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

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 30 June 2007 and 2006 together with our unaudited consolidated interim condensed financial information as of and for the three and six months ended 30 June 2007. The unaudited consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*. This consolidated interim condensed financial information should be read together with the audited consolidated financial statements for the year ended 31 December 2006 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 the "Group").

OVERVIEW

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

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

SELECTED DATA

millions of Russian roubles except as stated	**Three months ended 30 June: 2007**	**2006**	**Change %**
Financial results			
Total revenues (net of VAT and export duties)	15,044	12,721	18.3%
Operating expenses	(9,002)	(7,840)	14.8%
Profit attributable to NOVATEK shareholders	4,216	3,499	20.5%
EBITDA [(1)]	7,109	5,829	22.0%
Earnings per share of common stock (in Russian roubles)	1.39	1.15	20.9%
Operating results			
Natural gas sales volumes (mmcm)	7,722	7,683	0.5%
Stable gas condensate sales volumes (thousand tons)	389	331	17.5%
Liquefied petroleum gas sales volumes (thousand tons)	125	123	1.6%
Crude oil sales volumes (thousand tons)	57	74	(23.0%)
Oil product sales volumes (thousand tons)	13	35	(62.9%)
Cash flow results			
Net cash provided by operating activities	4,453	3,194	39.4%
Capital expenditures	3,003	1,035	190.1%

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Natural gas prices

As an independent natural gas producer, we are not subject to the government's regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom's domestic gas sales, although the prices we can achieve are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In the three months ended 30 June 2007, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 161 per mcm, or 14.4%, to RR 1,279 per mcm compared to RR 1,118 per mcm in the corresponding period in 2006. The terms for delivery of natural gas affect our average realized prices. Natural gas sold "ex-field" is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. Sales to wholesale traders allow us to diversify our gas sales without incurring additional commercial expenses. However, we realize higher prices and net margins for natural gas volumes sold directly to the end-customer, as the gas transportation tariff is included in the contract price and no retail margin is lost when realizing natural gas to wholesale gas traders. During the three months ended 30 June 2007, the average netback margin differential we received on end-customer sales compared to ex-field sales (average end-customer netback less average ex-field price) increased by RR 39 per mcm, or 54.9%, compared to the period in 2006 as a result of higher average realized prices to end-customers (see "Natural gas sales" below).

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 30 June 2007 and 2006:

	Three months ended 30 June:		Change
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to end-customers [(1)]	1,483	1,244	19.2%
Gas transportation expense for sales to end-customers	596	504	18.3%
Average natural gas netback on end-customer sales	887	740	19.9%
Average natural gas price ex-field (wholesale traders)	777	669	16.1%
Average netback margin differential	110	71	54.9%

[(1)] Includes cost of transportation.

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

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

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

In the three months ended 30 June 2007, as well as in the corresponding period of 2006, our stable gas condensate export delivery terms were delivery to the port of destination ex-ship (DES) or priced at cost and freight (CFR). Our average export stable gas condensate contract price, including export duties, in the three months ended 30 June 2007, was approximately USD 632 per ton compared to approximately USD 603 per ton in the corresponding period in 2006.

In the three months ended 30 June 2007, as well as in the corresponding period of 2006, our crude oil export delivery terms were delivery at frontier (DAF Adamova Zastava, Germany). In the 2007 period, our average crude oil export contract price, including export duties, was approximately USD 462 per ton compared to USD 456 per ton in the 2006 period.

The following table shows our average realized stable gas condensate and crude oil sales prices (net of VAT and export duties, where applicable) for the three months ended 30 June 2007 and 2006:

Russian roubles (RR) or US dollars (USD) per ton	**Three months ended 30 June:**		**Change**
	2007	**2006**	**%**
Stable gas condensate			
Net export price, RR per ton	12,097	11,636	4.0%
Net export price, USD per ton	467.8	427.7	9.4%
Domestic price, RR per ton	8,464	8,182	3.4%
Crude oil			
Net export price, RR per ton	7,504	7,177	4.6%
Net export price, USD per ton	290.2	263.8	10.0%
Domestic price, RR per ton [(1)]	5,818	6,499	(10.5%)

[(1)] Net of transportation costs.

Our LPG export and CIS delivery terms during the three months ended 30 June 2007 and 2006 were delivery at frontier (DAF) at the border of the customer's country. In the three months ended 30 June 2007, our average export LPG contract price, including export duties, was approximately USD 492 per ton compared to USD 465 per ton in the corresponding period in 2006. We are obliged to sell a portion of our LPG volumes at regulated prices while the remaining portion of our sales are sold under commercial terms. In the 2007 period, we sold 10 thousand tons at the regulated price of RR 3,500 per ton and 84 thousand tons at a commercial price of RR 6,665 per ton in the domestic market, compared to 10 thousand tons at RR 1,350 per ton and 87 thousand tons at RR 6,678 per ton, respectively, in the 2006 period. Domestic sales of oil products are priced free carrier (FCA) at the Surgut railroad station (located in the Khanty-Mansiysk Autonomous Region).

The following table shows our average realized liquefied petroleum gas and oil products sales prices (net of VAT and export duties, where applicable) for the three months ended 30 June 2007 and 2006:

Russian roubles (RR) or US dollars (USD) per ton	**Three months ended 30 June:**		**Change**
	2007	**2006**	**%**
LPG			
Net export price, RR per ton	9,573	8,865	8.0%
Net export price, USD per ton	370.2	325.9	13.6%
CIS price, RR per ton	8,076	7,497	7.7%
Domestic price, RR per ton	6,317	6,120	3.2%
Oil products			
Domestic price, RR per ton	7,084	6,534	8.4%

Transportation tariffs

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

Starting from 1 August 2006, the general methodology for calculating transportation tariffs for natural gas produced in the Russian Federation was changed by the FTS. Under the new methodology the transportation tariff consists of two parts: a rate for the utilization of the trunk pipeline and a transportation rate per mcm per 100 km. The rate for utilization of the trunk pipeline is based on an "input/output" function which is determined by where natural gas enters and exits the trunk pipeline (the maximum “input/output” rate effective from 1 March 2007 is RR 1,061.51 (excluding VAT) per mcm) and includes a constant rate of RR 13.8 (excluding VAT) per mcm for end-customers using Gazprom’s gas distribution systems. The constant rate is deducted from the utilization rate for end-customers using non-Gazprom gas distribution systems. The second component of the transportation rate for natural gas delivered within the customs territory of the Russian Federation and the member states of the Customs Union Agreement was set at RR 6.07 (excluding VAT) per mcm per 100 km.

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

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

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

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

Transactions with related parties

All natural gas producers and wholesalers operating in Russia transport their natural gas volumes through the Unified Gas Supply System (UGSS), which is owned and operated by the State monopoly Gazprom, a shareholder of OAO NOVATEK from October 2006. As an independent natural gas producer, we utilize the UGSS to transport natural gas to end-customers at the tariff established by the FTS (see “Transportation tariffs” above and Note 16 “Related party transactions” in our consolidated interim condensed financial information).

Our tax burden

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon sales volumes

In the three months ended 30 June 2007, we marginally increased our natural gas sales volumes primarily due to increased production. Our aggregated liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) also increased in the 2007 period due to a decrease in liquids inventory balances.

Natural gas sales volumes

millions of cubic meters	Three months ended 30 June : 2007	2006	Change %
Production from:			
Yurkharovskoye field	2,383	2,329	2.3%
East-Tarkosalinskoye field	3,780	3,966	(4.7%)
Khancheyskoye field	1,056	728	45.1%
Other fields	7	9	(22.2%)
Total natural gas production	**7,226**	**7,032**	**2.8%**
Purchases from:			
Gazprom	474	504	(6.0%)
Other	111	280	(60.4%)
Total natural gas purchases	**585**	**784**	**(25.4%)**
Total production and purchases	**7,811**	**7,816**	**(0.1%)**
Purovsky Plant and own usage	(7)	(8)	(12.5%)
Decrease (increase) in pipeline and underground gas storage facilities	(82)	(125)	(34.4%)
Total natural gas sales volumes	**7,722**	**7,683**	**0.5%**
Sold to end-customers	*3,531*	*3,256*	*8.4%*
incl. e-trading	*265*	*-*	*n/a*
Sold ex-field	*4,191*	*4,427*	*(5.3%)*

In the three months ended 30 June 2007, our total consolidated natural gas production increased by 194 mmcm, or 2.8%, compared to the corresponding period in 2006. The increase was primarily due to the expansion of production capacity at Khancheyskoye field related to the field’s second phase of development.

In the three months ended 30 June 2007, purchases decreased by 199 mmcm, or 25.4%, compared to the corresponding period in 2006, primarily due to a decrease in purchases from ‘other’ suppliers resulting from our ability to meet contractual obligations for natural gas from our own production sources.

At 30 June 2007, our cumulative natural gas volumes stored in Gazprom’s underground gas storage facilities totaled 247 mmcm, representing an increase of 140 mmcm during the period. We expect our volumes of natural gas injected into underground gas storage facilities to 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.

Liquids sales volumes

thousands of tons	Three months ended 30 June: 2007	2006	Change %
Production from:			
Yurkharovskoye field	172	167	3.0%
East-Tarkosalinskoye field	204	216	(5.6%)
Khancheyskoye field	175	187	(6.4%)
Other fields	24	26	(7.7%)
Total liquids production	**575**	**596**	**(3.5%)**
Purchases from:			
Purgazdobycha	-	19	n/a
Total liquids purchases	**-**	**19**	**n/a**
Total production and purchases	**575**	**615**	**(6.5%)**
Losses [(1)]	(5)	(5)	0.0%
Decreases (increases) in liquids inventory balances	14	(46)	n/a
Total liquids sales volumes	**584**	**564**	**3.5%**
Stable gas condensate export	*386*	*329*	*17.3%*
Stable gas condensate domestic	*3*	*2*	*50.0%*
LPG export	*20*	*7*	*185.7%*
LPG CIS	*11*	*20*	*(45.0%)*
LPG domestic	*94*	*97*	*(3.1%)*
Crude oil export	*32*	*20*	*60.0%*
Crude oil domestic	*25*	*54*	*(53.7%)*
Oil products domestic	*13*	*35*	*(62.9%)*

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

In the three months ended 30 June 2007, our gas condensate and crude oil production decreased by 21 thousand tons, or 3.5%, to 575 thousand tons compared to 596 thousand tons in the corresponding period in 2006. The decrease was due to natural declines in the concentration of gas condensate, due to decreasing reservoir pressure at the current gas condensate producing horizons, at our East-Tarkosalinskoye and Khancheyskoye fields.

As of the 30 June 2007, we had 168 thousand tons of stable gas condensate in transit and recognized as inventory until such time as it is delivered to the port of destination compared to 187 thousand tons as of 30 June 2006. Our stable gas condensate in transit and recognized as inventory was reduced by 14 thousand tons as at 30 June 2007 as compared to the inventory balance as at 31 March 2007, while in the corresponding periods of 2006 the inventory balance increased by 46 thousand tons.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 JUNE 2007 COMPARED TO THE CORRESPONDING PERIOD IN 2006

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2007 and 2006. Each line item is also shown as a percentage of our total revenues.

millions of Russian roubles	Three months ended 30 June: 2007	% of total revenues	2006	% of total revenues
Total revenues (net of VAT and export duties)	15,044	*100.0%*	12,721	*100.0%*
Other income (loss)	9	*0.1%*	(172)	*(1.4%)*
Total revenues and other income	**15,053**	***100.1%***	**12,549**	***98.6%***
Operating expenses	(9,002)	*(59.8%)*	(7,840)	*(61.6%)*
Profit from operations	**6,051**	***40.2%***	**4,709**	***37.0%***
Finance income (expense)	42	*0.3%*	(78)	*(0.6%)*
Profit before income tax and minority interest	**6,093**	***40.5%***	**4,631**	***36.4%***
Total income tax expense	(1,883)	*(12.5%)*	(1,188)	*(9.3%)*
Profit for the period	**4,210**	***28.0%***	**3,443**	***27.1%***
Minority interest	6	*0.0%*	56	*0.4%*
Profit attributable to NOVATEK shareholders	**4,216**	***28.0%***	**3,499**	***27.5%***

Total revenues and other income

The following table sets forth our sales (net of VAT and export duties, where applicable) and other income for the three months ended 30 June 2007 and 2006:

millions of Russian roubles	Three months ended 30 June: 2007	2006	Change %
Natural gas sales	**8,494**	**7,010**	**21.2%**
End-customer	*5,237*	*4,051*	*29.3%*
incl. e-trading	*281*	*-*	*n/a*
Ex-field	*3,257*	*2,959*	*10.1%*
Stable gas condensate sales	**4,692**	**3,842**	**22.1%**
Export	*4,668*	*3,830*	*21.9%*
Domestic	*24*	*12*	*100.0%*
Liquefied petroleum gas sales	**877**	**802**	**9.4%**
Export	*194*	*63*	*207.9%*
CIS	*88*	*148*	*(40.5%)*
Domestic	*595*	*591*	*0.7%*
Crude oil sales	**387**	**495**	**(21.8%)**
Export	*241*	*146*	*65.1%*
Domestic	*146*	*349*	*(58.2%)*
Oil products sales	**92**	**225**	**(59.1%)**
Total oil and gas sales	**14,542**	**12,374**	**17.5%**
Sales of polymer and insulation tape	411	291	41.2%
Other revenues	91	56	62.5%
Total revenues	**15,044**	**12,721**	**18.3%**
Other income (loss)	9	(172)	*n/a*
Total revenues and other income	**15,053**	**12,549**	**20.0%**

Natural gas sales

In the three months ended 30 June 2007, our revenues from sales of natural gas increased by RR 1,484 million, or 21.2%, compared to the corresponding period in 2006. The increase in natural gas revenues was primarily attributable to an overall increase in prices and sales volumes to end-customers.

In the three months ended 30 June 2007, our average realized natural gas price per mcm increased by RR 187 per mcm, or 20.5%, to RR 1,100 per mcm from RR 913 per mcm in the corresponding period in 2006. Our proportion of natural gas sales to end-customers increased from 57.8% in the 2006 period to 61.7% in the 2007 period. The average realized prices of our natural gas sold to end-customers and natural gas sold ex-field were higher by 19.2% and 16.1%, respectively, in the 2007 period compared to the corresponding period in 2006.

In November 2006, OAO NOVATEK started participating in the electronic trading of natural gas at non-regulated prices utilizing the electronic trading facilities of Mezhregiongaz, a subsidiary of Gazprom. In the three months ended 30 June 2007, we sold 265 mmcm of natural gas at an average price of RR 1,057 per mcm (netback price RR 943 per mcm). These sales were primarily to energy utility companies and are recorded in our end-customer volumes and average end-customer price. We view the commencement of electronic trading of natural gas as a positive development in the domestic natural gas market.

Stable gas condensate sales

In the three months ended 30 June 2007, our revenues from sales of stable gas condensate increased by RR 850 million, or 22.1%, compared to the corresponding period in 2006. The increase in stable gas condensate revenues was directly related to an increase in sales volumes and prices and a decrease in the average export duty. In the 2007 period, our sales volumes increased by 58 thousand tons compared to the corresponding period in 2006 primarily due to a decrease in goods in transit and recognized as inventory at the end of the 2007 period.

In the three months ended 30 June 2007, we exported 386 thousand tons of stable gas condensate, or 99.2% of our sales volumes, to markets in the United States and Europe. In the 2007 period, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market increased by USD 40.1 per ton, or 9.4%, to USD 467.8 per ton (DES and CFR) from USD 427.7 per ton (DES and CFR) in the corresponding period in 2006. The increase in the average realized export price was the result of a 7.9% reduction in our average export duty per ton and a 4.8% increase in our average export contract price.

Liquefied petroleum gas sales

In the three months ended 30 June 2007, our revenues from the sales of LPG increased by RR 75 million, or 9.4%, compared to the corresponding period in 2006, primarily due to an increase in export volumes and to a lesser degree increases in export, CIS and domestic prices.

In the 2007 period, we increased our sales volumes of LPG by 1 thousand tons to 125 thousand tons, of which 75.2% was sold domestically for an average price of RR 6,317 per ton (FCA excluding VAT); an increase of RR 197 per ton, or 3.2%, compared to the corresponding period in 2006. The remaining volumes of LPG were sold as follows: 16.0% was sold to the export market for an average price of USD 370.2 per ton (DAF excluding export duties) representing an increase of USD 44.3 per ton, or 13.6%, compared to the corresponding period in 2006; and 8.8% was sold in the CIS for an average price of RR 8,076 per ton (DAF excluding VAT) representing an increase of RR 579 per ton, or 7.7%, compared to the 2006 period. The increase in our average realized export prices was due to a 3.8% reduction in our average export duty per ton in the 2007 period.

Crude oil sales

In the three months ended 30 June 2007, our revenues from the sales of crude oil decreased by RR 108 million, or 21.8%, compared to the corresponding period in 2006, due to a reduction in both domestic prices and total crude oil sales volumes. The reduction in total crude oil sales volumes in the 2007 period was due to a decrease in unstable gas condensate deliveries to the Surgutsky refinery, a portion of which is sold as crude oil after refining. The reduction in domestic prices and volumes in the 2007 period was partially offset by an increase in export prices and volumes and a reduction in export duties. In the three months ended 30 June 2007, total sales volumes of crude oil decreased by 17 thousand tons, or 23.0%, compared to the corresponding period in 2006.

Our average realized sales price, excluding export duties, translated into US dollars for crude oil exported to international markets increased by USD 26.4 per ton, or 10.0%, to USD 290.2 per ton (DAF) in the three months ended 30 June 2007 compared to USD 263.8 per ton (DAF) in the corresponding period in 2006 as a result of a 10.9% reduction in our average export duty per ton and a 1.3% increase in our average realized crude oil export price. Our average realized crude oil domestic sales price (excluding VAT) decreased by RR 681 per ton, or 10.5%, to RR 5,818 per ton in the 2007 period, compared to RR 6,499 per ton in the corresponding period in 2006. The decrease in domestic crude oil prices was the result of an excess supply of crude oil to the domestic market.

Oil products sales

In the three months ended 30 June 2007, our revenue from the sales of oil products decreased by RR 133 million, or 59.1%, compared to the corresponding period in 2006. The decrease in oil products revenues was primarily due to a decrease in the volumes of unstable gas condensate delivered to the Surgutsky refinery, which resulted in a decrease in the output of oil products available for sale. In the 2007 period, oil products sales volumes amounted to 13 thousand tons compared to 35 thousand tons in the corresponding period in 2006. We sold 100% of our oil products' volumes to the domestic market in both periods.

Sales of polymer and insulation tape

Our revenues from the sales of polymer and insulation tape increased by RR 120 million, or 41.2%, to RR 411 million in the three months ended 30 June 2007, compared to RR 291 million in the corresponding period of 2006 primarily due to an increase in sales of certain pipe insulation products.

Other revenues

Other revenues include rent, polymer tolling, transportation, handling, storage and other services. In the three months ended 30 June 2007, other revenues increased by RR 35 million, or 62.5%, to RR 91 million from RR 56 million in the corresponding period in 2006. The increase was primarily due to an increase in transportation, handling and storage services and in polymer tolling, which accounted for RR 41 million and RR 23 million, respectively, of other revenues in the three months ended 30 June 2007 compared to RR 13 million and RR 15 million, respectively, in the corresponding period in 2006.

Other income (loss)

In the three months ended 30 June 2007, we realized other net income of RR 9 million, while in the corresponding period of 2006 we realized a net loss of RR 172 million mainly from disposals of fixed assets, equipment and materials.

Operating expenses

In the three months ended 30 June 2007, total operating expenses increased by RR 1,162 million, or 14.8%, to RR 9,002 million compared to RR 7,840 million in the three months ended 30 June 2006, primarily due to an increase in such non-controllable expenses as transportation expenses, and to a lesser extent an increase in materials, services and other and general and administrative expenses. As a percentage of total operating expenses, our non-controllable expenses, such as transportation and taxes other than income tax, increased in the three months ended 30 June 2007 to 57.0% compared to 55.2% in the corresponding period of 2006. Total operating expenses decreased as a percentage of total revenues to 59.8% in the 2007 period compared to 61.6% in the corresponding period in 2006, as shown in the table below.

	Three months ended 30 June:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Transportation expenses	3,520	*23.4%*	2,764	*21.7%*
Taxes other than income tax	1,615	*10.7%*	1,566	*12.3%*
Materials, services and other	1,141	*7.6%*	943	*7.4%*
General and administrative expenses	1,109	*7.4%*	860	*6.8%*
Depreciation, depletion and amortization	992	*6.6%*	996	*7.8%*
Purchases of oil, gas condensate and natural gas	423	*2.8%*	461	*3.6%*
Exploration expenses	207	*1.4%*	115	*0.9%*
Net impairment expense	16	*0.1%*	18	*0.1%*
Change in inventory	(21)	*(0.2%)*	117	*1.0%*
Total operating expenses	**9,002**	***59.8%***	**7,840**	***61.6%***

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In the three months ended 30 June 2007, non-controllable expenses of transportation and taxes other than income tax increased by RR 805 million, or 18.6%, to RR 5,135 million from RR 4,330 million in the corresponding period in 2006, primarily due to the increase in both the transportation tariff set by the FTS for natural gas and our natural gas volumes sold to end-customers. As a percentage of total revenues, our non-controllable expenses increased by 0.1% to 34.1% in the 2007 period compared to 34.0% in the corresponding period in 2006.

Transportation expenses

Our total transportation expenses in the three months ended 30 June 2007, increased by RR 756 million, or 27.4%, compared to the corresponding period in 2006.

	Three months ended 30 June:		Change
millions of Russian roubles	**2007**	**2006**	**%**
Natural gas transportation to customers	2,106	1,641	28.3%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	839	724	15.9%
Stable gas condensate transported by tankers	519	364	42.6%
Transportation of unstable gas condensate from the fields to the processing facilities through third party pipelines	30	19	57.9%
Crude oil transportation to customers by pipeline	25	13	92.3%
Other transportation costs	1	3	(66.7%)
Total transportation expenses	**3,520**	**2,764**	**27.4%**

In the three months ended 30 June 2007, our transportation expense for natural gas increased by RR 465 million, or 28.3%. The increase in our gas transportation expense was partially due to an 8.5% increase in our sales volumes of natural gas sold to end-customers, for whom the cost of transportation is included in the sales price, and increases in the transportation tariff as of 1 August 2006 and 1 March 2007 (see "Transportation tariffs" above).

In the three months ended 30 June 2007, our total expenses for transportation by rail increased by RR 115 million, or 15.9%, due to an increase in volumes sold and an increase in the railroad transportation tariff.

During the 2007 period, our combined volumes of stable gas condensate and LPG sold increased by 59 thousand tons, or 13.0%, to 514 thousand tons from 455 thousand tons in the corresponding period in 2006.

Our expense for stable gas condensate transported by rail to international markets increased by RR 91 million, or 20.1%, from RR 453 million to RR 544 million, or from RR 1,377 per ton in the three months ended 30 June 2006 to RR 1,409 per ton in the 2007 period. The increase in the rate per ton was primarily due to a tariff increase of approximately 12.7% in January 2007.

In the three months ended 30 June 2007, our expense for LPG transported by rail amounted to RR 287 million, of which RR 100 million was related to export sales, RR 26 million to CIS sales, and RR 161 million to domestic sales, or RR 4,935 per ton, RR 2,344 per ton, and RR 1,711 per ton, respectively. In the 2006 period, transportation expenses for LPG amounted to RR 251 million, of which RR 44 million was related to export sales, RR 45 million to CIS sales, and RR 162 million to domestic sales, or RR 6,187 per ton, 2,293 per ton and RR 1,675 per ton, respectively.

The remaining RR 8 million of the transportation expenses by rail in the three months ended 30 June 2007 and RR 20 million in the corresponding period of 2006 were related to the transportation of oil products and other railroad services not allocated between products.

Total transportation expense for delivery of stable gas condensate by tanker to international markets increased by RR 155 million, or 42.6%, from RR 364 million in the three months ended 30 June 2006, to RR 519 million in the corresponding period of 2007. The increase was primarily due to a 17.3% increase in volumes sold and an 48.3% increase in our respective average freight rates.

Taxes other than income tax

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2007**	**2006**	**%**
Unified natural resources production tax (UPT)	1,421	1,393	2.0%
Property tax	152	107	42.1%
Excise tax	7	38	(81.6%)
Other taxes	35	28	25.0%
Total taxes other than income tax	**1,615**	**1,566**	**3.1%**

In the three months ended 30 June 2007, taxes other than income tax increased by RR 49 million, or 3.1%, of which RR 28 million and RR 45 million was due to UPT and property tax increases, respectively, which was partially offset by a decrease of excise tax by RR 31 million.

The UPT increase in 2007 was primarily due to 2.8% increase in natural gas production volumes that was partially offset by a decrease in our average production tax rate for crude oil from RR 2,486 per ton to RR 2,393 per ton. The natural gas production tax rate in the 2007 and 2006 periods remained unchanged at RR 147 per mcm.

The increase in property tax expense was primarily due to additions of property, plant and equipment (PPE) at the Purovsky Processing Plant and at our production subsidiaries.

Materials, services and other

In the three months ended 30 June 2007, our materials, services and other expenses increased by RR 198 million, or 21.0%, to RR 1,141 million compared to RR 943 million in the corresponding period in 2006. The main components of this expense in the three months ended 30 June 2007 were payroll and materials expenses.

millions of Russian roubles	Three months ended 30 June: 2007	2006	Change %
Payroll expense	422	317	33.1%
Materials expense	383	301	27.2%
Repair and maintenance services	94	79	19.0%
Security and fire safety expense	65	61	6.6%
Energy and fuel expense	52	36	44.4%
Processing services expense	52	69	(24.6%)
Other expenses	73	80	(8.8%)
Total materials, services and other	**1,141**	**943**	**21.0%**

Payroll expense increased by RR 105 million, or 33.1%, to RR 422 million compared to RR 317 million in the corresponding period in 2006. The increase in our payroll expense was mainly due to an increase in average wages at our production subsidiaries, and semi-annual bonus payments paid in the three months ended 30 June 2007. In the 2007 period, we recorded an additional RR 10 million of payroll expense related to the accrual of pension obligations due to the implementation of a post-employment benefit program in February 2007 (see Note 7 “Pension obligations” in our consolidated interim condensed financial information).

Materials expense increased by RR 82 million, or 27.2%, mainly due to an increase in production of polymers and insulation tape products and the associated increase in purchases of raw materials.

Security and fire safety expenses increased by RR 4 million, or 6.6%, to RR 65 million from RR 61 million in the corresponding period in 2006, and was primarily related to activities at the Purovsky Processing Plant and to ongoing fire safety activities at our field sites.

Processing services expense decreased by RR 17 million, or 24.6%, mainly due to a decrease in oil products refining services, due to a reduction in volumes sent to the Surgutsky refinery in the 2007 period.

General and administrative expenses

In the three months ended 30 June 2007, our general and administrative expenses increased by RR 249 million, or 29.0%, to RR 1,109 million compared to RR 860 million in the corresponding period in 2006. The main components of these expenses were payroll, legal, audit and consulting and social and charitable expenses which, on aggregate comprised 79.2% and 68.7% of total general and administrative expenses for the three months ended 30 June 2007 and 2006, respectively.

millions of Russian roubles	Three months ended 30 June: 2007	2006	Change %
Payroll expense	576	394	46.2%
Legal, audit and consulting expenses	162	61	165.6%
Social and charitable expenses	140	136	2.9%
Rent expenses	39	27	44.4%
Insurance expense	29	49	(40.8%)
Other expenses	163	193	(15.5%)
Total general and administrative expenses	**1,109**	**860**	**29.0%**

In the three months ended 30 June 2007, payroll expense increased by RR 182 million, or 46.2%, to RR 576 million compared to RR 394 million in the corresponding period in 2006. The increase in payroll expense was mainly due to an increase in average salaries and semi-annual bonus payments paid in the three months ended 30 June 2007 and, to a lesser extent, an increase in the number of employees. In the 2007 period, we also accrued pension obligations in the amount of RR 14 million (see Note 7 “Pension obligations” in our consolidated interim condensed financial information).

Legal, audit and consulting services expenses increased by RR 101 million, or 165.6%, to RR 162 million compared to RR 61 million in the corresponding period in 2006. The increase was primarily related to ongoing consulting services provided to the Group for various management efficiency programs and information technology system reviews.

In the three months ended 30 June 2007, social and charitable expenses increased by RR 4 million, or 2.9%, to RR 140 million compared to RR 136 million in the corresponding period in 2006, and were primarily related to our continued support for charities and social programs in the regions where we operate.

In the three months ended 30 June 2007, rent expenses increased by RR 12 million, or 44.4%, to RR 39 million as compared to RR 27 million in the corresponding period in 2006. The increase in rent expenses was mainly attributable to a general increase in rental rates and additional office space rented in Moscow.

Insurance expense decreased by RR 20 million, or 40.8%, to RR 29 million compared to RR 49 million in the corresponding period in 2006. The decrease was primarily due to lower Group insurance rates due to a reduction in claims for accidents and a re-assessment of items to be insured.

Other general and administrative expenses decreased by RR 30 million, or 15.5%, compared to the corresponding period in 2006 mostly due to a decrease in repair and maintenance expenses and bank charges, which accounted for RR 22 million and RR 15 million of the decrease respectively, and was partially offset by an increase in fire safety and security expenses of RR 11 million.

Depreciation, depletion and amortization

In the three months ended 30 June 2007, our depreciation, depletion and amortization ("DDA") expense decreased by RR 4 million, or 0.4%, compared to the corresponding period in 2006, primarily due to a RR 20 million decrease in depreciation accrued using the "units of production" method that was partially offset by an increase in straight-line depreciation. In the 2007 period, our DDA per barrel of oil equivalent (boe) was RR 16.8 compared to DDA per boe of RR 17.4 in the corresponding period in 2006 largely due to an increase in our proved developed reserves estimates as of 31 December 2006.

Purchases of oil, gas condensate and natural gas

Our purchases of hydrocarbons decreased by RR 38 million, or 8.2%, to RR 423 million in the three months ended 30 June 2007 from RR 461 million in the corresponding period in 2006 primarily due to a decrease in natural gas volumes purchased from third parties.

Change in inventory

In the three months ended 30 June 2007, we recorded a credit to our change in inventory expense in the amount of RR 21 million compared to an expense of RR 117 million in the corresponding period in 2006. The credit represents an adjustment to our operating expenses during the period for "goods in transit" recorded as inventory balances at the end of the period.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 1,342 million, or 28.5%, in the three months ended 30 June 2007 compared to the corresponding period in 2006. In the 2007 period, our profit from operations as a percentage of total revenues increased to 40.2% as compared to 37.0% in the corresponding period in 2006.

Finance income (expense)

Total finance income increased from a net expense of RR 78 million in the three months ended 30 June 2006 to a net income of RR 42 million in the corresponding period in 2007. The increase was due to significantly lower interest expenses combined with foreign exchange gains in the 2007 period compared to higher interest expenses and foreign exchange losses in the 2006 period.

In the three months ended 30 June 2007, interest expense decreased by RR 70 million or 52.2% compared to the corresponding period in 2006, primarily due to a reduction in our total debt. In the three months ended 30 June 2007, interest income increased by RR 12 million, or 13.8%, due to an increase in interest income on bank deposits. Foreign exchange gain increased by RR 38 million to net gain of RR 7 million in the 2007 period, compared to a net foreign exchange loss of RR 31 million in the corresponding period in 2006 due to a decrease in our foreign currency denominated borrowings and the strengthening of the Russian rouble against the US dollar.

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 30.9% and 25.7% for the three months ended 30 June 2007 and 2006, respectively. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 32.2% and 25.9% in the 2007 and 2006 periods, respectively. Russian statutory income tax rate for both periods was 24%. The difference between our effective and statutory income tax rates are primarily due to certain non-deductible expenses.

The increase in the Group's consolidated income tax rate for the three months ended 30 June 2007 is due to additional income tax on the distribution of profits from the Group's wholly owned domestic subsidiaries. During the period, the Group recorded an increase in current tax expense of RR 134 million representing 9% withholding tax on dividends paid by subsidiaries for dividends distributed to the parent. Moreover, the Group recorded an additional tax accrual of RR 135 million during the period at withholding tax rate of 9% for profit distribution expected to be paid by the end of the year.

Profit for the period and earnings per share

As a result of the factors discussed above, profit for the period increased by RR 767 million, or 22.3%, to RR 4,210 million in three months ended 30 June 2007 from RR 3,443 million in the corresponding period in 2006. The profit attributable to NOVATEK shareholders increased by RR 717 million, or 20.5%, to RR 4,216 million in three months ended 30 June 2007 from RR 3,499 million in the corresponding period in 2006.

Our weighted average basic and diluted earnings per share increased to RR 1.39 per share, or 20.9%, in the three months ended 30 June 2007 from RR 1.15 per share in the corresponding period in 2006.

LIQUIDITY AND CAPITAL RESOURCES

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 30 June 2007 and 2006:

millions of Russian roubles	Three months ended 30 June: 2007	2006	Change %
Net cash provided by operating activities	4,453	3,194	39.4%
Net cash used in investing activities	(2,772)	(1,163)	138.3%
Net cash used in financing activities	(2,817)	(3,781)	(25.5%)

Liquidity ratios	30 June 2007	31 March 2007	Change %
Current ratio	2.9	2.8	3.6%
Total debt to equity	0.023	0.047	(51.1%)
Long-term debt to long term debt and equity	0.002	0.003	(33.3%)
Net debt to total capitalization [(1)]	(0.07)	(0.07)	0.0%

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

Net cash provided by operating activities

Net cash provided by operating activities increased by RR 1,259 million, or 39.4%, to RR 4,453 million in the three months ended 30 June 2007 compared to RR 3,194 million in the corresponding period in 2006. The increase was mainly attributable to higher operating income from our oil and gas sales as a result of increases in our natural gas realized prices and stable gas condensate sales volumes in the 2007 period compared to the corresponding period in 2006.

Net cash used in investing activities

Net cash used in investing activities increased by RR 1,609 million to RR 2,772 million in the three months ended 30 June 2007 compared to RR 1,163 million in the corresponding period in 2006. The increase in the 2007 period was primarily due to an increase in capital expenditures related to further development of our three core fields and the construction activities for the second phase of the Purovsky Processing Plant.

Net cash used in financing activities

Net cash used for financing activities decreased by RR 964 million, or 25.5%, to RR 2,817 million in the three months ended 30 June 2007 compared to RR 3,781 million in the corresponding period in 2006. The decrease was primarily due to a considerable reduction in our borrowings resulting from our ability to fund operating, exploration and development activities from cash generated by operations.

Working capital

At 30 June 2007, our net working capital position (current assets less current liabilities) was RR 11,362 million compared to RR 10,720 million at 31 December 2006. The strengthening of our working capital position is the result of strong operating activities. The increase was mainly due to the increase in cash and cash equivalents.

Capital expenditures

Total capital expenditures on property, plant and equipment for the three months ended 30 June 2007 and 2006 are as follows:

millions of Russian roubles	Three months ended 30 June: 2007	2006	Change %
Exploration and production	2,862	1,007	183.6%
Other	141	28	425.0%
Total	**3,003**	**1,035**	**190.1%**

Exploration and production expenditures represent our investments in exploring for and developing our oil and gas properties. During both reporting periods, the majority of our capital expenditures related to ongoing development and exploration activities at our three core fields. During the three months ended 30 June 2007, we spent RR 384 million, RR 626 million and RR 1,248 million for field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 224 million on construction of the second phase at the Purovsky Processing Plant.

Debt obligations

In the three months ended 30 June 2007, the Group repaid RR 441 million (USD 16.7 million) of long-term debt to BNP PARIBAS Bank as scheduled and fully repaid ahead of schedule a short-term loan in the amount of RR 845 million (USD 32.5 million) from CALYON S.A.

Also, at 30 June 2007, the Group had withdrawn RR 113 million (USD 4.4 million) of bank overdrafts to finance its short-term needs.

At 30 June 2007, the Group had unused credit facilities in the aggregate amount of RR 6,341 million (USD 245.6 million) at either fixed or variable interest rates subject to the specific type of credit facility.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar and Euro. As of 30 June 2007, RR 1,191 million, or 70.3%, of our long-term debt was denominated in US dollars (out of RR 1,694 million of our total borrowings at that date). Changes in the value of the Russian rouble relative to the US dollar will impact our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Russian rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, approximately 34.6% in the 2007 period, is denominated in US dollars. As of 30 June 2007, the Russian rouble had strengthened against the US dollar by approximately 2% since 1 January 2007.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 30 June 2007 would have resulted in an estimated foreign exchange gain of approximately RR 120 million on foreign currency denominated borrowings held at that date.

Commodity risk

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

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

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

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

At 30 June 2007, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.