
<b>Total inventories</b>	<b>1,868</b>	<b>1,790</b>

The Group recorded an impairment expense of RR 8 million and RR 46 million during the years ended 31 December 2010 and 2009, respectively, to write-down the carrying value of inventory due to obsolescence. No inventories were pledged as security for the Group's borrowings or payables at both dates.

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(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**11 TRADE AND OTHER RECEIVABLES**

	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Trade receivables (net of provision of RR nil million and RR 7 million at 31 December 2010 and 2009, respectively)	7,031	6,440
Other receivables	1,445	1,772
Interest on loans receivable	194	292
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

The carrying values of trade and other receivables approximate their respective fair values. The related exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above.

The Group holds letter of credit in banks with investment grade rating as security for trade receivables in amount RR 1,667 million and RR 2,627 million at 31 December 2010 and 2009, respectively. Also the Group holds as a collateral 100 percent participation interest in OOO NOVATEK-Polymer for other receivables from OAO SIBUR Holding (see Note 5). The Group does not hold any other collateral as security for trade and other receivables (see Note 27 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 8 million and RR 188 million at 31 December 2010 and 2009, 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:

	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Up to 90 days past-due	-	77
91 to 360 days past-due	-	103
Over 360 days past-due	8	8
<b>Total past due but not impaired</b>	<b>8</b>	<b>188</b>
Not past due and not impaired	8,662	8,316
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

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

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>At 1 January</b>	<b>7</b>	<b>34</b>
Additional provision recorded	184	51
Receivables written off as uncollectible	(191)	(72)
Provision amount reversed into income	-	(6)
<b>At 31 December</b>	<b>-</b>	<b>7</b>

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



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(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**12 PREPAYMENTS AND OTHER CURRENT ASSETS**

	At 31 December:	
	2010	2009
<i>Financial assets</i>		
Russian rouble denominated loans	969	1,477
Short-term bank deposits	-	111
<i>Non-financial assets</i>		
Recoverable value-added tax	1,340	955
Prepayments and advances to suppliers (net of provision of RR 89 million and RR 77 million at 31 December 2010 and 2009)	2,388	1,814
Deferred export duties for stable gas condensate	1,151	-
Prepaid taxes other than income tax	912	660
Deferred transportation expense for natural gas	824	581
Deferred transportation expense for stable gas condensate	514	78
Other current assets	406	124
<b>Total prepayments and other current assets</b>	<b>8,504</b>	<b>5,800</b>

**13 CASH AND CASH EQUIVALENTS**

	At 31 December:	
	2010	2009
Cash at current bank accounts	4,509	2,944
Russian rouble denominated deposits (average interest rate 2.4% p.a. and 1.8% p.a. for 2010 and 2009, respectively)	4,105	5,479
US dollar denominated deposits (average interest rate 0.3% p.a. and 0.4% p.a. for 2010 and 2009, respectively)	1,584	2,107
Other currencies denominated deposits	40	2
<b>Total cash and cash equivalents</b>	<b>10,238</b>	<b>10,532</b>

All deposits have original maturities of less than three months (see Note 27 for credit risk disclosures).

**14 LONG-TERM DEBT**

	At 31 December:	
	2010	2009
Russian rouble denominated loans	24,948	11,030
US dollar denominated loans	19,129	26,673
Russian rouble denominated bonds	9,949	-
<b>Total</b>	<b>54,026</b>	<b>37,703</b>
Less: current portion of long-term debt	(6,952)	(13,827)
<b>Total long-term debt</b>	<b>47,074</b>	<b>23,876</b>

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**14 LONG-TERM DEBT (CONTINUED)**

At 31 December 2010 and 2009, the Group's long-term debt by facility is as follows:

	At 31 December:	
	2010	2009
Sberbank	14,948	4,924
Gazprombank	10,000	6,106
Russian rouble denominated bonds	9,949	-
Syndicated term loan facility	6,952	20,646
Nordea Bank	6,095	-
UniCredit Bank	6,082	6,027
<b>Total</b>	<b>54,026</b>	<b>37,703</b>

**Sberbank.** On 28 August 2009, the Group obtained a RR 5 billion loan from OAO Sberbank repayable in January and February 2011. Throughout 2010, the Group gradually reduced the stated interest rate from the initial 12.37 percent to 8.5 percent per annum. In July 2010, the loan was fully repaid ahead of its maturity schedule.

On 6 December 2010, the Group obtained a RR 15 billion loan from Sberbank for general corporate purposes including financing capital expenditures. The loan bears an interest rate of 7.5 percent per annum and is repayable in December 2013. At 31 December 2010, the outstanding loan amount was RR 14,948 million, net of unamortized part of the transaction cost of RR 52 million.

**Gazprombank.** On 3 November 2009, the Group signed a loan agreement with OAO Gazprombank, which provided the Group with a loan facility of RR 10 billion until November 2012. At 31 December 2010, the full amount had been drawn down under this loan agreement. Throughout 2010, the Group gradually reduced the stated interest rate from the initial 13 percent to 8.5 percent per annum. Subsequent to the balance sheet date, in February 2011, the Group was able to further reduce the interest rate to 8 percent per annum.

**Russian rouble denominated bonds.** In June 2010, the Group issued ten million three-year non-convertible Russian rouble denominated bonds, each with a nominal value RR 1,000 and an annual coupon rate of 7.5 percent, payable semi-annually. At 31 December 2010, the outstanding amount was RR 9,949 million, net of unamortized part of the transaction costs of RR 51 million.

**Syndicated term loan facility.** On 21 April 2008, the Group obtained a USD 800 million unsecured syndicated term loan facility for general corporate purposes including funding capital expenditures. The facility has a three-year tenure with payments to begin 18 months after 21 April 2008 and is to be repaid in quarterly installments thereafter. The facility paid an initial interest of LIBOR plus 1.25 percent per annum for the first 18 months and subsequently increased to LIBOR plus 1.5 percent per annum thereafter (1.79 percent and 1.78 percent at 31 December 2010 and 2009, respectively). The loan facility includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the remaining amount of the loan facility was RR 6,952 million (USD 228 million), net of unamortized part of the transaction costs of RR 15 million.

**Nordea Bank.** On 16 November 2010, the Group entered into a USD 200 million credit line facility with OAO Nordea Bank. The facility has a three-year tenure with repayments to begin in the first quarter 2013 and is to be repaid in quarterly installments thereafter until November 2013. The facility has an initial interest rate of LIBOR plus 1.9 percent per annum (2.16 percent at 31 December 2010) and includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the full amount of RR 6,095 million (USD 200 million) had been drawn under this agreement.

**UniCredit Bank.** On 5 October 2009, the Group obtained a USD 200 million loan until October 2012 under credit line facilities with UniCredit Bank at an initial interest rate of LIBOR plus 6.5 percent, which was subsequently reduced to LIBOR plus 4.65 percent effective from 25 February 2010 (4.92 percent and 6.73 percent at 31 December 2010 and 2009, respectively). The loan includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the amount of RR 6,082 million (USD 200 million), net of unamortized part of the transaction costs of RR 13 million, had been drawn under this agreement. Subsequent to the balance sheet date, in January 2011, the Group was able to further reduce the interest rate to LIBOR plus 3.25 percent per annum.

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**14 LONG-TERM DEBT (CONTINUED)**

The fair values of long-term debt at 31 December 2010 were as follows:

	<u>At 31 December 2010</u>
Sberbank	15,000
Gazprombank	10,122
Russian rouble denominated bonds	10,061
Syndicated term loan facility	6,885
UniCredit Bank	6,139
Nordea Bank	5,814
<b>Total</b>	<b>54,021</b>

Scheduled maturities of long-term debt at 31 December 2010 were as follows:

<u>Maturity period:</u>	<u>RR million</u>
1 January 2012 to 31 December 2012	16,082
1 January 2013 to 31 December 2013	30,992
<b>Total long-term debt</b>	<b>47,074</b>

**15 PENSION OBLIGATIONS**

In February 2007, the Group announced the implementation of a post-employment benefit program for its retired employees. 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 statement of financial position and included in other non-current liabilities are determined as follows:

	<u>At 31 December:</u>	
	<u>2010</u>	<u>2009</u>
Present value of the defined benefit obligations	758	620
Unrecognized past service cost	(200)	(228)
<b>Defined benefit plan liability recognized in the consolidated statement of financial position</b>	<b>558</b>	<b>392</b>

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**15 PENSION OBLIGATION (CONTINUED)**

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

	Year ended 31 December:	
	2010	2009
<b>At 1 January</b>	<b>620</b>	<b>468</b>
Interest cost	31	30
Benefits paid	(8)	(5)
Current service cost	66	60
Past services cost	51	-
Disposal of obligation due to disposal of subsidiary	(75)	-
Actuarial (gain) loss	73	67
<b>At 31 December</b>	<b>758</b>	<b>620</b>

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

	Year ended 31 December:	
	2010	2009
Current service cost	66	60
Interest cost	31	30
Disposal of obligation due to disposal of subsidiary	(75)	-
Actuarial (gain) loss	73	67
Amortization of past service cost	79	28
<b>Defined benefit plan (benefits) costs recognized in operating expenses</b>	<b>174</b>	<b>185</b>
<i>of which the following amounts were included as employee compensation in:</i>		
Materials, services and other	73	85
General and administrative expenses	101	100

The Group recognized a gain of RR 5 million and RR 2 million as a result of experience adjustments on plan liabilities during the years ended 31 December 2010 and 2009, respectively, included in actuarial (gain) loss.

The principal actuarial assumptions used at 31 December 2010 and 2009 are as follows:

	At 31 December:	
	2010	2009
Weighted average discount rate	7.6%	7.8%
Projected annual increase in employee compensation	10%	10%
Expected increases to pension benefits	5%	5%

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. Inflation forecasts have been estimated to reduce from 7.9 percent for 2010 to 5.8 percent in 2015 and on average equal to 5.6 percent thereafter.

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 statement of financial position.

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**16 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT**

	At 31 December:	
	2010	2009
US dollar denominated loans	18,200	-
Total	18,200	-
Add: current portion of long-term debt	6,952	13,827
<b>Total short-term debt and current portion of long-term debt</b>	<b>25,152</b>	<b>13,827</b>

**Bridge loan facility.** On 29 November 2010, the Group obtained a USD 600 million bridge loan facility for financing of the acquisition by its joint venture OOO Yamal Development of a 51 percent participation interest in OOO SeverEnergia (see Note 5). The bridge loan facility has a one year tenure with a bullet repayment to be made by 15 November 2011. The interest rate under the bridge facility is LIBOR plus 1 percent per annum for the first six months from 16 November 2010, LIBOR plus 1.25 percent from May 2011 and LIBOR plus 1.5 percent from August 2011 and includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the outstanding amount of the loan facility was RR 18,200 million (USD 597 million), net of unamortized part of the transaction costs of RR 85 million. In February 2011, the bridge loan was fully repaid ahead of its maturity schedule (see Note 33).

**Available credit facilities.** Available credit facilities at 31 December 2010 were as follows:

<i>in millions of Russian roubles</i>	Par value in	Expiring	
		Within one year	Between 1 and 2 years
Credit Agricole Corporate and Investment Bank <sup>(a)</sup>	USD	3,048	-
BNP PARIBAS Bank <sup>(a)</sup>	USD	-	3,048
UniCredit Bank <sup>(a)</sup>	USD	-	3,048
Sumitomo Mitsui Banking Corporation Europe Limited <sup>(b)</sup>	USD	6,096	-
<b>Total available credit facilities</b>		<b>9,144</b>	<b>6,096</b>

<sup>(a)</sup> – interest rates negotiated at time of each withdrawal

<sup>(b)</sup> – interest rate LIBOR plus 1.45 percent

The Group also maintained available funds under short-term credit lines in the form of bank overdrafts with various international banks for RR 5,943 million (USD 195 million) and RR 6,048 million (USD 200 million) at 31 December 2010 and 2009, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

**17 TRADE PAYABLES AND ACCRUED LIABILITIES**

	At 31 December:	
	2010	2009
<b>Financial liabilities</b>		
Trade payables	2,194	2,483
Other payables	24,760	1,979
Interest payable	53	100
<b>Non-financial liabilities</b>		
Advances from customers	412	2,041
Salary payables	897	719
Other payables	163	13
<b>Trade payables and accrued liabilities</b>	<b>28,479</b>	<b>7,335</b>

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**17 TRADE PAYABLES AND ACCRUED LIABILITIES (CONTINUED)**

At 31 December 2010, other payable included RR 21,176 million relating to the acquisition of 51 percent ownership in Sibneftegas (see Note 5).

**18 SHAREHOLDERS' EQUITY**

**Ordinary share capital.** Share capital issued and paid in consisted of 3,036,306,000 ordinary shares at 31 December 2010 and 2009 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.

**Treasury shares.** In accordance with the share buyback program authorized by the Board of Directors on 11 February 2008, the Group's wholly-owned subsidiary, Novatek Equity (Cyprus) Limited, has periodically purchased ordinary shares of OAO NOVATEK in the form of Global Depository Receipts (GDRs) on the London Stock Exchange through the use of independent brokers. At 31 December 2010 and 2009, the Group held 312,277 GDRs (3,123 thousand ordinary shares) and 419,233 GDRs (4,192 thousand ordinary shares) at total cost of RR 446 million and RR 599 million, respectively. The Group has decided that these shares do not vote.

During the year ended 31 December 2010, the Group sold 106,956 GDRs (1,070 thousand ordinary shares) for RR 341 million recognizing a gain of RR 188 million which was recorded within additional paid-in capital in the consolidated statement of changes in equity.

**Dividends.** Dividends (including tax on dividends) declared and paid were as follows:

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Dividends payable at 1 January	13	-
Total dividends declared (*)	9,855	7,641
Dividends paid (*)	(9,868)	(7,628)
<b>Dividends payable at 31 December</b>	<b>-</b>	<b>13</b>
Dividends per share declared during the year (in Russian roubles)	3.25	2.52
Dividends per GDR declared during the year (in Russian roubles)	32.5	25.2

(\*) – excluding treasury shares

The Group declares and pays dividends in Russian roubles. Dividends declared in 2010 and 2009 were as follows:

Final for 2009: RR 1.75 per share or RR 17.5 per GDR declared in April 2010	5,314
Interim for 2010: RR 1.50 per share or RR 15.0 per GDR declared in October 2010	4,554
<b>Total dividends declared in 2010</b>	<b>9,868</b>
Final for 2008: RR 1.52 per share or RR 15.2 per GDR declared in May 2009	4,615
Interim for 2009: RR 1.00 per share or RR 10.0 per GDR declared in October 2009	3,036
<b>Total dividends declared in 2009</b>	<b>7,651</b>

**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.

**18 SHAREHOLDERS' EQUITY (CONTINUED)**

**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. As of the date of preparation of these consolidated financial statements the statutory net profit of NOVATEK for 2010 as determined under Russian Accounting Rules has not been finalized. For 2009, the net statutory profit of NOVATEK as reported in the published annual statutory reporting forms was RR 11,835 million and the closing balance of the accumulated profit including the current year net statutory profit totaled RR 59,853 million.

Accumulated profits legally distributable are based on the amounts available for distribution in accordance with the applicable legislation and as reflected in the statutory financial statements of the individual entities of the Group. These amounts may differ significantly from the amounts calculated on the basis of IFRS.

**19 SHARE-BASED COMPENSATION PROGRAM**

On 12 February 2010, NOVATEK's Management Committee approved a share-based compensation program (the "Program") for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee, which aims to encourage participants to take an active interest in the future development of the Group and to provide material incentive to create shareholders value in ОАО NOVATEK. The Program was established in accordance with the *Concept of the Long-Term Incentive of Senior Employees* approved by the Board of Directors on 25 September 2006 and the *Share Buyback Program*.

The Program is established as a cash-settled payment program and references the Group's GDRs, which are publicly traded on the London Stock Exchange under the ticker symbol "NVTK". At 31 December 2010, the Program covered 164 employees amongst which 382,368 GDRs were allocated. Each participant is assigned a pre-determined number of GDRs in accordance with their respective job classification grade and the entitlement for the cash-settled share-based payment cannot be transferred to another person. The cash-settled payments will only be awarded if the participant is employed with the Group at the date of payment.

	<i>Number of GDRs</i>
Total amount of GDRs granted at 12 February 2010	407,766
Granted	-
Exercised	-
Forfeited	(25,398)
Total amount of GDRs granted at 31 December 2010	382,368

The Program has three one-year vesting periods ending 31 January 2011, 2012, and 2013. Each participant is granted share appreciation rights, as part of their remuneration package, and may elect to get paid in cash at the end of each vesting period or to defer payment to the subsequent vesting periods during the Program life. Each payment is based on the sale of the allocated GDRs and is calculated as the difference between the GDRs market price at time of sale and the Program's pre-defined price set at USD 48.62 relating to the one-third of the total number of GDRs assigned to each participant during the vesting period, including any deferrals from prior vesting periods. The grant date is defined as 31 March 2010 and represents the date when all participants agreed to a share-based payment arrangement. The closing prices per GDR on the LSE at 31 December 2010 and 2009 were USD 119.50 and USD 66.00, respectively.

In accordance with IFRS 2 "*Share-based payment*", the Group re-measures the employees' services rendered and the liability incurred at the fair value of the liability. Until the liability is settled, the Group re-measures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model based on Monte-Carlo simulations, and to the extent to which the employees have rendered service to date.



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**19 SHARE-BASED COMPENSATION PROGRAM (CONTINUED)**

The fair value of the Program is determined based on the following assumptions:

	2010	2011	2012
Expected volatility	57.7%	57.7%	57.7%
Risk-free interest rate	-	0.32%	0.69%
Expected option life (years)	0.08	0.96	1.96
Exercise price per GDR (USD)	48.62	48.62	48.62

Expected volatility is calculated based on the historical volatility of the price per GDR for the historical period equal to the expected life of the Program (2.1 years). Risk-free interest rate is based on a benchmark USD curve including DEPO, FRA and IRS rates.

The fair value of the share-based payments is recognized as a payable to the employees over the vesting period and any changes in the fair value of the liability recognized in the consolidated statement of income.

During the year ended 31 December 2010, the Group recorded RR 400 million, as expenses under this Program, which is included in general and administrative expenses, and RR 164 million and RR 236 million was recognized as trade payables and accrued liabilities and other non-current liabilities at 31 December 2010, respectively.

**20 OIL AND GAS SALES**

	Year ended 31 December:	
	2010	2009
Natural gas	71,060	53,623
Stable gas condensate	29,754	23,599
Liquefied petroleum gas	12,747	8,253
Crude oil	1,458	1,335
Oil products	143	93
<b>Total oil and gas sales</b>	<b>115,162</b>	<b>86,903</b>

**21 TRANSPORTATION EXPENSES**

	Year ended 31 December:	
	2010	2009
Natural gas transportation to customers	26,569	20,019
Liquids transportation by rail	7,350	5,820
Liquids transportation by tankers	2,771	2,675
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	307	340
Crude oil transportation to customers	190	160
Other	13	12
<b>Total transportation expenses</b>	<b>37,200</b>	<b>29,026</b>

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**22 TAXES OTHER THAN INCOME TAX**

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

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Unified natural resources production tax	7,861	6,699
Property tax	1,482	1,155
Excise and fuel taxes	454	-
Other taxes	280	188
<b>Total taxes other than income tax</b>	<b>10,077</b>	<b>8,042</b>

In 2010 and 2009, 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 blend and an average exchange rate over the relevant tax period.

**23 GENERAL AND ADMINISTRATIVE EXPENSES**

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Employee compensation	3,874	2,840
Charitable contributions	774	533
Legal, audit, and consulting services	504	301
Rent expense	270	245
Business trips expense	265	207
Fire safety and security expenses	149	143
Depreciation – administrative buildings	141	150
Concession management services	125	225
Insurance expense	73	90
Other	558	392
<b>Total general and administrative expenses</b>	<b>6,733</b>	<b>5,126</b>

*Auditors' fees and services.* ZAO PricewaterhouseCoopers Audit has served as the Group's independent external auditors for each of the reported financial years. The independent external auditor is 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:

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Audit services fee (audit of the Group's consolidated financial statements and the statutory audit of the parent company)	36	37
Non-audit services	4	1
<b>Total auditors' fees and services</b>	<b>40</b>	<b>38</b>

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**24 MATERIALS, SERVICES AND OTHER**

	Year ended 31 December:	
	2010	2009
Employee compensation	2,572	2,457
Materials and supplies	1,386	1,455
Repair and maintenance services	640	396
Processing fees	566	556
Electricity and fuel	388	331
Fire safety and security expense	179	186
Third party services (under operator contracts)	3	624
Other	338	254
<b>Total materials, services and other</b>	<b>6,072</b>	<b>6,259</b>

**25 FINANCE INCOME (EXPENSE)**

<i>Interest income</i>	Year ended 31 December:	
	2010	2009
Interest income on cash and cash equivalents	170	294
Interest income on loans issued	328	168
<b>Interest income (on historical cost basis)</b>	<b>498</b>	<b>462</b>
IAS 32 and IAS 39 " <i>Financial Instruments</i> " – fair value remeasurement	100	65
<b>Total interest income</b>	<b>598</b>	<b>527</b>

<i>Interest expense</i>	Year ended 31 December:	
	2010	2009
8.5% RR 10 billion Gazprombank November 2012 <sup>(a)</sup>	700	298
7.5% RR 10 billion Bonds June 2013	392	-
8.5% RR 5 billion Sberbank February 2011 <sup>(a)</sup>	341	231
LIBOR+4.65% USD 200 million UniCredit Bank October 2012 <sup>(a)</sup>	325	86
LIBOR+1.5% USD 800 million BNP PARIBAS April 2011	318	828
7.5% RR 15 billion Sberbank December 2013	46	-
Interest expense on short-term debt <sup>(b)</sup>	64	288
Other interest expense	6	59
<b>Subtotal</b>	<b>2,192</b>	<b>1,790</b>
Less: capitalised interest	(2,166)	(1,280)
<b>Interest expense (on historical cost basis)</b>	<b>26</b>	<b>510</b>
IAS 32 and IAS 39 " <i>Financial Instruments</i> " – fair value remeasurement	198	126
Provisions for asset retirement obligations: unwinding of the present value discount	213	183
<b>Total interest expense</b>	<b>437</b>	<b>819</b>

<sup>(a)</sup> – interest rates were changed during the periods (see Note 14)

<sup>(b)</sup> – including credit facility with interest rates negotiated at time of each withdrawal (see Note 16)

26 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:	
	2010	2009
Profit before income tax (excluding share of profit (loss) of associates, net of income tax)	51,428	32,702
Theoretical income tax expense at statutory rate of 20 percent	10,286	6,541
Increase (decrease) due to:		
Non-deductible expenses	538	493
Foreign entities' taxation at lower income tax rate	(112)	(161)
Other non-temporary differences	92	(95)
<b>Total income tax expense</b>	<b>10,804</b>	<b>6,778</b>

Domestic and foreign components of current income tax expense were:

	Year ended 31 December:	
	2010	2009
Russian Federation income tax	9,289	5,806
Foreign income tax	116	90
<b>Total current income tax expense</b>	<b>9,405</b>	<b>5,896</b>

**Effective income tax rate.** The Group's Russian statutory income tax rate for 2010 and 2009 was 20 percent. For the years ended 31 December 2010 and 2009, the Group's effective income tax rate was 21.0 percent and 20.7 percent, respectively.

The Group does not file a consolidated tax return according to Russian legislation. Instead, each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

**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.

Deferred income tax balances are presented in the consolidated statement of financial position as follows:

	At 31 December:	
	2010	2009
Long-term deferred income tax asset (other non-current assets)	1,392	499
Long-term deferred income tax liability	(9,473)	(7,460)
<b>Net deferred income tax liability</b>	<b>(8,081)</b>	<b>(6,961)</b>

Deferred income tax assets expected to be realized within twelve months of 31 December 2010 and 2009 were RR 747 million and RR 26 million, respectively. Deferred tax liabilities expected to be reversed within twelve months of 31 December 2010 and 2009 were RR 258 million and RR 82 million, respectively.

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**26 INCOME TAX (CONTINUED)**

Movements in deferred income tax assets and liabilities during the years ended 31 December 2010 and 2009 are as follows:

	At 31 December 2010	Statement of Income effect	Acquisitions	Disposals	At 31 December 2009	
<b>Liabilities</b>						
Property, plant and equipment	(11,100)	(2,050)	(70)	282	(9,262)	
Inventories	(75)	2	-	14	(91)	
Other current assets	(63)	(61)	-	(2)	-	
Trade payables and accrued liabilities	(91)	(8)	(82)	(1)	-	
<b>Total deferred income tax liabilities</b>	<b>(11,329)</b>	<b>(2,117)</b>	<b>(152)</b>	<b>293</b>	<b>(9,353)</b>	
<b>Assets</b>						
Inventories	1,344	426	299	102	517	
Trade and other receivables	116	(14)	-	1	129	
Trade payables and accrued liabilities	948	331	(11)	(106)	734	
Tax losses carried forward	835	47	38	(181)	931	
Other	5	(72)	-	(4)	81	
<b>Total deferred income tax assets</b>	<b>3,248</b>	<b>718</b>	<b>326</b>	<b>(188)</b>	<b>2,392</b>	
<b>Net deferred income tax liabilities</b>	<b>(8,081)</b>	<b>(1,399)</b>	<b>174</b>	<b>105</b>	<b>(6,961)</b>	
	At 31 December 2009	Reclassification to the (assets) liabilities classified as held for sale	Statement of Income effect	Acquisitions	Disposals	At 31 December 2008
<b>Liabilities</b>						
Property, plant and equipment	(9,262)	(26)	(1,672)	(126)	35	(7,473)
Inventories	(91)	-	(43)	-	8	(56)
Other current assets	-	-	-	-	10	(10)
Trade payables and accrued liabilities	-	-	25	-	-	(25)
<b>Total deferred income tax liabilities</b>	<b>(9,353)</b>	<b>(26)</b>	<b>(1,690)</b>	<b>(126)</b>	<b>53</b>	<b>(7,564)</b>
<b>Assets</b>						
Inventories	517	30	(191)	318	(70)	430
Trade and other receivables	129	-	84	-	-	45
Trade payables and accrued liabilities	734	-	228	117	-	389
Tax losses carried forward	931	29	694	40	(58)	226
Other	81	1	(7)	5	-	82
<b>Total deferred income tax assets</b>	<b>2,392</b>	<b>60</b>	<b>808</b>	<b>480</b>	<b>(128)</b>	<b>1,172</b>
<b>Net deferred income tax liabilities</b>	<b>(6,961)</b>	<b>34</b>	<b>(882)</b>	<b>354</b>	<b>(75)</b>	<b>(6,392)</b>

26 INCOME TAX (CONTINUED)

At 31 December 2010, the Group had recognized deferred income tax assets of RR 835 million (31 December 2009: RR 931 million) in respect of unused tax loss carry forwards of RR 4,175 million (31 December 2009: RR 4,655 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.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

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

<i>Financial assets</i>	<i>Loans and receivables</i>	
	At 31 December:	
	2010	2009
<i>Non-current</i>		
Long-term loans receivable	38,057	-
Trade and other receivables	2,094	933
Long-term bank deposits	-	20
<i>Current</i>		
Short-term loans receivable	969	1,477
Trade and other receivables	8,670	8,504
Short-term bank deposits	-	111
Cash and cash equivalents	10,238	10,532
<b>Total carrying amount</b>	<b>60,028</b>	<b>21,577</b>
<i>Measured at amortized cost</i>		
At 31 December:		
	2010	2009
<i>Financial liabilities</i>		
<i>Non-current</i>		
Long-term debt	47,074	23,876
Other non-current liabilities	110	2,636
<i>Current</i>		
Current portion of long-term debt	6,952	13,827
Short-term debt	18,200	-
Trade and other payables	27,007	4,562
<b>Total carrying amount</b>	<b>99,343</b>	<b>44,901</b>

**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.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

**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. 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.

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 2010	Russian rouble	US dollar	Other	Total
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	37,955	102	-	38,057
Trade and other receivables	2,072	-	22	2,094
<i>Current</i>				
Short-term loans receivable	969	-	-	969
Trade and other receivables	4,759	3,582	329	8,670
Cash and cash equivalents	6,085	3,169	984	10,238
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(34,897)	(12,177)	-	(47,074)
Other non-current liabilities	-	(110)	-	(110)
<i>Current</i>				
Current portion of long-term debt	-	(6,952)	-	(6,952)
Short-term debt	-	(18,200)	-	(18,200)
Trade and other payables	(23,589)	(3,350)	(68)	(27,007)
<b>Net exposure at 31 December 2010</b>	<b>(6,646)</b>	<b>(33,936)</b>	<b>1,267</b>	<b>(39,315)</b>



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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

At 31 December 2009	Russian rouble	US dollar	Other	Total
<i>Financial assets</i>				
<i>Non-current</i>				
Trade and other receivables	933	-	-	933
Long-term deposits	20	-	-	20
<i>Current</i>				
Short-term loans receivable	1,477	-	-	1,477
Trade and other receivables	4,461	4,021	22	8,504
Short-term bank deposits	43	-	68	111
Cash and cash equivalents	7,390	3,128	14	10,532
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(11,030)	(12,846)	-	(23,876)
Other non-current liabilities	-	(2,636)	-	(2,636)
<i>Current</i>				
Current portion of long-term debt	-	(13,827)	-	(13,827)
Short-term debt				
Trade and other payables	(4,312)	(222)	(28)	(4,562)
<b>Net exposure at 31 December 2009</b>	<b>(1,018)</b>	<b>(22,382)</b>	<b>76</b>	<b>(23,324)</b>

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 in accordance with IFRS requirements.

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 2010 and 2009, respectively.

<i>Effect on pre-tax profit</i>	Increase in exchange rate	At 31 December:	
		2010	2009
RUR / USD	10%	(3,394)	(2,239)

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 for natural gas sold 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 the plan, the FTS increased the regulated price by 5 percent, 7 percent, 7 percent and 6.2 percent effective 1 January 2009, 1 April 2009, 1 July 2009 and 1 October 2009, respectively. In December 2009, the FTS approved an increase of 15 percent in the regulated price effective 1 January 2010 for the year 2010. In December 2010, the FTS approved a further increase of 15 percent in the regulated price effective 1 January 2011 for the year 2011.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015. The regulation of the domestic natural gas price prior to 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets while taking into account the cost of alternative fuels.

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, European and Asian-Pacific Region (hereinafter referred to as “APR”) markets are based on benchmark reference crude oil prices of WTI, Brent IPE and Dubai or Naphtha Japan, respectively, plus a margin or discount, depending on current market situation. Crude oil sold internationally is 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.

(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.

The interest rate profiles of the Group’s interest-bearing financial instruments at the reporting dates were as follows:

	At 31 December:	
	2010	2009
At variable rate	37,327	26,673
At fixed rate	34,899	11,030
<b>Total debt</b>	<b>72,226</b>	<b>37,703</b>

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 2010 would decrease by the amounts shown below.

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

<i>Effect on pre-tax profit</i>	At 31 December:	
	2010	2009
Increase by 100 basis points	373	267

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

The Group is examining various ways to manage its cash flow interest rate risk by using a combination of floating and fixed interest rates. No swaps or other similar instruments were in place as of 31 December 2010 and 2009, or during 2010 and 2009.

**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; however, if the customer has a credit rating below BBB-, the Group requires the collateral for the trade receivable to be in the form of letters of credit from banks with an investment grade rating. 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 generally 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 consolidated statement of financial position.

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

Moody's and/or Fitch	At 31 December:	
	2010	2009
Investment grade rating	4,489	5,176
Non-investment grade rating	1,338	2,939
No external rating	2,843	389
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

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

Moody's and/or Fitch	At 31 December:	
	2010	2009
Investment grade rating	8,008	9,614
Non-investment grade rating	1,781	846
No external rating	449	72
<b>Total cash and cash equivalents</b>	<b>10,238</b>	<b>10,532</b>

Investment grade ratings classification referred to as Aaa to Baa3 for Moody's Investment Services and as AAA to BBB- for Fitch Rating, respectively.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

**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.

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 2010	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
Principal <sup>(*)</sup>	-	10,000	25,000	35,000
Interest	2,725	2,372	1,411	6,508
Debt at variable rate				
Principal <sup>(*)</sup>	25,252	6,095	6,095	37,442
Interest	656	413	78	1,147
Trade and other payables	27,007	-	-	27,007
<b>Total financial liabilities</b>	<b>55,640</b>	<b>18,880</b>	<b>32,584</b>	<b>107,104</b>
At 31 December 2009	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
Principal <sup>(*)</sup>	-	4,924	6,106	11,030
Interest	619	77	-	696
Debt at variable rate				
Principal <sup>(*)</sup>	13,827	6,819	6,027	26,673
Interest	570	385	209	1,164
Trade and other payables	4,562	2,636	-	7,198
<b>Total financial liabilities</b>	<b>19,578</b>	<b>14,841</b>	<b>12,342</b>	<b>46,761</b>

(\*) – differs from long-term debt (Note 14) for transaction costs

**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.

At the reporting date, the Group had investment grade credit ratings of Baa3 (stable outlook) by Moody's Investor Services, BBB- (negative outlook) by Fitch Ratings, and a credit rating of BBB- (negative outlook) by Standard & Poor's. To maintain its credit ratings, 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.

## 28 CONTINGENCIES AND COMMITMENTS

The Group has a stated dividend policy that distributes at least 30 percent of its parent company's non-consolidated statutory net profit determined according to Russian accounting standards. However, the dividend for a specific year is determined after taking 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.

The Group defines the term "capital" as equity attributable to ОАО NOVATEK shareholders minus net debt (total debt less cash and cash equivalents). There were no changes to the Group's approach to capital management during the year.

**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, currency and customs legislation is subject to varying interpretations, frequent changes and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in 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.

The Group's business operations are primarily located in the Russian Federation and are thus exposed to the economic and financial markets of the country.

**Commitments.** At 31 December 2010, the Group had contractual capital expenditures commitments aggregating approximately RR 9,834 million (at 31 December 2009: RR 10,974 million) mainly for phase two development of the Yurkharovskoye field (through 2012), development of the East-Tarkosalinskoye and Khancheyskoye fields (through 2011), for continuation of phase two construction of the Purovsky Gas Condensate Plant (through 2011) and development of the South-Tambeyskoye field (through 2012) all in accordance with duly signed agreements. In addition, at 31 December 2010, the Group has capital commitments for exploration activities under the El Arish Concession Agreement aggregating USD nil million (at 31 December 2009: USD 13 million). Furthermore the Group's share of capital commitments for investments in joint ventures aggregates approximately RR 4,581 million development of the Samburgskoye field through 2012 (at 31 December 2009: nil).

**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. Furthermore, 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 preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2010, 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.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

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 its associates and joint ventures and their expiry dates are:

Field	License holder	License expiry date
Yurkharovskoye	ООО NOVATEK-Yurkharovneftegas	2034
East-Tarkosalinskoye	ООО NOVATEK-Tarkosaleneftegas	2043
Khancheyskoye	ООО NOVATEK-Tarkosaleneftegas	2044
Sterkhovoye (within the Olimpiyskiy license area)	ООО NOVATEK-Tarkosaleneftegas	2026
South-Tambeyskoye	ОАО Yamal LNG	2045
Termokarstovoye	ЗАО Тернефтегаз (joint venture)	2021
Beregovoe	ОАО Sibneftegas (associate)	2023
Pyreinoye	ОАО Sibneftegas (associate)	2021
Samburgskoye	ОАО Арктическая газовая компания (under control of joint venture Yamal Development)	2018
Yevo-Yakhinskoye	ОАО Арктическая газовая компания (under control of joint venture Yamal Development)	2018
Yaro-Yakhinskoye	ЗАО Urengoil Inc. (under control of joint venture Yamal Development)	2018
North-Chaselskoye	ОАО Нефтегастехнология (under control of joint venture Yamal Development)	upon full production

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.

**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.

**OAQ NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**29 PRINCIPAL SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES**

The principal subsidiaries and associates of the Group and respective ownership in the ordinary share capital at 31 December 2010 and 2009 are set out below.

	Ownership percent at 31 December:		Country of incorporation	Principal activities
	2010	2009		
<i>Subsidiaries</i>				
OOO NOVATEK-Yurkharovneftegas	100	100	Russia	Exploration and production
OOO NOVATEK-Tarkosaleneftegas	100	100	Russia	Exploration and production
OOO NOVATEK-Purovsky ZPK	100	100	Russia	Gas Condensate Plant
OOO NOVATEK-Transervice	100	100	Russia	Transportation services
OOO NOVATEK-AZK	100	100	Russia	Wholesale and retail trading
OOO NOVATEK Severo-Zapad	100	100	Russia	Trading and marketing
OOO NOVATEK-Polymer	-	100	Russia	Production of polymer and insulation tape
OOO NOVATEK-Ust-Luga	100	100	Russia	Construction of sea terminal
OOO Yargeo	51	51	Russia	Exploration activities
OAQ Yamal LNG	51	51	Russia	Exploration activities
OOO Oiltechproduct-Invest (merged into OOO NOVATEK-Tarkosaleneftegas in December 2010)	-	25	Russia	Exploration activities
OOO Petra Invest-M	100	25	Russia	Exploration activities
OOO Tailiksneftegas	100	25	Russia	Exploration activities
OOO Tambeyneftegaz	100	-	Russia	Exploration activities
OOO NOVATEK-Perm	100	-	Russia	Trading and marketing
OOO Yamalgazresurs-Chelyabinsk	100	-	Russia	Trading and marketing
OOO EkropromStroy	100	100	Russia	Construction of office building
Novatek Overseas AG	100	100	Switzerland	Holding company
Runitek GmbH	100	100	Switzerland	Trading and marketing
Novatek Overseas Exploration & Production GmbH	100	100	Switzerland (branch in Egypt)	Exploration activities
Novatek Equity (Cyprus) Limited	100	100	Cyprus	Purchase and sale of the Group's shares
Novatek Polska	100	100	Poland	Trading and marketing
<i>Joint ventures</i>				
ZAO Terneftegas (until September 2009 OOO Terneftegas)	51	100	Russia	Exploration and production
OOO Yamal Developmet	50	-	Russia	Holding company
OOO SeverEnergiya (through OOO Yamal Developmet)	25.5	-	Russia	Exploration and production
<i>Associates</i>				
OAQ Sibneftegas	51	-	Russia	Exploration and production



**OAO NOVATEK****Notes to the Consolidated Financial Statements**

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**30 RELATED PARTY TRANSACTIONS**

Transactions between NOVATEK and its subsidiaries, which are related parties of NOVATEK, have been eliminated on consolidation and are not disclosed in this Note.

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 with OAO Gazprom, a shareholder of significant influence, from October 2006 until 20 December 2010, and its subsidiaries are presented below.

<i>Related parties – OAO Gazprom and its subsidiaries</i>	<b>As at and for the year ended</b>	
	<b>31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Transactions</b>		
<b><i>OAO Gazprom:</i></b>		
Natural gas sales	12,935	-
Natural gas transportation to customers	(26,550)	(19,930)
Other expenses	(25)	(3)
<b><i>OOO Gazprom mezhregiongaz (formerly OOO Mezhregiongaz):</i></b>		
Natural gas sales	1,055	15,791
<b><i>Other Gazprom subsidiaries:</i></b>		
Sales of polymer and insulation tape	22	37
Unstable gas condensate transportation	(307)	(340)
Processing fees	(458)	(532)
Natural gas transportation	(4)	(3)
Other operating income (loss)	9	-
Other expenses	(34)	(33)
<b>Balances</b>		
<b><i>OAO Gazprom:</i></b>		
Trade payables and accrued liabilities	-	530
<b><i>OOO Gazprom mezhregiongaz (formerly OOO Mezhregiongaz):</i></b>		
Trade and other receivables	-	784
<b><i>Other Gazprom subsidiaries:</i></b>		
Trade and other receivables	-	16
Trade payables and accrued liabilities	-	157

On 20 December 2010, OAO Gazprom sold 9.4 percent of its NOVATEK shares to a third party and consequently ceased to be a related party of the Group from that date.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – associates and joint ventures</i>	As at and for the year ended 31 December:	
	2010	2009
<b>Transactions</b>		
<i>ОАО Sibneftegas (from December 2010):</i>		
Interest income on loans issued	45	-
<i>ООО Yamal Development and its subsidiaries (from November 2010):</i>		
Interest income on loans issued	191	-
<i>ООО Oiltechproduct-Invest, ООО Petra Invest-M and ООО Tailiksneftegas (until February 2010):</i>		
Other revenues	-	773
Interest income on loans issued	-	76
<b>Balances</b>		
<i>ОАО Sibneftegas (from December 2010):</i>		
Long-term loans receivable	10,070	-
Interest on long-term loans receivable	33	-
Short-term loans receivable	967	-
<i>ООО Yamal Development and its subsidiaries (from November 2010):</i>		
Long-term loans receivable	27,886	-
Interest on long-term loans receivable	191	-
<i>ZAO Terneftegas (from February 2010):</i>		
Long-term loans receivable	102	-
<i>ООО Oiltechproduct-Invest, ООО Petra Invest-M and ООО Tailiksneftegas (until February 2010):</i>		
Long-term loans and receivable	-	108
Trade and other receivables	-	80
Short-term loans receivable	-	837

As discussed in Note 5, in February 2010, the Group's effective control over ZAO Terneftegas ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity were disclosed as related parties – joint ventures.

As discussed in Note 5, in February 2010, the Group increased its participation interests in ООО Oiltechproduct-Invest, ООО Petra Invest-M and ООО Tailiksneftegas to 51 percent. These companies ceased to be associates subsequent to the date that the Group effectively acquired a controlling stake in these companies and, from that date forwards, are fully consolidated and are no longer accounted for as related parties.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – parties under significant influence of key management personnel</i>	As at and for the year ended 31 December:	
	2010	2009
<b>Transactions</b>		
<b>OOO Nova (formerly SNP NOVA):</b>		
Purchases of construction services (capitalized within property, plant and equipment)	3,825	2,245
Oil products sales	17	28
Other revenues	7	20
Other expenses	(9)	(5)
Other operating income (loss)	17	-
<b>OAO Tambeyneftegas (until July 2010):</b>		
Other operating income (loss)	(11)	-
Other expenses	(15)	(16)
Interest income on loans issued	44	79
<b>Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited:</b>		
Finance income (expense)	(221)	(41)
<b>Balances</b>		
<b>OOO Nova (formerly SNP NOVA):</b>		
Trade and other receivables	20	11
Advances for construction	278	137
Trade payables and accrued liabilities	312	188
<b>OAO Tambeyneftegas (until July 2010):</b>		
Trade and other receivables	-	184
Short-term loans receivable	-	636
<b>OAO SIBUR Holding (from December 2010):</b>		
Trade and other receivables	218	-
Long-term receivable	1,548	-
Trade payables and accrued liabilities	11	-
<b>Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited:</b>		
Other non-current liabilities	-	2,636
Trade payables and accrued liabilities	2,836	-

In December 2010, Chairman of the Management Board of NOVATEK acquired an effective 25 percent stake in OAO SIBUR Holding. As a result, the Group's balances and transactions with this company and its subsidiaries are disclosed from that date as related parties – parties under significant influence of key management personnel.

As discussed in Note 5, in July 2010, the Group acquired a 75 percent ownership interest in OAO Tambeyneftegas from parties under significant influence of a member of the Group's Board of Directors for RR 234 million (USD 7 million) and, as a result, this entity is fully consolidated and is no longer accounted for as a related party.

As discussed in Note 5, in May 2009, the Group purchased a 51 percent stake in OAO Yamal LNG. Following the acquisition (but not as of the acquisition date), an individual who significantly influences the sellers of the stake became a member of the Group's Board of Directors. Consequently, the sellers are considered a related party at 31 December 2009 and thereafter. The Group included outstanding liabilities to these related parties (Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited) in trade payables and accrued liabilities and other non-current liabilities at 31 December 2010 and 2009, respectively.

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**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

In addition, in June 2010, the Group paid RR 30 million in transaction fees to Investment Company Troika Dialog, the party under significant influence of a member of the Group's Board of Directors, for services related to the issuance of Russian rouble denominated bonds. This transaction cost was capitalized within long-term debt and will be amortized over the bonds life time.

<i>Related parties – party under control of key management personnel</i>	As at and for the year ended 31 December:	
	2010	2009
<b>Transactions</b>		
<b><i>ОАО Пervobank:</i></b>		
Finance income (expense)	18	30
Other expenses	(12)	-
<b>Balances</b>		
<b><i>ОАО Пervobank:</i></b>		
Cash and cash equivalents	1,760	845

As discussed in Note 5, in June 2009, the Group purchased 100 percent participation interest of ООО EkropromStroy from several members of the Group's key management personnel. As part of this acquisition, the Group consolidated a US dollar denominated long-term debt of RR 468 million (USD 15 million) of ООО EkropromStroy to SWGI Growth Fund (Cyprus) Limited, a party under control of key management personnel. The loan bore annual interest of 5.2 percent and was fully repaid in July 2009 ahead of its maturity schedule.

**Key management compensation.** The Group paid to key management personnel (members of the Board of Directors and the Management Committee, some of whom have also direct and indirect interests in the Group) short-term compensation, including salary, bonuses, and excluding dividends the following amounts.

<i>Related parties – members of the key management personnel</i>	Year ended 31 December:	
	2010	2009
Board of Directors	93	38
Management Committee	1,049	624
<b>Total compensation</b>	<b>1,142</b>	<b>662</b>

Such amounts include personal income tax and are net of unified social tax. The Board of Directors consists of nine members. The Management Committee consisted of 11 members until 4 December 2009 and was subsequently increased to 15 members.

The remuneration for serving on the Board of Directors is subject to approval by the General Meeting of Shareholders. Members of the Management Committee also receive certain short-term benefits related to healthcare.

In addition, RR 68 million and RR 176 million was recognized during the years ended 31 December 2010 and 2009, respectively, as part of the share-based compensation scheme and included in general and administrative expenses. At 30 June 2010, share-based compensation to the key members of the Group's management team provided in 2005 (see Note 18) was fully recognized in the consolidated statement of changes in equity.

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**31 SEGMENT INFORMATION**

The Group's activities are considered by the chief operating decision maker (hereinafter referred to as "CODM", represented by the Management Committee of NOVATEK) to comprise the following operating segments:

- Exploration, production and marketing – acquisitions, exploration, development, production, processing, marketing and transportation of natural gas, gas condensate and related products; and
- Polymer products production and marketing – production and marketing of polymer insulation tape and other polymer products (disposed in September 2010, see Note 5).

Segment information is provided to the CODM in accordance with management accounting based on Regulations on Accounting and Reporting of the Russian Federation ("RAR") with reconciling items largely representing adjustments and reclassifications recorded in the consolidated financial statements for the fair presentation in accordance with IFRS.

Segment information for the year ended 31 December 2010 is as follows:

<i>For the year ended 31 December 2010</i>	<i>References</i>	<b>Exploration, production and marketing</b>	<b>Polymer products production and marketing</b>	<b>Segment information as reported to CODM</b>	<b>Reconciling items</b>	<b>Total per consolidated financial statements</b>
External revenues		115,590	1,739	117,329	(305)	117,024
Operating expenses	<i>a, b, c, d</i>	(67,879)	(1,545)	(69,424)	906	(68,518)
Other operating income (loss)	<i>e, b</i>	767	15	782	943	1,725
Interest expense	<i>f, h</i>	(2,010)	-	(2,010)	1,573	(437)
Interest income		414	2	416	182	598
Foreign exchange gain (loss)	<i>g</i>	580	-	580	456	1,036
<b>Segment result</b>		<b>47,462</b>	<b>211</b>	<b>47,673</b>	<b>3,755</b>	<b>51,428</b>
Share of loss of associates, net of income tax						(346)
<b>Profit before income tax</b>						<b>51,082</b>
Depreciation, depletion and amortization	<i>a, b</i>	9,031	50	9,081	(2,324)	6,757
Capital expenditures	<i>g, h</i>	22,259	57	22,316	3,790	26,106

Reconciling items mainly related to:

- different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 3,049 million in operating expenses under IFRS;
- different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 464 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- different methodology in recognizing expenses relating to natural gas storage services and payroll (incl. share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 149 million and additional payroll expenses of RR 708 million recorded in operating expenses under IFRS;
- different methodology in recognizing of impairment expenses in respect of different categories of assets between IFRS and management accounting, which resulted in additional operating expense of RR 541 million charged under IFRS;

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**31 SEGMENT INFORMATION (CONTINUED)**

- e. different methodology in recognizing the gain on disposal of ownership interest in ZAO Terneftegas and OOO NOVATEK-Polymer between IFRS and management accounting, which resulted in additional gain of RR 185 million recorded in other operating income (loss) under IFRS;
- f. different methodology in valuating long-term payables and asset retirement obligations between IFRS and management accounting, which resulted in additional interest expense of RR 411 million charged under IFRS;
- g. different methodology in capitalization policy between IFRS and management accounting which resulted in additional capitalization of foreign exchange loss of RR 455 million under IFRS; and
- h. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized and additional capitalization of foreign exchange loss of RR 2,349 million and additional capital expenditures of RR 1,441 million under IFRS.

Segment information for the year ended 31 December 2009 is as follows:

<i>For the year ended 31 December 2009</i>	<i>References</i>	<b>Exploration, production and marketing</b>	<b>Polymer products production and marketing</b>	<b>Segment information as reported to CODM</b>	<b>Reconciling items</b>	<b>Total per consolidated financial statements</b>
External revenues	<i>a</i>	87,588	1,925	89,513	441	89,954
Operating expenses	<i>b, c</i>	(54,088)	(1,824)	(55,912)	(218)	(56,130)
Other operating income (loss)	<i>c</i>	(1,133)	3	(1,130)	839	(291)
Interest expense	<i>d, e</i>	(1,212)	-	(1,212)	393	(819)
Interest income		347	1	348	179	527
Foreign exchange gain (loss)		(736)	(1)	(737)	198	(539)
<b>Segment result</b>		<b>30,766</b>	<b>104</b>	<b>30,870</b>	<b>1,832</b>	<b>32,702</b>
Share of loss of associates, net of income tax						(202)
<b>Profit before income tax</b>						<b>32,500</b>
Depreciation, depletion and amortization		5,825	36	5,861	(123)	5,738
Capital expenditures	<i>d</i>	19,557	32	19,589	(1,717)	17,872

Reconciling items mainly related to:

- a. different methodology in recognizing deferred natural gas revenue of RR 381 million recorded under IFRS in external revenues as a result of acquisitions of Tarkosalenefegas and Khancheyneftegas in 2004;
- b. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 951 million in operating expenses under IFRS;
- c. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 966 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- d. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized of RR 1,084 million and reversal of capital expenditures of RR 2,801 million under IFRS; and
- e. different methodology in valuating long-term payables and asset retirement obligations between IFRS and management accounting, which resulted in additional interest expense of RR 294 million charged under IFRS.

31 SEGMENT INFORMATION (CONTINUED)

**Geographical information.** The Group's two segments operate in four major geographical areas of the world. In the Russian Federation (considered the Group's home country), the Group is mainly engaged in the exploration, development, production and sales of natural gas, crude oil, gas condensate and related products and sales of polymer and insulation tape (until September 2010). 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), in Asian-Pacific region (sales of stable gas condensate) and other areas (sales of liquefied petroleum gas and sales of polymer and insulation tape).

Geographical information for the year ended 31 December 2010 and 2009 is as follows:

<i>For the year ended 31 December 2010</i>	Russian Federation	Outside Russian Federation					Subtotal	Total
		Europe	USA	APR	Other	Export duty		
Natural gas	71,060	-	-	-	-	-	-	71,060
Stable gas condensate	34	6,598	25,976	12,660	3,653	(19,167)	29,720	29,754
Liquefied petroleum gas	4,686	8,855	-	-	9	(803)	8,061	12,747
Crude oil	855	1,191	-	-	-	(588)	603	1,458
Oil products	143	-	-	-	-	-	-	143
<b>Oil and gas sales</b>	<b>76,778</b>	<b>16,644</b>	<b>25,976</b>	<b>12,660</b>	<b>3,662</b>	<b>(20,558)</b>	<b>38,384</b>	<b>115,162</b>
Polymer products sales	1,390	-	-	-	309	-	309	1,699
Other revenues	157	6	-	-	-	-	6	163
<b>Total external revenues</b>	<b>78,325</b>	<b>16,650</b>	<b>25,976</b>	<b>12,660</b>	<b>3,971</b>	<b>(20,558)</b>	<b>38,699</b>	<b>117,024</b>

<i>For the year ended 31 December 2009</i>	Russian Federation	Outside Russian Federation					Subtotal	Total
		Europe	USA	APR	Other	Export duty		
Natural gas	53,623	-	-	-	-	-	-	53,623
Stable gas condensate	354	3,303	21,415	10,324	-	(11,797)	23,245	23,599
Liquefied petroleum gas	2,724	5,533	-	-	100	(104)	5,529	8,253
Crude oil	781	945	-	-	-	(391)	554	1,335
Oil products	83	14	-	-	-	(4)	10	93
<b>Oil and gas sales</b>	<b>57,565</b>	<b>9,795</b>	<b>21,415</b>	<b>10,324</b>	<b>100</b>	<b>(12,296)</b>	<b>29,338</b>	<b>86,903</b>
Polymer products sales	1,534	-	-	-	339	-	339	1,873
Other revenues	1,178	-	-	-	-	-	-	1,178
<b>Total external revenues</b>	<b>60,277</b>	<b>9,795</b>	<b>21,415</b>	<b>10,324</b>	<b>439</b>	<b>(12,296)</b>	<b>29,677</b>	<b>89,954</b>

Revenues from external customers are based on the geographical location of customers even though all revenues are generated from assets located in the Russian Federation. Substantially all of the Group's assets are located in the Russian Federation.

**Major customers.** For the years ended 31 December 2010 and 2009, the Group has three and one major customer to whom individual revenues represent 42 percent and 18 percent of total external revenues, respectively.

Sales to major customers are included in the results of the Exploration, production and marketing segment.



**32 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 2010 and 2009 is as follows:

	Year ended 31 December:	
	2010	2009
<b>Net book value of assets value at 1 January</b>	<b>2,535</b>	<b>2,462</b>
Additions	1,394	249
Acquisition of subsidiaries	7,894	39,527
Disposals	(821)	(176)
Reclassification in proved properties	(4,630)	(39,527)
<b>Net book value of assets at 31 December</b>	<b>6,372</b>	<b>2,535</b>
Liabilities	3,026	2,653
Cash flows used for operating activities	1,151	350
Cash flows used for investing activities	2,112	16,786

**33 SUBSEQUENT EVENTS**

On 3 February 2011, the Group issued two tranches of Eurobonds, in the amount of USD 600 million with a coupon rate of 5.326 percent per annum due in five years and USD 650 million with a coupon rate of 6.604 percent per annum due in ten years. The proceeds from Eurobonds issues were used for repayment of a bridge loan.

As discussed in Note 16, in February 2011, the Group fully repaid a RR 18,285 (USD 600 million) bridge facility ahead of its maturity schedule.

### 34 NEW ACCOUNTING PRONOUNCEMENTS

Beginning 1 January 2010, in addition to that which is disclosed in Note 3, the Group has adopted the following new standards and interpretations:

- Amendments to IFRS 2, *Share-based Payment. Group Cash-settled Share-based Payment Transactions*. (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard;
- Amendment to IAS 39, *Financial Instruments: Recognition and Measurement. Eligible Hedged Items*. (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations;
- IFRIC 17, *Distribution of Non-Cash Assets to Owners* (effective for annual periods beginning on or after 1 July 2009). IFRIC 17 clarifies when and how distribution of non-cash assets as dividends to the owners should be recognized. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognized in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners;
- Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognized asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; and amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. In addition, the amendments clarifying classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary published as part of the *Annual Improvements to International Financial Reporting Standards*, which were issued in May 2008, are effective for annual periods beginning on or after 1 July 2009; and
- IFRIC 18, *Transfers of Assets from Customers* (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

### 34 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

The adoption of these new standards and interpretations, in case of such operations, had an insignificant effect on the Group's consolidated financial statement.

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

- IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments* (effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity settles its debt by issuing its own equity instruments. A gain or loss is recognised in profit or loss based on the fair value of the equity instruments compared to the carrying amount of the debt;
- Amendment to IAS 32 (effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives;
- Amendment to IAS 24, *Related Party Disclosures* (effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities;
- Amendment to IFRIC 14, IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Prepayments of a Minimum Funding Requirement* (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement;
- Improvements to International Financial Reporting Standards (issued in May 2010 and effective for the Group from 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits;

**34 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

- IFRS 9, *Financial Instruments Part 1: Classification and Measurement* (effective for annual periods beginning on or after 1 January 2013). IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities. Key features of the standard are as follows:
  - Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument;
  - An instrument is subsequently measured at amortized cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss;
  - All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealized and realized fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment; and
  - Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

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

**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 mainly 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, and also has an interest in oil and gas companies that are accounted for under the equity method.

**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 2010 and 2009 (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Costs incurred in exploration and development activities</b>		
Acquisition cost	7,694	39,897
Exploration costs	2,042	770
Development costs	22,123	15,977
<b>Total costs incurred in exploration and development activities</b>	<b>31,859</b>	<b>56,644</b>
The share of the Group in its equity investees	69,286	178
	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Capitalized costs relating to oil and gas producing activities</b>		
Wells and related equipment and facilities	163,130	134,538
Support equipment and facilities	29,222	22,509
Uncompleted wells, equipment and facilities	10,277	15,839
Total capitalized costs relating to oil and gas producing activities	202,629	172,886
Less: accumulated depreciation, depletion and amortization	(26,698)	(20,211)
<b>Net capitalized costs relating to oil and gas producing activities</b>	<b>175,931</b>	<b>152,675</b>
The share of the Group in its equity investees	69,413	1,896

**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).

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Revenues from oil and gas sales	115,162	86,903
Lifting costs	(4,786)	(3,646)
Transportation expenses	(37,187)	(28,482)
Taxes other than income tax	(9,363)	(7,840)
Depreciation, depletion and amortization	(6,384)	(5,139)
Exploration expenses	(1,595)	(566)
<b>Total production costs</b>	<b>(59,315)</b>	<b>(45,673)</b>
Purchases of natural gas, gas condensate and crude oil	(154)	(1,143)
Transportation expenses related to purchases of natural gas, gas condensate and crude oil	-	(533)
Results of operations for oil and gas producing activities before income tax	55,693	39,554
Less: related income tax expense	(11,139)	(7,911)
<b>Results of operations for oil and gas producing activities</b>	<b>44,554</b>	<b>31,643</b>

**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 qualified technical staff working directly with the oil and gas properties. The Group's technical staff periodically updates reserve estimates during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

The Group estimates its oil and gas reserves in accordance with rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves.

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 (until February 2010), Urengoyskoe, South-Tambeyskoye, West-Yurkharovskoye, Yarudeiskoye, North-Khancheyskoye and North-Russkoye fields. 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.

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

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 2010 and 2009.

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 2014 and 2045, with the most significant license, Yurkharovskoye and East-Tarkosalinskoye fields, expiring in 2034 and 2043, respectively. Legislation of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Management intends to extend its licenses for properties expected to produce beyond the license expiry dates.

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.

For convenience, reserves estimates are provided both in English and Metric units.



**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of natural gas are presented below.

	Year ended			
	31 December 2010:		31 December 2009:	
	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>
<b>Consolidated entities:</b>				
<b>Net proved reserves at 1 January</b>	<b>40,726</b>	<b>1,153</b>	<b>24,357</b>	<b>690</b>
Revisions of previous estimates	(54)	(1)	(187)	(6)
Extension and discoveries	3,097	88	4,278	121
Acquisitions	-	-	13,420	380
Disposals	(870)	(25)	-	-
Production	(1,314)	(37)	(1,142)	(32)
<b>Net proved reserves at 31 December<sup>(*)</sup></b>	<b>41,585</b>	<b>1,178</b>	<b>40,726</b>	<b>1,153</b>
Net proved developed reserves (included above)	22,515	638	20,612	584
Net proved undeveloped reserves (included above)	19,070	540	20,114	569
<b>Equity-accounted entities (based on the Group's proportional interest):</b>				
<b>Net proved reserves at 31 December</b>	<b>6,057</b>	<b>171</b>	-	-
Net proved developed reserves (included above)	2,536	71	-	-
Net proved undeveloped reserves (included above)	3,521	100	-	-

<sup>(\*)</sup> – The net proved reserves reported in the table above included reserves of natural gas attributable to non-controlling interest of 7,227 billions of cubic feet and 205 billion of cubic meters and 6,576 billions of cubic feet and 186 billions of cubic meters at 31 December 2010 and 2009, respectively.

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

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

	Year ended			
	31 December 2010:		31 December 2009:	
	<i>Millions of barrels</i>	<i>Millions of metric tons</i>	<i>Millions of barrels</i>	<i>Millions of metric tons</i>
<b><i>Consolidated entities:</i></b>				
<b>Net proved reserves at 1 January</b>	<b>589</b>	<b>70</b>	<b>452</b>	<b>55</b>
Revisions of previous estimates	(12)	(1)	(23)	(4)
Extension and discoveries	60	8	67	8
Acquisitions	-	-	118	14
Disposals	(40)	(5)	-	-
Production	(31)	(4)	(25)	(3)
<b>Net proved reserves at 31 December<sup>(*)</sup></b>	<b>566</b>	<b>68</b>	<b>589</b>	<b>70</b>
Net proved developed reserves (included above)	304	36	272	33
Net proved undeveloped reserves (included above)	262	32	317	37
<b><i>Equity-accounted entities (based on the Group's proportional interest):</i></b>				
<b>Net proved reserves at 31 December</b>	<b>103</b>	<b>13</b>	-	-
Net proved developed reserves (included above)	-	-	-	-
Net proved undeveloped reserves (included above)	103	13	-	-

(\*) – The net proved reserves reported in the table above included reserves of crude oil, gas condensate and natural gas liquids attributable to non-controlling interest of 65 millions of barrels and eight million of metric tons and 58 million of barrels and seven million of metric tons at 31 December 2010 and 2009, respectively.

During 2010, the Group acquired a 51 percent of the outstanding ordinary shares of OAO Sibneftegas, which holds licenses on Beregovoye, Pyreinoe and Khadyryahinskoye fields (see Note 5). During 2010, the Group's joint venture OOO Yamal Development acquired a 51 percent of the participation interest in OOO SeverEnergiya. OOO SeverEnergiya and its subsidiaries hold licenses on Samburgskoye, Yevo-Yakhinskoye, Yaro-Yakhinskoye and North-Chaselskoye fields (see Note 5).

During 2010, the Group disposed a 49 percent ownership in ZAO Terneftegas (see Note 5), the holder of the Termokarstovoye field. As a result, the Group's interest in ZAO Terneftegas is accounted for using the equity method.

During 2009, the Group acquired a 51 percent equity stake in OAO Yamal LNG (see Note 5), the holder of the South Tambeyskoye license area. Included in the reserves estimates noted above are reserves attributable to 100 percent of the equity in the acquired company as required by US GAAP SFAS 69, *Disclosures about Oil and Gas Producing Activities*. The reserves estimates for proved reserves attributable to the non-controlling interest are shown separately for natural gas and crude oil, gas condensate and natural gas liquids.

**ОАО NOVATEK**  
**Contact Information**

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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:

Ulitsa Pobedy 22a  
629850 Tarko-Sale  
Yamal-Nenets Autonomous Region  
Russian Federation

Telephone: 7 (495) 730-60-00  
Fax: 7 (495) 721-22-53

[www.novatek.ru](http://www.novatek.ru)

## Contact information

### Legal address

22 A Pobedy Street, Tarko-Sale,  
Yamal-Nenets Autonomous Region,  
629850, Russia

### Office in Moscow

12A, Nametkina Street, Moscow,  
117420, Russia

### Central information Service

**Tel:** +7 495 730-6000  
**Fax:** +7 495 721-2253  
**E-mail:** novatek@novatek.ru

### Press Service

**Tel:** +7 495 721-2207  
**E-mail:** press@novatek.ru

### Investor Relations

**Tel:** +7 495 730-6013  
**Fax:** +7 495 730-6000  
**E-mail:** ir@novatek.ru

## Investor Information

### Independent Auditor

ZAO PricewaterhouseCoopers Audit  
White Square Office Center, Butyrsky Val 10,  
125047 Moscow, Russia

**Tel:** +7 495 967-6000  
**Fax:** +7 495 967-6001

### Independent Reserves Auditor

DeGolyer and MacNaughton  
5001 Spring Valley Road, Suite 800,  
East Dallas

Texas 75244, USA

**Tel:** +1 214 368-6391  
**Fax:** +1 214 369-4061  
**E-mail:** degolyer@demac.com

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](http://www.novatek.ru) (Russian version)  
and  
[www.novatek.ru/eng](http://www.novatek.ru/eng) (English version)

Mentions in this Annual Report 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

<b>barrel</b>	one stock tank barrel, or 42 US gallons of liquid volume
<b>bcm</b>	billion cubic meters
<b>boe</b>	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
<b>km</b>	kilometer(s)
<b>mm</b>	millimeter
<b>mboe</b>	thousand boe
<b>mcm</b>	thousand cubic meters
<b>mt</b>	thousand metric tons
<b>mmbae</b>	million boe
<b>mmcm</b>	million cubic meters
<b>mmt</b>	million metric tons
<b>bcf</b>	billion cubic feet
<b>tcf</b>	trillion cubic feet
<b>ton</b>	metric ton
<b>SEC</b>	United States Securities and Exchange Commission
<b>PRMS</b>	Petroleum Resources Management System
<b>YNAO</b>	Yamal-Nenets Autonomous Region
<b>RR</b>	Russian rouble
<b>LPG</b>	liquid petroleum gases
<b>LNG</b>	liquified natural gas



### 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:

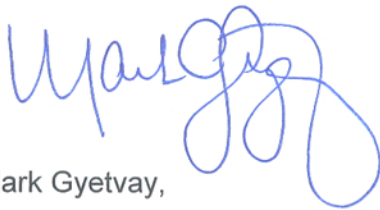
- changes in the balance of oil and gas supply and demand in Russia and Europe;
- the effects of domestic and international oil and gas price volatility and changes in regulatory conditions, including prices and taxes;
- the effects of competition in the domestic and export oil and gas markets;
- our 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.

## RESPONSIBILITY STATEMENT

I hereby confirm that to the best of my knowledge:

- (a) the set of financial statements, which has been prepared in accordance with International Accounting Standards, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the consolidation as a whole as required by the Disclosure and Transparency Rule (DTR) 4.1.6R,
- (b) the management report includes a fair review of the information required by DTR 4.1.9R, being a balanced and comprehensive analysis of development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that the company faces.



Mark Gyetvay,

Chief Financial Officer - Deputy Chairman of the Board of Directors





