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

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 31 March 2007 and 2006 together with our unaudited consolidated interim condensed financial information as of and for the three months ended 31 March 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, processing and marketing 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 and domestic markets. We generally sell our oil products on the domestic market.

SELECTED DATA

	Three months ended 31 March:		Change
millions of Russian roubles except as stated	**2007**	**2006**	**%**
Financial results			
Total revenues (net of VAT and export duties)	15,245	11,678	30.5%
Operating expenses	(9,565)	(6,784)	41.0%
Profit attributable to NOVATEK shareholders	4,347	3,717	16.9%
EBITDA [(1)]	6,774	5,864	15.5%
Earnings per share of common stock (in Russian roubles)	1.43	1.22	17.2%
Operating results			
Natural gas sales volumes (mmcm)	9,119	7,834	16.4%
Stable gas condensate sales volumes (thousand tons)	385	257	49.8%
Liquefied petroleum gas sales volumes (thousand tons)	123	129	(4.7%)
Crude oil sales volumes (thousand tons)	68	66	3.0%
Oil product sales volumes (thousand tons)	18	23	(21.7%)
Cash flow results			
Net cash provided by operating activities	6,593	5,375	22.7%
Capital expenditures	3,811	1,186	221.3%

[(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). In the three months ended 31 March 2007, the weighted average FTS price for the regions where we delivered our natural gas increased by RR 133 per mcm, or 12.1%, to RR 1,236 per mcm compared to RR 1,103 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 generally 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 31 March 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 17 per mcm, or 29.3%, compared to the period in 2006 mainly due to commencement of natural gas electronic trading at non-regulated prices (see "Natural gas sales" below).

The following table shows our average realized natural gas sales prices (net of VAT) for the three months ended 31 March 2007 and 2006:

	Three months ended 31 March:		Change
Russian roubles per mcm	**2007**	**2006**	**%**
Average natural gas price to end-customers [(1)]	1,455	1,220	19.3%
Gas transportation expense for sales to end-customers	587	483	21.5%
Average natural gas netback on end-customer sales	868	737	17.8%
Average natural gas price ex-field (wholesale traders)	793	679	16.8%
Average netback margin differential	75	58	29.3%

[(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. Our crude oil domestic delivery terms are such that the buyer takes ownership at the point of loading or the entrance to the trunk pipeline and is responsible for the transportation expense to the final destination.

In the three months ended 31 March 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 31 March 2007, was approximately USD 507 per ton compared to approximately USD 527 per ton in the corresponding period in 2006.

In the three months ended 31 March 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 375 per ton compared to USD 405 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 31 March 2007 and 2006:

	Three months ended 31 March:		Change
Russian roubles (RR) or US dollars (USD) per ton	**2007**	**2006**	**%**
Stable gas condensate			
Net export price, RR per ton [(1)]	8,393	9,877	(15.0%)
Net export price, USD per ton	319.1	350.7	(9.0%)
Crude oil			
Net export price, RR per ton [(1)]	5,112	6,724	(24.0%)
Net export price, USD per ton	194.3	238.8	(18.6%)
Domestic price, RR per ton	4,466	6,075	(26.5%)

[(1)] Includes cost of transportation.

Our LPG export and CIS delivery terms during the three months ended 31 March 2007 and 2006 were delivery at frontier (DAF) at the border of customer’s country. In the three months ended 31 March 2007, our average export LPG contract price, including export duties, was approximately USD 476 per ton compared to USD 531 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 8 thousand tons at the regulated price of RR 3,500 per ton and 84 thousand tons at a commercial price of RR 6,818 per ton in the domestic market, compared to 8 thousand tons at RR 1,350 per ton and 97 thousand tons at RR 7,408 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 Yamal-Nenets 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 31 March 2007 and 2006:

	Three months ended 31 March:		Change
Russian roubles (RR) or US dollars (USD) per ton	**2007**	**2006**	**%**
LPG			
Net export price, RR per ton [(1)]	9,026	10,629	(15.1%)
Net export price, USD per ton	343.1	377.4	(9.1%)
CIS price, RR per ton [(1)]	6,944	8,455	(17.9%)
Domestic price, RR per ton [(1)]	6,516	6,951	(6.3%)
Oil products			
Domestic price, RR per ton [(1)]	6,503	6,500	0.0%

[(1)] Includes cost of transportation.

Transportation tariffs

In the first seven months of 2006, the transportation tariff set by the FTS (established 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 was RR 931.97 (starting from 1 March 2007: RR 1,061.51) (excluding VAT) per mcm) and includes a constant rate of RR 12 (starting from 1 March 2007: 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 with their own gas distribution systems. The second component of the transportation rate for natural gas delivered within the customs territory of the Russian Federation and the member states of the Customs Union Agreement was set at RR 5.28 (starting from 1 March 2007: 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 contract terms. 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 are obliged to 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 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 15 “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 31 March 2007, we increased our natural gas sales volumes primarily due to the withdrawal of natural gas from underground storage facilities during the period. Our liquids sales volumes (crude oil, stable gas condensate, LPG and oil products) also increased in the 2007 period due to a one-time stable gas condensate inventory buildup in the 2006 period which was related to a change in export delivery terms for this product.

Natural gas sales volumes

millions of cubic meters	**Three months ended 31 March :** **2007**	**2006**	**Change %**
Production from:			
Yurkharovskoye field	2,414	2,434	(0.8%)
East-Tarkosalinskoye field	3,943	4,046	(2.5%)
Khancheyskoye field	1,182	736	60.6%
Other fields	9	5	80.0%
Total natural gas production	**7,548**	**7,221**	**4.5%**
Purchases from:			
Gazprom	508	528	(3.8%)
Other	208	81	156.8%
Total natural gas purchases	**716**	**609**	**17.6%**
Total production and purchases	**8,264**	**7,830**	**5.5%**
Purovsky Plant and own usage	(10)	(12)	(16.7%)
Decrease (increase) in pipeline and underground gas storage facilities	865	16	n/a
Total natural gas sales volumes	**9,119**	**7,834**	**16.4%**
Sold to end-customers	*4,713*	*3,718*	*26.8%*
incl. e-trading sales	*278*	*-*	*n/a*
Sold ex-field	*4,406*	*4,116*	*7.0%*

In the three months ended 31 March 2007, our total consolidated natural gas production increased by 327 mmcm, or 4.5%, compared to the corresponding period in 2006. The increase was primarily due to the expansion of gas condensate production capacity at our Khancheyskoye field related to the field’s second phase of development.

In the three months ended 31 March 2007, purchases increased by 107 mmcm, or 17.6%, compared to the corresponding period in 2006, primarily due to our ability to sell additional volumes beyond our own production levels.

As of 31 March 2007, our cumulative natural gas volumes stored in Gazprom’s underground gas storage facilities totaled 107 mmcm, representing a decrease of 893 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 31 March: 2007	2006	Change %
Production from:			
Yurkharovskoye field	171	169	1.2%
East-Tarkosalinskoye field	206	218	(5.5%)
Khancheyskoye field	183	186	(1.6%)
Other fields	26	23	13.0%
Total liquids production	**586**	**596**	**(1.7%)**
Purchases from:			
Purgazdobycha	16	23	(30.4%)
Total liquids purchases	**16**	**23**	**(30.4%)**
Total production and purchases	**602**	**619**	**(2.7%)**
Losses [(1)]	(6)	(5)	20.0%
Decreases (increases) in liquids inventory balances	(2)	(139)	(98.6%)
Total liquids sales volumes	**594**	**475**	**25.1%**
Stable gas condensate export	*385*	*257*	*49.8%*
LPG export	*18*	*13*	*38.5%*
LPG CIS	*13*	*11*	*18.2%*
LPG domestic	*92*	*105*	*(12.4%)*
Crude oil export	*26*	*6*	*333.3%*
Crude oil domestic	*42*	*60*	*(30.0%)*
Oil products domestic	*18*	*23*	*(21.7%)*

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

In the three months ended 31 March 2007, our gas condensate and crude oil production decreased by 10 thousand tons, or 1.7%, to 586 thousand tons compared to 596 thousand tons in the corresponding period in 2006. The decrease was due to natural declines in the concentration of liquids from the current producing horizons at our East-Tarkosalinskoye and Khancheyskoye fields.

In the three months ended 31 March 2007, purchases decreased by 7 thousand tons, or 30.4%, compared to the corresponding period in 2006, due to the expiration of the contract for crude oil purchases from Purgazdobycha in April 2006.

Our total liquids sales volumes were affected by the commencement of export sales through our foreign subsidiaries starting from January 2006 and the terms of delivery for these sales. In the 2006 period, we recorded 141 thousand tons of stable gas condensate as inventory, or goods in transit, until such time as it is delivered to the port of destination. This represented the initial buildup of inventory relating to the change in our export commercial terms. At 31 December 2006, we recorded 179 thousand tons of stable gas condensate as goods in transit. For the period ending 31 March 2007, we recorded 182 thousand tons of stable gas condensate as goods in transit until such time as it is delivered to the port of destination.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 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 31 March 2007 and 2006. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Total revenues (net of VAT and export duties)	15,245	*100.0%*	11,678	*100.0%*
Other income (loss)	16	*0.1%*	(113)	*(1.0%)*
Total revenues and other income	**15,261**	***100.1%***	**11,565**	***99.0%***
Operating expenses	(9,565)	*(62.7%)*	(6,784)	*(58.1%)*
Profit from operations	**5,696**	***37.4%***	**4,781**	***40.9%***
Finance income (expense)	23	*0.2%*	93	*0.8%*
Profit before income tax and minority interest	**5,719**	***37.5%***	**4,874**	***41.7%***
Total income tax expense	(1,377)	*(9.0%)*	(1,172)	*(10.0%)*
Profit for the period	**4,342**	***28.5%***	**3,702**	***31.7%***
Minority interest	5	*0.0%*	15	*0.1%*
Profit attributable to NOVATEK shareholders	**4,347**	***28.5%***	**3,717**	***31.8%***

Total revenues and other income

The following table sets forth our sales (net of VAT and export duties, where applicable) and other income for the three months ended 31 March 2007 and 2006:

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2007**	**2006**	**%**
Natural gas sales	**10,351**	**7,331**	**41.2%**
End-customer sales	*6,856*	*4,535*	*51.2%*
Ex-field sales	*3,495*	*2,796*	*25.0%*
Stable gas condensate sales	**3,234**	**2,539**	**27.4%**
Export sales	*3,234*	*2,539*	*27.4%*
Liquefied petroleum gas sales	**848**	**961**	**(11.8%)**
Export sales	*158*	*138*	*14.5%*
CIS sales	*92*	*93*	*(1.1%)*
Domestic sales	*598*	*730*	*(18.1%)*
Crude oil sales	**323**	**398**	**(18.8%)**
Export sales	*135*	*40*	*237.5%*
Domestic sales	*188*	*358*	*(47.5%)*
Oil products sales	**115**	**151**	**(23.8%)**
Total oil and gas sales	**14,871**	**11,380**	**30.7%**
Sales of polymer and insulation tape	309	257	20.2%
Other revenues	65	41	58.5%
Total revenues	**15,245**	**11,678**	**30.5%**
Other income (loss)	16	(113)	(114.2%)
Total revenues and other income	**15,261**	**11,565**	**32.0%**

Natural gas sales

In the three months ended 31 March 2007, our revenues from sales of natural gas increased by RR 3,020 million, or 41.2%, compared to the corresponding period in 2006. The increase in natural gas revenues was primarily attributable to an overall increase in prices and sales to end-customers and to a lesser extent to an increase in total sales volumes during the period.

In the three months ended 31 March 2007, our average realized natural gas price per mcm increased by RR 199 per mcm, or 21.3%, to RR 1,135 per mcm from RR 936 per mcm in the corresponding period in 2006, due to an overall increase in prices and an increase in sales volumes to end-customers. Our proportion of natural gas sales to end-customers increased from 61.9% in the 2006 period to 66.2% 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 19.3% and 16.8%, respectively, in the 2007 period compared to the corresponding period in 2006.

In November 2006, Russian independent gas producers, vertically integrated oil companies, and Gazprom commenced 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 31 March 2007 period, we sold 278 mmcm of natural gas at an average price of RR 1,312 per mcm (net back price RR 1,217 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 electronic trading commencement of natural gas as a positive development in the domestic natural gas market.

Stable gas condensate sales

In the three months ended 31 March 2007, our revenues from sales of stable gas condensate increased by RR 695 million, or 27.4%, compared to the corresponding period in 2006. The increase in revenues was directly related to an increase in export sales volumes due to the change in delivery terms for stable gas condensate beginning in January 2006. The increase in sales volumes was offset by lower realized prices in the 2007 period. In the 2007 period, our sales volumes increased by 128 thousand tons compared to the corresponding period in 2006 primarily due to the realization of 179 thousand tons recognized as goods in transit at 31 December 2006. We had no goods in transit recorded as inventory balances as of 31 December 2005.

In the three months ended 31 March 2007, we exported 385 thousand tons of stable gas condensate, or 100% of our sales volumes, to markets in the United States, Europe and South America. In the 2007 period, our average realized price, excluding export duties, translated into US dollars for stable gas condensate sold on the export market decreased by USD 31.6 per ton, or 9.0%, to USD 319.1 per ton (DES and CFR) from USD 350.7 per ton (DES and CFR) in the corresponding period in 2006 as a result of the growth in our export duties (by 8.6%) and the decrease of our average export contract price (by 3.8%). The decrease in our average realized contract prices was due to the overall decline in prices on international markets in the 2007 period.

Liquefied petroleum gas sales

In the three months ended 31 March 2007, our revenues from the sales of LPG decreased by RR 113 million, or 11.8%, compared to the corresponding period in 2006, primarily due to a reduction in export, CIS and domestic prices and, to a lesser degree, a decrease in volumes sold on the domestic market. In the 2007 period, we decreased our sales volumes of LPG by 6 thousand tons to 123 thousand tons, of which 74.8% was sold domestically for an average price of RR 6,516 per ton (FCA excluding VAT); a decrease of RR 435 per ton, or 6.3%, compared to the corresponding period in 2006. The remaining volumes of LPG were sold as follows: 14.6% was sold to the export market for an average price of USD 343.1 per ton (DAF excluding export duties) representing a decrease of USD 34.3 per ton, or 9.1%, compared to the corresponding period in 2006; and 10.6% was sold in the CIS for an average price of RR 6,944 per ton (DAF excluding VAT) representing a decrease of RR 1,511 per ton, or 17.9%, compared to the 2006 period. The decrease in our average export realized prices was due to the overall decline in prices in the 2007 period.

Crude oil sales

In the three months ended 31 March 2007, our revenues from the sales of crude oil decreased by RR 75 million, or 18.8%, compared to the corresponding period in 2006, due to a reduction in prices for both domestic and export sales during the 2007 period, which was partially offset by an increase in export volumes. In the three months ended 31 March 2007, total sales volumes of crude oil increased marginally, by 2 thousand tons, or 3.0%, 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 decreased by USD 44.5 per ton, or 18.6%, to USD 194.3 per ton (DAF) in the three months ended 31 March 2007 compared to USD 238.8 per ton (DAF) in the corresponding period in 2006 as a result of the growth in our export duties (by 9.2%) and the decrease of our average crude oil export contract price (by 7.4%). The decrease in our average crude oil export contract prices was due to the overall decline in crude oil prices in international markets in the 2007 period. Our average realized crude oil domestic sales price (excluding VAT) decreased by RR 1,609 per ton, or 26.5%, to RR 4,466 per ton in the 2007 period, compared to RR 6,075 per ton in the corresponding period in 2006.

Oil products sales

In the three months ended 31 March 2007, our revenue from the sales of oil products decreased by RR 36 million, or 23.8%, 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 18 thousand tons compared to 23 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 52 million, or 20.2%, to RR 309 million in the three months ended 31 March 2007, compared to RR 257 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 31 March 2007, other revenues increased by RR 24 million, or 58.5%, to RR 65 million from RR 41 million in the corresponding period in 2006. The increase was primarily due to an increase in polymer tolling, which accounted for RR 20 million of other revenues in the three months ended 31 March 2007 and nil in the corresponding period in 2006.

Other income (loss)

In the three months ended 31 March 2007, we realized other income of RR 16 million, of which RR 6 million was related to the disposals of fixed assets, equipment and materials, while in the corresponding period of 2006 we realized net loss of RR 80 million from the same operations.

Operating expenses

In the three months ended 31 March 2007, total operating expenses increased by RR 2,781 million, or 41.0%, to RR 9,565 million compared to RR 6,784 million in the three months ended 31 March 2006, primarily due to an increase in non-controllable expenses such as transportation and taxes other than income tax expenses. As a percentage of total operating expenses, our non-controllable expenses decreased in the three months ended 31 March 2007 to 59.5% compared to 62.0% in the corresponding period of 2006. Most of our controllable expenses in the 2007 period were lower as a percentage of total revenues as compared with the corresponding period in 2006 even though each expense category increased in absolute terms relative to the 2006 period. Total operating expenses increased as a percentage of total revenues to 62.7% in the 2007 period compared to 58.1% in the corresponding period in 2006, as shown in the table below.

	Three months ended 31 March:			
millions of Russian roubles	**2007**	**% of total revenues**	**2006**	**% of total revenues**
Transportation expenses	4,079	*26.8%*	2,655	*22.7%*
Taxes other than income tax	1,609	*10.6%*	1,553	*13.3%*
Materials, services and other	1,069	*7.0%*	964	*8.3%*
Depreciation, depletion and amortization	1,018	*6.7%*	996	*8.5%*
General and administrative expenses	713	*4.7%*	665	*5.7%*
Purchases of oil, gas condensate and natural gas	563	*3.7%*	409	*3.5%*
Exploration expenses	202	*1.3%*	112	*1.0%*
Net impairment expense	37	*0.2%*	76	*0.7%*
Change in inventory	275	*1.8%*	(646)	*(5.5%)*
Total operating expenses	**9,565**	***62.7%***	**6,784**	***58.1%***

Non-controllable expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses since we are unable to influence the increase in regulated tariffs for transportation of our hydrocarbons or the rates imposed by federal, regional or local tax authorities. In the three months ended 31 March 2007, non-controllable expenses of transportation and taxes other than income tax increased by RR 1,480 million, or 35.2%, to RR 5,688 million from RR 4,208 million in the corresponding period in 2006, primarily due to the increase in both the transportation tariff set by FTS for natural gas and our natural gas sales volumes. As a percentage of total revenues, our non-controllable expenses increased by 1.3% to 37.3% in the 2007 period compared to 36.0% in the corresponding period in 2006.

Transportation expenses

Our total transportation expense in the three months ended 31 March 2007, increased by RR 1,424 million, or 53.6%, compared to the corresponding period in 2006.

	Three months ended 31 March:		**Change**
millions of Russian roubles	**2007**	**2006**	**%**
Natural gas transportation to customers	2,766	1,796	54.0%
Stable gas condensate, liquefied petroleum gas and oil products transportation by rail	812	535	51.8%
Stable gas condensate transported by tankers	454	294	54.4%
Transportation of unstable gas condensate from the fields to the processing facilities through third party pipelines	25	20	25.0%
Crude oil transportation to customers by pipeline	18	5	260.0%
Other transportation costs	4	5	(20.0%)
Total transportation expenses	**4,079**	**2,655**	**53.6%**

In the three months ended 31 March 2007, our transportation expense for natural gas increased by RR 970 million, or 54.0%. The increase in our gas transportation expenses was partially due to a 26.8% 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 effective 1 August 2006 and 1 March 2007.

In the three months ended 31 March 2007, our total expense for transportation by rail increased by RR 277 million, or 51.8%, due to an increase in volumes sold and an increase in the railroad tariff. During the 2007 period, our combined volumes of stable gas condensate and LPG sold increased by 122 thousand tons, or 31.6%, to 508 thousand tons from 386 thousand tons in the corresponding 2006 period.

Our expense for stable gas condensate transported by rail to export markets increased by RR 231 million, or 79.1%, from RR 292 million to RR 523 million, or from RR 1,138 per ton in the three months ended 31 March 2006 to RR 1,359 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 31 March 2007, our expense for LPG transported by rail amounted to RR 277 million, of which RR 91 million was related to export sales, RR 31 million to CIS sales, and RR 155 million to domestic sales, or RR 5,195 per ton, RR 2,333 per ton, and RR 1,684 per ton, respectively. In the 2006 period, transportation expenses for LPG amounted to RR 233 million, of which RR 65 million was related to export sales, RR 20 million to CIS sales, and RR 148 million to domestic sales, or RR 4,854 per ton, 1,752 per ton and RR 1,406 per ton, respectively.

The remaining RR 12 million of the transportation expenses by rail in the three months ended 31 March 2007 and RR 10 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 160 million, or 54.4%, from RR 294 million in the three months ended 31 March 2006, to RR 454 million in the corresponding period of 2007. The increase was primarily due to a 49.8% increase in volumes sold.

Taxes other than income tax

In the three months ended 31 March 2007, taxes other than income tax increased by RR 56 million, or 3.6%, compared to the corresponding period in 2006.

millions of Russian roubles	**Three months ended 31 March:** 2007	2006	**Change** %
Unified natural resources production tax (UPT)	1,441	1,411	2.1%
Property tax	121	103	17.5%
Excise tax	26	26	0.0%
Other taxes	21	13	61.5%
Total tax other than income tax	**1,609**	**1,553**	**3.6%**

In the three months ended 31 March 2007, the increase in taxes other than income tax resulted primarily from a RR 30 million, or 2.1%, increase in the UPT. The UPT increase in 2007 was primarily due to 4.5% and 7.8% increase in natural gas and crude oil production volumes, respectively, that was partially offset by a decrease in the production tax rate for crude oil. The natural gas production tax rate in the 2007 and 2006 periods remained unchanged at RR 147 per mcm.

In the three months ended 31 March 2007, our property tax expense increased by RR 18 million, or 17.5%, to RR 121 million compared to RR 103 million in the corresponding period in 2006. The increase was primarily due to additions of property, plant and equipment (PPE) at the Purovsky Processing Plant.

Depreciation, depletion and amortization

In the three months ended 31 March 2007, our depreciation, depletion and amortization (DDA) expense increased by RR 22 million, or 2.2%, compared to the corresponding period in 2006, primarily due to a RR 20 million increase in straight-line depreciation. The remaining balance was due to higher natural gas production levels which increased depletion of our oil and gas properties. In the 2007 period, our DDA per barrel of oil equivalent (boe) was RR 16.7 compared to DDA per boe of RR 17.4 in the corresponding period in 2006 as a result of an increase in our proved developed reserves estimates as of 31 December 2006.

Materials, services and other

In the three months ended 31 March 2007, our materials, services and other expenses increased by RR 105 million, or 10.9%, to RR 1,069 million compared to RR 964 million in the corresponding period in 2006. The main components of this expense in the three months ended 31 March 2007 were payroll and materials expenses.

millions of Russian roubles	Three months ended 31 March: 2007	2006	Change %
Payroll expense	378	311	21.5%
Materials expense	350	356	(1.7%)
Security and fire safety expense	69	62	11.3%
Energy and fuel expense	64	56	14.3%
Processing services expense	61	61	0.0%
Other expenses	147	118	24.6%
Total materials, services and other	**1,069**	**964**	**10.9%**

Payroll expense increased by RR 67 million, or 21.5%, to RR 378 million compared to RR 311 million in the corresponding period in 2006. The increase in our payroll expense was mainly due to an increase in wages at our production subsidiaries, which resulted in an additional RR 51 million in payroll expense in the 2007 period. In the 2007 period, we recorded an additional RR 14 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 decreased marginally, by RR 6 million, or 1.7%, to RR 350 million in the three months ended 31 March 2007 compared to RR 356 million in the corresponding period in 2006.

Security and fire safety expenses increased by RR 7 million, or 11.3%, to RR 69 million from RR 62 million in the corresponding period in 2006, of which RR 6 million related to activities at the Purovsky Processing Plant and the remaining balance was related to ongoing fire safety activities at our field sites.

Processing services expense related to the de-ethanization of unstable gas condensate produced at the Yurkharovskoye field increased by RR 5 million in the three months ended 31 March 2007, mainly due to an increase in processing tariffs. The increase was offset by a decrease in oil products refining services, of RR 5 million, due to a reduction in volumes sent to the Surgutsky refinery in the 2007 period.

In the three months ended 31 March 2007, other expenses increased by RR 29 million compared to the corresponding period in 2006. The increase was mainly related to transport (not related to the transportation of our products) and repair and maintenance expenses which increased by RR 15 million and RR 13 million, respectively.

General and administrative expenses

In the three months ended 31 March 2007, general and administrative expenses increased by RR 48 million, or 7.2%, to RR 713 million compared to RR 665 million in the corresponding period in 2006. The main components of these expenses were payroll, social and charitable, legal, audit and consulting and insurance expenses which, on aggregate comprised 76.9% and 76.4% of total general and administrative expenses for the three months ended 31 March 2007 and 2006, respectively.

millions of Russian roubles	Three months ended 31 March: 2007	2006	Change %
Payroll expense	340	320	6.3%
Social and charitable expenses	120	85	41.2%
Legal, audit and consulting expenses	50	24	108.3%
Insurance expense	38	79	(51.9%)
Rent expenses	32	29	10.3%
Other expenses	133	128	3.9%
Total general and administrative expenses	**713**	**665**	**7.2%**

In the three months ended 31 March 2007, payroll expense increased by RR 20 million, or 6.3%, to RR 340 million compared to RR 320 million in the corresponding period in 2006. The increase in payroll expenses was mainly due to accrual of pension obligations in the three months ended 31 March 2007 of RR 13 million and to a lesser extent an increase in average employee compensation.

In the three months ended 31 March 2007, social and charitable expenses increased by RR 35 million, or 41.2%, to RR 120 million compared to RR 85 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.

Legal, audit and consulting services expenses increased by RR 26 million, or 108.3%, to RR 50 million compared to RR 24 million in the corresponding period in 2006, due to additional consulting services provided to the Group to increase management efficiency.

Insurance expense decreased by RR 41 million, or 51.9%, to RR 38 million compared to RR 79 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.

Other general and administrative expenses increased by RR 5 million, or 3.9%, compared to the corresponding period in 2006 mostly due an increase in business trip expenses and fire safety and security expenses.

Purchases of oil, gas condensate and natural gas

Our purchases of hydrocarbons increased by RR 154 million, or 37.7%, to RR 563 million in the three months ended 31 March 2007 from RR 409 million in the corresponding period in 2006 primarily due to an increase in natural gas volumes purchased from external companies.

Change in inventory

In the three months ended 31 March 2007, our change in inventory expense increased by RR 921 million to RR 275 million compared to a credit of RR 646 million in the corresponding period in 2006. The increase was primarily due to the withdrawal of 865 mmcm of natural gas which was sold during the 2007 period. In the 2006 period, we recognized a credit to inventory expense due to the initial buildup in stable gas condensate inventory balances of 141 thousand tons recorded as goods in transit as a result of the change in our export delivery terms.

Profit from operations

As a result of the factors discussed above, our profit from operations increased by RR 915 million, or 19.1%, in the three months ended 31 March 2007 compared to the corresponding period in 2006. In the 2007 period, our profit from operations as a percentage of total revenues decreased to 37.4% as compared to 40.9% in the corresponding period in 2006.

Finance income (expense)

Total finance income decreased by RR 70 million, or 75.3%, from RR 93 million in the three months ended 31 March 2006 to RR 23 million in the corresponding period in 2007.

In the three months ended 31 March 2007 period, interest expense decreased by RR 59 million or 43.1% compared to the corresponding period in 2006, primarily due to a reduction in our total debt. In the three months ended 31 March 2007, interest income increased by RR 31 million, or 49.2%, due to an increase in interest income on bank deposits. Foreign exchange gain decreased by RR 160 million to RR 7 million in the 2007 period, compared to RR 167 million in the corresponding period in 2006 due to a decrease in our foreign currency denominated borrowings.

Income tax expense

For the three months ended 31 March 2007 and 2006 our overall consolidated effective income tax rate (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) was 24.1% for both periods. Our effective income tax rate, after excluding the effect of foreign subsidiaries, was 28.6% and 25.7% in the 2007 and 2006 periods, respectively. Our effective tax rates in 2007 and 2006 correlate closely with our Russian statutory income tax rate of 24%. The differences between our effective and statutory income tax rates are primarily due to certain non-deductible expenses.

Profit for the period and earnings per share

As a result of the factors discussed above, profit for the period increased by RR 640 million, or 17.3%, to RR 4,342 million in three months ended 31 March 2007 from RR 3,702 million in the corresponding period in 2006. The profit attributable to NOVATEK shareholders increased by RR 630 million, or 16.9%, to RR 4,347 million in three months ended 31 March 2007 from RR 3,717 million in the corresponding period in 2006.

Our weighted average basic and diluted earnings per share increased to RR 1.43 per share in the three months ended 31 March 2007 from RR 1.22 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 31 March 2007 and 2006:

millions of Russian roubles	Three months ended 31 March: 2007	2006	Change %
Net cash provided by operating activities	6,593	5,375	22.7%
Net cash used in investing activities	(3,407)	(1,109)	207.2%
Net cash used in financing activities	(162)	(1,279)	(87.3%)

Liquidity ratios	31 March 2007	31 December 2006	Change %
Current ratio	2.8	3.1	(9.7%)
Total debt to equity	0.047	0.045	4.4%
Long-term debt to long term debt and equity	0.003	0.008	(62.5%)
Net debt to total capitalization [(1)]	(0.07)	(0.03)	(133.3%)

[(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 1,218 million, or 22.7%, to RR 6,593 million in the three months ended 31 March 2007 compared to RR 5,375 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 sales volumes and realized prices in the 2007 period compared to the corresponding period in 2006, which was partially offset by an increase in income tax payments.

Net cash used in investing activities

Net cash used in investing activities increased by RR 2,298 million to RR 3,407 million in the three months ended 31 March 2007 compared to RR 1,109 million in the corresponding period in 2006. The increase in the 2007 period was primarily due to the payment for the acquisition of the license for the West-Urengoiskoye field in the 2007 period of RR 1,410 million, and an increase in capital expenditures related to further development of our three core fields.

Net cash used in financing activities

Net cash used for financing activities decreased by RR 1,117 million, or 87.3%, to RR 162 million in the three months ended 31 March 2007 compared to RR 1,279 million in the corresponding period in 2006. The decrease is primarily due to a reduction in our borrowings resulting from our ability to fund operating, exploration and development activities from cash generated by operations.

Working capital

At 31 March 2007, our net working capital position (current assets less current liabilities) was RR 12,235 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 and trade and other receivables.

Capital expenditures

Total capital expenditures on property, plant and equipment for the three months ended 31 March 2007 and 2006 are as follows:

millions of Russian roubles	Three months ended 31 March: 2007	2006	Change %
Exploration and production	3,757	1,160	223.9%
Other	54	26	107.7%
Total	**3,811**	**1,186**	**221.3%**

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 relate to our ongoing development and exploration activities at our core three fields. In addition, in February 2007 we acquired and obtained the license to the West-Urengoiskoye field. During the three months ended 31 March 2007, we spent RR 178 million, RR 319 million and RR 1,254 million for field development at the Khancheyskoye, East-Tarkosalinskoye and Yurkharovskoye fields, respectively, and RR 59 million on construction of the second phase at the Purovsky Processing Plant.

Debt obligations

During the 2007 period, the Group repaid RR 458 million (USD 16.7 million) of long-term debt to BNP PARIBAS Bank as scheduled and received additional funding in the amount of RR 397 million (USD 15.5 million) from CALYON S.A. under a short-term loan agreement. The new funding has an annual interest rate of LIBOR plus 0.85 percent and is repayable in February 2008.

Also, at 31 March 2007, the Group had withdrawn RR 488 million (USD 18.7 million) of bank overdrafts to finance its short-term needs.

At 31 March 2007, the Group had unused credit facilities in the aggregate amount of RR 5,601 million (USD 215.3 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 31 March 2007, RR 1,662 million, or 78.8%, of our long-term debt was denominated in US dollars (out of RR 3,443 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 23.8% in the 2007 period, is denominated in US dollars. As of 31 March 2007, the Russian rouble had strengthened against the US dollar by approximately 1% since 1 January 2007.

A hypothetical and instantaneous 10% strengthening in the Russian rouble in relation to the US dollar as of 31 March 2007 would have resulted in an estimated foreign exchange gain of approximately RR 300 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 31 March 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.