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

You should read the following discussion and analysis of our financial condition and results of operations as of 31 December 2010 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the years ended 31 December 2010 and 2009. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom, in each case according to the Central Dispatch Administration of the Fuel and Energy Complex (the "CDU-TEK") for 2010. In terms of proved natural gas reserves, we are the second largest holder of natural gas resources in Russia after Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

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

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

RECENT DEVELOPMENTS

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

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

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

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

In July 2010, we created a joint venture, OOO "Yamal Development" ("Yamal Development"), with OAO "Gazprom Neft" to jointly develop potential hydrocarbon assets in YNAO, with each entity holding a 50% equity participation interest in Yamal Development. In November 2010, Yamal Development acquired a 51 percent participation interest in OOO "SeverEnergia" ("SeverEnergia"). SeverEnergia holds 100% of the shares of OAO “Arctic Gas”, ZAO “Urengoil Inc.” and OAO “Neftegaztechnologia”, which hold licenses for the development of oil and gas condensate fields in the YNAO. SeverEnergia’s proved reserves as appraised by D&M under the PRMS and SEC reserves methodologies as of 31 December 2010 totaled approximately 245 and 224 billion cubic meters of natural gas and 42 and 39 million tons of liquid hydrocarbons, respectively.

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

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

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

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

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

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

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

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

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

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

SELECTED DATA

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

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

[(2)] Normalized EBITDA excludes one-time effect from disposal of investments.

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

[(4)] EBITDA margin is calculated as EBITDA divided by total revenues and is shown as a percentage of total revenues.

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

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

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

SELECTED MACRO-ECONOMIC DATA

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

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

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

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

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

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current financial market conditions

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

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

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

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

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

Natural gas prices

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

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

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

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

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

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

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

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

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

[1] Includes cost of transportation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Transportation tariffs

Natural gas

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

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

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

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

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

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

Crude oil

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

Stable gas condensate, LPG and oil products

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

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

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

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

Transportation transactions with related parties

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

Our tax burden

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

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

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

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

OIL AND GAS RESERVES

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

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

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

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

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

[(1)] Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

[(2)] Disposals represent reserves attributable to the sale of an equity stake in a subsidiary and the loss of control.

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

[1] Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

[2] Disposals represent reserves attributable to the sale of an equity stake in a subsidiary and the loss of control.

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

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

[1] Proved reserves as 31 December 2008 were based on previous SEC reserve methodology.

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

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

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

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

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

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

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

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

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

The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for reserve determinations. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history. Our reserves estimates were prepared using standard geological and engineering methods generally accepted in the petroleum industry. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of the process, senior management reviews and approves the final reserves estimates issued by D&M.

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

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

OPERATIONAL HIGHLIGHTS

Oil and gas production costs

Our oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the *Unaudited Supplemental Oil and Gas Disclosures* in our consolidated financial statements for the years ended 31 December 2010 and 2009. Oil and gas production costs do not include general corporate overheads or their associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the years presented in millions of Russian roubles and on a barrel of oil equivalent (boe) basis in Russian roubles and US dollars:

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

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

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

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

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

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

Hydrocarbon sales volumes

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

Natural gas sales volumes

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

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

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

Liquids sales volumes

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

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

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

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

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

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

Total revenues

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

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

Natural gas sales

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

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

Stable gas condensate sales

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

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

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

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

Liquefied petroleum gas sales

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

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

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

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

Crude oil sales

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

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

Oil products sales

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

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

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

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

Sales of polymer and insulation tape

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

Other revenues

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

Operating expenses

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

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

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In 2010, non-controllable expenses of transportation and taxes other than income tax increased by RR 10,209 million, or 27.5%, to RR 47,277 million from RR 37,068 million in 2009. The change in transportation expenses was primarily due to an increase in the natural gas transportation tariff and sales volumes. Taxes other than income tax increased primarily due to higher liquids and natural gas production volumes and the corresponding impact on unified natural resources production tax as well as excise and fuel taxes incurred in 2010 with the commencement of commercial activities in Poland. As a percentage of total revenues, our non-controllable expenses marginally decreased to 40.4% in 2010 compared to 41.2% in 2009.

Transportation expenses

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

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

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

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

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

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

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

Taxes other than income tax

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

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

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

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

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

General and administrative expenses

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

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

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

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

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

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

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

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

Depreciation, depletion and amortization

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

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

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

Materials, services and other

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

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

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

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

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

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

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

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

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

Exploration expenses

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

Purchases of natural gas and liquid hydrocarbons

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

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

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

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

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

The following table highlights movements in our inventory balances:

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

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

Net gain on disposal of interest in subsidiaries

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

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

Other operating income (loss)

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

In 2009, we realized other operating loss of RR 343 million, of which RR 190 million was related to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") and RR 303 million was related to disposal of assets under construction, primarily at our subsidiary JSC "Energy Northern Company". The remaining other operating income of RR 150 million was primarily related to penalties from our customers due to non-compliance of their contractual obligations and other profit and loss items.

Profit from operations

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

Finance income (expense)

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

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

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

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

Share of income (loss) of associated companies

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

Income tax expense

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

Profit attributable to shareholders and earnings per share

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

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

LIQUIDITY AND CAPITAL RESOURCES

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

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

Liquidity ratios	31 December 2010	31 December 2009	Change, %
Current ratio	0.51	1.14	(55.3%)
Total debt to equity	0.49	0.33	48.5%
Long-term debt to long-term debt and equity	0.24	0.17	41.2%
Net debt to total capitalization (1)	0.25	0.15	66.7%

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

Net cash provided by operating activities

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

Net cash used in investing activities

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

Net cash provided by financing activities

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

Working capital

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

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

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

Capital expenditures

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

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

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

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

Debt obligations

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

Recent developments

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

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

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

Overview

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

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

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

[1] – interest rates were changed during the periods
[2] – Bridge loan repaid in February 2011 ahead of maturity schedule
[3] – Sberbank loan repaid in July 2010 ahead of maturity schedule

Maturities

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

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

Available credit facilities

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

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

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

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

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

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

Commodity risk

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

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

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

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

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