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

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 31 March 2008 and 2007 together with our unaudited consolidated interim condensed financial information as of and for the three months ended 31 March 2008. The unaudited consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*. This consolidated interim condensed financial information should be read together with the audited consolidated financial statements for the year ended 31 December 2007 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom. In terms of proved natural gas reserves, we are the fourth largest holder of natural gas resources in Russia after Gazprom, Rosneft and LUKOIL.

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

SELECTED DATA

millions of Russian roubles except as stated	**Three months ended 31 March:**		**Change**
	2008	**2007**	**%**
Financial results			
Total revenues (net of VAT and export duties)	20,876	15,259	36.8%
Operating expenses	(11,023)	(9,579)	15.1%
Profit attributable to NOVATEK shareholders	7,503	4,347	72.6%
EBITDA [(1)]	10,908	6,774	61.0%
Earnings per share (in Russian roubles)	2.47	1.43	72.7%
Operating results			
Natural gas sales volumes (mmcm)	8,391	9,119	(8.0%)
Stable gas condensate sales volumes (thousand tons)	441	385	14.5%
Liquefied petroleum gas sales volumes (thousand tons)	158	123	28.5%
Crude oil sales volumes (thousand tons)	77	68	13.2%
Oil product sales volumes (thousand tons)	26	18	44.4%
Cash flow results			
Net cash provided by operating activities	9,613	6,940	38.5%
Capital expenditures	6,537	3,811	71.5%

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Natural gas prices

As an independent natural gas producer, we are not subject to the government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In the three months ended 31 March 2008, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 291 per mcm, or 23.0%, to RR 1,556 per mcm compared to RR 1,265 per mcm in the corresponding period in 2007. The terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale traders allow us to diversify our gas sales without incurring additional commercial expenses. However, we realize higher prices and net margins for natural gas volumes sold directly to the end-customers, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders. During the three months ended 31 March 2008, the average netback margin differential we received on end-customer sales compared to ex-field sales (average end-customer netback less average ex-field price) increased by RR 57 per mcm, or 107.5%, compared to the period in 2007 as a result of higher average realized prices to end-customers (see "Natural gas sales" below).

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. Effective 1 January 2008, the FTS approved a 25% increase in the regulated price of natural gas for the year 2008. As part of that program, we expect further increases in the regulated price for natural gas in 2009 and 2010. The FTS approves the effective increase on an annual basis and reserves the right to modify the percentages published based on market conditions and other factors.

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 31 March 2008 and 2007:

Russian roubles per mcm	**Three months ended 31 March: 2008**	**2007**	**Change %**
Average natural gas price to end-customers	1,791	1,464	22.3%
Gas transportation expense for sales to end-customers	701	618	13.4%
Average natural gas netback price on end-customer sales	1,090	846	28.8%
Average natural gas price ex-field (wholesale traders)	980	793	23.6%
Average netback margin differential	110	53	107.5%

We also participate in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. Our average natural gas netback prices on electronic trading (e-trading) are shown in the table below:

Russian roubles per mcm	**Three months ended 31 March: 2008**	**2007**	**Change %**
Average natural gas price to customers on e-trading sales	1,728	1,312	31.7%
Gas transportation expense on e-trading sales	140	95	47.4%
Average natural gas netback on e-trading sales	1,588	1,217	30.5%

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

Crude oil, stable gas condensate, liquefied petroleum gas ("LPG") and oil products prices on international markets have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, and the ability and willingness of oil producing countries to sustain production levels to meet increasing global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters. Crude oil, stable gas condensate, LPG and oil products prices on the domestic market also fluctuate depending on supply and demand fundamentals. Crude oil prices in Russia have generally remained below prices in the international market primarily due to constraints on the ability of many Russian oil companies to transport their crude oil, whereas certain oil products and LPG prices in Russia have more closely followed prices on international markets. This has occasionally led to crude oil surpluses in key consuming regions in Russia driving down the price in the domestic market. Moreover, there is no independent or uniform benchmark price for crude oil in Russia because the majority of all crude oil destined for sale in Russia is produced and refined by the same vertically integrated Russian oil companies. Crude oil that is not exported from Russia or refined by the producer is offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as “Urals blend”, which normally trades at a discount to the international benchmark Brent crude oil.

Our stable gas condensate, LPG, crude oil and oil products prices at both international and domestic markets include transportation expense in accordance with the terms of delivery. Our delivery terms for the sale of crude oil on the domestic market changed effective January 2008 whereby our contract prices cover transportation expense as we are responsible for transportation, and the buyer takes ownership and associated risks at the point of its destination. Correspondingly, revenues and prices for the comparative period of 2007 were adjusted to gross up transportation expenses.

In the three months ended 31 March 2008, as well as in the corresponding period in 2007, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in the three months ended 31 March 2008 was approximately USD 861 per ton compared to approximately USD 507 per ton in the corresponding period in 2007.

In the three months ended 31 March 2008, we did not deliver our crude oil to the international markets due to our ability to achieve higher margins on the domestic market. In the three months ended 31 March 2007, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany), and our average crude oil export contract price, including export duties, was approximately USD 375 per ton.

The following table shows our average realized stable gas condensate and crude oil sales prices (net of VAT and export duties, where applicable) for the three months ended 31 March 2008 and 2007:

Russian roubles (RR) or US dollars (USD) per ton	**Three months ended 31 March: 2008**	**2007**	**Change %**
Stable gas condensate			
Net export price, RR per ton	13,488	8,393	60.7%
Net export price, USD per ton	556.0	319.1	74.2%
Crude oil			
Net export price, RR per ton	-	5,112	n/m
Net export price, USD per ton	-	194.3	n/m
Domestic price, RR per ton	7,257	4,796	51.3%

Our LPG export and CIS delivery terms during the three months ended 31 March 2008 were delivery at frontier (DAF) at the border of the customer’s country. In the three months ended 31 March 2008, our average export LPG contract price, including export duties, was approximately USD 758 per ton compared to USD 476 per ton in the corresponding period in 2007. We are obliged to sell a portion of our LPG volumes at regulated prices while the remaining portion of our sales are sold under commercial terms. In the three months ended 31 March 2008, we sold 8 thousand tons at the average regulated price (excluding transportation expense) of RR 4,500 per ton and 116 thousand tons at a average commercial price of RR 9,420 per ton in the domestic market, compared to 8 thousand tons at RR 3,500 per ton and 84 thousand tons at RR 6,818 per ton, respectively, in the 2007 period.

Domestic sales of oil products associated with our own production were priced free carrier (FCA) at the Surgut railroad station (located in the Khanty-Mansiysk Autonomous Region). In the three months ended 31 March 2008, our foreign trading subsidiary purchased from third parties approximately 25 thousand tons of naphtha and sold 18 thousand tons to the US and European markets at an average contract price USD 902 per ton. The delivery terms for these volumes were delivery to the port of destination ex-ship (DES Houston and Philadelphia, USA; and DES Rotterdam, Holland). There were no applicable export duties on these sales.

The following table shows our average realized liquefied petroleum gas and oil products sales prices (net of VAT and export duties, where applicable) for the three months ended 31 March 2008 and 2007 (excluding trading activities):

Russian roubles (RR) or US dollars (USD) per ton	**Three months ended 31 March:** 2008	2007	**Change** %
LPG			
Net export price, RR per ton	13,032	9,026	44.4%
Net export price, USD per ton	537.2	343.1	56.6%
CIS price, RR per ton	10,817	6,944	55.8%
Domestic price, RR per ton	9,085	6,516	39.4%
Oil products			
Domestic price, RR per ton	4,126	6,480	(36.3%)

Transportation tariffs

The methodology of calculating transportation tariffs for natural gas produced in the Russian Federation for shipments to consumers located within the customs territory of the Russian Federation and the member states of the Customs Union Agreement (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan) consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 km. The rate for utilization of the trunk pipeline is based on an "input/output" function which is determined by where natural gas enters and exits the trunk pipeline (the maximum "input/output" rate effective from 1 January 2008 is RR 1,351.01 (excluding VAT) per mcm) and includes a constant rate of RR 20.01 (excluding VAT) per mcm for end-customers using Gazprom's gas distribution systems. The constant rate is deducted from the utilization rate for end-customers using non-Gazprom gas distribution systems. The second component of the transportation rate for natural gas delivered within the customs territory of the Russian Federation and the member states of the Customs Union Agreement was set at RR 5.28 effective from 1 August 2006 and was increased by 15.0% to RR 6.07 from 1 March 2007, and by a further 19.1% from 1 January 2008 to RR 7.23 per mcm per 100 km (excluding VAT).

The increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts. There is no set timetable for reviews or changes in transportation tariffs set by the FTS, and thus changes in transportation tariffs occur on an irregular basis.

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

Our stable gas condensate (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.

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

Transactions with related parties

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

Our tax burden

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

Our natural gas sales volumes decreased primarily due to a reduction in withdrawals of natural gas from the underground gas storage facilities and reduced purchases from third parties. Our liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) increased primarily due to a reduction in our liquids inventory balances and an overall increase in liquids production.

Natural gas sales volumes

millions of cubic meters	Three months ended 31 March: 2008	2007	Change %
Production from:			
Yurkharovskoye field	2,532	2,414	4.9%
East-Tarkosalinskoye field	3,917	3,943	(0.7%)
Khancheyskoye field	1,121	1,182	(5.2%)
Other fields	8	9	(11.1%)
Total natural gas production	**7,578**	**7,548**	**0.4%**
Purchases from:			
Gazprom	503	508	(1.0%)
Other	44	208	(78.8%)
Total natural gas purchases	**547**	**716**	**(23.6%)**
Total production and purchases	**8,125**	**8,264**	**(1.7%)**
Purovsky Plant and own usage	(9)	(10)	(10.0%)
Decrease (increase) in pipeline and underground gas storage facilities	275	865	(68.2%)
Total natural gas sales volumes	**8,391**	**9,119**	**(8.0%)**
Sold to end-customers	*4,070*	*4,435*	*(8.2%)*
E-trading sales	*91*	*278*	*(67.3%)*
Subtotal sales treated as sold to end-customers	***4,161***	***4,713***	***(11.7%)***
Sold ex-field	***4,230***	***4,406***	***(4.0%)***

In the three months ended 31 March 2008, our total consolidated natural gas production increased by 30 mmcm, or 0.4%, compared to 2007 period. The increase was mainly due to organic growth in natural gas production at our Yurkharovskoye field that was partially offset by decreases in natural gas production at our other fields.

Our cumulative natural gas volumes stored in Gazprom’s underground gas storage facilities decreased from 40 mmcm at 1 January 2008 to 1 mmcm at 31 March 2008. Our natural gas volumes reserved in the pipeline network decreased from 295 mmcm at 1 January 2008 to 59 mmcm at 31 March 2008.

The decrease in our natural gas sales volumes by 728 mmcm, or by 8.0%, was attributable to a combination of factors. In the three months ended 31 March 2007, 893 mmcm of natural gas was withdrawn from underground storage facilities and resold to end-customers. Due to the warm winter in 2007 and our inability to inject natural gas into storage, the balance of natural gas stored in the underground facilities at 31 December 2007 totaled 40 mmcm as compared to 1,000 mmcm at 31 December 2006. As a result, in the 2008 period, the amount of natural gas withdrawn from underground storage and the pipeline network and resold to end-customers totaled 39 mmcm and 236 mmcm, respectively.

We expect our volumes of natural gas injected into underground gas storage facilities to continue fluctuating period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In the three months ended 31 March 2008, our natural gas purchases also decreased by 169 mmcm, or 23.6%, compared to the corresponding period in 2007, primarily due to our ability to meet domestic market demand from our own production and a reduction in our natural gas volumes stored in the UGSS from 295 mmcm at 1 January 2008 to 59 mmcm at 31 March 2008.

Liquids sales volumes

thousands of tons	**Three months ended 31 March:**		**Change**
	2008	**2007**	**%**
Production from:			
Yurkharovskoye field	184	171	7.6%
East-Tarkosalinskoye field	237	206	15.0%
Khancheyskoye field	182	183	(0.5%)
Other fields	28	26	7.7%
Total liquids production	**631**	**586**	**7.7%**
Purchases from:			
Purgazdobycha	-	16	n/m
Other	32	-	n/m
Total liquids purchases	**32**	**16**	**100.0%**
Total production and purchases	**663**	**602**	**10.1%**
Losses [(1)]	(6)	(6)	0.0%
Decreases (increases) in liquids inventory balances	45	(2)	n/m
Total liquids sales volumes	**702**	**594**	**18.2%**
Stable gas condensate export	***441***	***385***	***14.5%***
LPG export	*18*	*18*	*0.0%*
LPG CIS	*16*	*13*	*23.1%*
LPG domestic	*124*	*92*	*34.8%*
Subtotal LPG	***158***	***123***	***28.5%***
Crude oil export	*-*	*26*	*n/m*
Crude oil domestic	*77*	*42*	*83.3%*
Subtotal crude oil	***77***	***68***	***13.2%***
Oil products export	*18*	*-*	*n/m*
Oil products domestic	*8*	*18*	*(55.6%)*
Subtotal oil products	***26***	***18***	***44.4%***

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

In the three months ended 31 March 2008, our gas condensate and crude oil production increased by 45 thousand tons, or 7.7%, to 631 thousand tons compared to 586 thousand tons in the 2007 period. The higher gas condensate yields from the East-Tarkosalinskoye field were due to changes in the technical parameters of the gas separation process resulted to higher output of gas condensate from gas mix. The increase at our Yurkharovskoye field was due to organic growth in gas condensate production combined with a higher proportion of liquids concentration in the gas production. We also put into operation new wells at our East-Tarkosalinskoye field which increased our crude oil production during the period.

At 31 March 2008, we had 172 thousand tons of stable gas condensate in transit or storage and recognized as inventory until such time as it is delivered to the port of destination as compared to 224 thousand tons as of 31 December 2007. Our stable gas condensate in transit or storage and recognized as inventory was decreased by 52 thousand tons as at 31 March 2008 as compared to the inventory balance at 1 January 2008. At 31 March 2007, we had 192 thousand tons of stable gas condensate in transit or storage as compared to 190 thousand tons at 31 December 2006. The remaining change in liquids inventory balances related to changes in other liquid products.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2008 COMPARED TO THE THREE MONTHS ENDED 31 MARCH 2007

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2008 and 2007. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March:			
millions of Russian roubles	**2008**	**% of total revenues**	**2007**	**% of total revenues**
Total revenues (net of VAT and export duties)	20,876	*100.0%*	15,259	*100.0%*
including:				
natural gas sales	11,593	*55.5%*	10,351	*67.8%*
liquids sales	8,574	*41.1%*	4,534	*29.7%*
Other income (loss)	16	*0.1%*	16	*0.1%*
Total revenues and other income	**20,892**	***100.1%***	**15,275**	***100.1%***
Operating expenses	(11,023)	*(52.8%)*	(9,579)	*(62.8%)*
Profit from operations	**9,869**	***47.3%***	**5,696**	***37.3%***
Finance income (expense)	139	*0.7%*	23	*0.2%*
Share of income (loss) of associated companies	(22)	*(0.1%)*	-	*n/m*
Profit before income tax and minority interest	**9,986**	***47.8%***	**5,719**	***37.5%***
Total income tax expense	(2,487)	*(11.9%)*	(1,377)	*(9.0%)*
Profit for the period	**7,499**	***35.9%***	**4,342**	***28.5%***
Minority interest	4	*0.0%*	5	*0.0%*
Profit attributable to NOVATEK shareholders	**7,503**	***35.9%***	**4,347**	***28.5%***

Total revenues and other income

The following table sets forth our sales (net of VAT and export duties where applicable) and other income for the three months ended 31 March 2008 and 2007:

	Three months ended 31 March:		Change
millions of Russian roubles	**2008**	**2007**	**%**
Natural gas sales	**11,593**	**10,351**	**12.0%**
End-customer	*7,290*	*6,491*	*12.3%*
E-trading	*157*	*365*	*(57.0%)*
Ex-field	*4,146*	*3,495*	*18.6%*
Stable gas condensate sales	**5,943**	**3,234**	**83.8%**
Export	*5,943*	*3,234*	*83.8%*
Liquefied petroleum gas sales	**1,532**	**848**	**80.7%**
Export	*236*	*158*	*49.4%*
CIS	*174*	*92*	*89.1%*
Domestic	*1,122*	*598*	*87.6%*
Crude oil sales	**557**	**337**	**65.3%**
Export	*-*	*135*	*n/m*
Domestic	*557*	*202*	*175.7%*
Oil products sales	**542**	**115**	**371.3%**
Export	*398*	*-*	*n/m*
Domestic	*144*	*115*	*25.2%*
Total oil and gas sales	**20,167**	**14,885**	**35.5%**
Sales of polymer and insulation tape	551	309	78.3%
Other revenues	158	65	143.1%
Total revenues	**20,876**	**15,259**	**36.8%**
Other income (loss)	16	16	0.0%
Total revenues and other income	**20,892**	**15,275**	**36.8%**

Natural gas sales

In the three months ended 31 March 2008, our revenues from sales of natural gas increased by RR 1,242 million, or 12.0%, compared to the corresponding period in 2007. The increase in natural gas revenues was primarily attributable to an overall increase in prices and was partially offset by a decrease in volumes sold. Revenues from the sale of natural gas accounted for 55.5% and 67.8% of our total revenues in the three months ended 31 March 2008 and 2007, respectively. The change in natural gas sales as a percentage of total revenues was primarily due to a decrease in natural gas volumes sold and an increase in both our average prices for liquids and volumes sold.

In the three months ended 31 March 2008, our average realized natural gas price per mcm increased by RR 247 per mcm, or 21.8%, to RR 1,382 per mcm from RR 1,135 per mcm in the corresponding period in 2007. Our proportion of natural gas sold to end-customers, including e-trading sales, on a volume basis, decreased from 51.7% in the three months ended 31 March 2007 to 49.6% in the 2008 period due mainly to the lack of sales to end-customers to whom we are able to sell natural gas in winter periods only from underground storage facilities. We were unable to deliver additional volumes to these end-customers due to the lack of natural gas in underground storage facilities in close proximity to these customers. The average realized prices of our natural gas sold directly to end-customers, at the electronic trading system and natural gas sold ex-field were higher by 22.3%, 31.7% and 23.6%, respectively, in the three months ended 31 March 2008 compared to the corresponding period in 2007. Our sales of natural gas to end-customers were primarily to energy utilities and large industrial companies in both periods.

In the three months ended 31 March 2008, our e-trading natural gas sales decreased by RR 208 million, or 57.0%, primarily due to a reduction in volumes sold on the electronic trading exchange by 187 mmcm, or 67.3%, from 278 mmcm in the 2007 period which was partially offset by an increase in the average sales prices we received for these volumes sold. Our e-trading natural gas sales were primarily to energy utility companies in both periods.

Stable gas condensate sales

In the three months ended 31 March 2008, our revenues from sales of stable gas condensate increased by RR 2,709 million, or 83.8%, compared to the corresponding period in 2007 due to combination of both increase in export contract prices and an increase in export sales volumes.

In the three months ended 31 March 2008, we increased our export sales volumes of stable gas condensate to the US and European markets by 56 thousand tons, or 14.5%, to 441 thousand tons as compared to 385 thousand tons exported in the three months ended 31 March 2007. The increase was largely due to the reduction of stable gas condensate in transit or storage which was previously recorded as inventory at 31 December 2007. We delivered all of our stable gas condensate to the international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers.

In the three months ended 31 March 2008, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market increased by USD 236.9 per ton, or 74.2%, to USD 556.0 per ton (DES and CFR) from USD 319.1 per ton (DES and CFR) in the corresponding period in 2007. The increase in the average realized export price was the result of a 69.8% increase in our average export contract price combined with a 59.3% increase in our average export duty per ton. The increase in our average realized contract prices was due to the overall increase in prices on international markets in the 2008 period.

Liquefied petroleum gas sales

In the three months ended 31 March 2008, our revenues from the sales of LPG increased by RR 684 million, or 80.7%, compared to the corresponding period in 2007, primarily due to an increase in domestic prices and volumes.

In the three months ended 31 March 2008, we increased our sales volumes of LPG by 35 thousand tons, or 28.5%, to 158 thousand tons mainly due to an increase in throughput at our Purovsky Plant, of which 78.5% (77.8%) of LPG volumes was sold domestically for an average price of RR 9,085 per ton (FCA excluding VAT). This represent an increase of RR 2,569 per ton, or 39.4%, compared to the corresponding period in 2007. The remaining volumes of LPG were sold as follows: 11.4% was sold to the export market for an average price of USD 537.2 per ton (DAF excluding export duties) representing an increase of USD 194.1 per ton, or 56.6%, compared to the three months ended 31 March 2007; and 10.1% was sold in the CIS for an average price of RR 10,817 per ton (DAF) representing an increase of RR 3,873 per ton, or 55.8%, compared to the three months ended 31 March 2007. The increase in our average realized export prices (excluding export duties) were primarily due to an increase in our average contract prices by 59.2% combined with a 63.0% increase in our average export duty per ton in the 2008 period.

Crude oil sales

In the three months ended 31 March 2008, our revenues from the sales of crude oil increased by RR 220 million, or 65.3%, compared to the corresponding period in 2007, due to an increase in both domestic prices and volumes sold. The increase in crude oil volumes available for sale by 9 thousand tons, or 13.2%, from 68 thousand tons in the three months ended 31 March 2007 to 77 thousand tons in the 2008 period was mainly attributable to an increase in crude oil production at our East-Tarkosalinskoye field.

Our average realized crude oil domestic sales price (excluding VAT) increased by RR 2,461 per ton, or 51.3%, to RR 7,257 per ton in the three months ended 31 March 2008, compared to RR 4,796 per ton in the 2007 period. The increase in our average realized contract prices was due to the overall increase in prices on international and domestic markets in the 2008 period.

Oil products sales

In the three months ended 31 March 2008, our revenue from the sales of oil products increased by RR 427 million, or 371.3%, compared to the corresponding period in 2007, primarily due to the initiation of oil products trading on international markets by our foreign trading subsidiary.

In the three months ended 31 March 2008, we purchased 25 thousand tons of oil products and resold 18 thousand tons to customers in the US and Europe for an average contract price of USD 902 per ton (terms - DES). At 31 March 2008, 11 thousand tons were recorded as "goods in transit" in inventories until such time as they are delivered to the port of destination compared to 4 thousand tons at 31 December 2007.

Our domestic oil products sales increased by RR 29 million, or 25.2%, to RR 144 million in the three months ended 31 March 2008 from RR 115 million in the 2007 period primarily due to an increase in average prices that was partially offset by a decrease in sales volumes.

In the three months ended 31 March 2008, our domestic oil products sales volumes related to our own production decreased from 18 thousand tons to 1 thousand tons due to the migration of processing of our unstable gas condensate from the Surgutsky refinery to the Purovsky Plant. The price we received for our oil products sales also decreased by RR 2,354 per ton, or 36.3%, from RR 6,480 per ton to RR 4,126 per ton as the output we received from the refining process resulted in lower value products as compared to corresponding 2007 period.

In the three months ended 31 March 2008, our domestic oil products sales volumes sold via our domestic trading operations increased from 57 tons to seven thousand tons. The price we received from our trading activities increased by RR 6,959 per ton, or 49.5%, from RR 14,068 per ton to RR 21,027 per ton in the three months ended 31 March 2008 due to general increase in market prices.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 242 million, or 78.3%, to RR 551 million in the three months ended 31 March 2008, compared to RR 309 million in the 2007 period mainly due to an increase in BOPP film wrap and certain pipes insulation products.

Revenues from our sales of BOPP film wrap increased by RR 223 million, or 184.3%, from RR 121 million in the three months ended 31 March 2007 to RR 344 million in the 2008 period due to a more efficient utilization of the facilities which increased the volumes available for sale. The proportion of BOPP film wrap sales to total sales of polymer and insulation tape increased by 23.3% to 62.4% in the three months ended 31 March 2008 compared to 39.2% in the 2007 period.

Our revenues from pipe insulation products sales increased by RR 13 million, or 7.9%, from RR 164 million in the three months ended 31 March 2007 to RR 177 million in the 2008 period mainly due to an increase in new regional customers and a corresponding increase in volumes sold. The remaining RR 30 million and RR 25 million in the three months ended 31 March 2008 and 2007 related to sales of polymer pipes and other polymer products.

Other revenues

Other revenues include geological and geophysical research services, rent, polymer tolling, transportation, handling, storage and other services. In the three months ended 31 March 2008, other revenues increased by RR 93 million, or 143.1%, to RR 158 million from RR 65 million in the corresponding period in 2007. The increase in other revenues was primarily due to an increase in geological and geophysical research provided to our associates and rental income which accounted for RR 59 million and RR 27 million, respectively, in the three months ended 31 March 2008, compared to nil and RR 7 million in the corresponding period in 2007. In the three months ended 31 March 2008, revenues from transportation, handling and storage services increased marginally by RR 3 million whereas the remaining increase of RR 4 million was composed of various non-material items.

Other income (loss)

In the three months ended 31 March 2008, as well as in the corresponding period in 2007, we realized other income of RR 16 million that was related to the disposals of fixed assets, equipment and materials.

Operating expenses

In the three months ended 31 March 2008, our total operating expenses increased by RR 1,444 million, or 15.1%, to RR 11,023 million as compared to RR 9,579 million in the corresponding period in 2007. The increase was largely due to purchases of natural gas and liquid hydrocarbons, as well as increases in transportation costs and materials, services and other. Total operating expenses decreased as a percentage of total revenues to 52.8% in the three months ended 31 March 2008 compared to 62.8% in the corresponding period in 2007, as shown in the table below.

	Three months ended 31 March:			
millions of Russian roubles	**2008**	**% of total revenues**	**2007**	**% of total revenues**
Transportation expenses	4,556	*21.8%*	4,093	*26.8%*
Taxes other than income tax	1,763	*8.4%*	1,609	*10.6%*
Non-controllable expenses	**6,319**	***30.3%***	**5,702**	***37.4%***
Materials, services and other	1,469	*7.0%*	1,069	*7.0%*
Purchases of natural gas and liquid hydrocarbons	1,171	*5.6%*	563	*3.7%*
Depreciation, depletion and amortization	993	*4.8%*	1,018	*6.7%*
General and administrative expenses	837	*4.0%*	713	*4.7%*
Exploration expenses	230	*1.1%*	202	*1.3%*
Net impairment expense	6	*n/m*	37	*n/m*
Change in inventory	(2)	*n/m*	275	*n/m*
Total operating expenses	**11,023**	***52.8%***	**9,579**	***62.8%***

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In the three months ended 31 March 2008, non-controllable expenses of transportation and taxes other than income tax increased by RR 617 million, or 10.8%, to RR 6,319 million from RR 5,702 million in the corresponding period in 2007. The change was primarily due to an increase in the transportation tariff for natural gas and a combined increase in the transportation tariffs and volumes sold for liquids. Taxes other than income tax increased due to higher mineral production taxes for crude oil. As a percentage of total revenues our non-controllable expenses decreased by 7.1 % to 30.3% in the three months ended 31 March 2008 compared to 37.4% in the corresponding period in 2007.

Transportation expenses

In the three months ended 31 March 2008, our total transportation expenses increased by RR 463 million, or 11.3%, compared to the corresponding period in 2007.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2008**	**2007**	**%**
Natural gas transportation to customers	2,865	2,766	3.6%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	1,069	812	31.7%
Stable gas condensate transported by tankers	527	454	16.1%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	43	25	72.0%
Crude oil transportation to customers	28	32	(12.5%)
Other transportation costs	24	4	500.0%
Total transportation expenses	**4,556**	**4,093**	**11.3%**

In the three months ended 31 March 2008, our transportation expenses for natural gas increased by RR 99 million, or 3.6% to RR 2,865 million from RR 2,766 million in the corresponding period in 2007. The increase was mainly due to higher transportation tariffs effective from 1 January 2008 (see “Transportation tariffs” above), that was partially offset by a decrease in natural gas sales volumes sold directly to end-customers, where the cost of transportation is included in the sales price. We are not able to influence the transportation route of natural gas sold to end-customers and therefore we have no control over our average delivery distance. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period.

In the three months ended 31 March 2008, our total expenses for transportation by rail increased by RR 257 million, or 31.7%, due to an increase in volumes sold and higher railroad transportation tariffs. In the three months ended 31 March 2008, our combined volumes of stable gas condensate, LPG and oil products sold and transported via rail increased by 81 thousand tons, or 15.4%, to 607 thousand tons from 526 thousand tons in the 2007 period.

Our expense for stable gas condensate transported by rail to export markets increased by RR 147 million, or 28.1%, from RR 523 million to RR 670 million, or from RR 1,359 per ton in the three months ended 31 March 2007 to RR 1,521 per ton in the 2008 period. The increase in the transportation rate per ton was primarily due to a tariff increase of approximately 14.9% from 1 January 2008 and increase in volumes sold by 14.5%.

In the three months ended 31 March 2008, our expense for LPG transported by rail amounted to RR 397 million, of which RR 93 million was related to export sales, RR 44 million to CIS sales, and RR 260 million to domestic sales, or RR 5,155 per ton, RR 2,708 per ton, and RR 2,104 per ton, respectively. In the three months ended 31 March 2007, transportation expenses for LPG amounted to RR 277 million, of which RR 91 million was related to export sales, RR 31 million to CIS sales, and RR 155 million to domestic sales, or RR 5,195 per ton, RR 2,333 per ton and RR 1,684 per ton, respectively. In the three months ended 31 March 2008, our LPG rail transportation expense was also affected by an increase in transportation tariffs which was partially offset by the optimization of transport routes for deliveries of LPG to export markets.

The remaining RR 2 million of the transportation expenses by rail in the three months ended 31 March 2008 and RR 12 million in the corresponding period in 2007 were related to the transportation of oil products and other railroad services not allocated between products.

Total transportation expense for delivery of stable gas condensate by tanker to international markets increased by RR 73 million, or 16.1%, from RR 454 million in the three months ended 31 March 2007 to RR 527 million in the 2008 period. The change was primarily due to a 14.5% increase in stable gas condensate volumes sold and higher average freight rates as a result of increasing the average delivery distance to international markets. In the three months ended 31 March 2008, the percentage of stable gas condensate export volumes delivered to the US market increased by 30.5% to 87.5% of total volumes delivered compared to 57.0% in the corresponding period in 2007.

Taxes other than income tax

	Three months ended 31 March:		Change
millions of Russian roubles	**2008**	**2007**	**%**
Unified natural resources production tax (UPT)	1,655	1,441	14.9%
Property tax	142	121	17.4%
Other taxes	15	47	(68.1%)
Subtotal	1,812	1,609	12.6%
Less: reversal of UPT	(49)	-	n/m
Total taxes other than income tax	**1,763**	**1,609**	**9.6%**

In the three months ended 31 March 2008, taxes other than income tax increased by RR 154 million, or 9.6%, of which RR 214 million and RR 21 million was due to UPT and property tax increase, respectively, that was partially offset by a decrease in other taxes.

The increase in our UPT by RR 214 million, or 14.9%, was largely attributable to higher mineral production taxes paid for increasing our production of crude oil, which accounted for RR 135 million. In the three months ended 31 March 2008, we incurred an increase in our crude oil production tax rate by 73.5% and increased our volumes of crude oil produced by 33.3%. The remaining balance related to an increase in our gas condensate UPT expense of RR 68 million and a marginal increase in natural gas UPT expense for RR 10 million.

In the three months ended 31 March 2008, our property tax expense increased by RR 21 million, or 17.4%, to RR 142 million compared to RR 121 million in the corresponding period in 2007. The increase was primarily due to additions of property, plant and equipment ("PPE") at NOVATEK-YURKHAROVNEFTEGAS and NOVATEK-TARKOSALENEFTEGAS, which accounted for RR 8 and RR 8 million of the tax increase, respectively.

Materials, services and other

In the three months ended 31 March 2008, our materials, services and other expenses increased by RR 400 million, or 37.4%, to RR 1,469 million compared to RR 1,069 million in the corresponding period in 2007. The main components of this expense were employee compensation and materials and supplies, which comprised 38.2% and 29.2%, respectively, of total materials, services and other expenses in the 2008 period.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2008**	**2007**	**%**
Employee compensation	561	378	48.4%
Materials and supplies	429	350	22.6%
Electricity and fuel	81	64	26.6%
Repair and maintenance services	78	69	13.0%
Tolling and processing fees	60	61	(1.6%)
Fire safety and security expense	41	69	(40.6%)
Other	219	78	180.8%
Total materials, services and other	**1,469**	**1,069**	**37.4%**

Employee compensation increased by RR 183 million, or 48.4%, to RR 561 million compared to RR 378 million in the corresponding period in 2007. The change was due to additional bonuses paid to our employees during the quarter as well as an increase in general wages at our production entities, which resulted in an additional RR 121 million in employee compensation in the 2008 period. We also added new staff at our production subsidiaries, which increased employee compensation expenses by RR 52 million.

Materials and supplies expense increased by RR 79 million, or 22.6%, mainly due to higher production of polymers and insulation tape products and the associated increase in purchases of raw materials.

In the three months ended 31 March 2008, we incurred an increase in our average electricity tariff mainly at our production entities which increased our electricity and fuel expenses by RR 17 million, or 26.6%.

Our increase in repair and maintenance expenses by RR 9 million, or 13.0%, from RR 69 million in the three months ended 31 March 2007 to RR 78 million in the 2008 period was primarily related to repair works at our production subsidiary NOVATEK-YURKHAROVNEFTEGAS.

Fire safety and security expenses decreased by RR 28 million, or 40.6%, to RR 41 million from RR 69 million in the three months ended 31 March 2007 primarily due to a reduction in fire safety services provided by third parties to our production entities. During the fourth quarter 2007, the Group organized its own fire safety departments to meet the Group's overall fire and safety requirements at its production and processing facilities.

Other expenses include external operator services (geological and geophysical research), rent expenses, transport of raw materials, telecommunication services, and miscellaneous operating expenses. In the three months ended 31 March 2008, other expenses increased by RR 141 million, or 180.8%, of which RR 128 million and RR 23 million related to providing geological and geophysical research to the North-Russian, Anomalny, and West-Tazovsky fields and transportation expenses, respectively.

Purchases of natural gas and liquid hydrocarbons

Purchases of natural gas and liquid hydrocarbons increased by RR 608 million, or 108.0%, to RR 1,171 million from RR 563 million in the corresponding period in 2007 primarily due to purchases of oil products, namely naphtha, on the international markets for resale, which amounted to RR 540 million in the 2008 period.

Depreciation, depletion and amortization

In the three months ended 31 March 2008, our depreciation, depletion and amortization ("DDA") expense decreased by RR 25 million, or 2.5%, compared to the corresponding period in 2007 primarily due to a RR 30 million reduction in depreciation accrued using the "units of production" method that was partially offset by an increase in straight-line depreciation. In the 2008 period, our DDA per barrel of oil equivalent (boe) was RR 16.0 compared to DDA per boe of RR 16.7 in the corresponding period in 2007. The change in our DDA per boe was largely due to an increase in our proved developed reserves estimates as of 31 December 2007.

General and administrative expenses

In the three months ended 31 March 2008, our general and administrative expenses increased by RR 124 million, or 17.4%, to RR 837 million compared to RR 713 million in the corresponding period in 2007. The main components of these expenses were employee compensation, maintenance of social infrastructure and charitable contributions, legal, audit, and consulting services which, on aggregate comprised 73.0% and 71.5% of total general and administrative expenses in the three months ended 31 March 2008 and 2007, respectively.

	Three months ended 31 March:		Change
millions of Russian roubles	**2008**	**2007**	**%**
Employee compensation	474	340	39.4%
Maintenance of social infrastructure and charitable contributions	88	120	(26.7%)
Legal, audit, and consulting services	50	50	0.0%
Rent expense	37	32	15.6%
Insurance expense	19	38	(50.0%)
Other	169	133	27.1%
Total general and administrative expenses	**837**	**713**	**17.4%**

Employee compensation increased by RR 134 million, or 39.4%, to RR 474 million compared to RR 340 million in the corresponding period in 2007. Additional employees' wages and staff at NOVATEK accounted for RR 84 million, or 62.7%, of the total increase in employee compensation, of which RR 73 million related to increases in staff wages and RR 11 million related to staff additions.

Maintenance of social infrastructure and charitable contributions related to support for charities and social programs in the regions where we operate and correspond with the Company's plans in both periods. In the three months ended 31 March 2008, our maintenance of social infrastructure and charitable contributions decreased by RR 32 million, or 26.7%, to RR 88 million compared to RR 120 million in corresponding period in 2007, primarily due to a smaller donations to sport activities in the beginning of 2008 period.

Our legal, audit, and consulting services expenses remained unchanged and amounted to RR 50 million in the three months ended 31 March 2008 and 2007 respectively.

In the three months ended 31 March 2008, rent expense increased by RR 5 million, or 15.6%, to RR 37 million as compared to RR 32 million in the corresponding period in 2007. The increase in rent expense was mainly attributable to a general increase in rental rates and additional office space rented in Moscow.

Insurance expense decreased by RR 19 million, or 50.0%, to RR 19 million compared to RR 38 million in the three months ended 31 March 2007. The decrease was primarily due to lower Group insurance rates due to a reduction in claims for accidents and a re-assessment of items to be insured.

In the three months ended 31 March 2008, other general and administrative expenses increased by RR 36 million, or 27.1%, as compared to the 2007 period primarily due to an increase in depreciation on administrative buildings and assets, and fire safety and security expenses relating to administrative buildings and assets, which accounted for RR 9 million and RR 5 million, respectively, of the increase.

Change in inventory

We reduced our operating expenses by recording a credit to our change in inventory of RR 2 million in the three months ended 31 March 2008 as compared to the expense of RR 275 million in the corresponding period in 2007. The credit represents an adjustment to our operating expenses for "goods in transit" and volumes held in storage at the end of the period (see "Operational highlights" above).

In the three months ended 31 March 2007, we withdrew 893 mmcm of natural gas from underground gas storage facilities, while in the 2008 period we withdrew 39 mmcm of natural gas from the storage facilities. Our balance of stable gas condensate in transit decreased by 52 thousand tons in the three months ended 31 March 2008. The decrease in balances of natural gas and stable gas condensate at 31 March 2008 compared to 1 January 2008 was offset by an increase in oil products purchased on international markets which were not sold at the reporting date.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 4,173 million, or 73.3%, to RR 9,869 million in the three months ended 31 March 2008 compared to RR 5,696 million in the corresponding period in 2007. In the three months ended 31 March 2008, our profit from operations as a percentage of total revenues increased to 47.3 % as compared to 37.3% in the corresponding period in 2007.

Finance income (expense)

In the three months ended 31 March 2008, we recorded a net finance income of RR 139 million compared to net finance income of RR 23 million in the 2007 period. The increase was mainly due to an increase in foreign exchange gains in the 2008 period.

In the three months ended 31 March 2008, interest expense decreased by RR 21 million, or 26.9%, due to a reduction in our weighted average debt balances; interest income decreased by RR 24 million, or 25.5%, due to a decrease in interest income on funds held on account as bank deposits. During the period, we recorded a net foreign exchange gain of RR 126 million compared to RR 7 million in the corresponding period in 2007. The increase in our foreign exchange gain was due to the combination of a higher proportion of US dollar denominated liabilities than assets and the strengthening of the Russian rouble against US dollar in the 2008 period.

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 24.9% and 24.1% for the three months ended 31 March 2008 and 2007, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 25.2% and 24.6% in the 2008 and 2007 periods, respectively. Russian statutory income tax rate for both periods was 24%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed above, profit for the period increased by 3,157 million, or 72.7%, to RR 7,499 million in the three months ended 31 March 2008 from RR 4,342 million in the corresponding period in 2007. The profit attributable to NOVATEK shareholders increased by RR 3,156 million, or 72.6%, to RR 7,503 million in the three months ended 31 March 2008 from RR 4,347 million in the corresponding period in 2007.

We increased our weighted average basic and diluted earnings per share by RR 1.04 per share, or 72.7%, from RR 1.43 per share in the three months ended 31 March 2007 to RR 2.47 per share in the 2008 period based on the profits attributable to NOVATEK's shareholders.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2008 and 2007:

millions of Russian roubles	**Three months ended 31 March: 2008**	**2007**	**Change %**
Net cash provided by operating activities	9,613	6,940	38.5%
Net cash used in investing activities	(6,942)	(3,754)	84.9%
Net cash used in financing activities	(108)	(162)	(33.3%)

Liquidity ratios	**31 March 2008**	**31 December 2007**	**Change %**
Current ratio	1.57	1.41	11.3%
Total debt to equity	0.06	0.08	(25.0%)
Long-term debt to long term debt and equity	n/m	0.001	n/m
Net debt to total capitalization [1]	(0.002)	0.027	n/m

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

Net cash provided by operating activities

In the three months ended 31 March 2008, our net cash provided by operating activities increased by RR 2,673 million, or 38.5%, to RR 9,613 million compared to RR 6,940 million in the corresponding period in 2007. The change was mainly attributable to higher operating income from our oil and gas sales as a result of strong average realized prices for our natural gas and liquids volumes that were partially offset by an increase in income tax paid.

Net cash used in investing activities

Net cash used in investing activities increased by RR 3,188 million, or 84.9%, to RR 6,942 million in the three months ended 31 March 2008 compared to RR 3,754 million in the corresponding period in 2007. The change in the 2008 period was primarily due to an increase in capital expenditures related to further development of our three core fields and the construction activities associated with the second phase expansion of the Purovsky Processing.

Net cash used in financing activities

Net cash used for financing activities decreased by RR 54 million to RR 108 million in the three months ended 31 March 2008 compared to RR 162 million in the corresponding period in 2007. The decrease was primarily due to repayments of our borrowings in the 2007 period.

Working capital

Our net working capital position (current assets less current liabilities) at 31 March 2008 was RR 6,703 million compared to RR 4,963 million at 31 December 2007. The strengthening of our working capital position was the result of strong operating activities and financial results. The change by RR 1,740 million was mainly due to an increase in trade and other receivables and cash and cash equivalents and a decrease in short-term debt that was partially offset by a decrease in prepayments and other current assets at 31 March 2008.

Capital expenditures

Total capital expenditures on property, plant and equipment for the three months ended 31 March 2008 and 2007 are as follows:

millions of Russian roubles	Three months ended 31 March: 2008	2007	Change %
Exploration and production	6,028	3,757	60.4%
Other	509	54	842.6%
Total	**6,537**	**3,811**	**71.5%**

Exploration and production expenditures represent our investments in exploring for and developing our oil and gas properties. During both reporting periods, the majority of our capital expenditures related to ongoing development and exploration activities at our three core fields. In the three months ended 31 March 2008, we spent RR 141 million, RR 618 million, RR 3,648 million and RR 497 million for field development at the Khancheyskoye, East-Tarkosalinskoye, Yurkharovskoye and Sterkhovoye fields, respectively, and RR 831 million on construction of the second phase at the Purovsky Processing Plant.

Debt obligations

At 31 March 2008, the Group had a short-term USD denominated loans from BNP PARIBAS Bank in the amount of RR 2,352 million (USD 100 million) repayable in September 2008, and from CALYON S.A. and CALYON RUSBANK Corporate and Investment Bank in total amount of RR 2,352 million (USD 100 million) repayable in May 2008.

At 31 March 2008, the Group had unused short-term credit facilities in the aggregate amount of RR 5,191 million (USD 221 million) on either fixed or variable interest rates subject to the specific type of credit facility.

In addition, the Group has available funds up to the maximum amount of RR 2,352 million (USD 100 million) under a two year credit line facility with UniCredit Bank with interest rates negotiated on each withdrawal dates. At 31 March 2008 no funds were withdrawn under this facility.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar and Euro. As of 31 March 2008, RR 35 million, or 0.7%, of our long-term debt was denominated in US dollars (out of RR 5,057 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, approximately 31.6% in the three months ended 31 March 2008, is denominated in US dollars. As of 31 March 2008, the Russian rouble had appreciated by approximately 4% against the US dollar since 1 January 2008.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 31 March 2008 would have resulted in an estimated foreign exchange gain of approximately RR 484 million on foreign currency denominated borrowings held at that date.

Commodity risk

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

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

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

Pipeline access

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

Ability to reinvest

Our business requires significant ongoing capital expenditures in order to grow our production. An extended period of low natural gas prices or high transportation tariffs would limit our ability to maintain an adequate level of capital expenditures, which in turn could limit our ability to increase or maintain current levels of production and deliveries of natural gas, gas condensate, crude oil and other associated products, adversely affecting our results.

Off balance sheet activities

As of 31 March 2008, 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.