



**NOVATEK**

# HARNESSING THE ENERGY OF THE FAR NORTH

ANNUAL REPORT  
**2011**



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# 01 Overview

## Highlights in 2011

**Record financial and operational results** including a 52.5% increase in revenues from oil and gas sales and a 44.6% and 20.9% increase in natural gas and liquid hydrocarbon sales volumes, respectively.

**Increased total proved reserves** according to SEC standards by 16% or 1,305 million barrels of oil equivalent (mmboe).

**Delivered our Corporate Strategy Day** Presentation in London, where NOVATEK's senior management provided operational guidance for production and capital expenditures through 2020, an update on the Yamal LNG project as well as a review of the Company's performance and strategy implementation to date.

**Acquired four new license areas** for exploration and production in the Yamal-Nenets Autonomous region (YNAO) significantly increasing our resource base; two in the Gydan peninsula and two offshore in the northern portion of the Gulf of Ob.

**Opened the Northern Sea Route's** navigational period for high-tonnage tankers in June and closed the period in November establishing a new record for the longest use of the route during a single year.

**Acquired a 100% participation** interest in the share capital of the regional gas distributor OOO Gazprom Mezhhregiongas Chelyabinsk, which will allow the Company to supply 100% of the Chelyabinsk region's gas demand.

**Increased our equity interest** in Yamal LNG from 51% to 100% in September and subsequently, in October, we disposed of a 20% stake in the company to TOTAL S.A., our strategic partner in the Yamal LNG project.

**Successfully closed our debut** Eurobond issue in an aggregate amount of US\$ 1.25 billion. The Eurobond was approximately eight times oversubscribed and issued at par in two tranches, a five-year US\$ 600 million bond with a coupon rate of 5.326% and a ten-year US\$ 650 million bond with a coupon rate of 6.604%.



## 2011 Financial and Operating Highlights

millions of Russian roubles except per share amounts and ratios	Year ended 31 December		Change %
	2011	2010	
<b>Financial results</b>			
Oil and gas revenues <sup>1</sup>	175,602	115,162	52.5%
Total revenues	176,064	117,024	50.5%
Operating expenses	97,665	68,518	42.5%
Net income	119,291	40,278	196.2%
EBITDA <sup>2</sup>	148,349	57,506	158.0%
Normalized EBITDA <sup>3</sup>	85,401	56,177	52.0%
Normalized EBITDAX <sup>4</sup>	87,220	57,772	51.0%
Earnings per share (EPS), Russian roubles	39.45	13.37	195.1%
Normalized EPS, Russian roubles <sup>5</sup>	18.69	12.93	44.6%
<b>Operating results</b>			
Total proved reserves (SEC), mmboe	9,393	8,088	16.1%
Natural gas sales volumes by consolidated subsidiaries, bcm	53.667	37.117	44.6%
Liquid hydrocarbon sales volumes by consolidated subsidiaries, mt	4,111	3,401	20.9%
Incl. stable gas condensate sales volumes, mt	2,984	2,330	28.1%
<b>Equity and liquidity</b>			
Net cash provided by operating activities	71,907	44,863	60.3%
Capital expenditures <sup>6</sup>	38,031	26,106	45.7%
Net debt <sup>7</sup>	71,647	61,988	15.6%
Total debt to total shareholders equity	0.40	0.43	(7.0%)

<sup>1</sup> Net of VAT, excise tax and export duties

<sup>2</sup> EBITDA represents profit (loss) attributable to shareholders of OAO NOVATEK adjusted for the addback of net impairment expense, income tax expense and finance income (expense) from the Consolidated Statement of Income, and depreciation, depletion and amortization and share-based compensation from the Consolidated Statement of Cash Flows

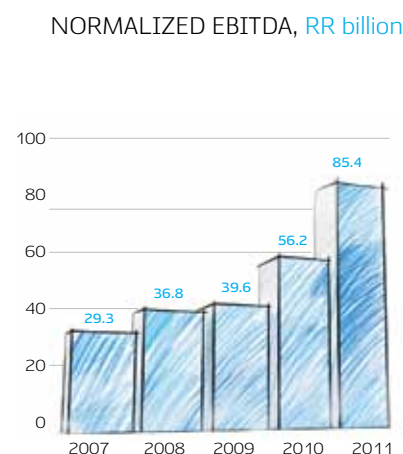
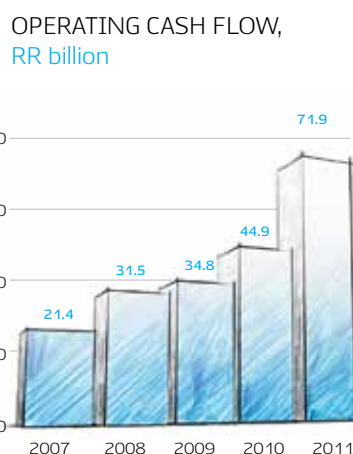
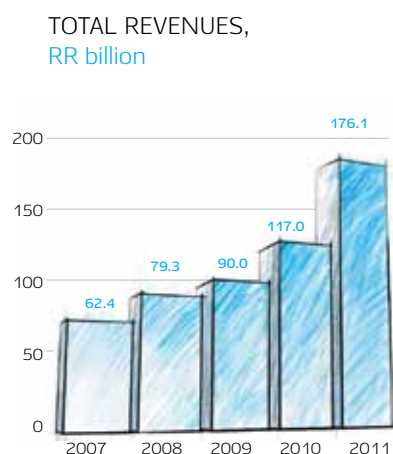
<sup>3</sup> Normalized EBITDA excludes net gain on disposal of interest in subsidiaries

<sup>4</sup> Normalized EBITDAX represents EBITDA as adjusted for the addback of exploration expenses and excludes net gain on disposal of interest in subsidiaries

<sup>5</sup> Normalized Earnings per share represents Earnings per share adjusted for net gain on disposal of interest in subsidiaries

<sup>6</sup> Including acquisition of mineral licenses

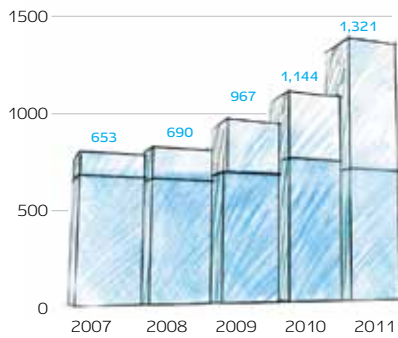
<sup>7</sup> Net debt calculated as long-term debt plus short-term debt less cash and cash equivalents





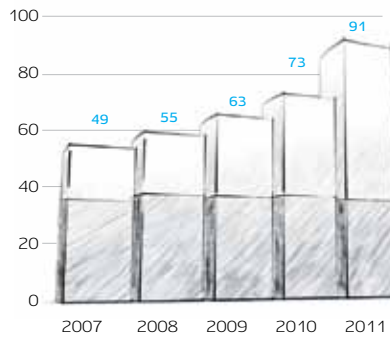
NATURAL GAS RESERVES (SEC),  
bcm

■ Proved undeveloped  
■ Proved developed



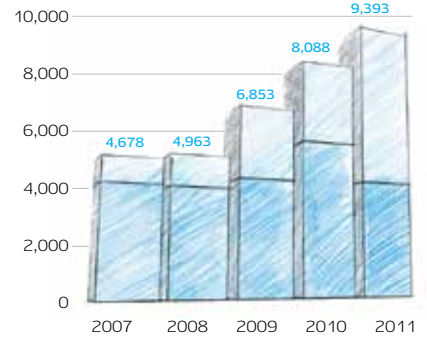
LIQUIDS RESERVES (SEC),  
mmt

■ Proved undeveloped  
■ Proved developed

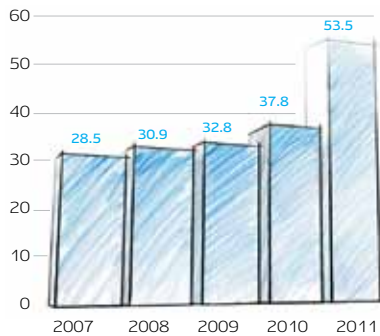


TOTAL RESERVES (SEC),  
mmboe

■ Proved undeveloped  
■ Proved developed

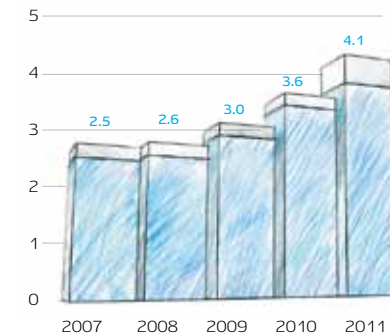


NATURAL GAS PRODUCTION,  
bcm



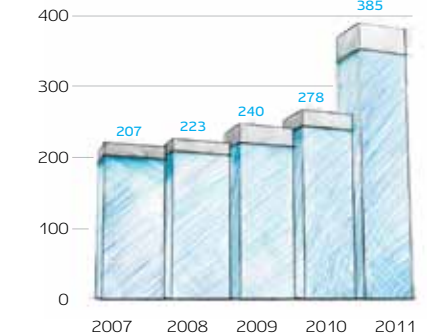
LIQUIDS PRODUCTION,  
mmt

■ Gas condensate  
■ Crude oil

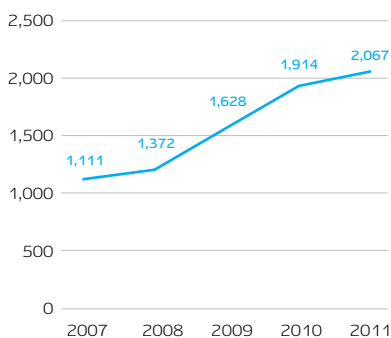


TOTAL PRODUCTION,  
mmboe

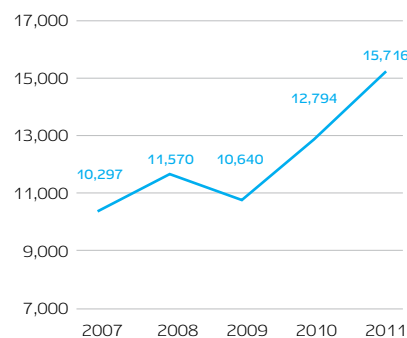
■ Natural gas  
■ Liquids



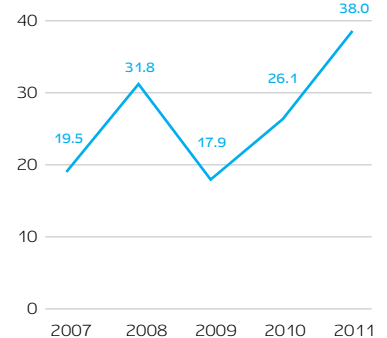
AVERAGE NATURAL GAS PRICES,  
RR per mcm\*



AVERAGE LIQUIDS PRICES,  
RR per ton\*



TOTAL CAPITAL EXPENDITURES,\*\*  
RR billion



\* Net of VAT, excise tax and export duties

\*\* Including acquisition of mineral licenses

## Letter to Shareholders

To our valued shareholders,

**HARNESSING THE ENERGY OF THE FAR NORTH** is the theme of our 2011 Annual Report as we begin an aggressive expansion of exploration and developments activities in the resource-rich Yamal and Gydan peninsulas.

**Russia's Far North**, comprising the Yamal Nenets Autonomous Region, is home to one of the world's largest concentration of natural resources, especially natural gas, and is the centerpiece of our future exploration and development activities in the Yamal and Gydan peninsulas as well as the cornerstone of our core operations. Moreover, Russia's Far North is a special, magical place and is home to vast array of wildlife and pristine landscapes. NOVATEK recognizes the critical importance of operating and developing our future hydrocarbons in this environmentally sensitive area and works closely with all stakeholders to ensure that our developments practices meets the highest standards of environmental and operational safety. We have worked very closely with the Regional Administration of the Yamal Nenets Autonomous Region to ensure a mutually beneficial working relationship and to outline a social investment program consistent with our development commitments.

**The natural gas markets** are undergoing profound structural changes as a result of the conflux of many different factors, including but not limited to, the shale gas revolution in the US, the growing emergence of LNG in global trade, the negative sentiments on nuclear energy from the aftershocks of the Fukushima nuclear plant disaster in Japan, and the regulatory mandate to "decarbonize" the world's energy footprint to name a few. To address these profound changes, we raised the bar to another level this past year by outlining our new strategic plans to the year 2020, essentially doubling our natural gas production and tripling our liquids hydrocarbons over the corresponding time period. Our new strategic plan envisages us diversifying our future production platform to the Far North and deeper into the Arctic Circle, thus embarking

on new transformational projects such as Yamal LNG as well as pioneering the hydrocarbon activities on the Gydan peninsula with future exploration and development work slated for the Geofizicheskiy and Utrenny license areas.

**The development of hydrocarbon** resources in the Far North undoubtedly brings a set of new challenges, yet the opportunities are immense to harness and deliver new sources of energy to both the Russian domestic market via traditional pipeline deliveries and eventually to the international markets via liquefied natural gas. Although the natural gas markets have experienced prolonged turmoil due to the lingering effects of the financial and economic crisis in the EU zone, we believe the future looks extremely bright for those companies producing natural gas as this clean burning fuel inevitably increases its overall proportion in the global total energy mix, and NOVATEK is well positioned to capitalize on these emerging trends.

**Two thousand and eleven** was another exceptional year for us operationally and financially. Our natural gas sales production increased by 42% to 52.9 billion cubic meters. Two thirds of the production growth was attributable to organic growth from our Yurkharovskoye and East-Tarkosalinskoye fields and one third – to our pro-rata share of equity production from Sibneftegas acquired in December 2010. We also increased our liquids production by 14%, led by our continuing development of "wet gas" production from the Yurkharovskoye field.

**Our Yurkharovskoye field** continues to play a crucial role in our near-term production growth and represents the cornerstone of the Company's "wet gas" field development program. Over the past year, we ramped up our production outflows from this important field, increasing year-on-year natural gas production by 31% to 32 billion cubic meters and our liquids production, consisting of unstable gas condensate, by 30% to 2.7 million tons. Last year, our Yurkharovskoye field was named "Best Gas Project, Eastern Europe 2011" by World Finance as part of its annual Oil and Gas awards program, and, based on the

field's 2011 production, is now the fourth largest natural gas producing field in Russia. We are extremely proud of the operational accomplishments and industry recognition we have achieved at this important field.

**In 2011**, our core oil and gas revenues increased by RR 60 billion to RR 176 billion, representing a 53% increase over the corresponding reporting period, but equally important, we continued our disciplined approach to managing our operating expenses, by optimizing our controllable expenses and reducing our per unit lifting costs. As a result, our EBITDA, excluding the net gain on disposals, increased by 52% in 2011 to RR 85 billion, and was consistent with our overall margin guidance and past year experience. We also ended 2011 in a positive free cash flow position achieving a record level of RR 41 billion, supporting our Board's recommendation to raise dividends for the seventh consecutive year to RR 6.00 per share, an increase of 50% over the prior year's dividend distribution.

**Over the past year**, we invested approximately RR 38 billion in capital related projects and mineral license acquisitions in support of our growth initiatives as well as securing new and exciting areas for future hydrocarbon exploration and development activities. The largest share of our capital spend went to ongoing development drilling at the Yurkharovskoye field, but we also began to diversify our capital program by investing funds into early stage development activities at the South Tambeykoye field and the West Urengoiyskiy license area, initial drilling of the East Tarkosalinskoye field's crude oil layers, and, by moving further down the value chain, we invested capital into the construction phase of the Ust Luga Gas Condensate Fractionation and Transshipment Complex.

**One of our main strategic objectives** is to increase our resource base as part of our prudent allocation of capital. Last year, we acquired four new license areas in the Yamal and Gydan peninsulas – Salmanovskiy (Utrenniy), Geofizicheskiy, North-Obskiy and East Tambeykiy – to complement our long-term exploration and development

plans. These license areas will serve as a future platform for natural gas and gas condensate production in this important hydrocarbon-rich geographical zone. Our exploration team is already onsite at the Geofizicheskiy license area and we will send another geological and geophysical expedition team to the Utrenniy license area during the summer months to begin exploratory work activities at these new license areas. The reserves and resources attributable to these four license areas were not appraised in our recent year-end reserve report, but offer tremendous future upside potential to continue our industry enviable track record of increasing our hydrocarbon resource base.

**It is important to highlight** that over the past year we continued to grow our reserve base through the prudent allocation of capital combined with the overall success achieved in our exploration and development activities. Our SEC proved reserves increased by 1.3 billion barrels of oil equivalent ("boe"), or by 16%, to approximately 9.4 billion boe at year-end 2011 (net of 2011 production volumes), resulting in a reserve to production life of 25 years and a three-year reserve replacement rate of 597%. On a single year basis, we successfully replaced 444% of our total 2011 production and 435% of our natural gas production, both according to the SEC reserve case. NOVATEK has slowly risen in the global reserve rankings amongst publically traded oil and gas companies, and at the end of 2011, now ranks in the Top 5 for total proved reserves for natural gas, and in the Top 15 for total combined reserves, both according to the SEC reserves reporting methodology.

**During 2011**, we made notable progress on our Yamal LNG project by successfully farming out a 20% equity stake in the project to a subsidiary of the French oil and gas company, Total SA, and continuing with the engineering and design work as well as achieving various early stage milestones consistent with our project plans, such as validating the conceptual design work for a new 170 thousand tons Yamal Arc 7 class LNG tanker, completing



three exploratory wells, optimizing the field development program and finalizing the corporate governance structure of Yamal LNG. In addition, the Russian Federation government fully endorsed our Yamal LNG project by formalizing the package of tax concessions originally announced in December 2010. We will continue to keep all of our stakeholders apprised with periodic progress reports for this crucial project.

**We built on the success** we achieved in 2010 by significantly increasing the number of voyages utilizing the Arctic Ocean's Northern Sea Route to target markets in the important Asian-Pacific region. Last year, we dispatched nine tankers carrying approximately 600 thousand tons of stable gas condensate to customers in China, South Korea and Thailand during the seasonal navigational period, thus again demonstrating the viability of this important logistical route and confirming our commercial abilities to penetrate new market areas for our hydrocarbon products. The voyages completed in 2011 took approximately half the time and distance required by the traditional navigational route through the Suez Canal and the Strait of Malacca (potential choke points) and will facilitate additional logistical options to transport products supporting future development of hydrocarbon fields located in the Yamal and Gydan peninsulas.

**Our strategic goal** of optimizing our marketing channels has been a key driver behind the success we achieved in increasing our oil and gas revenues and the monetizing our growing production volumes. We continued to make capital investments in the first phase of the 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. During the year, we announced our plans to expand the processing capacity of

our Purovsky processing plant from five million tons per annum to eleven million tons by 2014, including the announcement of a new strategic partnership with Sibur, Russia's largest petrochemical company, for the off-take of liquefied petroleum gas, or LPG.

**We remain 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. The success we achieved in delivering exceptional results was recognized by the equity markets in 2011 although there was considerable market volatility in Russian traded equities in the end of the year.

**Our achievements in 2011** would not have been possible without the dedication, commitment and professionalism from our trusted and valued employees. We highly value the teamwork and collaboration demonstrated throughout the year by our experienced professionals, and we offer our sincere gratitude for the collective efforts of our people throughout our organization. With the formal opening of our new, state-of-the-art corporate office in Moscow to a comprehensive program of supporting the regions where we operate, NOVATEK has created a culture of success and innovation, and a workplace of choice in Russia.

**In December 2011**, we outlined our ambitious corporate strategy to the year 2020 as well as looking back in time to what we have achieved since going public in 2005. It is quite clear that the choices we have made over the past years laid the foundation for a coherent and well-executed corporate strategy, which no doubt has been instrumental in delivering the exceptional results we achieved in 2011.

**On behalf of the Board of Directors and our Management Committee**, we would like to sincerely thank our valued shareholders, and, our new bondholders, for your continued support of NOVATEK. Looking to 2012 and beyond,

we are well positioned with our large resource base and a balanced mix of exploration and development projects to play an increasing role in the natural gas markets, both domestically and internationally. We remain committed to sustainable development principles, the tenets of corporate governance and creating shareholder value, and as we move forward with our operational plans to HARNESS THE ENERGY OF THE FAR NORTH, we are very excited about the future prospects of NOVATEK.

Sincerely,



**Alexander Natalenko**

Chairman of NOVATEK's Board of Directors



**Leonid Mikhelson**

Chairman of NOVATEK's Management Board



**Mark Gyetvay**

Chief Financial Officer



## 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 and is also recognized as one of the lowest cost producers globally. In 2011, the Company accounted for approximately eight percent of total Russian natural gas production and about 34% of natural gas produced by Russian independent producers, as well as playing a significant role in Russia's energy balance providing approximately 15% of total 2011 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 2011, the Company's reserve replacement rate was 444% and its three- and five-year reserve replacement rates were 597% and 492%, respectively. NOVATEK's total net proved reserves, conducted under the reserves estimation, reporting and disclosures rules promulgated by the U.S. Securities and Exchange Commission (SEC), as of the 31 December 2011 totaled 9,393 million barrels of oil equivalent (boe), of which approximately 92% was natural gas, and its reserve to production life was 25 years.





In 2011, NOVATEK invested Russian rouble (RR) 35,044 million, in exploration and development activities at its fields and license areas (including unproved acquisition costs of 7,448 million) resulting in an industry leading finding and development cost of RR 35.80 per boe (\$1.22 per boe)<sup>1</sup> and a three- and five-year finding and development cost of RR 44.16 per boe (\$1.46 per boe) and RR 50.56 per boe (\$1.78 per boe), respectively.

We increased our gross natural gas and liquid hydrocarbon production by 41.7% and 13.5%, respectively, compared to respective production volumes in 2010 while 2011 sales production (including share of production from joint ventures) of natural gas and liquid hydrocarbons increased by 42.0% and 13.7%, respectively, compared to 2010 production. In 2011, the Company's sales volumes totaled 53.7 billion cubic meters (bcm) of natural gas and 4.1 million tons (mmt) of liquid hydrocarbons, while total oil and gas revenues reached RR 175.6 billion.

A large portion of NOVATEK's reserve base, over 70% of SEC proved reserves, 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), in close proximity to the Company's production assets. 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, liquid petroleum gases (LPG), which meet the highest international quality standards, and regenerated methanol. 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.

As a result of the Company's production scale, processing capacity and marketing strategy, 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 2011, NOVATEK delivered natural gas to over 33 regions of the Russian Federation, including the Perm territory, Chelyabinsk, Orenburg, Sverdlovsk, Moscow, Kostroma, Kirov and Tyumen regions, the city of St-Petersburg as well as the YNAO and Khanty-Mansyisk Autonomous regions.

In November 2011, NOVATEK through its subsidiaries acquired a 100% participation interest in the share capital of OOO Gazprom Mezhhregiongas Chelyabinsk, the largest natural gas supplier to the Chelyabinsk region, which is one of the top ten Russian regions in terms of natural gas consumption. The Chelyabinsk region consumes up to 15 bcm of natural gas per annum and as a result of the acquisition, NOVATEK will now supply 100% of the region's natural gas demand compared to 30% in 2011.

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 2011, we dispatched nine consignments 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 ("NSR"). Transportation of goods via the NSR 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 shipments via the NSR 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.

<sup>1</sup> Average exchange rate of RR 29.39/USD(\$)

## Strategy

**The Company** was able to continue increasing sales volumes of natural gas and liquid hydrocarbons, which grew by 44.6% and 20.9%, respectively, due to an increase in production from the Yurkharovskoye and East-Tarkosalinskoye fields and the addition of our share in the production of the Pyreinoye and Beregovoye fields acquired at the end of 2010. The share of NOVATEK's liquid hydrocarbons sold to the export market, as a percentage of total liquid hydrocarbon volumes sold in 2011, was approximately 85.8%.

**During 2011**, we continued the development on our Yamal LNG project through investments in infrastructure at the South-Tambeyskoye field and adjacent areas as well as the validation of the design concept for the Arc 7, 170 thousand cubic meter capacity, Yamal class LNG carrier. In October 2011, NOVATEK closed the transaction for the sale of a 20% equity stake in OAO Yamal LNG to TOTAL S.A., the Company's strategic partner in the Yamal LNG project.

**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, strategic acquisitions 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 employing state-of-the-art and advanced techniques;
- Full development of the hydrocarbon value chain from production at the producing fields to the Company's own gas condensate processing and infrastructure facilities;
- Construction and operation of terminals to bring hydrocarbon products to market; and
- Successful experience working in the domestic natural gas market, which will benefit from the Russian Government's policy to increase domestic wholesale gas prices to achieve full market liberalization.



**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.**

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 continue to invest capital into the construction of the Ust-Luga transshipment and gas 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.

- **Increase Our Resource Base and Manage Reserves Effectively.**
- **Develop Relationships with Strategic Partners.**

We intend to manage our resource base in order to grow our proved reserves as we develop and explore for hydrocarbons at 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 and Gydan peninsulas, including the South-Tambeyskoye, Salmanovskoye (Utrenneye), Geofizicheskiy and other fields, will enable us to leverage our experience in developing complex gas condensate reserves to further expand our resource base both organically and geographically.

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, such as SIBUR, 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.







## 03 Operations in Review

### Exploration and Production

**NOVATEK's fields** and license areas are located in the YNAO of the Russian Federation, which is the world's largest natural gas producing region and accounts for approximately 17% of global natural gas production and approximately 84% of Russian natural gas production<sup>1</sup>. The concentration of the Company's producing and prospective fields, license areas and processing facilities in this region combined with the Region's 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 the YNAO, which has enabled it to effectively capitalize on the growth opportunities resident there to increase shareholder value.

**NOVATEK aims to expand** its resource base through geological exploration at fields and license areas not only in close proximity to existing transportation and production infrastructure, but also in new prospective areas. 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 2011**, we and our subsidiaries and equity investments held 38 licenses, of which 30 are classified as either production or combined exploration and production licenses and eight are classified as exploration licenses. The table below presents NOVATEK's reserves under the Russian reserve categories ABC1+C2.

#### ABC1+C2 Reserves as at 31 December

	2011	2010	2009
Natural gas, bcm	4,056	2,698	1,987
Liquid hydrocarbons, mmt	498	450	235
Total proved reserves, mm boe <sup>2</sup>	30,566	21,264	14,894

<sup>1</sup> According to Russian Governmental statistics and BP's 2010 Statistical Review.

<sup>2</sup> 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 2011, 2010 and 2009.



## SEC Proved Reserves<sup>1</sup> as at 31 December

	2011	2010	2009
Natural gas, bcm	1,321	1,144	967
Liquid hydrocarbons, mmt	91	73	63
Total proved reserves, mm boe <sup>2</sup>	9,393	8,088	6,853

<sup>1</sup> The Company's 2011 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, Khadyryakhinskiy, Pyreinoe, Severo-Chaselskoye, Yaro-Yakhinskiy, Beregovoy, Yevo-Yakhinskiy, and Samburgskiy fields and license areas, according to NOVATEK's shareholding in the respective fields and license areas. The 2011 reserve appraisal does not include Salmanovskoye and Geofizicheskoye fields which are located in the Gydan peninsula and were acquired in 2011. The appraisal reports were conducted under the reserves estimation, reporting and disclosures rules promulgated by the U.S. Securities and Exchange Commission ("SEC") reserves reporting methodology and do not include estimates for probable and possible reserves.

<sup>2</sup> 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 2009, 2010 and 2011.

**NOVATEK's total reserves** under the Russian reserve classification ABC1 + C2 totaled 4,056 bcm of natural gas and 498 mmt of liquid hydrocarbons, based on our equity ownership interest in the respective fields.

**The increase in NOVATEK's** total ABC1+C2 reserves for the ending 31 December 2011 was due in part to the recent acquisition of the Geofizicheskoy and Salmanovskiy (Utrnen-niy) license areas in the hydrocarbon-rich Gydan peninsula, which was acquired via a license tender, and a 29% increase in our equity stake in OAO "Yamal LNG", which holds the license to the South-Tambeyskoye field, as well successful exploration activities at our existing fields and license areas.

**The Company's reserves** are also appraised on an annual basis by independent petroleum engineers, "DeGolyer and MacNaughton" ("D&M") under the SEC reserves disclosure requirements and as of 31 December 2011, NOVATEK's total SEC proved reserves totaled 1,321 bcm of natural gas and 91 mmt of liquid hydrocarbons, based on our equity ownership interest in the respective fields.

**In 2011**, NOVATEK achieved significant growth in its SEC proved gas and gas condensate reserves due to ongoing production drilling at the Yurkharovskoye field, exploration work at the South-Tambeyskoye, North Russkoye, Samburgskoye and Yaro-Yakhinskiy fields and license areas, as well as an increase in the Company's equity interest in OAO "Yamal LNG". The increase in NOVATEK's SEC crude oil reserves was due to positive exploration results at the Yarudeyskoye field and ongoing production drilling at the East-Tarkosalinskoye field.

**NOVATEK's total net SEC** proved natural gas and liquid hydrocarbon reserves, on a boe basis, increased by 16.1% or, 1,305 million boe, to 9,393 million boe, while the Company's 2011 reserve to production ratio was approximately 25 years for both total hydrocarbons and natural gas.

**NOVATEK continued** to deliver low cost reserve growth in 2011 through strategically investing capital in development and exploration activities as well as strategic acquisitions, which enabled the Company to maintain its position as one of the lowest cost producers in the industry.

**The Company's total 2011** consolidated investments in exploration, development and acquisition activities totaled RR 35.04 billion, which resulted in a reserve replacement cost of RR 35.80 per boe (\$1.22 per boe)<sup>3</sup> while our three- and five-year reserve replacement costs amounted to RR 32.50 per boe (\$1.06 per boe) and RR 36.58 per boe (\$1.25 per boe), respectively.

**As part of our 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 located in Tyumen, and uses the latest methods 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 2011**, NOVATEK completed 41.3 thousand meters of exploration drilling and 1,738 square kilometers of Three-Dimensional ("3D") seismic and 376 linear kilometers of Two-Dimensional ("2D") seismic. The exploration activities at our fields targeted gas condensate and crude oil bearing Lower Cretaceous deposits at depths of between 2,000 to 4,400 meters. The table below shows figures for explora-

<sup>3</sup> Average exchange rate of RR 29.39/USD (\$)



## Exploration activities

	Units	2011	2010	Change
<b>2D seismic</b>		<b>376</b>	<b>322</b>	<b>17%</b>
Consolidated companies	linear km	91	322	(72%)
Associated companies	linear km	285	0	-
<b>3D seismic</b>		<b>1,738</b>	<b>522</b>	<b>233%</b>
Consolidated companies	sq. km	949	522	82%
Associated companies	sq. km	789	0	-
<b>Exploration wells drilled</b>		<b>41,287</b>	<b>15,116</b>	<b>173%</b>
Consolidated companies	meters	20,798	15,116	38%
Associated companies	meters	20,489	0	-

## Gross hydrocarbon production<sup>1</sup>

	Units	2011	2010	Change, %
Natural gas	bcm	53.5	37.8	41.5%
	mm boe	349.9	247.2	
Liquid hydrocarbons	mmt	4.124	3.632	13.5%
	mm boe	34.6	30.5	
<b>Total production</b>	<b>mm boe</b>	<b>384.5</b>	<b>277.7</b>	<b>38.5%</b>

<sup>1</sup>Equity share in natural gas production from joint ventures

tion activities both for the consolidated and associated companies.

**NOVATEK's 2011 gross production** from all fields amounted to 384.8 million boe (380.6 million boe of sales production), representing an increase of over 38% year on year, of which approximately 91% was natural gas production.

**In 2011**, total gross production amounted to 53.5 bcm of natural gas (sales production – 52.9 bcm) and 4.1 mmt of liquid hydrocarbons (sales production – 4.1 mmt). Natural gas production increased by 15.7 bcm or 41.5 %, while liquids production increased by 492 mt, or 13.5%, compared to the respective production volumes in 2010.

**The Company's total gas production capacity** as at 31 December 2011 amounted to 172.5 mmcm per day (including our share in the production capacity of Sibneftegas' fields) or approximately 62.5 bcm per annum.

**In 2011**, NOVATEK's **lifting costs**, or expenses directly related to the extraction and processing of natural gas, gas condensate and crude oil from the reservoir, decreased by 8.0% to RR 15.0 per boe on a Russian rouble basis and by 5.6% to \$0.51 per boe on a U.S. dollar basis.

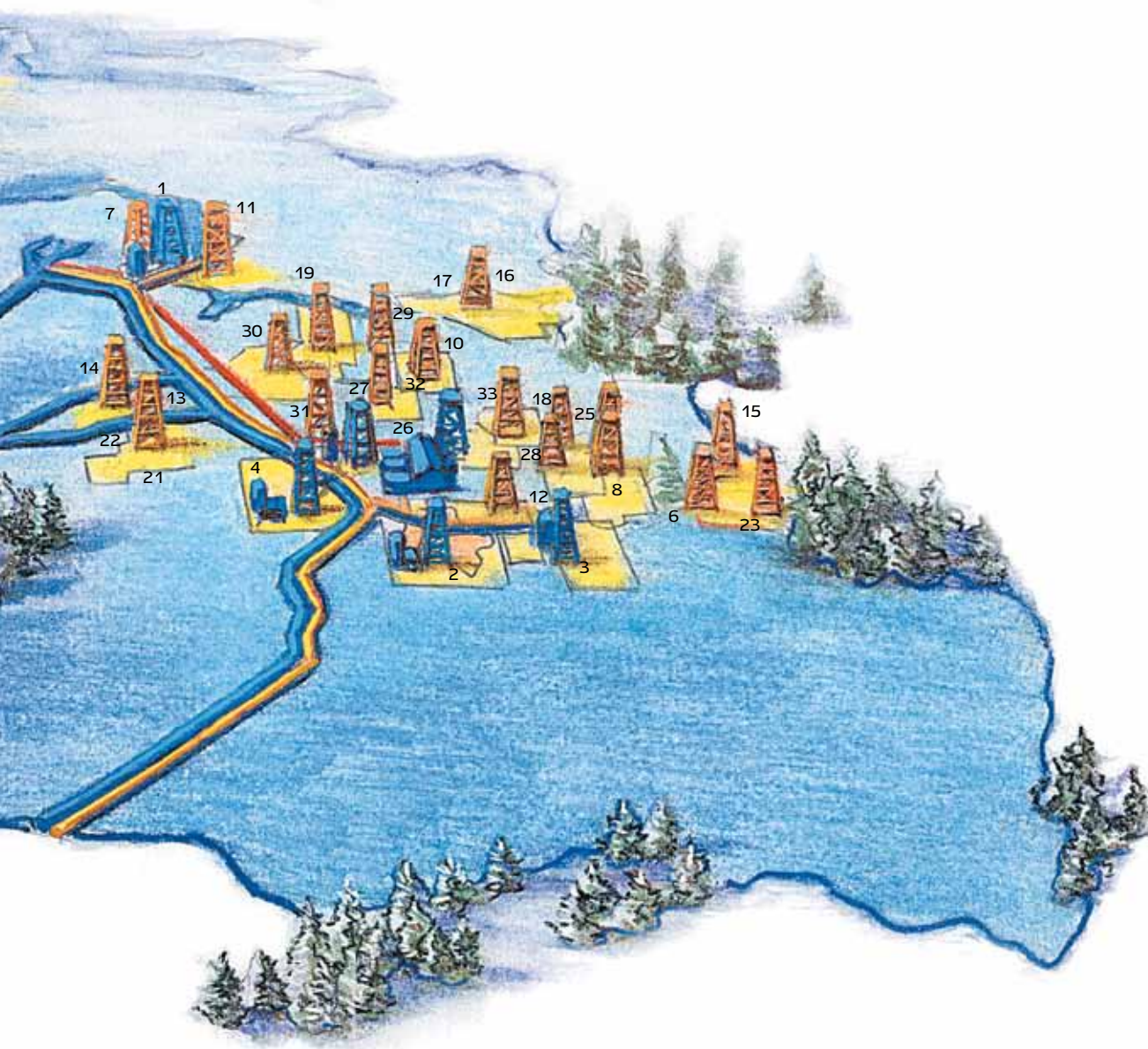
**The primary reason** for the 15.7 bcm increase in natural gas production was organic growth at the Yurkharovskoye field, which accounted for approximately 48% of the total increase while an increase in the utilization of dry gas production capacity at the East-Tarkosalinskoye field accounted for 16%. The remaining 33% of the increase was related to the addition of our equity share in the production from Sibneftegas in which the Company acquired a 51% stake in December 2010.





## NOVATEK'S FIELDS AND LICENSE AREAS

- |                                       |  |   |
|---------------------------------------|--|---|
| 01. Yurkharovskoye field              | 15. Severo-Termokarstoviy license area | 27. Pyreinoye field                       |
| 02. East-Tarkosalinskoye field        | 16. Severo-Russkiy license area        | 28. Khadyryakhinskiy license area         |
| 03. Khancheyskoye field               | 17. Severo-Russkoye field              | 29. Zapadno-Zapolyarnoye field            |
| 04. Olimpiyskiy license area          | 18. Sredniy-Chaselskiy license area    | 30. Samburgskiy license area              |
| 05. South-Tambeyskoye field           | 19. Zapadno-Tazovskiy license area     | 31. Yevo-Yakhinskiy license area          |
| 06. Termokarstovoye field             | 20. Anomalniy license area             | 32. Yaro-Yakhinskiy license area          |
| 07. West-Yurkharovskoye field         | 21. Severo-Yamsoveyskiy license area   | 33. Severo-Chaselskiy license area        |
| 08. North Khancheyskoye field         | 22. Ukrainsko-Yubileynoye field        | 34. Salmanovskiy ( Utrenniy) license area |
| 09. Yarudeyskoye field                | 23. Pilyalkinskiy license area         | 35. Geofizicheskiy license area           |
| 10. Raduzhnoye field                  | 24. Malo-Yamalskoye field              | 36. North-Obskiy license area             |
| 11. New Yurkharovskiy license area    | 25. Zapadno-Chaselskoye field          | 37. East-Tambeyskiy license area          |
| 12. Yumantilskiy license area         | 26. Beregovoy lisence area             | 38. Severo-Tasiyskiy license area         |
| 13. Zapadno-Urengoiyskiy license area |  |   |
| 14. Severo-Yubileynoye field          |  |   |



gas pipeline



other NOVATEK fields and license areas



gas condensate pipeline



Purovsky Plant



NOVATEK producing fields



gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant



## Producing fields

In 2011, hydrocarbon production was carried out at seven fields and license areas of which, our three core fields, Yurkharovskoye, East-Tarkosalinskoye and Khancheykoye accounted for approximately 90% of our natural gas and liquid hydrocarbons production. These three fields made up 52% of our total 2011 SEC proved reserves, as appraised by D&M. All of the fields are located in close proximity the Unified Gas Supply System (UGSS), the world's largest gas transporting infrastructure.

### 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, 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. 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 and the Purovsky Plant via our own pipeline infrastructure, which enables the transport of over 37 bcm of natural gas and three million tons of deethanized gas condensate, respectively, per annum. The unstable gas condensate is deethanized at the field using our own facilities with capacity for up to three million tons per annum.

In 2011, twelve production wells were drilled and connected to inter-field pipelines and a gas-gathering system was assembled. Currently, the field has 63 production wells for natural gas and gas condensate production. As a result of exploration works carried out at the field one new gas condensate deposit was discovered bringing the total number of field hydrocarbon deposits to 25.

Total field production capacity is approximately 33 bcm of natural gas and three mmt tons of unstable gas condensate.

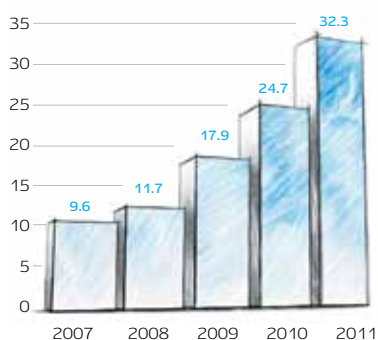
### Total Marketable (Sales) Production (full year 2011)

Natural gas	32.04 bcm (1,131 bcf)
Liquid hydrocarbons	2.718 mmt (23.37 mmbbl)

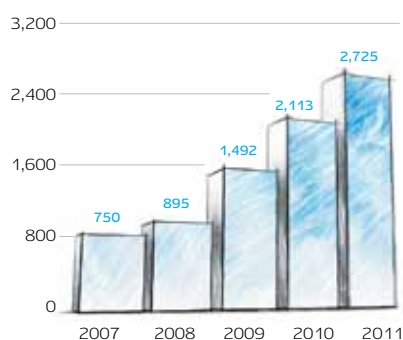
### Proved Reserves (SEC) as at 31 December 2011

Natural gas	445.6 bcm (15,736 bcf)
Liquid hydrocarbons	24.22 mmt (208.2 mmbbl)

YURKHAROVSKOYE FIELD  
NATURAL GAS PRODUCTION, bcm



YURKHAROVSKOYE FIELD  
GAS CONDENSATE PRODUCTION, mt



## East-Tarkosalinskoye field

**The field's license** for exploration and production of hydrocarbons is held by NOVATEK's wholly-owned subsidiary, OOO NOVATEK-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** is our most mature field and has reached its respective plateau levels in terms of natural gas and gas condensate production and 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 Khancheyskoye fields per annum. Unstable gas condensate is deethanized at the field and is transported via our 2.4 mmt per annum capacity 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 2011**, ten sidetracking wells were drilled, targeting the field's Cenomanian layers, of which seven were launched.

**We also began work** implementing the approved oil development program, including; project documentation approval for field development, drilling of five oil wells and one water well, launch of two oil wells and hydrofracking work at 20 oil wells to stimulate production. A crude oil gathering system and well clusters were also under construction during the period.

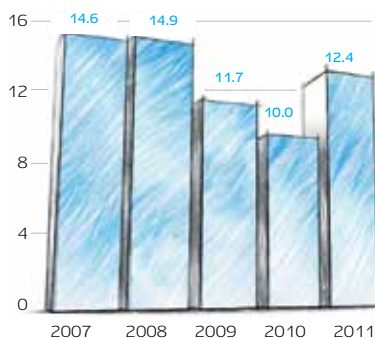
### Total Marketable (Sales) Production (full year 2011)

Natural gas	12.15 bcm (429.1 bcf)
Liquid hydrocarbons	0.808 mmt (6.490 mmbbl)

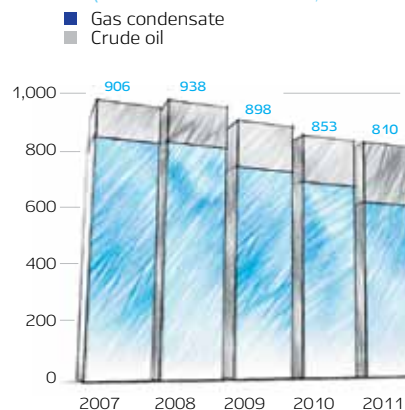
### Proved Reserves (SEC) as at 31 December 2011

Natural gas	212.0 bcm (7,488 bcf)
Liquid hydrocarbons	22.06 mmt (173.2 mmbbl)

EAST-TARKOSALINSKOYE FIELD  
NATURAL GAS PRODUCTION, bcm



EAST-TARKOSALINSKOYE FIELD  
LIQUIDS PRODUCTION, mt





### Beregovoy license area

**Sibneftegas**, in which NOVATEK owns a 51% share, holds the exploration and development license for the Beregovoy license area, which is valid until 2023. This license area encompasses the Beregovoye field, Sibneftegas' largest field in terms of reserves. The field is connected to the UGSS by pipeline with capacity of up to 12.5 bcm per annum and commercial production of natural gas began in 2007.

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

#### Net Marketable (Sales) Production (full year 2011)

Natural gas	4.920 bcm (173.7 bcf)
Liquid hydrocarbons	-

#### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	81.57 bcm (2,881 bcf)
Liquid hydrocarbons	0.356 mmt (2.954 mmbbl)

### Khancheysoy field

**The Khancheysoy field** was discovered in 1990 and is located 65 kilometers to the east of the East-Tarkosalinskoye field. The license for exploration and production of hydrocarbons at the Khancheysoy field is held by OOO NOVATEK-Tarkosalenftegas 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 gas pipeline to the East-Tarkosalinskoye field, and then further transported to customers using the East-Tarkosalinskoye field's connection to the UGSS. The intra-field pipeline's current capacity is 7.5 bcm per annum.

**The field's unstable** gas condensate production is transported via our pipeline to the East-Tarkosalinskoye field, where it is deethanized 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.

**A small amount** of oil is extracted along from the gas condensate wells and is prepared and processed with the unstable gas condensate.

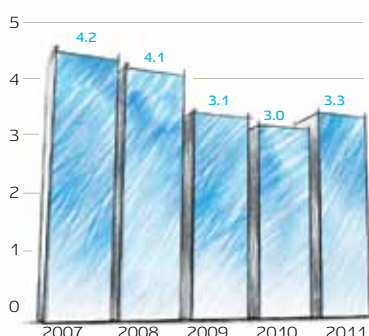
#### Total Marketable (Sales) Production (full year 2011)

Natural gas	3.263 bcm (115.2 bcf)
Liquid hydrocarbons	0.560 mmt (4.530 mmbbl)

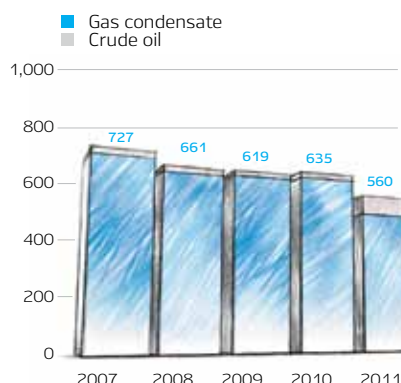
#### Proved Reserves (SEC) as at 31 December 2011

Natural gas	33.72 bcm (1,191 bcf)
Liquid hydrocarbons	3.952 mmt (32.12 mmbbl)

KHANCHEYSKOYE FIELD  
NATURAL GAS PRODUCTION, bcm



KHANCHEYSKOYE FIELD  
LIQUIDS PRODUCTION, mt



## Pyreinoye field

**Sibneftegas** also holds the license for exploration and production at the Pyreinoye gas condensate field, which is valid until 2021. Commercial production of gas and gas condensate began in 2009, and the field is connected to the UGSS by way of a 36 kilometer natural gas pipeline with capacity of 2.5 bcm per annum.

**Currently**, Sibneftegas has completed the interpretation of 3D seismic exploration data at the field in order to update the existing geological model for further development.

### Net Marketable (Sales) Production (full year 2011)

Natural gas	0.464 bcm (16.37 bcf)
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### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	8.413 bcm (297.1 bcf)
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## Olimpiyskiy license area

**The license** for exploration and production of hydrocarbons at the Olimpiyskiy license area is held by OOO NOVATEK-Tarkosaleneftegas and is valid until 2026. Natural gas and gas condensate production began in 2009 and is carried out at the Sterkhovoye field, which is located within the Olimpiyskiy license area.

### Total Marketable (Sales) Production (full year 2011)

Natural gas	0.068 bcm (2.401 bcf)
Liquid hydrocarbons	0.024 mmt (0.196 mmbbl)

### Proved Reserves (SEC) as at 31 December 2011

Natural gas	27.44 bcm (969.1 bcf)
Liquid hydrocarbons	2.56 mmt (20.88 mmbbl)

**The Sterkhovoye field** is connected to the UGSS by a 14 kilometer natural gas pipeline with transportation capacity of 3.1 bcm per annum. Deethanized gas condensate from the 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.

**In 2011**, two new gas condensate deposits and one gas deposit were discovered as a result of exploration activities at the license area, which significantly increased the reserve of the Dobrovolskoye field and increased the gas bearing capacity of the Cenomanian deposits at the Urengoykoye field. Production from these fields is expected to commence in the near future.

## Yumantilskoye field

**The license for exploration** and production at the field is held by OOO NOVATEK-Tarkosaleneftegas and is valid until 2024. Commercial production began in 2001, but has been periodically interrupted due to well maintenance problems. We expect production to restart after the necessary geological and technical activities are carried out and the economics for further field development is assessed.

### Total Marketable (Sales) Production (full year 2011)

Natural gas	0.004 bcm (0.155 bcf)
Liquid hydrocarbons	0.001 mmt (0.008 mmbbl)

## Prospective fields

In the medium-term period, we plan to launch 10 new fields, which have either been discovered as a result of exploration activities, or acquired through strategic investments. These fields will not only support production levels from producing fields, but will also provide production growth in the short- and medium-term periods. All of the fields are located in close proximity to our existing transportation and processing infrastructure and the infrastructure of the Purovsky Plant.

### Samburgskiy license area

The Samburgskoye field, along with Severo-Yesetinskoye+Vostochno-Urengoiszkoye and Severo-Purovskoye fields and part of the Urengoiszkoye field are all located within the Samburgskiy license area. The license for exploration and development is owned by OAO Arcticgas, a wholly owned subsidiary of SeverEnergiya. The ownership structure of SeverEnergiya includes Yamal Development, a 50/50 joint venture between NOVATEK and Gazprom Neft, which holds a 51% equity stake and Italian companies ENI and Enel, which together hold the remaining 49%.

In 2011, eight deviated wells have been completed and tested and four new horizontal and two horizontal side-track wells have been drilled at the Samburgskoye field. We have completed the 46 kilometer gas pipeline connecting the field's gas preparation unit with the UGSS and the 20 kilometer deethanized gas condensate pipeline, connecting to the Yurkharov-Purovsky Plant pipeline. The table below shows NOVATEK's net equity share in the reserves of the Samburgskiy license area.

#### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	24.50 bcm (865.3 bcf)
Liquid hydrocarbons	5.62 mmt (45.87 mmbbl)

### Yaro-Yakhinskiy, Severo-Chaselskiy and the Yevo-Yakhinskiy license areas

In addition to the Samburgskiy license area, SeverEnergiya, holds through its wholly owned subsidiaries, ZAO Urengoil Inc., OAO Neftegaztehnologiya and OAO Arcticgas, licenses for exploration and development of three more license areas; Yaro-Yakhinskiy, Severo-Chaselskiy and Yevo-Yakhinskiy, respectively.

All of SeverEnergiya's fields and license areas are in close proximity to our producing fields and existing transportation and processing infrastructure. We are currently working with the other partners to refine and approve the development plans for these fields and license areas. The table below shows NOVATEK's net equity share in the reserves of Yaro-Yakhinskiy, Severo-Chaselskiy and Yevo-Yakhinskiy license areas.

#### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	37.37 bcm (1,320 bcf)
Liquid hydrocarbons	4.225 mmt (34.28 mmbbl)

### 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 December 2011, NOVATEK together with its partner TOTAL made the final investment decision to develop the field. The project start-up is expected in 2015 with production capacity of approximately 65,000 barrels of oil equivalent per day. The table below shows NOVATEK's net equity share in the reserves of the Termokarstovoye field.

#### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	12.57 bcm (443.9 bcf)
Liquid hydrocarbons	2.360 mmt (20.19 mmbbl)

## North Khancheykoye field

The license for exploration and production is held by OOO NOVATEK-Tarkosaleneftegaz and is valid until 2029. In 2011, as a result of exploration works carried out at the field two new gas deposits were discovered. Work is underway on creating a geological field model in order to finalize a field development plan.

### Proved Reserves (SEC) as at 31 December 2011

Natural gas	1.959 bcm (69.18 bcf)
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## Yarudeyskoye field

OOO YARGEO, in which NOVATEK has a 51% equity stake, holds the license for exploration and production at the Yarudeyskoye field, which is valid until 2029. Most of the field's reserves are located in oil-rich deposits. In 2011, additional exploration work was done and we are currently in the process of finalizing the field's development plan in order to launch production. The table below shows NOVATEK's net equity share in the reserves of the Yarudeyskoye field.

### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	3.533 bcm (124.8 bcf)
Liquid hydrocarbons	2.151 mmt (16.70 mmbbl)

## North-Russkoye field

The license for exploration and production is held by OOO NOVATEK-Tarkosaleneftegaz and is valid until 2031. In 2011, as a result of exploration works carried out at the field one new gas deposit was discovered and the field's gas bearing capacity was increased, which significantly increased the resource base potential. The field's development plan was completed in 2011.

### Proved Reserves (SEC) as at 31 December 2011

Natural gas	22.49 bcm (794.3 bcf)
Liquid hydrocarbons	1.943 mmt (15.59 mmbbl)

## Additional prospective fields and license areas

In addition to the Beregovoy license area and Pyreinoye field, Sibneftegas holds geological exploration and development licenses for the Khadyryakhinskiy license area and the Zapadno-Zapolyarnoye field, which are in the early stages of geological exploration. Sibneftegas is currently planning to conduct further exploration drilling at the Khadyryakhinskiy license area where 3D seismic data interpretation is nearly complete in order to determine the geological structure of the deposits and identify any 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.

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 fields, deposits and the most effective use of our assets.

## Yamal and Gydan peninsula fields

With the 2009 acquisition of an equity stake in Yamal LNG, the license holder of the South-Tambeyskoye field in the Yamal peninsula, and the 2011 acquisition of four new license areas on the Gydan peninsula and in the Gulf of Ob, NOVATEK is rapidly expanding its operations in the northern portion of the YNAO. These fields and license areas are responsible for the Company's long-term production growth and may be used as feedstock for LNG and stable gas condensate sold to the export markets as well as a potential source for domestic deliveries of natural gas through the UGSS. The fields and license areas are being developed from "greenfield" stages and will require significant investment in production, transportation and processing infrastructure.



## South-Tambeyskoye field

**Yamal LNG**, in which NOVATEK holds an 80% equity stake, holds the license for exploration and production at the South-Tambeyskoye field. Yamal LNG is engaged in the design and construction work of an onshore integrated LNG facility at the license area, and once completed, will be the operator of the facility. The feedstock for the LNG facility is based on the resources of the South-Tambeyskoye field.

**The field has already been** thoroughly studied with 3D seismic and exploration wells drilled, and a detailed geological model has been completed. In 2011, three exploration wells were drilled as a result of which nine new hydrocarbon deposits were discovered, confirming the field's rich reserve base.

### Net Proved Reserves (SEC) as at 31 December 2011

Natural gas	377.3 bcm (13,323 bcf)
Liquid hydrocarbons	16.00 mmt (137.6 mmbbl)

## Geofizicheskoye and Salmanovskoye (Utrenneye) fields

**In August 2011**, our wholly owned subsidiary, OOO NOVATEK- Yurkharovneftegas, was granted four new license areas for exploration and production in the YNAO based on a positive ruling by the Russian Government as part of a tender process.

**Two of the license** areas are located in the hydrocarbon-rich Gydan peninsula. License obligations include a five-year exploration period to run 250 linear kilometers (km) of 2D seismic and 2,300 km<sup>2</sup> of 3D seismic as well as the drilling of four exploration wells. Licenses have been granted to carry out exploration and production activities until 2031. NOVATEK has already launched full-scale exploration and seismic works at the fields.

### ABC1+C2 Reserves as at 31 December 2011

Natural gas	978.6 bcm (34,545 bcf)
Liquid hydrocarbons	46.32 mmt (384.8 mmbbl)

## North-Obskiy and East-Tambeyskiy license areas

**The remaining** two license areas are located offshore in the northern portion of the Gulf of Ob. Both of the license areas are adjacent to the Yamal peninsula where the Company is developing its Yamal LNG project.

**License obligations** include a ten-year exploration period to run 6,000 km of 2D seismic and 252 km<sup>2</sup> of 3D seismic as well as the drilling of four exploration wells. Licenses have been granted to carry out exploration and production activities until 2041.

**The field** has no reserves under international standards.

### D1 Resources as at 31 December 2011

Natural gas	1,763 bcm (62,223 bcf)
Liquid hydrocarbons	220.7 mmt (1,855 mmbbl)

## Processing

### Purovsky Plant

**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 deethanized 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 midstream 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 utilizing the services of a third-party processor.

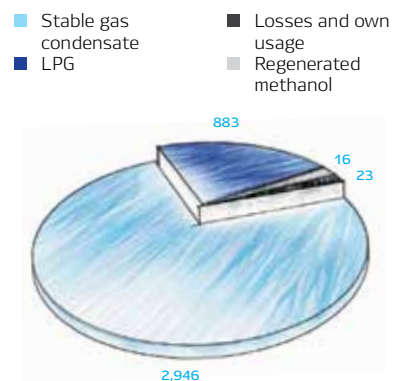
**In 2011**, the Purovsky Plant received feedstock from two sources and a third was added in the first quarter of 2012:

- through our unstable gas condensate pipelines from the East-Tarkosalinskoye and Khancheyskoye fields;
- through our Yurkharov-Purovsk unstable gas condensate pipeline from the Yurkharovskoye and Sterkhovoye fields; and
- through the Yurkharov-Purovsk unstable gas condensate pipeline from the Samburgskoye field.

**In 2011, the Purovsky Plant** processed 3.9 mmt of deethanized unstable gas condensate, or 13.8% more than in 2010, resulting in the commercial production of 2.9 mmt of stable gas condensate and 883 mt of LPG as well as approximately 16 mt of methanol produced during the LPG scrubbing process.

**During the year**, the Purovsky Plant operated at approximately 77% of full capacity, providing us with the ability to continue developing our gas condensate fields. 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. Also, the Purovsky Plant's fourth 9,600 cm LPG storage facility was completed and the Company's future plans include expanding the Purovsky Plant's

PUROVSKY PLANT OUTPUT 2011, mt



processing capacity to 11 mmt per annum by 2014, which will allow us to process the deethanized gas condensate produced from current and prospective fields.

**The Purovsky Plant** has storage facilities for stable condensate (90.0 mcm), LPG (25.2 mcm) and raw materials (13.6 mcm). The Purovsky Plant also has facilities for loading stable condensate and LPG into rail tank cars, and our own railway line connects the plant to the Russian railway network at the Limbey rail station.

### Ust-Luga Transshipment and Gas Fractionation Unit

**As part of our strategy** to maximize margins through value added projects, we launched construction of 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 will be used as feedstock to the fractionation unit for further processing into light and heavy naphtha, aviation kerosene, diesel and heating oil, which will be sold to both domestic and international export markets while the remaining volumes supplied to the facility by rail transport will be loaded onto tankers for delivery to export markets.

**The estimated gas** fractionation capacity of the Ust-Luga terminal is up to six mmt per annum, and will be constructed in two phases. We expect to launch the first phase with fractionation capacity of three million tons of feedstock per annum in the fourth quarter of 2012 and the second phase with similar capacity in the fourth quarter of 2013.



**Upon completion,** the complex will include two 3 mmt per annum fractionation trains, reservoir tank farms for feed-stock and processed products, rail facilities for loading and receiving finished and raw materials, two 17.5 meter deep-water tanker berths and associated port facilities. Our wholly owned subsidiary, NOVATEK-Ust-Luga will be the operator of the terminal.

**In 2011,** we began construction of the reservoir tank farms, which will consist of 25 reservoirs with total capacity of 640 mcm. Concrete forms for the jetty have been completed and construction of two tanker loading berths, administrative facilities, the foundation for the first phase fractionation unit and living quarters for employees began in 2011.

**The project will allow** us to move further down the hydro-carbon value chain to realize premium pricing for the facilities product slate and diversify customer risk by increasing the number of potential off-takers for the new product mix as well as decrease the transportation distance to the point of export by approximately 383 kilometers.

## Yamal LNG Facility

**NOVATEK** holds an 80% equity stake in Yamal LNG, which is engaged in the engineering and design work for the construction of an onshore LNG facility (the Project) on the Yamal peninsula. Yamal LNG holds the exploration and production license for the South-Tambeykoye field, which will provide the resources for the Project. In June 2010, a long-term agency agreement was signed between Gazprom Export and Yamal LNG, pursuant to which GazpromExport will act as an agent for export sales of LNG between Yamal LNG and Yamal LNG's wholly-owned export marketing subsidiary.

**In 2009,** NOVATEK acquired a 51% shareholding in Yamal LNG, and in September 2011, the Company increased its shareholding to 100% by exercising two options for the remaining 49%. In October 2011, we reduced our shareholding to 80% as a result of the sale of a 20% stake in Yamal LNG to TOTAL S. A., our strategic partner in the Project.

**In early 2011,** we completed pre-Front End Engineering and Design concept (FEED) and currently the Company is engaged in preparation of the site for construction and the FEED, which is expected to be completed in the first quarter of 2012.

**In 2011,** we started construction works on infrastructure facilities related to the Project in Sabetta, including: housing facilities, administrative buildings, a fuel depot, the inter-field roads and the airport runway. We also validated the design concept for the construction of a new 170,000 cubic meter capacity Arc 7 LNG Carrier.

## Marketing

During 2011, NOVATEK supplied natural gas to 33 regions of the Russian Federation and acquired the largest gas distributor in the Chelyabinsk region. The Company also expanded its use of the Northern Sea Route to significantly reduce delivery time for shipments of stable gas condensate to countries of the Asian-Pacific region.

### Natural Gas Sales

According to the CDU-TEK, total Russian natural gas production increased by 3% in 2011 and Russia remained the second largest consumer of natural gas in the world consuming approximately 469.1 bcm. The largest Russian consumer of natural gas is the power generation sector accounting for 35% of total 2011 domestic natural gas consumption.

In 2011, NOVATEK accounted for approximately 15% of the total natural gas deliveries to the domestic market through the UGSS.

NOVATEK's 2011 natural gas sales volumes amounted to 53.7 bcm, an increase of 44.6% compared to 2010 sales volumes of 37.1 bcm, of which 29.3 bcm (54.7%) was sold to the end-customer segment and 24.3 bcm (45.3%) was sold ex-field to the wholesale trader segment.

Total revenues from natural gas sales increased to RR 110.9 billion or by 56.1%, in 2011 as compared to 2010, due to the higher volumes and an increase in prices.

In 2011, our customers were located primarily in the Perm territory, Chelyabinsk, Orenburg, Sverdlovsk, Moscow, Kostroma, Kirov and Tyumen regions, the city of St-Petersburg as well as the YNAO and Khanty-Mansyisk Autonomous regions.

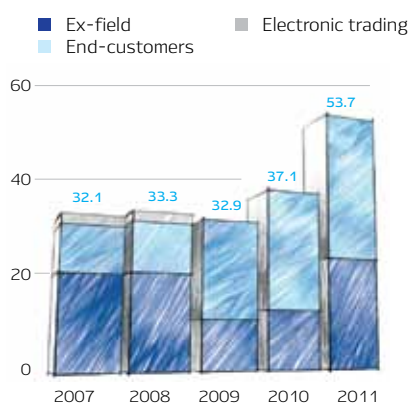
In April 2011, NOVATEK through its subsidiaries acquired OOO Yamalenergogaz, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Perm region. In January 2012, OOO Yamalenergogaz was merged into OOO NOVATEK-Perm.

In November 2011, NOVATEK through its wholly-owned subsidiaries acquired a 100% participation interest in the share capital of OOO Gazprom Mezhhregiongas Chelyabinsk, the largest gas distributor in the Chelyabinsk region, which is one of the largest natural gas consuming regions. As a result of the acquisition NOVATEK will now supply 100% of the Chelyabinsk region's natural gas demand.

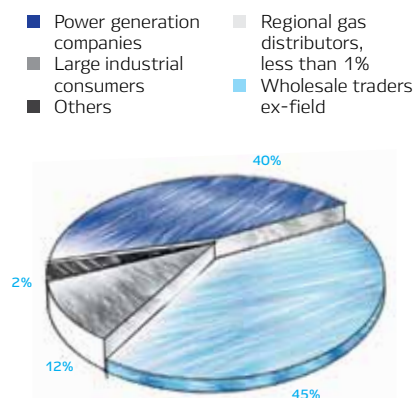
In order to maintain production levels during periods of seasonality in demand NOVATEK has entered into an agreement with OAO Gazprom for the use of their underground storage facilities on a space available basis. Historically, natural gas is injected into underground storage facilities during warmer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

In 2010, NOVATEK withdrew 1,199 mmcm of natural gas from underground storage facilities during periods of high demand and injected 1,171 mmcm when space was available. At the end of 2011, the Company had 732 mmcm of natural gas in storage and available for withdrawal in future periods.

NATURAL GAS SALES VOLUMES, bcm



2011 BREAKDOWN OF NATURAL GAS SALES VOLUMES, %



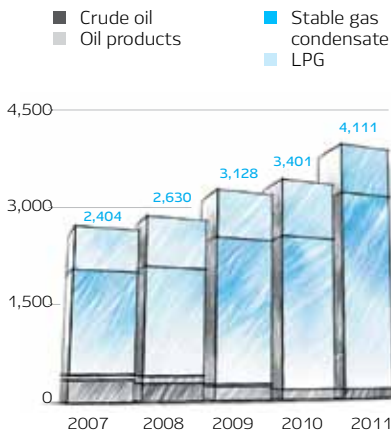


## Liquid Hydrocarbon Sales

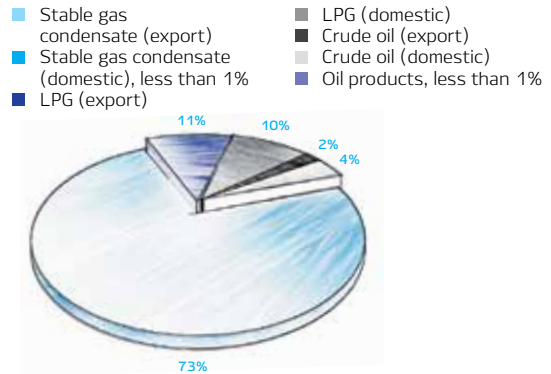
The Company's primary liquid hydrocarbon sales volumes are comprised of stable gas condensate and liquefied petroleum gases (LPG). The stable gas condensate is primarily used in the petrochemical and oil refining industries as an alternative to naphtha and light crude oil, respectively. Our LPG is sold 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 transportation and storage 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.

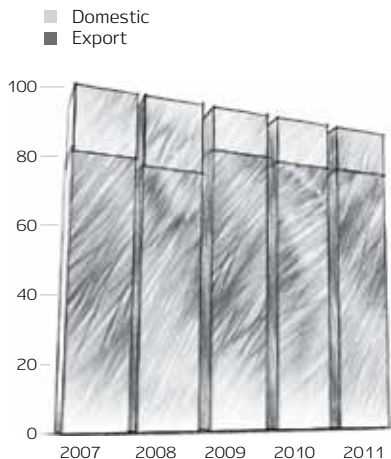
LIQUIDS SALES VOLUMES, mt



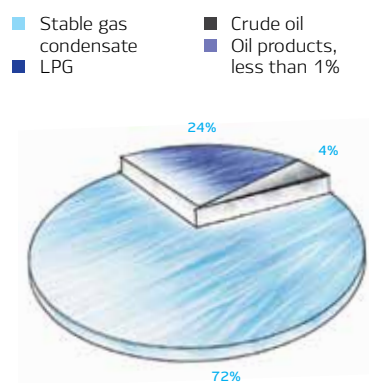
2011 BREAKDOWN OF LIQUIDS SALES VOLUMES, %



LIQUIDS SALES REVENUE MARKET DISTRIBUTION, %



2011 BREAKDOWN OF LIQUIDS SALES REVENUES, %



**Total sales** volumes of liquid hydrocarbons in 2011 amounted to 4,111 mt, a 20.9% increase over 2010 volumes, while total revenues from liquids sales increased to RR 64.7 billion, or by 46.6%, in 2011 as compared to 2010, due to the increase in sales volumes and higher benchmark pricing on international markets.

**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 2011, we loaded 2.9 mmt at the port or 19.4% more than in 2010.

**During 2011**, we sold 51 tankers of stable gas condensate, of which 22.3% were sold to markets in the USA, 43.4% to countries in the Asian-Pacific region and 34.3% to markets in Europe, accounting for over 99% of our export volumes. We had one tanker in transit at year-end.

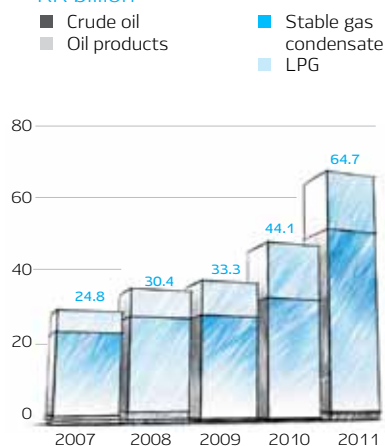
**In 2011**, NOVATEK opened the NSR's navigational period for high-tonnage tankers early, sending the first tanker on

23 June, and closed the navigational period in November. During the five month navigational period, NOVATEK transported approximately 600 thousand tons of stable gas condensate to consumers in South Korea, China and Thailand.

**The Company sells** its LPG volumes to both the export and domestic markets. In 2011, total LPG export sales volumes accounted for 51.5% of total LPG sales volumes and Novatek Polska, our wholly owned LPG trading company in Poland, was responsible for 23.6% of our total LPG export sales. NOVATEK's LPG and oil products domestic sales, through its network of retail and small wholesale stations in the Chelyabinsk and Volgograd regions, doubled in 2011 compared to 2010. The total amount of LPG sold through our domestic network of retail and small wholesale stations amounted to 10.2% of total LPG sales volumes in 2011.

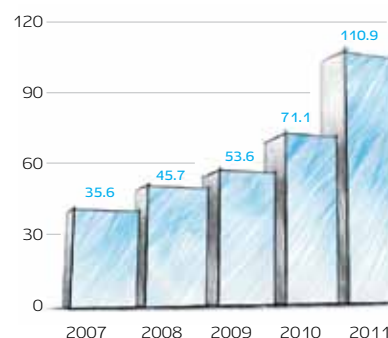
**At the end of 2011**, the Company's owned and leased rolling stock, for transportation of liquid hydrocarbons from the Purovsky Plant, totaled six thousand rail cisterns.

LIQUIDS SALES REVENUE,  
RR billion\*



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

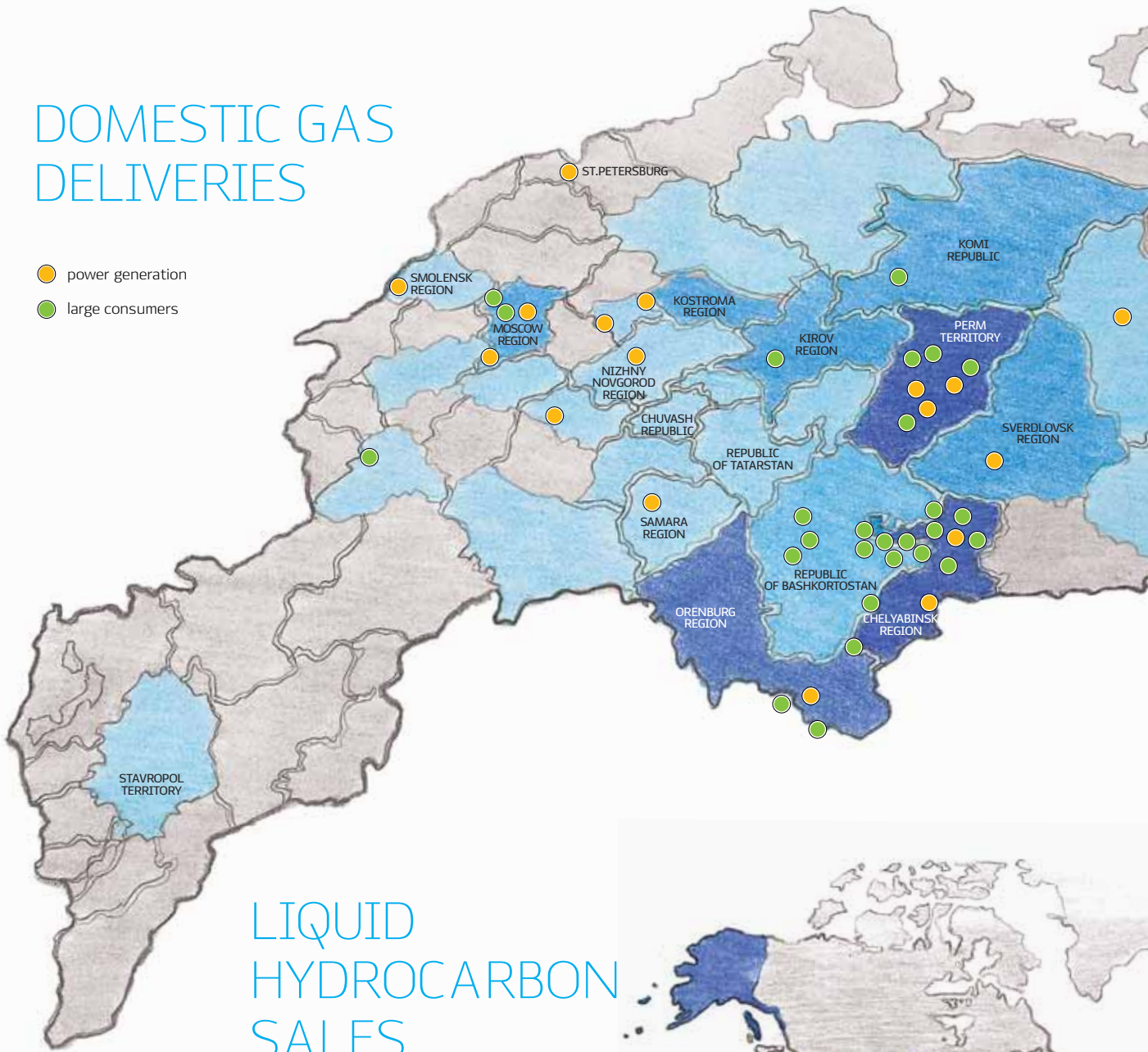
NATURAL GAS SALES REVENUE,  
RR billion\*



\* Net of VAT.

# DOMESTIC GAS DELIVERIES

- power generation
- large consumers



# LIQUID HYDROCARBON SALES

- stable gas condensate export sales
- LPG export sales
- LPG domestic sales
- crude oil export sales
- 15 approximate # of delivery days

## GAS CONDENSATE — USA

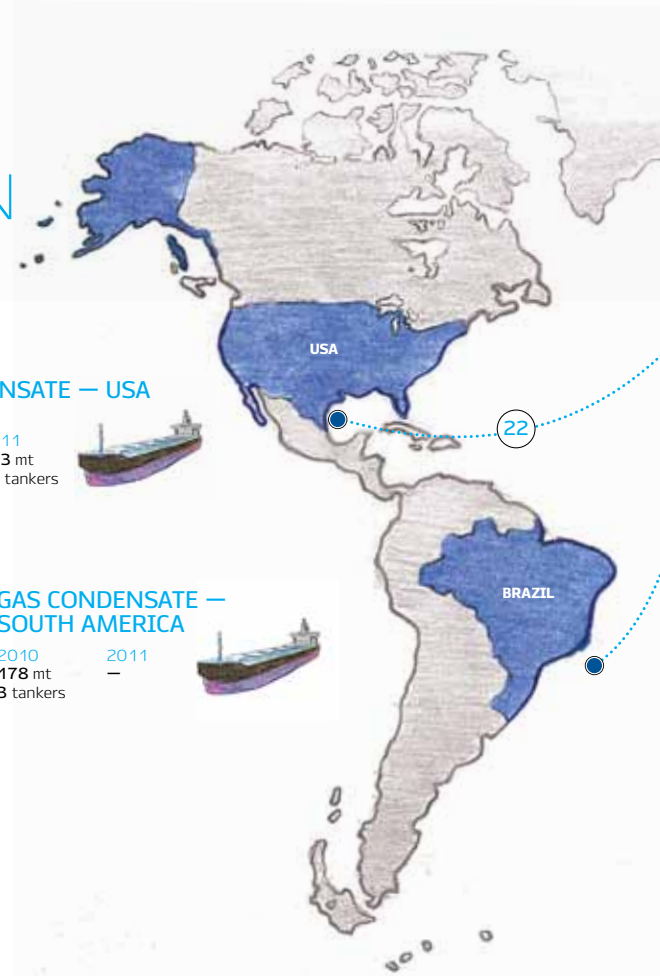
2010	2011
1,242 mt	603 mt
21 tankers	10 tankers



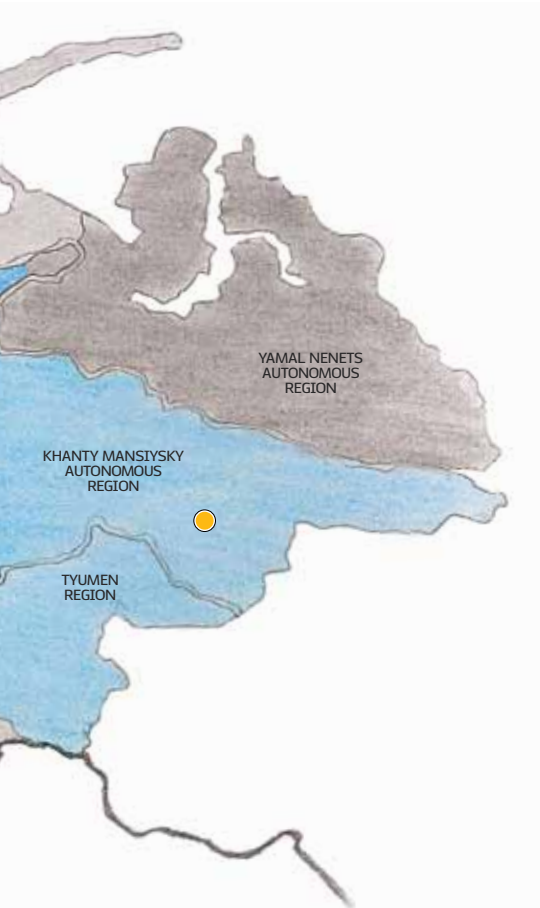
22

## GAS CONDENSATE — SOUTH AMERICA

2010	2011
178 mt	—
3 tankers	

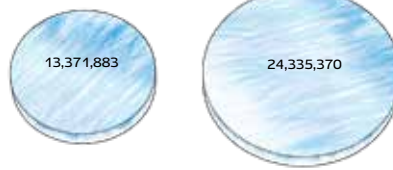




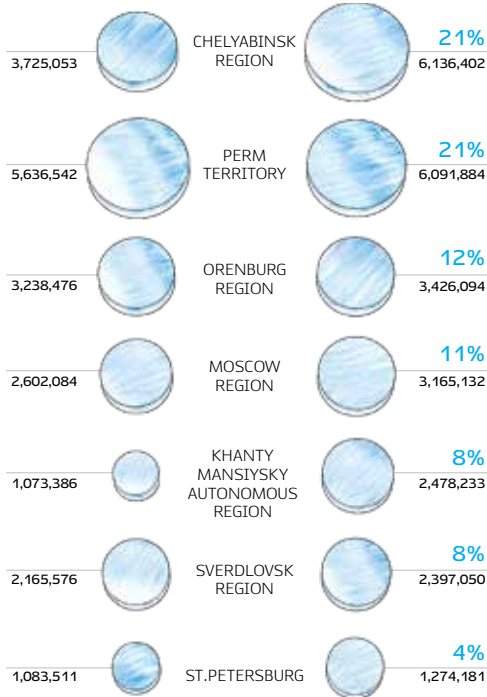


Natural Gas Sales Volumes, **mmcm**  
2010 2011

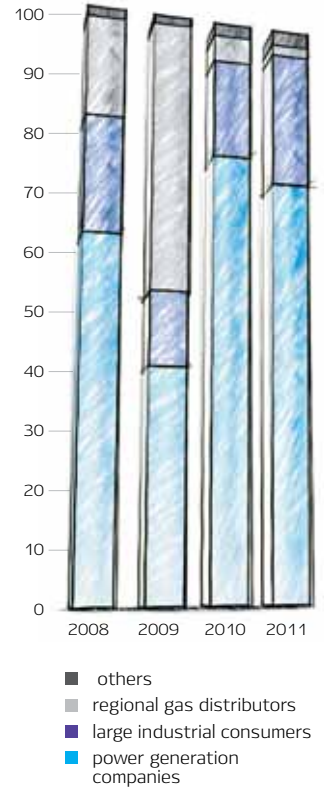
YAMAL NENETS AUTONOMOUS REGION  
(EX FIELD SALES)



End-Customer Sales Breakdown,  
% of NOVATEK's total deliveries to end-customers

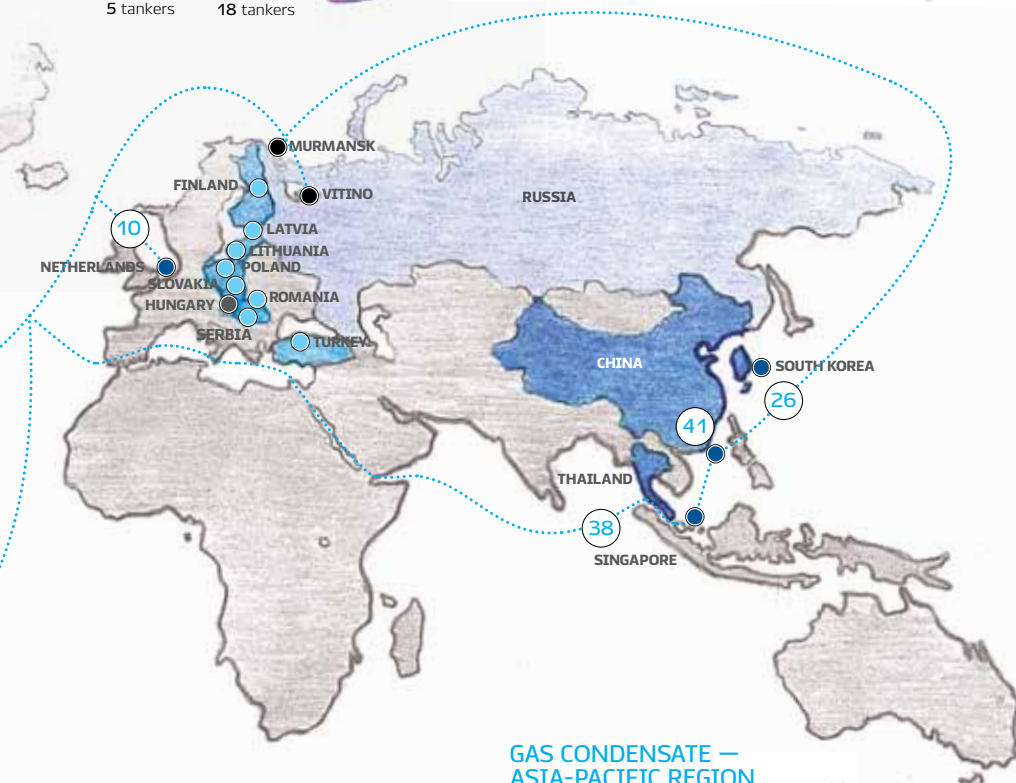


End-Customer Sales Breakdown, %



GAS CONDENSATE EUROPE

2010 2011  
299 mt 1,083 mt  
5 tankers 18 tankers



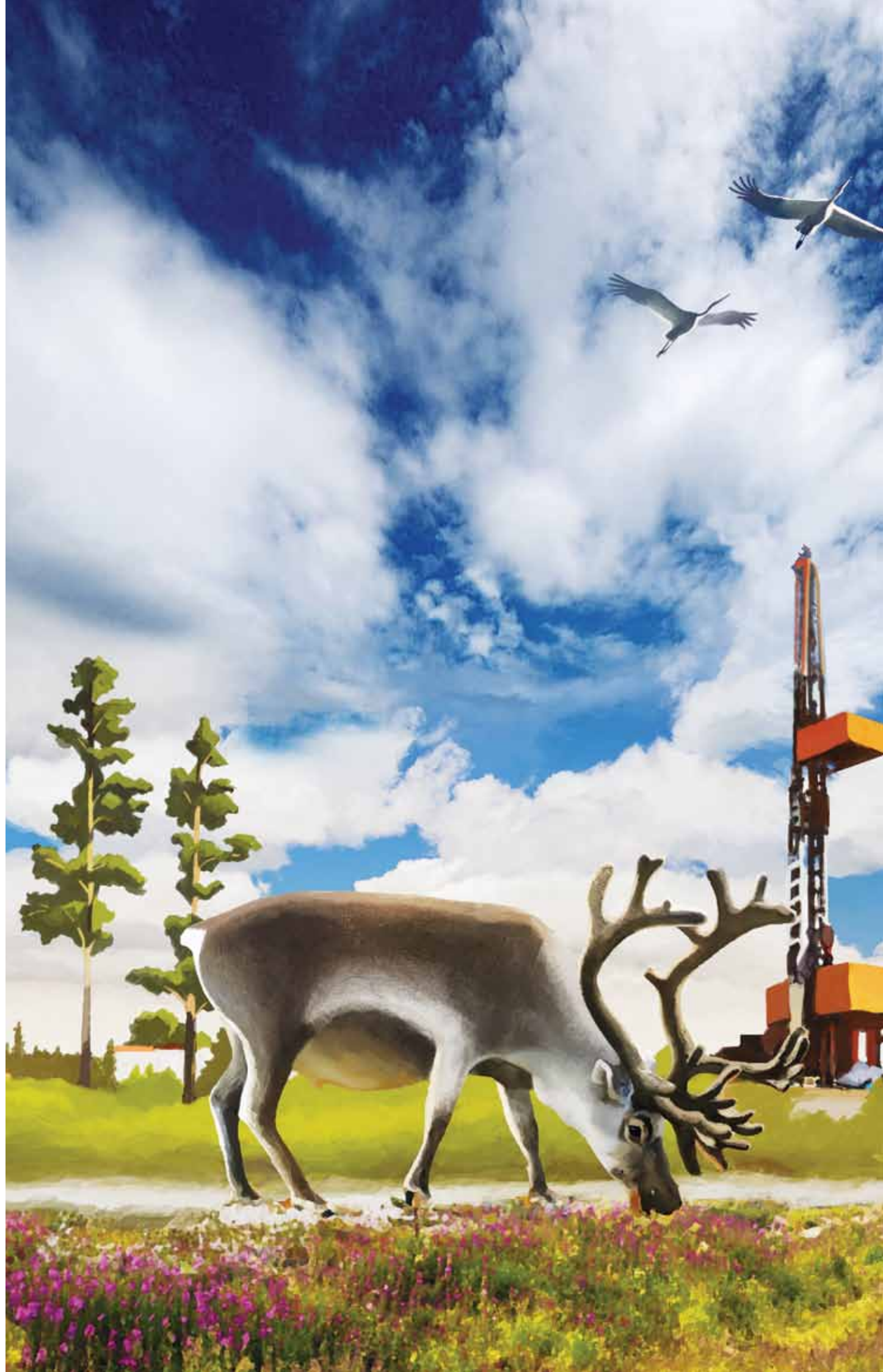
GAS CONDENSATE — ASIA-PACIFIC REGION

2010 2011  
606 mt 1,294 mt  
10 tankers 22 tankers



NOVATEK sent 9 tankers via the Northern Sea Route in 2011





## 04 Environmental and Social Responsibility

NOVATEK adheres to the principles of effective and responsible business conduct and considers the welfare of its employees and their families, environmental and industrial safety, the creation of a stable and beneficial social environment as well as contributing to Russia's overall economic development as priorities and responsibilities of the Company.

### Environmental, Health and Safety

**Innovations related** to resource efficiency and environmental safety play a significant role at NOVATEK and its subsidiaries' activities.

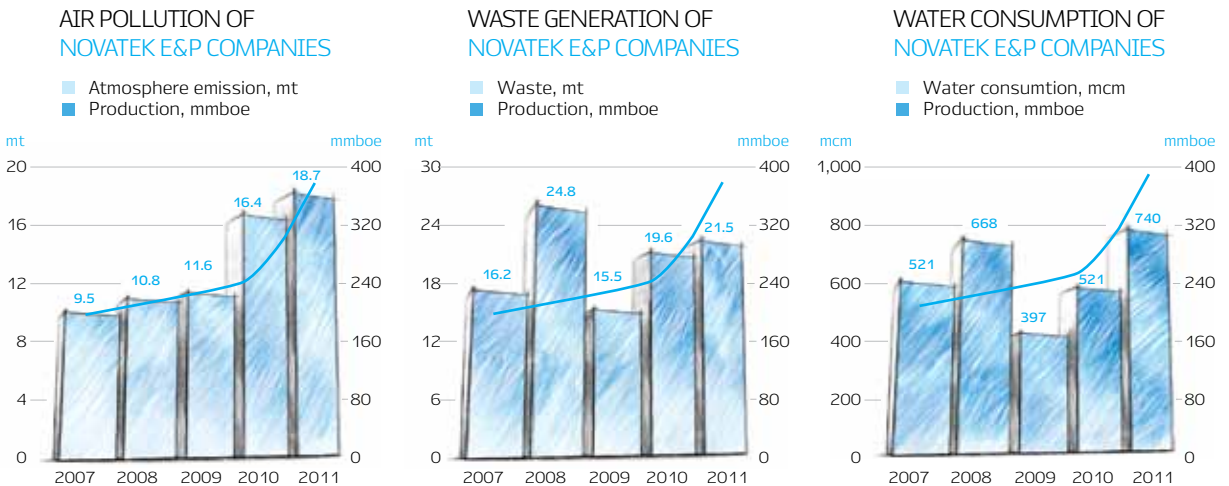
**In 2011**, the Company continued implementing a program to improve the rational use of associated petroleum gas (APG), which reduced the amount of flared APG by 114.6 mcm.

**As part of our commitment** to communities and stakeholders, NOVATEK participates in the Carbon Disclosure Project (CDP), which discloses information on greenhouse gas emissions and the energy efficiency of production on an annual basis.

**In 2011**, for the first time NOVATEK participated in the CDP Water Disclosure Project, which disclosed information on the use of water resources and the assessment of water-related risks. We support the CDP's initiatives to promote environmentally safe solutions during the implementation of investment projects and our participation in the project is aimed not only at disclosure of water use information but also at finding new solutions to the management of water-related risks in light of the impact water supply issues have on the development of the oil and gas industry.

**During the implementation** of NOVATEK's Environmental Policy, the Company reduced per unit water consumption by 12% compared to the previous year as a result of the introduction of environmentally efficient technologies at the Yurkharovskoye field, including water treatment equipment for the low-tonnage (40 mt capacity) methanol production unit. As





part of this solution, the existing river water treatment unit, which uses ultrafiltration and reverse osmosis technologies, was supplemented by a new treatment block using chemical agents. The new technology allowed the Company to reduce unit water consumption at the field by approximately 1.3 times.

**The Company provides** access to information regarding the effect of operations on the environment to the public in a wide range of federal and regional media and on the Company's website.

**As part of our ongoing** Commitment to Environmental Protection and Occupational Health and Safety, OOO NOVATEK-Transservice was certified in accordance with ISO 14001:2004 and OHSAS 18001:2007 international standards. NOVATEK's primary operating subsidiaries have already passed compliance and recertification audits of their environmental management systems in accordance with these internationally recognized standards.

**Employee training** and education are integral parts of our environmental management system. All activities related to improving the qualifications of personnel are planned, implemented and controlled both by NOVATEK and its subsidiaries and, in 2011, 2,197 employees underwent training courses.

**According to** NOVATEK's Environmental, Health and Safety (EHS) Policy (the Policy) our strategic goal is to achieve a leading position amongst oil and gas companies in the sphere of industrial and workforce safety through the implementation of best practices. In order to accomplish the goals set forth by the Policy, the Company's integrated management system is continually updated, improved and implemented at all of NOVATEK's subsidiaries.



Energy Resource Consumption in 2011<sup>1</sup>

Energy Sources	Volume	Thousands of Russian roubles, net of VAT
Natural gas, mcm	465,740.43	330,354.15
Electricity, MWh	228,868.28	707,196.15
Heating energy, Gcal	237,139.52	175,441.20
Oil, tons	-	-
Motor gasoline, tons	596.50	15,702.29
Diesel fuel, tons	3,130.56	74,788.44
Other, tons	1,023.20	3,017.74

<sup>1</sup> Company data

In 2011, the Company developed and implemented the technical specifications for the manufacture of protective clothing and these specifications will be standardized among the Company's subsidiaries and is also applicable to sub-contractors, working at our facilities. We plan to provide our employees with the new protective clothing starting in 2012.

In accordance with the requirements of the federal law "On Industrial Safety of Hazardous Production Facilities" and "Rules on the Organization and Implementation of Industrial Control for Compliance with Requirements of Industrial Safety at Hazardous Production Facilities" all of our subsidiaries have developed their own rules for the organization and implementation of industrial control for compliance with these requirements. We have also established, industrial control compliance commissions, which carry out periodic audits of departments and production facilities to comply with the EHS requirements.

The table above sets out the physical volume and Russian rouble equivalent of energy resources consumed by the Company in 2011.



## 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, and equal opportunity, and provides an open dialogue between management and personnel. NOVATEK also offers continuous, comprehensive training and professional development opportunities for the Company's employees at all levels.

**As of the end of 2011**, NOVATEK had 4,767 employees, 43% of whom work in exploration and production and 57% in plant operations, processing, transportation and sales.

### Personnel Training and Development

**In an environment** of rapidly developing technologies and management systems, our multilevel training and professional development program enables NOVATEK's workers to maintain the Company's high level of competitiveness. In 2011, the primary goals in the field of training and professional development included the following:

- Completion of the "Leadership Horizons" program for developing future managers;
- Development and implementation of the corporate program for assessment of employees' technical qualifications in the following areas: geology, field development, drilling, oil treatment, oil production technology, gas preparation, gas production technology, gas processing (synthetic methanol production), processing of deethanized gas condensate and environmental protection;
- 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.

**During the past year**, NOVATEK continued its efforts to increase employee training, improve working conditions and ensure a safe environment at its production facilities. In 2011, 43.6% of the Company's engineers and technicians completed employee certification and industrial safety courses and 35.1% of our specialists and line workers have upgraded their respective qualifications.

**NOVATEK completed** the implementation of the "Leadership Horizons" program for developing future managers and

in 2011, employees participated in the following program modules; "Economic Reasoning in Decision Making" – 65 employees, "Development Center" – 135 employees and "Basics of Finance and Management Decisions" and "Human Resources Management" – 53 employees.

**In order to improve** and develop the technical capabilities of our employees, 333 employees from our exploration and production units were tested in order to assess their technical qualifications. Based on the results, programs will be developed to ensure all of our technical employees are properly trained.

**In September 2011**, the "6th Interregional Research-to-Practice Conference" for NOVATEK's young specialists was held in Moscow and 38 of the Company'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. In addition, two winners nominated in the category "Best Implemented Project 2011" were awarded cash prizes and the top seven projects advanced to the "FEC 2010 Competition of Youth Projects" sponsored by the Russian Federation's Ministry of Energy.

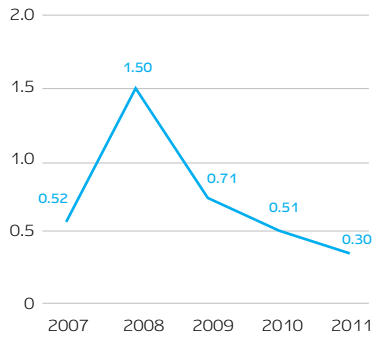
**In 2011**, three of NOVATEK's young specialists who were winners of the "FEC 2010 Competition of Youth Projects" received commendations from the Ministry of Energy.

### Social Programs

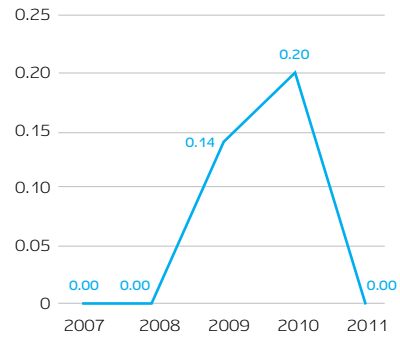
**The central feature** of NOVATEK's social policy is a systematic approach to solving social problems and supporting workers and their families. According to the Core Concept of the Company's social policy, which was adopted in 2006, the social benefits package for employees includes the following programs:

- 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.

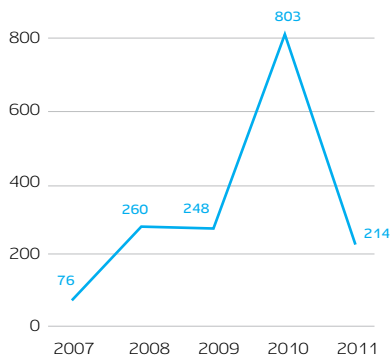
**INJURY FREQUENCY RATE**  
(no. of injuries / million working hrs)



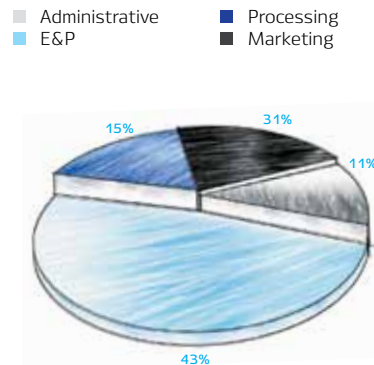
**SERIOUS INJURY FREQUENCY**  
(no. of serious injuries / million working hrs)



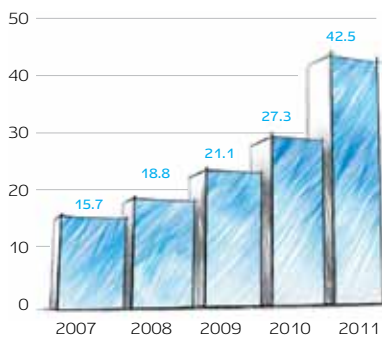
**ACCIDENT SEVERITY RATE**  
(total no. of employee working hrs lost per accident / no. of accidents)



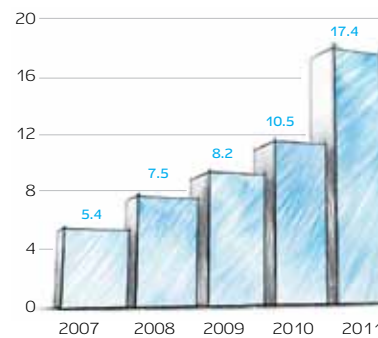
**BREAKDOWN OF PERSONNEL AS AT 31 DECEMBER 2011**



**TOTAL REVENUES PER EMPLOYEE,**  
RR million



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



## Social Policy and Charity

**During 2011**, NOVATEK continued to contribute to an improvement in the living standards of the local populations in the YNAO, Samara, Chelyabinsk and Tyumen regions. Special priority was given to the performance of our long-term agreements with the municipalities of these regions for financing programs targeting education and youth development, support for low-income families, repair and modernization of socially important facilities and preservation of the cultural heritage of the indigenous peoples of the Far North and Russia as a whole. In 2011, NOVATEK invested approximately RR 1,212 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 2011**, NOVATEK financed projects aimed at repair and construction of socially important facilities, located within trading stations, as well as to support the learning and development process of local communities in accordance to agreements with the Yamal for Descendants association and its district branches.

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

- The Association of Minority Populations of Indigenous Peoples of the Far North, Siberia, and Far East of the Russian Federation – for legal services and a workshop on adaptation for Indigenous Peoples;
- The Administration of the YNAO – for publishing services related to a book about the national peculiarities of life and customs of the Indigenous Peoples of the Far North;
- The Yamal district – for the transportation of goods to reindeer-breeders and hunters;
- The Tazov district – for construction of socially important facilities at the Yuribey and Razvilka trading stations; and
- The Nadym district – for capital construction works and infrastructure repair at the Kutopyugan village.

**During the period**, NOVATEK also created the Fund for Development of Rural Yamal to provide assistance for infrastructure improvements at Indigenous Peoples' settlements, which included the construction of a post-natal assistance station in the Yar-Sale village.

### Educational Programs

**NOVATEK continued** to develop the Company's continuing education program, which provides opportunities to gifted students, from the regions where we operate, to further their education at 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 with school #8 of Novokuybyshevsk in the Samara region, and in 2004 school #2 in Tarko-Sale in the YNAO, special classes are formed on a competitive basis from the most talented students. The program is designed for students in grades 10 and 11 who have consistently demonstrated 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. In 2011, 341 grants were awarded and a total of 1,527 grants have been awarded since the launch of the program.

**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. In 2011, 30 grants were awarded and a total of 93 grants have been awarded since the launch of the program.

**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 University, 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. This cooperation system with higher educational institutions is designed to resolve key issues confronting

the Company's Human Resources policy. The NOVATEK-VUZ program is a set of measures aimed at forming a focused high-quality five-year training program for specialists enrolled in degree programs in areas that are important to the Company's development to meet the demand for young specialists.

**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. This experience allows them to apply the knowledge obtained at lectures and seminars to real-life situations and gain experience in the professions they've chosen, while the Company receives an opportunity to meet potential employees.

### 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 continued during the 2011 period.

**NOVATEK continued** its long-term cooperation with the Russian State Museum (St.Petersburg), the Moscow Kremlin Museum, the State Tretyakov Gallery, the Multimedia Art Museum (the Moscow House of Photography Museum and Exhibition Complex), the Moscow Museum of Modern Art and the Samara Regional Art Museum.

**An exhibition jointly** sponsored by NOVATEK, the State Tretyakov Gallery and the Russian State Museum of one of the most famous artists of the 20th century, Boris Grigoriev, attracted significant attention and was well received by critics. We also continued to support the annual International Festival "Imperial Gardens of Russia", sponsored and staged by the Russian State Museum. NOVATEK was also a sponsor of the exhibition, "Mastership of the Russian Armorer", which was organized by the Moscow Kremlin Museum and the Samara Regional Art Museum.

**In 2011**, special priority was given to projects and exhibitions of modern art and NOVATEK supported the exhibition "Arte Povera", which was organized for the first time in Russia by the Multimedia Art Museum and presented works of art from the most important Italian modern artists of the second half of the 20th century. NOVATEK also became a

partner of the Moscow Museum of Modern Art in 2011 and supported the large-scale exhibition project "Impossible Community", which brought together 35 Russian and foreign painters, many of whom displayed their works in Russia for the first time.

**NOVATEK also remained** a General Partner of the Moscow Soloists Chamber Ensemble under the direction of soloist and conductor Yuri Bashmet.

### Sports Projects

**NOVATEK has continued** its support for semi-professional and high-level amateur sports programs and is the General Partner of the Dinamo Hockey Club (Moscow), the Spartak Basketball Club (St. Petersburg) and the NOVA Volleyball Team (Novokuybyshevsk). The Company also promotes corporate sponsored sporting events in soccer, volleyball, basketball and swimming, which are held annually among teams from NOVATEK and its subsidiaries. A team made up of Company employees also takes part in the annual Moscow Mini-Soccer Championship.

### Charitable Projects

**The Company continued** 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 2011**, NOVATEK also actively supported the "Gift of Life" charity fund's blood donor movement whereby the Company's Moscow office hosted a blood donor session to benefit the children of the Russian Children's Clinical Hospital.

**The activities** of the ALL TOGETHER volunteer movement, which was initially launched in 2008 by NOVATEK employees continues to provide aid and services to those in need. In 2011, dozens of our employees, their relatives as well as NOVATEK's partners participated in a number of causes including; support for orphans and children with various illnesses, veterans, orphaned animals as well as support for the blood donor movement and the organization of other charitable programs..





# 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 (Minutes No. 49 of 28 November 2001).

The Board of Directors (Minutes No. 60 of 15 December 2005) has approved the Corporate Governance Code of NOVATEK (the Code). The Code has since been elaborated on in accordance with best Russian and international practices in corporate governance, ethical norms and specific conditions for Russian public companies, local and international stock markets and in accordance with Russian legislation and the Company's Charter.

NOVATEK's Corporate Governance Code sets out the Company's business principles and is based on the respect of the rights and interests of all stakeholders and aims to guarantee that NOVATEK's activities are directed and controlled in a responsible, professional and transparent manner with the purpose of safeguarding the Company's long-term success. The principles are also intended to increase the confidence of various stakeholders in NOVATEK.



## Board of Directors

**The Company's corporate** governance system enables management to act reasonably and conscientiously and to manage NOVATEK's operating activities to the benefit of the Company while maintaining accountability to the Board of Directors and shareholders.

**We are incorporated** in the Russian Federation and our shares are listed on MICEX-RTS Stock Exchange. 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. We support high standards of corporate governance and will progressively adopt best practices in line with the Combined Code on Corporate Governance.

**Prior to 28 April 2011**, the Board of Directors (the Board) was comprised of the following members elected by the Annual General Shareholder Meeting on 27 May 2010:

- Alexander Y. Natalenko – Chairman of the Board
- Andrei I. Akimov
- Burckhard Bergmann
- Vladimir A. Dmitriev
- Mark A. Gyetvay
- Leonid V. Mikhelson
- Kirill G. Seleznev
- Gennady N. Timchenko
- Ruben Vardanian

**The power of the Board** elected on 28 April 2011 was early terminated, and the current Board members were elected at the Extraordinary General Meeting of Shareholders on 27 June 2011. The Board now is comprised of the following members:

- Alexander Y. Natalenko – Chairman of the Board
- Andrei I. Akimov
- Burckhard Bergmann
- Yves Louis Darricarrere
- Mark A. Gyetvay
- Leonid V. Mikhelson
- Kirill G. Seleznev
- Gennady N. Timchenko
- Ruben K. Vardanian



The table below sets out the current Board of Directors and their Board Committee membership:

Director	Committee membership
Alexander Y. Natalenko <sup>1</sup>	Audit Committee, Corporate Governance and Remuneration Committee
Leonid V. Mikhelson	
Andrei I. Akimov <sup>2</sup>	Audit Committee (chairman)
Burckhard Bergmann <sup>2</sup>	Corporate Governance and Remuneration Committee, Strategy and Investments Committee
Yves Louis Darricarrere <sup>2</sup>	Strategy and Investments Committee
Mark A. Gyetvay	Strategy and Investments 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

<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** 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 and is chaired by Mr. Alexander Natalenko. The Chairman is responsible for leading the Board and ensuring its effectiveness. The Board has a strong independent element and currently comprises six

non-executive directors who are considered independent according to the definition contained in the Russian Federal "Law on Joint-Stock Companies" and two non-executive directors are considered independent according to the definition contained in the UKLA Combined Code.

**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

To ensure an efficient and effective discharge of its responsibilities, the Board meets regularly, but not less than once every two months, and in 2011, held 14 meetings, six of which were by proxy.

Member	Board of Directors	Audit Committee	Corporate Governance and Remuneration Committee	Strategy and Investments Committee
Alexander Y. Natalenko <sup>1</sup>	14/14	2/2	6/6	
Leonid V. Mikhelson	14/14			
Andrei I. Akimov	14/14	4/4		
Burckhard Bergmann	14/14		6/6	3/3
Yves Louis Darricarrere <sup>2</sup>	6/6			2/2
Mark A. Gyetvay	14/14			3/3
Kirill G. Seleznev	13/14			3/3
Ruben Vardanian	14/14	4/4	6/6	
Gennady N. Timchenko	10/14			2/3

<sup>1</sup> Mr. Natalenko was elected to the Audit Committee on 27 June 2011 by approval of the Extraordinary General Meeting of Shareholders.

<sup>2</sup> Mr. Darricarrere was elected to the Board of Directors and the Strategy and Investments Committee on 27 June 2011 by approval of the Extraordinary General Meeting of Shareholders.

## Board Activities during the Year

The Board met 14 times during 2011 where the following key issues were discussed and respective decisions made:

- reviewed and approved the Company's 2010 full year operating and financial results;
- reviewed and approved NOVATEK's business plan for 2012;
- reviewed and approved NOVATEK's corporate strategy until 2020;
- approved the sale of a 20% equity interest in Yamal LNG to TOTAL S.A.;
- approved the Company's Internal Regulation on the procedure of accessing NOVATEK's insider information, the protection of its confidentiality, and the disclosure and control over the unlawful use of NOVATEK's insider information;
- approved NOVATEK's Code of Business Conduct and Ethics; and
- recommended a full year dividend for 2010, based on full year financial results, and an interim dividend for first half 2011, 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.

The Board 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 performance 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.

## Committee membership as of 31 December 2011:

	Audit Committee	Strategy and Investment Committee	Corporate Governance and Remuneration Committee
<b>Chairman</b>	<b>Andrei Akimov</b>	<b>Mark Gyetvay</b>	<b>Ruben Vardanian</b>
Members	Ruben Vardanian Alexander Natalenko	Burckhard Bergmann Yves Louis Darricarrere Gennady Timchenko Kirill Seleznev	Alexander Natalenko Burckhard Bergmann

**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.

**To ensure the Committee** discharges its responsibilities, in 2011, the Strategy and Investment Committee met three times.

### 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 2011**, the Corporate Governance and Remuneration Committee met six 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/with 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.

**In 2011**, the Audit Committee met four times, including once by absentee vote. 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 22 to the Company's 2011 IFRS consolidated financial statements.

**Audit Committee Charter** regulating the Committee's activities is available on Company's website.

## 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.

### 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.

**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.

**Members** of the Management Committee were elected by the Board of Directors (minutes No.118 as of December 3, 2009 and minutes No.113 as of March 24, 2011).

### Management Committee Members

- Leonid Mikhelson (Chairman)
- Mikhail Popov
- Vladimir Baskov
- Mark Gyetvay
- Tatyana Kuznetsova
- Iosif Levinzon
- Alexander Fridman
- Kirill Yanovskiy

## Shareholder Communications

**The Company** maintains an active dialogue with its key financial audiences, including institutional shareholders and sell-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 during 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 and presentation material from major Company events and investor seminars and conferences.

**The Board** recognizes the importance of the communication 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.

## NOVATEK Corporate Culture, Brand and Media Relations

**In 2011**, NOVATEK continued implementing a program aimed at developing the Company's corporate culture in order to give employees, specialists and managers a sense of involvement in the Company's activities, and promote a proactive attitude to their work and creative thinking. Internal corporate communication channels have been further developed to support effective program implementation.

### Corporate Media

**The main** objectives of NOVATEK's corporate media activities in 2011 were the following: to provide employees and their family members with in-depth, reliable information about the Company's activities and involve NOVATEK employees, specialists and managers in corporate cultural, sports and charitable activities.

NOVATEK's corporate newspaper, including its new supplement "NOVATEK-Family", is an effective means of communication inside the company and in 2011, as in the previous years, played an important role in achieving these objectives.

### Employee Access to Senior Management

In 2011, we continued providing opportunities for employees to meet directly with the Company's senior management. During the year, these meetings were attended by the Chairman, Deputy Chairmen and members of the Management Board. Meetings with employees took place in Moscow, Noviy Urengoy, Tarko-Sale and Tyumen at least once a quarter.

### Corporate Events: Sports, Culture and Education

In 2011, we continued to create opportunities for employees to participate in recreational and sporting activities, including competitions and social events. The number of employees who took part in corporate events has increased by approximately 20% since 2009.

More than four thousand employees and their family members spent their leisure time at exhibitions sponsored by Russia's national museums, classical music and jazz concerts as well as professional hockey, basketball and soccer matches.

### NOVATEK Image 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. At year-end 2011, NOVATEK took first place on the Transparency Rating of Russian Fuel and Energy Companies, compiled by the Agency for Political and Economic Communications. According to the judges, one of the key elements of NOVATEK's transparent information policy is effective communication with investors and shareholders as well as an active dialogue with representatives of media outlets.

#### Image and Publications

NOVATEK's image is based on five key attributes that characterize the Company. They include: **confidence** in our capabilities based on our resources, the dynamic growth

of the Company's operations and potential for social good; business **integrity**, throughout all of the Company's integrated components, from hydrocarbon exploration and production to processing and marketing to consumers; use of **innovative** and proprietary technologies; focused and clear **strategy** for implementing large-scale projects up to 2020; and **respect** for people and the environment.

During 2011, NOVATEK produced or updated the following promotional materials to highlight these attributes:

- a Company booklet;
- video clips "Ahead of the Times" and "We produce gas in Russia";
- Annual Report; and
- a booklet on the Northern Sea Route and others.

#### Exhibitions and Conferences

During 2011, NOVATEK managers and employees represented the Group at 16 exhibitions, conferences and round tables and gave eight presentations on key industry issues. One of the most important events was the First International Conference on Construction of an Ice Class Tanker Fleet, which was organized by NOVATEK. According to the conference participants, among which were heads of the relevant Russian ministries and institutions as well as scientists and businessmen from Russia, Europe and the Asian-Pacific Region, the conference was highly organized and a majority of delegates supported the suggestion of making the conference an annual event.

#### 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 information policy approved by the Board.

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.

## Securities

**Our share capital** is RR 303,630,600 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 and Russian roubles on the MICEX-RTS Stock Exchange and have an A1 listing (symbol: NVTK)

**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: N10).

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NOVATEK share price and RTS index 2011

As of the year-end NOVATEK's market capitalization was \$38 billion  
NOVATEK's GDRs on LSE outperformed RTS index in 2011 by 25%



NOVATEK GDR price since IPO  
(LSE, closing, US dollars)



## 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 Annual 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.

The amount of paid dividends accrued for the years 2006 to 2010, and for the first six months of 2011 is reported as of 31 December 2011. 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 19 March 2012, the Board of Directors of OAO NOVATEK recommended to the Annual General Meeting of Shareholders to pay dividends for FY 2011 in the amount of RR 3.5 per ordinary share or RR 35.0 per one Global Depositary Receipt (GDR), exclusive of RR 2.5 of interim dividends per ordinary share or RR 25.0 per one GDR for the first six months of 2011.

Thus, should the General Meeting of Shareholders approve the above recommended dividend, the dividends for 2011 will total six Russian roubles per ordinary share, and the total amount of dividends payable for 2011 will be 18,217,836,000 Russian roubles.

### Accrued and Paid Dividends on NOVATEK Shares for the period 2006 to 2011

Dividend Accrual Period	Amount of Dividends, RR per Share	Total Amount of Dividends Accrued, RR	Total Amount of Dividends Paid, RR
2006 <sup>1</sup>	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
2010	4.00	12,145,224,000	12,144,967,156
First 6 months of 2011	2.50	7,590,765,000	7,590,367,500

<sup>1</sup> In July 2006 the Company executed a share split in proportion of 1:1000



## 06 Additional Information

### Major Risk Factors Associated with the Company's Operations<sup>1</sup>

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 forecasted to be supplied to the export market. With the decrease of natural gas consumption in the European markets, Gazprom 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 Company 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 de-

<sup>1</sup>The complete review of the Company's risks is available at NOVATEK's site: [www.novatek.ru/eng](http://www.novatek.ru/eng)

nominated 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 gas condensate under spot contracts. Gas condensate volumes sold to the US, European and Asian Pacific markets are based on benchmark reference prices of WTI and Brent 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 WTI and 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. Almost 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.

**This factor** is not considered a major risk to our business 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 Global Financial Crisis

**The main risks** relating to the impact of global financial crisis are Russian 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 Russian 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 2011, the Company has not consummated any major transactions or transactions to be approved pursuant to the Company's Charter.

In 2011, the Company consummated the following transactions where the scope of obligations totals 10 or more percent of the Company's assets' book value according to its financial statements for the last accounting quarter preceding the transaction date:

**1. Non-Revolving Credit Facility Agreement** between OAO Sberbank of Russia (the "Lender") and OAO NOVATEK (the "Borrower").

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

- Provision of a non-revolving credit facility to finance operating costs and financial activities including the provision and repayment of loans, acquisition of shareholdings / equity participation in companies' share capital, repayment of credits provided by other banks;
- Loan amount: up to RR 40,000,000,000 (Forty billion);
- Loan term: up to 3 (three) years;
- Availability period: before 14 March 2012;
- The transaction amount comprises 16.5% of the Company's assets value.

The transaction was approved by NOVATEK's Board of Directors (Minutes № 144 of 23.12.2011).

**2. Deed of Guarantee** between OAO NOVATEK (the "Sponsor") and JSCB Bank of Moscow (OAO) (the "Bank").

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

**Guarantor:** JSCB Bank of Moscow (OAO);

**Sponsor:** OAO NOVATEK;

**Principal:** OOO NOVATEK Severo-Zapad;

**Scope of the Transaction:** The Sponsor shall be jointly and fully liable to the Guarantor for the performance of the Principal's obligations under the Bank Guarantee Agreement entered into by and between the Guarantor and the Principal;

- Bank Guarantee amount: up to RR 26,000,000,000 (Twenty six billion).
- Bank Guarantee duration: not more than 300 days from the date of guarantee provision.

**Beneficiaries** under the Bank Guarantee: the entities selling the ordinary registered shares in OAO Sibneftegas in accordance with the Principal's Mandatory Offer to acquire issuable securities of OAO Sibneftegas.

The transaction was approved by NOVATEK's Board of Directors (Minutes № 130 of 08.12.2010).

In 2011, the Company consummated one related party transaction the amount of which exceeds 2 percent of the Company's assets' book value as of the last accounting date:

**Amendment Agreement** to the Gas Transportation Services Agreement №22NPtr/k-2004 of 06.10.2003 between OAO NOVATEK and OAO Gazprom.

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

- Provision of services to OAO Gazprom for the transportation of gas owned by OAO NOVATEK through the territory of the Russian Federation and the Republic of Kazakhstan from Yurkharovskoye, Khancheyskoye, East-Tarkosalinskoye, Sterkhovoye, Yumantylskoye, Beregovoye and Pyreinoye fields and from/to Punginskoye, North-Stavropolskoye and Kasimovskoye UGS.
- Services provision period: from 1 January 2012 to 31 December 2015.
- Gas transportation volume: 140,000,000,000 m<sup>3</sup>.
- Price of services: RR 227,444,888,000 (Two hundred twenty seven billion four hundred forty four million eight hundred eighty eight thousand) incl. an 18% VAT. The price of services is calculated for the Contract duration based on the forecasted increase in tariffs for gas transportation via trunk pipelines.

**Interested parties:** NOVATEK's Board Member Seleznev Kirill Gennadievich is a member of OAO Gazprom's Management Board; NOVATEK's Board Member, Burckhard Bergmann, is a member of OAO Gazprom's Management Board.

The transaction was approved by NOVATEK's AGM (Minutes № 112 of 28.04.2011).

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

### MR. ALEXANDER Y. NATALENKO

**Chairman of NOVATEK's Board of Directors and member of its Audit Committee and its Corporate Governance and Remuneration Committee**

Born in 1946

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 Audit Committee and Corporate Governance and Remuneration 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

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

Born in 1953

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 a member of the Board of Directors of ZAO Gerosgaz, Carbon Trade & Finance SICAR S.E. and Chairman of the Supervisory Board of Gazprombank (Switzerland) Ltd. Since June 2011, Mr. Akimov has been a member of the Board of Directors of OAO Gazprom and since October 2011, he has been the Chairman of the Board of Directors of OAO Rosneftegaz. Currently, he is a Chairman of Audit Committee of OAO NOVATEK.

### DR. BURCKHARD BERGMANN

**Member of NOVATEK's Board of Directors, its Corporate Governance and Remuneration Committee and its Strategy and Investments Committee, Member of the Advisory Board of the Union of German Science Funds**

Born in 1943

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 Jülich 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. 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, Commerzbank AG, E.ON Energie AG, Contilia GmbH, Telenor ASA. In addition, he is a member of the Advisory Boards for Dana Gas International, Akkumulatorenwerke Hoppecke Carl Zoellner & Sohn GmbH, IVG Immobilien AG. He has been elected as Chairman of the Advisory Board of Jaeger Beteiligungsgesellschaft mbH & Co KG.

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 Direc-

tor of the Year, Moscow (2007). In June 2011, by means of presidential Decree he became a recipient of the Order of the Friendship of Peoples award for significant contribution in development of the Russian-German relations.

#### MR. RUBEN VARDANIAN

**Member of NOVATEK's Board of Directors, Chairman of its Corporate Governance and Remuneration Committee and member of its Audit Committee**

Born in 1968

Ruben Vardanian is Co-head of the Corporate Investment Unit and Head of Wealth Management of Sberbank of Russia. Mr. Vardanian is working at Troika Dialog since its foundation in 1997, now he is President of Troika Dialog. Prior to closing the deal to merge Sberbank of Russia and Troika Dialog in January 2012 he was Chairman of the Board of Directors of Troika Dialog.

Mr. Vardanian is a Board member of several companies: OAO AvtoVAZ, OAO KAMAZ, OAO NOVATEK, ZAO SIBUR Holding, Joule Unlimited, Inc (a pioneer in production of renewable fuel based on solar energy) and others. He is also Board Chairman of several companies: OAO Rosgosstrakh, AmeriaBank, OAO Russian Ventures Company.

Mr. Vardanian is Co-founder of the Moscow-based Skolkovo School of Management and is represented on its Coordinating Council. The school was established on the initiative of Mr. Vardanian and several Russian businessmen. Between 2006 and 2011, Mr. Vardanian was President of the Skolkovo School of Management.

Mr. Vardanian is also a member of the President's Council on Implementation of National Projects and Demographic Policy, President's International Advisory Committee on Establishment of International Financial Center in the Russian Federation. He is a member of the RF Government's Competition and Entrepreneurship Council.

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 for three consecutive years (rating by the "Kommersant" newspaper and Managers Association).

Mr. Vardanian, graduated with honors from Moscow State University with a degree in Economics. In 2000, he also

completed executive management courses at INSEAD (Fontainebleau, France) and, in 2001 and 2005, he completed the courses at Harvard Business School (USA).

#### MR. MARK A. GYETVAY

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

Born in 1957

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. 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 a Chairman of the Strategy and Investments Committee of NOVATEK's Board of Directors. Since 2003, he has been Chief Financial Officer and, in August 2007, Mr. Gyetvay was elected to NOVATEK's Management Board and, in July 2010, he became Deputy Director of NOVATEK's Management Board.



**MR. YVES LOUIS CHARLE JUSTIN DARRICARRERE**

**Executive Vice President, Total S.A., President, Total Exploration & Production, Member of NOVATEK's Board of Directors and its Strategy and Investments Committee**

Born in 1951

After two years lecturing at the Ecole Nationale Supérieure des Mines de Paris, Yves-Louis Darricarrère began his career in Elf Aquitaine in 1978, first in the Mining Division in Australia and later in the Exploration & Production Branch, where he was appointed successively Country Representative for Australia and Egypt at head office; Managing Director of the subsidiaries in Egypt and Colombia; Director Business development and new ventures, then Finance Director of the Exploration & Production Branch and of the Oil and Gas directorate. In 1998, he was appointed Deputy Director-General of Elf Exploration-Production responsible for Europe and the United States and was nominated a member of the Management Committee of Elf-Aquitaine.

In 2000, he was appointed Senior Vice-President for Exploration & Production Northern Europe and became a member of the Total Group Management Committee.

On 1 September 2003, Yves-Louis Darricarrère was nominated to the Group's Executive Committee and was appointed President of Total Gas & Power, and on 14 February 2007, he became President of Total Exploration & Production.

Yves-Louis Darricarrère is a graduate of the Ecole Nationale Supérieure des Mines and the Institut d'Etudes Politiques in Paris and holds a master's degree in economic science. He is Chevalier de la Légion d'Honneur (Knight of the French Legion of Honour).

**MR. LEONID V. MIKHELSON**

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

Born in 1955

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".

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 and Chairman of the Board of Directors of OAO Stroytransgas. From 2008 to 2011 he was a member of the Board of Directors of OOO Art Finance. He is the Chairman of the Board of Directors of ZAO SIBUR Holding and a member of the Supervisory Board of the OAO Russian Regional Development Bank. Mr. Mikhelson is the recipient of the Russian Federation's Order of the Badge of Honor.

**MR. KIRILL G. SELEZNEV**

**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**

Born in 1974

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.

## Shares in NOVATEK's equity capital held by Members of the Company's Board of Directors<sup>1</sup>

	Share in equity capital and number of ordinary shares	
	Share as of 31 December 2011, %	Number of ordinary shares
Natalenko A.Y.	-	-
Akimov A.I.	-	-
Bergmann B.	0.0007	20,000
Vardanian R.K.	-	-
Gyetvay M.	-	-
Darricarrere Y-L.	-	-
Mikhelson L.V.	0.4686	14,228,940
Seleznev K.G.	-	-
Timchenko G.N.	-	-

<sup>1</sup> Share information is based on NOVATEK's shareholder register in compliance with Russian law.

### MR. GENNADY TIMCHENKO

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

Born in 1952

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 was 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. Mr. Timchenko is also the Chairman of the Board of Directors and President of the Ice Hockey Club SKA St-Petersburg.

## Information on Members of NOVATEK's Management Committee

### LEONID VIKTOROVICH MIKHELSON

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

Born in 1955

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

### VLADIMIR ALEKSEEVICH BASKOV

**Deputy Chairman of NOVATEK's Management Committee**

Born in 1960

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 2003 he was appointed Director of the Business Support Department for NOVATEK. In 2005 he was appointed Deputy Chairman of NOVATEK's Management Board and in August 2007 he became a member of NOVATEK's Management Board.

### MARK ANTHONY GYETVAY

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

Born in 1957

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

### TATYANA SERGEEVNA KUZNETSOVA

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

Born in 1960

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 Purneftegasegeologiya. In 1998, she was appointed Deputy General Director of OAO Nordpipes. Since 2002, she has been Director of the Legal Department for NOVATEK. Since 2005, she has been the Deputy Chairman of NOVATEK's Management Committee - Director of NOVATEK's Legal Department and in August 2007, she became a member of NOVATEK's Management Committee.

### IOSIF LIPATIEVICH LEVINZON

**Deputy Chairman of NOVATEK's Management Committee**

Born in 1956

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 Purneftegasegeologiya. 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 he 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.

### MIKHAIL VIKTOROVICH POPOV

**First Deputy Chairman of NOVATEK's Management Committee, Commercial Director**

Born in 1969

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. In 2004, Mr. Popov was elected First Deputy Chairman of NOVATEK's Management Committee. Since August 2007, he has been a member of the Management Committee and since May 2011, he has been NOVATEK's First Deputy Chairman-Commercial Director.

### ALEXANDER MIKHAILOVICH FRIDMAN

**Deputy Chairman of NOVATEK's Management Committee**

Born in 1951

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 2004, Mr. Fridman was elected Deputy Chairman of the Management Committee of OAO NOVATEK. In August 2007, he has been a member of NOVATEK's Management Committee.

#### KIRILL NIKOLAYEVICH YANOVSKIY

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

Born in 1967

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 August 2007, Mr. Yanovskiy was elected to NOVATEK's Management Committee and in 2007 he was appointed Deputy Director for Finance and Development Strategy Department. Since May 2011 he has been Director for Finance and Development Strategy Department.

## Shares in NOVATEK's equity capital held by Members of the Company's Management Committee<sup>1</sup>

	Share in equity capital and number of ordinary shares	
	Share as of 31 December 2011, %	Number of ordinary shares
Mikhelson L.V.	*information is given in the section on the Board of Directors	
Baskov V.A.	0.0288	874,408
Gyetvay M.	-	-
Kuznetsova T.S.	0.1944	5,903,035
Levinzon I.L.	-	-
Popov M.V.	0.1440	4,372,038
Fridman A.M.	0.0751	2,281,049
Yanovskiy K.N.	0.1051	3,192,530

<sup>1</sup> Share information is based on NOVATEK's shareholder register in compliance with Russian law.

## Information on remuneration of Members of the Company's Board of Directors and Management Committee in 2011

Payment Description	Board of Directors <sup>1</sup>	Management Committee
<b>Total paid, RR</b>	<b>103,504,508</b>	<b>1,510,548,476</b>
including:		
Salaries, RR		400,531,813
Bonuses, RR		839,379,736
Fees, RR	103,253,726	-
Other property advancements	250,782	270,636,927

<sup>1</sup> 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.

**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 OAO NOVATEK 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.

# 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 2011 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2011 and 2010. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

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

### **OVERVIEW**

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

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

### **RECENT DEVELOPMENTS**

In November 2011 and December 2010, the Group acquired OOO Gazprom mezhregiongas Chelyabinsk ("Gazprom mezhregiongas Chelyabinsk") and OOO Yamalgazresurs-Chelyabinsk, respectively, two natural gas traders serving the Chelyabinsk Region of the Russian Federation, to support and expand the Group's regional natural gas sales commercial operations.

In September 2011, the Group increased its equity interest in Yamal LNG from 51% to 100% and subsequently disposed of a 20% interest in the company in October 2011 to TOTAL S.A., the Group's strategic partner in the Yamal LNG project.

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

In June 2011, we dispatched a consignment of stable gas condensate to China via the Northern Sea Route ("NSR") using a new route north of the New Siberian Islands making us the first company to utilize the NSR in the 2011 navigational period. We shipped a total of nine cargos, or more than 600 thousand tons of stable gas condensate, produced by the Purovsky Gas Condensate Plant ("Purovsky Plant"), to markets in the Asian-Pacific region ("APR") via the NSR in 2011.

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

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

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

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

In July 2010, we created a 50/50 joint venture, OOO Yamal Development (“Yamal Development”), with OAO Gazprom Neft to jointly develop potential hydrocarbon assets in the YNAO. In November 2010, Yamal Development acquired a 51% participation interest in OOO SeverEnergiya (“SeverEnergiya”), those subsidiaries hold licenses for the development of oil and gas condensate fields (Samburgskoye, Yaro-Yakhinskoye, North-Chaselskoye, Urengoiszkoye and other fields) in the YNAO. SeverEnergiya’s proved reserves as appraised by D&M under the SEC and PRMS reserves methodologies, as of 31 December 2010, totaled approximately 224 and 245 billion cubic meters of natural gas and 39 and 42 million tons of liquid hydrocarbons, respectively.

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

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

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

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

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

## SELECTED DATA

<i>millions of Russian roubles except as stated</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>Financial results</b>			
Total revenues (net of VAT and export duties)	176,064	117,024	50.5%
Operating expenses	(97,665)	(68,518)	42.5%
Profit attributable to shareholders of OAO NOVATEK	119,655	40,533	195.2%
Profit attributable to shareholders of OAO NOVATEK, excluding net gain on disposal	56,707	39,204	44.6%
EBITDA <sup>(1)</sup>	148,349	57,506	158.0%
Normalized EBITDA <sup>(2)</sup>	85,401	56,177	52.0%
Normalized EBITDAX <sup>(3)</sup>	87,220	57,772	51.0%
Earnings per share (in Russian roubles)	39.45	13.37	195.1%
Normalized Earnings per share (in Russian roubles) <sup>(4)</sup>	18.69	12.93	44.6%
<b>Operating results</b>			
Natural gas sales volumes (million cubic meters)	53,667	37,117	44.6%
Stable gas condensate sales volumes (thousand tons)	2,984	2,330	28.1%
Liquefied petroleum gas sales volumes (thousand tons)	880	876	0.5%
Crude oil sales volumes (thousand tons)	242	185	30.8%
Oil product sales volumes (thousand tons)	5	10	(50.0%)
Total hydrocarbons production (million barrels of oil equivalent) <sup>(5)</sup>	380.6	274.0	38.9%
Total daily production (thousand barrels of oil equivalent per day) <sup>(5)</sup>	1,043	751	38.9%
<b>Cash flow results</b>			
Net cash provided by operating activities	71,907	44,863	60.3%
Capital expenditures	31,143	26,030	19.6%
Free cash flow <sup>(6)</sup>	40,764	18,833	116.4%

<sup>(1)</sup> EBITDA represents profit (loss) attributable to shareholders of OAO NOVATEK adjusted for the addback of net impairment expense, income tax expense and finance income (expense) from the Consolidated Statement of Income, and depreciation, depletion and amortization and share-based compensation from the Consolidated Statement of Cash Flows.

<sup>(2)</sup> Normalized EBITDA excludes net gain on disposal of interest in subsidiaries.

<sup>(3)</sup> Normalized EBITDAX represents EBITDA as adjusted for the addback of exploration expenses and excludes net gain on disposal of interest in subsidiaries.

<sup>(4)</sup> Normalized Earnings per share represents Earnings per share adjusted for net gain on disposal of interest in subsidiaries.

<sup>(5)</sup> Total hydrocarbons production and total daily production are calculated based on net production, including our proportionate share in the production of our joint venture.

<sup>(6)</sup> Free cash flow represents the excess of Net cash provided by operating activities over Capital expenditures.

Reconciliation of normalized EBITDA and EBITDAX to profit (loss) attributable to shareholders of OAO NOVATEK is as follows for the years ended 31 December 2011 and 2010:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Profit (loss) attributable to shareholders of OAO NOVATEK</b>	<b>119,655</b>	<b>40,533</b>
Depreciation, depletion and amortization	9,475	6,757
Net impairment expense	782	541
Total finance income (expense)	2,703	(1,197)
Total income tax expense	15,734	10,804
Share-based compensation	-	68
<b>EBITDA</b>	<b>148,349</b>	<b>57,506</b>
Less: Net gain on disposal of interest in subsidiaries	(62,948)	(1,329)
<b>Normalized EBITDA</b>	<b>85,401</b>	<b>56,177</b>
Exploration expenses	1,819	1,595
<b>Normalized EBITDAX</b>	<b>87,220</b>	<b>57,772</b>

## SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate, Russian roubles for one US dollar</i>	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change Y-o-Y, %
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	
At the beginning of the period	30.48	30.24	28.43	29.36	28.08	31.20	31.88	30.40	30.48	30.24	0.8%
At the end of the period	28.43	29.36	28.08	31.20	31.88	30.40	32.20	30.48	32.20	30.48	5.6%
Average for the period	29.27	29.89	27.99	30.24	29.05	30.62	31.23	30.71	29.39	30.37	(3.2%)

<i>Crude oil prices, USD / bbl</i>	1 quarter		2 quarter		3 quarter		4 quarter		Year		Change Y-o-Y, %
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	
<b>WTI <sup>(1)</sup></b>											
At the end of the period	106.7	83.8	95.4	75.6	79.2	80.0	98.8	91.4	98.8	91.4	8.1%
Average for the period	94.6	78.9	102.3	78.1	89.5	76.2	94.1	85.2	95.1	79.6	19.5%
<b>Brent <sup>(2)</sup></b>											
At the end of the period	116.9	80.3	111.5	75.0	105.2	81.0	106.5	92.5	106.5	92.5	15.1%
Average for the period	105.4	76.4	117.0	78.2	113.4	76.9	109.4	86.4	111.3	79.5	40.0%
<b>Urals <sup>(2)</sup></b>											
At the end of the period	113.1	78.2	110.1	74.3	102.3	79.9	104.3	90.3	104.3	90.3	15.5%
Average for the period	102.6	75.4	113.7	76.9	111.5	75.6	108.7	85.1	109.1	78.3	39.3%

<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, %
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	
<b>Crude oil, stable gas condensate</b>											
At the end of the period	365.0	253.6	462.1	292.1	444.1	273.5	406.6	303.8	406.6	303.8	33.8%
Average for the period	343.0	263.8	446.5	281.7	442.5	262.0	403.7	287.0	408.9	273.6	49.5%
<b>LPG</b>											
At the end of the period	150.2	80.0	189.8	27.3	192.0	45.2	221.8	118.1	221.8	118.1	87.8%
Average for the period	166.1	63.7	137.0	48.4	182.6	34.3	218.3	98.5	176.0	61.2	187.6%

<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**

We continue to witness signs of economic instability in the Euro-Zone that have prolonged a period of market volatility. The second Greek bailout package and the potential threat to the European banking community of a sovereign-debt crisis in the European Union has been the main driver of the market volatility. The recent wave of market uncertainty may continue to negatively impact all borrowers by limiting access to the capital markets as well as causing continued volatility in the equity and currency markets, especially for those companies operating in the so-called “emerging markets”.

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

We have reviewed our capital expenditure program for the 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 Group commensurate with our investment grade credit ratings and our capital requirements.

### **Natural gas prices**

As an independent natural gas producer, we are not subject to the Russian Government’s regulation of natural gas prices, 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 2011, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RR 320 per mcm, or 13.9%, to RR 2,619 per mcm compared to RR 2,299 per mcm in 2010.

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

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

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015 but there are various Governmental discussions indicating that this program may be further extended. The regulation of the domestic natural gas price prior to 2015 will be based on the netback parity of natural gas prices on the domestic and export markets. According to the revised Forecast of Socio-economic Development of the Russian Federation for 2012 announced in September 2011, the regulated natural gas prices will be increased by 15% effective from 1 July 2012, as well as an expected increase of 15% in 2013 and 2014. We expect that the FTS will continue to approve the effective increase on an annual basis and reserves the right to modify the percentages published, as well as potentially prolong the timetable toward market price liberalization based on market conditions and other factors.



In 2011, our average natural gas price to end-customers (excluding trading activities) and ex-field price increased by 13.7% and 14.9%, respectively, whereas our average transportation expense for the delivery of natural gas to end-customers (excluding trading activities) increased by 7.9% primarily due to a 9.3% increase in the average transportation tariff set by the FTS (see “Transportation tariffs” below). As a result, our average netback price on end-customers sales (excluding trading activities) increased by 19.2%, while our total average natural gas price excluding transportation expense increased by 17.3% compared to respective prices in 2010.

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

The following table shows our average realized natural gas sales prices excluding trading activities (net of VAT) for the years ended 31 December 2011 and 2010:

<i>Russian roubles per mcm</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
Average natural gas price to end-customers <sup>(4)</sup>	2,627	2,310	13.7%
Average natural gas transportation expense for sales to end-customers	(1,207)	(1,119)	7.9%
Average natural gas netback price on end-customer sales	1,420	1,191	19.2%
Average natural gas price ex-field (wholesale traders)	1,392	1,211	14.9%
<b>Total average natural gas price excluding transportation expense</b>	<b>1,407</b>	<b>1,199</b>	<b>17.3%</b>

<sup>(4)</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. In 2011, the average benchmark crude oil prices were more than 20% higher than in 2010.

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

In 2011, our stable gas condensate export delivery terms were delivery at point of destination (DAP), or priced at cost, insurance and freight (CIF), or cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or delivery at terminal (DAT), while in 2010 our delivery terms were either DES, CIF, or CFR. Our average stable gas condensate export contract price, including export duties, in 2011 was approximately USD 931 per ton compared to approximately USD 692 per ton in 2010.

In 2011, our crude oil export delivery terms were DAP Feneshtitke, Hungary, while in 2010 our delivery terms were delivery at frontier (DAF, Feneshtitke, Hungary). Our average crude oil export contract price, including export duties, was approximately USD 787 per ton compared to USD 557 per ton in 2010.

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 2011 and 2010 (prices in US dollars were translated from Russian roubles using the average exchange rate for the period):

<i>Russian roubles or US dollars per ton</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>Stable gas condensate</b>			
Net export price, RR per ton	15,676	12,778	22.7%
Net export price, USD per ton	533.4	420.8	26.8%
Domestic price, RR per ton	13,818	10,022	37.9%
<b>Crude oil</b>			
Net export price, RR per ton	10,983	8,538	28.6%
Net export price, USD per ton	373.7	281.2	32.9%
Domestic price, RR per ton	9,792	7,523	30.2%

In 2011, our LPG export delivery terms were DAP at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia) and free carrier (FCA) at terminal points in Poland, compared to DAF (at the border of the customer's country), CPT (the Port of Temryuk) and FCA (terminal points in Poland) in 2010. In 2011, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately USD 904 per ton compared to USD 619 per ton in 2010.

In 2011, as well as in 2010, we were obliged to sell a portion of our LPG sales volumes on the domestic market at regulated prices, while the remaining portion of our sales was sold under commercial terms. In 2011, we sold a total of 58 thousand tons of LPG on the domestic market at the regulated price of RR 7,605 per ton, while in 2010, we sold 53 thousand tons at the regulated price of RR 6,557 per ton. In 2011, we sold 368 thousand tons at an average commercial price of RR 13,822 per ton, including volumes sold through our wholly owned subsidiary OOO NOVATEK-Refueling Complexes, compared to 389 thousand tons at an average commercial price of RR 11,167 per ton in 2010.

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

<i>Russian roubles or US dollars per ton</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>LPG</b>			
Net export price, RR per ton	21,401	18,433	16.1%
Net export price, USD per ton	728.2	606.9	20.0%
Domestic commercial price, RR per ton	13,822	11,167	23.8%
Domestic regulated price, RR per ton	7,605	6,557	16.0%
<b>Oil products</b>			
Domestic price, RR per ton	-	6,773	n/a
<b>Methanol</b>			
Domestic price, RR per ton	10,000	-	n/a

## **Transportation tariffs**

### *Natural gas*

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

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

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

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

According to the announcement from the FTS in September 2011, the transportation tariff for natural gas will be increased as of the same date as the increase in the regulated natural gas prices, effective from 1 July 2012, with a range of between 6% to 12%.

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

### *Crude oil*

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

### *Stable gas condensate and LPG*

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

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

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

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

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

### **Our tax burden**

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

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

According to amendments to the Russian Tax Code, approved in November 2011, the UPT rate for gas condensate was set at RR 556, RR 590 and RR 647 per ton for 2012, 2013 and 2014, respectively. In 2011 and 2010, the UPT rate for gas condensate was set at 17.5% of gas condensate revenues recognized by the producing entities.

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 ("D&M"). The Group's total proved reserves, comprised of proved developed and proved undeveloped reserves as of 31 December 2011 and 2010, 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 a comparison of the Group's estimated reserves under SEC and PRMS classifications attributable to all consolidated subsidiaries and joint ventures *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>Based on our equity ownership interest in the fields</i>	<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>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>(1)</sup>	(426)	(12)	(426)	(12)
Reclassifications <sup>(2)</sup>	(444)	(13)	(444)	(13)
Production	(1,314)	(37)	(1,314)	(37)
<b>Total proved reserves at 31 December 2010</b>	<b>34,358</b>	<b>973</b>	<b>38,519</b>	<b>1,091</b>
<i>Equity share of total proved reserves at 31 December 2010</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>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	2,238	64	2,918	82
Acquisitions <sup>(3)</sup>	8,161	231	11,861	336
Disposals <sup>(1)</sup>	(3,331)	(95)	(4,841)	(137)
Reclassifications <sup>(2)</sup>	(13,323)	(377)	(19,364)	(548)
Production	(1,676)	(48)	(1,676)	(48)
<b>Total proved reserves at 31 December 2011</b>	<b>26,427</b>	<b>748</b>	<b>27,417</b>	<b>776</b>
<i>Equity share of total proved reserves at 31 December 2011</i>	<i>20,236</i>	<i>573</i>	<i>28,562</i>	<i>809</i>
<b>Grand total proved reserves at 31 December 2011</b>	<b>46,663</b>	<b>1,321</b>	<b>55,979</b>	<b>1,585</b>

<sup>(1)</sup> Disposals represent reserves attributable to the sale of an equity stake in a subsidiary.

<sup>(2)</sup> Reclassifications represent reserves attributable to equity stake in a subsidiary reclassified to joint venture due to loss of control.

<sup>(3)</sup> Acquisitions represent reserves attributable to acquired equity stake in a subsidiary.



	Crude oil, gas condensate and natural gas liquids			
	SEC		PRMS	
	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons
<i>Based on our equity ownership interest in the fields</i>				
<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>(1)</sup>	(20)	(2)	(20)	(2)
Reclassifications <sup>(2)</sup>	(20)	(3)	(20)	(3)
Production	(31)	(4)	(31)	(4)
<b>Total proved reserves at 31 December 2010</b>	<b>501</b>	<b>60</b>	<b>645</b>	<b>79</b>
<i>Equity share of total proved reserves at 31 December 2010</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>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries	91	11	91	10
Acquisitions <sup>(3)</sup>	84	10	125	15
Disposals <sup>(1)</sup>	(34)	(4)	(51)	(6)
Reclassifications <sup>(2)</sup>	(138)	(16)	(204)	(24)
Production	(35)	(4)	(35)	(4)
<b>Total proved reserves at 31 December 2011</b>	<b>469</b>	<b>57</b>	<b>571</b>	<b>70</b>
<i>Equity share of total proved reserves at 31 December 2011</i>	<i>283</i>	<i>34</i>	<i>399</i>	<i>48</i>
<b>Grand total proved reserves at 31 December 2011</b>	<b>752</b>	<b>91</b>	<b>970</b>	<b>118</b>

<sup>(1)</sup> Disposals represent reserves attributable to the sale of an equity stake in a subsidiary.

<sup>(2)</sup> Reclassifications represent reserves attributable to equity stake in a subsidiary reclassified to joint venture due to loss of control.

<sup>(3)</sup> Acquisitions represent reserves attributable to acquired equity stake in a subsidiary.

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

	Combined natural gas, crude oil, gas condensate and natural gas liquids in millions of barrels of oil equivalent	
	SEC	PRMS
<i>Based on our equity ownership interest in the fields</i>		
<b>Total proved reserves:</b>		
At 31 December 2009	6,853	7,711
At 31 December 2010	8,088	9,325
At 31 December 2011	9,393	11,337
<i>including subsidiaries</i>	<i>5,363</i>	<i>5,649</i>
<i>including equity share of reserves</i>	<i>4,030</i>	<i>5,688</i>

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>	Natural gas		Crude oil, gas condensate and natural gas liquids	
	<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 2009	13,520	383	375	46
At 31 December 2010	18,748	531	587	73
At 31 December 2011	18,471	523	652	81
<i>including subsidiaries</i>	<i>8,944</i>	<i>253</i>	<i>365</i>	<i>46</i>
<i>including equity share of reserves</i>	<i>9,527</i>	<i>270</i>	<i>287</i>	<i>35</i>
<b>Possible reserves:</b>				
At 31 December 2009	9,416	267	696	89
At 31 December 2010	14,867	421	915	117
At 31 December 2011	17,187	487	1,000	127
<i>including subsidiaries</i>	<i>6,560</i>	<i>186</i>	<i>645</i>	<i>82</i>
<i>including equity share of reserves</i>	<i>10,627</i>	<i>301</i>	<i>355</i>	<i>45</i>

The Group's PRMS proved reserves attributable to consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in the respective fields aggregated approximately 1.6 trillion cubic meters (tcm) of natural gas and 118 million tons of gas condensate and crude oil as of 31 December 2011. Combined, these proved reserves represent approximately 11.3 billion barrels of oil equivalent.

Our total PRMS proved reserves attributable to consolidated subsidiaries and joint ventures based on the Group's equity ownership interest in their respective fields have increased by 21.6% during 2011 due primarily to the 29% increase in our equity stake in Yamal LNG as of 31 December 2011, revisions of previous estimates 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 2011 was also primarily due to the increase in our equity stake in Yamal LNG that was partially offset by the migration of probable reserves to proved reserve category at SeverEnergiya's fields as a result of ongoing field development activities.

The SEC and PRMS reserve tables noted above do not include reserves attributable to our recent acquisitions of four new licenses in the Yamal and Gydan peninsulas, which will be appraised in subsequent reserve reports as exploration and development activities commence.

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 2011 and 2010 under both reserves reporting methodologies *based on our equity ownership interest, rather than 100% of the reserves attributable to all consolidated subsidiaries and joint ventures*:

<i>Number of years (based on our equity ownership interest in the fields)</i>	SEC		PRMS	
	<i>At 31 December: 2011</i>	<i>2010</i>	<i>At 31 December: 2011</i>	<i>2010</i>
Total proved reserves to production	25	30	30	34
Total proved and probable reserves to production	-	-	40	49
Total proved, probable and possible reserves to production	-	-	51	62

The decrease in our total proved reserves to production was primarily due to an increase in our production.

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 the Group's 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 2011 and 2010. 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 %
	2011	2010	
<b>Production costs:</b>			
Lifting costs	5,180	4,469	15.9%
Taxes other than income tax	17,287	9,831	75.8%
Transportation expenses	46,064	37,187	23.9%
<b>Total production costs before DD&amp;A</b>	<b>68,531</b>	<b>51,487</b>	<b>33.1%</b>
Depreciation, depletion and amortization (DD&A)	8,878	6,384	39.1%
<b>Total production costs</b>	<b>77,409</b>	<b>57,871</b>	<b>33.8%</b>
<i>RR per boe</i>	Year ended 31 December:		Change %
	2011	2010	
<b>Production costs:</b>			
Lifting costs	15.0	16.3	(8.0%)
Taxes other than income tax	50.1	35.9	39.6%
Transportation expenses	133.6	135.8	(1.6%)
<b>Total production costs before DD&amp;A</b>	<b>198.7</b>	<b>188.0</b>	<b>5.7%</b>
Depreciation, depletion and amortization (DD&A)	25.8	23.3	10.7%
<b>Total production costs</b>	<b>224.5</b>	<b>211.3</b>	<b>6.2%</b>
<i>USD per boe</i>	Year ended 31 December:		Change %
	2011	2010	
<b>Production costs:</b>			
Lifting costs	0.51	0.54	(5.6%)
Taxes other than income tax	1.71	1.18	44.9%
Transportation expenses	4.55	4.46	2.0%
<b>Total production costs before DD&amp;A</b>	<b>6.77</b>	<b>6.18</b>	<b>9.5%</b>
Depreciation, depletion and amortization (DD&A)	0.88	0.76	15.8%
<b>Total production costs</b>	<b>7.65</b>	<b>6.94</b>	<b>10.2%</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 the Group's IFRS consolidated financial statements, in that the lifting costs as presented in the Group's IFRS consolidated financial statements include 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 the Group's IFRS consolidated financial statements is set forth below:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
Lifting costs presented in "Oil and Gas Production Costs" above	5,180	4,469	15.9%
Change in balances of natural gas and hydrocarbon liquids stated at cost in the Group's Consolidated Statement of Financial Position	56	385	(85.5%)
<b>Lifting costs per "Unaudited Supplemental Oil and Gas Disclosures"</b>	<b>5,236</b>	<b>4,854</b>	<b>7.9%</b>

## Hydrocarbon sales volumes

Our natural gas sales volumes increased primarily due to a combination of increased production at our core producing fields and purchases from our joint venture, Sibneftegas. Liquids sales volumes increased primarily due to an increase in unstable gas condensate production at the Yurkharovskoye field and, to a lesser extent, a buildup in liquids inventory balances in 2010. Our inventory balances tend to fluctuate period-on-period due to loading schedules and final destinations of stable gas condensate shipments.

### *Natural gas sales volumes*

<i>millions of cubic meters</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>Production from:</b>			
Yurkharovskoye field	32,035	24,436	31.1%
East-Tarkosalinskoye field	12,151	9,735	24.8%
Khancheyevskoye field	3,263	3,013	8.3%
Other fields	72	77	(6.5%)
<b>Total natural gas production</b>	<b>47,521</b>	<b>37,261</b>	<b>27.5%</b>
<b>Purchases from:</b>			
Sibneftegas, the Group's joint venture	5,384	-	n/a
Third parties	841	-	n/a
<b>Total production and purchases</b>	<b>53,746</b>	<b>37,261</b>	<b>44.2%</b>
Purovsky Plant and own usage	(109)	(98)	11.2%
Decrease (increase) in UGSF, UGSS and own pipeline infrastructure	30	(46)	n/a
<b>Total natural gas sales volumes</b>	<b>53,667</b>	<b>37,117</b>	<b>44.6%</b>
<i>Sold to end-customers</i>	<i>29,332</i>	<i>23,745</i>	<i>23.5%</i>
<i>Sold ex-field</i>	<i>24,335</i>	<i>13,372</i>	<i>82.0%</i>

In 2011, our total natural gas production (including our share in production of our joint venture Sibneftegas) increased by 15,644 mmcm, or 42.0%, compared to 37,261 mmcm in 2010 primarily due to an increase in production at our Yurkharovskoye and East-Tarkosalinskoye fields, as well as the consolidation of our share in production of the Group's joint venture. We were able to increase natural gas production at the Yurkharovskoye field due to the launch of the third stage of the field's second phase development in October 2010. The increase in natural gas production at the East-Tarkosalinskoye field was due to increased demand in 2011 resulting in a greater utilization of the field's production capacity.

In December 2011, we purchased 841 mmcm of natural gas from third parties in the Chelyabinsk region, the price of which included the cost of transportation to this region, through our subsidiary Gazprom mezhregiongas Chelyabinsk, a regional gas trader acquired in November 2011. The purchases were made according to pre-existing contractual obligations and effective January 2012 we will no longer purchase natural gas under these agreements.

In 2011, we used 63 mmcm of natural gas as feedstock for the production of methanol compared to 53 mmcm in 2010. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation (condensation) during the production, preparation and transportation of hydrocarbons.



*Liquids sales volumes*

<i>thousands of tons</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>Production from:</b>			
Yurkharovskoye field	2,718	2,099	29.5%
East-Tarkosalinskoye field	808	852	(5.2%)
Khancheyskoye field	560	635	(11.8%)
Other fields	25	31	(19.4%)
<b>Total liquids production</b>	<b>4,111</b>	<b>3,617</b>	<b>13.7%</b>
<b>Purchases from:</b>			
Third parties	6	12	(50.0%)
<b>Total production and purchases</b>	<b>4,117</b>	<b>3,629</b>	<b>13.4%</b>
Losses and own usage <sup>(1)</sup>	(37)	(39)	(5.1%)
Gas condensate pipeline fill and de-ethanization	-	(36)	n/a
Decreases (increases) in liquids inventory balances	31	(153)	n/a
<b>Total liquids sales volumes</b>	<b>4,111</b>	<b>3,401</b>	<b>20.9%</b>
<i>Stable gas condensate export</i>	<i>2,981</i>	<i>2,326</i>	<i>28.2%</i>
<i>Stable gas condensate domestic</i>	<i>3</i>	<i>4</i>	<i>(25.0%)</i>
<b><i>Subtotal stable gas condensate</i></b>	<b><i>2,984</i></b>	<b><i>2,330</i></b>	<b><i>28.1%</i></b>
<i>LPG export</i>	<i>453</i>	<i>434</i>	<i>4.4%</i>
<i>LPG CIS</i>	<i>1</i>	<i>0</i>	<i>n/a</i>
<i>LPG domestic</i>	<i>336</i>	<i>397</i>	<i>(15.4%)</i>
<i>LPG sold through domestic retail and small wholesale stations</i>	<i>90</i>	<i>45</i>	<i>100.0%</i>
<b><i>Subtotal LPG</i></b>	<b><i>880</i></b>	<b><i>876</i></b>	<b><i>0.5%</i></b>
<i>Crude oil export</i>	<i>93</i>	<i>71</i>	<i>31.0%</i>
<i>Crude oil domestic</i>	<i>149</i>	<i>114</i>	<i>30.7%</i>
<b><i>Subtotal crude oil</i></b>	<b><i>242</i></b>	<b><i>185</i></b>	<b><i>30.8%</i></b>
<i>Oil products domestic</i>	<i>5</i>	<i>10</i>	<i>(50.0%)</i>
<b><i>Subtotal oil products</i></b>	<b><i>5</i></b>	<b><i>10</i></b>	<b><i>(50.0%)</i></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 2011, our liquids production increased by 494 thousand tons, or 13.7%, to 4,111 thousand tons compared to 3,617 thousand tons in 2010, due primarily to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the third stage of the field's second phase development in October 2010. The decrease in liquids production at the Khancheyskoye and East-Tarkosalinskoye fields was due to lower concentration of gas condensate in the extracted gas. Natural declines in the concentrations of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

**RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2011 COMPARED TO THE YEAR ENDED 31 DECEMBER 2010**

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2011 and 2010. 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>2011</b>	<b>% of total revenues</b>	<b>2010</b>	<b>% of total revenues</b>
<b>Total revenues (net of VAT and export duties)</b>	<b>176,064</b>	<b>100.0%</b>	<b>117,024</b>	<b>100.0%</b>
<i>including:</i>				
natural gas sales	110,932	63.0%	71,060	60.7%
liquids sales	64,670	36.7%	44,102	37.7%
Operating expenses	(97,665)	(55.5%)	(68,518)	(58.6%)
Net gain on disposal of interest in subsidiaries	62,948	35.8%	1,329	1.1%
Other operating income (loss)	261	0.1%	396	0.4%
<b>Profit from operations</b>	<b>141,608</b>	<b>80.4%</b>	<b>50,231</b>	<b>42.9%</b>
Finance income (expense)	(2,703)	(1.5%)	1,197	1.0%
Share of profit (loss) of equity investments, net of income tax	(3,880)	(2.2%)	(346)	(0.2%)
<b>Profit before income tax</b>	<b>135,025</b>	<b>76.7%</b>	<b>51,082</b>	<b>43.7%</b>
Total income tax expense	(15,734)	(8.9%)	(10,804)	(9.3%)
<b>Profit (loss)</b>	<b>119,291</b>	<b>67.8%</b>	<b>40,278</b>	<b>34.4%</b>
Non-controlling interest	364	0.2%	255	0.2%
<b>Profit attributable to shareholders of OAO NOVATEK</b>	<b>119,655</b>	<b>68.0%</b>	<b>40,533</b>	<b>34.6%</b>

## Total revenues

The following table sets forth our sales (net of VAT and export duties, where applicable) for the years ended 31 December 2011 and 2010:

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2011	2010	
<b>Natural gas sales</b>	<b>110,932</b>	<b>71,060</b>	<b>56.1%</b>
<i>End-customers</i>	77,046	54,860	40.4%
<i>Ex-field sales</i>	33,886	16,200	109.2%
<b>Stable gas condensate sales</b>	<b>46,778</b>	<b>29,754</b>	<b>57.2%</b>
<i>Export</i>	46,732	29,720	57.2%
<i>Domestic</i>	46	34	35.3%
<b>Liquefied petroleum gas sales</b>	<b>15,227</b>	<b>12,747</b>	<b>19.5%</b>
<i>Export</i>	9,697	8,052	20.4%
<i>CIS</i>	10	9	11.1%
<i>Domestic</i>	5,520	4,686	17.8%
<b>Crude oil sales</b>	<b>2,479</b>	<b>1,458</b>	<b>70.0%</b>
<i>Export</i>	1,021	603	69.3%
<i>Domestic</i>	1,458	855	70.5%
<b>Oil and gas products sales</b>	<b>186</b>	<b>143</b>	<b>30.1%</b>
<i>Domestic</i>	186	143	30.1%
<b>Total oil and gas sales</b>	<b>175,602</b>	<b>115,162</b>	<b>52.5%</b>
Sales of polymer and insulation tape	-	1,699	n/a
Other revenues	462	163	183.4%
<b>Total revenues</b>	<b>176,064</b>	<b>117,024</b>	<b>50.5%</b>

### *Natural gas sales*

In 2011, our revenues from sales of natural gas increased by RR 39,872 million, or 56.1%, compared to 2010 largely due to an increase in sales volumes and, to a lesser extent, an increase in natural gas prices.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased to 54.7% in 2011 from 64.0% in 2010. The decrease was due to the increase of sales volumes to one of our main gas traders and the commencement from January 2011 of natural gas sales, ex-field, to ITERA, a Russian oil and gas company, under a long-term contract signed in April 2010 for annual volumes of approximately four billion cubic meters. There were no corresponding sales of natural gas to ITERA in 2010.

The average realized prices of our natural gas sold directly to end-customers (including transportation expense and excluding trading activities) and sold ex-field were higher by 13.7% and 14.9%, respectively, in 2011 compared to 2010. In 2011, as well as in 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies. In addition, in December 2011, we commenced natural gas sales to a new end-customer segment in the Chelyabinsk region, residential customers, as a result of the acquisition of our wholly owned trading subsidiary Gazprom mezhregiongas Chelyabinsk in November 2011.

### *Stable gas condensate sales*

In 2011, our revenues from sales of stable gas condensate increased by RR 17,024 million, or 57.2%, compared to 2010 due to both an increase in volumes sold and an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation.

Our total stable gas condensate sales volumes increased by 654 thousand tons, or 28.1%, due to an increase in our unstable gas condensate production and a decrease in the stable gas condensate inventory balance in 2011 compared to an increase in 2010 (see “Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress” below). In 2011, we exported 2,981 thousand tons of stable gas condensate, or 99.9% of our total sales volumes, to APR, Europe and the United States, with the remaining three thousand tons sold domestically. In 2010, we exported 2,326 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to the United States, APR, Europe and South America, with the remaining four thousand tons sold domestically.

In 2011, our average realized price, excluding export duties, for stable gas condensate sold on the export market increased by USD 112.6 per ton, or 26.8%, to USD 533.4 per ton (DAP, CIF, CFR, DES and DAT) from USD 420.8 per ton (DES, CFR and CIF) in 2010 due to a 34.5% increase in our average export contract price that was partially offset by a 48.3% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in 2011 compared to 2010.

### *Liquefied petroleum gas sales*

In 2011, our revenues from sales of LPG increased by RR 2,480 million, or 19.5%, compared to 2010, primarily due to an increase in our average realized prices.

In 2011, we sold 453 thousand tons of LPG, or 51.5% of our total LPG sales volumes, to export markets compared to 434 thousand tons, or 49.5%, in 2010. In 2011, our export sales volumes of LPG representing greater than 10% were primarily to Poland and Finland compared to sales to Poland, Finland and Turkey in 2010.

Our average realized LPG export price, excluding export duties, increased by USD 117.2 per ton, or 19.2%, to USD 728.2 per ton in 2011 (DAP, CPT and FCA) compared to USD 611.0 per ton in 2010 primarily due to a 46.0% increase in our average contract price that was partially offset by a three-fold increase in the average export duty per ton.

In 2011, we sold 426 thousand tons of LPG, or 48.4% of our total LPG sales volumes, on the domestic market at an average price of RR 12,971 per ton (FCA, excluding VAT) representing an increase of RR 2,362 per ton, or 22.3%, compared to 2010.

### *Crude oil sales*

In 2011, our revenues from sales of crude oil increased by RR 1,021 million, or 70.0% , compared to 2010, due to an increase in sales volumes and, to a lesser extent, an increase in our average realized prices. Our crude oil sales volumes increased by 57 thousand tons, or 30.8%, to 242 thousand tons from 185 thousand tons in 2010 due primarily to an increase in crude oil production at our East-Tarkosalinskoye field.

The majority of our crude oil sales volumes, representing 61.6% in 2011, was sold domestically at an average price of RR 9,792 per ton (excluding VAT) representing an increase of RR 2,269 per ton, or 30.2%, compared to 2010. The remaining 38.4% of our crude oil volumes were sold to export markets at an average price of USD 373.7 per ton (DAP, excluding export duties) representing an increase of USD 92.5 per ton, or 32.9%, compared to 2010.

The increase in the average realized export price (excluding export duties) was the result of a 41.3% increase in our average export contract price that was partially offset by a 50.4% increase in the average export duty per ton. The increase in our average realized contract price was due to an overall increase in benchmark crude oil prices on international markets in 2011 compared to 2010.

### *Oil and gas products sales*

In 2011, our revenue from the sales of oil and gas products increased by RR 43 million, or 30.1%, to RR 186 million from RR 143 million in 2010.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RR 37 million to RR 147 million in 2011, compared to RR 110 million in 2010 due to an increase in sales prices. In 2011 and 2010, we sold approximately 5.4 thousand and 4.8 thousand tons of oil products (diesel fuel and petrol) for an average price of RR 27,232 and RR 22,951 per ton, respectively.

In 2011, we had no revenues from domestic sales of oil products produced at the Surgutsky refinery, compared to revenues of RR 33 million in 2010, due to the cessation of deliveries of our unstable gas condensate to the Surgutsky refinery starting in September 2010. In August 2010, we launched our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant eliminating the need for third-party transportation and processing.

In 2011, we sold approximately four thousand tons of methanol to our joint venture, Sibneftegas, and recorded revenues of RR 39 million from such sale.

### *Sales of polymer and insulation tape*

In 2011, we had no revenues from the sales of polymer and insulation tape, compared to revenues of RR 1,699 million in 2010, due to the disposal of our polymer and insulation tape production subsidiary NOVATEK–Polymer in September 2010.

### *Other revenues*

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In 2011, other revenues increased by RR 299 million, or 183.4%, to RR 462 million from RR 163 million in 2010. The increase was primarily comprised of RR 131 million in other revenue for the sublet of leased tankers as well as a RR 81 million increase in revenue from transportation, handling and storage services. The remaining increase of RR 87 million in other revenues was made up of various immaterial items.

## Operating expenses

In 2011, our total operating expenses increased by RR 29,147 million, or 42.5%, to RR 97,665 million compared to RR 68,518 million in 2010, primarily due to an increase in transportation expenses, taxes other than income tax and purchases of natural gas. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, decreased to 67.3% in 2011 compared to 69.0% in 2010. Total operating expenses decreased as a percentage of total revenues to 55.5% in 2011 compared to 58.6% in 2010, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas and liquids volumes and sales prices, as well as cost optimization due to the launch of our own transport and processing infrastructure in August 2010.

<i>millions of Russian roubles</i>	Year ended 31 December:			
	2011	% of total revenues	2010	% of total revenues
Transportation expenses	48,176	27.4%	37,200	31.8%
Taxes other than income tax	17,557	10.0%	10,077	8.6%
<b>Subtotal non-controllable expenses</b>	<b>65,733</b>	<b>37.3%</b>	<b>47,277</b>	<b>40.4%</b>
Depreciation, depletion and amortization	9,277	5.3%	6,616	5.7%
General and administrative expenses	8,218	4.7%	6,733	5.8%
Purchases of natural gas and liquid hydrocarbons	5,994	3.4%	154	0.1%
Materials, services and other	5,947	3.4%	6,072	5.2%
Exploration expenses	1,819	1.0%	1,595	1.4%
Net impairment expense	782	0.4%	541	0.5%
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress	(105)	n/m	(470)	n/m
<b>Total operating expenses</b>	<b>97,665</b>	<b>55.5%</b>	<b>68,518</b>	<b>58.6%</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 2011, non-controllable expenses of transportation and taxes other than income tax increased by RR 18,456 million, or 39.0%, to RR 65,733 million from RR 47,277 million in 2010. The change in transportation expenses was primarily due to an increase in natural gas sales volumes, as well as the increase in the natural gas and liquids transportation tariffs. Taxes other than income tax increased primarily due to a 61.2% increase in the natural gas production tax rate effective from 1 January 2011, as well as higher natural gas and liquids production volumes. As a percentage of total revenues, our non-controllable expenses decreased to 37.3% in 2011 from 40.4% in 2010.



### Transportation expenses

In 2011, our total transportation expenses increased by RR 10,976 million, or 29.5%, compared to 2010.

<i>million of Russian roubles</i>	Year ended 31 December:		Change %
	2011	2010	
Natural gas transportation to customers	34,441	26,569	29.6%
Liquids transportation by rail	9,638	7,350	31.1%
Liquids transportation by tankers	3,647	2,771	31.6%
Crude oil transportation to customers	281	190	47.9%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	-	307	n/a
Other transportation costs	169	13	n/a
<b>Total transportation expenses</b>	<b>48,176</b>	<b>37,200</b>	<b>29.5%</b>

In 2011, our transportation expenses for natural gas increased by RR 7,872 million, or 29.6%, to RR 34,441 million from RR 26,569 million in 2010. The change was mainly due to a 20.0% increase in our sales volumes of natural gas to end-customers, for which we incurred transportation expense, as well as a 9.3% increase in the natural gas transportation tariff set by the FTS (see “Transportation tariffs” above). Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

In 2011, total expenses for liquids transportation by rail increased by RR 2,288 million, or 31.1%, to RR 9,638 million from RR 7,350 million in 2010 due to an increase in our combined liquids volumes sold and transported via rail, as well as higher average liquids transportation tariffs. In 2011, our combined liquids volumes sold and transported via rail increased by 653 thousand tons, or 20.7%, to 3,806 thousand tons from 3,153 thousand tons in 2010.

In 2011, our weighted average transportation tariff for liquids delivered by rail increased by 8.7% to RR 2,533 per ton from RR 2,331 per ton in 2010 primarily due to an 8.0% increase in rail tariffs set by the FTS effective 1 January 2011. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-to-period and depends on products type and the geography of deliveries.

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

Total transportation expense for liquids delivered by tankers to international markets increased by RR 876 million, or 31.6%, to RR 3,647 million in 2011 from RR 2,771 million in 2010. The change was primarily due to a 28.2% increase in volumes sold, as well as a slight increase in average freight rates. In 2011, we sold 43.4% of our total stable gas condensate export volumes to the APR, 34.3% to Europe and 22.3% to the United States, whereas in 2010, we sold 53.4% to the United States, 26.1% to the APR, 12.9% to Europe and 7.6% to South America.

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

*Taxes other than income tax*

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change</b>
	<b>2011</b>	<b>2010</b>	<b>%</b>
Unified natural resources production tax (UPT)	14,523	7,861	84.7%
Property tax	1,742	1,482	17.5%
Excise and fuel taxes	998	454	119.8%
Other taxes	294	280	5.0%
<b>Total taxes other than income tax</b>	<b>17,557</b>	<b>10,077</b>	<b>74.2%</b>

In 2011, taxes other than income tax increased by RR 7,480 million, or 74.2%, primarily due to an increase in the unified natural resources production tax expense.

In 2011, our UPT for natural gas increased by RR 5,850 million, or 106.6%, due to a 61.2% increase in the natural gas production tax rate effective 1 January 2011 (from RR 147 to RR 237 per mcm), and an increase in our natural gas production volumes. The remaining increase in UPT expenses of RR 812 million related to the UPT for gas condensate and crude oil and was primarily due to an increase in the crude oil tax rate and production volumes. Our average UPT rate for crude oil is linked to the Urals benchmark crude oil price and increased to RR 4,490 per ton in 2011 from RR 3,099 per ton in 2010.

In 2011, our property tax expense increased by RR 260 million, or 17.5%, to RR 1,742 million from RR 1,482 million in 2010, primarily due to additions of property, plant and equipment (PPE) at our production subsidiaries.

In 2011, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska increased by RR 544 million, or 119.8%, due to an increase in our LPG export sales through this subsidiary. The excise and fuel taxes are payable when LPG enters Polish territory.

*Depreciation, depletion and amortization*

In 2011, our depreciation, depletion and amortization (“DDA”) expense increased by RR 2,661 million, or 40.2%, to RR 9,277 million from RR 6,616 million in 2010 as a result of an increase in our depletable cost base, as well as a 26.0% increase in our total hydrocarbon production (excluding our proportionate share in the production of joint ventures) in barrels of oil equivalent (boe). The Group accrues depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In 2011, our DDA per boe was RR 23.1 compared to RR 20.5 in 2010. 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 third stage of the second phase development at the Yurkharovskoye field in October 2010 as well as other costs capitalized during 2011.

Our reserve base, used as the denominator in the calculation of the DDA charge under the “units of production” method, is only appraised on an annual basis as of 31 December and does not fluctuate during the year, whereas our depletable cost base does change each quarter due to the ongoing capitalization of our costs throughout the year.

### General and administrative expenses

In 2011, our general and administrative expenses increased by RR 1,485 million, or 22.1%, to RR 8,218 million compared to RR 6,733 million in 2010. The main components of these expenses were employee compensation, social expenses and compensatory payments and legal, audit and consulting services, which, on aggregate, comprised 80.7% and 76.5% of total general and administrative expenses in 2011 and 2010, respectively.

<i>millions of Russian roubles</i>	Year ended 31 December:		Change %
	2011	2010	
Employee compensation	4,650	3,874	20.0%
Social expenses and compensatory payments	1,212	774	56.6%
Legal, audit, and consulting services	774	504	53.6%
Business trip expenses	218	265	(17.7%)
Depreciation – administrative buildings	198	141	40.4%
Fire safety and security expenses	178	149	19.5%
Rent expense	140	270	(48.1%)
Board remuneration	103	93	10.8%
Concession management services	63	125	(49.6%)
Bank charges	58	59	(1.7%)
Other	624	479	30.3%
<b>Total general and administrative expenses</b>	<b>8,218</b>	<b>6,733</b>	<b>22.1%</b>

Employee compensation increased by RR 776 million, or 20.0%, to RR 4,650 million in 2011 as compared to RR 3,874 million in 2010 primarily due to a RR 530 million increase in bonuses paid for the results achieved in 2010 and accrued for the results achieved in 2011. In addition, an increase of RR 298 million was due to an indexation of base salaries by 9.6% from 1 July 2011. The increase was partially offset by a decrease in the recognition of charges related to NOVATEK's share-based compensation program for the Group's senior and key management from RR 400 million in 2010 to RR 235 million in 2011.

In 2011, our social expenses and compensatory payments increased by RR 438 million, or 56.6%, to RR 1,212 million compared to RR 774 million in 2010 primarily due to the commencement in 2011 of direct payments to the YNAO government to undertake new socio-economic programs related to the Yamal LNG project. Social expenses and compensatory payments will continue to fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support in the regions where we operate.

Legal, audit, and consulting services expenses increased by RR 270 million, or 53.6%, to RR 774 million compared to RR 504 million in 2010 largely due to an increase in legal and consulting services connected with the development of the Yamal LNG project.

In 2011, depreciation of administrative buildings increased by RR 57 million, or 40.4%, due to the completion and opening of our new Moscow head-office in the second quarter 2011. Administrative buildings are depreciated on a straight-line basis over their estimated useful lives.

Fire safety and security expenses increased by RR 29 million, or 19.5%, to RR 178 million in 2011 from RR 149 million in 2010 as a result of the opening of our new Moscow head-office in May 2011.

In 2011, our rent expense decreased by RR 130 million, or 48.1%, to RR 140 million from RR 270 million in 2010 due to the relocation of Moscow head-office employees to our new office building in May 2011.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El-Arish concession area located in Egypt). In 2011, our expenses related to concession management services decreased by RR 62 million, or 49.6%, compared to 2010 due to the termination of the concession agreement in 2011.

In 2011, other general and administrative expenses increased by RR 145 million, or 30.3%, to RR 624 million from RR 479 million in 2010. The increase of RR 77 million related to the statutory requirement to maintain a bank guarantee in respect of minority shareholders due to the Sibneftegas acquisition. In addition, our materials and repair expenses related primarily to the maintenance of our new head-office in Moscow increased by RR 46 and RR 22 million, respectively.

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

In 2011, our purchases of natural gas and liquid hydrocarbons amounted to RR 5,994 million, of which RR 5,854 million related to natural gas purchases from our joint venture Sibneftegas and from third parties related to the acquisition and consolidation of Gazprom mezhregiongas Chelyabinsk in November 2011. The remaining purchases of RR 140 million related to oil products (diesel fuel and petrol), which were resold. In 2010, our purchases of RR 154 million related to liquid hydrocarbons purchased for resale.

### *Materials, services and other*

In 2011, our materials, services and other expenses decreased by RR 125 million, or 2.1%, to RR 5,947 million compared to RR 6,072 million in 2010. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 49.7% and 24.1%, respectively, of total materials, services and other expenses in 2011.

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change</b>
	<b>2011</b>	<b>2010</b>	<b>%</b>
Employee compensation	2,953	2,572	14.8%
Repair and maintenance services	1,435	640	124.2%
Electricity and fuel	405	388	4.4%
Materials and supplies	309	1,386	(77.7%)
Security expenses	237	179	32.4%
Transportation expenses	184	106	73.6%
Processing fees	99	566	(82.5%)
Rent expenses	43	27	59.3%
Other	282	208	35.6%
<b>Total materials, services and other</b>	<b>5,947</b>	<b>6,072</b>	<b>(2.1%)</b>

Our employee compensation increased by RR 381 million, or 14.8%, to RR 2,953 million compared to RR 2,572 million in 2010 due primarily to a 9.6% indexation of base salaries effective 1 July 2011.

Repair and maintenance services increased by RR 795 million, or 124.2%, to RR 1,435 million in 2011 compared to RR 640 million in 2010. The increase was primarily related to on-going repair works at our production assets and was consistent with our maintenance schedules.

In 2011, electricity and fuel expenses increased by RR 17 million, or 4.4%, to RR 405 million from RR 388 million in 2010. The increase was primarily due to an increase in electricity volumes used by our production subsidiaries resulting from recently completed infrastructure projects as well as higher electricity rates in 2011 compared to 2010 which were partially offset by cost savings due to the disposal of NOVATEK-Polymer in September 2010.

Materials and supplies expense decreased by RR 1,077 million, or 77.7%, mainly due to a cessation of purchases of raw materials required for the production of polymer and insulation tape products as a result of the disposal of NOVATEK-Polymer in September 2010, which accounted for RR 1,100 million of the total decrease in materials and supplies expense.

Security expenses increased by RR 58 million, or 32.4%, to RR 237 million in 2011 from RR 179 million in 2010 largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

Transportation expenses related to the delivery of materials and equipment to our fields increased by RR 78 million, or 73.6%, to RR 184 million in 2011 from RR 106 million in 2010 primarily due to an increase in scheduled repair and maintenance works at our production subsidiaries.

Processing fees decreased by RR 467 million, or 82.5%, to RR 99 million in 2011, from RR 566 million in 2010 due primarily to the launch of our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010 that allowed us to cease contracting similar third party services.

### Exploration expenses

In 2011, our exploration expenses increased by RR 224 million, or 14.0%, to RR 1,819 million from RR 1,595 million in 2010 primarily due to an increase in seismic works. In 2011, we expensed the capitalized cost of three exploratory wells in accordance with our accounting policy aggregating RR 806 million at the Raduzhny and Yarudeiskiy licence areas compared to the expensing of two exploratory wells aggregating RR 821 million at the El Arish (Egypt) and Anomalny licence areas in 2010.

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

In 2011, we recorded a reversal of RR 105 million to change in inventory expense compared to a reversal of RR 470 million in 2010:

<i>millions of Russian roubles</i>	Year ended 31 December:	
	2011	2010
Natural gas	(112)	2
Stable gas condensate	91	(379)
Other	(84)	(93)
<b>Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress</b>	<b>(105)</b>	<b>(470)</b>

In 2011, we recorded a reversal to our operating expenses of RR 112 million primarily due to an increase in the cost of natural gas balances resulting from the higher UPT rate in 2011 as compared to 2010 that was partially offset by a 30 mmcm decrease in our natural gas inventory balance. Our volumes of natural gas injected into Gazprom's underground gas storage facilities fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in 2011, we recorded a charge of RR 91 million to our operating expenses due to a 36 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage.

The following table highlights movements in our inventory balances:

<i>Inventory balances in transit or in storage</i>	2011			2010		
	At 31 December	At 1 January	Increase / (decrease)	At 31 December	At 1 January	Increase / (decrease)
<b>Natural gas (millions of cubic meters)</b>	<b>760</b>	<b>790</b>	<b>(30)</b>	<b>790</b>	<b>744</b>	<b>46</b>
<i>including Gazprom's UGSF</i>	732	761	(29)	761	584	177
<b>Liquid hydrocarbons (thousand tons)</b>	<b>325</b>	<b>356</b>	<b>(31)</b>	<b>356</b>	<b>167</b>	<b>189</b>
<i>including stable gas condensate</i>	228	264	(36)	264	111	153

### Net gain on disposal of interest in subsidiaries

In 2011, we realized a net gain of RR 62,948 million on the disposal of a 20% participation interest in OAO Yamal LNG to TOTAL S.A., our strategic partner in the Yamal LNG project. The net gain is comprised of a net gain on disposal of RR 28,685 million and a gain of RR 34,263 million due to the revaluation to fair value of our remaining 80% participation interest.

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

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

In 2011, we recognized other operating income of RR 261 million, of which RR 192 million related to insurance compensation received in respect of insured accident which incurred in 2010. 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.

### **Profit from operations**

As a result of the factors discussed above, our profit from operations, increased by RR 91,377 million, or 181.9%, to RR 141,608 million in 2011, compared to RR 50,231 million in 2010. Our profit from operations, adjusted for non-recurring transactions, primarily excluding the net gain on disposal of interest in subsidiaries, increased by RR 29,758 million, or 60.9%, to RR 78,660 million in 2011 from RR 48,902 million in 2010. In 2011, our profit from operations, excluding the net gain on disposal of interest in subsidiaries, as a percentage of total revenues increased to 44.7% compared to 41.8% in 2010 primarily due to higher natural gas and liquids sales volumes and prices.

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

In 2011, we recorded net finance expense of RR 2,703 million due primarily to an increase in a non-cash foreign exchange loss from the depreciation of the Russian rouble relative to the US dollar as compared to a net finance gain of RR 1,197 million in 2010 due to a non-cash foreign exchange gain.

In 2011, our total accrued interest expense increased to RR 5,422 million compared to RR 2,192 million in 2010 as a result of an increase in our average borrowings. In 2011 and 2010, we capitalized RR 3,709 and RR 2,166 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with the Group's accounting policy. In addition, we recognized RR 437 and RR 411 million related to the fair value remeasurement of financial instruments and the unwinding of the present value discount related to provisions of asset retirement obligations as part of interest expense in 2011 and 2010, respectively.

Interest income increased to RR 3,392 million in 2011 from RR 598 million in 2010 primarily due to an increase in interest income on loans provided to our joint ventures.

In 2011, we recorded a net foreign exchange loss of RR 3,945 million compared to a net foreign exchange gain of RR 1,036 million in 2010 due primarily to the revaluation of our US dollar denominated borrowings. The Russian rouble depreciated by 5.6% against the US dollar during 2011 compared to Russian rouble depreciation of 0.8% in 2010. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio.

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

Our proportionate share in loss of equity investments increased from RR 346 million in 2010 to RR 3,880 million in 2011, of which a significant portion was related to our joint ventures Sibneftegas and Yamal Development. The losses we recognized in Sibneftegas were primarily due to the revaluation of oil and gas properties acquired to fair value and the subsequent amortization of those costs under IFRS. The losses related to Yamal Development resulted from the recognition of interest expense on loans obtained.

### **Income tax expense**

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 11.7% and 21.2% for the years ended 31 December 2011 and 2010, respectively.

After excluding the effect of 20% disposal of Yamal LNG, the Group's effective income tax rate for the year ended 31 December 2011 was 21.7%. Our effective income tax rates, excluding the effect of foreign subsidiaries and the net gain on disposal of subsidiaries, were 22.0% and 21.8% in the years ended 31 December 2011 and 2010, respectively.

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



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

As a result of the factors discussed above, profit for the period increased by RR 79,013 million, or 196.2%, to RR 119,291 million in 2011 from RR 40,278 million in 2010. The profit attributable to shareholders of OAO NOVATEK increased by RR 79,122 million, or 195.2%, to RR 119,655 million in 2011 from RR 40,533 million in 2010. The profit attributable to shareholders of OAO NOVATEK, adjusted to exclude the net gain on disposal of subsidiaries, increased by RR 17,503 million, or 44.6%, to RR 56,707 million in 2011 from RR 39,204 million in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by approximately RR 26.08 per share, or 195.1%, to RR 39.45 per share in 2011 from RR 13.37 per share in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, adjusted to exclude the net gain on disposal of subsidiaries, increased by RR 5.76 per share, or 44.6%, to RR 18.69 per share in 2011 from RR 12.93 per share in 2010.

## LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2011 and 2010:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
Net cash provided by operating activities	71,907	44,863	60.3%
Net cash provided by (used in) investing activities	(46,643)	(68,842)	(32.2%)
Net cash provided by (used in) financing activities	(11,735)	23,782	n/a

<i>Liquidity and credit ratios</i>	<b>31 December 2011</b>	<b>31 December 2010</b>	<b>Change, %</b>
Current ratio	1.16	0.51	127.5%
Total debt to equity	0.40	0.43	(7.0%)
Long-term debt to long-term debt and equity	0.24	0.22	9.1%
Net debt to total capitalization <sup>(1)</sup>	0.20	0.25	(20.0%)
Net debt to EBITDA <sup>(2)</sup>	0.48	1.08	(55.6%)
Net debt to Normalized EBITDA <sup>(2)</sup>	0.84	1.10	(23.6%)
Interest coverage ratio <sup>(3)</sup>	42	35	20.0%

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

<sup>(2)</sup> For EBITDA and Normalized EBITDA definitions see "Selected data" above.

<sup>(3)</sup> Interest coverage ratio is calculated as Normalized EBITDA divided by interest expense, including capitalized interest, less interest income from the Consolidated Statement of Income.

### *Net cash provided by operating activities*

In 2011, our net cash provided by operating activities increased by RR 27,044 million, or 60.3%, to RR 71,907 million compared to RR 44,863 million in 2010. The increase was primarily due to an increase in natural gas and liquids sales volumes and prices that was partially offset by an increase in income tax payments.

### *Net cash provided by (used in) investing activities*

In 2011, our net cash used in investing activities decreased by RR 22,199 million, or 32.2%, to RR 46,643 million as compared to RR 68,842 million in 2010 due primarily to a decrease in loans provided to our joint ventures, that was partially offset by the payment in 2011 for shares of our joint venture Sibneftegas, which was acquired in 2010, as well as the payment of RR 6.9 billion for four licenses in YNAO (see "Recent developments" above).

### *Net cash provided by (used in) financing activities*

In 2011, our cash used in repayment of debt and dividends, as well as cash paid to increase the Group's equity interest in Yamal LNG from 51% to 100%, exceeded cash provided by new loans by RR 11,735 million. In 2010, our cash provided by new loans and borrowings exceeded cash used for repayment of loans and dividends, that resulted in a net cash inflow from financing activities of RR 23,782 million.

## Working capital

Our net working capital position (current assets less current liabilities) at 31 December 2011 was positive RR 8,202 million compared to a negative RR 27,876 million at 31 December 2010. The strengthening of our net working capital position was due to a decrease of short-term debt and accounts payable, as well as an increase in balance of cash and cash equivalents and trade and other accounts receivable.

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

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

## Capital expenditures

Total capital expenditures on property, plant and equipment for the years ended 31 December 2011 and 2010 were as follows:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>		<b>Change %</b>
	<b>2011</b>	<b>2010</b>	
<b>Capital expenditures</b>			
Exploration, production and marketing	31,143	25,701	21.2%
Polymer production and marketing	-	329	n/a
<b>Total capital expenditures</b>	<b>31,143</b>	<b>26,030</b>	<b>19.6%</b>
Acquisition of mineral licenses per Consolidated Statement of Cash Flows	6,888	76	n/m
<b>Total additions to property, plant and equipment per Note 6 “Property, Plant and Equipment” in the Group’s IFRS Consolidated Financial Statements</b>	<b>38,031</b>	<b>26,106</b>	<b>45.7%</b>

Exploration, production and marketing expenditures represent our investments in exploring for and developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities for the years ended 31 December 2011 and 2010:

<i>millions of Russian roubles</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Yurkharovskoye field	11,403	15,375
South-Tambeyskoye field	4,148	1,678
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga)	3,923	664
East-Tarkosalinskoye field	2,430	1,058
Purovsky Plant	1,369	1,292
Khancheyevskoye field	612	87
North-Russkiy license area	574	399
West-Urengoiyskiy license area	515	33
Olimpiyskiy license area	345	424
Other	5,824	4,691
<b>Exploration, production and marketing</b>	<b>31,143</b>	<b>25,701</b>

Our capital expenditures to oil and gas properties increased by RR 5,442 million and related primarily to the fields at the early stage of development such as the South-Tambeyskoye field and the West-Urengoiyskiy license area, as well as the construction of processing assets such as Ust-Luga. We increased our capital expenditures at the East-Tarkosalinskoye field due to further development of the field’s crude oil deposits and at the Khancheyevskoye field as a result of capitalized repair works.

In 2011, the Group purchased, through participation in a tender process, exploration and production licenses for the Salmanovskoye (Utrenneye) and Geofizicheskoye fields and geological studies and production for the North-Obskiy and East-Tambeyskiy license areas for a total payment of RR 6,870 million (see “Recent developments” above).

## Debt obligations

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

### Overview

Our total debt increased from RR 72,226 million at 31 December 2010 to RR 95,478 million at 31 December 2011, or by RR 23,252 million, in order to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields, investments in processing assets such as the Purovsky Plant and Ust-Luga, as well as acquisitions of new oil and gas assets.

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

Facility	Amount	Maturity	Interest rate	Year ended 31 December:	
				2011	2010
Eurobonds Ten-Year	USD 650 million	February 2021	6.604%	20,776	-
Eurobonds Five-Year	USD 600 million	February 2016	5.326%	19,206	-
Sberbank	RR 15 billion	December 2013	7.5%	14,966	14,948
Gazprombank <sup>(1)</sup>	RR 10 billion	November 2012	8% <sup>(2)</sup>	10,000	10,000
Russian rouble Bonds	RR 10 billion	June 2013	7.5%	9,971	9,949
Sumitomo Mitsui Banking Corporation Europe Limited	USD 300 million	December 2013	LIBOR+1.45%	7,685	-
Nordea Bank	USD 200 million	November 2013	LIBOR+1.9%	6,439	6,095
UniCredit Bank	USD 200 million	October 2012	LIBOR+3.25% <sup>(2)</sup>	6,435	6,082
Bridge loan facility <sup>(3)</sup>	USD 600 million	November 2011	LIBOR+1%	-	18,200
Syndicated term loan facility	USD 800 million	April 2011	LIBOR+1.5%	-	6,952
<b>Total</b>				<b>95,478</b>	<b>72,226</b>

<sup>(1)</sup> – the loan from Gazprombank repaid in January 2012 ahead of maturity schedule.

<sup>(2)</sup> – interest rates were changed during the periods.

<sup>(3)</sup> – bridge loan repaid in February 2011 ahead of maturity schedule.

### Maturities of long-term loans

Scheduled maturities of our long-term debt outstanding (net of unamortized transaction costs) at 31 December 2011 were as follows:

Maturity schedule:	RR million
1 January 2013 to 31 December 2013	35,198
1 January 2014 to 31 December 2014	-
1 January 2015 to 31 December 2015	-
1 January 2016 to 31 December 2016	19,206
After 31 December 2016	20,776
<b>Total long-term debt</b>	<b>75,180</b>

### *Available credit facilities*

At 31 December 2011, the Group had available funds under short-term credit lines in the form of bank overdrafts with various international banks in the aggregate amount of RR 6,278 million (USD 195 million) at either fixed or variable interest rates subject to the specific type of credit facility.

The Group also has funds available under credit facilities with OAO Sberbank in the amount of RR 40 billion until July 2012 with an annual interest rate of 9.2%, Credit Agricole Corporate and Investment Bank in the amount of USD 100 million until June 2012 and ZAO UniCredit Bank in the amount of USD 150 million until August 2012, with the interest rates applicable under the aforementioned credit facilities to be negotiated at the time of each withdrawal, as well as funds available under credit facility with ZAO BNP PARIBAS Bank in the amount of USD 100 million until September 2012 with predetermined interest rate depending on the period of debt.

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

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

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

### **Foreign currency risk**

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 December 2011, total amount of our long-term debt denominated in US dollars was RR 50,243 million, or 52.6% of our total borrowings at that date. Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms, as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, approximately 29.7% in 2011, is denominated in US dollars. As of 31 December 2011, the Russian rouble depreciated by approximately 5.6% against the US dollar since 31 December 2010.

A hypothetical and instantaneous 10% depreciation in the Russian rouble in relation to the US dollar as of 31 December 2011 would have resulted in an estimated non-cash foreign exchange loss of approximately RR 6,054 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 2011, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.



IFRS Consolidated  
Financial Statements  
and Independent  
Auditor's Report  
for the years ended  
31 December 2011  
and 2010

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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 72, which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of cash flows and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory information.

### **Management's Responsibility for the Consolidated Financial Statements**

- 2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **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 consolidated financial statements are free from material misstatement.
- 4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of OAO NOVATEK and its subsidiaries as at 31 December 2011, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
5 March 2012

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

	Notes	At 31 December:	
		2011	2010
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	6	166,784	185,573
Investments in joint ventures	7	123,029	27,026
Long-term loans and receivables	8	32,130	40,151
Other non-current assets		3,173	2,858
<b>Total non-current assets</b>		<b>325,116</b>	<b>255,608</b>
<b>Current assets</b>			
Inventories	9	1,683	1,868
Current income tax prepayments		1,153	285
Trade and other receivables	10	16,699	8,670
Prepayments and other current assets	11	14,950	8,504
Cash and cash equivalents	12	23,831	10,238
<b>Total current assets</b>		<b>58,316</b>	<b>29,565</b>
<b>Total assets</b>		<b>383,432</b>	<b>285,173</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Non-current liabilities</b>			
Long-term debt	13	75,180	47,074
Deferred income tax liabilities	26	12,805	9,473
Other non-current liabilities		917	917
Asset retirement obligations		2,734	2,482
<b>Total non-current liabilities</b>		<b>91,636</b>	<b>59,946</b>
<b>Current liabilities</b>			
Short-term debt and current portion of long-term debt	15	20,298	25,152
Trade payables and accrued liabilities	16	24,922	28,479
Current income tax payable		611	1,212
Other taxes payable		4,283	2,598
<b>Total current liabilities</b>		<b>50,114</b>	<b>57,441</b>
<b>Total liabilities</b>		<b>141,750</b>	<b>117,387</b>
<b>Equity attributable to OAO NOVATEK shareholders</b>			
Ordinary share capital		393	393
Treasury shares		(281)	(446)
Additional paid-in capital		31,220	30,865
Currency translation differences		193	(120)
Asset revaluation surplus on acquisitions		5,617	5,617
Retained earnings		203,871	110,810
<b>Total equity attributable to OAO NOVATEK shareholders</b>	17	<b>241,013</b>	<b>147,119</b>
<b>Non-controlling interest</b>		<b>669</b>	<b>20,667</b>
<b>Total equity</b>		<b>241,682</b>	<b>167,786</b>
<b>Total liabilities and equity</b>		<b>383,432</b>	<b>285,173</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 5 March 2012:



L. Mikhelson  
General Director



M. Gyetvay  
Financial Director

**OAD NOVATEK**
**Consolidated Statement of Income**

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

	Notes	Year ended 31 December:	
		2011	2010
<b>Revenues</b>			
Oil and gas sales	19	175,602	115,162
Sales of polymer and insulation tape		-	1,699
Other revenues		462	163
<b>Total revenues</b>		<b>176,064</b>	<b>117,024</b>
<b>Operating expenses</b>			
Transportation expenses	20	(48,176)	(37,200)
Taxes other than income tax	21	(17,557)	(10,077)
Depreciation, depletion and amortization	6	(9,277)	(6,616)
General and administrative expenses	22	(8,218)	(6,733)
Materials, services and other	23	(5,947)	(6,072)
Purchases of natural gas and liquid hydrocarbons	24	(5,994)	(154)
Exploration expenses		(1,819)	(1,595)
Net impairment expenses		(782)	(541)
Change in natural gas, liquid hydrocarbons, polymer products and work-in-progress		105	470
<b>Total operating expenses</b>		<b>(97,665)</b>	<b>(68,518)</b>
Net gain on disposal of interest in subsidiaries		62,948	1,329
Other operating income (loss)		261	396
<b>Profit from operations</b>		<b>141,608</b>	<b>50,231</b>
<b>Finance income (expense)</b>			
Interest expense	25	(2,150)	(437)
Interest income	25	3,392	598
Foreign exchange gain (loss)		(3,945)	1,036
<b>Total finance income (expense)</b>		<b>(2,703)</b>	<b>1,197</b>
Share of profit (loss) of equity investments, net of income tax	7	(3,880)	(346)
<b>Profit before income tax</b>		<b>135,025</b>	<b>51,082</b>
<b>Income tax expense</b>			
Current income tax expense		(12,467)	(9,405)
Net deferred income tax expense		(3,267)	(1,399)
<b>Total income tax expense</b>	26	<b>(15,734)</b>	<b>(10,804)</b>
<b>Profit (loss)</b>		<b>119,291</b>	<b>40,278</b>
Profit (loss) attributable to:			
Non-controlling interest		(364)	(255)
<b>Shareholders of OAO NOVATEK</b>		<b>119,655</b>	<b>40,533</b>
Basic and diluted earnings per share (in Russian roubles)		39.45	13.37
<i>Weighted average number of shares outstanding (in thousands)</i>		<i>3,033,302</i>	<i>3,032,218</i>

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:	
		2011	2010
<b>Other comprehensive income (loss) after income tax:</b>			
Currency translation differences		313	(8)
<b>Other comprehensive income (loss)</b>		<b>313</b>	<b>(8)</b>
<b>Profit (loss)</b>		<b>119,291</b>	<b>40,278</b>
<b>Total comprehensive income (loss)</b>		<b>119,604</b>	<b>40,270</b>
Total comprehensive income (loss) attributable to:			
Non-controlling interest		(364)	(255)
<b>Shareholders of ОАО NOVATEK</b>		<b>119,968</b>	<b>40,525</b>

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:	
		2011	2010
<b>Profit before income tax</b>		<b>135,025</b>	<b>51,082</b>
<b>Adjustments to profit before income tax:</b>			
Depreciation, depletion and amortization		9,475	6,757
Net impairment expenses		782	541
Net foreign exchange loss (gain)		3,945	(1,036)
Net loss (gain) on disposal of assets		(62,811)	(1,253)
Interest expense		2,150	437
Interest income		(3,392)	(598)
Share of loss (profit) in equity investments, net of income tax		3,880	346
Net change in other non-current assets and long-term receivables		1,132	1,063
Share-based compensation	17	-	68
Other adjustments		202	241
<b>Working capital changes</b>			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(6,103)	(2,675)
Decrease (increase) in inventories		(132)	(479)
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends payable		567	(1,821)
Increase (decrease) in other taxes payable		1,120	765
<b>Total effect of working capital changes</b>		<b>(4,548)</b>	<b>(4,210)</b>
Income taxes paid		(13,933)	(8,575)
<b>Net cash provided by operating activities</b>		<b>71,907</b>	<b>44,863</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(25,317)	(21,360)
Acquisition of mineral licenses		(6,888)	(76)
Purchases of inventories intended for construction		(773)	(1,200)
Acquisition of subsidiaries net of cash acquired		(4,188)	(1,718)
Acquisition of and capital contribution to equity investments		(25,131)	(4,660)
Proceeds from disposals of subsidiaries net of cash disposed		11,796	1,173
Interest paid and capitalized		(3,508)	(2,002)
Loans provided		(6,729)	(39,402)
Repayments of loans provided		13,166	219
Interest received		929	184
<b>Net cash (used for) provided by investing activities</b>		<b>(46,643)</b>	<b>(68,842)</b>
<b>Cash flows from financing activities</b>			
Proceeds from long-term debt		44,885	35,018
Proceeds from short-term debt		3,700	20,331
Repayments of long-term debt		(8,552)	(18,718)
Repayments of short-term debt		(21,321)	(2,729)
Interest paid		(818)	(301)
Dividends paid	17	(15,166)	(9,868)
Acquisition of non-controlling interest	5	(14,817)	(629)
Additional capital contribution into subsidiaries	5	-	337
Proceeds from sale of treasury shares	17	354	341
<b>Net cash (used for) provided by financing activities</b>		<b>(11,735)</b>	<b>23,782</b>
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		64	(45)
<b>Net increase (decrease) in cash, cash equivalents and bank overdrafts</b>		<b>13,593</b>	<b>(242)</b>
Cash and cash equivalents at beginning of the period		10,238	10,532
Net decrease (increase) in cash and cash equivalents reclassified to assets classified as held for sale		-	(52)
<b>Cash, cash equivalents and bank overdrafts at end of the period</b>		<b>23,831</b>	<b>10,238</b>

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



**ОАО 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	Asset revaluation surplus on acquisitions	Currency translation differences	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b><i>For the year ended 31 December 2010</i></b>										
<b>1 January 2010</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>5,617</b>	<b>(112)</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>-</b>	<b>(8)</b>	<b>40,533</b>	<b>40,525</b>	<b>(255)</b>	<b>40,270</b>
Dividends (Note 17)	-	-	-	-	-	-	(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 (Note 5)	-	-	-	-	-	-	-	-	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 17)	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>5,617</b>	<b>(120)</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.

**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	Asset revaluation surplus on acquisitions	Currency translation differences	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b><i>For the year ended 31 December 2011</i></b>										
<b>1 January 2011</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>5,617</b>	<b>(120)</b>	<b>110,810</b>	<b>147,119</b>	<b>20,667</b>	<b>167,786</b>
Currency translation differences	-	-	-	-	-	313	-	313	-	313
Profit (loss)	-	-	-	-	-	-	119,655	119,655	(364)	119,291
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>313</b>	<b>119,655</b>	<b>119,968</b>	<b>(364)</b>	<b>119,604</b>
Dividends (Note 17)	-	-	-	-	-	-	(15,166)	(15,166)	-	(15,166)
Equity call option reclassification (Note 5)	-	-	-	-	-	-	322	322	-	322
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	286	286
Acquisition of non-controlling interest (Note 5)	-	-	-	-	-	-	(11,750)	(11,750)	(19,920)	(31,670)
Sales of treasury shares (Note 17)	<i>1,154</i>	-	165	355	-	-	-	520	-	520
<b>31 December 2011</b>	<b>3,034,338</b>	<b>393</b>	<b>(281)</b>	<b>31,220</b>	<b>5,617</b>	<b>193</b>	<b>203,871</b>	<b>241,013</b>	<b>669</b>	<b>241,682</b>

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

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

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## 1 ORGANISATION AND PRINCIPAL ACTIVITIES

ОАО 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 and gas products remain relatively stable from period to period.

In November 2011 and December 2010, the Group acquired ООО Gazprom mezhregiongas Chelyabinsk and ООО Yamalgazresurs-Chelyabinsk, respectively, both Russian regional natural gas traders, to support and expand natural gas sales opportunities in the Chelyabinsk Region of the Russian Federation (see Note 5).

In September 2011, the Group increased its ownership in ОАО Yamal LNG from 51 percent to 100 percent. In October 2011, the Group disposed a 20% stake in the company to TOTAL S.A., the strategy partner of the Group in the Yamal LNG project (see Note 5).

In 2011, the Group continued the legal process of renaming its subsidiaries to create a uniform brand image for NOVATEK and, as a result, the Group’s subsidiaries, Runitек GmbH and ООО Yamalgazresurs-Chelyabinsk, were renamed to Novatek Gas & Power GmbH and ООО NOVATEK-Chelyabinsk, respectively.

In December 2010, the Group acquired 51 percent ownership in ОАО Sibneftegas, an oil and gas production company, which owns four licenses for the fields located in YNAO (see Note 5).

In November 2010, ООО Yamal Development, the Group’s joint venture, acquired a 51 percent participation interest in ООО SeverEnergia. SeverEnergia 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 ООО NOVATEK-Polymer, its non-core subsidiary, to ЗАО SIBUR Holding (see Note 5).

In August 2010, the Group acquired 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 December 2010, Intergaz-System was merged into Novatek Polska, the Group’s wholly owned subsidiary.

In July 2010, NOVATEK and ОАО Gazprom Neft, a subsidiary of ОАО Gazprom, established a joint venture ООО Yamal Development for the purpose of developing potential hydrocarbon assets in the YNAO (see Note 5).

In May 2010, the Group established ООО 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. Furthermore, in April 2011, the Group acquired ООО Yamalenergogaz, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Perm Region for RR 75 million. In January 2012, Yamalenergogaz was merged into NOVATEK-Perm.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

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## 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.

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 Group’s 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 statements for the entities whose functional currency is not the Russian rouble were as follows:

<i>For one currency unit to one Russian rouble</i>	<u>At 31 December:</u>		<u>Average annual rate</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
US dollar (“USD”)	32.20	30.48	29.39	30.37
Polish Zloty (“PLN”)	9.47	10.17	9.94	10.09

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**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 Revised IAS 24.** Effective 1 January 2011 the Group adopted revised of IAS 24, *Related Party Disclosures* which simplified the definition of a related party and eliminated inconsistencies and contradictions in the standard. In accordance with the revised standard, parties under significant influence of key management personnel are not related parties of the Group (see Note 30).

**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.

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. Acquisition-related costs are recognised as expenses rather than included in goodwill.

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. Changes in the Group's ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions.

**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.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Investments in associates and joint ventures.** Associated companies and joint ventures are entities over which the Group has significant influence or joint control, respectively, 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 and joint ventures. The carrying amount of associates and joint ventures includes goodwill identified on acquisition less accumulated impairment losses, if any. Other post-acquisition changes in the Group's share of net assets of an associate or joint venture are recognised as follows: (i) the Group's share of profits or losses is recorded in the consolidated profit or loss for the year as share of result of associates or joint ventures; (ii) the Group's share of other comprehensive income is recognised in other comprehensive income and presented separately; and (iii) all other changes in the Group's share of the carrying value of net assets of associates or joint ventures are recognised in profit or loss within the share of result of associates or joint ventures. 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.

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.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 of property, plant and equipment are determined by comparing proceeds with the carrying amount. Gains and losses are recognized in the consolidated statement of income.

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

**Depreciation.** Depreciation, depletion and amortization of oil and gas properties and equipment (except for processing facilities) is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for costs associated with acquisitions of proved properties. 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 except for derivatives that are linked to and must be settled by delivery of investments in equity instruments that do not have a quoted, market price in an active market and whose fair value cannot be reliably determined. Derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year.

Derivatives that are linked to and must be settled by delivery of investments in equity instruments that do not have a quoted, market price in an active market and whose fair value cannot be reliably determined, are measured at cost.

Certain derivative instruments embedded in other financial instruments are treated as separate derivative instruments when their risks and characteristics are not closely related to those of the host contract.

The Group did not hold any instruments qualifying for hedging accounting during both reporting periods.

**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.



**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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

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

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

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivative instruments are also categorized as held for trading unless they are designated as hedges. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the consolidated statement of income. Gains or losses arising from changes in the fair value of the “financial assets at fair value through profit or loss” category are presented in the consolidated statement of income within other 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 include quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold 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 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 in other comprehensive income and accumulated in revaluation reserve 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 a reclassification adjustment from other comprehensive income.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 other comprehensive income. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in other comprehensive income. 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 a reclassification adjustment from other comprehensive income.

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 recognized in the consolidated statement of income as a reclassification adjustment from other comprehensive 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.** Effective 1 January 2012, Russian tax legislation introduced an option to prepare and file a single, consolidated income tax declaration. According to the new legislation, the taxpayers' group should comprise of a holding company and any number of entities with at least 90 percent ownership in each (direct or indirect). To be eligible for registration, the taxpayers' group must be registered with tax authorities and meet certain conditions and criteria. The tax declaration can be submitted then by any member of the group. Management has chosen to adopt this option, as discussed in Note 26.

In prior periods, Russian legislation did not contain the concept of a "consolidated tax payer" and, accordingly, the Group's entities were subject to Russian taxation on an individual company basis.

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

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 or joint ventures, 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. Any resultant deferred income tax is measured at the expected tax rate.

**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.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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 on borrowings and exchange differences arising from foreign currency borrowings (to the extent that they are regarded as an adjustment to interest costs) used to finance the construction of property, plant and equipment are capitalized during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

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

**Provisions for liabilities and charges.** Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events; 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 whose construction is substantially completed. 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.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 (loss) for the reporting period.

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

**Revenue recognition.** Revenues represent the 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, legal and other advisory expenses, insurance of properties, social expenses and compensatory payments of general nature not directly linked to the Group's oil and gas activities, charity 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.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Share based compensation.** The Group accounts for share-based compensation in accordance with IFRS 2, *Share-based Payment*. 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 14).

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 and then attributing such present value to years of service of the respective employees. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The discount rate was determined by reference to Russian rouble denominated bonds issued by the Government of the Russian Federation chosen to match the duration of the post-employment benefit obligations.

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

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

**Segment reporting.** Operating segments are defined as components of the Group where separate financial information is available and reported regularly to the Group's chief operating decision maker (hereinafter referred to as "CODM", represented by the Management Committee of NOVATEK). Segments whose revenues, results or assets are ten percent or more of the total segments are reported separately.

**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

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

Management reviews these estimates and assumptions on a continuous basis, by reference to past experiences and other factors considered as reasonable which form the basis for assessing the book values of assets and liabilities. Adjustments to accounting estimates are recognized in the period in which the estimate is revised if the change affects only that period or in the period of the revision and subsequent periods, if both periods are affected. Management also makes certain judgments, apart from those involving estimations, in the process of applying the Group's accounting policies. Actual results may differ from such estimates if different assumptions or circumstances apply.

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.

**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)**

***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.

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.



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**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)**

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

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.

**Fair value assessment of OAO Yamal LNG.** As further discussed in Note 5, the Group ceased control of Yamal LNG effective 6 October 2011, but retained joint control and, consequently, was required to fair value the remaining interest in Yamal LNG in accordance with IFRS. The fair value of the investment in Yamal LNG was calculated based on a discounted cash flow model for the Yamal LNG project. The discounted cash flow model included a number of key assumptions, the sensitivities of which are included in Note 5.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

## 5 MERGERS, ACQUISITIONS AND DISPOSALS

### *Acquisition of OOO Gazprom mezhregiongas Chelyabinsk*

In November 2011, the Group acquired a 100 percent participation interest in OOO Gazprom mezhregiongas Chelyabinsk to expand and market natural gas sales in the Chelyabinsk Region of the Russian Federation for cash consideration of RR 1,550 million, which was fully paid in December 2011. Gazprom mezhregiongas Chelyabinsk is responsible for the sale of natural gas to industrial and residential customers in the Chelyabinsk Region, one of the top ten Russian regions in terms of natural gas consumption.

Management has assessed the fair value of identifiable assets and liabilities and calculated that no goodwill arose on the acquisition. The following table represents the net fair values of the assets and liabilities of Gazprom mezhregiongas Chelyabinsk:

<i>OOO Gazprom mezhregiongas Chelyabinsk</i>	<b>Fair values at the acquisition date</b>
Property, plant and equipment	321
Other non-current assets	1,230
Trade receivables	2,112
Other current assets	205
Cash and cash equivalents	654
Non-current liabilities	(232)
Trade payables	(2,364)
Other current liabilities	(376)
<b>Total identifiable net assets</b>	<b>1,550</b>
Purchase consideration	(1,550)
<b>Goodwill</b>	<b>-</b>

The financial and operational activities of Gazprom mezhregiongas Chelyabinsk would have had an effect of an additional RR 12.1 billion on the Group's revenues and increased the Group's profit before tax by RR 1.3 billion if the acquisition occurred in January 2011. These figures do not include adjustments for the following: (a) depreciation, depletion and amortization was not increased to reflect the higher carrying values of intangible assets after fair value adjustments; (b) intercompany eliminations; and (c) income tax.

### *Acquisition of additional equity stake in OAO Yamal LNG*

In May 2009, the Group signed a call option agreement, which provided the Group with the right, but not the obligation, to purchase an additional 23.9 percent equity stake in Yamal LNG for USD 450 million until 4 June 2012. 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 February 2011, the Group reassigned the call option to purchase a 23.9 percent equity stake in Yamal LNG from its foreign subsidiary to its Russian subsidiary. As a result of a change in the functional currency from US dollars to Russian roubles, the call option was no longer considered an equity instrument and was reclassified to a financial asset with a value of RR 284 million (USD 10 million).

In March 2011, the Group signed a second call option agreement, which provides the Group with the right, but not the obligation, to purchase an additional 25.1 percent equity stake in Yamal LNG for USD 526 million until 1 July 2012. To enter into this call option agreement, the Group paid RR 422 million (USD 15 million), which was to be offset against total consideration.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

On 28 September 2011, the Group increased its equity stake in Yamal LNG from 51 percent to 100 percent by exercising the two aforementioned call options. The following table summarizes the total purchase consideration for the acquisition of an additional 49 percent stake:

	USD million	Exchange rate	RR million
<b>23.9% call option:</b>			
Cash	10	28.43	284
Accrued liability	450	32.22	14,499
<b>25.1% call option:</b>			
Cash	15	28.16	422
Accrued liability	511	32.22	16,465
<b>Total purchase consideration</b>	<b>986</b>		<b>31,670</b>

As a result of these two transactions, the Group reduced non-controlling interest by RR 19,920 million and recorded a difference of RR 11,750 million directly to retained earnings.

In accordance with the aforementioned transactions, the Group recorded an aggregated liability of USD 961 million, payable in instalments with the final payment due by 30 June 2012. At 31 December 2011, the balance due on these two transactions was RR 16,244 million (USD 505 million) (see Note 16).

**Disposal of ownership interest in OAO Yamal LNG**

On 5 October 2011, the Board of Directors of OAO NOVATEK approved the sale of a 20 percent stake in OAO Yamal LNG, the Group's wholly owned subsidiary, to TOTAL S.A., the strategic partner in the Yamal LNG project (the "Project"). Prior to that date, the proposed sale received the necessary approvals from the Russian Federation's Strategic Investment Committee and Federal Anti-Monopoly Service.

On 6 October 2011, the Group entered into a Sales contract and signed a new shareholder's agreement (the "Shareholders' agreement") with TOTAL E&P YAMAL SAS, an affiliate of TOTAL S.A., establishing the framework for joint cooperation in exploring and developing the South-Tambeyskoye field (held by Yamal LNG) located in the YNAO.

Total consideration for the 20 percent stake in Yamal LNG to be paid by TOTAL E&P YAMAL comprises of three tranches:

- i. *first tranche* – a cash payment of USD 425 million to NOVATEK upon the contract conclusion (payment received in October 2011);
- ii. *second tranche* – a cash payment of USD 375 million through additional capital contributions to the ordinary share capital of Yamal LNG, of which USD 204 million was received in 2011 and the remainder is expected to be received throughout 2012; and
- iii. *third tranche* – an additional cash payment ranging from USD nil to USD 500 million depending on the amount of the Project's capital expenditure through additional capital contribution to the ordinary share capital of Yamal LNG; the final amount of the additional payment will be determined based on the result of the Final Investment Decision. Management has assessed that it is most likely that the full USD 500 million will need to be paid. If the actual amount is less than the amount assessed then the associated consideration and gain recognized for the disposal of the 20 percent stake would need to be adjusted.

In addition, TOTAL E&P YAMAL agreed to compensate past costs of USD 11 million, incurred by NOVATEK in respect of the Project prior to finalization of contractual terms and conditions, through an additional capital contribution to the ordinary share capital of Yamal LNG, which was paid in December 2011.

The Shareholders' agreement further stipulates that additional financing for the Project, if needed, will be partly exercised in a form of disproportional loans from shareholders. Management is unable to quantify at this time the likelihood, amount, timing or interest rate for these loans and, based on this assessment, has determined that their fair value cannot be measured reliably at this moment.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

#### 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

The Shareholders' agreement also permits the Group to subsequently reduce its shareholding in Yamal LNG to 51 percent based on certain pre-specified terms and governance structure.

Presently, the Group has retained an 80 percent interest in Yamal LNG after the transaction; however, the Shareholders' agreement stipulates that key strategic, operational and financial decisions are subject to approval by eight out of nine members of the Board of Directors. As a result of these changes, the Group's effective control over Yamal LNG ceased on 6 October 2011. The Group has determined Yamal LNG to be a joint venture and will account for this investment under the equity method.

Based on the Shareholders' agreement and the provisions of the Sales contract, the Group recorded the disposal of a 20 percent interest in Yamal LNG for total consideration of RR 36,893 million realizing a gain of RR 62,831 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 Yamal LNG:

	<u>RR million</u>
First tranche (USD 425 million at exchange rate of 32.64 to USD 1.00)	13,871
Compensation of past costs (80 percent of USD 11 million at exchange rate of 32.64 to USD 1.00)	294
Second tranche (80 percent of USD 375 million at exchange rate of 32.64 to USD 1.00)	9,790
Third tranche (80 percent of USD 500 million at exchange rate of 32.64 to USD 1.00 discounted at 0.884 percent per annum)	12,938
<b>Total consideration</b>	<b>36,893</b>
Less: carrying amount of the Group's 20 percent interest in the net assets	(8,208)
Add: fair value adjustment relating to the retained investment in joint venture	34,263
<b>Gain on the sale of ownership interest</b>	<b>62,948</b>

In accordance with IAS 27 "Consolidated and Separate Financial Statements", the Group remeasured its retained investment in Yamal LNG at fair value at the date of ceasing control, with the change in value of RR 34,263 million recognized as an additional gain from disposal as reflected in net gain on disposal of interest in subsidiaries in the consolidated statement of income. The fair value of the investment in Yamal LNG was based on a discounted cash flow model for the Yamal LNG project. The significant assumptions in the discounted cash flow model are: forecasted prices for liquefied natural gas ("LNG"); anticipated production volumes; future capital expenditures required to build necessary infrastructure and drill production wells; and the discount factor used in the fair value calculation. The key sensitivities in relation to the discounted cash flows are:

- future LNG prices were based on estimated Brent prices using growth rates as forecasted by the World Bank. If these estimated future prices were to decrease by one percent for each year in the cash flow projection then, assuming that other parameters remain unchanged, the fair value of the retained interest in Yamal LNG and the associated gain on the revaluation would be reduced by RR 6,903 million;
- future production was based on estimates of proved and probable reserves. If production volumes were to be one percent lower in the cash flow projection then, assuming that other parameters remain unchanged, the fair value of the retained interest in Yamal LNG and the associated gain on the revaluation would be reduced by RR 4,903 million;
- future capital expenditure over the life of the project has been estimated based on preliminary engineering and costing estimates. If the level of capital expenditure were to be one percent higher in the cash flow projection then, assuming that other parameters remain unchanged, the fair value of the retained interest in Yamal LNG and the associated gain on the revaluation would be reduced by RR 3,904 million; and
- the discount rate was assumed to be 11.9% (in US dollar terms). If the discount rate was increased by half of one percent (to 12.4%) then, assuming that other parameters remain unchanged, the fair value adjustment and the associated gain on the revaluation would be reduced by RR 21,139 million.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

Below is a breakdown of major classes of assets and liabilities at the date of disposal:

<i>ОАО Yamal LNG</i>	<b>RR million</b>
Property, plant and equipment	45,867
Other non-current assets	1,404
Cash and cash equivalents	1,846
Other current assets	1,135
Other non-current liabilities	(810)
Short-term debt	(8,100)
Other current liabilities	(300)
<b>Total identifiable net assets at disposal</b>	<b>41,042</b>

The aforementioned property, plant and equipment in the amount of RR 45,867 million (including the costs of mineral rights aggregating RR 39,714 million) was included in the line “disposal of subsidiaries, net” as disclosed in Note 6. Short-term debt in the amount of RR 8,100 million, which was owed to the Group was settled in December 2011 ahead of its maturity schedule.

The following table reconciles the carrying value of Yamal LNG 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>ОАО Yamal LNG</i>	<b>RR million</b>
Carrying value of the net assets at disposal	41,042
Add: Group’s proportion of proceeds from additional shares emissions	23,022
Less: carrying amount of the Group’s 20 interest in the net assets	(8,208)
Add: fair value adjustment relating to the retained investment in joint venture	34,263
<b>The carrying value of equity investment</b>	<b>90,119</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.

***Acquisition of ООО Yamalgazresurs-Chelyabinsk***

In December 2010, the Group acquired a 100 percent participation interest in ООО 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 in the amount of 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 had 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 had 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.

**ОАО 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 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 million, of which RR 4,650 million was paid in December 2010 and the remaining RR 21,176 was paid in the first quarter of 2011. Sibneftegas holds production licenses in four fields, of which two, the Beregovoye and Pyreinoye gas condensate fields expire in 2023 and in 2021, respectively, are currently producing. Estimated aggregated proved reserves on these two fields as well as the Khadyryahinskoye (which expires in 2031) field appraised by DeGolyer and MacNaughton at 31 December 2010 under the PRMS and SEC reserve methodologies totaled approximately 282 billion and 200 billion cubic meters of natural gas and 2 million 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 a 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, representing unanimous approval by both shareholders and, consequently, the voting mechanism effectively establishes joint control over Sibneftegas. The Group accounts for it under the equity method.

At 31 December 2010, in accordance with IAS 31 "Interests in Joint ventures", the Group assessed preliminary fair values of the identified assets and liabilities of Sibneftegas and recorded provisional figures for those items. During 2011, an independent appraiser was engaged to assess the company's fair values of identifiable assets and liabilities at the acquisition date, which was completed in December 2011. As a result, the provisional values of non-current assets and non-current liabilities were increased by RR 16,305 million and RR 3,264 million, respectively, with a corresponding decrease in goodwill. The principal changes to the preliminary fair value assessment related to changes in the assessment of the fair value of the production assets and mineral licenses. Revisions made to the preliminary assessment were reflected as of the acquisition date and there was no goodwill included in the carrying amount of the investment in the joint venture. Finalization of purchase price allocation did not result in amendments to the comparative information.

The following table represents the final net fair values comprising 100 percent of the identifiable assets and liabilities of Sibneftegas:

<i>OAO Sibneftegas</i>	<b>Final fair values at the acquisition date</b>
Property, plant and equipment	83,128
Other non-current assets	107
Cash and cash equivalents	432
Other current assets	657
Long-term debt	(19,747)
Other non-current liabilities	(11,716)
Short-term debt	(1,766)
Other current liabilities	(456)
<b>Total identifiable net assets</b>	<b>50,639</b>
Purchase consideration	25,826
Fair value of the Group's interest in net assets (RR 50,639 million at 51% ownership)	(25,826)
<b>Goodwill</b>	<b>-</b>

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### *Establishment of OOO Yamal Development and acquisition of OOO SeverEnergiya*

In 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 this 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). NOVATEK financed its part of the loan to Yamal Development through the use of a bridge loan facility (see Note 13).

SeverEnergiya through its three wholly owned subsidiaries holds exploration and production licenses listed below:

Subsidiary of SeverEnergiya	License area	Expiring date
OAO Arkticheskaya gazovaya kompaniya	Samburgskoye and Yevo-Yakhinskoye	2018
ZAO Urengoil Inc.	Yaro-Yakhinskoye	2018
OAO Neftegastehnologiya	North-Chaselskoye	Life of field

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 billion and 224 billion cubic meters of natural gas and 42 million and 39 million tons of hydrocarbon liquids, respectively.

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.

As described above, Yamal Development acquired a 51 percent participation interest in SeverEnergiya; however, the Charter agreement of SeverEnergiya stipulates that key financial and operational decisions regarding its business activities are subject to approval by six out of the seven members of the Board of Directors, meaning that none of the participants have a preferential voting right. As a result, the Group has determined that SeverEnergiya is a joint venture of Yamal Development; the assets and liabilities of SeverEnergiya and its financial results are included in the assets, liabilities and financial results of Yamal Development under the equity method in the disclosure of summarized financial information about the Group's investments in joint ventures (see Note 7). The transaction provides the Group with an effective interest ownership of 25.5 percent in SeverEnergiya.

At 31 December 2010, in accordance with IAS 31 "Interests in Joint ventures", the Group assessed preliminary fair values of the identified assets and liabilities of SeverEnergiya and its subsidiaries and recorded provisional figures for those items. During 2011, an independent appraiser was engaged to assess the fair values of identifiable assets and liabilities of the company at the acquisition date, which was completed in December 2011. As a result, the provisional values of non-current assets and non-current liabilities were decreased by RR 735 million and RR 622 million, respectively, with the remaining RR 113 million recorded as changes in other items. The principal changes to the preliminary fair value assessment related to changes in the assessment of the fair value of the production assets and mineral licenses. Revisions made to the preliminary assessment were reflected as of the acquisition date and there was no goodwill included in the carrying amount of the investment in the joint venture. Finalization of purchase price allocation did not result in amendments to the comparative information.



## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

The following table represents the final net fair values comprising 100 percent of the identifiable assets and liabilities of SeverEnergia and its subsidiaries:

<i>SeverEnergia and its subsidiaries</i>	<b>Final fair values at the acquisition date</b>
Property, plant and equipment	136,493
Cash and cash equivalents	1,515
Other current assets	2,427
Deferred income tax liabilities	(22,060)
Other non-current liabilities	(268)
Short-term debt	(19,613)
Other current liabilities	(2,974)
<b>Total identifiable net assets</b>	<b>95,520</b>
Purchase consideration	48,715
Fair value of the Yamal Development's interest in net assets of SeverEnergia (RR 95,520 million at 51% ownership)	(48,715)
<b>Goodwill</b>	<b>-</b>

### *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, OOO 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 had 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 2011, a final investment decision was made and the respective field development plan was approved.

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 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) was to be paid upon approval by TOTAL of the final investment decision (payment received in December 2011); and
- a further increase of TOTAL's equity share in Terneftegas to 49 percent through a subscription to the entity's additional shares emission for total consideration of USD 18 million.

The Group transferred legal ownership of a 28 percent interest in Terneftegas to Total Termokarstovoye B.V. in February 2010 upon the execution of the first arrangement. In January 2010, 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 completed and the subscription for the issuance of the additional shares was registered with the FSFM by Total Termokarstovoye B.V.

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 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.

**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 following table summarizes the consideration details and shows the components of the gain from the sale of the ownership interest in 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 Terneftegas; however, the Agreement stipulates that key financial and operational decisions 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 Terneftegas ceased. As a result of these changes, the Group has determined that Terneftegas is a joint venture and is accounted for using the equity method.

In accordance with IAS 27 "*Consolidated and Separate Financial Statements*", the Group remeasured its retained investment in 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 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.

***Acquisition of controlling interests in associates***

On 15 February 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailikneftegas, 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, Oiltechproduct-Invest obtained the production license for the West-Chaselskoe field, which expires in 2030.

**OOO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)**

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.

***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, Oiltechproduct-Invest into its wholly owned subsidiary OOO NOVATEK-Tarkosaleneftegas. In November 2011, the Group merged its wholly owned subsidiary, Tailiksneftegas into its wholly owned subsidiary OOO NOVATEK-Yurkharovneftegas. The aforementioned mergers did not affect the Group’s consolidated financial and operational results.

**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 ZAO 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 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 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
Total consideration	2,019
Less: carrying amount of net assets disposed	(2,273)
<b>Loss on disposal</b>	<b>(254)</b>

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 billion cubic meters and 14.4 million tons, 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 Тамбейнефтегас</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 Тамбейнефтегас were not material to the Group's revenues and results of operations for the year ended 31 December 2010.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**6 PROPERTY, PLANT AND EQUIPMENT**

Movements in property, plant and equipment, for the years ended 31 December 2011 and 2010 are as follows:

	Oil and gas properties and equipment	Assets under construction and advances for construction	Other	Total
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 1 January 2010</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>
Acquisition of subsidiaries	108	183	30	321
Additions	10,140	27,869	22	38,031
Transfers	15,455	(20,216)	4,761	-
Depreciation, depletion and amortization	(9,026)	-	(424)	(9,450)
Disposal of subsidiaries, net	(40,136)	(5,665)	(66)	(45,867)
Impairment	(513)	(107)	-	(620)
Disposals, net	(549)	(439)	(216)	(1,204)
Cost	177,788	17,647	8,603	204,038
Accumulated depreciation, depletion and amortization	(35,824)	-	(1,430)	(37,254)
<b>Net book value at 31 December 2011</b>	<b>141,964</b>	<b>17,647</b>	<b>7,173</b>	<b>166,784</b>

Included within the oil and gas properties and equipment balance at 31 December 2011 and 2010 are proved properties of RR 22,355 million and RR 62,509 million, net of accumulated depreciation, depletion and amortization of RR 10,300 million and RR 8,915 million, respectively.

Included within the oil and gas properties and equipment balance at 31 December 2011 and 2010 are unproved properties of RR 14,061 million and RR 6,991 million, respectively. The Group's management believes these costs are recoverable and has plans to explore and develop the respective unproved properties.

Included within assets under construction and advances for construction are advances to suppliers of equipment of RR 3,781 million and RR 2,676 million at 31 December 2011 and 2010, respectively.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**6 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

Included in additions to property, plant and equipment for the years ending 31 December 2011 and 2010 are capitalized interest and foreign exchange differences of RR 4,145 million and RR 2,621 million, respectively. The interest capitalization rates for 2011 and 2010 used for additions were 7.1 percent and 5.4 percent, respectively.

During 2011, the transfers to oil and gas properties and equipment include the completion of the third stage of the second phase development of the Yurkharovskoye field in the amount of RR 9,785 million. During 2010, the transfers to oil and gas properties and equipment included the second stage completion and third stage partial completion of the second phase development of the Yurkharovskoye field in the amount of RR 20,618 million.

In June 2011, the Group purchased, through participation in a tender process, exploration and production licenses for the Salmanovskoye (Utrenneye) and Geofizicheskoye fields and geological studies, exploration and production for the North-Obskiy and East-Tambeyskiy license areas for a total payment of RR 6,870 million, which were included in additions to oil and gas properties.

In October 2011, the Group ceased control of OAO Yamal LNG as described in Note 5 and has recorded a disposal aggregating RR 45,867 million as “disposal of subsidiaries, net” in property, plant and equipment. The Group retained 80 percent of Yamal LNG and has recorded its proportional share in investments in joint ventures (see Note 7).

Reconciliation of depreciation, depletion and amortization (DD&A):

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
DD&A included in operating expenses (excluding RR 111 million and RR nil million for the years ended 31 December 2011 and 2010, respectively, related to Intangible assets)	9,166	6,616
DD&A included in general and administrative expenses (see Note 22)	198	141
DD&A capitalized in the course of intra-group construction services	86	71
<b>Total depreciation, depletion and amortization</b>	<b>9,450</b>	<b>6,828</b>

At 31 December 2011 and 2010, no property, plant and equipment were pledged as security for the Group’s borrowings. Impairment of RR 620 million and RR 321 million was recognized in respect of oil and gas properties and equipment for the years ended 31 December 2011 and 2010, 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 1,615 million and RR 1,115 million at 31 December 2011 and 2010, 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.



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**7 INVESTMENTS IN JOINT VENTURES**

	At 31 December:	
	2011	2010
<i>Joint ventures:</i>		
ОАО Yamal LNG	89,549	-
ОАО Sibneftegas	24,187	25,758
ООО Yamal Development (consolidated)	8,100	-
ZАО Terneftegas	1,193	1,268
<b>Total investments in joint ventures</b>	<b>123,029</b>	<b>27,026</b>

In June 2011, the charter capital of ООО Yamal Development was increased by converting RR 20 billion of the loans, including accrued interest, provided to the company by its participants, of which RR 10 billion, including accrued interest in the amount of RR 225 million, is attributable to NOVATEK (see Note 8).

The Group's investment in Yamal Development at 31 December 2010 was valued at RR 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 in the amount of RR 238 million were recorded as a reduction of long-term loans provided by the Group to the joint venture (see Note 8).

As discussed in Note 5, in October 2011, the Group's effective control over ОАО Yamal LNG ceased and subsequent to that event, the Group's interest in this entity is accounted for using the equity method.

The table below summarizes the movement in the carrying amounts of the Group's equity investments.

	Year ended 31 December:	
	2011	2010
<b>At 1 January</b>	<b>27,026</b>	<b>1,214</b>
Share of profit (loss) of equity investments before income tax	(4,725)	(412)
Share of income tax (expense) benefit	845	66
<b>Share of profit (loss) of equity investments, net of income tax</b>	<b>(3,880)</b>	<b>(346)</b>
Acquisition of equity investments	-	25,836
Contribution to charter capital	10,000	-
Losses (reversals) recognized in excess of equity investments, reclassified to long-term loans receivable for these companies	(238)	238
Disposals of subsidiaries resulting in recognition of equity investments	90,121	1,298
Acquisition of controlling stake resulting in derecognition of equity investments	-	(1,214)
<b>At 31 December</b>	<b>123,029</b>	<b>27,026</b>

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**7 INVESTMENTS IN JOINT VENTURES (CONTINUED)**

At 31 December 2011 and 2010, the Group's interests in its joint ventures and their summarized financial information, relating to the Group's interest, were as follows:

<i>As at and for the year ended 31 December 2011</i>	<b>Non- current assets</b>	<b>Current assets</b>	<b>Non- current liabilities</b>	<b>Current liabilities</b>	<b>Net assets</b>	<b>Revenues</b>	<b>Profit (loss)</b>	<b>Interest held</b>
Yamal LNG	85,529	1,946	20,542	240	66,693	32	(707)	80%
Yamal Development (consolidated)	24,340	109	-	16,349	8,100	-	(1,662)	50%
SeverEnergia	37,068	1,264	5,933	8,376	24,023	-	(224)	25.5%
Less: investment and share of loss of Yamal Development in SeverEnergia	(24,023)	-	-	-	(24,023)	-	224	-
Sibneftegas	40,046	640	15,469	1,030	24,187	3,661	(1,571)	51%
Terneftegas	1,713	164	668	16	1,193	-	(74)	51%
<b>Total</b>	<b>164,673</b>	<b>4,123</b>	<b>42,612</b>	<b>26,011</b>	<b>100,173</b>	<b>3,693</b>	<b>(4,014)</b>	
<i>As at and for the year ended 31 December 2010</i>	<b>Non- current assets</b>	<b>Current assets</b>	<b>Non- current liabilities</b>	<b>Current liabilities</b>	<b>Net assets</b>	<b>Revenues</b>	<b>Profit (loss)</b>	<b>Interest held</b>
Yamal Development (consolidated)	28,050	27	27,886	191	-	-	(248)	50%
SeverEnergia	35,076	1,005	5,962	5,812	24,307	-	(50)	25.5%
Less: investment and share of loss of Yamal Development in SeverEnergia	(24,307)	-	-	-	(24,307)	-	50	-
Sibneftegas	42,369	712	16,046	1,277	25,758	157	(68)	51%
Terneftegas	1,543	170	442	3	1,268	2	(30)	51%
<b>Total</b>	<b>82,731</b>	<b>1,914</b>	<b>50,336</b>	<b>7,283</b>	<b>27,026</b>	<b>159</b>	<b>(346)</b>	

At 31 December 2011, the Group's investment in Yamal LNG totaled RR 89,549 million which differed from its share in the net assets of RR 66,693 million as noted above. This difference of RR 22,856 million relates to the Group's share in the second and third tranches recognized as part of the consideration for the disposal of the 20 percent interest in Yamal LNG (see Note 5).

All of the joint ventures listed above are registered in the Russian Federation.

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**8 LONG-TERM LOANS AND RECEIVABLES**

	At 31 December:	
	2011	2010
Russian rouble denominated loans	9,737	38,923
US dollar denominated loans	220	102
<b>Total</b>	<b>9,957</b>	<b>39,025</b>
Less: current portion of long-term loans	(634)	(968)
<b>Total long-term loans</b>	<b>9,323</b>	<b>38,057</b>
Long-term receivables	22,027	2,063
Long-term interest receivable	780	31
<b>Total long-term loans and receivables</b>	<b>32,130</b>	<b>40,151</b>

**Russian rouble denominated loans.** On 15 December 2010, the Group provided two loans to OAO Sibneftegas, the Group's joint venture, 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. The second loan was issued at an annual interest rate of 9.5 percent and is repayable quarterly in equal parts starting from March 2011 until November 2014. At 31 December 2011 and 2010, the loans provided to Sibneftegas amounted to RR 9,737 million and RR 11,038 million, respectively (see Note 30).

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 is repayable in November 2011; however, 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 in the amount of RR 28,123 million, net of accumulated losses 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). In June 2011, NOVATEK converted RR 9,775 million, excluding accrued interest, of this loan to equity (see Note 7).

In November 2011, the participants of Yamal Development made a decision to pro-rata increase its charter capital by converting the remaining unpaid part of the loan provided to the company in the amount of RR 32,697 million, including accrued interest, to equity. The legal procedures to register the new charter were not completed at 31 December 2011 and, accordingly, the Group's pro-rate share of RR 16,348 million, including accrued interest of RR 1,162 million, was recognized as long-term receivables.

In December 2011, the shareholders of OAO Yamal LNG, the Group's joint venture, made a decision to increase its charter capital through a subscription to the entity's additional shares emission in the amount of RR 10,780 million, which were fully paid. The legal procedures to register the new charter were not completed at 31 December 2011 and, accordingly, the Group's share of RR 3,955 million was recognized as long-term receivables. The Group's shareholding will not change after the share emission.

No provisions for impairment of long-term loans and receivables were recognized in the consolidated statement of financial position at 31 December 2011 and 2010.

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**9 INVENTORIES**

	At 31 December:	
	2011	2010
Natural gas and hydrocarbon liquids at cost	1,146	1,090
Materials and supplies at cost	400	575
Materials and supplies at net realizable value (net of provisions of RR 31 million and RR 33 million at 31 December 2011 and 2010, respectively)	133	192
Other inventories	4	11
<b>Total inventories</b>	<b>1,683</b>	<b>1,868</b>

The Group recorded an impairment expense of nil and RR 8 million during the years ended 31 December 2011 and 2010, 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.

**10 TRADE AND OTHER RECEIVABLES**

	At 31 December:	
	2011	2010
Trade receivables (net of provision of RR 133 million and RR nil million at 31 December 2011 and 2010, respectively)	14,900	7,031
Other receivables	1,703	1,445
Interest on loans receivable	96	194
<b>Total trade and other receivables</b>	<b>16,699</b>	<b>8,670</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 letters of credit in banks with investment grade rating as security for trade receivables in amount RR 1,706 million and RR 1,667 million at 31 December 2011 and 2010, respectively. Also the Group holds as a collateral 100 percent participation interest in OOO NOVATEK-Polymer for other receivables from ZAO 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 478 million and RR 8 million at 31 December 2011 and 2010, respectively, were past due but not impaired.

The Group has expanded its natural gas sales to a larger number of mid- to small-sized customers as a result of the recent acquisitions of regional gas traders. The Group has assessed the payment history of these accounts and recognized impairments where deemed necessary.

The ageing analysis of these past due but not impaired trade and other receivables are as follows:

	At 31 December:	
	2011	2010
Up to 90 days past-due	343	-
91 to 360 days past-due	135	-
Over 360 days past-due	-	8
<b>Total past due but not impaired</b>	<b>478</b>	<b>8</b>
Not past due and not impaired	16,221	8,662
<b>Total trade and other receivables</b>	<b>16,699</b>	<b>8,670</b>

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**10 TRADE AND OTHER RECEIVABLES (CONTINUED)**

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

	Year ended 31 December:	
	2011	2010
<b>At 1 January</b>	-	7
Additional provision recorded	184	184
Acquisition of subsidiaries	76	-
Receivables written off as uncollectible	(107)	(191)
Provision reversed	(20)	-
<b>At 31 December</b>	<b>133</b>	<b>nil</b>

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

**11 PREPAYMENTS AND OTHER CURRENT ASSETS**

	At 31 December:	
	2011	2010
<b>Financial assets</b>		
Russian rouble denominated loans	6,859	969
Short-term bank deposits	17	-
<b>Non-financial assets</b>		
Recoverable value-added tax	1,550	1,340
Prepayments and advances to suppliers (net of provision of RR 12 million and RR 89 million at 31 December 2011 and 2010, respectively)	3,322	2,388
Deferred export duties for stable gas condensate	922	1,151
Prepaid taxes other than income tax	668	912
Deferred transportation expenses for natural gas	1,139	824
Deferred transportation expenses for stable gas condensate	413	514
Other current assets	60	406
<b>Total prepayments and other current assets</b>	<b>14,950</b>	<b>8,504</b>

On 29 April 2011, the direct and indirect shareholders of SeverEnergiya, a joint venture of Yamal Development, provided proportionally a loan facility to SeverEnergiya in the aggregated amount up to RR 31 billion, of which 25.5 percent or RR 7,905 million is attributable to NOVATEK. The facility bears interest rate of MosPrime plus three percent per annum (9.78 percent at 31 December 2011) and is repayable in April 2012. At 31 December 2011, NOVATEK provided RR 6,225 million under this loan facility included in Russian rouble denominated loans (see Note 30).

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**12 CASH AND CASH EQUIVALENTS**

	At 31 December:	
	2011	2010
Cash at current bank accounts	7,958	4,509
Russian rouble denominated deposits (average interest rate 4.5% p.a. and 2.4% p.a. for 2011 and 2010, respectively)	4,986	4,105
US dollar denominated deposits (average interest rate 0.8% p.a. and 0.3% p.a. for 2011 and 2010, respectively)	10,822	1,584
Other current denominated deposits	65	40
<b>Total cash and cash equivalents</b>	<b>23,831</b>	<b>10,238</b>

All deposits have original maturities of less than three months (see Note 27 for credit risk disclosures).

**13 LONG-TERM DEBT**

	At 31 December:	
	2011	2010
US dollar denominated bonds	39,982	-
Russian rouble denominated loans	24,966	24,948
US dollar denominated loans	20,559	19,129
Russian rouble denominated bonds	9,971	9,949
<b>Total</b>	<b>95,478</b>	<b>54,026</b>
Less: current portion of long-term debt	(20,298)	(6,952)
<b>Total long-term debt</b>	<b>75,180</b>	<b>47,074</b>

At 31 December 2011 and 2010, the Group's long-term debt by facility is as follows:

	At 31 December:	
	2011	2010
Eurobonds – Ten-Year Tenor	20,776	-
Eurobonds – Five-Year Tenor	19,206	-
Sberbank	14,966	14,948
Gazprombank	10,000	10,000
Russian rouble denominated bonds	9,971	9,949
Sumitomo Mitsui Banking Corporation Europe Limited	7,685	-
Nordea Bank	6,439	6,095
UniCredit Bank	6,435	6,082
Syndicated term loan facility	-	6,952
<b>Total</b>	<b>95,478</b>	<b>54,026</b>

**Eurobonds.** In February 2011, the Group issued Eurobonds in an aggregate amount of USD 1,250 million. The Eurobonds were issued at par in two tranches, a five-year USD 600 million bond with a coupon rate of 5.326 percent and a ten-year USD 650 million bond with a coupon rate of 6.604 percent. The coupons are payable semi-annually. At 31 December 2011, the outstanding amount was RR 39,982 million (USD 1,242 million), net of unamortized transaction costs of RR 263 million.

**Sberbank.** On 16 December 2010, the Group obtained a RR 15 billion loan from Sberbank for general corporate purposes including the financing of capital expenditures. The loan bears an interest rate of 7.5 percent per annum and is repayable in December 2013. At 31 December 2011, the outstanding loan amount was RR 14,966 million, net of unamortized transaction costs of RR 34 million.

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**13 LONG-TERM DEBT (CONTINUED)**

**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. By the end of 2010, the Group withdrew the full amount of the loan facility. Throughout 2010 and the first three months of 2011, the Group gradually reduced the stated interest rate from the initial 13 percent to 8 percent per annum. At 31 December 2011, the outstanding amount was RR 10 billion. In January 2012, the loan was fully repaid ahead of its maturity schedule.

**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 2011, the outstanding amount was RR 9,971 million, net of unamortized transaction costs of RR 29 million.

**Sumitomo Mitsui Banking Corporation Europe Limited.** On 5 April 2011, the Group obtained a USD 300 million credit line facility with Sumitomo Mitsui Banking Corporation Europe Limited at an interest rate of LIBOR plus 1.45 percent per annum (2.03 percent at 31 December 2011). In April 2011, the Group withdrew the full amount of the USD 300 million credit line facility payable until December 2013. The loan facility includes maintenance of certain restrictive financial covenants. At 31 December 2011, the outstanding amount was RR 7,685 million (USD 239 million), net of unamortized transaction costs of RR 42 million.

**Nordea Bank.** On 16 November 2010, the Group obtained a USD 200 million credit line facility with OAO Nordea Bank. The facility has a three-year tenure, an interest rate of LIBOR plus 1.9 percent per annum (2.18 percent and 2.16 percent at 31 December 2011 and 2010, respectively) and includes the maintenance of certain restrictive financial covenants. At 31 December 2011, the outstanding amount was RR 6,439 million (USD 200 million).

**UniCredit Bank.** At 31 December 2011 and 2010, the US dollar denominated loans included the outstanding loan under credit line facility with UniCredit Bank until October 2012 in the amount of RR 6,435 million (USD 200 million), net of unamortized transaction costs of RR 4 million, and RR 6,082 million (USD 200 million), net of unamortized transaction costs of RR 13 million, respectively. The loan bears an interest rate of LIBOR plus 4.65 percent per annum effective from 25 February 2010 and LIBOR plus 3.25 percent per annum effective from 11 January 2011 (3.52 percent and 4.92 percent at 31 December 2011 and 2010, respectively). The loan facility includes the maintenance of certain restrictive financial covenants.

**Syndicated term loan facility.** At 31 December 2010, the US dollar denominated loans included an unsecured syndicated term loan facility in the amount of RR 6,952 million (USD 228 million) net of unamortized transaction costs of RR 15 million. The facility paid an interest of LIBOR plus 1.5 percent per annum (1.79 percent at 31 December 2010). In April 2011, the loan facility was fully repaid in accordance with its maturity schedule.

The fair values of long-term debt at 31 December 2011 and 2010 were as follows:

	At 31 December:	
	2011	2010
Eurobonds – Ten-Year Tenor	21,150	-
Eurobonds – Five-Year Tenor	19,414	-
Sberbank	14,539	15,000
Gazprombank	9,928	10,122
Russian rouble denominated bonds	10,000	10,061
Sumitomo Mitsui Banking Corporation Europe Limited	7,561	-
UniCredit Bank	6,439	6,139
Nordea Bank	6,256	5,814
Syndicated term loan facility	-	6,885
<b>Total</b>	<b>95,287</b>	<b>54,021</b>

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**13 LONG-TERM DEBT (CONTINUED)**

Scheduled maturities of long-term debt at 31 December 2011 were as follows:

<i>Maturity period:</i>	<b>RR million</b>
1 January 2013 to 31 December 2013	35,198
1 January 2014 to 31 December 2014	-
1 January 2015 to 31 December 2015	-
1 January 2016 to 31 December 2016	19,206
After 31 December 2016	20,776
<b>Total long-term debt</b>	<b>75,180</b>

**14 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 (extended to five years effective 1 February 2011) 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:

	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Present value of the defined benefit obligations	810	758
Unrecognized past service cost	(146)	(200)
<b>Defined benefit plan liability recognized in the consolidated statement of financial position</b>	<b>664</b>	<b>558</b>

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

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>At 1 January</b>	<b>758</b>	<b>620</b>
Interest cost	48	31
Benefits paid	(13)	(8)
Current service cost	88	66
Past services cost	-	51
Disposal of obligation due to disposal of subsidiary	-	(75)
Actuarial (gain) loss	(71)	73
<b>At 31 December</b>	<b>810</b>	<b>758</b>



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**14 PENSION OBLIGATIONS (CONTINUED)**

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

	Year ended 31 December:	
	2011	2010
Current service cost	88	66
Interest cost	48	31
Disposal of obligation due to disposal of subsidiary	-	(75)
Actuarial (gain) loss	(71)	73
Amortization of past service cost	55	79
<b>Defined benefit plan (benefits) costs recognized in operating expenses</b>	<b>120</b>	<b>174</b>
<i>of which the following amounts were included as employee compensation in:</i>		
Materials, services and other	46	73
General and administrative expenses	74	101

The Group recognized a loss of RR 5 million and a gain of RR 5 million as a result of experience adjustments on plan liabilities during the years ended 31 December 2011 and 2010, respectively, included in actuarial (gain) loss.

The principal actuarial assumptions used at 31 December 2011 and 2010 are as follows:

	At 31 December:	
	2011	2010
Weighted average discount rate	7.4%	7.6%
Projected annual increase in employee compensation	5.8%	10%
Expected increases to pension benefits	5.8%	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 5.9 percent for 2012 to 4.7 percent in 2016 and on average equal to 4.4 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.

**15 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT**

	At 31 December:	
	2011	2010
US dollar denominated loans	-	18,200
Total	-	18,200
Add: current portion of long-term debt	20,298	6,952
<b>Total short-term debt and current portion of long-term debt</b>	<b>20,298</b>	<b>25,152</b>

**ОАО NOVATEK**

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

**Bridge loan facility.** At 31 December 2010, the US dollar denominated loans included the RR 18,200 million (USD 597 million), net of unamortized part of transaction costs of RR 85 million, bridge loan facility obtained for financing of the acquisition by the Group's joint venture OOO Yamal Development of a 51 percent participation interest in OOO SeverEnergia. The bridge loan facility had a one-year tenure with a bullet repayment to be made by 15 November 2011. The interest rate under the bridge facility was LIBOR plus one percent per annum. In February 2011, the bridge loan was fully repaid ahead of its maturity schedule.

**Available credit facilities.** The Group's available credit facilities at 31 December 2011 were as follows:

	Par value	Expiring	
		Within one year	Between 1 and 2 years
Credit Agricole Corporate and Investment Bank <sup>(a)</sup>	USD 100 million	3,220	-
BNP PARIBAS Bank <sup>(a)</sup>	USD 100 million	3,220	-
UniCredit Bank <sup>(a)</sup>	USD 150 million	4,829	-
Sberbank <sup>(b)</sup>	RR 40 billion	40,000	-
<b>Total available credit facilities</b>		<b>51,269</b>	<b>-</b>

<sup>(a)</sup> – interest rates are predetermined or negotiated at time of each withdrawal.

<sup>(b)</sup> – interest rate set to 9.2 percent per annum and the facility is repayable by December 2014.

The Group also maintained available funds under short-term credit lines in the form of bank overdrafts with various international banks for RR 6,278 million (USD 195 million) and RR 5,943 million (USD 195 million) at 31 December 2011 and 2010, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

**16 TRADE PAYABLES AND ACCRUED LIABILITIES**

	At 31 December:	
	2011	2010
<b>Financial liabilities</b>		
Trade payables	5,187	2,194
Other payables	16,615	24,760
Interest payable	1,009	53
<b>Non-financial liabilities</b>		
Advances from customers	743	412
Salary payables	1,124	897
Other liabilities	244	163
<b>Trade payables and accrued liabilities</b>	<b>24,922</b>	<b>28,479</b>

At 31 December 2011, other payables included RR 16,244 million (USD 505 million) relating to the acquisition of a 49 percent equity stake in OAO Yamal LNG.

At 31 December 2010, other payables included RR 21,176 million relating to the acquisition of 51 percent ownership in Sibneftegas, which was fully paid in March 2011.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**17 SHAREHOLDERS' EQUITY**

**Ordinary share capital.** Share capital issued and paid in consisted of 3,036,306,000 ordinary shares at 31 December 2011 and 2010 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, during 2008 has 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 2011 and 2010, the Group held 196,853 GDRs (1,969 thousand ordinary shares) and 312,277 GDRs (3,123 thousand ordinary shares) at a total cost of RR 281 million and RR 446 million, respectively. The Group has decided that these GDRs do not vote.

During the years ended 31 December 2011 and 2010, the Group sold 115,424 GDRs (1,154 thousand ordinary shares) and 106,956 GDRs (1,070 thousand ordinary shares) for RR 536 million and RR 341 million, recognizing gains of RR 355 million and RR 188 million, respectively, which were 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:

	Year ended 31 December:	
	2011	2010
Dividends payable at 1 January	-	13
Dividends declared (*)	15,166	9,855
Dividends paid (*)	(15,166)	(9,868)
<b>Dividends payable at 31 December</b>	<b>-</b>	<b>-</b>
Dividends per share declared during the year (in Russian roubles)	5.00	3.25
Dividends per GDR declared during the year (in Russian roubles)	50.0	32.5

(\*) – excluding treasury shares.

The Group declares and pays dividends in Russian roubles. Dividends declared in 2011 and 2010 were as follows:

Final for 2010: RR 2.50 per share or RR 25.0 per GDR declared in April 2011	7,591
Interim for 2011: RR 2.50 per share or RR 25.0 per GDR declared in October 2011	7,591
<b>Total dividends declared in 2011</b>	<b>15,182</b>
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>

**Distributable retained earnings.** In accordance with Russian legislation, NOVATEK distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. Russian legislation identifies the net profit as basis of distribution. For 2011 and 2010, the net statutory profits of NOVATEK as reported in the published annual statutory reporting forms were RR 39,714 million and RR 21,323 million, respectively. The closing balances of the accumulated profit including the respective years net statutory profit totalled RR 120,889 million and RR 81,176 million at 31 December 2011 and 2010, respectively.

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.

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**18 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 OAO 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 ("LSE") under the ticker symbol "NVTK". At 31 December 2011 and 2010, the Program covered 146 and 164 employees, respectively. 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>	<i>Weighted average or closing price (LSE), USD per GDR</i>
<b>Total amount of GDRs granted at 12 February 2010</b>	<b>407,766</b>	<b>68.1</b>
Granted	5,352	94.1
Exercised	-	-
Forfeited	(30,750)	-
<b>Total amount of GDRs granted at 31 December 2010</b>	<b>382,368</b>	<b>119.5</b>
Granted	-	-
Exercised	(104,728)	105.0
Forfeited	(36,984)	-
<b>Total amount of GDRs granted at 31 December 2011</b>	<b>240,656</b>	<b>125.2</b>

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.

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.

The fair value of the Program is determined based on the following assumptions:

	<b>2011</b>	<b>2012</b>
Expected volatility	49.84%	49.84%
Risk-free interest rate	-	0.67%
Expected option life (years)	0.09	1.09
Exercise price per GDR (USD)	48.62	48.62

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(in Russian roubles, [tabular amounts in millions] unless otherwise stated)

**18 SHARE-BASED COMPENSATION PROGRAM (CONTINUED)**

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 (1.1 years). Risk-free interest rate is based on a benchmark USD curve including Deposit Rates (DEPO), Forward Rate Agreements (FRA) and Interest Rate Swaps (IRS).

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.

The amounts recognized by the Group in respect of the Program are as follows:

<i>Expenses included in</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
General and administrative expenses	235	400
<hr/>		
<i>Liabilities included in</i>	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Other non-current liabilities	226	236
Trade payables and accrued liabilities	244	164
<hr/>		
<b>Total share-based compensation program liabilities</b>	<b>470</b>	<b>400</b>

**19 OIL AND GAS SALES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Natural gas	110,932	71,060
Stable gas condensate	46,778	29,754
Liquefied petroleum gas	15,227	12,747
Crude oil	2,479	1,458
Oil and gas products	186	143
<hr/>		
<b>Total oil and gas sales</b>	<b>175,602</b>	<b>115,162</b>

**20 TRANSPORTATION EXPENSES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Natural gas transportation to customers	34,441	26,569
Liquids transportation by rail	9,638	7,350
Liquids transportation by tankers	3,647	2,771
Crude oil transportation to customers	281	190
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	-	307
Other	169	13
<hr/>		
<b>Total transportation expenses</b>	<b>48,176</b>	<b>37,200</b>

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

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**21 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>2011</b>	<b>2010</b>
Unified natural resources production tax	14,523	7,861
Property tax	1,742	1,482
Excise and fuel taxes	998	454
Other taxes	294	280
<b>Total taxes other than income tax</b>	<b>17,557</b>	<b>10,077</b>

The unified natural resources production tax for natural gas production was set at a rate of RR 237 and RR 147 per thousand cubic meters for 2011 and 2010.

The unified natural resources production tax rate for gas condensate was 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.

**22 GENERAL AND ADMINISTRATIVE EXPENSES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Employee compensation	4,650	3,874
Social expenses and compensatory payments	1,212	774
Legal, audit, and consulting services	774	504
Business trips expense	218	265
Depreciation – administrative buildings	198	141
Fire safety and security expenses	178	149
Rent expense	140	270
Board remuneration	103	93
Concession management services	63	125
Bank charges	58	59
Other	624	479
<b>Total general and administrative expenses</b>	<b>8,218</b>	<b>6,733</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>2011</b>	<b>2010</b>
Audit services fee (audit of the Group's consolidated financial statements and the statutory audit of the parent company)	39	36
Non-audit services	1	4
<b>Total auditors' fees and services</b>	<b>40</b>	<b>40</b>

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**23 MATERIALS, SERVICES AND OTHER**

	Year ended 31 December:	
	2011	2010
Employee compensation	2,953	2,572
Repair and maintenance services	1,435	640
Electricity and fuel	405	388
Materials and supplies	309	1,386
Security expenses	237	179
Transportation expenses	184	106
Processing fees	99	566
Rent expenses	43	27
Other	282	208
<b>Total materials, services and other</b>	<b>5,947</b>	<b>6,072</b>

**24 PURCHASES OF NATURAL GAS AND LIQUID HYDROCARBONS**

	Year ended 31 December:	
	2011	2010
Natural gas	5,854	-
Liquid hydrocarbons	140	154
<b>Total purchases of natural gas and liquid hydrocarbons</b>	<b>5,994</b>	<b>154</b>

Natural gas purchases included volumes procured from Sibneftegas, the Group's joint venture, acquired in December 2010 (see Note 5), pro-rata to its total production in the amount of RR 3,661 million (see Note 30) and volumes procured from one of Gazprom's subsidiaries by the Group's regional gas trader, Gazprom mezhtregiongas Chelyabinsk, post its acquisition by the Group in November 2011 (see Note 5) in the amount of RR 1,929 million.

**ОАО NOVATEK**

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**25 FINANCE INCOME (EXPENSE)**

<i>Interest expense (including transaction costs)</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
6.604% USD 650 million Eurobonds February 2021	1,165	-
7.5% RR 15 billion Sberbank December 2013	1,144	46
5.326% USD 600 million Eurobonds February 2016	879	-
8% RR 10 billion Gazprombank November 2012 <sup>(1)</sup>	805	700
7.5% RR 10 billion Bonds June 2013	772	392
LIBOR+3.25% USD 200 million UniCredit Bank October 2012 <sup>(1)</sup>	215	325
LIBOR+1.45% USD 300 million Sumitomo Mitsui Banking Corporation Europe Limited December 2013	148	-
LIBOR+1.9% USD 200 million Nordea Bank November 2013	125	-
LIBOR+1.5% USD 800 million Syndicated term loan facility April 2011	37	318
8.5% RR 5 billion Sberbank February 2011 <sup>(1)</sup>	-	341
Other interest expenses <sup>(2)</sup>	132	70
<b>Subtotal</b>	<b>5,422</b>	<b>2,192</b>
Less: capitalised interest	(3,709)	(2,166)
<b>Interest expense (on historical cost basis)</b>	<b>1,713</b>	<b>26</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	212	198
Provisions for asset retirement obligations: unwinding of the present value discount	225	213
<b>Total interest expense</b>	<b>2,150</b>	<b>437</b>

<sup>(1)</sup> – interest rates were reduced during the periods (see Note 13).  
<sup>(2)</sup> – including credit facility with interest rates negotiated at time of each withdrawal (see Note 15).

<i>Interest income</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Interest income on cash and cash equivalents	355	170
Interest income on loans issued	2,828	328
<b>Interest income (on historical cost basis)</b>	<b>3,183</b>	<b>498</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	209	100
<b>Total interest income</b>	<b>3,392</b>	<b>598</b>



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**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.

	Year ended 31 December:	
	2011	2010
Profit before income tax	135,025	51,082
Theoretical income tax expense at statutory rate of 20 percent	27,005	10,216
Increase (decrease) due to:		
Non-temporary differences in respect of share of losses of equity investments	776	-
Non-deductible expenses	686	538
Russian entities' taxation at lower income tax rate	(118)	-
Foreign entities' taxation at lower income tax rate	(226)	(112)
Deferred taxes write-off	342	31
Disposal of 20% interest in Yamal LNG	(12,473)	-
Other non-temporary differences	(258)	131
<b>Total income tax expense</b>	<b>15,734</b>	<b>10,804</b>

Domestic and foreign components of current income tax expense were:

	Year ended 31 December:	
	2011	2010
Russian Federation income tax	12,364	9,289
Foreign income tax	103	116
<b>Total current income tax expense</b>	<b>12,467</b>	<b>9,405</b>

**Effective income tax rate.** The Group's Russian statutory income tax rate for 2011 and 2010 was 20 percent. For the years ended 31 December 2011 and 2010, the Group's effective income tax rate was 11.7 percent and 21.2 percent, respectively. Excluding the effect of 20% disposal of Yamal LNG, the Group's effective income tax rate for the year ended 31 December 2011 was 21.7 percent.

The Group did not file a consolidated tax return for 2010 and will not file one for 2011. Instead, each legal entity filed (and will file for 2011) separate tax returns with various tax authorities, primarily in the Russian Federation. As Russian tax legislation provided an option to submit a single consolidated income tax return starting from 1 January 2012, the Group's management assessed such opportunity and is going to register NOVATEK and its core Russian producing subsidiaries as a consolidated group of taxpayers for 2012 and thereafter.

The Group has recorded a deferred tax liability in respect of the temporary difference associated with the investment in Yamal LNG at a zero tax rate as management expects that the carrying value of the investment in Yamal LNG would be recovered primarily through dividends taxable at zero tax rate and also potentially partially through a sale of an additional equity stake in the entity. The Group did not recognize deferred taxes related to a future sale as the tax base in respect of potential interest in Yamal LNG to be sold is assessed to be equal to its carrying amount.

**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.

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**26 INCOME TAX (CONTINUED)**

Deferred income tax balances are presented in the consolidated statement of financial position as follows:

	At 31 December:	
	2011	2010
Long-term deferred income tax asset (other non-current assets)	660	1,392
Long-term deferred income tax liability	(12,805)	(9,473)
<b>Net deferred income tax liability</b>	<b>(12,145)</b>	<b>(8,081)</b>

Deferred income tax assets expected to be realized within twelve months of 31 December 2011 and 2010 were RR 462 million and RR 747 million, respectively. Deferred tax liabilities expected to be reversed within twelve months of 31 December 2011 and 2010 were RR 199 million and RR 258 million, respectively.

Movements in deferred income tax assets and liabilities during the years ended 31 December 2011 and 2010 are as follows:

	At 31 December 2011	Statement of Income effect	Acquisitions	Disposals	At 31 December 2010
Property, plant and equipment	(14,388)	(3,426)	-	138	(11,100)
Intangible assets	(324)	23	(265)	-	(82)
Other	(180)	(20)	(13)	-	(147)
<b>Total deferred income tax liabilities</b>	<b>(14,892)</b>	<b>(3,423)</b>	<b>(278)</b>	<b>138</b>	<b>(11,329)</b>
Inventories	654	(167)	-	(83)	904
Tax losses carried forward	1,375	603	16	(519)	1,275
Asset retirement obligation	547	131	-	(80)	496
Other	171	(411)	11	(2)	573
<b>Total deferred income tax assets</b>	<b>2,747</b>	<b>156</b>	<b>27</b>	<b>(684)</b>	<b>3,248</b>
<b>Net deferred income tax liabilities</b>	<b>(12,145)</b>	<b>(3,267)</b>	<b>(251)</b>	<b>(546)</b>	<b>(8,081)</b>

	At 31 December 2010	Statement of Income effect	Acquisitions	Disposals	At 31 December 2009
Property, plant and equipment	(11,100)	(2,050)	(70)	282	(9,262)
Intangible assets	(82)	-	(82)	-	-
Other	(147)	(67)	-	11	(91)
<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>
Inventories	904	(14)	299	102	517
Tax losses carried forward	1,275	487	38	(181)	931
Asset retirement obligation	496	12	38	-	446
Other	573	233	(49)	(109)	498
<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>

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**26 INCOME TAX (CONTINUED)**

At 31 December 2011, the Group had recognized deferred income tax assets of RR 1,375 million (31 December 2010: RR 1,275 million) in respect of unused tax loss carry forwards of RR 6,875 million (31 December 2010: RR 6,375 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:	
	2011	2010
<i>Non-current</i>		
Long-term loans receivable	9,323	38,057
Trade and other receivables	22,807	2,094
<i>Current</i>		
Trade and other receivables	16,699	8,670
Prepayments and other current assets	6,876	969
Cash and cash equivalents	23,831	10,238
<b>Total carrying amount</b>	<b>79,536</b>	<b>60,028</b>

<i>Financial liabilities</i>	<i>Measured at amortized cost</i>	
	At 31 December:	
	2011	2010
<i>Non-current</i>		
Long-term debt	75,180	47,074
Other non-current liabilities	-	110
<i>Current</i>		
Current portion of long-term debt	20,298	6,952
Short-term debt	-	18,200
Trade and other payables	22,811	27,007
<b>Total carrying amount</b>	<b>118,289</b>	<b>99,343</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.

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**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 in 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:

<i>At 31 December 2011</i>	<b>Russian rouble</b>	<b>US dollar</b>	<b>Other</b>	<b>Total</b>
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	9,103	220	-	9,323
Trade and other receivables	22,761	14	32	22,807
<i>Current</i>				
Trade and other receivables	8,692	7,618	389	16,699
Prepayments and other current assets	6,859	-	17	6,876
Cash and cash equivalents	10,774	12,113	944	23,831
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(24,937)	(50,243)	-	(75,180)
<i>Current</i>				
Current portion of long-term debt	(10,000)	(10,298)	-	(20,298)
Trade and other payables	(4,949)	(17,799)	(63)	(22,811)
<b>Net exposure at 31 December 2011</b>	<b>18,303</b>	<b>(58,375)</b>	<b>1,319</b>	<b>(38,753)</b>

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

<i>At 31 December 2010</i>	<b>Russian rouble</b>	<b>US dollar</b>	<b>Other</b>	<b>Total</b>
<b>Financial assets</b>				
<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>				
Trade and other receivables	4,759	3,582	329	8,670
Prepayments and other current assets	969	-	-	969
Cash and cash equivalents	6,085	3,169	984	10,238
<b>Financial liabilities</b>				
<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>

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 2011 and 2010, respectively:

<i>Effect on pre-tax profit</i>	<b>Increase in exchange rate</b>	<b>Year ended 31 December:</b>	
		<b>2011</b>	<b>2010</b>
RUR / USD	10%	(5,838)	(3,394)

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, in December 2010, the FTS approved an increase of 15 percent in the regulated prices 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. According to the Government's program, the regulation of the domestic natural gas price after 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets.

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 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 and Naphtha CIF NWE, 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:	
	2011	2010
At variable rate	20,559	37,327
At fixed rate	74,919	34,899
<b>Total debt</b>	<b>95,478</b>	<b>72,226</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.

**OAO NOVATEK****Notes to the Consolidated Financial Statements**

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

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 would decrease by the amounts shown below:

<i>Effect on pre-tax profit</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Increase by 100 basis points	206	373

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 2011 and 2010, or during 2011 and 2010.

**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.

As a result of recent acquisitions of Russian regional natural gas trading companies, the Group's exposure to small and medium-size industrial users and individuals has increased. The Group monitors the recoverability of these debtors by analyzing ageing of receivables by type of customers and their respective prior payment history.

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.

<b>Moody's and/or Fitch</b>	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Investment grade rating	9,059	4,489
Non-investment grade rating	1,581	1,338
No external rating	6,059	2,843
<b>Total trade and other receivables</b>	<b>16,699</b>	<b>8,670</b>

**OAO NOVATEK**

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The table below highlights the Group's cash and cash equivalents balances to published credit ratings of its banks and/or their parent companies.

Moody's and/or Fitch	At 31 December:	
	2011	2010
Investment grade rating	19,381	8,008
Non-investment grade rating	4,358	1,781
No external rating	92	449
<b>Total cash and cash equivalents</b>	<b>23,831</b>	<b>10,238</b>

Investment grade ratings classification referred to as Aaa to Baa3 for Moody's Investors Service and as AAA to BBB- for Fitch Rating, respectively.

**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:

<i>At 31 December 2011</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
<i>Principal</i> <sup>(*)</sup>	10,000	25,000	19,318	20,927	75,245
<i>Interest</i>	4,748	3,825	6,298	5,655	20,526
Debt at variable rate					
<i>Principal</i> <sup>(*)</sup>	10,303	10,302	-	-	20,605
<i>Interest</i>	366	135	-	-	501
Trade and other payables	22,811	-	-	-	22,811
<b>Total financial liabilities</b>	<b>48,228</b>	<b>39,262</b>	<b>25,616</b>	<b>26,582</b>	<b>139,688</b>

<i>At 31 December 2010</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
<i>Principal</i> <sup>(*)</sup>	-	10,000	25,000	-	35,000
<i>Interest</i>	2,725	2,372	1,411	-	6,508
Debt at variable rate					
<i>Principal</i> <sup>(*)</sup>	25,252	6,095	6,095	-	37,442
<i>Interest</i>	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>-</b>	<b>107,104</b>

<sup>(\*)</sup> – differs from long-term debt (Note 13) for transaction costs.



**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

**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 Investors Service and BBB- (stable outlook) by Fitch Ratings, as well as a credit rating of BBB- (stable 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 or additional contributions to share capital.

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 OAO 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 ended 31 December 2011.

**28 CONTINGENCIES AND COMMITMENTS**

**Operating environment.** The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is in practice not convertible in most countries outside of the Russian Federation, and relatively high inflation. The tax, 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 2011, the Group had contractual capital expenditures commitments aggregating approximately RR 17,805 million (at 31 December 2010: RR 9,834 million) mainly for ongoing development activities at the Yurkharovskoye field (through 2013), development of the North-Russkoe field (through 2013) and Urengoiyskoye field (within the Olimpiyskiy license area, through 2013), phase three construction of the Purovsky Gas Condensate Plant (through 2013), construction of the terminal for the transshipment and fractionation of stable gas condensate (through 2012) and development of the East-Tarkosalinskoye and Khancheyskoye fields (through 2012) all in accordance with duly signed agreements. Furthermore, the Group's share in capital commitments for its interests in joint ventures aggregates approximately RR 5,850 million for development of the South-Tambeyskoye (through 2013), Urengoiyskoye (within the Samburgskiy license area, through 2012) and Termokarstovoye (through 2013) fields (at 31 December 2010: RR 2,661 million).

**Taxation.** Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such taxation legislation as applied to the Group's transactions and activities may be periodically 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.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

As at 31 December 2011, 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, results of operations or cash flows.

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

Field	License holder	License expiry date
<b>Subsidiaries:</b>		
Yurkharovskoye	ООО NOVATEK-Yurkharovneftegas	2034
Salmanovskoye (Utrenneye)	ООО NOVATEK-Yurkharovneftegas	2031
Geofizicheskoye	ООО NOVATEK-Yurkharovneftegas	2031
East-Tarkosalinskoye	ООО NOVATEK-Tarkosaleneftegas	2043
Urengoiyskoye (within the Olimpiyskiy license area)	ООО NOVATEK-Tarkosaleneftegas	2026
Khancheyevskoye	ООО NOVATEK-Tarkosaleneftegas	2044
North-Russkoe	ООО NOVATEK-Tarkosaleneftegas	2031
Malo-Yamalsky	ОАО Тамбейнефтегаз	2019
<b>Joint ventures:</b>		
South-Tambeyskoye	ОАО Yamal LNG	2045
Termokarstovoye	ЗАО Тернефтегаз	2021
Yaro-Yakhinskoye	ЗАО Urengoil Inc.	2018
Urengoiyskoye (within the Samburgskiy and Yevo-Yakhinskiy license areas)	ОАО Арктическая газовая компания	2018
Beregovoe	ОАО Sibneftegas	2023
Pyreinoye	ОАО Sibneftegas	2021
North-Chaselskoye	ОАО Нефтегазтехнология	Life of field

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 arising 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, results of operations or cash flows.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

**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.

**29 PRINCIPAL SUBSIDIARIES AND JOINT VENTURES**

The principal subsidiaries and joint ventures of the Group and respective ownership in the ordinary share capital at 31 December 2011 and 2010 are set out below:

	Ownership percent at 31 December:		Country of incorporation	Principal activities
	2011	2010		
<b><i>Subsidiaries</i></b>				
ООО NOVATEK-Yurkharovneftegas	100	100	Russia	Exploration and production
ООО NOVATEK-Tarkosaleneftegas	100	100	Russia	Exploration and production
ООО NOVATEK-Purovsky ZPK	100	100	Russia	Gas Condensate Plant
ООО NOVATEK-Transervice	100	100	Russia	Transportation services
ООО NOVATEK-AZK	100	100	Russia	Wholesale and retail trading
ООО NOVATEK Severo-Zapad	100	100	Russia	Trading and marketing
ООО NOVATEK-Ust-Luga	100	100	Russia	Construction of sea terminal
ОАО Tambeyneftegaz	100	100	Russia	Exploration and production
ООО Gazprom mezhrefiongas Chelyabinsk	100	-	Russia	Trading and marketing
ООО NOVATEK-Chelyabinsk (formerly ООО Yamalgazresurs-Chelyabinsk)	100	100	Russia	Trading and marketing
ООО Yamalenergogaz	100	-	Russia	Trading and marketing
Novatek Gas & Power GmbH (formerly Runitek GmbH)	100	100	Switzerland	Trading and marketing
Novatek Polska	100	100	Poland	Trading and marketing
<b><i>Joint ventures</i></b>				
ООО Yamal Development	50	50	Russia	Holding company
ООО SeverEnerгия (through ООО Yamal Development)	25.5	25.5	Russia	Exploration and production
ОАО Sibneftegas	51	51	Russia	Exploration and production
ОАО Yamal LNG (subsidiary until October 2011)	80	51	Russia	Exploration and production

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**30 RELATED PARTY TRANSACTIONS**

Transactions between the NOVATEK and its subsidiaries, which are related parties of the 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.

*Related parties – OAO Gazprom and its subsidiaries  
(until December 2010)*

	Year ended 31 December:	
	2011	2010
<b>Transactions</b>		
<i>OAO Gazprom:</i>		
Natural gas sales	-	12,935
Natural gas transportation to customers	-	(26,550)
<i>OOO Gazprom mezhregiongaz (formerly OOO Mezhregiongaz):</i>		
Natural gas sales	-	1,055
<i>Other Gazprom subsidiaries:</i>		
Processing fees	-	(458)
Unstable gas condensate transportation	-	(307)

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.

*Related parties – equity investments*

	As at and for the year ended 31 December:	
	2011	2010
<b>Transactions</b>		
<i>OAO Sibneftegas (from December 2010):</i>		
Interest income on loans issued	1,023	45
Oil and gas products sales	39	-
Purchases of natural gas	(3,661)	-
<i>OOO Yamal Development (from November 2010):</i>		
Interest income on loans issued	1,325	191
<i>OOO SeverEnergiya (from November 2010):</i>		
Interest income on loans issued	247	-
<i>OAO Yamal LNG (from October 2011):</i>		
Interest income on loans issued	167	-

**ОАО NOVATEK**

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**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – equity investments</i>	As at and for the year ended 31 December:	
	2011	2010
<b>Balances</b>		
<i>ОАО Sibneftegas (from December 2010):</i>		
Long-term loans receivable	9,103	10,070
Interest on long-term loans receivable	775	33
Short-term loans receivable	634	967
Trade payables and accrued liabilities	387	-
<i>ООО Yamal Development (from November 2010):</i>		
Long-term loans and receivables	16,348	27,886
Interest on long-term loans receivable	-	191
<i>ООО SeverEnergiya (from November 2010):</i>		
Short-term loans receivable	6,225	-
Interest on short-term loans receivable	94	-
<i>ZАО Terneftegas (from February 2010):</i>		
Long-term loans receivable	220	102

As discussed in Note 5, in October 2011, the Group's effective control over ОАО Yamal LNG ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity are disclosed as related parties – equity investments.

As discussed in Note 5, in February 2010, the Group's effective control over ZАО Terneftegas ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity are disclosed as related parties – equity investments.

In September 2011, the Chairman of the Management Committee of NOVATEK acquired a controlling stake in ZАО SIBUR Holding. As a result, the Group's balances with this company and its subsidiaries at 31 December 2011 were disclosed as related parties – parties under control of key management personnel.

<i>Related parties – parties under control of key management personnel</i>	As at and for the year ended 31 December:	
	2011	2010
<b>Balances</b>		
<i>ОАО Pervobank:</i>		
Cash and cash equivalents	4,066	1,760
<i>ZАО SIBUR Holding and its subsidiaries (from September 2011):</i>		
Long-term receivable	1,424	-
Trade and other receivables	248	-

Effective 1 January 2011, the Group adopted the revised standard IAS 24, *Related Party Disclosures*, which adjusted the definition of the related party. In accordance with the revised standard, parties under significant influence of key management personnel are not related parties of the Group. Thus ООО Nova, Aldi trading Limited, Orsel consultant Limited and Innecto ventures Limited are no longer considered to be related parties.

The comparative figures in the disclosure with respect to balances at 31 December 2010 and transactions for the year ended 31 December 2010 have been adjusted to reflect the change in definitions of a related party following the adoption of the revised standard IAS 24, *Related Party Disclosures*.

**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.

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**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – members of the key management personnel</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Board of Directors	103	93
Management Committee	1,242	1,049
<b>Total compensation</b>	<b>1,345</b>	<b>1,142</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 15 members until 24 March 2011 and was subsequently reduced to eight 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 was recognized during the year ended 31 December 2010 as part of the share-based compensation scheme and included in general and administrative expenses. In May 2010, share-based compensation to the key members of the Group's management team was fully recognized.

**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).

Segment information is provided to the CODM in accordance with 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.

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.

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**31 SEGMENT INFORMATION (CONTINUED)**

Segment information for the year ended 31 December 2011 is as follows:

<i>For the year ended 31 December 2011</i>	References	Exploration, production and marketing	Segment information as reported to CODM	Reconciling items	Total per consolidated financial statements
External revenues	<i>a</i>	176,340	176,340	(276)	176,064
Operating expenses	<i>b, c, d, e</i>	(101,659)	(101,659)	3,994	(97,665)
Other operating income (loss)	<i>c, f</i>	12,950	12,950	50,259	63,209
Interest expense	<i>g</i>	(5,392)	(5,392)	3,242	(2,150)
Interest income		3,137	3,137	255	3,392
Foreign exchange gain (loss)	<i>g</i>	(4,368)	(4,368)	423	(3,945)
<b>Segment result</b>		<b>81,008</b>	<b>81,008</b>	<b>57,897</b>	<b>138,905</b>
Share of loss of equity investments, net of income tax					(3,880)
<b>Profit before income tax</b>					<b>135,025</b>
Depreciation, depletion and amortization	<i>b, c</i>	12,925	12,925	(3,450)	9,475
Capital expenditures	<i>g</i>	30,510	30,510	7,521	38,031

Reconciling items mainly related to:

- a. different methodology of liquefied petroleum gas sales recognition under IFRS and the RAR which requires reversal of external revenues for RR 207 million under IFRS;
- 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 3,892 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 280 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- d. different methodology in recognizing expenses relating to natural gas storage services and payroll (including 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 37 million and additional payroll expenses of RR 233 million recorded in operating expenses under IFRS;
- e. different methodology in the recognition of impairment expenses between IFRS and management accounting, which resulted in net reversal of RR 755 million recorded in operating expenses under IFRS;
- f. different methodology in recognizing the gain on disposal of ownership interest in OAO Yamal LNG between IFRS and management accounting, which resulted in additional gain of RR 49,589 million recorded in other operating income (loss) under IFRS; and
- g. 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 differences of RR 3,942 million and additional capital expenditures of RR 3,579 million under IFRS.

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**31 SEGMENT INFORMATION (CONTINUED)**

Segment information for the year ended 31 December 2010 is as follows:

<i>For the year ended 31 December 2010</i>	References	Exploration, production and marketing	Polymer products production and marketing	Segment information as reported to CODM	Reconciling items	Total per consolidated financial statements
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>b, e</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 equity investments, 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:

- a. 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;
- b. 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;
- c. 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;
- d. 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;
- 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 of RR 2,349 million and additional capital expenditures of RR 1,441 million under IFRS.



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**31 SEGMENT INFORMATION (CONTINUED)**

**Geographical information.** The Group's two segments operate in four major geographical areas of the world. In the Russian Federation, its 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. 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 (hereinafter referred to as "APR") (sales of stable gas condensate) and other areas (sales of liquefied petroleum gas and sales of polymer and insulation tape).

Geographical information for the years ended 31 December 2011 and 2010 is as follows:

<i>For the year ended 31 December 2011</i>	Russian Federation	Outside Russian Federation					Subtotal	Total
		Europe	USA	APR	Other	Export duty		
Natural gas	110,932	-	-	-	-	-	-	110,932
Stable gas condensate	46	28,265	17,920	35,642	-	(35,095)	46,732	46,778
Liquefied petroleum gas	5,520	12,023	-	-	10	(2,326)	9,707	15,227
Crude oil	1,458	2,143	-	-	-	(1,122)	1,021	2,479
Oil and gas products	186	-	-	-	-	-	-	186
<b>Oil and gas sales</b>	<b>118,142</b>	<b>42,431</b>	<b>17,920</b>	<b>35,642</b>	<b>10</b>	<b>(38,543)</b>	<b>57,460</b>	<b>175,602</b>
Other revenues	323	139	-	-	-	-	139	462
<b>Total external revenues</b>	<b>118,465</b>	<b>42,570</b>	<b>17,920</b>	<b>35,642</b>	<b>10</b>	<b>(38,543)</b>	<b>57,599</b>	<b>176,064</b>

<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 and gas 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 (until September 2010)	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>

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 2011 and 2010, the Group has two and three major customer to whom individual revenues represent 30 percent and 42 percent of total external revenues, respectively.

Sales to major customers are included in the results of the Exploration, production and marketing segment.

**ОАО NOVATEK****Notes to the Consolidated Financial Statements**

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**32 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES**

	Year ended 31 December:	
	2011	2010
<b>Net book value of assets value at 1 January</b>	<b>6,372</b>	<b>2,535</b>
Additions	13,500	1,394
Acquisition of subsidiaries	-	7,894
Disposals	(1,921)	(821)
Reclassification in proved properties	(1,700)	(4,630)
<b>Net book value of assets at 31 December</b>	<b>16,251</b>	<b>6,372</b>
Liabilities	650	3,026
Cash flows used for operating activities	1,469	1,151
Cash flows used for investing activities	10,093	2,112

**33 NEW ACCOUNTING PRONOUNCEMENTS**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012 or later, and which the Group has not early adopted.

IFRS 9, *Financial Instruments: Classification and Measurement*. IFRS 9, issued in November 2009, 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 and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. 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 amortised 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 amortised 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 payments of principal and interest only (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 recognise unrealised and realised 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.
- 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 at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 10, *Consolidated Financial Statements* (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27, *Consolidated and separate financial statements*, and SIC-12, *Consolidation - special purpose entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

IFRS 11, *Joint Arrangements*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-Monetary Contributions by Ventures*. Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

**33 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

IFRS 12, *Disclosure of Interest in Other Entities*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28, *Investments in associates*. IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgments and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

IFRS 13, *Fair value measurement*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its consolidated financial statements.

IAS 27, *Separate Financial Statements*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, *Consolidated Financial Statements*. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IAS 28, *Investments in Associates and Joint Ventures*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Amendments to IFRS 7, *Disclosures—Transfers of Financial Assets* – (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Group is currently assessing the impact of the amended standard on disclosures in its consolidated financial statements.

Amendments to IAS 1, *Presentation of Financial Statements* (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its consolidated financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, *Employee Benefits* (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

**33 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

Amendments to IFRS 7, *Disclosures—Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity’s financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Amendments to IAS 32, *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of ‘currently has a legally enforceable right of set-off’ and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment, the impact on the Group and the timing of its adoption by the Group.

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

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES**

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

The Group’s exploration and production activities are 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 2011 and 2010 (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Costs incurred in exploration and development activities</b>		
Acquisition cost	-	7,694
Acquisition of unproved properties	7,448	76
Exploration costs	2,447	2,042
Development costs	23,098	22,047
<b>Total costs incurred in exploration and development activities</b>	<b>32,993</b>	<b>31,859</b>
The share of the Group in its equity investees	2,051	78,300

	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Capitalized costs relating to oil and gas producing activities</b>		
Wells and related equipment and facilities	145,063	163,130
Support equipment and facilities	30,717	29,222
Uncompleted wells, equipment and facilities	12,862	10,277
<b>Total capitalized costs relating to oil and gas producing activities</b>	<b>188,642</b>	<b>202,629</b>
Less: accumulated depreciation, depletion and amortization	(35,540)	(26,698)
<b>Net capitalized costs relating to oil and gas producing activities</b>	<b>153,102</b>	<b>175,931</b>
The share of the Group in its equity investees	150,449	78,220

The Group has reclassified capitalized costs relating to oil and gas producing activities of Yamal LNG due to cessation of control on 6 October 2011 and the subsequent accounting of its activities under the equity method (see Note 5).

**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, revenues from oil and gas sales are comprised of the sale of the Group's hydrocarbons and include processing costs, related to the Group's processing facilities as well as transportation expenses to the customer (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Revenues from oil and gas sales	163,765	115,008
Lifting costs	(5,236)	(4,854)
Transportation expenses	(46,064)	(37,187)
Taxes other than income tax	(17,287)	(9,831)
Depreciation, depletion and amortization	(8,878)	(6,384)
Exploration expenses	(1,819)	(1,595)
<b>Total production costs</b>	<b>(79,284)</b>	<b>(59,851)</b>
Results of operations for oil and gas producing activities before income tax	84,481	55,157
Less: related income tax expense	(16,896)	(11,031)
<b>Results of operations for oil and gas producing activities</b>	<b>67,585</b>	<b>44,126</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"). The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for the reserve determination. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of this process, senior management reviews and approves the final reserve estimates issued by D&M.

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

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2011 and 2010.

Extensions of production licenses are assumed to be at the discretion of the Group. Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. The Group's licenses expire between 2018 and 2045, with the most significant licenses for 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.

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 and the Group's ownership percentage of the net proved reserves quantities of the joint ventures. 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.



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**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of natural gas are presented below.

	Net proved reserves		Group's share in equity companies		Total net proved reserves	
	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters
<b>Reserves at 31 December 2009</b>	<b>40,726</b>	<b>1,153</b>	-	-	<b>40,726</b>	<b>1,153</b>
Changes attributable to:						
Revisions of previous estimates	(54)	(1)	-	-	(54)	(1)
Extension and discoveries	3,097	88	-	-	3,097	88
Acquisitions	-	-	5,613	158	5,613	158
Disposals	(426)	(12)	-	-	(426)	(12)
Reclassifications	(444)	(13)	444	13	-	-
Production	(1,314)	(37)	-	-	(1,314)	(37)
<b>Reserves at 31 December 2010</b>	<b>41,585</b>	<b>1,178</b>	<b>6,057</b>	<b>171</b>	<b>47,642</b>	<b>1,349</b>
Changes attributable to:						
Revisions of previous estimates	(106)	(3)	370	11	264	8
Extension and discoveries	3,398	97	676	19	4,074	116
Disposals	(3,331)	(95)	-	-	(3,331)	(95)
Reclassifications	(13,323)	(377)	13,323	377	-	-
Production	(1,676)	(48)	(190)	(5)	(1,866)	(53)
<b>Reserves at 31 December 2011</b>	<b>26,547</b>	<b>752</b>	<b>20,236</b>	<b>573</b>	<b>46,783</b>	<b>1,325</b>
<b>Net proved developed reserves (included above)</b>						
At 31 December 2009	20,612	584	-	-	20,612	584
At 31 December 2010	22,515	638	2,536	71	25,051	709
At 31 December 2011	20,763	588	2,348	66	23,111	654
<b>Net proved undeveloped reserves (included above)</b>						
At 31 December 2009	20,114	569	-	-	20,114	569
At 31 December 2010	19,070	540	3,521	100	22,591	640
At 31 December 2011	5,784	164	17,888	507	23,672	671

The net proved reserves reported in the table above included reserves of natural gas attributable to non-controlling interest of 120 billion of cubic feet and 4 billion of cubic meters and 7,227 billion of cubic feet and 205 billion of cubic meters at 31 December 2011 and 2010, respectively.

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**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

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

	Net proved reserves		Group's share in equity companies		Total net proved reserves	
	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons
<b>Reserves at 31 December 2009</b>	<b>589</b>	<b>70</b>	-	-	<b>589</b>	<b>70</b>
Changes attributable to:						
Revisions of previous estimates	(12)	(1)	-	-	(12)	(1)
Extension and discoveries	60	8	-	-	60	8
Acquisitions	-	-	83	10	83	10
Disposals	(20)	(2)	-	-	(20)	(2)
Reclassifications	(20)	(3)	20	3	-	-
Production	(31)	(4)	-	-	(31)	(4)
<b>Reserves at 31 December 2010</b>	<b>566</b>	<b>68</b>	<b>103</b>	<b>13</b>	<b>669</b>	<b>81</b>
Changes attributable to:						
Revisions of previous estimates	10	1	4	1	14	2
Extension and discoveries	116	14	38	4	154	18
Disposals	(34)	(4)	-	-	(34)	(4)
Reclassifications	(138)	(16)	138	16	-	-
Production	(35)	(4)	-	-	(35)	(4)
<b>Reserves at 31 December 2011</b>	<b>485</b>	<b>59</b>	<b>283</b>	<b>34</b>	<b>768</b>	<b>93</b>
<b>Net proved developed reserves (included above)</b>						
At 31 December 2009	272	33	-	-	272	33
At 31 December 2010	304	36	-	-	304	36
At 31 December 2011	282	33	-	-	282	33
<b>Net proved undeveloped reserves (included above)</b>						
At 31 December 2009	317	37	-	-	317	37
At 31 December 2010	262	32	103	13	365	45
At 31 December 2011	203	26	283	34	486	60

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 16 million of barrels and 2 million of metric tons and 65 million of barrels and 8 million of metric tons at 31 December 2011 and 2010, respectively.

In October 2011, the Group's effective control over OAO Yamal LNG, the holder of the South-Tambeyskoye field, ceased. As a result, the Group's interest in Yamal LNG is accounted for using the equity method.

During 2010, the Group acquired 51 percent of the outstanding ordinary shares of OAO Sibneftegas, which holds licenses on Beregovoye, Pyreinoeye 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 SeverEnergia. SeverEnergia and its subsidiaries hold licenses on Samburgskiy, Yevo-Yakhinskiy, Yaro-Yakhinskiy and North-Chaselskiy license areas (see Note 5).

In February 2010, the Group's effective control over ZAO Terneftegas, the holder of the Termokarstovoye field, ceased. As a result, the Group's interest in Terneftegas is accounted for using the equity method.

**OAO 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

The Group's office in Moscow is:

Ulitsa Udaltsova 2  
119415 Moscow  
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

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**Investor Relations** Tel: +7 495 730-6013  
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## Investor Information

### Independent Auditor

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 10, Butyrsky Val, White Square Office Center,  
 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)  
[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.
<b>km</b>	kilometer(s)
<b>km<sup>2</sup></b>	cubic 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