

## IMPORTANT NOTICE

**IMPORTANT: You must read the following before continuing.** The following applies to the Prospectus (as defined herein) following this page, and you are therefore advised to read this carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from us as a result of such access.

NOTHING IN THE FOLLOWING PROSPECTUS CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. ANY SECURITIES TO BE ISSUED WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION, AND THE SECURITIES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT), EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE FOLLOWING PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER, AND IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. PERSON (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT) OR TO ANY U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORIZED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

**Confirmation of your representation:** In order to be eligible to view this Prospectus or make an investment decision with respect to any securities, investors must be (i) “qualified institutional buyers” (as defined in Rule 144A under the Securities Act) that are also “qualified purchasers” (as defined in Section 2(A)(51) of the U.S. Investment Company Act of 1940, as amended) or (ii) non-U.S. persons (as defined in Regulation S under the Securities Act) outside the United States who are not acting for the account or benefit of U.S. Persons. By accessing these materials, you shall be deemed to have represented to us that you (i) are a qualified institutional buyer and a qualified purchaser or (ii) are outside the United States and are not a U.S. Person and are not acting for the account or benefit of a U.S. Person.

Under no circumstances shall this Prospectus constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the securities being offered, in any jurisdiction in which such offer, solicitation or sale would be unlawful. Recipients of this Prospectus who intend to subscribe for or purchase the Notes are reminded that any subscription or purchase may only be made on the basis of the information contained in this Prospectus.

The Notes are not eligible for placement and circulation in the Russian Federation, unless, and to the extent, otherwise permitted by Russian law. The information provided in this Prospectus is not an offer, or an invitation to make offers, sell, exchange or otherwise transfer the Notes in the Russian Federation or to or for the benefit of any Russian person or entity.

This Prospectus and information contained herein does not constitute an advertisement or an offer of any securities in the Russian Federation. It is not intended to be, and must not be, distributed or circulated in the Russian Federation unless and to the extent otherwise permitted under Russian law.

You are reminded that this Prospectus has been delivered to you on the basis that you are a person into whose possession this Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorized to, deliver this Prospectus to any other person.

The materials relating to the offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer and the underwriters or any affiliate of the underwriters is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the underwriters or such affiliate on behalf of the Issuer in such jurisdiction.

This Prospectus has been sent to you in an electronic form. You are responsible for protecting against viruses and other destructive items. Your use of this e-mail is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently neither OAO Novatek, Novatek Finance Limited, Barclays Bank PLC, Goldman Sachs International, GPB-Financial Services Ltd or SIB (CYPRUS) LIMITED, nor any person who controls it nor any director, officer, employee nor agent of it or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between this Prospectus distributed to you in electronic format and the hard copy version available to you on request from OAO Novatek, Novatek Finance Limited, Barclays Bank PLC, Goldman Sachs International, GPB-Financial Services Ltd and SIB (CYPRUS) LIMITED.



**U.S.\$1,000,000,000 4.422% Loan Participation Notes due 2022**  
**issued by, but with limited recourse to,**  
**Novatek Finance Limited**  
**for the sole purpose of financing a loan to OAO NOVATEK**  
**Issue Price of the Notes: 100%**

Novatek Finance Limited, a company incorporated as a limited liability company under the laws of Ireland (the “**Issuer**”), is issuing an aggregate principal amount of U.S.\$1,000,000,000 4.422% Loan Participation Notes due 2022 (the “**Notes**”) for the sole purpose of financing a U.S.\$1,000,000,000 loan (the “**Loan**”) to OAO NOVATEK, an open joint stock company organized under the laws of the Russian Federation (“**NOVATEK**” or the “**Borrower**”), pursuant to a loan agreement dated 10 December 2012 (the “**Loan Agreement**”) between the Issuer and the Borrower.

Pursuant to a trust deed (the “**Trust Deed**”) relating to the Notes between the Issuer and Citicorp Trustee Company Limited, as trustee (the “**Trustee**”), the Issuer will provide certain security for all payment obligations in respect of the Notes for the benefit of the Noteholders (as defined in the Loan Agreement), including a first fixed charge in favor of the Trustee of all amounts paid and payable to it under the Loan Agreement and an assignment to the Trustee of the Issuer’s rights and interests under the Loan Agreement, other than in respect of certain reserved rights (as more fully described in “*Description of the Transaction*” and the Trust Deed). Interest on the Notes will be paid at an annual rate equal to 4.422%, subject to receipt of funds therefor from the Borrower. The Issuer will make interest payments on the Notes in arrear on 13 June and 13 December in each year, commencing on 13 June 2013, as described under “*Terms and Conditions of the Notes—Interest*”. The Terms and Conditions of the Notes beginning on page 175 shall be referred to as the “**Terms and Conditions of the Notes**”.

The Notes are limited recourse obligations of the Issuer. In each case where amounts of principal, interest, premium (if any) and additional amounts (if any) are stated to be payable in respect of the Notes, the obligation of the Issuer to make any such payment shall constitute an obligation only to account to the Noteholders, on each date upon which such amounts of principal, interest, premium (if any) and additional amounts (if any) are due, for an amount equivalent to the principal, interest, premium (if any) and additional amounts (if any) actually received by or for the account of the Issuer from the Borrower pursuant to the Loan Agreement. The Issuer will have no other financial obligation under the Notes. **Noteholders will be deemed to have accepted and agreed that they will be relying solely on the covenant to pay under the Loan Agreement and the credit and financial standing of NOVATEK in respect of the financial servicing of the Notes.**

Except as set forth herein, payments in respect of the Notes will be made without any deduction or withholding for, or on account of, the taxes of any relevant jurisdiction. The Loan and the Notes may be redeemed early at the option of NOVATEK in certain circumstances all as more fully described in the Loan Agreement and in the “*Terms and Conditions of the Notes*”.

**AN INVESTMENT IN THE NOTES INVOLVES A HIGH DEGREE OF RISK. SEE “RISK FACTORS” BEGINNING ON PAGE 4.**

The Notes and the Loan (together, the “**Securities**”) have not been, and will not be, registered under the U.S. Securities Act of 1933, as amended (the “**Securities Act**”), and, subject to certain exceptions, may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act (“**Regulation S**”). The Notes may be offered and sold (i) within the United States only to qualified institutional buyers (“**QIBs**”), as defined in Rule 144A under the Securities Act (“**Rule 144A**”), that are also qualified purchasers (“**QPs**”), as defined in Section 2(a)(51) of the U.S. Investment Company Act of 1940, as amended (the “**Investment Company Act**”), in reliance on the exemption from registration under Section 5 of the Securities Act provided by Rule 144A or on another exemption therefrom (the “**Rule 144A Notes**”); and (ii) to certain non-U.S. persons in offshore transactions as defined in and in reliance on Regulation S (the “**Regulation S Notes**”). The Issuer has not been and will not be registered under the Investment Company Act. Prospective purchasers are hereby notified that sellers of the Rule 144A Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of these and certain further restrictions on offers, sales and transfers of the Notes and the distribution of this prospectus (the “**Prospectus**”), see “*Plan of Distribution*” and “*Transfer Restrictions*”.

The Prospectus has been approved by the Central Bank of Ireland (the “**Central Bank**”), as competent authority under Directive 2003/71/EC, as amended (the “**Prospectus Directive**”). The Central Bank only approves this Prospectus as meeting the requirements imposed under Irish and the European Union (“**EU**”) law pursuant to the Prospectus Directive. Application has been made to the Irish Stock Exchange for the Notes to be admitted to the Official List (the “**Official List**”) and trading on its regulated market (the “**Main Securities Market**”). Reference in this Prospectus to Notes being “**listed**” (and all related references) shall mean that such Notes have been admitted to trading on the Main Securities Market. The Main Securities Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments. This Prospectus constitutes a “**Prospectus**” for the purposes of the Prospectus Directive.

It is expected that the Notes will be rated BBB- by Fitch Ratings Ltd. (“**Fitch**”), Baa3 by Moody’s Investors Service Limited (“**Moody’s**”) and BBB- by Standard & Poor’s Credit Market Services Europe Ltd. (“**S&P**”). Credit ratings included or referred to in this Prospectus have been issued by Fitch, Moody’s and S&P, each of which is established in the EU and registered under Regulation (EC) No 1060/2009, as amended (the “**CRA Regulation**”). As such, each of Fitch, Moody’s and S&P are included in the list of credit rating agencies published by the European Securities and Markets Authority (the “**ESMA**”) on its website in accordance with the CRA Regulation. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by any assigning rating agency.

The Notes will be offered and sold in the minimum denomination of U.S.\$200,000 and integral multiples of U.S.\$1,000 thereafter. The Regulation S Notes will initially be represented by interests in a global unrestricted note in registered form (the “**Regulation S Global Note Certificate**”), without interest coupons, which will be deposited with a common depository for Euroclear Bank SA/NV (“**Euroclear**”) and Clearstream Banking, *société anonyme* (“**Clearstream, Luxembourg**”), and registered in the name of a nominee, on or about 13 December 2012 (the “**Issue Date**”). The Rule 144A Notes will initially be represented by interests in a global restricted note in registered form (the “**Rule 144A Global Note Certificate**”), and the Rule 144A Global Note Certificate together with the Regulation S Global Note Certificate, the “**Global Note Certificates**” and each a “**Global Note Certificate**”), without interest coupons which will be registered in the name of Cede & Co., as nominee of, and deposited with a custodian for, The Depository Trust Company (“**DTC**”) on or about the Issue Date. Beneficial interests in the Global Note Certificates will be shown on, and transfers thereof will be effected only through records maintained by, DTC, Euroclear or Clearstream, Luxembourg (as the case may be) and their respective participants. See “*Clearing and Settlement*”. Individual note certificates in registered form will only be available in certain limited circumstances as described herein.

**Joint Lead Managers**

**Barclays**

**Gazprombank**

**Goldman Sachs  
International**

**Sberbank CIB**

The date of this Prospectus is 10 December 2012.

## IMPORTANT INFORMATION ABOUT THIS PROSPECTUS

This Prospectus comprises a Prospectus for the purposes of Article 5 of the Prospectus Directive as implemented in Ireland by the Prospectus (Directive 2003/71/EC) Regulations 2005, as amended (the “**Prospectus Regulations**”), and for the purpose of giving information with respect to the Issuer, NOVATEK, NOVATEK and its consolidated subsidiaries in accordance with the Financial Statements (as defined below in “*Presentation of Financial and Other Information*”) taken as a whole (the “**Group**”), the Loan and the Notes, which, according to the particular nature of the Issuer, NOVATEK, the Loan and the Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Issuer and NOVATEK.

Each of the Issuer and NOVATEK (whose registered office is set out on page 39 of the Prospectus) accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of each of the Issuer and NOVATEK (each of whom has taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information. This Prospectus does not constitute an offer of, or an invitation by or on behalf of the Issuer, NOVATEK, Barclays Bank PLC, Goldman Sachs International, GPB-Financial Services Ltd and SIB (CYPRUS) LIMITED (collectively, the “**Joint Lead Managers**”) or the Trustee to subscribe for or purchase any Notes in any jurisdiction where it is unlawful to make such an offer or invitation. The distribution of this Prospectus and the offering of the Notes (the “**Offering**”) in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer, NOVATEK, the Joint Lead Managers and the Trustee to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of the Notes and distribution of this Prospectus, see “*Plan of Distribution*” and “*Transfer Restrictions*”.

No person is authorized to provide any information or to make any representation not contained in this Prospectus and any information or representation not so contained must not be relied upon as having been authorized by or on behalf of the Issuer, NOVATEK, the Joint Lead Managers or the Trustee. The delivery of this Prospectus at any time does not imply that the information contained in it is correct as at any time subsequent to its date. Neither the delivery of this Prospectus nor the Offering, sale or delivery of any Notes shall in any circumstances create any implication that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Issuer or NOVATEK since the date of this Prospectus.

None of the Issuer, NOVATEK, the Joint Lead Managers, the Trustee or any of its or their respective representatives or affiliates makes any representation to any offeree or purchaser of the Notes offered hereby regarding the legality of an investment by such offeree or purchaser under applicable legal, investment or similar laws. Each investor should consult with its own advisers as to the legal, tax, business, financial and related aspects of the purchase of the Notes.

Prospective purchasers must comply with all laws that apply to them in any place in which they buy, offer or sell any Notes or possess this Prospectus. Any consents or approvals that are needed in order to purchase any Notes must be obtained. The Issuer, NOVATEK, the Joint Lead Managers and the Trustee are not responsible for compliance with these legal requirements. The appropriate characterization of the Notes under various legal investment restrictions, and thus the ability of investors subject to these restrictions to purchase the Notes, is subject to significant interpretative uncertainties. No representation or warranty is made as to whether, or the extent to which, the Notes constitute a legal investment for investors whose investment authority is subject to legal restrictions, and investors should consult their legal advisers regarding such matters. No prospective investor should consider any information in this Prospectus to be investment, legal, tax or other advice.

This Prospectus has been filed with and approved by the Central Bank as required by the Prospectus Regulations. The Prospectus approved by the Central Bank will be filed with the Irish Companies Registration Office in accordance with Regulation 38(1)(b) of the Prospectus Regulations.

Any investment in the Notes does not have the status of a bank deposit and is not within the scope of the deposit protection scheme operated by the Central Bank. The Issuer is not and will not be regulated by the Central Bank as a result of issuing the Notes.

In connection with the issue of the Notes, Goldman Sachs International (the “**Stabilizing Manager**”) (or any person acting on behalf of the Stabilizing Manager) may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilizing Manager (or any person acting on behalf of the Stabilizing Manager) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if commenced, may be discontinued at any time and must be brought to an end no later than the earlier of 30 days after the Issue Date of the Notes and 60 days after the date of the allotment of the Notes.

The contents of the websites or any other documents of NOVATEK or of any of its subsidiaries or Joint Ventures (as defined below) do not form any part of this Prospectus.

No representation or warranty, express or implied, is made by the Joint Lead Managers, the Trustee or any of its or their affiliates or any person acting on their behalf as to the accuracy or completeness of the information set forth in this Prospectus. Nothing contained in this Prospectus is, or shall be relied upon as, a promise or representation, whether as to the past or the future.

Each person receiving this Prospectus acknowledges that such person has not relied on the Joint Lead Managers, the Trustee or any of its or their affiliates or any person acting on their behalf in connection with its investigation of the accuracy or completeness of such information or its investment decision. Each person contemplating making an investment in the Notes from time to time must make its own investigation and analysis of the creditworthiness of the Issuer and NOVATEK and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience, and any other factors which may be relevant to it in connection with such investment.

#### **NOTICE TO RESIDENTS OF THE RUSSIAN FEDERATION**

Information contained in this Prospectus is not an offer, or an invitation to make offers, sell, purchase, exchange or transfer any securities in the Russian Federation, and does not constitute an advertisement of offering of any securities in the Russian Federation. The securities referenced in this Prospectus have not been and will not be registered in the Russian Federation or admitted to public placement and/or public circulation in the Russian Federation and are not intended for “placement” or “circulation” in the Russian Federation except as permitted by Russian law.

#### **NOTICE TO UNITED KINGDOM RESIDENTS**

This document is only being distributed to and is only directed at (1) persons who are outside the United Kingdom or (2) to investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “**Order**”) or (3) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as “**Relevant Persons**”). The Notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Notes will be engaged in only with, Relevant Persons. Any person who is not a Relevant Person should not act or rely on this document or any of its contents.

#### **NOTICE TO UNITED STATES INVESTORS**

**The Notes and the Loan have not been registered, approved or disapproved by the U.S. Securities and Exchange Commission (the “SEC”), any state securities commission in the United States or any other U.S. regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the Offering or the accuracy or the adequacy of this Prospectus. Any representation to the contrary is a criminal offense in the United States.**

The Notes have not and will not be registered under the Securities Act, and the Notes may be sold in the United States only to QIBs in reliance on Rule 144A who are also QPs. This Offering is being made in the United States in reliance upon an exemption from registration under the Securities Act for an offer and sale of the Notes which does not involve a public offering. In making your purchase, you will be deemed to have made certain acknowledgments, representations and agreements. See “*Plan of Distribution*” and “*Transfer Restrictions*”.

This Prospectus is being provided (1) to a limited number of investors in the United States that the Issuer reasonably believes to be QIBs as defined in Rule 144A that are QPs within the meaning of Section 2(a)(51) of the Investment Company Act for informational use solely in connection with their consideration of the purchase of the Notes and (2) to investors outside the United States who are not U.S. persons in connection with offshore transactions complying with Rule 903 or Rule 904 of Regulation S.

#### **NOTICE TO NEW HAMPSHIRE RESIDENTS**

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES (“**RSA 421-B**”) WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT

THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY, OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER, OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

#### AVAILABLE INFORMATION

The Issuer and NOVATEK have agreed that, for so long as any Notes are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, they will, during any period in which they are neither subject to Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner or to the Trustee for delivery to such holder, beneficial owner or prospective purchaser, in each case upon the request of such holder, beneficial owner, prospective purchaser or the Trustee, the information required to be provided by Rule 144A(d)(4) under the Securities Act.

#### REFERENCES

Unless the context otherwise requires, references to “**we**,” “**us**” and “**our**” refer to, collectively, NOVATEK and its subsidiaries consolidated in accordance with the Financial Statements (as defined below). Prior to March 2003, NOVATEK was known as OAO FIK Novafininvest. Certain gas and oil related terms used in this Prospectus are defined in “*Glossary of Gas and Oil Terms*” beginning on page 240 of this Prospectus. Unless the context otherwise requires, references to “**shares**” refer to our ordinary shares.

References to “**Russia**” shall mean the Russian Federation.

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## OVERVIEW

*The following overview should be read in conjunction with, and is qualified in its entirety by reference to, the more detailed information in this Prospectus and our Audited Financial Statements and the related notes and unaudited supplemental oil and gas disclosures and our Unaudited Financial Statements included elsewhere in this Prospectus. Investing in the Notes involves a high degree of risk. The information set out under “Risk Factors” should be carefully considered. Certain statements in this Prospectus include forward-looking statements which also involve risks and uncertainties as described under “Forward-Looking Statements”.*

### General Description of NOVATEK

We are Russia’s largest independent natural gas producer and the second-largest natural gas producer in Russia after OAO Gazprom (“**Gazprom**”), in each case according to data from the Central Dispatch Administration of the Fuel and Energy Complex (the “**CDU-TEK**”) for the nine months ended 30 September 2012. We are principally engaged in the exploration, production, processing and marketing natural gas and liquid hydrocarbons and have over 17 years of operational experience in the Russian natural gas and oil sector. In 2011 and the nine months ended 30 September 2012, we accounted for approximately 8% and 9%, respectively, of the natural gas produced in Russia, providing approximately 15% and 17%, respectively, of total natural gas deliveries through the Unified Gas Supply System (the “**UGSS**”) to the domestic market, according to the CDU-TEK. In 2012, we started trading activities on the European gas market, by selling and purchasing natural gas. Except where expressly stated otherwise, all of NOVATEK’s operational information herein, including the reserves and the production data, is on a “net” basis, meaning it includes NOVATEK’s proportionate share of the respective results of operations of its consolidated subsidiaries and Joint Ventures (as defined below).

Our core strategy is to maintain our position as the leading independent natural gas producer in Russia, based on reserves and production, by increasing our hydrocarbon production on a sustainable and profitable basis, while efficiently expanding our hydrocarbon resource base, developing our marketing channels and exploring complementary and value added projects. We supply natural gas to Russia’s domestic market and are focused on meeting the anticipated growing demand in Russia (as forecasted by the International Energy Agency), and, as such, we expect to benefit from future increases in regulated prices for natural gas sold and in power generation capacity and infrastructure investments in Russia, as projected by the Ministry of Economic Development of the Russian Federation.

Our exploration, development, production and processing of natural gas and liquid hydrocarbons are conducted within the Russian Federation and our operating areas are concentrated in the Yamalo-Nenets Autonomous District (“**YNAO**”), in Western Siberia. According to the YNAO Administration, the Ministry of Energy of the Russian Federation (“**MER**”) and the BP Statistical Review of World Energy (June 2012), YNAO is the leading gas producing region in Russia, accounting for approximately 90% of Russia’s natural gas production and approximately 17% of the global natural gas production in 2011.

As of 31 December 2011, we had 9,393 mmboc of proved reserves, of which 92% were natural gas reserves, under SEC reserves methodology (see “*Classification of Reserves—SEC Reserves Methodology*”). For the three years ended 31 December 2011, our three-year average reserves replacement ratio was 597%, on a boc basis, based on proved reserves under SEC reserves methodology. The reserve life of our proved reserves under SEC reserves methodology was 25 years based on our annual production in 2011.

During the periods under review, we have consistently increased our hydrocarbon production, and we expect to continue increasing our production levels in the future. In the nine months ended 30 September 2012, we produced 41.4 bcm of natural gas and 3.1 mmt of liquid hydrocarbons, an increase of 7.3% and 2.0%, respectively, compared to the nine months ended 30 September 2011. Our natural gas and liquid hydrocarbons production totaled 52.9 bcm and 4.1 mmt, respectively, in 2011, 37.3 bcm and 3.6 mmt, respectively, in 2010, and 32.4 bcm and 3.0 mmt, respectively, in 2009.

Our three core fields – Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye (the “**Core Fields**”) accounted for 52.5% of our total proved reserves, under SEC reserves methodology, as of 31 December 2011 and approximately 90% of our gas production volumes in 2011. A significant portion of our total hydrocarbon proved reserves and production is contributed by our joint ventures for which (as we share control over these entities with our joint venture partners) we account under the equity method (the “**Joint Ventures**” or “**JV**”), comprising:

- our 50/50 joint venture OOO Yamal Development (“**Yamal Development**”) with JSC Gazprom neft (“**Gazprom neft**”), which in turn holds a 51% stake in its joint venture OOO SeverEnergia (“**SeverEnergia**”) with Artic Russia B.V. (owned by Eni S.p.A (“**Eni**”) and Enel S.p.A (“**Enel**”)) holding a 49% stake;

- our joint venture OAO Sibneftegas (“**Sibneftegas**”) in which we hold a 51% stake and OOO Neftegazovaya Kompaniya “**ITERA**” (“**Itera**”) holds a 49% equity stake; in turn, Itera is held 51% by Rosneft Oil Company (“**Rosneft**”) and 49% by Itera Group Ltd. (“**Itera Group**”);
- our joint venture ZAO Terneftegas (“**Terneftegas**”) in which we hold a 51% stake and our strategic partner Total S.A. (“**TOTAL**”) a 49% stake; and
- our joint venture OAO Yamal LNG (“**Yamal LNG**”) in which we hold an 80% stake and TOTAL 20%.

Our Joint Ventures accounted, collectively, for 42.9% of our proved reserves, under SEC reserves methodology, as of 31 December 2011. In particular, our 25.5% economic interest in SeverEnergiya and 51% stake in Sibneftegas together accounted for 14.1% of our proved reserves as of 31 December 2011, and our 80% economic interest in Yamal LNG accounted for 27.7% of our proved reserves as of 31 December 2011. Production at SeverEnergiya commenced in April 2012; our *pro rata* share in Sibneftegas’ production accounted for 10.2% of our natural gas production volumes in 2011. Yamal LNG has not yet started production. We also hold licenses for as yet undeveloped fields in the Gydan peninsula.

We generate revenues primarily from natural gas and gas condensate sales and, to a lesser extent, sales of other liquid hydrocarbons. In the nine months ended 30 September 2012, our sales of (i) natural gas accounted for 66.3% of our total revenues, (ii) stable gas condensate for 23.1% and (iii) liquefied petroleum gas (“**LPG**”), crude oil and oil related products for 10.3%. In 2011, our sales of (i) natural gas accounted for 62.9% of our total revenues, (ii) stable gas condensate for 26.5% and (iii) LPG, crude oil and oil related products accounted for 10.3%. For the nine months ended 30 September 2012, we had total revenues of RUB152.2 billion and EBITDA (as defined in “*Selected Consolidated Financial and Other Data—Certain Financial Items and Ratios*”) of RUB69.9 billion. In 2011, we generated total revenues of RUB176.3 billion and EBITDA of RUB148.3 billion.

In accordance with Russian law, we currently sell all our natural gas production to customers in the Russian Federation. Our customers are primarily power generation companies, industrial users, regional gas distributors and wholesale gas traders. We also sell a portion of our gas to households. As an independent natural gas producer, we are not subject to regulation by the Government of the Russian Federation (the “**Government**”) with respect to natural gas prices except for our sales to households, which represent a minor share of our total sales volumes. However, the regulated price as set by the Federal Tariff Service (the “**FTS**”) significantly influences the market conditions in our regions of delivery, as well as the price in our natural gas contracts with end-customers and wholesale traders. The FTS-regulated wholesale price has been increasing in recent years, including the latest increase of 15% which took effect on 1 July 2012.

We transport our natural gas through our pipelines into the UGSS, which we use to deliver our gas to end-customers in accordance with the relevant transportation contracts we enter into with Gazprom. The UGSS transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. UGSS transportation tariffs are set by the FTS.

Substantially all of our stable gas condensate is sold internationally, whereas our other liquid hydrocarbons, including LPG, crude oil and oil related products, are sold domestically and internationally. Gas condensate is produced in an unstable form and requires processing before it can be delivered to customers. We currently process all of our de-ethanized gas condensate at our Purovsky Gas Condensate Plant (the “**Purovsky Plant**”). We are currently expanding the capacity of our Purovsky Plant from 5 mmt to 11 mmt per annum. In the nine months ended 30 September 2012 and in 2011, we processed 2.9 mmt and 3.9 mmt, respectively, of de-ethanized gas condensate. Following processing, we export substantially all of our stable gas condensate to international markets, via the Port of Vitino on the White Sea in the Murmansk region. In the nine months ended 30 September 2012 and in 2011, we sold 2.2 mmt and 3.0 mmt, respectively, of stable gas condensate. We are currently building a new gas condensate transshipment and fractionation complex at the Ust-Luga terminal on the Baltic Sea. We expect that the completion of this project will allow us to partially replace sales of gas condensate with sales of a range of petroleum products, as well as to replace the Port of Vitino for deliveries of our gas condensate and products made from it to the international markets. The terminal is expected to begin operations in 2013.

NOVATEK has pursued, and continues to consider, participating in natural gas projects outside Russia. In 2007-2011, we pursued the El-Arish offshore gas and oil project in Egypt; when initial exploratory works and drilling failed to confirm sufficient commercially recoverable reserves we ended our participation in this project, expensing our capital costs. With our strategic partner TOTAL and Gazprombank (Open Joint-stock Company) (“**Gazprombank**”), we are currently pursuing an offshore natural gas project in the Republic of Cyprus via a joint venture, in which we have a 25% stake, TOTAL 65% and Gazprombank 10%. The joint venture is currently in negotiations with the Cypriot authorities regarding the terms of exploration and production on a block of the Cypriot shelf under a production sharing agreement.



## Competitive Strengths

We believe the following competitive strengths distinguish our past operational and financial performance and our future growth prospects from other independent natural gas producers in Russia:

- high-quality asset base;
- strategic location with access to infrastructure and attractive markets;
- integrated operations and logistics capabilities;
- low-cost and disciplined producer;
- strong relationships with a diverse customer base;
- financial strength and flexibility;
- experienced management team; and
- strong relationship with Gazprom.

## Business Strategy

Our strategic objective is to leverage our competitive strengths to increase our hydrocarbon production on a sustainable and profitable basis, while efficiently increasing our resource base and operating in a socially and environmentally responsible manner. Moreover, we intend to continue to expand and optimize our marketing channels, expand our processing capacities and explore complementary and value added projects. Specifically, we intend to:

- increase our resource base and manage reserves effectively;
- substantially increase our production of hydrocarbons;
- maintain our low cost structure;
- efficiently monetize our reserves of liquid hydrocarbons; and
- maximize risk-adjusted margins on sales of natural gas and liquids and expand our customer base.

## Credit Ratings

We are currently rated “Baa3” by Moody’s, “BBB-” by S&P and “BBB-” by Fitch. To maintain our credit rating, we have established certain financial targets and coverage ratios that we monitor on a quarterly and annual basis. A securities rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating organization.

## Recent Developments

On 27 November 2012, we completed the acquisition of a 49% equity stake in ZAO Nortgas (“**Nortgas**”) from R.E.D.I. HOLDINGS. Gazprom currently holds the remaining 51% in Nortgas. The purchase price for the acquisition was U.S.\$1,375 million. See “*Use of Proceeds*”.

Nortgas holds the hydrocarbon production license for the North-Urengoyskoye field, located in the Nadym-Pur-Taz and Purovskiy regions of YNAO, and is in close proximity to our existing production, transportation and processing infrastructure. According to Nortgas, as at 31 December 2011, it had estimated proved reserves of 1.7 bboe under PRMS (as defined below) reserves methodology, and for the nine months ended 30 September 2012, the North-Urengoyskoye field produced 3.1 bcm of natural gas and 320 mt of de-ethanized gas condensate.

In connection with the financing of the Nortgas acquisition, we entered into a short-term bridge financing in principal amount of U.S.\$667 million with Barclays Bank PLC and Goldman Sachs Bank USA (the “**Bridge Facility**”); we also issued three-year RUB20 billion domestic bonds in October 2012, using a portion of their proceeds to finance the Nortgas acquisition. The proceeds of the Offering are to be used to repay the Bridge Facility, as well as for general corporate purposes. See “*Use of Proceeds*”, “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Bridge Facility*” and “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Rouble Bond Issuance*”.

## RISK FACTORS

*An investment in the Notes involves a high degree of risk. You should carefully consider the following information about these risks, together with the other information contained elsewhere in this Prospectus, before you decide to invest in the Notes. Each of the risks highlighted below could have a material adverse effect on our business, financial condition, results of operations or prospects or on the trading price of the Notes, and you could lose all or part of your investment.*

*We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently are not aware of or deem immaterial, could have the effects set forth above.*

### **Risks Relating to Our Business and Industry**

***Russian state authorities, directly and through the control of Gazprom, which owns and operates the gas pipeline network transporting our gas (the UGSS) and which beneficially owns 9.99% of our shares, effectively control the Russian natural gas industry and could significantly restrict the activities and operations of independent natural gas producers such as ourselves.***

All material aspects of the Russian natural gas industry are subject to or materially affected by state regulation and control. See “*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK*”. Through the majority share ownership of the Russian Federation in Gazprom, representation on its board of directors and its regulatory authority, Russian state authorities have effective control over Gazprom, which beneficially owns 9.99% of our shares. Gazprom is the dominant participant in our industry in Russia, due, in particular, to its ownership of the UGSS and its exclusive right to export natural gas, including in the form of liquefied natural gas (“LNG”), abroad under Federal Law No. 117-FZ “On the Export of Gas” (the “**Gas Export Law**”), except for natural gas produced under certain grandfathered production sharing agreements. In addition, over the past decade, Russian state authorities have increased their influence in our industry, as well as the strength of state-controlled industry participants. For example, according to public announcements, Rosneft Oil Company (“**Rosneft**”), Russia’s largest oil company (in terms of proved oil and gas condensate reserves and production in 2011), which is majority-owned by the state, has recently entered into separate tentative agreements that would result in Rosneft acquiring all of the equity of TNK-BP Ltd., which in turn holds an approximately 95% equity interest in OJSC “TNK-BP Holding” (“**TNK-BP**”), Russia’s third largest oil company in terms of proved oil and gas condensate reserves and production in 2011, by acquiring 50% from BP plc and 50% from the AAR Consortium. As such, Russian state authorities both effectively control the Russian natural gas industry and own many of our competitors and substantial stakes in our Joint Ventures. See also “—*We are dependent to a certain extent on the Russian power generation sector for sales of our natural gas and also sell our stable gas condensate to a limited number of customers*”, “—*Global and domestic shifts in the pricing of natural gas could increase competition on the domestic market*” and “—*We conduct several of our operations through joint ventures which are subject to specific risks*”.

The significant participation in the Russian natural gas industry of independent natural gas producers is a relatively recent development. If Russian state authorities were to determine that independent natural gas producers should have a less significant role in the Russian natural gas industry than currently envisioned in what we understand to be the authorities’ intention and strategy, as evidenced by the “Energy Strategy for Russia until 2030” approved by the Government and signed by then Prime Minister Putin on 13 November 2009 (the “**Russian Federation Energy Strategy 2030**”), the authorities could take various legislative, administrative and other actions (including through Gazprom) that would have a material adverse effect on our business, financial condition, results of operations or prospects, possibly even threatening our ability to continue as a going concern. See also “—*Risks Relating to Russia*”.

***State regulation keeps Gazprom’s domestic natural gas prices lower than its international natural gas prices, and we have limited ability to set domestic prices higher than those charged by Gazprom.***

In 2011, Gazprom sold approximately 73% (by volume) of all natural gas sold in Russia (according to Gazprom data). The prices Gazprom charges for natural gas in Russia are subject to control by Russian state authorities under Federal Law No. 69-FZ of 31 March 1999 “On Gas Supply in the Russian Federation” (as amended) (the “**Gas Supply Law**”). See “*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK*”. At present, the prices that state authorities have set for sale of Gazprom’s natural gas in Russia are significantly lower than the prices that Gazprom charges off-takers in Europe. For example, as reported by Gazprom, its average sale price of natural gas in 2011 was RUB9,187 per mcm in European countries, other than certain former USSR countries, as compared with RUB2,725 per mcm in Russia (excluding VAT, excise taxes and customs duties). In accordance with the Gas Export Law, Gazprom and its wholly-owned subsidiaries are the only entities permitted to export natural gas produced in Russia, which precludes all other natural gas producers, including us, from exporting natural gas independently. As a result, we sell all natural gas we produce in Russia and, although the sales prices of our natural gas are not regulated, the large majority of our customers are eligible to

purchase natural gas from Gazprom at regulated prices. Thus, the prices we can achieve for our natural gas in Russia strongly correlate to regulated prices applied to Gazprom.

There can be no assurance that natural gas prices in Russia will continue to increase, either as foreseen by the current plan for the gradual liberalization of the domestic natural gas market, approved by the Government in 2011 (the “**Domestic Gas Market Liberalization Plan**”) or in response to an increase in energy prices elsewhere in the world, or that the domestic regulation of natural gas prices or exports will be changed with the effect that our prices are not affected by the prices used by the dominant player in our industry, Gazprom. Accordingly, we have and may continue to have limited pricing flexibility with respect to our sales of natural gas. In addition, our prices for natural gas could also be adversely affected by any future liberalization of prices in the Russian natural gas industry, as there can be no assurance that free market prices would be higher than those set by state authorities.

Furthermore, regulated prices (including the regulated prices at which Gazprom sells natural gas) may be subject to various political and administrative factors. For example, in 2012, the effective date for an annual indexation of regulated prices for natural gas was postponed from 1 January (the traditional timing to increase regulated pricing) to 1 July, thereby negatively influencing the prices and revenues we achieved in the first half of 2012.

These limitations and developments could have a material adverse effect on our business, financial condition, results of operations or prospects, particularly if the regulated prices decrease or if we experience a significant increase in our operating costs.

***Global economic developments and Russian market conditions may adversely affect our business, financial condition and results of operations.***

Our results of operations are significantly influenced by general economic conditions, in particular in Russia. Substantially all our assets and the majority of our customers are located in, or have businesses related to, Russia. As a result, we are substantially affected by the health of the Russian economy, which is, to a significant degree, dependent on exports of key commodities, such as oil, gas, iron ore and other raw materials. The Russian economy was severely impacted by the weakening global economic conditions and the turmoil in global financial markets, particularly in the second half of 2008 and the first half of 2009. Falling global prices of key commodities in the second half of 2008 and the first half of 2009 resulted in sharp decreases in Russian state revenues, as well as revenues of private companies operating in these sectors in Russia, which, in turn, had a severely negative effect on the overall national economy. For example, according to the Russian Federal Statistics Service (“**Rosstat**”), Russia’s gross domestic product (“**GDP**”) experienced a real decline of 7.8% in 2009, compared to 5.2% growth in real terms in 2008. Since 2009, Russia has continued to be affected by volatility and market disruption. For example, in January 2012, Fitch lowered its credit outlook for the Russian Federation from positive to stable based on perceived increased political uncertainty and the global economic outlook. Global financial markets have experienced increased volatility since the second half of 2011, a period which has seen the sovereign rating downgrades of, among others, the United States, France, Japan, Austria, Greece, Ireland, Portugal, Spain and Italy and continued concerns over the stability of the European monetary system and the stability of certain European economies, notably Greece, Ireland, Portugal, Spain and Italy. Though repeated summits of, and attempts by, European leaders to find a lasting solution to market concerns about such countries’ ability to repay their debt have produced bail-out packages and restructuring agreements for certain sovereign debtors such as Greece, there remain continuing doubts concerning the stability of the European monetary system and economy. There can be no assurance that a further economic downturn or financial crisis will not occur.

Furthermore, the value of the Rouble relative to the U.S. Dollar remains vulnerable to any future possible declines in global commodity prices. There can be no assurance that future declines in, or periods of significant volatility of, commodity prices will not lead again to GDP contraction or slower GDP growth in Russia, or adversely affect the Rouble/U.S. Dollar exchange rate. See “—*We face foreign exchange risks that could have a material adverse effect on our business, financial condition, results of operations and prospects*”.

In addition, a general decrease in industrial production could have an adverse impact on our customers, which, in turn, could lower demand for our products. Furthermore, a worsening in the financial condition of our joint venture partners could adversely affect our operations. Deterioration in the global financial markets could also lead to the downgrade of lenders’ credit ratings, both in Russia and abroad, ultimately making access to credit more difficult and costly.

Adverse economic developments of the kind described above have negatively affected us and could have a material adverse effect on our business, financial condition and result of operations, as well as the value of the Notes in the future.

***A substantial or extended decline in prices for natural gas or liquid hydrocarbons would have a material adverse effect on our business, financial condition, results of operations and prospects.***

World markets for natural gas and liquid hydrocarbons are very volatile. Historically, such prices have fluctuated widely in response to relatively minor changes in supply and demand, market uncertainty and a variety of

other factors. We do not and will not have control over certain factors affecting prices for natural gas, crude oil, refined products and petrochemical products. These factors include: global and regional supply and demand, and expectations regarding future supply and demand for natural gas and liquid hydrocarbons; domestic and global economic conditions or trends; political, social and economic conditions (including outbreaks of armed hostilities or acts of terrorism), particularly in oil and natural gas producing regions; the ability of the Organization of Petroleum Exporting Countries (“OPEC”) to agree to and maintain oil production controls; weather and climate conditions, natural disasters and industrial accidents; domestic and foreign government regulation, including export restrictions and taxes, which can substantially affect profitability; prices and availability of alternative and competing fuels; and prices and availability of new technology. In addition, certain other factors, such as the cost of exploring for, developing, producing, processing and marketing natural gas, crude oil, refined products and petrochemical products, as well as the loss, decline and failure to develop infrastructure and transport facilities, though partially controlled by us, can be affected by uncontrollable circumstances and developments.

The prices we charge for our natural gas in Russia are strongly influenced by the prices the Government sets for the sale of natural gas by Gazprom, and these prices may decline for external or domestic reasons.

The prices we charge for our liquid hydrocarbons are determined by prices established on the world market. Thus, declines in the prices for liquid hydrocarbons on world markets would result in a decrease in our revenue and would have a material adverse effect on our business, financial condition, results of operations or prospects.

Lower prices for our natural gas and liquid hydrocarbons may not only decrease our revenues on a per unit basis, but also may reduce the amount of hydrocarbons that we can produce economically. This may result in us having to make downward adjustments to our estimated proved reserves. If this occurs or if our estimates of development costs increase, production data factors change or our exploration results deteriorate, we may not be able to meet our strategic goals; in addition, accounting rules under the International Financial Reporting Standards as issued by International Accounting Standards Board (“IFRS”) may require us to write down, as a non-cash charge to earnings, the carrying value of our natural gas and oil properties for impairments. A decline or volatility in the prices of natural gas, crude oil, refined products or petrochemical products could have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

***We are dependent on state authorities to set tariffs for transportation of our key products, and such tariffs are expected to continue to increase.***

In Russia, the FTS regulates tariffs for the transportation of natural gas. In the nine months ended 30 September 2012 and in 2011, our average natural gas transportation expenses represented 44.1% and 45.9%, respectively, of the average price per one mcm of natural gas sold to end-customers, net of VAT. Regulated natural gas transportation tariffs have risen in recent years, and are expected to continue to rise at least until 2015 at a rate not exceeding the forecasted inflation rate, according to the Ministry of Economic Development of the Russian Federation. As approved by the FTS, an increase in the average regulated transportation tariff for independent gas producers using the UGSS by 7% came into effect on 1 July 2012. If natural gas transportation tariffs continue to rise, as expected, and we become unable to pass on these additional costs to our end-customers, or the impact of increased transportation tariffs on our wholesale customers requires us to decrease the natural gas prices we charge on a non-delivered basis, it could have a material adverse effect on our business, financial condition, results of operations or prospects.

The FTS is also responsible for setting the tariffs of OAO AK Transneft (“Transneft”), a state-owned monopoly that operates the Russian national network of trunk pipelines through which we transport our crude oil. The tariffs charged by Transneft have risen in recent years and are expected to continue to rise. Failure to pay these fees could result in the termination or temporary suspension of our access to the Transneft network. Similarly, the FTS sets the transportation tariffs (other than transit tariffs charged when crossing international borders) for OAO Russian Railways (“RZD”), on which we are dependent for the transportation of our liquid hydrocarbons.

We are generally unable to pass on to our customers the additional costs associated with an increase in Transneft and RZD tariffs. Accordingly, the continued increase of these tariffs, above those projected and budgeted by us, could have a material adverse effect on our business, financial condition, results of operations, financial condition or prospects.

***We rely on third parties, primarily state-owned monopolies, to transport our products to customers.***

*We are dependent on Gazprom for the transportation and storage of our natural gas.*

We transport substantially all of our natural gas through the UGSS, which is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia. The UGSS is owned and operated by Gazprom. Under existing legislation, Gazprom must provide access to the UGSS to all independent suppliers on a non-discriminatory basis, subject to the availability of capacity in the UGSS, the compliance of the gas being transported with certain quality and technical parameters and the availability of connecting and branch pipelines to consumers. See “State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK”. In practice, however, Gazprom could exercise considerable discretion over access to the UGSS as the sole holder of

information relating to UGSS' capacity. There can be no assurance that Gazprom will continue to provide us with access to the UGSS, or that the terms of our access to the UGSS will be commercially reasonable. A change in law, or a failure by Gazprom to comply with the law, such that Gazprom no longer provides access to the UGSS on a non-discriminatory or commercially reasonable basis, or other action by Gazprom to restrict our access to the UGSS, would likely result in a decrease in our production and sales, and consequently, could have a material adverse effect on our business, financial condition or prospects or on the value of the Notes.

To reduce seasonal fluctuations in our sales of natural gas, we inject our gas into underground storage gas facilities ("UGSF") owned and operated by Gazprom as part of the UGSS. Tariffs for gas storage in the UGSFs are not subject to FTS regulation. If the storage capacity of Gazprom's UGSFs is restrained or we are otherwise unable to continue to inject our natural gas into Gazprom's UGSFs as commercial need arises on acceptable terms, our sales of natural gas and, accordingly, revenues could be adversely affected.

*Our ability to transport natural gas may be limited by capacity constraints of the UGSS.*

The UGSS includes an extensive network of pipelines and compressor installations that have been developed over the past forty years. Most of the pipelines in the UGSS are over fifteen years old with certain parts being over thirty years old. As a result, the UGSS may experience outages or capacity constraints during required maintenance periods, and it is likely that maintenance work will increase in the future. During these maintenance periods, we may experience delays in or be prevented from supplying natural gas to our customers.

We share the transportation capacity of the UGSS with Gazprom, Rosneft, OAO "LUKOIL" ("LUKOIL") and others. Each of Gazprom, Rosneft and LUKOIL has announced that they plan to develop large fields in YNAO, production from which competes with our natural gas for the transportation capacity of the UGSS. A substantial increase in production by any of them in the areas in which we currently have access to the available capacity of the UGSS could limit our access to the transportation capacity we need to market our natural gas.

To date, Gazprom has generally avoided serious disruptions in the deliveries of our natural gas via the UGSS. However, a major disruption in the UGSS or a limitation of our access to the transportation capacity would likely result in a decrease in our production and sales of natural gas, and could have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

*We are dependent on Transneft for the transportation of our crude oil.*

We transport our crude oil through the Russian national network of trunk pipelines operated by Transneft. While alternative means of transportation that are not dependent on the Transneft system exist in Russia, such means are generally more expensive than the Transneft pipeline system. Transneft has generally avoided serious disruptions in the transport of crude oil and, to date, we have not suffered significant losses arising from the failure of the pipeline network. Nonetheless, much of the Transneft-operated pipeline system is over ten years old, with some sections constructed over forty years ago, and much of the system is located in regions with harsh climates where construction, maintenance and refurbishment are difficult and costly. As a result, the Transneft-operated network may experience outages or capacity constraints during required maintenance periods, and maintenance work is likely to increase in the future. During the maintenance or repair periods, we may experience delays in or be prevented from transporting crude oil, and may incur additional costs associated with the implementation of alternative modes of transportation. A major disruption in the Transneft operated system could have an adverse effect on our business, financial condition, results of operations or prospects.

*We are dependent on RZD for the transportation of our liquid hydrocarbons.*

We are dependent on the Government-owned rail monopoly, RZD, for the transport of stable gas condensate from our Purovsky Plant to our storage and loading facilities at the Port of Vitino, where we load our stable gas condensate onto ocean going tankers for export. In addition, we also use RZD to transport our LPG from the Purovsky Plant to our domestic and international export customers. Use of the Russian railway system exposes us to certain risks, such as disruptions in transportation schedules, theft during transport or spills.

Our ability to transport these liquid products by rail depends on the availability of well-maintained railway tank cars, which are currently provided by OAO Transoil ("Transoil") and OAO SG-Trans. Although we have partially reduced our dependence on these third parties by purchasing 420 railway tank cars for the transportation of LPG, we still use third-party railway tank cars, and there can be no assurance that we will be able to obtain access to a sufficient number of such cars in the future. An inability to obtain a sufficient number of railway tank cars could adversely affect our ability to transport our liquid products to either domestic or export markets.

*Our export revenues for stable gas condensate depend on sea transport from the Ports of Vitino and, in the near future, Ust-Luga.*

We utilize the Port of Vitino and, in the near future, will start utilizing the Port of Ust-Luga for the transshipment of our stable gas condensate supplied to foreign markets. Port transport in Russia is associated with certain risks, including the possibility of bottlenecks due to increasing volumes as well as various other delays. In particular, delays in the transshipment of any goods, including those of third parties, at a port can increase the

terminal time of all railway cars in the vicinity of the port. As a result, RZD can suspend or completely restrict the delivery of our stable gas condensate from the Purovsky Plant to such port.

Severe winters can result in ice conditions that disrupt vessel arrival and departure schedules, as well as loading and unloading of cargos. In addition, there can be an insufficient number of tankers available to transport our liquid hydrocarbons.

***We encounter intense competition from other gas and oil companies in all areas of our operations.***

The gas and oil industry is intensely competitive. We compete with oil and natural gas companies, including Gazprom, Rosneft, LUKOIL, TNK-BP (which Rosneft is seeking to acquire) and “Surgutneftegas” OJSC. Domestic competition with gas and oil companies has increased as a result of the growth of their gas production and recent legislative requirements, according to which gas and oil companies must utilize (i.e., consume or sell) 95% of the produced associated gas starting from 1 January 2012. Our ability to market and transport our natural gas and liquid products depends upon our ability to negotiate favorable terms with customers and to successfully arrange with Gazprom for sufficient transportation capacity of the UGSS in this highly competitive environment. See “—*We rely on third parties, primarily state-owned monopolies, to transport our products to customers*”.

The key activities in which we face competition include:

- the acquisition of subsoil licenses at auctions or tenders run by state authorities and obtaining desirable licenses for future exploration and production;
- the acquisition of other companies that may already own licenses or existing hydrocarbon-producing assets;
- the engagement of leading third-party service providers (including, among others, gas field services providers), whose capacity to provide key services may be limited;
- the purchase of capital equipment that may be scarce;
- marketing of our natural gas and liquid hydrocarbons to major industrial and energy customers, including as a result of pricing competition with Gazprom or other independent gas producers;
- the employment of the best qualified and most experienced staff;
- access to critical transportation infrastructure on reasonable terms;
- the acquisition of existing retail outlets or sites for new retail outlets; and
- marketing of our natural gas and other products.

***Global and domestic shifts in the pricing of natural gas could increase competition on the natural gas market.***

Recently, the global natural gas market has been subjected to a number of trends, which have had the effect of lowering international gas prices, particularly in the U.S. market. In particular, shale gas, a form of natural gas embedded in highly impervious shale, is becoming increasingly important for the United States and, to date to a lesser extent, certain European markets. The increase of shale gas production has contributed to a general decrease in the price of gas at the Henry Hub, which is the benchmark spot price for the North American market of natural gas, as production (or supply) has outpaced demand growth. According to the U.S. Department of Energy, the spot price of gas at the Henry Hub decreased to below U.S.\$2 per mmbtu in April 2012, close to the lowest level in the past five years. The increase of LNG processing and the development of more effective ways to transport LNG to different markets have contributed to the supply of natural gas on the international spot markets and thus a decline in the global gas price. Some LNG plants in the United States originally designed to take LNG imports are now being re-designed, in light of increased natural gas production in the United States in part due to shale gas, to export LNG, and as these plants come into operation their LNG exports could affect global gas pricing. According to the U.S. Department of Energy, the United States is expected to become a net exporter of LNG in 2016 and an overall net exporter of natural gas by around 2022.

Domestically, competition in the Russian gas industry is intensifying. For example, in August 2012, Rosneft and Itera Group, a parent company of Itera, announced the formation of a joint venture owned 51% by Rosneft and 49% by Itera Group, in which they pooled their natural gas assets. Itera Group included into this joint venture with Rosneft its 49% interest in our Joint Venture with Itera, Sibneftegas.

More generally, in light of a regulation of the Government establishing from 1 January 2012 significantly higher emission charges for flaring more than 5% of the associated gas produced in the exploitation of gas and oil fields, a number of Russian oil companies have announced plans and investment programs to capture associated gas, which may lead to increased volumes of natural gas being available for sale in Russia. In addition, domestic gas prices in Russia are expected to increase and ultimately converge with the price (net of transport costs and taxes) of natural gas exported from Russia. In particular, in November 2006, the Government first announced its plan to

liberalize the price of natural gas sold on the Russian domestic market (i.e., to increase it to the level of the export price, net of transportation costs and taxes) by 2011 and formally approved it in 2007. Subsequently, the Government decided to postpone the liberalization until after 2015, in accordance with the Domestic Gas Market Liberalization Plan. Recently, high-level officials of the Government have publicly suggested that the convergence of domestic and export gas prices may be postponed until after 2017 and might result primarily from decreasing exports netbacks, rather than further increases of domestic gas prices.

At the same time, Gazprom's use of long-term take-or-pay supply contracts with its European customers with pricing derived from benchmark crude oil pricing has come under review, including investigations by the EU authorities (in keeping with the EU's Third Gas Directive, which seeks to liberalize the EU gas market), which may ultimately lead to increased use of spot pricing, greater volatility in pricing, and possibly lower prices for Gazprom's natural gas sales in Europe and, consequently, in Russia.

As a result of price liberalization, an increase in prices for natural gas in Russia, decrease in the prices Gazprom realizes on its export sales, and/or greater domestic supply by producers who cannot export production, Gazprom and other Russian producers could focus more on the Russian natural gas market, which in turn could result in greater competition both for transportation capacity and domestic sales to end-customers and traders, which could negatively affect our business, financial condition, results of operations or prospects or the value of the Notes.

***Delinquent or non-collectible payments by our customers could adversely affect us.***

Our customers may not pay at all, or on untimely basis, for our products. Although we have not experienced in the past material non-performance from our customers and, in the ordinary course of business, take measures to mitigate our credit risk, it is possible that we may experience a higher than normal level of delayed non-payments by our customers due to ongoing economic and financial instability. As we are expanding our business geographically into new regions of Russia, in particular following the acquisition of local traders in Perm and Chelyabinsk, our customer base is growing to include small- and medium-sized industrial enterprises and households that may be particularly exposed to the impacts of macroeconomic instability. Accordingly, our cash flows could be adversely affected by the inability or limited ability of our customers to pay for our hydrocarbons.

In accordance with the Gas Supply Law and implementing regulations, customers in Russia are obliged to pay for natural gas supplies and transportation services. If customers fail to make such payments, suppliers have the right to limit or suspend natural gas supplies to such customers in accordance with specific procedures set forth by the Government. However, gas supplies to certain types of customers cannot be limited or suspended under law. These customers include, among others, military units, nuclear plants, communication organizations and certain vital utilities. At present, the share of such regulated supplies in our overall supplies of natural gas is insignificant; however, we may enter into further gas supply agreements with this category of customers in the future, as we expand our domestic distribution channels to new regions. We may be required to continue delivering natural gas to such customers, even if they do not pay for such supplies within the period set forth in the relevant gas supply agreement. A failure by the state or local budget to timely reimburse us for such non-paid supplies could have an adverse effect on our business, financial condition, results of operations or prospects.

***Government policies to ensure sufficient supplies of hydrocarbons in the domestic market could impact our ability to sell our products at the best available prices and disrupt our relations with our customers.***

We sell natural gas and a portion of our liquid hydrocarbons on the Russian domestic market. Historically, the Government has used and continues to use various administrative and fiscal measures to ensure that sufficient supplies of liquid hydrocarbons, including oil and refined products, are made available to domestic customers.

The Government has the authority to direct us to deliver natural gas or liquid hydrocarbons to certain Government-designated domestic customers, which may take precedence over market sales. Requirements for the delivery of such hydrocarbons, with or without a corresponding limitation or ban of export sales, could be used if the domestic market experiences a shortage of natural gas, crude oil, liquid hydrocarbons or refined products. We may be directed to make deliveries to remote regions or government agencies or other specific consumers. Depending on the level of such required supplies, any Government-directed deliveries may force us to curtail our export of hydrocarbons, disrupt our relations with our customers and lead to delays in the receipt of payments for hydrocarbons delivered.

We may be required by the Government to supply a certain volume of LPG at regulated prices to gas-distribution organizations for domestic needs, such as fuel being supplied for the heating of residential properties. As of 30 September 2012, the regulated segment of the domestic market of LPG accounted for approximately 10% of our total LPG sales volumes. A potential shortage of LPG on the domestic market could lead to us being ordered to sell an additional portion of our LPG on the domestic market at prices regulated by the FTS, i.e., below our regular prices for market customers.

As a result of these factors, an increase in the levels of Government-directed deliveries with respect to, or a revocation or restriction of export rights for, or any further increase in export duties on, hydrocarbons could have a material adverse effect on our business, financial condition, results of operations or prospects.

***We are dependent to a certain extent on the Russian power generation sector for sales of our natural gas and also sell our stable gas condensate to a limited number of customers.***

Our sales of natural gas significantly depend on the demand for gas in the Russian power generation sector. In the nine months ended 30 September 2012 and in 2011, our natural gas sales to end-customers in the Russian power generation sector accounted for 40% of our overall natural gas sales (in terms of volumes), and we expect the Russian power generation sector to be an important customer segment going forward. In the nine months ended 30 September 2012 compared to the nine months ended 30 September 2011, our natural gas sales to end-customers increased by more than 8.7 billion mcm (representing a 42.6% increase), which was primarily due to our acquisition of OOO Gazprom mezhregiongas Chelyabinsk (“**Gazprom mezhregiongas Chelyabinsk**”) allowing us to supply 100% of the demand for natural gas in the Chelyabinsk region, and entry into or extension of contracts with major customers in the Russian power generation sector, such as the Russian subsidiaries of E.ON AG (“**E.ON**”) and Fortum Corporation (“**Fortum**”). See “*Business—Sales and Marketing—Natural Gas—Sales of natural gas*”.

A material reduction in our gas supplies to major customers may have a material adverse effect on our business, results of operations, financial condition and prospects, if we are unable to timely secure other customers on contractual terms similar to, or more beneficial than, those currently in place with our major customers.

In addition, we sell our natural gas condensate to a relatively small number of international customers. As a result, we might experience difficulties if one or more of such off-takers were to terminate their customer relationship with us. Although we aim to diversify our customer base in stable gas condensate sales (in particular, by commissioning the Ust-Luga complex), we expect a certain degree of customer concentration to persist.

Certain concentration among our customers affects our overall credit risk in that such customers may be similarly affected by changes in industry-specific economics or other more general economic conditions. The inability of one or more of our significant customers to meet their obligations to us or our inability to further diversify our customer base could have a material adverse effect on our business, results of operations, financial condition or prospects.

***Our licenses may be suspended, amended or terminated prior to their expiration, and we may be unable to obtain or maintain various other permits or authorizations.***

In accordance with Russian law, many of our business operations are subject to regulatory regimes, including licensing, and the receipt of various permits and authorizations, including the operations of our subsidiaries, which are required to secure licenses for subsoil use. Our exploration and production licenses for our Core Fields currently have terms extending through the period between 2034 and 2044. See “*Business—Exploration and Production—Overview*”. To date, we have been able to obtain and extend licenses, permits and authorizations necessary to carry out our current operations, but no assurance can be given that we will be able to do so or maintain the issued licenses, permits and authorizations in the future.

The licensing regime in Russia for the geological study, exploration and production of natural gas, gas condensate and crude oil is governed primarily by Law No. 2395-1 “On Subsoil” dated 21 February 1992, as amended (the “**Subsoil Law**”) and related regulations. See “*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK*”. Under the current licensing regime, the Federal Agency for Subsoil Use (“**Rosnedra**”) and the Federal Service for Supervision in the Sphere of the Use of Natural Resources (“**Rosprirodnadzor**”), both operating under the jurisdiction of the Ministry of Natural Resources and Environment of the Russian Federation (“**MNR**”), are responsible, respectively, for issuing licenses for subsoil use and monitoring compliance with the terms of such licenses. The Subsoil Law provides that licenses may be suspended, revoked or terminated, as possible sanctions, if the licensee fails to comply with the license requirements, timely pay levies and taxes for subsoil use, provide geological information to state authorities, carry out the minimum geological study and exploration works, reach certain production levels, or becomes bankrupt or fails to fulfill any capital expenditure and/or hydrocarbon production requirements within a specified period or meet other requirements.

We may not be able to remain in compliance with some or all of these or other requirements. If we fail to fulfill the specific terms of any of our licenses or government-approved development plans, or if we operate in our license areas in a manner that violates Russian law, state authorities may impose fines on us or suspend, revoke or terminate our licenses. In addition, as we were not the initial owners of all of our subsidiaries and Joint Ventures and did not exercise control over them when they originally obtained licenses for subsoil use, we cannot say with certainty that all the initial or current licenses of such subsidiaries and Joint Ventures were issued or, if relevant, re-issued in accordance with applicable law or that the terms of such licenses have been always complied with.

To conduct our business and develop our fields, we need to obtain permits to use and develop land or other real property and certain ancillary permits such as land allotments, approvals of projects and feasibility studies, pilot projects and plans for the development of deposits from federal, regional and local authorities. Procedures for obtaining such permits and authorizations may be cumbersome, which makes it difficult for us to obtain or renew all the required approvals in a timely manner, without significant expense, or at all.



Compliance with the requirements imposed by regulatory authorities may be costly and time consuming and may result in delays in the commencement or continuation of exploration or production operations. No assurance can be given that we will at all times be in full compliance with all government regulations, including administrative real estate regulations. If any of our existing or prospective operational or construction sites are found not to be in compliance with all applicable regulations, we may be subject to fines or our rights to such properties may be affected.

Any failure to comply with existing license or permit terms or sanctions imposed as a result of such failure, including the potential suspension or loss of any licenses or permits, or any difficulties we may face in obtaining required permits and authorizations may have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes. See “—*Some of our reserves have been booked and reported in this Prospectus on the basis that the respective licenses will be extended, although the licensing regime does not provide an absolute legal right to such an extension*”.

***Our business and prospects could be materially adversely affected by laws regarding foreign control and ownership of entities holding licenses for mineral deposits of federal significance.***

Under legislation that came into force in May 2008 – Federal Law No. 57-FZ “On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for National Defense and State Security” (as amended, “**SIL**”) and related legal acts, including amendments to the Subsoil Law – the Government monitors foreign control and ownership over strategic sectors of the Russian economy, including “**deposits of federal significance**” such as gas fields with 50 bcm or more of gas reserves. A company holding a license in respect of such a gas field is a “**strategic company**”. Under SIL, if a transaction would result in (i) a foreign person (together with its related group of persons) holding over 25% of the voting shares of (or otherwise having certain governance rights over) a strategic company or (ii) a foreign person otherwise having control over a strategic company – for example, by owning over 50% of the voting shares of the parent of the strategic company – then such transaction must be approved by a special Government commission overseeing foreign investment into strategic sectors, chaired by the Prime Minister (the “**SIL Commission**”). See “*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK*”.

Several of our subsidiaries and Joint Ventures are strategic companies holding licenses for deposits of federal significance, including OOO NOVATEK-Yurkharovneftegas (“**NOVATEK-Yurkharovneftegas**”), OOO NOVATEK-Tarkosaleneftegas (“**NOVATEK-Tarkosaleneftegas**”), Sibneftegas, Yamal LNG and OAO Arcticgas (“**Arcticgas**”) (a 100% subsidiary of SeverEnerga). In the future, we (or our Joint Ventures) may discover or acquire further deposits of federal significance.

In 2009, one of our subsidiaries sought to acquire 100% of OAO Tambeyneftegas (“**Tambeyneftegas**”), which held a license to the Malo-Yamalskiy field, a deposit of federal significance. Our subsidiary applied for consent of the Russian Federal Antimonopoly Service (“**FAS**”) under the Competition Law. FAS initially took the position that because more than 50% of our voting shares are held by various foreign legal persons (although no single foreign person and its group holds more than 50%), such acquisition was subject to approval by the SIL Commission. See “*Shareholders*”. FAS also argued that indirect control over a strategic company is equal to the equity stake of the indirect shareholder in such strategic company. This dispute was taken to court, and the trial court ruled against us. On appeal, however, FAS itself changed its position and agreed with our reading of the SIL: approval by the SIL Commission would be needed if a single foreign person (and its group) held over 50% of our voting shares, but disparate foreign holdings should not be aggregated, and hence no approval by the SIL Commission was needed in that case. The appellate court in its August 2010 decision confirmed this reading and application of the SIL. Based on our most recent discussions with FAS, FAS at present does not consider NOVATEK or our subsidiaries (or our Joint Ventures) to be under control of a foreign person. Accordingly, no approval by the SIL Commission has been required for our acquisition of a 49% equity stake in Nortgas, which is a strategic company. Nonetheless, the SIL could be amended, or state authorities or courts could interpret the SIL, in a way unfavorable to us.

Separately, the Subsoil Law can be read as providing that the Government may refuse to issue a license in respect of a deposit of federal significance (including an exploration and production license for a field discovered on the basis of a geological study license) if: (i) a foreign person holds any shares in the entity that would hold the license or (ii) such entity is otherwise controlled by a foreign person. In this regard, (i) our deposits of federal significance are all licensed to our wholly-owned subsidiaries; and (ii) as discussed above, NOVATEK is not controlled by a foreign investor. As for our Joint Ventures holding deposits of federal significance, some have multiple shareholders, including minority shareholdings held by Russian companies that are subsidiaries of foreign entities, but we believe this complies with the Subsoil Law and no authorities have asserted otherwise; in the case of Yamal LNG, TOTAL holds its 20% stake using a foreign affiliate, but Yamal LNG has its production license in place, and we do not believe TOTAL’s subsequent investment into Yamal LNG would be grounds to revoke the license.

Any future change in the regime regarding foreign ownership and control in the strategic companies and deposits of federal significance, or any adverse interpretation of the existing rules by the courts or state authorities, could preclude us, our subsidiaries or Joint Ventures from (i) obtaining licenses to develop newly-discovered deposits of federal significance, (ii) acquiring deposits of federal significance, and/or (iii) maintaining our existing licenses for deposits of federal significance, which may have a material adverse effect on our business, financial condition, results of operations or prospects, or on the value of the Notes.

***We could face administrative fines, if FAS were to conclude that we conducted our business in contravention of the Russian competition law.***

FAS included NOVATEK and our 100% subsidiary OOO Novatek-Chelyabinsk (“**Novatek-Chelyabinsk**”) in a list of business entities whose market share exceeds 35% in a particular regional market. FAS estimated the aggregate share of NOVATEK and Novatek-Chelyabinsk to exceed 50% in the market of natural gas supplies to legal entities in the Chelyabinsk region. Due to such market share, NOVATEK and Novatek Chelyabinsk may be deemed to have a dominant position in such regional market. Under Federal Law No. 135-FZ “On the Protection of Competition” of 26 July 2006 (the “**Competition Law**”), a business’s dominant market position does not, in itself, constitute a breach of the Competition Law. At the same time, NOVATEK and Novatek Chelyabinsk are subject to certain regulatory restrictions in carrying out their business in the relevant market intended to protect and develop competitive market conditions.

As a result of the restrictions applicable to entities having a dominant position in a particular market, the pricing flexibility of NOVATEK and Novatek-Chelyabinsk in the natural gas market of the Chelyabinsk region is constrained. In particular, their sale prices must be economically justifiable and consistent with market prices. Court or administrative practice on what constitutes an economically justifiable price is varied, and we cannot give any assurance that our rationale for natural gas pricing in the Chelyabinsk region will be deemed economically justifiable by FAS or a Russian court. Recently, FAS has started investigating customers’ allegations that Novatek-Chelyabinsk abused its dominant position by setting a monopolistically high price. This investigation remains pending as of the date of this Prospectus. Court practice related to challenging FAS decisions, in particular abuses of a dominant market position by setting high prices, is not consistent, but often Russian courts support the position of FAS.

On 6 January 2012, amendments to the Competition Law and related legislation entered into force that changed the methodology of calculating administrative fines for a violation of the antimonopoly legislation. The amendments provide that an abuse of the dominant market position that results in a possible restriction of competition in a particular market is subject to a fine of up to a certain percentage of the revenues of the responsible entity from its sales in such market (this percentage varies depending on the proportion of the revenues from sales in such market to the total revenues from all sales), but not exceeding 2% of the total revenues of the responsible entity. The amendments also provide for certain aggravating and mitigating circumstances which should be taken into account by FAS when determining a fine. Following these amendments, potential consequences of violating the Competition Law have considerably increased.

As we seek greater penetration of local markets as we have in Chelyabinsk and Perm regions, we face the prospect of further FAS inquiries. If FAS were to conclude that our business has been conducted in a prohibited manner in a particular market, it could impose administrative sanctions us and/or our subsidiaries, which could have a material adverse effect on our business, results of operations, financial condition and prospects.

***We may be subject to environmental liabilities, as well as liabilities for breach of health and safety laws.***

Our operations are subject to the risk of liability inherent in the gas and oil industry arising from environmental damage or pollution, and the cost of any associated remedial work in connection thereto. Environmental laws regulate, among other things: the composition and quantity of emissions into the atmosphere, water and soil; the volume, use, storage, and transport of the by-products of production; the restoration of contaminated sites; and the dismantlement and rehabilitation of properties at the end of their useful lives. In connection with our application for exploration and production licenses, we are required to make significant commitments concerning the levels of pollutants that we release. Furthermore, our shipping and other transportation operations are subject to extensive environmental and other regulations.

Russian environmental legislation consists of numerous federal and regional regulations which occasionally conflict with each other and are subject to differing interpretations. In addition, new laws and regulations, the imposition of tougher requirements in licenses, increasingly strict enforcement of existing laws, regulations or licenses or the discovery of previously unknown contamination or pollution may require us to modify, curtail or cease certain activities or require further expenditures. These expenditures may include expenditures to install pollution-control equipment, perform site clean-ups, pay fees and fines and make other payments for discharges or other breaches of environmental standards relating to our operations. Our operations could also expose us to civil claims by third parties for alleged liability resulting from contamination of the environment or personal injuries caused by environmental damage.

We incur and expect to continue to incur substantial capital and operating costs to comply with these increasingly complex laws, regulations and policies. These include costs to reduce certain types of air emissions and discharges to the waterways and to remediate contamination at various owned and previously owned facilities. For instance, the Government has enacted legislation restricting gas flaring and mandating the utilization of 95% of associated gas produced in the course of oil extraction. To achieve and maintain compliance with these requirements at our facilities, we have incurred and are incurring additional expenses. There are additional costs associated with the handling, use, storage, transportation, disposal and clean-up of hazardous materials and non-hazardous wastes and the dismantlement or abandonment of our properties at the end of their useful lives.

Costs of environmental compliance or potential liabilities due to environmental damage may have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

***Two individual shareholders together hold a substantial number of our shares. Their interests may conflict with those of the Noteholders.***

At the date of this Prospectus, approximately 48.3% of our outstanding shares are controlled by two members of the Board of Directors of NOVATEK (the “**Board of Directors**”), one of whom is also the Chairman of the Management Board of NOVATEK (the “**Management Board**”) (the “**Principal Shareholders**”). See “*Shareholders*”. We believe that the involvement of the Principal Shareholders in our operations has been, and will continue to be, beneficial in the pursuit and implementation of our strategy. However, there can be no assurance that the Principal Shareholders will remain significant shareholders in the future. Our business and prospects could suffer if either Principal Shareholder ceases to participate in our business.

Our Charter provides that, if not otherwise required by law, resolutions at a shareholders’ meeting will be adopted by a simple majority in a meeting at which shareholders holding more than half of the issued share capital are present or represented. Accordingly, the Principal Shareholders exercise significant and, in certain cases, decisive influence on the outcome of matters to be decided by a majority vote at a shareholders’ meeting, as well as the election of the majority of the Board of Directors via cumulative voting procedures. In addition, the Principal Shareholders exercise significant influence on matters with a higher threshold for approval, such as a merger proposal, proposed substantial sale of assets or other major corporate transactions.

As a result, apart from their supervisory and managerial roles, the Principal Shareholders have the ability to significantly influence our business through their voting on shareholder matters and power to cause election of the candidates they nominate to our Board of Directors. The interests of our Principal Shareholders may give rise to a conflict of interest between their duties owed to us as members of our governing bodies – and by extension the Noteholders – and their private interests in our shares, for example, by causing them to pursue short-term gains in respect of those private interests.

***As a result of their beneficial ownership of our shares, Gazprom and TOTAL could have certain influence over us and over decisions of our Board of Directors.***

Gazprom became an indirect shareholder of NOVATEK in 2006 when, through its affiliate, it acquired 19.4% of our shares. In 2010, Gazprom decreased its stake to 9.99% of our shares. As a matter of practice, since 2006, two nominees of Gazprom have served on our Board of Directors; given the use of cumulative voting procedures to elect the Board of Directors, Gazprom is likely to have at least one member on our Board of Directors.

In April 2011, an affiliate of TOTAL acquired 12.09% of our shares, with the intention to increase its beneficial holding to 15% of our shares within 12 months and 19.4% of our shares within three years from March 2011. At present, TOTAL indirectly holds 15.16% of our shares, which entitles TOTAL, under cumulative voting, to the election of at least one member of our Board of Directors. Upon reaching a 19.4% stake, TOTAL would likely be in a position to elect two members of our Board of Directors.

Our Board of Directors is responsible for important decisions, including the approval of our business priorities and strategy, acquisition or sales of shareholdings in other enterprises, and approval of the annual budget and business plan. Such decisions require eight out of nine votes. See “*Management*”. In addition, certain “major transactions” under Russian corporate law require the support of all nine directors. Though it has not happened to date, the director(s) nominated by Gazprom or TOTAL may block certain actions of the Board of Directors, which might have a negative impact on the Noteholders and a material adverse effect on our business, financial condition, results of operations or prospects.

***Failure to develop our fields as planned or to explore new fields may prevent us from meeting our production targets and may lead to a decline in our production levels.***

An important element of our growth strategy is to grow our proved resource base through the development of new fields and the construction of new operation facilities. The development and exploration of natural gas and oil fields are subject to many risks. For example, our fields in the development stage and fields that we are exploring are located far from population centers, where challenging environmental conditions prevail and where the cost of drilling, completing and operating wells can be uncertain. There can be no assurance that we will be able to develop

our fields or explore new fields as planned due to the possibility of unforeseeable and unpredictable cost overruns, lower natural gas prices, unexpected drilling conditions, abnormal formation pressure or other irregularities in geological formations, equipment failures or accidents, mechanical difficulties, adverse weather conditions, difficulty complying with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

We intend to continue to explore for further reserves in our license areas and seek to add new reserves to our reserves base. However, we cannot assure you that our exploration programs will be successful. Through our majority interest in Yamal LNG, we acquired a license held by Tambeyneftegas to the South-Tambeyskoye field in YNAO, where we expect to use our experience in developing complex gas condensate reserves to further expand our resource base. See *“Business—Strategic Acquisitions—Yamal LNG”*. Other acquisitions, such as our purchase of Sibneftegas and the purchase of SeverEnergiya by Yamal Development, one of our Joint Ventures, have already significantly increased and are expected to further increase our resource base. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Gas and Liquids Reserves”*. Nevertheless, SeverEnergiya only started production in April 2012, and the production infrastructure on the fields owned by SeverEnergiya is not yet completed.

Our strategic projects are at various stages of development and are subject to risks including cancellation, delay and non-completion. By the time our operational facilities are constructed, technological advances in the production, delivery and use of alternative fuels that are, or are perceived to be, cleaner, more cost-effective or more readily available than natural gas or LNG may prevent us from achieving our targeted natural gas or LNG sales. In addition, we may experience technical difficulties during exploration, construction, testing and commencement of operations that may not be resolved in a timely or cost-effective manner, or at all. For example, construction of the on-site natural gas liquefaction plant and associated infrastructure, storage and loading facilities at Yamal LNG is a highly complex and capital intensive project. At the current stage of the project, the total capital expenditures for the Yamal LNG project are expected to be on the order of approximately U.S.\$20 billion. However, actual capital expenditures are subject, among other factors, to our making a final investment decision on the project, which we plan to make in the near future (see *“Business—Description of Our Fields—Prospective Fields—South-Tambeyskoye field and the Yamal LNG project”*). There can be no assurance that the financing and other investments necessary to implement the Yamal LNG project, as currently planned, will be available in full, on commercially reasonable terms, or at all. See also *“—We may be unable to finance the significant capital expenditures needed to maintain our current production levels and replace our reserves or other planned capital expenditures and investments and may fail to implement our investment program within budget and on time”*. Other risks associated with the Yamal LNG project include intensified competition from other producers of natural gas, such that we are not able to market the projected volumes of LNG.

These projects also depend on the services of certain contractors and the products of a limited range of suppliers. For example, there is a limited number of suppliers of LNG technology for the construction, operation and maintenance of an LNG production facility, such as the one proposed to be built at Yamal LNG, as well as of the suitable equipment, and we may be unable to obtain alternate suppliers or supplies on commercially reasonable terms, in a timely manner or at all. A reduction or cessation of certain contractors retained to assist on these projects or a shortage in the necessary supplies to complete these projects could also result in delays and could inflate the costs associated with these projects.

Furthermore, we may experience operational difficulties with these projects due to the limited experience of the employees and/or contractors in the management and operation of such large projects. We may also incur cost overruns in connection with completing the projects, which we may not have sufficient financial resources to fund. These projects may not be completed as scheduled, or at all, and we may lose the value of any investments made and may be required to incur further costs and expenses.

Our future production is highly dependent upon our ability to develop our existing reserves base and, in the longer term, finding or acquiring additional reserves. Unless we successfully complete exploration and development projects or acquire properties containing proven reserves, or both, our reserves base will decline and we may not be able to complete our production growth targets, which would adversely affect our business, financial condition, results of operations and prospects.

***We conduct several of our operations through joint ventures which are subject to specific risks.***

We participate in several Joint Ventures, and we may enter into further joint ventures in the future. See *“Overview”* and *“Business—Description of Our Fields—Prospective Fields—Geofizicheskoye and Salmanovskoye (Utrenneye) fields”*. Joint ventures necessarily involve special risks. Whether or not we hold majority interests or maintain operational control in our Joint Ventures, our co-investors may:

- have inconsistent or opposing economic or business interests or goals to our strategic approach;
- exercise veto rights so as to block actions that we believe are in our or the joint venture’s best interests;

- take action contrary to our policies or objectives with respect to our investments; or
- as a result of financial or other difficulties, be unable or unwilling to fulfill their obligations under the joint venture or other agreements, such as contributing capital to development, expansion, production or maintenance projects.

We exercise limited control over our Joint Ventures. For example, our effective interest in SeverEnergi is 25.5%, held through a relatively complex structure, which does not provide us with control over the operations or assets of SeverEnergi. We do not exercise control over Sibneftegas either: although we hold a 51% stake in Sibneftegas, which allows us to nominate the chief executive officer and four out of seven members of its board of directors, the charter of Sibneftegas stipulates that resolutions of certain major matters can only be passed with the support of six votes out of seven. Another example is Yamal LNG where we currently hold an 80% interest and TOTAL a 20% interest, but we do not fully control ourselves key strategic, operational and financial decisions.

As we do not fully control the operations and assets of Yamal Development, SeverEnergi, Sibneftegas, Terneftegas or Yamal LNG, we do not consolidate the results of operations and financial condition of these companies in the Financial Statements. Instead, we treat these entities as joint ventures accounted for under the equity method under IFRS.

There can be no assurance that there will be no changes in the ownership or management structure of our existing or future joint ventures. Any such change or failure to conduct business of the joint venture as planned could have a material adverse effect on us or our investments in our existing or future joint ventures. Moreover, improper management or ineffective policies, procedures or controls of the joint ventures over which we do not have operational management could adversely affect the ventures' operations and, by association, may damage our reputation and thereby harm our other operations and access to new assets. If the joint ventures, in which we currently participate or will participate in the future, substantially deviate from our projections and the agreed business plans, our financial standing, results of operations and prospects, as well as the value of the Notes, may be materially adversely affected.

***Our acquisitions of businesses are subject to acquisition-related risks.***

Our acquisitions, such as Nortgas, as well as any future acquisitions present numerous risks. For example, the integration of acquired businesses requires significant time and effort of our senior management. Integration of new businesses can be difficult, as our culture may differ from the cultures of the businesses we acquire or of our partners in such businesses, unpopular cost-cutting measures may be required and control over cash flows and expenditures may be difficult to establish. Other risks associated with acquisitions include:

- inability to retain key personnel of the acquired business;
- inability to achieve the financial and strategic goals of the acquired business;
- inability to take advantage of potential tax benefits;
- potential failure of the due diligence processes to identify significant problems, liabilities or other shortcomings or challenges of an acquired business; and
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition.

A failure to successfully integrate newly acquired businesses, retain their staff and/or achieve the anticipated synergies could have a material adverse effect on our financial condition, results of operations, prospects and strategy.

***We may be unable to finance the significant capital expenditures needed to grow our current production levels and replace our reserves or other planned capital expenditures and investments and may fail to implement our investment program within budget and on time.***

Our business requires significant capital expenditures, including in the areas of exploration and development, production, transportation and refining, and to meet our obligations under environmental laws and regulations. In the nine months ended 30 September 2012 and in 2011, we recorded capital expenditures, representing additions to property, plant and equipment (excluding acquisitions of mineral licenses), of RUB31,269 million and RUB31,143 million, respectively. See “*Selected Consolidated Financial and Other Data—Certain Financial Items and Ratios*”. Our expansion plans, in particular our participation in the Yamal LNG project and joint ventures such as SeverEnergi and Sibneftegas, will require us to make substantial investments in the short and medium term. See “*Business—Exploration and Development Capital Expenditures*” and “*Business—Description of Our Fields—Prospective Fields—South-Tambeyskoye field and the Yamal LNG project*”.

We rely on cash flows from our operating activities or on external sources of funding, including bank borrowings and offerings of debt securities in the international and domestic capital markets, to finance our capital expenditures. Our ability to obtain debt or equity financing in amounts sufficient to meet our financial needs or to

attract co-investors could be materially adversely affected by many factors beyond our control, including but not limited to the state of the global economy, economic conditions in Russia and the health of the Russian banking sector. Since 2009, despite some recovery, the global banking and capital markets have experienced significant disruptions characterized by severe reductions in liquidity, greater volatility and the general widening of credit spreads. As a result, many lenders reduced or ceased providing funding to borrowers, particularly in emerging markets, and there was a general increase in the cost of borrowing for private-sector borrowers. A reoccurrence of the disruption witnessed during the financial crisis could impact our access to funding and the cost at which we borrow and could have a material adverse effect on our ability to grow our operations. See “—*Global economic developments and Russian market conditions may adversely affect our business, financial condition and results of operations*”.

Additional borrowings to fund capital expenditures would likely increase our debt service obligations. See “—*Substantial leverage and debt service obligations may adversely affect us*”. In addition, even if we obtain the required financing, we may be unable to implement our investment program within the allocated budget or on time, which would adversely affect our operations, competitiveness and prospects. See “—*Failure to develop our fields as planned or to explore new fields may prevent us from meeting our production targets and may lead to a decline in our production levels.*”

***Substantial leverage and debt service obligations may adversely affect us.***

We have a substantial amount of outstanding indebtedness, in particular, due to financing major acquisitions in the recent years with debt. Recently, we have raised the Bridge Facility to finance the acquisition of a 49% equity interest in Nortgas. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Bridge Facility*”. The development of our Yamal LNG project, if pursued, will entail significant investments and debt financing (see “*Business—Description of Our Fields—Prospective Fields—South-Tambeyskoye field and the Yamal LNG project*”). We also obtain working capital lines of credit as part of our ordinary course of business, long-term debt and vendor financing, and have capital lease arrangements.

Our substantial indebtedness could have significant negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing or to refinance existing indebtedness;
- requiring the dedication of a substantial portion of our cash flow from operations to service our indebtedness, thereby reducing the amount of our cash flow available for other purposes, including capital expenditures;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete;
- placing us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have greater access to capital resources; and
- a downgrade in our credit rating that increases our cost of debt.

In addition, we are subject to various restrictive covenants under our facility agreements, which may affect our flexibility to operate and dispose of our assets, and our ability to comply with these covenants may be affected by events beyond our control.

There can be no assurance that we will be able to generate and raise sufficient funds to meet debt obligations in the future, including our obligations under the Loan Agreement. If we are unable to generate sufficient cash flow or obtain funds necessary to pay the principal, interest and other amounts due under our indebtedness, or we otherwise breach the covenants under our financing facilities, we would be in default under the terms of our indebtedness, which would permit the holders of such indebtedness to accelerate the maturity of such indebtedness and could cause cross-defaults under our other financing instruments, including the Loan Agreement. Such defaults could delay or preclude payments of interest or principal under our existing indebtedness, including under the Loan Agreement.

***The natural gas and liquids reserves data in this Prospectus are only estimates, and our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates.***

DeGolyer and MacNaughton (“**D&M**”) carried out independent appraisals of the reserves attributable to all our consolidated subsidiaries, as well as of our proportionate share of the reserves of our Joint Ventures based on our equity ownership interest in the respective fields (the “**Group and JV Reserves**”, and the reserves of the Joint Ventures only – the “**JV Reserves**”), rather than recognizing 100% of the reserves attributable to all consolidated subsidiaries, as at 31 December 2011, under SEC and Petroleum Resource Management System (“**PRMS**”) standards. See “*Classification of Reserves*” and “*Presentation of Financial and Other Information*”. We provide D&M with engineering, geological and geophysical data, actual production histories and other information

necessary for the reserves determination, on an annual basis. D&M's and our technical staffs meet to review and discuss the information provided, and upon completion of this process, our senior management reviews and approves the final reserves estimates issued by D&M. A summary of the 2011 Reserves Reports (as defined below, see "*Presentation of Financial and Other Information—Natural Gas and Liquids Reserves Data*") is included as Appendix A to this Prospectus. See "*Appendix A – Summary Reserves Reports*".

We have not commissioned any independent appraisals of the reserves estimates of Nortgas prior to its acquisition. The information in this Prospectus regarding the business and operations of Nortgas (including its reserves data) is based either on the information provided to us by Nortgas in connection with our recent acquisition of a 49% equity stake in Nortgas or on publicly available information. Although we do not have any information that would indicate that such information is inaccurate or incomplete, we cannot assure you of the accuracy or completeness of such information.

There are numerous uncertainties inherent in estimating quantities of proved and probable reserves and in projecting future rates of production and the timing of development expenditures, including many factors beyond our control. The natural gas reserves and liquids reserves data included in this Prospectus represent only estimates and should not be construed as exact quantities. Petroleum engineering is a subjective process of estimating underground accumulations of gas and oil that cannot be measured in an exact manner, and estimates of different engineers often vary significantly. Estimates of the value and quantity of economically recoverable reserves, rates of production, future net revenues and the timing of development expenditures are based on existing economic and operating conditions using prices and costs as at the date when the estimate is made. In addition, estimates necessarily depend upon a number of variable factors and assumptions, including the following:

- historical production from the area compared with production from other comparable producing areas;
- interpretation of geological and geophysical data; and
- the assumed effects of regulations by state authorities.

Because all reserves estimates are subjective, each of the following items may prove to differ materially from those assumed in estimating reserves:

- the quantities of gas and oil that are ultimately recovered;
- the production and operating costs incurred;
- the amount and timing of future development expenditures; and
- gas and oil prices.

Results of drilling, testing and production subsequent to the date of an estimate generally result in revisions to that estimate. Accordingly, reserves estimates may be materially different from the quantities of natural gas, gas condensate and crude oil that are ultimately recovered and, if recovered, the revenue therefrom could be less, and the costs related thereto could be more, than estimated amounts. The significance of such estimates is highly dependent upon the accuracy of the assumptions on which they were based, the quality of the information available and the ability to verify such information against industry standards. The reserves evaluations carried out were based on production data, prices, costs, ownership, geological and engineering data, and other information supplied by us.

In addition, the reserves estimates assume, among other things, that the future development of all of our gas and oil fields and the future marketability of our natural gas, gas condensate and oil will be similar to past development and marketability. These economic assumptions may prove to be incorrect. In particular, the Russian economy is more volatile and subject to more significant and sudden changes than more developed economies, and thus economic assumptions in Russia are subject to a significant degree of uncertainty. Potential investors should not place undue reliance on the forward-looking statements in respect of the reserves estimates or on comparisons of similar reserves data of peer international and domestic companies.

Furthermore, estimates under SEC and PRMS methodologies differ from one another in certain material respects. See "*Classification of Reserves*".

***Some of our reserves have been booked and reported in this Prospectus on the basis that the respective licenses will be extended, although the licensing regime does not provide an absolute legal right to such an extension.***

Some of our exploration and production licenses expire before the end of what we currently estimate to be the productive life of the licensed field. We have booked reserves, and reported them and other operational figures for our expected future production in this Prospectus, on the assumption that these licenses will be extended to the extent necessary to recover all current proved reserves, although the licensing regime does not provide an absolute legal right to such an extension. As at the date of this Prospectus, we have always been successful in receiving our license extensions; however there can be no assurance that such extensions will be granted in the future. A failure to receive such extensions would have a material adverse effect on our reserves, business, results of operations or prospects.

***Some of our reserves information is presented using the Russian reserves system, which differs significantly from SEC and PRMS reserves methodologies.***

Some of the information relating to natural gas and liquids reserves contained in this Prospectus has been prepared on the basis of the Russian reserves system which differs significantly from SEC and PRMS reserves methodologies, particularly with respect to which and the extent to which commercial factors are taken into account in calculating reserves. Reserves that are calculated by different methods are not comparable. See “*Classification of Reserves—Russian Reserves System*”.

***Our business operations could be disrupted if our existing and new management information systems fail to perform adequately.***

We depend upon our management information systems to conduct our operations. We are also in the process of introducing new solutions to support our exploration and development activities and standardizing and rationalizing the accounting systems used at our subsidiaries. Implementation of major new systems and enhancements to existing systems could cause disruptions in our operations. If the implementation of our new management information systems is delayed or the systems fail to perform as anticipated, we could experience difficulties in conducting our operations or generating necessary financial and accounting information. Although we believe that we have alternative information technology and personnel capabilities to meet our obligations, there can be no assurance that such alternative information technology and personnel capabilities will prove to be sufficient or adequate. Any of these or other systems-related problems could, in turn, adversely affect our financial condition and results of operations.

***There are numerous operating risks inherent in the gas and oil industry, and insurance may not be adequate, affordable or available to protect us against all these risks.***

There are numerous operating risks inherent in the gas and oil industry. Our drilling and production operations are subject to all the risks and hazards normally associated with the drilling and production of gas and gas condensate, such as fires, explosions, blowouts, cratering and leaks, each of which could result in substantial damage to natural gas and oil wells, producing facilities, other property, including that owned by third parties, and the environment or in personal injury.

Furthermore, our exploration, production and transportation operations may be adversely affected by many factors, including breakdowns or failure of equipment or processes, performance below expected levels of output or efficiency, labor disputes, natural disasters or weather conditions due, in part, to the location of our core producing fields in the far northern YNAO region, terrorist attacks or sabotage to the transportation systems.

In October 2010, an explosion at the compressor booster station at our Khancheykskoye field destroyed an operations building and resulted in a number of injuries and one fatality. Following this accident, a commission comprising representatives of Rostekhnadzor was formed in accordance with Russian legislative requirements to conduct an investigation. The commission determined that faulty manufacturing of certain materials used at the station caused the accident. No court claims or prosecutions followed, but we paid certain compensation to the injured in accordance with the Labor Code of Russia and the collective labor agreement of NOVATEK-Tarkosaleneftegas.

The insurance industry in Russia is not as advanced in certain respects as in more developed economies, and many forms of insurance protection are unavailable or unavailable on commercially reasonable terms, including coverage for business interruption. We maintain insurance against some, but not all, potential risks and losses affecting our operations and we do not have full coverage for all of our facilities. We had insurance coverage for the accident that happened in October 2010 at our Khancheykskoye field, but there can be no assurance that we will have insurance coverage should similar accidents occur in the future. In addition, we do not have any coverage for business interruption, nor do we carry third-party liability insurance in respect of property or environmental damage arising from accidents on our property or relating to our operations in excess of the mandatory third-party liability insurance required under Russian law. To the extent that our losses and liabilities from any of the risks we face are not adequately covered by insurance, we may incur significant costs that could have a material adverse effect on our operations, financial condition, results of operations or prospects or on the value of the Notes.

***All our stable gas condensate and LPG are processed at the Purovsky Plant, which may suffer damage, equipment failure or interruptions.***

Our sales of stable gas condensate and LPG accounted in aggregate for 30.9% of our revenues in the nine months ended 30 September 2012 and 35.3% of our revenues in 2011. All our unstable gas condensate is processed into stable gas condensate and LPG at the Purovsky Plant. Any damage, equipment failure or interruptions at the Purovsky Plant or the associated infrastructure at our fields and transportation facilities may result in a shutdown of the Purovsky Plant or a reduction of stable gas condensate or LPG processing. Consequently, we may experience a significant loss of revenues and may require large capital expenditures to repair or replace the Purovsky Plant facilities, which could have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.



***We depend on our senior management and other key personnel and face the risk of a shortage of qualified personnel.***

Our growth and future success depends to a significant extent upon the continued contributions of a number of our senior management, particularly Mr. Mikhelson, who is the Chairman of our Management Board, member of the Board of Directors and one of our key founders, as well as on our ability to attract employees with relevant expertise. There is a growing global shortage of workers in the gas and oil industry which has caused foreign companies to look to the Russian labor market for employees. A shortage in the supply of laborers in Russia, particularly given the remote locations of our core operations, could cause a shortage of workers or an increase in salaries, either of which could result in an increase in our labor costs. The loss of some or all of our key management or our inability to attract and retain qualified employees in a cost-effective manner may have a material adverse effect on our business, results of operations, financial condition or prospects.

***We face foreign exchange and inflation risks that could have a material adverse effect on our business, financial condition, results of operations and prospects.***

Over the past ten years, the U.S. Dollar/Rouble exchange rate has been volatile. Although the Rouble steadily appreciated during certain periods in the first half of 2011 and the first months of 2012, it experienced material depreciation in the recent past. For example, the Rouble depreciated against the U.S. Dollar by almost 40% and against the Euro by nearly 30% from October 2008 to February 2009, due in part to significant declines in the prices of oil and commodities, which are the principal generators of Russia's export earnings. The Central Bank of Russia (the "CBR") has used significant amounts of the Russian foreign currency and gold reserves to support the Rouble, but has expressed that it may be unwilling or unable to continue such support in the future.

We are exposed to market risk from changes in foreign currency exchange rates, primarily related to the Rouble/U.S. Dollar exchange rate. Depreciation of the Rouble against the U.S. Dollar will increase the amount of our U.S. Dollar-denominated debt in Rouble terms, leading to foreign exchange losses as the book value of our U.S. Dollar-denominated debt increases when translated into Roubles, which would be partially offset by our U.S. Dollar revenues. As of 30 September 2012, RUB49,852 million, or 58.9%, of our total debt was denominated in U.S. Dollars. See Note 20 to our Unaudited Financial Statements (as defined below).

In addition, the relatively high rate of inflation in Russia reduces the value of our Rouble-denominated cash assets, including Rouble deposits, domestic debt instruments and accounts receivable. According to the CBR, inflation in Russia in the nine months ended 30 September 2012, as well as in 2011, 2010 and 2009 was 6.0%, 6.1%, 8.8% and 8.8%, respectively. According to the CBR, the nominal depreciation of the Rouble against the U.S. Dollar in the nine months ended 30 September 2012, as well as in 2011, 2010 and 2009 was 1.7%, 6.1%, 0.8% and 2.9%, respectively, while in real terms the Rouble rose by 0.9%, 0.4%, 7.9% and 5.6% against the U.S. Dollar in those same periods, respectively.

The Rouble also remains largely non-convertible outside of the Russian Federation. A market exists within the Russian Federation for the conversion of Roubles into other currencies, but it is limited in size and is subject to rules limiting or prohibiting such conversion. From 1 August 2008 to 1 April 2012, Russia's foreign currency and gold reserves decreased from U.S.\$596.6 billion to U.S.\$513.5 billion, and as of 1 November 2012 are U.S.\$526.8 billion. Although Russia's currency foreign currency and gold reserves may be sufficient to sustain the domestic currency market in the short term, there can be no assurance that the currency market will not further deteriorate in the medium or long term due to the lack of foreign currency funding available in the global markets. The Government and the CBR may impose burdensome requirements governing currency operations, as they have done in the past. If these restrictions were re-introduced, they could prevent or delay any operations outside Russia that we may want to pursue. Additionally, any delay or other difficulty in converting Roubles into a foreign currency to make a payment or any practical difficulty in the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the acceleration of debt obligations and cross-defaults. There are also only a limited number of available Rouble-denominated instruments in which we may invest our excess cash.

***Arcticgas, a subsidiary of SeverEnergiya, is potentially exposed to liability under previously issued promissory notes, the repayment of which could adversely affect our financial condition and results of operations.***

In April 2007, SeverEnergiya acquired, through an auction sale of the assets of the former Russian oil company OAO Yukos ("Yukos"), a 100% interest in each of Arcticgas, ZAO Urengoil Inc. ("Urengoil") and OAO "Neftegaztehnologia" ("Neftegaztehnologia"), which were fully-owned subsidiaries of Yukos. In 2012, Urengoil and Neftegaztehnologia were merged into Arcticgas and no longer exist. During 2003 and 2004, Arcticgas, Urengoil and Neftegaztehnologia issued promissory notes to certain Russian entities, including other Yukos subsidiaries, in the total aggregate principal amount of approximately RUB7.3 billion with maturity dates in 2004 to 2005. Some of these promissory notes were subsequently transferred to other companies, including Glendale Group Limited ("Glendale"), a BVI corporation which is reported in the press to be controlled by the former management of Yukos.

In late 2008, after the relevant promissory notes had reached maturity but before the expiration of the applicable three-year limitation period for bringing a claim in Russia, Glendale instituted separate claims in the Arbitration Court of YNAO against Arcticgas and Urengoil in respect of the promissory notes acquired by Glendale. Glendale is seeking to collect principal debt and interest under those promissory notes in the total aggregate amount of approximately RUB5.25 billion. Glendale is claiming that, although it failed to present the promissory notes for payment prior to the respective maturity dates, the debt under the promissory notes is nonetheless recoverable through court action. As of the date of this Prospectus, these claims remain undecided.

The remaining promissory notes of Arcticgas, as well as promissory notes issued by the liquidated companies Urengoil and Neftegaztehnologia, in the total aggregate principal amount and interest of approximately RUB4.7 billion were not timely presented for payment, and the statute of limitations periods with respect to such promissory notes expired between 2008 and 2009. Despite the expiration of the statute of limitations periods, we believe there is still a risk that the holders of such other promissory notes may try to toll the application of the statute of limitations through court proceedings, which could, if adversely determined, expose Arcticgas (as the successor company) to additional liability with respect to such promissory notes. Our potential liabilities in respect of Glendale's existing claims or any possible future claims against Arcticgas, however, are effectively limited to the 25.5% economic interest we hold in SeverEnergiya.

The current proceedings by Glendale, or any potential future proceedings instituted by holders of the relevant promissory notes, if adversely determined, could result in Arcticgas being ordered to make substantial payments on their promissory notes in question, which could, in turn, adversely affect our financial condition and results of operations.

***One or more of our subsidiaries or Joint Ventures may be forced into liquidation or their indebtedness accelerated due to technical non-compliance with certain requirements of Russian corporate law.***

Under Russian law and practice, if, calculated on the basis of the Russian accounting standards (“**RAS**”), a company has negative net assets as at the end of the second or any subsequent financial year of the company, state authorities may take court action to liquidate the company, if its shareholders themselves fail to take a decision to liquidate the company within six months after the financial year. If a company's net assets exceed the minimum statutory charter capital, but are less than the company's charter capital (“**insufficient net assets**”) as of the end of certain financial years and the company does not timely resolve to decrease its charter capital to match the net assets, state authorities could force it into liquidation, too. In addition, with respect to Russian companies incorporated as joint-stock companies, if the company fails to take a decision on its voluntarily liquidation or decrease of its charter capital, as described above, within the period set by law, its creditors have the right to accelerate the company's obligations. There have been Russian court cases in which non-compliance with the statutory requirements regarding net assets have resulted in liquidation of a legal entity. In practice, many Russian companies from time to time have negative or insufficient net assets, for example, due to low historical asset values reflected on their RAS balance sheets or due to substantial capital expenditures combined with a lack of cash-flow generating operations. However, negative or insufficient net assets do not necessarily mean that this company is unable to pay debts and taxes as they come due.

Some of our subsidiaries and Joint Ventures, including Yamal LNG and Arcticgas, a 100% subsidiary of SeverEnergiya, historically had negative and/or insufficient net assets, and the measures to rectify the situation were taken. In particular, the RAS net assets of Yamal LNG and Arcticgas were negative in 2009, but became compliant with the statutory requirements (i.e., exceeded their respective charter capitals) in 2010 and so remain to date. The RAS net assets of OOO NOVATEK-Ust-Luga (“**NOVATEK-Ust-Luga**”) were negative as of the end of 2009 and 2010, and insufficient in 2011, but have increased in 2012 and currently exceed its charter capital. Although in the past some of our subsidiaries and Joint Ventures failed to meet applicable net assets tests, we believe that such subsidiaries and Joint Ventures should not currently be subject to liquidation on such grounds and that none of the violations were of a material nature. However, weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions of a Russian court or a state authority difficult, if not impossible, to predict. If involuntary liquidation were to occur, we or our respective Joint Ventures may be forced to reorganize the operations currently conducted through the affected entity. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations or prospects.

### **Risks Relating to Russia**

We are a Russian company, and most of our fixed assets are located in, and a significant portion of our revenues is derived from, Russia. There are certain risks associated with an investment in Russian businesses.

### **Political, Economic and Social Risks**

***Emerging markets such as Russia are subject to greater risks than more developed markets.***

Investors in emerging markets such as Russia should be aware that these markets are subject to greater risks than more developed markets, including in some cases significant legal, economic, political and social risks. Moreover, financial turmoil in any emerging market country tends to adversely affect the condition of all emerging

market countries, as investors move their money to more stable developed markets. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. During such times, companies that operate in emerging markets can face severe liquidity constraints as foreign funding sources are withdrawn. Thus, even if the Russian economy remains relatively stable, financial turmoil in any emerging market country could have an adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

Investors should also note that emerging economies such as the economy of the Russian Federation are subject to rapid change, and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment in the Notes is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who are familiar with and fully appreciate the significance of the risks involved in investing in such markets, and prospective investors are urged to consult with their own legal and financial advisers before making an investment in the Notes.

***Political and governmental instability could have a material adverse effect on the value of investments in Russia, including the Notes, as well as our business, financial condition, results of operations or prospects.***

Although the political situation in Russia has stabilized since the 1990s, any future political instability could result in a worsening overall economic situation, including capital flight and a slowdown of investment and business activity. Future changes in the Government, the State Duma or the presidency, the reform of authorities regulating the gas and oil industry, major policy or regulatory shifts or a lack of consensus between the president, the Government, Russia's parliament and powerful economic and social groups could lead to political instability and disrupt or reverse political, economic or regulatory reforms, which could have a material adverse effect on the value of investments relating to Russia and the Notes in particular, as well as on our business, ability to obtain financing, financial condition or prospects.

***Domestic and international political conflicts could create an uncertain operating environment hindering our long-term planning ability and could have a material adverse effect on the value of investments in Russia, including the value of the Notes.***

The Russian Federation is a federation of sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts, some of which have the right to manage their internal affairs pursuant to agreements with the federal government and in accordance with applicable laws. The delineation of authority and jurisdiction among the constituent units of the Russian Federation and the federal government remains, in many instances, uncertain and contested. In practice, the uncertainty concerning the division of authority could hinder our long-term planning efforts and may lead to uncertainties in our operating environment, which may prevent us from effectively and efficiently carrying out our business strategy. As we expand our operations internationally, including projects to develop natural gas reserves outside of Russia, such projects and our financial condition and prospects may be adversely affected by local political tensions and conflicts.

In addition, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflicts. In the future, such divisions, military conflict or terrorist activities could have significant political and economic consequences.

Russia has been involved in military and political conflicts and tensions. For example, a military conflict in August 2008 between Russia and Georgia involving South Ossetia and Abkhazia resulted in a significant overall price decline for listed Russian securities. The emergence or escalation of any tensions or hostilities in Russia, including terrorist attacks, or with foreign countries could negatively affect the Russian economy. These uncertainties, tensions and conflicts may lead to reduced liquidity, deterioration in the investment climate, trading volatility, and significant reduction in the prices of listed Russian securities, with a resulting negative effect on the liquidity, ability for Russian companies to raise financing on commercially acceptable terms and trading price of the Notes and our business, financial condition, results of operations or prospects.

***Economic or social instability could have a material adverse effect on our business.***

Over the last two decades, the Russian economy has experienced at various times:

- significant declines in its GDP;
- high levels of inflation;
- an unstable local currency;
- a relatively unstable banking system providing limited liquidity to Russian enterprises;
- the continued operation of loss-making enterprises due to the lack of effective bankruptcy proceedings;
- the use of fraudulent bankruptcy actions in order to take unlawful possession of property;

- widespread tax evasion;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime in the economy;
- increases in, or high, interest rates and unstable credit conditions;
- a weakly diversified economy, which depends significantly on global prices for raw materials;
- significant increases in unemployment and underemployment;
- low personal income levels of a significant part of the Russian population; and
- a major deterioration of the physical infrastructure.

The recent global financial turmoil has also adversely affected the Russian economy. In the past few years, the Russian economy has been characterized by volatility in the debt and equity markets, which experienced significant declines in the second half of 2008 and the second half of 2011, continuing in 2012. In 2008, the high degree of volatility caused market regulators to temporarily suspend trading multiple times on the principal Russian securities exchanges, the Moscow Interbank Currency Exchange and Russian Trading System (which have since combined their operations as OJSC “Moscow Exchange MICEX-RTS” (“**Moscow Exchange**”)). The Russian economy has also been characterized by significant reductions in foreign investment and sharp decreases in GDP. For example, in 2009, Russian GDP declined 7.9%.

As Russia produces and exports large quantities of crude oil, natural gas and other commodities, the Russian economy is also particularly vulnerable to fluctuations in the prices of crude oil, natural gas and other commodities on the world markets. Russian banks, and the Russian economy generally, have also been adversely affected by the global financial crisis, from which the Russian economy has not fully recovered. There can be no assurance that any measures adopted by the Government since 2008 to mitigate the effect of the financial and economic crisis will result in a sustainable recovery of the Russian economy. Current macroeconomic challenges, low or negative economic growth in the United States, Japan and Europe and market volatility may prolong the economic crisis. In recent months, global markets have shown increased volatility due to continued macroeconomic challenges. The Russian economy remains vulnerable to further external shocks. Events occurring in one geographic or financial market sometimes result in an entire region or class of investments being disfavored by international investors – so-called “contagion effects”. Russia has been adversely affected by contagion effects in the past, and it is possible that the market for Russian investment, including the Notes, will be similarly affected in the future by negative economic or financial developments in other countries. There can be no assurance that recent economic volatility, or a future economic crisis, will not negatively affect investors’ confidence in the Russian markets or economy or in the ability of Russian companies to raise capital in the international debt markets, any of which, in turn, could have a material adverse effect on the Russian economy and our results of operations, financial condition or prospects or on the value of the Notes. In addition, any declines in the price of crude oil, natural gas or other commodities could further disrupt the Russian economy and materially adversely affect our business.

The past failures of the Government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living led to labor and social unrest, and this could recur. Any of these consequences could adversely impact our operations and lead to the loss of revenue, materially adversely affecting our business, financial condition, results of operations, prospects or the value of the Notes.

***The Russian banking system is not as strong as the banking systems of certain developed markets, and another banking crisis in Russia could place severe liquidity constraints on our business, materially adversely affecting our business, financial condition, results of operations and prospects.***

Russia’s banking and other financial systems are not as strong as the banking systems in more developed markets, and Russian legislation relating to banks and bank accounts is subject to varying interpretations. Although a number of major Russian banks have an investment-grade credit rating, there are still many Russian banks that do not meet international banking standards, and the transparency of some parts of the Russian banking sector may still not meet internationally accepted norms.

The deficiencies in the Russian banking sector, combined with the reported deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to the current worldwide credit market downturn and economic slowdown. In the autumn of 2008, the credit crisis that began in the U.S. resulted in decreased liquidity in the Russian credit market and weakened the Russian financial system. Starting from the second half of 2008, the majority of Russian banks experienced difficulties with funding on domestic and international markets, and interest rates increased significantly. Some of the banks were unable to service their obligations and were sold to larger banks. Credit ratings of multiple banks have been lowered. An extended or serious banking crisis or the bankruptcy of a number of Russian banks could have a material adverse effect on our business and our ability to complete banking transactions in Russia.

***Russia's physical infrastructure is in fair condition, which could disrupt or impair our normal business activity, and efforts by the Government to improve the country's infrastructure may result in increased costs for us.***

Russia's physical infrastructure largely dates back to the Soviet period and in certain respects has not been adequately maintained and developed due to insufficient funding. In some areas road networks, power generation and transmission systems, communication systems and manufacturing facilities are particularly affected. For example, in August 2009, an accident at the Sayano-Shushenskaya hydroelectric power plant resulted in a full loss of energy supply to the local power grid, which led to widespread power failure in the region and forced all major users such as aluminum smelters to switch to generators. Other parts of the country could face similar problems. Road conditions in many regions of Russia are also poor, with many roads not meeting minimum requirements for usability and safety. Further deterioration of Russia's physical infrastructure could harm the national economy, disrupt the transportation of goods and services, add costs to doing business in Russia and interrupt business operations.

The Government is actively considering plans to strengthen and enhance the nation's rail, electricity and other infrastructure facilities. Any such effort, while supporting and enhancing our commercial operations, would also likely result in increased charges and tariffs and may not result in the anticipated capital investment that is needed to repair, maintain and improve these facilities. In addition, any effort to improve the country's infrastructure may be halted or delayed in the event of a prolonged economic downturn, which would likely lead to a deterioration in Russia's infrastructure network. The occurrence of any these factors could have a material adverse effect on our business, financial condition or results of operations.

***We are required to repatriate our export sales revenues. We may also be required to convert some portion of our export sales into Roubles in the future.***

We are subject to the requirement of mandatory repatriation of our export sales revenues. Currently, the CBR does not require any portion of our proceeds from export sales to be converted into Roubles. In the past, however, we have been required to convert into Roubles a percentage of our proceeds from export sales, and at times this percentage has been as high as 75%. There can be no assurance that the CBR will not require us to convert into Roubles a percentage of our export sales in the future.

#### **Risks Related to the Russian Legal System and Russian Legislation**

***The Russian legal system and Russian legislation is in a developmental stage and this may create an uncertain environment for investment and business activity.***

The Russian legal framework applicable to a market economy is still under development. Since 1991, Soviet law has been largely, but not entirely, replaced by a new legal regime established by the 1993 Constitution of the Russian Federation, the Civil Code, other federal laws and decrees, orders and regulations issued by the Russian President, the Government and state authorities, which are, in turn, complemented by regional and local rules and regulations. These legal norms, at times, overlap with or contradict one another, or have substantial gaps. The recent nature of much Russian legislation and the rapid evolution of the Russian legal system may cast doubt on the enforceability and underlying constitutionality of certain laws and result in ambiguities, inconsistencies and anomalies. Russia is a civil law jurisdiction, and, as a rule, judicial precedents have no binding effect on subsequent decisions. The powers of various state authorities are not always clearly delineated, which may lead to administrative and/or legal conflicts. We can give no assurance that the development or implementation or application of legislation or regulations will not adversely affect foreign investors or private investors generally.

Among the risks of the current Russian legal system are:

- conflicting local, regional and federal rules and regulations;
- the limited availability of judicial and administrative guidance on interpreting Russian legislation;
- substantial gaps in the regulatory structure due to delay or absence of implementing legislation;
- the relative lack of independence of the judiciary;
- limited court personnel, especially in lower courts, with the ability to interpret developing Russian legislation, particularly business and corporate law;
- a high degree of discretion on the part of state authorities, which could result in arbitrary actions, and potentially corruption;
- bankruptcy procedures that are not well developed and potentially subject to abuse; and
- the difficulty in enforcing domestic and foreign court judgments, as well foreign arbitral awards in practice.

As a result of these factors, even the best efforts to comply with Russian law may not always result in full compliance. See “—*Risks Relating to Our Business and Industry—Our licenses may be suspended, amended or terminated prior to their expiration and we may be unable to obtain or maintain various permits or authorizations*”. In addition, all of the above weaknesses could affect our ability to enforce our rights under contracts and licenses or to defend ourselves against claims by others and could affect the ability of investors to have their rights upheld in a Russian court.

***Selective or arbitrary government action could materially adversely affect our business.***

We operate in an uncertain regulatory environment. State authorities in Russia have a high degree of discretion and may at times exercise their discretion arbitrarily, without hearing or prior notice, or in a manner that could be unduly influenced by political or commercial considerations. Selective or arbitrary governmental actions have included unscheduled inspections by regulators, suspension or withdrawal of licenses and permits, unexpected tax audits, criminal prosecutions and civil actions. In addition, state authorities have also tried, in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Furthermore, federal and local authorities have used common defects in matters surrounding the documentation of business activities as pretexts for court claims and other demands to invalidate such activities or to void transactions, sometimes to further interests different from the formal substance of the claims. The occurrence of such selective or arbitrary action against us could have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

***The difficulty of enforcing court decisions and the discretion of state authorities in enforcing claims could prevent us or you, as an investor in the Notes, from obtaining effective redress in court proceedings.***

The independence of the judicial system from economic and political influences in Russia is developing. The court system is reported to be understaffed. Under Russian legislation, judicial precedents generally have no binding effect on subsequent decisions and are not recognized as a source of law. However, in practice, courts usually consider prior judicial decisions, particularly those of high-level courts, in their decisions. Enforcement of court judgments can in practice be very difficult in Russia. Additionally, court claims are sometimes reported to be used in furtherance of political and commercial aims. All of these factors make judicial decisions in Russia difficult to predict and make effective redress uncertain in some instances.

These uncertainties also extend to property rights. During Russia’s transformation from a centrally planned economy to a market economy, legislation was enacted to protect private property against expropriation and nationalization. However, due to a relative lack of experience in enforcing this legislation and potential political changes, we may not be able to obtain proper redress in the courts and may not receive adequate compensation if, in the future, the Government decides to nationalize or expropriate some or all of our assets. The expropriation or nationalization of any of our or our subsidiaries’ assets without fair compensation may have a material adverse effect on our business, financial condition, results of operations or prospects or on the value of the Notes.

Any incidents of the judiciary’s corruption and occasional abuse of discretion could lead to unjustified and abusive court decisions. It is not uncommon for excessive injunctive remedies or damages to be sought by a claimant (which may be a small shareholder of a public company) and granted by courts in commercial disputes. In the past, we have experienced situations in connection with some commercial disputes where courts have granted broad injunctions preventing us and our subsidiaries from accessing transportation facilities or prohibiting FAS from approving transactions based on unsubstantiated claims by parties not related to the transactions. While in the past we have always been successful in having such injunctions lifted and claims dismissed, we cannot assure you that will always be the case.

Russia is not a party to treaties for the mutual enforcement of court judgments with most Western countries. Consequently, if a judgment is obtained from a court in any such jurisdiction, it is highly unlikely to be given direct effect in Russian courts. However, Russia (as a successor to the Soviet Union) is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “**New York Convention**”). A foreign arbitral award obtained in a state which is a party to the New York Convention should be recognized and enforced by a Russian court (subject to the qualifications provided for in the New York Convention and in compliance with Russian civil procedure and other procedures and requirements established by Russian legislation). The Arbitration Procedural Code of the Russian Federation is in conformity with the New York Convention and thus has not introduced any substantial changes relating to the grounds for refusing to recognize and enforce foreign arbitral awards and court judgments. Nonetheless, in practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of Russian courts or other officials, thereby introducing substantial delay, difficulty and uncertainty into the process of enforcing any foreign judgment or any foreign arbitral award in Russia. Such issues could prevent us or investors from obtaining effective redress in court proceedings in Russia. See “*Enforceability of Judgments*”.

***Difficulty in ascertaining the validity and enforceability of title to land or other real property in Russia and its encumbrances may have a material adverse effect on our business, financial condition, results of operations or prospects.***

The legal framework relating to the ownership and use of land and other real property in Russia is not yet sufficiently developed to support private ownership of land and other real property to the same extent as is common in countries with more developed market economies. Because of Russia's vast territory and difficulties of being in a transitional phase, the process of surveying and title registration may last for many years. Thus, it is often difficult to ascertain the validity and enforceability of title to land or other real property in Russia and the extent to which it is encumbered. These uncertainties may have a material adverse effect on our business, financial condition, results of operations or prospects.

***Lack of developed corporate and securities laws and regulations in Russia may limit our ability to attract future investment.***

The regulation and supervision of the securities market, financial intermediaries and issuers are relatively less developed in Russia than in the United States and certain members of the EU. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to us. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance with the domestic securities laws and regulations.

***Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries and associates.***

Russian legislation generally provides that shareholders in a Russian joint stock company or members in a Russian limited liability company are not liable for the obligations of the joint stock company or limited liability company and bear only the risk of loss of their investment. This may not be the case, however, when one person (the "effective parent") is capable of determining decisions made by another entity (the "effective subsidiary") on the basis of an agreement between the two or in accordance with the charter of the subsidiary. Under certain circumstances, the effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary prior to its insolvency in carrying out such decisions. The Civil Code and Federal Law No. 127-FZ "On Insolvency (Bankruptcy)" of October 26, 2002 (as amended) provide for certain other circumstances where a parent company may be deemed secondarily liable for the debts of its insolvent subsidiary. Accordingly, we could be liable in some cases for the debts of our subsidiaries. This liability could have a material adverse effect on our business, results of operations, financial condition or prospects.

***Shareholder rights provisions under Russian law may impose additional costs on us.***

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to require the company to purchase their shares at market value. The decisions that trigger this right include:

- decisions with respect to a reorganization;
- the approval by shareholders of a "major transaction", which, in general terms, is a transaction involving property worth more than 50% of the gross book value of the relevant company's assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of the relevant company's charter in a manner that limits shareholder rights.

NOVATEK's (or, as the case may be, our subsidiaries') obligation to purchase shares in these circumstances, which is limited to 10% of NOVATEK's (or our respective subsidiary's) net assets calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon, could have a material adverse effect on our business, financial condition, results of operations or prospects.

***Our interested party transactions require the approval of disinterested directors or disinterested shareholders.***

Russian law requires a joint stock company that enters into transactions with certain related persons that are referred to as "interested party transactions" to comply with special approval procedures. Under Russian law, an "interested party" of a company includes: (i) members of the board of directors, (ii) the executive body of the company, including the managing organization or hired manager, (iii) a member of a collegial executive body, (iv) a shareholder who, together with its affiliates, owns at least 20% of the company's voting shares or (v) a person who has the right to give mandatory instructions to the company. The above persons are deemed interested in a transaction if they, a close relative or an affiliate of such person, is:

- a party to, representative in, intermediary in or a beneficiary of the transaction;

- the owner, whether individually or collectively, of at least 20% of the shares in a company that is a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction;
- a member of a governing body of a company that is a party to, or a beneficiary of, a transaction with the company, whether directly or as a representative or intermediary, or an officer of the managing organization of such company; or
- in other cases provided for by the company's charter.

Under applicable Russian law, interested party transactions require approval by a majority of the disinterested (or, if the company has more than 1,000 shareholders, also independent) directors or disinterested shareholders of the company. A majority vote of the disinterested shareholders of the company is required if (i) the number of disinterested directors is less than the required quorum for board of directors (supervisory council) meetings (or, if a company with more than 1,000 shareholders, there are no disinterested independent directors), (ii) the value of the transaction (or of a number of interrelated transactions) is equal to or exceeds 2% of the balance sheet value of the company's assets (determined under Russian Accounting Standards according to its latest balance sheet) or (iii) the transaction (or a series of interrelated transactions) involves the issuance or sale by the company of ordinary shares or securities convertible into such shares, in a quantity exceeding 2% of the company's issued ordinary shares. A failure to obtain the appropriate approval for a transaction may result in it being declared invalid upon a claim by the company or its shareholders made within three months from the day when the decision in question was known or should have been known and the reasons for which it may be declared invalid.

### **Risks Relating to the Russian Taxation System**

*The Russian taxation system is not well-developed and is subject to frequent changes, which could have an adverse effect on us.*

The Government is continually reforming the tax system by redrafting parts of the Tax Code of the Russian Federation (the "**Russian Tax Code**"). These changes have resulted in some improvement in the tax climate. As of 1 January 2009, the corporate profits tax rate was reduced to 20%. For individuals who are tax residents in Russia the current personal income tax rate is 13%. The general rate of VAT is 18%. Since 1 January 2010, the Unified Social Tax was replaced by social security charges to the Russian pension, social security and medical insurance funds. The total rate of the respective social security charges equals 30% on the taxable base of up to RUB512,000 of an employees' annual remuneration and 10% on the amount exceeding RUB512,000 for 2012. In addition, new Russian transfer pricing legislation has been in force since 1 January 2012.

The production and export of hydrocarbons are subject to taxes, which may be increased on relatively short notice. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Certain Factors Affecting Our Results of Operations—Our Tax Burden—UPT*". For example, NOVATEK pays the natural resources production tax ("**UPT**", commonly referred to as mineral extraction tax or "**MET**") on our natural gas and gas condensate production. The UPT rate applied to our natural gas production has escalated significantly in recent years: from RUB147 per mcm in 2009 and 2010 to RUB237 per mcm in 2011 to RUB251 in 2012. For independent natural gas producers such as NOVATEK, the UPT is calculated by applying a reducing co-efficient to the base UPT rate. Recently, a law has been adopted that will significantly increase the UPT NOVATEK will pay in 2013, 2014 and 2015 and will generally enter into force on 1 January 2013 (the "**2012 UPT Amendments**"). According to the 2012 UPT Amendments, the UPT base rates per mcm will be increased to RUB622 for the period from 1 July 2013 until 31 December 2013 (under current law, the base tax rate for 2013 is RUB582) using a co-efficient of 0.646 (rather than the 0.455 under current law), RUB700 for 2014 (under current law, the base tax rate for 2014 is RUB622) using a co-efficient of 0.673 (rather than the 0.447 under current law) and RUB788 using a co-efficient of 0.701 for the period starting from 1 January 2015. Under the 2012 UPT Amendments, the UPT rates for the extraction of gas condensate are kept at the level currently set by the Russian Tax Code for the period until 2014, i.e., RUB590 per ton for 2013 and RUB647 per ton for 2014; starting from 1 January 2015, the UPT rate for the extraction of gas condensate will increase to RUB679 per ton.

Russian tax laws, regulations and court practice are subject to frequent change (as evidenced, for example, by the 2012 UPT Amendments and the ongoing discussions about changing the methodology for calculating the UPT for natural gas), as well as to varying interpretations and inconsistent and selective enforcement. In accordance with the Constitution of the Russian Federation, laws that introduce new taxes or worsen a taxpayer's position cannot be applied retroactively. Nonetheless, there have been several instances when such laws have been introduced and applied retroactively.

Despite the Government's taking steps to reduce the overall tax burden in recent years in line with its objectives, there is a possibility that the Russian state authorities could impose additional taxes in the future, which could have a material adverse effect on our business, results of operations, financial condition, and the value of the Notes.



Generally, taxpayers are subject to tax audits for a period of three calendar years immediately preceding the year in which the decision to carry out a tax audit has been taken. In certain circumstances repeat tax audits (i.e., audits with respect to same taxes and the same periods) are possible. Generally, the statute of limitations for the commission of a tax offense is also limited to three years from the date on which it was committed or from the date following the end of the tax period during which the tax offense was committed (depending on the nature of the tax offense). Nevertheless, according to the Russian Tax Code and based on current judicial interpretation, there may be cases where the statute of limitations for a tax offense may be extended beyond three years.

We may incur additional costs following tax audits or inspections, in particular if the relevant tax authorities conclude that we did not satisfy our tax obligations in any given year. Such audits or inspections may also impose additional burdens on us by diverting the attention of management resources. The outcome of these audits or inspections could have a material adverse effect on our business, results of operations, financial condition or the trading price of the Notes.

In October 2006, the Plenum of the Supreme Arbitrazh Court of the Russian Federation issued a ruling concerning judicial practice with respect to unjustified tax benefits. In this context, a tax benefit means a reduction in the amount of a tax liability resulting, in particular, from a reduction of the tax base, the receipt of a tax deduction or tax concession or the application of a lower tax rate, and the receipt of a right to a refund (offset) or reimbursement of tax. The ruling provides that, where the true economic intent of operations is inconsistent with the manner in which they have been taken into account for tax purposes, a tax benefit may be deemed to be unjustified. The same conclusion may apply when an operation lacks a reasonable economic or business rationale. As a result, a tax benefit cannot be regarded as a business objective in its own right. On the other hand, the fact that the same economic result might have been obtained with a lesser tax benefit accruing to the taxpayer does not constitute grounds for declaring a tax benefit to be unjustified. Moreover, there are no rules and little practice for distinguishing between lawful tax optimization and tax avoidance or evasion. The tax authorities have actively sought to apply this concept when challenging tax positions taken by taxpayers in court and are anticipated to expand this trend in the future. Although the intention of this ruling was to combat tax law abuses, in practice there can be no assurance that the tax authorities will not seek to apply this concept in a broader sense than may have been intended by the Supreme Arbitrazh Court.

The above conditions create tax risks in the Russian Federation that are more significant than the tax risks typically found in countries with more developed taxation, legislative and judicial systems. These tax risks impose additional burdens and costs on our operations, including management resources. Furthermore, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to fines, penalties and enforcement measures.

We cannot offer prospective investors any assurance that additional tax exposures will not arise. The above-mentioned tax risks and potential additional tax exposures could have an adverse effect on our business, results of operations, financial condition, and the value of the Notes.

***Consolidation of the certain Group companies for Russian tax purposes under the recently adopted Russian law could be subject to challenge by the Russian tax authorities.***

In accordance with the amendments to the Russian Tax Code introduced in November 2011, in 2012, the Group set up a consolidated group of taxpayers (the “**Consolidated Group of Taxpayers**”). The companies among the Consolidated Group of Taxpayers are considered as a single taxpayer for profits tax purposes. Furthermore, as part of the Consolidated Group of Taxpayers the Group companies may reduce the profits tax base of the current tax period by the amount of tax losses incurred by one of the members of the Consolidated Group of Taxpayers in such tax period. According to the Russian Tax Code, the transactions conducted between Group companies included in the Consolidated Group of Taxpayers should not be considered as controlled transactions for transfer pricing purposes. However, there can be no assurance that the above Russian tax treatment of the Group companies as the Consolidated Group of Taxpayers will not be challenged by the Russian tax authorities throughout the term of the Loan.

***New Russian transfer pricing rules may subject our prices to challenge by the Russian tax authorities.***

Since 1 January 2012, new transfer pricing legislation has been introduced into Russian tax law, resulting in new transfer pricing rules.

In particular, the methods for monitoring the prices of controlled transactions have been expanded and the list of controlled transactions currently includes:

- cross-border transactions with certain types of commodities where the amount of income attributable to one counterparty exceeds RUB60 million (with transitional thresholds of RUB100 million for 2012 and RUB80 million for 2013);

- Russian domestic transactions between related entities if the total annual turnover of such transactions exceeds RUB1 billion (with transitional thresholds of RUB3 billion for 2012 and RUB2 billion for 2013);
- transactions with residents of offshore jurisdictions included in the list established by the Ministry of Finance of the Russian Federation where the amount of income attributable to one counterparty exceeds RUB60 million; and
- transactions between Russian legal entities and related foreign legal entities.

The amended transfer pricing law requires taxpayers to notify the Russian tax authorities as to all controlled transactions. Taxpayers are also required to present to the Russian tax authorities transfer pricing documentation upon their request. The Russian transfer pricing law could have a material adverse effect on our business, results of operations or financial condition.

### **Risks Relating to the Issuer, the Notes and the Trading Market**

#### ***The Issuer is a special purpose vehicle and payments under the Notes are limited to the amount of certain payments received by the Issuer under the Loan Agreement.***

The Issuer is a special purpose vehicle with no business other than issuing debt securities and advancing the proceeds of each issuance as loans to us, and has no assets other than such loans. See “*The Issuer*”. The Issuer is only obliged to make payments under the Notes to the Noteholders in an amount equal to, and in the same currency as, the sum of principal, interest, and additional amounts (if any) actually received by, or for the account of, the Issuer from us pursuant to the Loan Agreement. Consequently, if we fail to meet our payment obligations under the Loan Agreement in full, this will result in the Noteholders receiving less than the scheduled amount of principal or interest or any other amounts, if any, on the relevant due date.

#### ***No direct recourse of the Noteholders to us.***

Except as otherwise expressly provided for in the “*Terms and Conditions of the Notes*” and in the Trust Deed, the Noteholders will not have any proprietary or other direct interest in the Issuer’s rights under or in respect of the Loan Agreement. Subject to the terms of the Trust Deed, no Noteholder will have any entitlement to enforce any of the provisions of the Loan Agreement or have direct recourse against us, except through action by the Trustee under the Charge (as defined in the “*Terms and Conditions of the Notes*”) or assignment of rights. In addition, Noteholders should be aware that neither the Issuer nor the Trustee accepts any responsibility for NOVATEK’s performance of its obligations under the Loan Agreement.

#### ***The Notes will be structurally subordinated to our other liabilities.***

Most of our operations are conducted through our subsidiaries, and to a large extent we depend on the earnings, cash flows and distributions of these subsidiaries to meet our liabilities, including our obligations under the Loan Agreement. Our subsidiaries have no obligation in respect of any amounts due under any of the Loan Agreement, and neither the Issuer nor holders of Notes will have any claims on such subsidiaries’ cash flows or assets. In the event of a bankruptcy, liquidation or reorganization of any of our subsidiaries, its creditors will generally be entitled to payment of their claims from the cash flows and assets of such subsidiary before any cash flows or assets are made available for distribution to NOVATEK as a shareholder. In addition, our subsidiaries may have or incur in the future secured indebtedness, and holders of such secured indebtedness will have a claim against the relevant subsidiary that will have a priority to claims of unsecured creditors, including our claims, if any, under intergroup claims or loans. These circumstances may adversely affect our ability to service our payment obligations under the Loan Agreement.

In addition, our subsidiaries may be subject to legal, contractual or other restrictions that would prevent them from paying dividends or otherwise distributing cash to us. There can be no assurance that any of our subsidiaries will be able to make distributions to us to enable us to make payments under the Loan Agreement, which could adversely affect the Issuer’s ability to make payments under the Notes as they fall due.

#### ***The market price of the Notes may be volatile.***

The market price of the Notes could be subject to significant fluctuations in response to actual or anticipated variations in our own or our competitors’ operating results, adverse business developments, changes to the regulatory environment in which we operate, changes in financial estimates by securities analysts, and the actual or expected sale of a large number of Notes, as well as other factors. Any such disruptions may harm the Noteholders. In addition, in recent years the global financial markets have experienced significant price and volume fluctuations that, if repeated in the future, could adversely affect the market price of the Notes without regard to our results of operations, prospects or financial condition.

***The lack of a public market for the Notes could reduce the value of an investment in the Notes.***

There may not be an existing market for the Notes at the time they are issued. The Notes are expected to be admitted to trading on the Main Securities Market of the Irish Stock Exchange. However, there can be no assurance that the Notes will remain listed, that a liquid market will develop for the Notes, that Noteholders will be able to sell their Notes, or that such holders will be able to sell their Notes for a price that reflects their value.

***Noteholders may not be adequately protected against any corporate restructurings or highly leveraged transactions which we may undertake.***

The terms of the Notes do not contain provisions that would afford Noteholders protection in the event of a decline in our credit quality resulting from highly leveraged or other similar transactions in which we may engage. We are also not limited in the amount of other unsecured indebtedness or liabilities that we may incur or securities that we may issue. Holders of the Notes do not have the right to require us to repurchase or redeem the Notes in the event of many types of highly leveraged transactions.

***The protection afforded by the negative pledge contained in the Loan Agreement is limited, which may adversely affect the value of investments in the corresponding Notes.***

In clause 10.1 of the Loan Agreement, we have agreed (A) not to, and to procure that no Subsidiary (as defined therein) will, create or permit to subsist any Security Interest (as defined therein) other than a Permitted Security Interest (as defined therein) upon the whole or any part of its undertaking, property, assets or revenues, present or future, to secure for the benefit of the holders of any Relevant Indebtedness (as defined therein): (i) payment of any sum due in respect of any such Relevant Indebtedness; (ii) any payment under any guarantee of any such Relevant Indebtedness; or (iii) any payment under any indemnity or other like obligation relating to any such Relevant Indebtedness; and (B) procure that no Affiliate (as defined therein) gives any guarantee of, or indemnity in respect of any of our Relevant Indebtedness to the holders thereof; without in any such case at the same time or prior thereto procuring that the Loan (x) is secured equally and rateably with such Relevant Indebtedness for so long as such Relevant Indebtedness is so secured or (y) have the benefit of such other guarantee, indemnity or other like obligations or such other security (in each case) as the Issuer as lender in its absolute discretion shall deem to be not materially less beneficial or (z) as shall be approved by the Issuer as lender.

The application of this negative pledge and the protection that it affords to holders of the Notes is limited. For example, the definition of Relevant Indebtedness is limited to the present or future Indebtedness (as defined in the Loan Agreement) in the form of, or represented by, notes, debentures, bonds or other securities (but for the avoidance of doubt, excluding term loans (whether syndicated or unsyndicated), credit facilities, credit agreements and other similar facilities and evidence of indebtedness under such loans, facilities or agreements, and also excluding certain bonds issued for the purpose of financing all or part of the costs of acquisition, construction or development of the Yamal LNG project, together with certain guarantees issued in respect of such bonds) which either are by their terms payable, or confer a right to payment, in any currency, and are for the time being, or ordinarily are quoted, listed or ordinarily dealt in or traded on any stock exchange, over-the-counter or other securities market. In addition, pursuant to an exemption from the negative pledge, we will be permitted to secure an aggregate amount of Relevant Indebtedness not exceeding 20% of the Consolidated Assets (as defined in the Loan Agreement), without any obligation to afford any equal and rateable security to holders of the Notes. As a result, we will be permitted to secure a range of other forms of indebtedness and may also create security in respect of a significant amount of Relevant Indebtedness without, at the same time, being obliged to grant equal and rateable security in respect of the Loan, which may adversely affect the value of the Notes and/or effectively cause holders of the Notes to rank in terms of priority behind such secured creditors.

***Payments on the Loan may be subject to Russian withholding tax.***

In general, interest payments made by a Russian legal entity to a non-resident legal entity or organization on borrowed funds are subject to Russian withholding tax at a rate of 20% for legal entities and 30% for non-resident individuals, unless such withholding is reduced or eliminated pursuant to the terms of an applicable double tax treaty. Based on professional advice received, we believe that interest payments on the Loan made to the Issuer should not be subject to withholding tax under the terms of the applicable double tax treaty between the Russian Federation and Ireland. However, there can be no assurance that such double tax treaty relief will be available or will continue to be available throughout the term of the Loan.

The application of tax benefits under the double tax treaty could be influenced by changes in the position of the Russian tax authorities to look beyond the mere form of the transaction while assessing the availability of treaty benefits.

On the other hand, the amendments to the Russian Tax Code introduced by Federal Law No. 97-FZ dated 29 June 2012 (the “**Tax Code Amendments**”) should allow the interest on the Loan not to be subject to withholding. In particular, the Tax Code Amendments introduced into the Russian Tax Code an exemption from the obligation to withhold tax from interest paid under transactions similar to the transactions described herein. The Tax Code Amendments were approved into law and became effective from 1 July 2012.

According to the Tax Code Amendments, in respect of the bonds issued prior to 1 January 2014, Russian borrowers are exempt from the obligation to withhold Russian withholding tax from interest payments made to foreign companies on debt obligations arising in connection with placement by these foreign companies of quoted bonds, provided that (i) there is a double tax treaty between the Russian Federation and the jurisdiction of tax residence of the issuer, and (ii) the issuer duly confirms its tax residence. The Tax Code Amendments do not provide tax exemption for the holders of Eurobonds from Russian tax on interest payments, although at present there is no mechanism or requirement for non-residents to self-assess and pay the tax.

For the purpose of the Tax Code Amendments, “quoted bonds” mean bonds and other debt obligations which passed the listing procedure and/or were admitted to circulation on one or more foreign stock exchanges and/or rights to which are recorded by a foreign depository-clearing organization, provided such foreign stock exchanges and depository-clearing organizations are on the list approved by the Federal Service for Financial Markets of the Russian Federation (the “FSFM”) in consultation with the Ministry of Finance of the Russian Federation. Until such list is adopted, bonds and other debt obligations which passed the listing procedure and/or were admitted to circulation on one or more foreign stock exchanges and/or rights to which are recorded by any foreign depository-clearing organization are to be recognized as “quoted bonds”. Based on publicly reported information, a draft of this list has been released, but not officially adopted or yet enforced.

According to the Tax Code Amendments, the above exemption established for interest payments is also applicable to (i) income payable by a Russian legal entity in connection with a guarantee, surety or other security granted by such Russian organization with respect to a debt obligation to a foreign organization and/or with respect to quoted bonds and (ii) other income payable by a Russian organization providing that the payment of such income is established by the provisions of the respective debt obligation or such income is paid due to a change in the terms and conditions of the respective quoted bonds and/or debt obligations including the cases of their early repurchase or redemption. The Tax Code Amendments do not address Russian tax treatment of payments under the quoted bonds issued on or after 1 January 2014.

If any payments under the Loan are subject to any Russian or Irish withholding tax, we will be obliged to increase the amounts payable as may be necessary to ensure that the recipient receives a net amount equal to the amount it would have received in the absence of such withholding taxes. In addition, payments in respect of the Notes will, except in certain limited circumstances, be made without deduction or withholding for or on account of Irish taxes except as required by law. Payments in respect of the Notes should only be subject to deduction or withholding for or on account of Irish taxes as described in “*Taxation—Ireland*”. In the event of such a deduction or withholding, the Issuer will be required to increase payments to the extent that it receives corresponding amounts from us under the Loan Agreement. While the Loan Agreement provides for us to pay such corresponding amounts in these circumstances, there are some doubts as to whether a tax gross up clause such as that contained in the Loan Agreement is enforceable under Russian law. Due to the limited recourse nature of the Notes, if we fail to pay any such gross-up amounts, the amount payable by the Issuer under the Notes will be correspondingly reduced. Any failure by us to increase such payments would constitute an Event of Default under the Loan Agreement. In certain circumstances (including following enforcement of security upon the occurrence of a Relevant Event as defined in the Trust Deed), in the event that we are obliged to increase the amounts payable, we may prepay the principal amount of the Loan together with the accrued interest and/or additional amounts payable (if any) thereon, and all outstanding Notes would be redeemed by the Issuer (to the extent that it has actually received the relevant funds from us).

The Issuer will grant security over certain of its rights in the Loan Agreement to the Trustee in respect of its obligations under the Notes. The security under the Trust Deed will become enforceable upon the occurrence of a Relevant Event, as defined in the Trust Deed. In these circumstances, payments under the Loan Agreement (other than in respect of Reserved Rights) would be required to be made to, or to the order of, the Trustee. Under Russian tax law, payments of interest and other payments made by us to the Trustee will in general be subject to the Russian income tax withholding at a rate of 20% (or, potentially, 30% in respect of non-resident individual Noteholders). It is not expected that the Trustee will, or will be able to, claim a withholding tax exemption under any double tax treaty. In addition, while it may be possible for some Noteholders who may be eligible for an exemption from Russian withholding tax under double tax treaties to claim a refund of tax withheld, there would be considerable practical difficulties in obtaining any such refund.

There is a risk that under the Russian thin capitalization rules, in certain circumstances where parties related to us (i.e., any our foreign corporate shareholder owning directly or indirectly more than a 20% share in our charter capital and, potentially, affiliates of such foreign corporate shareholder, collectively the “**Related Parties**”) hold Notes, a portion or all of the interest to be paid by us under the Loan could be reclassified as dividends for Russian tax purposes. This would occur if the overall amount of our “controlled debt”, calculated on an individual related-party basis, exceeded three times our capital, calculated in accordance with the requirements of the Russian Tax Code. Interest in the amount of such excess would be reclassified as dividends for the Russian tax purposes. There is a risk that our “controlled debt” may include all or part of the Loan, to the extent that any Related Party acquires any portion of the Notes.

Such reclassification of all or a portion of the interest under the Loan as dividends could potentially lead to the imposition of Russian withholding tax on such reclassified interest at the rate of 15%, subject to a possible tax relief under the double tax treaty between the Russian Federation and Ireland, and the non-deductibility of such interest for Russian profit tax purposes by us. Also, such withholding on dividends would trigger our gross-up obligation discussed above.

Based on the assumption that the amount of our “controlled debt” calculated in accordance with the requirements of Article 269 of the Russian Tax Code does not exceed three times the amount of our “own capital” (“*sobstvenniy kapital*”) calculated on an individual related-party basis, the Russian thin capitalization rules should not apply currently to the interest on the Loan. However, changes in these assumptions could result in all or a portion of such interest being subject to the thin capitalization rules in the future, so as to treat “excess interest” related to the Loan as a dividend under the double tax treaty between the Russian Federation and Ireland subject to 15% withholding tax applicable to dividends (subject to possible tax treaty relief, if any), rather than a zero withholding tax applicable to interest. Such withholding on dividends would trigger our gross-up obligation discussed above.

It is currently unclear whether our obligations with respect to gross-up payments will be enforceable in the Russian Federation. If, in the case of litigation in the Russian Federation, a Russian court does not rule in favor of the Issuer or the Trustee or the Noteholders, there is a risk that the tax gross-up for withholding tax will not take place and that payments made by us under the Loan Agreement will be reduced by Russian income tax withheld by NOVATEK. See “*Taxation—Russian Federation*”.

***Tax might be withheld on disposals of the Notes in the Russian Federation, reducing their value.***

If a non-resident Noteholder that is a legal person or organization, which in each case is not organized under Russian law and which holds and disposes of the Notes otherwise than through a permanent establishment in Russia, sells the Notes and receives proceeds from a source within the Russian Federation, there is a risk that any part of the payment that represents accrued interest may be subject to a 20% Russian withholding tax (even if a disposal is performed at a loss). The foreign Noteholder may be entitled to a reduction of such Russian withholding tax under an applicable double tax treaty.

Where proceeds from a disposal of the Notes are received from a source within the Russian Federation by a non-resident Noteholder that is an individual, there is a risk that Russian withholding tax would be charged at a rate of 30% on gross proceeds from such disposal of the Notes less any available cost deduction. There is no assurance that advance double tax treaty relief would be granted to an individual and obtaining a refund can involve considerable practical difficulties.

The imposition or risk of imposition of this withholding tax could adversely affect the value of the Notes. See “*Taxation—Russian Federation*”.

***The Notes may or must be redeemed early in a number of circumstances.***

On the occurrence of one of the early redemption events described in “*Terms and Conditions of the Notes—Redemption and Purchase*”, we may, or in some cases must, prepay the Loan in whole or in part together with accrued interest at any time, and (to the extent that it has actually received the relevant funds from us) the Issuer shall redeem all outstanding Notes in accordance with the “*Terms and Conditions of the Notes*”.

On such redemption, or at maturity, we may not have the funds to fulfill our obligations under the Loan Agreement and we may not be able to arrange for additional financing. If the early repayment or maturity date of the Loan occurs at a time when other arrangements prohibit us from repaying the Loan, we would try to obtain waivers of such prohibitions from the lenders under those arrangements, or we could attempt to refinance the borrowings that contain the restrictions. If we are unable to obtain the necessary waivers or refinance these borrowings, we would be unable to repay the Loan.

***Ratings of the Notes may be limited.***

In general, European-regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances while the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by the ESMA on its Web site in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. See “*Overview—Credit Ratings*”.

***The credit ratings may not reflect all risks of an investment in the Notes, and changes to our credit rating or those of the Russian Federation may adversely affect the Notes' trading price.***

It is expected that the Notes will be rated BBB- by Fitch, BBB- by S&P, and Baa3 by Moody's. The credit ratings of the Notes may not reflect the potential impact of all risks related to structure and other factors on any trading market for, or trading value of, the Notes. In addition, real or anticipated changes in our credit ratings – or those of the Russian Federation or one or more other Russian corporate borrowers or banks – may generally affect any trading market for, or trading value of, the Notes.

A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. There is no assurance that a credit rating will remain for any given period of time or that a credit rating will not be lowered or withdrawn by the relevant rating agency if, in its judgment, circumstances so warrant. The impact of other activities that we undertake, changes in our dividend policy and, particularly, increases in our debt levels could also result in future declines in our credit ratings. In the event that a credit rating assigned to us or the Notes is subsequently lowered for any reason, no person or entity is obliged to provide any additional support or credit enhancement with respect to the Notes, and the market value of the Notes is likely to be adversely affected.

***Noteholders may face foreign exchange risks by investing in the Notes.***

The Notes will be denominated and payable in U.S. Dollars. For a Noteholder who measures its investment returns by reference to a currency other than the U.S. Dollar an investment in the Notes entails foreign exchange related risks due to, among other factors, possible significant changes in the value of the U.S. Dollar relative to the currency by reference to which a Noteholder measures its investment returns because of economic, political and other factors over which we have no control. Depreciation of the U.S. Dollar against the currency by reference to which a Noteholder measures its investment returns could cause a decrease in the effective yield of the Notes below their stated coupon rates and could result in a loss when the return on the Notes is translated into the currency by reference to which a Noteholder measure its investment returns. There may be tax consequences for Noteholders as a result of any foreign exchange gains or losses from any investment in the Notes.

***Legal investment considerations may restrict certain investments.***

The investment activities of certain investors are subject to investment laws and regulations, or to the review by, or regulation of, certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Notes are legal investments to it; (ii) the Notes can be used as collateral for various types of borrowings; and (iii) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk based capital or similar rules.

***Noteholders' Rights Will Be Limited so Long as the Notes Are Issued in Book-Entry Interests.***

Except in limited circumstances, the Notes will be issued only in global form with interests therein held through the facilities of Euroclear, Clearstream Luxembourg and/or DTC. Owners of book-entry interests will not be considered owners or holders of the Notes unless and until definitive notes are issued in exchange for book-entry interests. Instead, Euroclear, Clearstream, Luxembourg, or DTC, or their nominees, will be the sole holders of the Notes.

Payments of principal, interest and other amounts owing on or in respect of the Notes in global form will be made as described in “*Summary of the Provisions Relating to the Notes in Global Form*” and none of the Issuer, the Trustee or any paying agent will have any responsibility or liability for any aspect of the records relating to or payments of interest, principal or other amounts to Euroclear, Clearstream, Luxembourg or DTC, or to owners of book-entry interests.

Owners of book-entry interests will not have the direct right to act upon our solicitations for consents or requests for waivers or other actions from holders of the Notes, including enforcement of security for the Notes. Instead, Noteholders who own a book-entry interest will be reliant on the nominees for the common depositary or custodian (as registered holder of the Notes) to act on their instructions and/or will be permitted to act directly only to the extent such holders have received appropriate proxies to do so from Euroclear, Clearstream, Luxembourg or DTC or, if applicable, from a participant. There can be no assurances that procedures implemented for the granting of such proxies will be sufficient to enable the Noteholders to vote on any requested actions or to take any other action on a timely basis.

The laws of some jurisdictions may require that certain purchasers of securities take physical delivery of such securities in definitive form. These laws may impair the ability to transfer beneficial interests in the Notes. Because Euroclear, Clearstream, Luxembourg and/or DTC can only act on behalf of their participants, which, in turn, act on behalf of owners of beneficial interests held through such participants and certain banks, the ability of a person having a beneficial interest in a note to pledge or transfer such interest to persons or entities that do not participate in the Euroclear, Clearstream, Luxembourg and/or DTC may be impaired.

***An investment in the Notes is subject to ERISA restrictions.***

The Notes may be regarded for purposes of the United States Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), as equity interests in a separate entity whose sole asset is the Loan corresponding to the Notes. Accordingly, the Notes should not be acquired by any “benefit plan investor” within the meaning of Section 3(42) of ERISA (“**Benefit Plan Investor**”). Each purchaser and/or holder of Notes and each transferee therefore will be deemed to have made representations that it is not a Benefit Plan Investor. Potential purchasers should read the sections entitled “*Certain U.S. Employee Benefit Plan Considerations*” and “*Transfer Restrictions*”.

***Examiners, preferred creditors under Irish law and floating charges may impose additional risks on the Notes.***

***COMI***

The Issuer has its registered office in Ireland. As a result, there is a rebuttable presumption that its center of main interest (“**COMI**”) is in Ireland and, consequently, that any main insolvency proceedings applicable to it would be governed by Irish law. In the decision by the European Court of Justice (“**ECJ**”) in relation to Eurofood IFSC Limited, the ECJ restated the presumption in Council Regulation (EC) No. 1346/2000 dated 29 May 2000 on Insolvency Proceedings that the place of a company’s registered office is presumed to be the company’s COMI and stated that the presumption can only be rebutted if “*factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at the registered office is deemed to reflect*”. As the Issuer has its registered office in Ireland, has Irish directors, is registered for tax purposes in Ireland and has an Irish corporate services provider, the Issuer does not believe that factors exist that would rebut this presumption, although this would ultimately be a matter for the relevant court to decide, based on the circumstances existing at the time when it was asked to make that decision. If the Issuer’s COMI is not in Ireland, and is held to be in a different jurisdiction within the EU, main insolvency proceedings may not be opened in Ireland.

***Examinership***

Examinership is a court procedure available under the Irish Companies (Amendment) Act 1990, as amended (the “**1990 Act**”) to facilitate the survival of Irish companies in financial difficulties.

The Issuer, the directors of the Issuer, a contingent, prospective or actual creditor of the Issuer, or shareholders of the Issuer holding, at the date of presentation of the petition, not less than one-tenth of the voting share capital of the Issuer are each entitled to petition the court for the appointment of an examiner. The examiner, once appointed, has the power to halt, prevent or rectify acts or omissions, by or on behalf of the company after his appointment, and, in certain circumstances, negative pledges given by the company prior to his appointment will not be binding on the company. Furthermore, where proposals for a scheme of arrangement are to be formulated, the company may, subject to the approval of the court, affirm or repudiate any contract under which some element of performance other than the payment remains to be rendered both by the company and the other contracting party or parties.

During the period of protection, the examiner will compile proposals for a compromise or scheme of arrangement to assist in the survival of the company or the whole or any part of its undertaking as a going concern. A scheme of arrangement may be approved by the Irish High Court when a minimum of one class of creditors, whose interests are impaired under the proposals, has voted in favor of the proposals and the Irish High Court is satisfied that such proposals are fair and equitable in relation to any class of members or creditors who have not accepted the proposals and whose interests would be impaired by implementation of the scheme of arrangement and the proposals are not unfairly prejudicial to any interested party.

That the Issuer is a special purpose entity and that all its liabilities are of a limited recourse nature means that it is unlikely that an examiner would be appointed to the Issuer.

If, however, for any reason, an examiner were appointed while any amounts due by the Issuer under the Notes were unpaid, the primary risks to the holders of Notes would be as follows:

- (i) the Trustee, acting on behalf of Noteholders, would not be able to enforce rights against the Issuer during the period of examinership; and
- (ii) a scheme of arrangement may be approved involving the writing down of the debt due by the Issuer to the Noteholders irrespective of the Noteholders’ views.

***Preferred Creditors***

If the Issuer becomes subject to an insolvency proceeding and the Issuer has obligations to creditors that are treated under Irish law as creditors that are senior relative to the Noteholders, the Noteholders may suffer losses as a result of their subordinated status during such insolvency proceedings. In particular:

- (i) under the terms of Trust Deed, the Notes will be secured in favor of the Trustee for the benefit of itself

and the Noteholders by security over the Loan Agreement and sums held in the Account. Under Irish law, the claims of creditors holding fixed charges may rank behind other creditors (namely fees, costs and expenses of any examiner appointed and certain capital gains tax liabilities) and, in the case of fixed charges over book debts, may rank behind claims of the Irish Revenue Commissioners for PAYE and VAT;

- (ii) under Irish law, for a charge to be characterized as a fixed charge, the charge holder is required to exercise the requisite level of control over the assets purported to be charged and the proceeds of such assets including any bank account into which such proceeds are paid. There is a risk therefore that even a charge which purports to be taken as a fixed charge, such as the Charge, may take effect as a floating charge if a court deems that the requisite level of control was not exercised; and
- (iii) in an insolvency of the Issuer, the claims of certain other creditors (including the Irish Revenue Commissioners for certain unpaid taxes), as well as those of creditors mentioned above, will rank in priority to claims of unsecured creditors and claims of creditors holding floating charges.

#### **Other Risks**

***We have not independently verified information we have sourced from third parties.***

We have sourced certain information contained in this Prospectus from third parties, including private companies and Russian public authorities, and we have relied on the accuracy of this information without independent verification. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those in certain more developed economies. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this Prospectus must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information. In addition, the veracity of some official data released by Russian public authorities may be questionable.



## ENFORCEABILITY OF JUDGMENTS

We are an open joint stock company incorporated under the laws of the Russian Federation, and the majority of our directors and executive officers reside in the Russian Federation. In addition, most of our assets and the assets of such persons are located outside of the United States, the United Kingdom and Ireland. As a result, it may not be possible for you to:

- effect service of process within the United States or the United Kingdom upon us or any of our directors or executive officers named in this Prospectus; or
- enforce, in the U.S. or English courts, judgments obtained outside the U.S. or English courts against us or any of our directors and executive officers named in this Prospectus in any action, including actions under the civil liability provisions of the U.S. securities laws or any state or territory of the United States.

In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions located outside the United States or the United Kingdom, liabilities predicated upon the U.S. securities laws or upon English laws.

Judgments rendered by a court in any jurisdiction outside the Russian Federation will be generally recognized by courts in the Russian Federation if an international treaty providing for the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered and/or a federal law is adopted in the Russian Federation that provides for the recognition and enforcement of foreign court judgments.

No such treaty for the reciprocal enforcement of foreign court judgments in civil and commercial matters exists between the Russian Federation and certain jurisdictions (including the United Kingdom and the United States), and no relevant federal law on enforcement of foreign court judgments has been adopted in the Russian Federation.

In the absence of an applicable treaty, enforcement of a final judgment rendered by a foreign court may still be recognized by a Russian court on the basis of reciprocity, if courts of the country where the foreign judgment is rendered have previously enforced judgments issued by Russian courts. While Russian courts have recently recognized and enforced English court judgments on these grounds, the existence of reciprocity must be established at the time the recognition and enforcement of a foreign judgment is sought, and it is not possible to predict whether a Russian court will in the future recognize and enforce on the basis of reciprocity a judgment issued by a foreign court, including an English court. Even if an applicable international treaty is in effect or a foreign judgment might otherwise be recognized and enforced on the basis of reciprocity, the recognition and enforcement of a foreign judgment will in all events be subject to exceptions and limitations provided for in Russian law. For example, a Russian court may refuse to recognize or enforce a foreign judgment if its recognition or enforcement would contradict Russian public policy.

The Loan Agreement and any non-contractual obligations arising out of or in connection with the Loan Agreement will be governed by English law, and the Loan Agreement provides for disputes, controversies and causes of action brought by the Issuer against us to be settled by arbitration in accordance with the Rules of the LCIA (formerly the London Court of International Arbitration). The Russian Federation is a party to the New York Convention.

However, it may be difficult to enforce arbitral awards in the Russian Federation due to, *inter alia*:

- the inexperience of the Russian courts in enforcing international commercial arbitral awards;
- official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors; and
- the Russian courts' inability or unwillingness to enforce such orders.

Furthermore, any arbitral award pursuant to arbitration proceedings in accordance with the rules of the LCIA and the application of English law to the Loan Agreement may be limited by the mandatory provisions of Russian law relating to the exclusive jurisdiction of Russian courts and the application of Russian law with respect to bankruptcy, winding up or liquidation of Russian companies.

For further description of the risks relating to your ability to enforce court judgments against us or any of our directors and executive officers, see “*Risk Factors—Risks Related to the Russian Legal System and Russian Legislation—The difficulty of enforcing court decisions and the discretion of state authorities in enforcing claims could prevent us or you, as an investor in the Notes, from obtaining effective redress in court proceedings*”.

## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### Presentation of Financial Information

Our audited consolidated financial statements as of and for the years ended 31 December 2011 and 2010 (the “**2011 Audited Financial Statements**”) and as of and for the years ended 31 December 2010 and 2009 (the “**2010 Audited Financial Statements**”, and together with the 2011 Audited Financial Statements, the “**Audited Financial Statements**”) have been prepared in accordance with IFRS. Our unaudited consolidated interim condensed financial information as of and for the three and nine months ended 30 September 2012, with 2011 comparatives (the “**Unaudited Financial Statements**”) have been prepared in accordance with International Accounting Standard No. 34 “Interim Financial Reporting”. The Audited Financial Statements and the Unaudited Financial Statements (the “**Financial Statements**”) are included in this Prospectus on pages F-2 through F-196. The Rouble is the functional and reporting currency for the Financial Statements.

Our financial information set forth herein as of and for the nine months ended 30 September 2012 (with 2011 comparatives) has been extracted from the Unaudited Financial Statements. Our financial information set forth herein as at and for the year ended 31 December 2011 has been extracted from the 2011 Audited Financial Statements, and as at and for the year ended 31 December 2010 from the 2010 comparatives in the 2011 Audited Financial Statements. Our financial information set forth herein as at and for the financial year ended 31 December 2009 has been extracted from the 2009 comparatives in the 2010 Audited Financial Statements.

Certain financial information for 2011, 2010 and 2009 included herein differs from the presentation in the respective Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For further details and a reconciliation of the reclassified financial information for 2011, 2010 and 2009 included herein to the Audited Financial Statements, see “—*Impact of Changes in Presentation*”. In addition, in the Unaudited Financial Statements, we adjusted the comparative figures for the nine months ended 30 September 2011 to reflect the final fair value assessment of the identifiable assets and liabilities of Sibneftegas after its acquisition in December 2010. At the date of acquisition of Sibneftegas, we recorded the preliminary fair values for oil and gas properties, which were used as the basis for depreciation through the nine months of 2011. In December 2011, we completed an independent valuation of the fair values of Sibneftegas’ identifiable net assets. Revisions made to the preliminary assessment were reflected as of the acquisition date and, accordingly, our share of profit (loss) of joint ventures, net of income tax, and as a result, profit attributable to shareholders of NOVATEK for the nine months ended 30 September 2011 was decreased by RUB253 million to reflect the revised depreciation of Sibneftegas’ assets.

We include information in this Prospectus regarding our EBITDA, EBITDAX, normalized EBITDA, normalized EBITDAX, EBITDA margin, net debt and debt to equity, which are not financial measures specifically defined under IFRS. See “*Selected Consolidated Financial and Other Data*”. These measures may not be comparable to other similarly titled measures of other companies and are not measurements under IFRS or other generally accepted accounting principles, and they should not be considered as substitutes for the information contained in the Financial Statements.

### Impact of Changes in Presentation

In connection with the preparation of the Unaudited Financial Statements, we changed the presentation of certain statement of income items compared to the Audited Financial Statements, due to a change in our policy on recognizing revenues from hydrocarbon liquids sales to certain customers effective from 1 January 2012. Prior to 1 January 2012, we recognized such revenues on a net basis, i.e., certain transportation costs for which we were reimbursed by these customers were not part of our reported transportation expenses, nor of our revenues. As of 1 January 2012, we record sales on a gross basis, i.e., include a portion of the transportation costs for which we are reimbursed as revenues and transportation expenses. Accordingly, certain items in the Audited Financial Statements are not presented on a directly comparable basis to the current presentation in the Unaudited Financial Statements. These changes in presentation had no impact on the profit in the statement of income for the years ended 31 December 2011, 2010 and 2009.

The table below shows the statement of income items in the Audited Financial Statement affected by the reclassifications, as their presentation was conformed to the Unaudited Financial Statements. The remaining statement of income items in the Audited Financial Statements have not been changed.

	Year ended 31 December					
	2011		2010		2009	
	As reported	Reclassified (unaudited)	As reported	Reclassified (unaudited)	As reported	Reclassified (unaudited)
			<i>(RUB millions)</i>			
Oil and gas sales.....	175,602	175,809	115,162	115,303	86,903	86,956
Total revenues .....	176,064	176,271	117,024	117,165	89,954	90,007
Transportation expenses.....	(48,176)	(48,329)	(37,200)	(37,298)	(29,026)	(29,062)
Total operating expenses .....	(97,665)	(97,818)	(68,518)	(68,616)	(56,130)	(56,166)
Other operating income (loss).....	261	207	396	353	(343)	(360)

## Currency

In this Prospectus:

“**RUB**”, “**Russian Rouble**” or “**Rouble**” means the lawful currency of the Russian Federation;

“**U.S. Dollar**”, “**USD**” or “**U.S.\$**” means the lawful currency of the United States; and

“**Euro**” or “**€**” means the lawful currency of the EU.

## Natural Gas and Liquids Reserves Data

This Prospectus contains information concerning our estimated proved and probable natural gas and liquids reserves that has been derived or extracted from the reports of D&M, a firm of independent petroleum engineers, dated as of 31 December 2011 (collectively, the “**2011 Reserves Reports**”), and which are estimated in accordance with the following two sets of global standards of reserves measurement:

- the standards of reserves measurement applied by the SEC; and
- PRMS standards (formerly called SPE standards, approved in March 2007 by the Society of Petroleum Engineers, the World Petroleum Council, the American Association of Petroleum Geologists and the Society of Petroleum Evaluation Engineers).

*Appendix A – Summary Reserves Reports* contains:

- a summary reserves report as of 31 December 2011 insofar as it relates to the review of our natural gas, gas condensate and crude oil fields under SEC reserves methodology; and
- a summary reserves report as of 31 December 2011 insofar as it relates to the review of our natural gas, gas condensate and crude oil fields under PRMS reserves methodology (collectively, the “**Summary Reserves Reports**”).

We also present estimates of our reserves under the Russian reserves system, which are based on data approved by the relevant Russian state authorities. The Russian reserves system differs significantly from SEC and PRMS reserves methodologies, in particular with respect to the extent to which commercial factors are taken into account in calculating reserves. Reserves that are calculated using different methods cannot be accurately reconciled. See “*Classification of Reserves*”.

Petroleum engineering is a subjective process of estimating underground accumulations of hydrocarbons that cannot be measured in an exact manner. These estimates necessarily depend upon a number of variable factors and assumptions, many of which are beyond our control. Due to the inherent uncertainties and the necessarily limited nature of reservoir data and the inherently imprecise nature of reserves estimates the reserves amounts disclosed in this Prospectus may change as additional information becomes available. Prospective investors should not place undue reliance on the ability of the reserves reports prepared by D&M to predict actual reserves or on comparisons of similar reserves data of peer international and Russian companies.

Under SEC reserves methodology in effect as of the date of the 2011 Reserves Reports, proved gas and oil reserves are those quantities of gas and oil, which, by analysis of geosciences and engineering data, can be estimated with reasonable certainty to be economically producible – from a given date forward, from known reservoirs, and under existing conditions, operating methods, and government regulations – prior to the time at which the contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain regardless of whether deterministic or probabilistic methods are used for the estimation; the project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time. In addition, under SEC reserves methodology in effect as of the date of the 2011 Reserves Reports, proved reservoirs include, among others: (i) (A) the area identified by drilling and limited by fluid contacts, if any and (B) adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil and gas on the basis of available geosciences and engineering data; (ii) in the absence of data on fluid contacts, proved quantities in a reservoir are limited to the lowest known hydrocarbons as seen in well penetration unless geoscience, engineering, or performance data and reliable

technology establish a lower contact with reasonable certainty. Reserves that can be produced economically through application of improved recovery techniques (including, but not limited to fluid injection) are included in the proved classification upon successful testing through a pilot project or other evidence using reliable technology and obtaining all approvals for development from all necessary parties, including governmental entities.

Information relating to our estimated proved natural gas and liquids reserves is not necessarily indicative of information that would be reported under SEC standards in an offering document registered with the SEC.

### **Presentation of Operational Data**

Except where expressly stated otherwise, NOVATEK’s operational information herein regarding the reserves and the hydrocarbons production data is on a “net” basis, meaning it includes NOVATEK’s proportionate share of the respective results of operations of its consolidated subsidiaries and Joint Ventures.

### **Presentation of Information relating to the Recent Acquisition of Nortgas**

This Prospectus contains information regarding the business and operations of Nortgas (including an estimate of its proved reserves under PRMS reserves methodology) and is based either on the information provided to us by Nortgas in connection with our recent acquisition of a 49% equity stake in Nortgas or on publicly available information. Although we do not have any information that would indicated that such information is inaccurate or incomplete, we cannot assure you of the accuracy or completeness of such information.

### **Conversion Measures**

We present our reserves and production data using the following measures (abbreviated as follows):

barrel ..... one stock tank barrel, or 42 U.S. gallons of liquid volume.  
 bbl..... barrel.  
 bboe ..... billion boe.  
 bcf..... billion cubic feet, as measured under one atmosphere of pressure at 20°C; to convert bcm into bcf, we use the conversion factor of one bcm to 35.315 bcf.  
 bcm ..... billion cubic meters, as measured under one atmosphere of pressure at 20°C.  
 boe ..... barrels of oil equivalent, as for which:

for natural gas, we use the conversion factor of one mcm to 6.54 barrels;

for gas condensate, we use conversion factors of one ton to:

- 8.599 barrels for our Yurkharovskoye field
- 8.195 barrels for our East-Tarkosalinskoye field
- 8.153 barrels for our Khancheyskoye field
- 8.153 barrels for our Olimpiyskiy subsoil area
- 8.598 barrels for our West-Yurkharovskoye field
- 8.558 barrels for our Termokarstovoye field
- 8.063 barrels for our West-Urengoykiy area
- 8.599 barrels for our South-Tambeyskoye field
- 8.129 barrels for our Yarudeyskoye field

for crude oil, we use conversion factors of one ton to:

- 7.616 barrels for our Yurkharovskoye field
- 7.615 barrels for our East-Tarkosalinskoye field
- 7.619 barrels for our Khancheyskoye field
- 7.718 barrels for our Yarudeyskoye field
- 7.723 barrels for our West-Urengoykiy area

These conversion factors differ due to the differing quality of the hydrocarbons at the fields, including differences in calorific content.

bpd..... barrels per day.  
 km..... kilometers.  
 mbbbl..... thousand barrels.  
 mboe ..... thousand boe.  
 mcm..... thousand cubic meters, as measured under one atmosphere of pressure at 20°C.  
 mmbbl..... million barrels.  
 mmboe..... million boe.  
 mmboepd..... mmboe per day.  
 mmcf ..... million cubic feet, as measured under one atmosphere of pressure at 20°C.  
 mmcm..... million cubic meters, as measured under one atmosphere of pressure at 20°C.  
 mmt ..... million metric tons.

mt..... thousand metric tons.  
tcf..... trillion cubic feet, as measured under one atmosphere of pressure at 20°C.  
tcm..... trillion cubic meters, as measured under one atmosphere of pressure at 20°C.  
ton..... metric ton.

### **Contact Information**

NOVATEK is an open joint stock company incorporated under the laws of the Russian Federation. We are registered in the Unified State Register of Legal Entities under principal state registration number 1026303117642. Our registered office is located at 22a Pobedy Street, Tarko-Sale, Yamal-Nenets Autonomous District (YNAO), Russia, and our principal executive offices are located at 2 Udaltsova Street, Moscow, 119415, Russia. Our telephone number is +7 (495) 730 6000. Our Internet address is [www.novatek.ru](http://www.novatek.ru).

## INFORMATION DERIVED FROM THIRD PARTIES

We have obtained certain statistical and market information that is presented in this Prospectus on such topics as the Russian gas industry, the Russian economy in general and related subjects from publicly available data (such as information contained on official websites and in publications of the Government and various state agencies of the Russian Federation and its constituent entities, the BP Statistical Review of World Energy (June 2012), IHS Herold and International Energy Agency publications, or mass media sources) and we confirm that such information has been accurately reproduced and that, so far as we are aware and are able to ascertain from information published by such sources, no facts have been omitted which would render the reproduced information inaccurate or misleading.

Certain information in this Prospectus has been derived or extracted from the reports of D&M. In addition, the Summary Reserves Reports under SEC and PRMS reserves methodologies are included in *“Appendix A—Summary Reserves Reports”*. This third party information is presented in the following sections of this Prospectus: *“Overview”*, *“Risk Factors”*, *“Management’s Discussion and Analysis of Financial Condition and Results of Operations”* and *“Business”*. NOVATEK has accurately reproduced such information and, as far as NOVATEK is aware and is able to ascertain from information published by such third party, no facts have been omitted that would render the reproduced information inaccurate or misleading. In addition, in certain cases we have made statements in this Prospectus regarding our industry and our position in the industry based on our experience and our own investigation of market conditions.

D&M is a Delaware corporation with offices at 5001 Spring Valley Road, Suite 800, East Dallas, Texas 75244, USA. The firm has been providing petroleum consulting services throughout the world for more than 65 years. The firm’s professional engineers, geologists, geophysicists, petrophysicists, and economists are engaged in the independent appraisal of gas and oil properties, evaluation of hydrocarbon and other mineral prospects, basin evaluations, comprehensive field studies, equity studies, and studies of supply and economics related to the energy industry. Except for the provision of professional services on a fee basis, D&M has no commercial arrangement with any other person or company involved in the interests which are the subject of their reports.

This Prospectus contains certain information regarding the business and operations of Nortgas based on the information provided to us by Nortgas in connection with our recent acquisition of a 49% equity stake in Nortgas or on publicly available information. See *“Presentation of Certain Financial and Other Information—Presentation of Information relating to the Recent Acquisition of Nortgas”*.

## FORWARD-LOOKING STATEMENTS

Certain statements in this Prospectus are not historical facts and are “forward looking” within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. This Prospectus contains certain forward-looking statements in various locations, including, without limitation, under the headings “*Overview*”, “*Risk Factors*”, “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” and “*Business*”. We may from time to time make written or oral forward-looking statements in reports to our shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

Forward-looking statements that may be made by us from time to time (but that are not included in this Prospectus) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios.

Words such as “*believes*”, “*anticipates*”, “*expects*”, “*estimates*”, “*intends*” and “*plans*” and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors include:

- the prevailing global and domestic economic environment;
- inflation, interest rate and exchange rate fluctuations;
- the prices of natural gas and crude oil;
- our ability to finance our anticipated capital expenditures through the global capital markets, revenue from operations or otherwise;
- the effects of, and changes in, the policies of the Government;
- the inherent uncertainties in estimating our reserves of natural gas, gas condensate and crude oil;
- the effects of competition in the geographic and business areas in which we conduct operations;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- our ability to maintain and increase market share for our products and control expenses;
- acquisitions or divestitures, and our ability to integrate recently acquired businesses and to realize the operational goals of our various joint ventures;
- technological changes;
- the effects of international and domestic political events on our businesses;
- our ability to manage operational risks in our gas and crude oil exploration, production and transportation activities and other business operations; and
- our success at managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made. Accordingly, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise except as otherwise required by applicable law or under the Prospectus Directive and the relevant implementing measures in Ireland. We do not make any representation, warranty or prediction that the results or events anticipated by such forward-looking statements will be achieved or occur, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

## CURRENCIES AND EXCHANGE RATES

The following tables show, for the periods indicated, certain information regarding the exchange rate between the Rouble and the U.S. Dollar, based on the official exchange rate quoted by the CBR. These rates may differ from the actual rates used in the preparation of the Financial Statements and other financial information appearing in this Prospectus.

<b>Year</b>	<b>Roubles per U.S. Dollar</b>			
	<b>High</b>	<b>Low</b>	<b>Period average<sup>(1)</sup></b>	<b>Period End</b>
2011 .....	32.68	27.26	29.39	32.20
2010 .....	31.78	28.93	30.37	30.48
2009 .....	36.43	28.67	31.72	30.24
2008 .....	29.38	23.13	24.86	29.38
2007 .....	26.58	24.26	25.58	24.55
<b>Month</b>				
December 2012 (up to 4 December 2012).....	30.84	30.81	30.82	30.82
November 2012.....	31.73	30.94	31.41	31.06
October 2012.....	31.53	30.72	31.10	31.53
September 2012.....	32.57	30.59	31.53	30.92
August 2012 .....	32.54	31.48	31.98	32.29
July 2012 .....	32.99	31.95	32.50	32.19
June 2012 .....	34.04	32.13	32.92	32.82
May 2012 .....	32.45	29.36	30.66	32.45
April 2012 .....	29.80	29.28	29.47	29.36
March 2012 .....	29.67	28.95	29.37	29.33
February 2012 .....	30.41	28.95	29.88	28.95
January 2012 .....	32.20	30.36	31.52	30.36

<sup>(1)</sup> The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR for each such business day) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

The exchange rate between the Rouble and the U.S. Dollar on 4 December 2012 was 30.82 Roubles per U.S.\$1.00.

The Rouble is generally not convertible outside Russia. A market exists within Russia for the conversion of Roubles into other currencies, but the limited availability of other currencies may tend to distort their values relative to the Rouble. See “*Risk Factors—Risks Related to Our Business and Industry—We face foreign exchange and inflation risks that could have a material adverse effect on our business, financial condition, results of operations and prospects*”, “*Risk Factors—Risks Relating to the Issuer, the Notes and the Trading Market—Risks relating to Notes denominated in Roubles*” and “*Risk Factors—Risks Relating to the Issuer, the Notes and the Trading Market—Noteholders may face foreign exchange risks by investing in the Notes.*”



## OVERVIEW OF THE OFFERING

*The following overview of the Offering should be read in conjunction with, and is qualified in its entirety by “Terms and Conditions of the Notes”, “Clearing and Settlement” and “The Loan Agreement”.*

### The Notes

Issuer:	Novatek Finance Limited, a company organized and existing as a limited liability company under the laws of Ireland. The Issuer is not a subsidiary of NOVATEK, directly or indirectly.
Joint Lead Managers:	Barclays Bank PLC, Goldman Sachs International, GPB-Financial Services Ltd and SIB (CYPRUS) LIMITED.
Notes Offered:	U.S.\$1,000,000,000 4.422% Loan Participation Notes due 2022.
Issue Price of the Notes:	100% of the principal amount of the Notes.
Maturity Date of the Notes:	13 December 2022.
Issue Date of the Notes:	13 December 2012.
Trustee:	Citicorp Trustee Company Limited.
Principal Paying and Transfer Agent:	Citibank, N.A., London Branch.
Registrar:	Citigroup Global Markets Deutschland AG.
Interest:	On each interest payment date (being 13 June and 13 December in each year and commencing on 13 June 2013) or such later date as amounts equivalent to amounts of interest due on such date are received, the Issuer shall account to the Noteholders for an amount equal to the amount of interest actually received by or for the account of the Issuer pursuant to the Loan Agreement, which interest under the Loan is payable at a rate of 4.422% per annum from and including the Issue Date.
Form and Denomination:	The Notes will be issued in registered form, in denominations of U.S.\$200,000 and multiples of U.S.\$1,000 in excess thereof. The Notes will be represented by the Regulation S Global Note Certificate and the Rule 144A Global Note Certificate. The Regulation S Global Note Certificate and the Rule 144A Global Note Certificate will be exchangeable for Definitive Certificates (as defined in the Loan Agreement) in the limited circumstances specified in the Regulation S Global Note Certificate and the Rule 144A Global Note Certificates.
Initial Delivery of Notes:	On or before the Issue Date, the Regulation S Global Note Certificate shall be registered in the name of a nominee of, and deposited with a common depository for, Euroclear and Clearstream, Luxembourg and the Rule 144A Global Note Certificate shall be registered in the name of Cede & Co. as nominee of, and deposited with a custodian for, DTC.
Status of the Notes:	<p>The Notes are limited recourse, secured obligations of the Issuer, as more fully described in <i>“Terms and Conditions of the Notes—Condition 1—Status”</i>.</p> <p>The Notes will constitute the obligation of the Issuer to apply the proceeds from the issue of the Notes solely for financing the Loan to the Borrower and to account to the Noteholders for an amount equivalent to sums of principal, interest and other amounts (if any) actually received and retained (net of tax) by or for the account of the Issuer pursuant to the Loan Agreement less any amount in respect of Reserved Rights, all as more fully described in <i>“Terms and Conditions of the Notes—Condition 1—Status”</i>.</p>

Security:	<p>The Notes will be secured by the Charge (as defined in the Trust Deed) on:</p> <ul style="list-style-type: none"> <li>• all rights to principal, interest and other amounts payable to the Issuer by NOVATEK under the Loan;</li> <li>• the right to receive all sums which may be or become payable by NOVATEK under any claim, award or judgment relating to the Loan Agreement; and</li> <li>• all the rights, title and interest in and to all sums of money held from time to time in the Account (as defined in the Trust Deed) and the debts represented thereby (including interest from time to time earned on such Account, if any), pursuant to the Trust Deed,</li> </ul> <p><i>provided that</i> Reserved Rights and any amounts relating to Reserved Rights are excluded from such Charge. The Notes will also be secured by an absolute assignment with full title guarantee by the Issuer to the Trustee of its rights under the Loan Agreement (save for the Reserved Rights and those rights subject to the Charge) pursuant to the Trust Deed.</p>
Withholding Taxes and Increased Costs:	<p>All payments in respect of the Notes by or on behalf of the Issuer will be made free and clear of, and without deduction or withholding for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Ireland or any political subdivision or any authority thereof or therein having the power to tax, other than as required by law. In the event that any deduction or withholding is required by law, the Issuer will be required, except in certain limited circumstances, to pay increased amounts of principal, interest or any other payment due thereon to the extent that it receives corresponding amounts from NOVATEK under the Loan Agreement.</p>
Optional Redemption for Taxation Reasons:	<p>The Issuer will be required to redeem in whole, but not in part, the Notes at the principal amount thereof, together with accrued and unpaid interest and additional amounts, if any, to the date of redemption should (1) NOVATEK elect to repay the Loan in the event that it is required to pay increased amounts of principal, interest or any other payment due under the Loan Agreement on account of Russian or Irish withholding taxes or as a result of the enforcement of the security provided for in the Trust Deed, or (2) NOVATEK elect to repay the Loan in the event it is required to pay additional amounts on account of certain costs incurred by the Issuer pursuant to the Loan Agreement.</p>
Optional Redemption by the Issuer for Illegality:	<p>In limited circumstances as more fully described in the Loan Agreement, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, upon giving notice to the Trustee and the Noteholders, at the principal amount thereof, together with accrued and unpaid interest and additional amounts, if any, to the date of redemption, in the event that it becomes unlawful for the Issuer to fund the Loan or allow the Loan to remain outstanding under the Loan Agreement or allow the Notes to remain outstanding or for the Issuer to maintain or give effect to any of its obligations in connection with the Loan Agreement or the Notes and/or to charge or receive or to be paid interest at the rate then applicable to the Loan or the Notes and in such case the Issuer shall require the Loan to be repaid in full.</p>
Relevant Events:	<p>Upon the occurrence of a Relevant Event (as defined in the Trust Deed), the Trustee may, subject as provided in the Trust Deed and subject to being indemnified and/or secured and/or prefunded to its satisfaction, enforce the security created in its favor pursuant to the Trust Deed.</p>
Ratings:	<p>It is expected that the Notes will be rated BBB- by Fitch, Baa3 by Moody's and BBB- by S&amp;P. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organization. Similar ratings on different types of notes do not necessarily mean the same</p>

thing. The ratings do not address the likelihood that the principal on the Notes will be prepaid, paid on an expected final payment date or paid on any particular date before the legal final maturity date of the Notes. The ratings do not address the marketability of the Notes or any market price. Any change in the credit ratings of the Notes or NOVATEK could adversely affect the price that a subsequent purchaser will be willing to pay for the Notes. The significance of each rating should be analyzed independently from any other rating.

Listing:	Application has been made to the Irish Stock Exchange for the Notes to be admitted to the Official List and trading on the Main Securities Market. The Main Securities Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.
Selling Restrictions:	The Notes are subject to selling restrictions in the United Kingdom, the United States, Ireland and the Russian Federation. See “ <i>Plan of Distribution</i> ”.
Governing Law and Arbitration:	The Notes, the Trust Deed, the paying agency agreement relating to the Notes and any non-contractual obligations arising out of or in connection with them shall be governed by and construed in accordance with English law and contain provisions for arbitration in London, England.
Use of Proceeds:	The Issuer will lend the aggregate proceeds from the Offering for the sole purpose of financing the Loan to NOVATEK. See also “— <i>The Loan—Use of Proceeds</i> ”.
Security Codes:	<i>Regulation S Notes:</i> Common Code: 086438372 International Security Identification Numbers (“ <b>ISIN</b> ”): XS0864383723 CUSIP: G66749 AC9 <i>Rule 144 A Notes:</i> Common Code: 086451611 ISIN: US66989PAC41 CUSIP: 66989P AC4
Clearing Systems:	DTC (in the case of the Rule 144A Notes) and Euroclear and Clearstream, Luxembourg (in the case of the Regulation S Notes).
Yield:	The annual yield of the Notes when issued is 4.422%.
Risk Factors:	An investment in the Notes involves a high degree of risk. See “ <i>Risk Factors</i> ”.
Certain Covenants:	The Issuer has covenanted under the Trust Deed that, as long as any Notes remain outstanding, it will not, without the prior written consent of the Trustee or an Extraordinary Resolution or Written Resolution (as each defined in the Trust Deed), agree to any amendment or any modification or waiver of, or authorize any breach or proposed breach of, the terms of the Loan Agreement, except as otherwise expressly provided in the Trust Deed or the Loan Agreement.

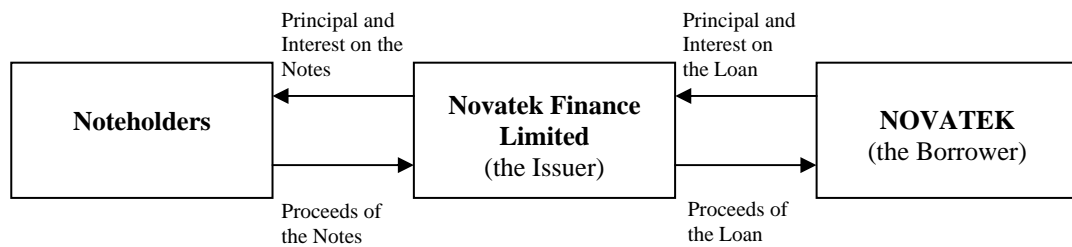
## **The Loan**

Lender:	Novatek Finance Limited, a company organized and existing as a limited liability company under the laws of Ireland.
Borrower:	NOVATEK, an open joint stock company incorporated under the laws of the Russian Federation.
Status of the Loan:	The Loan is a direct, unconditional, unsubordinated and unsecured obligation of NOVATEK and obligations under the Loan will rank at least <i>pari passu</i> with all other direct, unconditional, unsubordinated and

	unsecured indebtedness of NOVATEK.
Principal Amount of the Loan:	U.S.\$1,000,000,000.
Interest on the Loan:	4.422% per annum, payable semi-annually in arrear starting on 13 June 2013.
Use of Proceeds:	NOVATEK will use the proceeds of the Loan, less any commissions or expenses payable by it in connection with the Notes and the Loan, to repay in full the U.S.\$667 million Bridge Facility which it drew to finance part of the acquisition of a 49% interest in Nortgas, as well as for general corporate purposes.
Early Prepayments by NOVATEK:	See “— <i>The Notes—Optional Redemption for Taxation Reasons</i> ” and “— <i>The Notes—Optional Redemption by the Issuer for Illegality</i> ”.
Withholding Taxes and Increased Costs:	Payments under the Loan Agreement shall, except in certain limited circumstances, be made without deduction or withholding for or on account of Russian, or Irish taxes, except as required by law. In the event that any deduction or withholding is required by law with respect to payments under the Notes or the Loan Agreement, NOVATEK will be obliged, except in certain limited circumstances, to increase the amounts payable under the Loan Agreement by an amount equivalent to the required tax payment.
Certain Covenants:	As described in “ <i>The Loan Agreement</i> ”.
Events of Default:	As described in “ <i>The Loan Agreement</i> ”.
Governing Law:	The Loan Agreement and any non-contractual obligations arising out of or in connection with it shall be governed by and construed in accordance with English law.

## DESCRIPTION OF THE TRANSACTION

The following summary contains basic information about the Notes and the Loan and should be read in conjunction with, and is qualified in its entirety by, the information set forth under “The Loan Agreement” and the “Terms and Conditions of the Notes” appearing elsewhere in this Prospectus.



The transaction will be structured as a Loan from the Issuer to the Borrower. The Issuer will issue the Notes, which will be secured limited recourse loan participation notes issued for the sole purpose of making the Loan to the Borrower. The Notes are limited recourse obligations, and the Issuer will not have any obligation to the Noteholders other than the obligation to account to the Noteholders for payment of principal, interest and additional amounts (if any) actually received and retained (net of tax) by it under the Loan. In the event that the amount due and payable by the Issuer under the Notes exceeds the sums so received or recovered and retained (net of tax), the right of any person to claim payment of any amount exceeding such sums shall be extinguished, and the Noteholders may take no further action against the Issuer to recover such amounts.

The Loan will each be constituted by, be subject to, and have the benefit of, the Trust Deed. As provided in the Trust Deed, the Issuer will charge, by way of the Charge in favor of the Trustee, for the benefit of the Noteholders, as continuing security for its payment obligations in respect of the Notes:

- all rights, interest and benefit to principal, interest and additional amounts (if any) payable to the Issuer by the Borrower under the Loan Agreement;
- the right to receive all sums that may be or become payable by the Borrower under any claim, award or judgment relating to the Loan Agreement; and
- all the rights, title and interest in and to all sums of money held from time to time in an account specified in the Loan Agreement, together with the debts represented thereby (including interest earned on the account, if any),

*provided*, in each case, that the Reserved Rights (as defined in the Trust Deed), and any amounts in respect thereof, are excluded from the Charge and that the Issuer remains the legal and beneficial owner of the relevant Charged Property (as defined in the Trust Deed).

In addition, the Issuer with full title guarantee will assign absolutely to the Trustee for the benefit of itself and the respective Noteholders all the rights, title, interest and benefits, both present and future, that may accrue to the Issuer as lender under or pursuant to the Loan Agreement (including, without limitation, the right to declare the Loan immediately due and payable and to commence proceedings to enforce the Borrower’s obligations thereunder), other than any rights, interests or benefits that are subject to the Charge and other than the Reserved Rights (as defined in the Trust Deed), and any amounts relating thereto. As a consequence of such assignment, the Trustee will assume the rights of the Issuer under the Loan Agreement, as set forth in the relevant provisions of the Trust Deed.

The Issuer will agree in the Trust Deed not to agree to any amendments to or modification or waiver of, and not to authorize any breach of, the Loan Agreement unless the Trustee has given its prior written consent or unless authorized to do so by an Extraordinary Resolution (as defined in the Trust Deed) or Written Resolution (as defined in the Trust Deed) of the Noteholders, except in respect of the Reserved Rights (as defined in the Trust Deed). The Issuer will agree to act at all times in accordance with any instructions of the Trustee with respect to the Loan Agreement, except as provided in the Trust Deed and except in respect of the Reserved Rights. Unless the Trustee agrees otherwise, the Issuer will notify the Noteholders of any amendments, modifications, waivers or authorizations made with the Trustee’s consent in accordance with “Terms and Conditions of the Notes—Notices”.

Payments in respect of the Notes by or on behalf of the Issuer will be made without any deduction or withholding for or on account of taxes imposed or levied by or on behalf of any governmental or other taxing authority, except as required by law. If any deduction or withholding for taxes imposed by Ireland or any other taxing jurisdiction to which the Issuer becomes subject is required by law, the Issuer must, except in certain limited circumstances, pay additional amounts to the extent it receives corresponding amounts from the Borrower pursuant

to the Loan Agreement. In addition, payments under the Loan Agreement will be made without deduction or withholding for or on account of taxes imposed or levied by or on behalf of any governmental or other taxing authority, except as required by law. See “*Risk Factors—Risks Related to the Issuer, the Notes and the Trading Market—Payments on the Loan may be subject to Russian withholding tax*”. If any deduction or withholding for taxes imposed by Ireland or any other taxing jurisdiction in which the Issuer becomes a tax resident is required by law with respect to payments under the Notes, or if any deduction or withholding for taxes is required by Irish or Russian law with respect to the Loan Agreement, the Borrower must, except in certain limited circumstances, increase the amounts payable under the Loan Agreement to ensure that the Issuer receives a net amount equal to the full amount it would have received had payment not been made subject to taxes.

The Borrower may prepay the Loan at its principal amount, together with accrued and unpaid interest and additional amounts (if any), if it must increase the amount payable or pay additional amounts on account of the taxes in respect of which it is required to pay additional amounts under the Loan Agreement or if it must pay additional amounts on account of certain costs incurred by the Issuer. As set forth in the Loan Agreement, the Issuer may, at its own discretion, require the Borrower to prepay the Loan if it becomes unlawful for the Loan or the Notes to remain outstanding.

## USE OF PROCEEDS

The Issuer will lend the aggregate proceeds it receives from the Notes for the sole purpose of financing the Loan to NOVATEK. The proceeds of the Loan, less any commissions or expenses payable by NOVATEK in connection with the Notes and the Loan (see “*Capitalization*”) will be used by NOVATEK:

- to repay in full the U.S.\$667 million Bridge Facility which we drew to finance part of the acquisition of a 49% interest in Nortgas (see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Acquisition of Nortgas*”); and
- for general corporate purposes.

## CAPITALIZATION

The following table sets forth our consolidated cash and cash equivalents and capitalization as of 30 September 2012, is extracted from the Unaudited Financial Statements (except for the line “Total capitalization”) and does not reflect any changes subsequent to 30 September 2012. For further information regarding our financial position, see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” and the *Financial Statements*.

	<b>As of 30 September 2012</b>
	<b>(unaudited)</b>
	<i>(RUB millions)</i>
<b>Cash and cash equivalents</b> .....	<b>17,472</b>
<b>Short-term debt and current portion of long-term debt</b> .....	<b>18,938</b>
<b>Long-term debt, excluding current portion</b> .....	<b>65,721</b>
<b>Non-controlling interest</b> .....	<b>1,147</b>
<b>Equity attributable to NOVATEK shareholders</b> .....	<b>281,087</b>
Ordinary share capital .....	393
Treasury shares .....	(281)
Additional paid in capital .....	31,220
Asset revaluation surplus on acquisitions .....	5,617
Currency translation differences .....	(24)
Retained earnings .....	244,162
<b>Total capitalization</b> <sup>(1)</sup> .....	<b>366,893</b>

<sup>(1)</sup> Total capitalization is the sum of short-term debt and current portion of long-term debt, long-term debt, excluding its current portion, non-controlling interest, and equity attributable to NOVATEK shareholders.

Except as set forth below, since 30 September 2012, there have been no material changes in our capitalization:

- on 15 October 2012, we issued three-year non-convertible Rouble-denominated domestic bonds in the amount of RUB20 billion with a coupon rate of 8.35% per annum;
- on 26 November 2012, we received U.S.\$667 million under the Bridge Facility; and
- we expect to receive net proceeds from the Offering of approximately U.S.\$994,300,000 (taking into account the estimated total commissions and expenses payable in relation to the Offering and the admission to trading of the Notes, which are expected to be approximately U.S.\$5,700,000).



## SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The following tables present our selected consolidated financial data as of the dates and for the periods indicated. The statements of financial position as of 31 December 2011, 2010 and 2009 and cash flows data for the years ended 31 December 2011, 2010 and 2009 have been derived from the Audited Financial Statements included elsewhere in this Prospectus. The statement of income for the years ended 31 December 2011, 2010 and 2009 has been derived from the Audited Financial Statements, subject to reclassifications of certain line items, as described in “Presentation of Financial and Other Information—Presentation of Financial Information”. The statement of financial position as of 30 September 2012 and statements of income and cash flows data for the nine months ended 30 September 2012 and 2011 have been derived from our Unaudited Financial Statements included elsewhere in this Prospectus. The financial results for the nine months ended 30 September 2012 are not necessarily indicative of future financial results.

The information in this “Selected Consolidated Financial and Other Data” section should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Financial Statements.

### Statement of Income

	For the nine months ended 30 September		For the year ended 31 December		
	2012 (unaudited)	2011 (unaudited)	2011	2010	2009
	<i>(RUB millions)</i>				
<b>Revenues:</b>					
Oil and gas sales .....	151,698	125,265	175,809	115,303	86,956
Sales of polymer and insulation tape.....	-	-	-	1,699	1,873
Other revenues .....	551	288	462	163	1,178
<b>Total revenues.....</b>	<b>152,249</b>	<b>125,553</b>	<b>176,271</b>	<b>117,165</b>	<b>90,007</b>
<b>Operating expenses:</b>					
Transportation expenses .....	(43,649)	(34,788)	(48,329)	(37,298)	(29,062)
Taxes other than income tax .....	(13,108)	(12,809)	(17,557)	(10,077)	(8,042)
Purchases of natural gas and liquid hydrocarbons .....	(11,606)	(2,833)	(5,994)	(154)	(1,143)
Depreciation, depletion and amortization .....	(7,588)	(6,307)	(9,277)	(6,616)	(5,588)
General and administrative expenses.....	(7,235)	(5,872)	(8,218)	(6,733)	(5,126)
Materials, services and other .....	(5,138)	(4,394)	(5,947)	(6,072)	(6,259)
Exploration expenses.....	(629)	(1,639)	(1,819)	(1,595)	(566)
Net impairment expenses.....	(49)	(682)	(782)	(541)	(125)
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress .....	526	486	105	470	(255)
<b>Total operating expenses.....</b>	<b>(88,476)</b>	<b>(68,838)</b>	<b>(97,818)</b>	<b>(68,616)</b>	<b>(56,166)</b>
Net gain (loss) on disposal of interest in subsidiaries .....	-	-	62,948	1,329	52
Other operating income (loss) .....	344	(9)	207	353	(360)
<b>Profit from operations .....</b>	<b>64,117</b>	<b>56,706</b>	<b>141,608</b>	<b>50,231</b>	<b>33,533</b>
<b>Finance income (expense):</b>					
Interest expense.....	(2,150)	(1,534)	(2,150)	(437)	(819)
Interest income.....	1,237	2,530	3,392	598	527
Foreign exchange gain (loss) .....	3,285	(3,075)	(3,945)	1,036	(539)
<b>Total finance income (expense) .....</b>	<b>2,372</b>	<b>(2,079)</b>	<b>(2,703)</b>	<b>1,197</b>	<b>(831)</b>
Share of profit (loss) of associates and joint ventures, net of income tax .....	(1,813)	(2,521)	(3,880)	(346)	(202)
<b>Profit before income tax .....</b>	<b>64,676</b>	<b>52,106</b>	<b>135,025</b>	<b>51,082</b>	<b>32,500</b>
<b>Income tax expense:</b>					
Current income tax expense .....	(12,830)	(9,083)	(12,467)	(9,405)	(5,896)
Net deferred income tax expense .....	(954)	(1,949)	(3,267)	(1,399)	(882)
<b>Total income tax expense.....</b>	<b>(13,784)</b>	<b>(11,032)</b>	<b>(15,734)</b>	<b>(10,804)</b>	<b>(6,778)</b>
<b>Profit .....</b>	<b>50,892</b>	<b>41,074</b>	<b>119,291</b>	<b>40,278</b>	<b>25,722</b>
Profit (loss) attributable to:					
Non-controlling interest .....	(19)	(353)	(364)	(255)	(321)
<b>Shareholders of OAO NOVATEK.....</b>	<b>50,911</b>	<b>41,427</b>	<b>119,655</b>	<b>40,533</b>	<b>26,043</b>

## Statement of financial position

	As of		As of	
	30 September		31 December	
	2012	2011	2010	2009
	(unaudited)			
	(RUB millions)			
<b>Assets</b>				
<b>Non-current assets:</b>				
Property, plant and equipment .....	190,032	166,784	185,573	161,448
Investments in associates and joint ventures .....	144,026	123,029	27,026	1,214
Long-term loans and receivables .....	13,456	32,130	40,151	933
Other non-current assets .....	3,007	3,173	2,858	2,669
<b>Total non-current assets .....</b>	<b>350,521</b>	<b>325,116</b>	<b>255,608</b>	<b>166,264</b>
<b>Current assets</b>				
Inventories .....	2,580	1,683	1,868	1,790
Current income tax prepayments .....	288	1,153	285	241
Trade and other receivables .....	15,260	16,699	8,670	8,504
Prepayments and other current assets .....	13,102	14,950	8,504	5,800
Cash and cash equivalents .....	17,472	23,831	10,238	10,532
<b>Total current assets .....</b>	<b>48,702</b>	<b>58,316</b>	<b>29,565</b>	<b>26,867</b>
Assets held for sale .....	-	-	-	508
<b>Total assets .....</b>	<b>399,223</b>	<b>383,432</b>	<b>285,173</b>	<b>193,639</b>
<b>Liabilities and Equity</b>				
<b>Non-current Liabilities:</b>				
Long-term debt .....	65,721	75,180	47,074	23,876
Deferred income tax liabilities .....	13,933	12,805	9,473	7,460
Asset retirement obligations .....	2,609	2,734	2,482	2,232
Other non-current liabilities .....	857	917	917	3,034
<b>Total non-current liabilities .....</b>	<b>83,120</b>	<b>91,636</b>	<b>59,946</b>	<b>36,602</b>
<b>Current liabilities:</b>				
Short-term debt and current portion of long-term debt .....	18,938	20,298	25,152	13,827
Trade payables and accrued liabilities .....	9,985	24,922	28,479	7,335
Current income tax payable .....	1,358	611	1,212	386
Other taxes payable .....	3,588	4,283	2,598	2,045
<b>Total current liabilities .....</b>	<b>33,869</b>	<b>50,114</b>	<b>57,441</b>	<b>23,593</b>
Liabilities associated with assets held for sale .....	-	-	-	4
<b>Total liabilities .....</b>	<b>116,989</b>	<b>141,750</b>	<b>117,387</b>	<b>60,199</b>
<b>Equity attributable to shareholders of NOVATEK:</b>				
Ordinary share capital .....	393	393	393	393
Treasury shares .....	(281)	(281)	(446)	(599)
Additional paid-in capital .....	31,220	31,220	30,865	30,609
Currency translation differences .....	(24)	193	(120)	(112)
Asset revaluation surplus on acquisitions .....	5,617	5,617	5,617	5,617
Retained earnings .....	244,162	203,871	110,810	78,393
<b>Total equity attributable to shareholders of NOVATEK .....</b>	<b>281,087</b>	<b>241,013</b>	<b>147,119</b>	<b>114,301</b>
Non-controlling interest .....	1,147	669	20,667	19,139
<b>Total equity .....</b>	<b>282,234</b>	<b>241,682</b>	<b>167,786</b>	<b>133,440</b>
<b>Total liabilities and equity .....</b>	<b>399,223</b>	<b>383,432</b>	<b>285,173</b>	<b>193,639</b>

## Statement of Cash Flows Data

	For the nine months ended		For the year ended		
	30 September		31 December		
	2012	2011	2011	2010	2009
	(unaudited)	(unaudited)			
	(RUB millions)				
Net cash provided by operating activities .....	57,644	46,883	71,907	44,863	34,847
Net cash provided by (used for) investing activities .....	(27,260)	(51,314)	(46,643)	(68,842)	(36,185)
Net cash provided by (used for) financing activities .....	(37,134)	11,021	(11,735)	23,782	761

## Other Financial Data (Unaudited)

	For the nine months ended 30 September		For the year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(RUB millions)</i>				
Capital expenditures <sup>(1)</sup> .....	31,269	21,480	31,143	26,030	17,872
Free cash flow <sup>(2)</sup> .....	26,375	25,403	40,764	18,833	16,975

<sup>(1)</sup> Represents additions to property, plant and equipment excluding acquisitions of mineral licenses.

<sup>(2)</sup> Free cash flow represents the excess of net cash provided by operating activities over capital expenditures.

## Selected Operational Data (Unaudited)

	For the nine months ended 30 September		For the year ended 31 December		
	2012	2011	2011	2010	2009
<b>Operating results:</b>					
Natural gas sales volumes (mmcm).....	43,004	38,088	53,667	37,117	32,937
Stable gas condensate sales volumes (mt).....	2,155	2,137	2,984	2,330	2,170
Liquefied petroleum gas sales volumes (mt).....	664	654	880	876	749
Crude oil sales volumes (mt).....	308	168	242	185	198
Oil product sales volumes (mt).....	7	4	5	10	11

## Certain Financial Items and Ratios (Unaudited)

	For the nine months ended 30 September		For the year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(RUB millions, certain percentages)</i>				
EBITDA <sup>(1)</sup> .....	69,883	61,656	148,349	57,506	39,691
EBITDA margin <sup>(2)</sup> .....	45.9%	49.1%	84.2%	49.1%	44.1%
EBITDAX <sup>(1)</sup> .....	70,512	63,295	150,168	59,101	40,257
Net debt <sup>(3)</sup> .....	67,187	—	71,647	61,988	27,171
Debt to equity <sup>(4)</sup> .....	30.0%	—	39.5%	43.0%	28.3%

<sup>(1)</sup> EBITDA represents profit (loss) attributable to shareholders of NOVATEK adjusted for the addback of income tax expense, finance expense (income), net impairment expenses and loss (income) from changes in fair value of derivative financial instruments from the statement of income, and depreciation, depletion and amortization and share-based compensation from the statement of cash flows. EBITDAX represents EBITDA as adjusted for the addback of exploration expenses. We present EBITDA and EBITDAX because we consider them important supplemental measures of our operating performance and believe they are frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. EBITDA and EBITDAX have limitations as analytical tools, and you should not consider them in isolation, or as a substitute for analysis of our operating results as reported under IFRS. Some of these limitations are as follows:

- EBITDA and EBITDAX do not reflect the impact of financing costs, which are significant and could further increase if we incur more debt or net impairment expenses on our operating performance.
- EBITDA and EBITDAX do not reflect the impact of income taxes on our operating performance.
- EBITDA and EBITDAX do not reflect the impact of depreciation, depletion and amortization on our operating performance. The assets of our business which are being depreciated, depleted and/or amortized will have to be replaced in the future and such depreciation, depletion and amortization expense may approximate the cost to replace these assets in the future. By excluding this expense from EBITDA and EBITDAX, EBITDA and EBITDAX do not reflect our future cash requirements for these replacements.
- Other companies in our industry may calculate EBITDA and EBITDAX differently or may use it for different purposes than we do, limiting its usefulness as a comparative measure.

We compensate for these limitations by relying primarily on our IFRS operating results and using EBITDA and EBITDAX only supplementally. See the Financial Statements included elsewhere in this Prospectus.

EBITDA and EBITDAX are measures of our operating performance that are not required by, defined by, or presented in accordance with, IFRS.

Neither EBITDA nor EBITDAX is a measurement of our operating performance under IFRS and should not be considered as an alternative to profit (loss) from operations or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, neither EBITDA nor EBITDAX should be considered as a measure of discretionary cash available to us to invest in the growth of our business.

<sup>(2)</sup> Calculated as EBITDA divided by total revenues and shown as a percentage of total revenues.

<sup>(3)</sup> Calculated as total debt less cash and cash equivalents. Total debt is a sum of long-term debt and short-term debt, including current portion of long-term debt reported as short-term debt.

<sup>(4)</sup> Total Debt as calculated in footnote 3 above divided by total equity and shown as a percentage of total equity.

Reconciliation of EBITDA and EBITDAX to profit attributable to shareholders of NOVATEK is as follows for the periods indicated:

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(RUB millions)</i>				
<b>Profit (loss) attributable to shareholders of</b>					
<b>NOVATEK</b> .....	<b>50,911</b>	<b>41,427</b>	<b>119,655</b>	<b>40,533</b>	<b>26,043</b>
Depreciation, depletion and amortization .....	7,833	6,436	9,475	6,757	5,738
Net impairment expenses .....	49	682	782	541	125
Loss (income) from changes in fair value of derivative financial instruments .....	(322)	-	-	-	-
<b>Total finance expense (income)</b> .....	<b>(2,372)</b>	<b>2,079</b>	<b>2,703</b>	<b>(1,197)</b>	<b>831</b>
<b>Total income tax expense</b> .....	<b>13,784</b>	<b>11,032</b>	<b>15,734</b>	<b>10,804</b>	<b>6,778</b>
Share-based compensation .....	-	-	-	68	176
<b>EBITDA</b> .....	<b>69,883</b>	<b>61,656</b>	<b>148,349</b>	<b>57,506</b>	<b>39,691</b>
Less: Net gain on disposal of interest in subsidiaries .....	-	-	(62,948)	(1,329)	(52)
<b>Normalized EBITDA</b> <sup>(1)</sup> .....	<b>69,883</b>	<b>61,656</b>	<b>85,401</b>	<b>56,177</b>	<b>39,639</b>
Exploration expenses .....	629	1,639	1,819	1,595	566
<b>Normalized EBITDAX</b> <sup>(2)</sup> .....	<b>70,512</b>	<b>63,295</b>	<b>87,220</b>	<b>57,772</b>	<b>40,205</b>

<sup>(1)</sup> Normalized EBITDA excludes net gain on disposal of interests in subsidiaries.

<sup>(2)</sup> Normalized EBITDAX represents EBITDA as adjusted for the addback of exploration expenses and excludes net gain on disposal of interest in subsidiaries.

### Selected Macro-Economic Data

Exchange rate of Rouble to U.S. Dollar <sup>(1)</sup>	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(RUB per 1 U.S.\$)</i>				
At the beginning of the period.....	32.20	30.48	30.48	30.24	29.39
At the end of the period.....	30.92	31.88	32.20	30.48	30.24
Average for the period .....	31.10	28.77	29.39	30.37	31.72

Crude oil prices	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(U.S.\$ / bbl)</i>				
<b>West Texas Intermediate (WTI)</b> <sup>(2)</sup>					
At the end of the period .....	92.10	79.20	98.83	91.38	79.36
Average for the period .....	95.69	95.47	95.12	79.61	60.09
<b>Brent</b> <sup>(3)</sup>					
At the end of the period .....	111.03	105.25	106.51	92.55	77.67
Average for the period .....	112.21	111.89	111.26	79.50	61.67
<b>Urals</b> <sup>(3)</sup>					
At the end of the period .....	109.93	102.31	104.29	90.27	77.00
Average for the period .....	110.90	109.23	109.09	78.29	61.18

<sup>(1)</sup> According to the CBR. The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR for each such business day) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

<sup>(2)</sup> Based on New York Mercantile Exchange Light Sweet prices provided by Reuters to Platts.

<sup>(3)</sup> Based on Brent (Dtd) prices and Russian Urals/ESPO spot assessments prices as provided by Reuters to Platts. ESPO stands for East Siberian Pipeline Ocean crude oil.

Export duties	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(U.S.\$ / ton<sup>(1)</sup>)</i>				
<b>Crude oil, stable gas condensate</b>					
At the end of the period.....	393.8	444.1	406.6	303.8	271.0
Average for the period .....	403.5	410.7	408.9	273.6	179.3
<b>LPG</b>					
At the end of the period.....	76.2	192.0	221.8	118.1	105.0
Average for the period .....	156.7	161.9	176.0	61.2	105.0 <sup>(2)</sup>

<sup>(1)</sup> Export duties are determined by the Government in U.S. Dollars and are paid in Roubles.

<sup>(2)</sup> A zero export duty for LPG was effective 1 January to 1 December 2009. For December 2009 export duty was set at U.S.\$ 105.0 per ton.

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

*The following discussion and analysis of our financial condition and results of operations as at and for the nine months ended 30 September 2012 and 2011, and as at and for each of the years ended 31 December 2011, 2010 and 2009 should be read in conjunction with "Selected Consolidated Financial and Other Data" and the Financial Statements included in this Prospectus. This review includes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from the anticipated in the forward-looking statements as a result of numerous factors, including the risks described in "Risk Factors". See "Forward-Looking Statements".*

### Overview

We are Russia's largest independent natural gas producer and second-largest natural gas producer in Russia after Gazprom, in each case according to data from the CDU-TEK for the nine months ended 30 September 2012. We are principally engaged in the exploration, production, processing and marketing of natural gas and liquid hydrocarbons and have over 17 years of operational experience in the Russian natural gas and oil sector. In 2011 and the nine months ended 30 September 2012, we accounted for approximately 8% and 9%, respectively, of the natural gas produced in Russia, providing approximately 15% and 17%, respectively, of total natural gas deliveries through the UGSS to the domestic market, according to the CDU-TEK. In 2012, we started trading activities on the European gas market, by selling and purchasing natural gas.

Our core strategy is to maintain our position as the leading independent natural gas producer in Russia, based on reserves and production, by increasing our hydrocarbon production on a sustainable and profitable basis, while efficiently expanding our hydrocarbon resource base, developing our marketing channels and exploring complementary and value added projects. We supply natural gas to Russia's domestic market and are focused on meeting the anticipated growing demand in Russia (as forecasted by the International Energy Agency), and, as such, we expect to benefit from future increases in regulated prices for natural gas sold and in power generation capacity and infrastructure investments in Russia, as projected by the Ministry of Economic Development of the Russian Federation.

Our exploration, development, production and processing of natural gas and liquid hydrocarbons are conducted within the Russian Federation and our operating areas are concentrated in YNAO, in Western Siberia. According to the YNAO Administration, the MER and the BP Statistical Review of World Energy (June 2012), YNAO is the leading gas producing region in Russia, accounting for approximately 90% of Russia's natural gas production and approximately 17% of the global natural gas production in 2011.

As of 31 December 2011, we had 9,393 mmbob of proved reserves, of which 92% were natural gas reserves, under SEC reserves methodology. For the three years ended 31 December 2011, our three-year average reserves replacement ratio was 597%, on a boe basis, based on proved reserves under SEC reserves methodology. The reserve life of our proved reserves under SEC reserves methodology was 25 years based on our annual production in 2011.

During the periods under review, we have consistently increased our hydrocarbon production, and we expect to continue increasing our production levels in the future. In the nine months ended 30 September 2012, we produced 41.4 bcm of natural gas and 3.1 mmt of liquid hydrocarbons, an increase of 7.3% and 2.0%, respectively, compared to the nine months ended 30 September 2011. Our natural gas and liquid hydrocarbons production totaled 52.9 bcm and 4.1 mmt, respectively, in 2011, 37.3 bcm and 3.6 mmt, respectively, in 2010, and 32.4 bcm and 3.0 mmt, respectively, in 2009.

Our three Core Fields accounted for 52.5% of our total proved reserves, under SEC reserves methodology, as of 31 December 2011, and approximately 90% of our gas production volumes in 2011. A significant portion of our total hydrocarbon proved reserves and production is contributed by our Joint Ventures which we account under the equity method, as we share control over these entities with our joint venture partners.

Our Joint Ventures accounted, collectively, for 42.9% of our proved reserves, under SEC reserves methodology, as of 31 December 2011. In particular, our 25.5% economic interest in SeverEnergia and 51% stake in Sibneftegas together accounted for 14.1% of our proved reserves as of 31 December 2011; and our 80% economic interest in Yamal LNG accounted for 27.7% of our proved reserves as of 31 December 2011. Production at SeverEnergia commenced in April 2012; in 2011, our share in Sibneftegas' production accounted for 10.2% of our total natural gas production volumes. Yamal LNG has not yet started production. We also hold licenses for as yet undeveloped fields in the Gydan peninsula.

We generate revenues primarily from natural gas and gas condensate sales and, to a lesser extent, sales of other liquid hydrocarbons. In the nine months ended 30 September 2012, our sales of (i) natural gas accounted for 66.3% of our total revenues, (ii) stable gas condensate for 23.1% and (iii) LPG, crude oil and oil related products for 10.3%. In 2011, our sales of (i) natural gas accounted for 62.9% of our total revenues, (ii) stable gas condensate for 26.5% and (iii) LPG, crude oil and oil related products accounted for 10.3%. For the nine months ended 30 September 2012, we

had total revenues of RUB152.2 billion and EBITDA of RUB69.9 billion. In 2011, we generated total revenues of RUB176.3 billion and EBITDA of RUB148.3 billion.

In accordance with Russian law, we currently sell all our natural gas production to customers in the Russian Federation. Our customers are primarily power generation companies, industrial users, regional gas distributors and wholesale gas traders. We also sell some of our gas to households. As an independent natural gas producer, we are not subject to the Government's regulation of natural gas prices except for our sales to households, which represent a minor share of our total sales volumes. Nevertheless, the regulated price as set by the FTS significantly influences the market conditions in our regions of delivery as well as the price in our natural gas contracts with end-customers and wholesale traders. The FTS-regulated wholesale price has been increasing in recent years, including the latest increase of 15% which took effect on 1 July 2012.

We transport our natural gas through our pipelines into the UGSS, which we use to deliver our gas to end-customers in accordance with the relevant transportation contracts we enter into with Gazprom. The UGSS transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. UGSS transportation tariffs are set by the FTS.

Substantially all of our stable gas condensate is sold internationally, whereas our other liquid hydrocarbons, including LPG, crude oil and oil related products, are sold domestically and internationally. Gas condensate is produced in an unstable form and requires processing before it can be delivered to customers. We currently process all of our de-ethanized gas condensate at our Purovsky Plant, the capacity of which we are currently expanding from 5 mmt to 11 mmt per annum. In the nine months ended 30 September 2012 and in 2011, we processed 2.9 mmt and 3.9 mmt, respectively, of de-ethanized gas condensate. Following processing, we export substantially all of our stable gas condensate to international markets, via the Port of Vitino on the White Sea in the Murmansk region. In the nine months ended 30 September 2012 and in 2011, we sold 2.2 mmt and 3.0 mmt, respectively, of stable gas condensate. We are currently building a new gas condensate transshipment and fractionation complex at the Ust-Luga terminal on the Baltic Sea. We expect that the completion of this project will allow us to partially replace sales of stable gas condensate with sales of a range of petroleum products, as well as to replace the Port of Vitino for deliveries of our gas condensate and products made from it to the international markets. The terminal is expected to begin operations in 2013.

NOVATEK has pursued, and continues to consider, participating in natural gas projects outside Russia. In 2007-2011, we pursued the El-Arish offshore gas and oil project in Egypt; when initial exploratory works and drilling failed to confirm sufficient commercially recoverable reserves we ended our participation in this project, expensing our capital costs. With our strategic partner TOTAL and Gazprombank, we are currently pursuing an offshore natural gas project in the Republic of Cyprus via a joint venture, in which we have a 25% stake, TOTAL 65% and Gazprombank 10%. The joint venture is currently in negotiations with the Cypriot authorities regarding the terms of exploration and production on a block of the Cypriot shelf under a production sharing agreement.

## **Recent Developments**

### ***Operating Environment***

#### *Changes to the UPT Rate*

See “*Risk Factors—Risks Relating to the Russian Taxation System—The Russian taxation system is not well-developed and is subject to frequent changes, which could have an adverse effect on us*”.

### ***Operational Developments***

#### *Natural Gas Supply Contract with MOSENERGO*

On 5 December 2012, our Board of Directors approved a deal to deliver 27 bcm of natural gas to MOSENERGO in 2013-2015, which we believe facilitates closer access to end-consumers. Completion of the deal is subject to the satisfaction of several conditions, including approval by our General Meeting of Shareholders.

#### *Acquisition of Nortgas*

On 27 November 2012, we completed the acquisition of a 49% equity stake in Nortgas from R.E.D.I. HOLDINGS. Gazprom currently holds the remaining 51% in Nortgas. The purchase price for the acquisition was U.S.\$1,375 million. See “*Use of Proceeds*”, “*—Bridge Facility*” and “*—Rouble Bond Issuance*”. We will account for this company under the equity method.

Nortgas holds the hydrocarbon production license (which expires in 2018) for the North-Urengoyskoye field, located in the Nadym-Pur-Taz and Purovskiy regions of YNAO, and is in close proximity to our existing production, transportation and processing infrastructure. According to Nortgas, as at 31 December 2011, it had estimated proved reserves of 1.7 bboe of hydrocarbons, including 225 bcm of natural gas and 27 mmt of liquids, under PRMS (as defined below) reserves methodology. Accordingly, our acquisition of the 49% stake in Nortgas has increased our proved reserves (in terms of boe) by approximately 7% (with reference to our PRMS proved reserves as of 31 December 2011). In the nine months ended 30 September 2012, the North-Urengoyskoye field produced 3.1 bcm

of natural gas and 320 mt of de-ethanized gas condensate. Prior to the acquisition, we obtained all necessary corporate approvals, the FAS antimonopoly clearance and a waiver of Gazprom's pre-emptive right to acquire the stake sold by R.E.D.I. HOLDINGS.

#### *Bridge Facility*

On 26 November 2012, we received a U.S.\$667 million bridge loan under the Bridge Facility. The Bridge Facility, which includes certain restrictive financial covenants, has a 1.5 year tenor with a bullet repayment to be made by 20 May 2014. The interest rate under the bridge facility is LIBOR plus 1% per annum until 19 May 2013; LIBOR plus 1.5% per annum from 20 May 2013 until 19 August 2013; LIBOR plus 1.75% per annum from 20 August 2013 until 19 November 2013; and LIBOR plus 2.25% per annum for the period from 20 November 2013 until the maturity date. We intend to repay the bridge facility using the proceeds of the Loan. See "Use of Proceeds".

#### *Domestic Rouble Bonds Program*

On 20 November 2012, our Board of Directors approved the establishment of a RUB45 billion domestic bonds program (the "**Domestic Bonds Program**") and related regulatory filings. The Domestic Bonds Program comprises four series of non-convertible interest-bearing bonds with principal amounts of RUB10 billion, RUB10 billion, RUB10 billion and RUB15 billion, respectively, each series having a three-year maturity period and semi-annual coupons (or a total of six coupon payments). The bonds issued under the Domestic Bonds Program will be placed on the Moscow Exchange. As of the date of this Prospectus, no bonds were issued under the Domestic Bonds Program.

#### *Share Buy-Back Program*

On 16 November 2012, NOVATEK announced that it began purchases under its share/GDR buy-back program. See "Shareholders—Buy-back Program".

#### *Rouble Bond Issuance*

On 15 October 2012, we issued three-year non-convertible Rouble-denominated bonds in the amount of RUB20 billion with a coupon rate of 8.35% per annum. A portion of the proceeds of the bonds were used to finance the Nortgas acquisition, as well as general corporate purposes.

#### *Yurkharovskoye Field Development*

In October 2012, we completed the construction of the fourth stage of the second phase development at our Yurkharovskoye field, which includes the construction of two gas treatment trains with total annual capacity of 7 bcm. Launch of the fourth stage is expected to allow us to increase natural gas production at the field to a plateau level of 36.5 bcm per annum.

### **Certain Factors Affecting Our Results of Operations**

The following factors are the key factors that have significantly affected our results of operations and financial condition during the periods under review, and the comparability thereof, or which we expect will significantly affect (or continue to affect) our operations in the future.

#### ***Impact of the Global Financial Crisis and Current Financial Market Conditions***

Our financial condition and results of operations are significantly influenced by general economic conditions, in particular, the health of the Russian economy and those countries where we make sales to, and the availability of financing on the domestic and international capital markets. See "Risk Factors—Risks Relating to Our Business and Industry—Global economic developments and Russian market conditions may adversely affect our business, financial condition and results of operations" and "Risk Factors—Risks Relating to Russia—Political, Economic and Social Risks—Economic or social instability could have a material adverse effect on our business".

The global financial crisis had a negative impact on the Russian economy and consequently on our customers' demand for natural gas. A fall in GDP, for example, would likely lead to a decline in our sales. Russian GDP declined by 7.9% in 2009. At the same time, our sales of natural gas (excluding traders in remote points) in 2009 declined by approximately a quarter in terms of volumes, compared to 2008. Nevertheless, a prolonged cold spell in the winter of 2008 as well as an unusually cold winter in 2009 helped to sustain customer demand for natural gas and counter the negative effects of the crisis and declining GDP in Russia. As a result of the reduced demand, in the second quarter of 2009, we renegotiated the sales terms for some of our natural gas volumes and began sales to "traders in remote points", which involved us assuming transportation expenses and making wholesale gas deliveries to Gazprom's subsidiary OOO "Gazprom Mezhrefiongaz" (formerly OOO "Mezhrefiongaz" ("**Mezhrefiongaz**")) to regions close to Mezhrefiongaz's end-customers, as opposed to our general practice of entering into wholesale sales on an ex-field basis. The renegotiated sales terms contributed to an overall decrease in our total average natural gas netback price of 1.8% in 2009 compared to 2008, which was primarily due to additional transportation expense incurred for these volumes and distances delivered. Nevertheless, by renegotiating this contract, we were able to grow our natural gas production volumes by 6.3% in 2009 compared to 2008, which yielded gas condensate and LPG so that we increased

our stable gas condensate and LPG sales volumes which we sold to customers in the international markets. The above sales terms with Mezhhzongas were in effect until December 2009.

The global financial crisis also had an impact on our ability to raise financing and fund capital planned capital expenditures. The crisis, among other things, resulted in a lower level of capital market raising activities, a lower level of liquidity across the international and Russian banking sector and higher interbank lending rates. It led to a reduction of our capital expenditures in 2009 to RUB17,872 million from RUB31,810 million in 2008. In 2009, our actual capital expenditures were lower than planned, in part, because the economic crisis contributed to a significant reduction in costs for construction materials and equipment and costs of contractor and service companies' services, allowing us to realize our plans in full with a lower capital expenditure program.

The global financial crisis and its impact on the Russian economy has somewhat receded since 2010. According to Rosstat, Russian GDP rose by 4.3% in each of 2010 and 2011. In the six months ended 30 June 2012, GDP increased by 4.5% compared to the corresponding period in 2011. Our total sales in the nine months ended 30 September 2012 rose by 21.3% in terms of revenues compared to the nine months ended 30 September 2011; in 2011, our total sales increased by 50.4% in terms of revenues compared to 2010; in 2010 increased by 30.2% in terms of revenues compared to 2009. As the economy began to recover from the crisis, we were able to maintain sufficient cash flows and access to short-term credit, so as to adequately fund our natural gas business operations and meet our planned capital expenditure levels in 2010 and 2011 and the nine months ended 30 September 2012.

Our results of operations have been negatively affected by inflation in Russia. The relatively high rate of inflation in Russia reduces the value of our Rouble-denominated cash assets, including Rouble deposits, domestic debt instruments and accounts receivable. According to Rosstat, inflation in Russia in 2011, 2010 and 2009 was 6.1%, 8.8% and 8.8%, respectively. High levels of domestic inflation in the future will reduce the value of our cash assets denominated in Roubles. As of 30 September 2012, 45% of our cash and cash equivalents were denominated in Roubles.

Our results of operations have also been negatively affected by depreciation of the Rouble against the U.S. Dollar because such depreciation increases the amount of our U.S. Dollar-denominated debt in Rouble terms, leading to foreign exchange losses as the book value of our U.S. Dollar-denominated debt increases when translated into Roubles (which is partially offset by our revenues denominated in U.S. Dollars). According to the CBR, the nominal depreciation of the Rouble against the U.S. Dollar during 2011, 2010 and 2009 was 6.1%, 0.8% and 2.9%. During the global financial crisis, the Rouble exhibited significant volatility, depreciating, in nominal terms, against the U.S. Dollar by almost 40% and against the Euro by nearly 30% from October 2008 to February 2009. Any depreciation of the Rouble in the future will have a similar impact on the Rouble value of our U.S. Dollar-denominated debt and revenues. As of 30 September 2012, RUB49,852 million, or 58.9%, of our long-term and short-term debt was denominated in U.S. Dollars. See *"Risk Factors—Risks Relating to Our Business and Industry—We face foreign exchange and inflation risks that could have a material adverse effect on our business, financial condition, results of operations and prospects"*.

We continue to witness signs of economic instability in the Eurozone that have prolonged a period of market volatility as well as changes in the political landscape following the recent elections in Russia. The Greek bailout package, the looming debt crisis in certain EU countries, the proposed "austerity programs" in the Eurozone and the potential threat to the European banking community of a sovereign-debt crisis in the EU have been the main drivers of the market volatility. The recent wave of market uncertainty continues to negatively impact all borrowers by limiting access to the capital markets as well as causing continued volatility in the equity and currency markets, especially for those companies operating in emerging markets.

The impact of this continued economic stability is difficult to predict. We will continue to monitor the economic environment in Russia, as well as the domestic and international capital markets, to determine if any further corrective and/or preventive measures are required to sustain and grow our business. In addition, if we deem necessary, we will attempt to mitigate counterparty credit exposure from our natural gas and liquid hydrocarbon sales and take steps to ensure the safety of our excess funds deposited with both domestic and international banks.

### **Natural Gas Prices**

As an independent natural gas producer, we are generally not subject to the Government's regulation of natural gas prices, except for those volumes delivered to households, although the prices we can achieve on the domestic market are strongly influenced by the prices regulated by the FTS and present market conditions. The FTS price for natural gas varies from region to region. When the FTS increases gas tariffs, the increase may vary regionally from the overall nation-wide average increase. See *"Risk Factors—Risks Relating to Our Business and Industry—Government regulation keeps Gazprom's natural gas prices in Russia lower than its international natural gas prices, and we have limited ability to set higher domestic prices than those charged by Gazprom"* and *"Business—Sales and Marketing—Natural Gas—Sales of natural gas"*.

In the nine months ended 30 September 2012, the weighted average FTS price for the primary regions where we delivered our natural gas increased by RUB110 per mcm, or 4.2%, to RUB2,732 per mcm compared to



RUB2,622 per mcm in the corresponding period in 2011. In 2011, the weighted average FTS price for the primary regions where we delivered our natural gas was RUB2,619 per mcm, compared to RUB2,299 in 2010 and RUB1,776 mcm in 2009.

In November 2006, the FTS approved and published an initial plan to liberalize the price of natural gas sold on the Russian domestic wholesale market by 2011. As part of the initial plan, the FTS approved four quarterly increases in the regulated gas price for natural gas in 2009, raising it by 5% in the first quarter, 7% in the second quarter, 7% in the third quarter and 6.2% in the fourth quarter (resulting in an average total increase of 15.9% in 2009). In December 2009, the FTS increased the regulated prices for natural gas by 15% effective from 1 January 2010 and subsequently in December 2010 by a further 15% effective from 1 January 2011. According to the Domestic Gas Market Liberalization Plan, which was approved by the Government in 2011 and which introduced certain revisions to the plan approved by the FTS in 2006, the target start date for the full liberalization of the domestic natural gas market is 1 January 2015, but there are various governmental discussions indicating that this program may be further extended. As part of the Domestic Gas Market Liberalization Plan, the FTS announced a 15% increase in natural gas prices effective 1 July 2012. According to the revised Forecast of Socio-Economic Development of the Russian Federation for 2012, published by the Ministry of Economic Development in September 2011, the regulated natural gas prices will be increased by 15% effective 1 July 2013 and by a further 15% effective 1 July 2014. We cannot predict the timing of price liberalization on the domestic gas market or the extent to which the market will be liberalized, as the FTS reserves the right to modify the percentage increases already published, as well as to prolong the timetable toward market price liberalization based on market conditions and other factors. We do not expect domestic gas prices to rise sharply in the next three years.

The specific terms for delivery of natural gas affect our average realized prices. Natural gas sold “ex-field” is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs and transportation arrangements. However, in 2009, we sold a portion of our natural gas to a major wholesale gas trader, Mezhtregiongaz, on a delivered basis to the regions where the natural gas was consumed (the “traders in remote points” category of our natural gas sales). See “—*Impact of the Global Financial Crisis and Current Financial Market Conditions*”, above. Generally, sales to wholesale gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses, such as transportation expenses. We sell our natural gas to end-customers on a delivered basis. The transport tariffs set by the FTS vary from region to region, and our transport costs also reflect the distance of our gas deliveries. Historically, we have realized higher prices and margins for natural gas volumes sold directly to end-customers, as the gas transportation tariff is included in the contract price and end-customers do not take the retail margin that wholesale gas traders take. In the present or future market conditions, such tendency may or may not prevail, as evidenced by shifts in our sales composition since 2010.

In December 2011, we commenced natural gas sales to households at FTS-regulated prices in the Chelyabinsk region as a result of the acquisition of the regional gas trader Gazprom mezhtregiongas Chelyabinsk, since merged into our wholly-owned subsidiary NOVATEK-Chelyabinsk. We include such sales in our end-customers category.

In the nine months ended 30 September 2012, as compared with the corresponding period in 2011, our average natural gas price to end-customers (including transportation cost) and ex-field price increased by 4.7% and 6.2%, respectively, whereas our average transportation expenses for the delivery of natural gas to end-customers increased by 0.4% due to the postponement of the 7.0% increase in the average transportation tariff set by the FTS to 1 July from 1 January 2012. In addition, since 2011, the growth of the FTS-regulated natural gas prices (which affect the prices we charge our end-customers) has been significantly outpacing the growth of the FTS tariffs for gas transportation, the single largest component of our operating expenses. As of 1 July 2012, the FTS-set natural gas price increased by 15%, while the average FTS transportation tariff increased by 7%. As a result, in the nine months ended 30 September 2012, our average natural gas netback price on end-customer sales (which represents our average natural gas price to end-customers less average natural gas transportation expense to end-customers) increased by 8.5%, whereas our total average natural gas price excluding transportation expense increased by 7.9%, compared to the respective prices in the nine months ended 30 September 2011.

In 2011, our average natural gas price to end-customers (including transportation cost, excluding trading activities) and ex-field price increased by 13.7% and 14.9%, respectively, as compared to 2010, whereas our average transportation expenses for the delivery of natural gas to end-customers (excluding trading activities) increased by 7.9% primarily due to a 9.3% increase in the average transportation tariff for 2011, compared to average transportation tariffs in 2010 (see “—*Transportation Tariffs—Natural Gas*”). As a result, our average netback price on end-customer sales (excluding trading activities) increased by 19.2%, whereas our total average natural gas price excluding transportation expense increased by 17.3%, compared to the respective prices in 2010. In addition, our average netback price on end-customer sales (excluding trading activities) in 2011 improved compared to 2010, because the FTS-regulated gas prices (affecting our prices for end-customers) grew by 15%, which outpaced the growth in the FTS average transportation tariff in 2011 (9.3% effective from 1 January 2011).

In 2010, our average natural gas price to end-customers (including transportation cost, excluding traders in remote points) and ex-field price increased by 19.5% and 15.4%, respectively, as compared to 2009, whereas our average transportation expenses for the delivery of natural gas to end-customers (excluding traders in remote points)

increased by 38.3% primarily due to a 22.9% increase in the average transportation tariff set by the FTS for 2010 compared to average transportation tariff in 2009. (See “—*Transportation Tariffs—Natural Gas*”), as well as an increase in our average delivery distance. As a result of the above factors as well as the termination of natural gas sales to traders in remote points effective 1 January 2010, in 2010, our average natural gas netback price on end-customer sales increased by 6.0%, while our total average natural gas price excluding transportation expenses increased by 17.5%, compared to the respective prices in 2009.

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

In the third quarter of 2012, we entered into a series of long-term and short-term contracts for the purchase and sale of natural gas on the European market. See “—*Segment Information*” and “—*Liquidity and Capital Resources—Derivative contracts*”, below, and “—*Qualitative and Quantitative Disclosures and Market Risks—Commodity Risk—Natural gas foreign trading activities*”. The prices in these contracts are based on formulas with reference to benchmark natural gas prices quoted for the North-Western European natural gas hubs, crude oil and products’ prices and/or a combination thereof.

The following table shows our average realized domestic natural gas sales prices (net of VAT) for the nine months ended 30 September 2012 and 2011 and the years ended 31 December 2011, 2010 and 2009, excluding volumes purchased for resale in the location of our end-customers in 2012:

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(RUB per mcm)				
<b>Average natural gas price:<sup>(1)</sup></b>					
End-customers <sup>(2)</sup> .....	2,753	2,629	2,627	2,310	1,933
Traders in remote points .....	—	—	—	—	1,836
<b>Average natural gas price to end-customers<sup>(1)</sup></b>	<b>2,753</b>	<b>2,629</b>	<b>2,627</b>	<b>2,310</b>	<b>1,900</b>
<b>Average natural gas transportation expense:</b>					
End-customers.....	(1,215)	(1,210)	(1,207)	(1,119)	(809)
Traders in remote points .....	—	—	—	—	(1,054)
<b>Average natural gas transportation expense for sales to end-customers.....</b>	<b>(1,215)</b>	<b>(1,210)</b>	<b>(1,207)</b>	<b>(1,119)</b>	<b>(893)</b>
<b>Average natural gas netback price:</b>					
End-customers.....	1,539	1,419	1,420	1,191	1,124
Traders in remote points .....	—	—	—	—	782
<b>Average natural gas netback price on end-customer sales.....</b>	<b>1,539</b>	<b>1,419</b>	<b>1,420</b>	<b>1,191</b>	<b>1,007</b>
<b>Average natural gas price ex-field (wholesale traders)</b>	<b>1,478</b>	<b>1,392</b>	<b>1,392</b>	<b>1,211</b>	<b>1,049</b>
<b>Total average natural gas price excluding transportation expense.....</b>	<b>1,518</b>	<b>1,407</b>	<b>1,407</b>	<b>1,199</b>	<b>1,020</b>
<b>Weighted average regulated price in regions where NOVATEK delivers gas.....</b>	<b>2,732</b>	<b>2,622</b>	<b>2,619</b>	<b>2,299</b>	<b>1,776</b>

<sup>(1)</sup> Includes cost of transportation.

<sup>(2)</sup> Starting from December 2011, end-customers include household customers.

### ***Crude Oil, Stable Gas Condensate, LPG and Oil Products Prices***

Crude oil, stable gas condensate, LPG and oil products prices have historically been volatile depending on, among other things, the balance between supply and demand fundamentals, the ability and willingness of oil producing countries to sustain or change production levels to meet changes in global demand and potential disruptions in global crude oil supplies due to war, geopolitical developments, terrorist activities or natural disasters. See “*Risk Factors—Risks Relating to Our Business and Industry—A substantial or extended decline in natural gas, oil, refined products or petrochemical products prices would have a material adverse effect on our business, financial condition, results of operations and prospects*”.

The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management, such as movements in international benchmark crude oil prices. Crude oil that we sell bound for international markets is transported through the Transneft pipeline system where it is blended with other crude oil of varying qualities to produce an export blend commonly referred to as “Urals blend”, which historically has traded at a discount to the international benchmark Brent crude oil. See “*Selected Consolidated Financial and Other Data—Selected Macro-Economic Data*”.

Volatile movements in benchmark crude oil prices can have a positive and/or negative impact on the ultimate prices we receive for our sales of hydrocarbon liquids on both the domestic and international markets, among many other factors. In the nine months ended 30 September 2012, the average benchmark crude oil prices were

approximately the same as in the corresponding period in 2011. In 2011, the average benchmark crude oil prices exceeded those in 2010 by more than 20%, which in turn exceeded those in 2009 by more than 25%.

The following table shows our average realized stable gas condensate, LPG, methanol, crude oil and oil products sales prices, excluding LPG trading activities (net of VAT and export duties, where applicable) for the nine months ended 30 September 2012 and 2011, and the years ended 31 December 2011, 2010 and 2009 (prices in U.S. Dollars were translated from Roubles using the average exchange rates for the period indicated):

	Nine months ended		Year ended		
	30 September		31 December		
	2012	2011	2011	2010	2009
	<i>(RUB or U.S.\$ per ton)</i>				
<b>Stable gas condensate</b>					
Net export price, RUB per ton .....	16,360	15,819	15,676	12,778	10,989
Net export price, U.S.\$ per ton.....	526.0	549.9	533.4	420.8	346.4
Domestic price, RUB per ton.....	12,374	13,818	13,818	10,022	6,483
<b>LPG</b>					
Net export price, RUB per ton .....	21,592	21,163	21,401	18,433	13,416
Net export price, U.S.\$ per ton.....	694.3	735.6	728.2	606.9	422.9
CIS price, RUB per ton.....	—	13,355	13,355	17,351	10,694
Domestic price, RUB per ton.....	13,627	12,856	13,458	10,928	8,283
<b>Methanol</b>					
Domestic price, RUB per ton.....	10,673	9,999	10,000	—	—
<b>Crude oil</b>					
Net export price, RUB per ton .....	12,096	10,747	10,983	8,538	8,093
Net export price, U.S.\$ per ton.....	388.9	373.5	373.7	281.2	255.1
Domestic price, RUB per ton.....	11,000	9,567	9,792	7,523	6,051
<b>Oil products</b>					
Net export price, RUB per ton .....	—	—	—	—	9,498
Net export price, U.S.\$ per ton.....	—	—	—	—	299.4
Domestic price, RUB per ton.....	—	—	—	6,773	5,419

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

#### *Stable Gas Condensate*

We sell our stable gas condensate under spot contracts. In the nine months ended 30 September 2012, our stable gas condensate export delivery terms were cost and freight (CFR), or delivery to the port of destination ex-ship (DES), or delivery at point of destination (DAP) or price at cost, insurance and freight (CIF), while in the corresponding period in 2011 our delivery terms were CIF, DAP, CFR, delivery at terminal (DAT), or DES. In the nine months ended 30 September 2012, our average export stable gas condensate contract price, including export duties, equaled approximately U.S.\$933 per ton compared to approximately U.S.\$942 per ton in the corresponding period of 2011.

In 2011, our stable gas condensate export delivery terms were DES, CIF, CFR, DAP or DAT. In 2010 and 2009, stable gas condensate was exported DES, CIF or CFR. In 2011, 2010 and 2009, our average export stable gas condensate contract price, including export duties, equaled approximately U.S.\$931, U.S.\$692 and U.S.\$530 per ton, respectively.

#### *LPG*

In the nine months ended 30 September 2012 and 2011, our LPG export delivery terms were DAP at the border of the customer's country, carriage paid to (CPT) the Port of Temryuk (southern Russia on the Sea of Azov) and free carrier (FCA) at terminal points in Poland. In the nine months ended 30 September 2012, our average export contract price for LPG produced at the Purovsky Plant, including export duties, was approximately U.S.\$863 per ton compared to approximately U.S.\$893 per ton in the corresponding period of 2011.

In 2011, our LPG export delivery terms were DAP at the border of the customer's country, CPT to the Port of Temryuk and FCA at terminal points in Poland. In 2010, our LPG export delivery terms were delivery at frontier (DAF) at the border of the customer's country, CPT to the Port of Temryuk, CPT to the rail station Klyucharki (western Ukraine), CPT to the border of the customer's country; and FCA at terminal points in Poland. In 2009, our LPG export delivery terms were DAF at the border of the customer's country and CPT to the Port of Temryuk. For customers located in the CIS, in 2009 and 2010 we only used DAF at the border of the customer's country.

In 2011, 2010 and 2009, our average export contract price for LPG produced at the Purovsky Plant, including export duties, equaled U.S.\$904, U.S.\$619 and U.S.\$439 per ton, respectively.

In addition, in the third quarter of 2010, we sold in Poland approximately two thousand tons of LPG purchased for resale from third parties through our wholly-owned subsidiary, Intergaz-System Spz.o.o. (“**Intergaz-System**”).

In the nine months ended 30 September 2012, we sold a total of 312 thousand tons of LPG on the domestic market at an average price of RUB13,623 per ton, including volumes purchased for resale and sold through our wholly-owned subsidiary OOO NOVATEK-AZK (“**NOVATEK-AZK**”), compared to 310 thousand tons at an average price of RUB12,856 per ton in the nine months ended 30 September 2011.

In 2011, we sold a total of 426 thousand tons of LPG on the domestic market at an average price of RUB13,458 per ton; in 2010, 442 thousand tons at an average price of RUB10,928 per ton; and in 2009, 335 thousand tons at an average price of RUB8,283 per ton.

#### *Methanol*

In the nine months ended 30 September 2012, we sold approximately seven thousand tons of methanol produced by our production subsidiaries to our Joint Ventures and third parties at an average price of RUB10,673 per ton, compared to approximately three thousand tons at an average price of RUB9,999 per ton in the corresponding period in 2011.

In 2011, we sold approximately four thousand tons of methanol produced by our production subsidiaries to our Joint Ventures and third parties at an average price of RUB10,000 per ton. No such sales were made in 2010 and 2009.

#### *Crude Oil*

We sell our crude oil under spot contracts. Our crude oil export prices are based on benchmark crude oil prices of Brent dated, less a discount; our domestic sales are arranged on a transaction-by-transaction basis. In the nine months ended 30 September 2012 and 2011, we sold our crude oil exports DAP (Feneshlitke, Hungary). In the nine months ended 30 September 2012, our average crude oil export contract price, including export duties, equaled approximately U.S.\$788 per ton compared to approximately U.S.\$790 per ton in the corresponding period of 2011.

In 2011 and 2010, we sold our crude oil exports DAP (Feneshlitke, Hungary) and DAF (Feneshlitke, Hungary), respectively. In 2009, our crude oil export delivery terms were either DAF (Adamova Zastava, Germany) or DAF (Feneshlitke, Hungary). In 2011, 2010 and 2009, our average crude oil export contract price, including export duties, equaled approximately U.S.\$787, U.S.\$557 and U.S.\$441 per ton, respectively.

#### *Oil Products*

We have made no deliveries of oil products to export markets after 2009. We make domestic sales of oil products produced from our unstable gas condensate on FCA (Surgut railroad station, Khanty-Mansiysk Autonomous Region) basis. The prices for our domestic sales of oil products are arranged on a transaction-by-transaction basis.

In 2010, our wholly-owned subsidiary NOVATEK-AZK sold approximately 5 thousand tons of diesel fuel and petrol, purchased for resale in Russia from third parties, through its retail stations, compared to sales of approximately 2 thousand tons in 2009. In 2009, we sold one thousand tons of oil products (light distillate) produced from our unstable gas condensate at the Surgutsky refinery to international markets on free on board (FOB) (Port of Vitino) terms at an average contract price, including export duties, of U.S.\$385 per ton.

#### *Transportation Tariffs*

For risks related to our transportation arrangements and their tariffs, see “*Risk Factors—Risks Relating to Our Business and Industry—We are dependent on state authorities to set tariffs for transportation of our key products, and such tariffs are expected to continue to increase*” and “*Risk Factors—Risks Relating to Our Business and Industry—We rely on third parties, primarily state-owned monopolies, to transport our products to customers.*”

#### *Natural Gas*

We transport our natural gas through our own pipelines into the UGSS, which transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. The FTS sets the transportation tariffs for use of the UGSS by independent producers. The actual transportation tariff we pay to Gazprom for utilization of the UGSS varies region by region. Accordingly, the change in our average natural gas transportation expense for sales to end-customers in any particular period reflects the geographical distribution of our natural gas deliveries to end-customers in such period.

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

In December 2008, the FTS approved four quarterly increases in the transportation tariff for natural gas deliveries in 2009 for an average total increase of 15.7% for the year, largely in line with increases in natural gas prices. Effective from 1 January 2009, the rate for utilization of the trunk pipeline ranged from RUB29.21 to RUB1,630.97 (excluding VAT) per mcm, and the transportation rate was RUB9.15 (excluding VAT) per mcm per 100 km, as at 31 December 2009.

In December 2009, the FTS approved a 12.3% average increase for the 2010 transportation tariff for natural gas effective 1 January 2010, from the tariff in effect as of 31 December 2009. Overall, the average transportation tariff in 2010 was 22.9% higher than the average transportation tariff in 2009. Effective from 1 January 2010, the rate for utilization of the trunk pipeline ranged from RUB32.92 to RUB1,818.37 (excluding VAT) per mcm, and the transportation rate was RUB10.27 (excluding VAT) per mcm per 100 km.

In December 2010, the FTS approved a 9.3% average increase for the 2011 transportation tariff for natural gas effective 1 January 2011. Effective from 1 January 2011, the rate for utilization of the trunk pipeline ranged from RUB44.97 to RUB1,964.13 (excluding VAT) per mcm, and the transportation rate was RUB11.23 (excluding VAT) per mcm per 100 km.

Effective from 1 July 2012, the FTS approved a 7.0% average increase of the transportation tariff for natural gas and the rate for utilization of the trunk pipeline ranged from RUB50.78 to RUB1,995.44 (excluding VAT) per mcm, and the transportation rate was RUB12.02 (excluding VAT) per mcm per 100 km.

According to the revised Forecast of Socio-Economic Development of the Russian Federation for 2012, announced in September 2011 by the Ministry of Economic Development of the Russian Federation, the transportation tariff for natural gas will be increased in 2013 and 2014 as of the same date as the increase in the regulated natural gas prices (expected to be 1 July) and will not exceed the forecasted inflation rate.

We are normally able to pass on the increases in regulated transportation tariffs to our end-customers pursuant to the terms of most our contracts for delivery of natural gas.

#### *Crude Oil*

We transport most of our crude oil through the pipeline network owned and operated by Transneft, Russia's state-owned monopoly crude oil pipeline operator. The FTS sets tariffs for transportation of crude oil through Transneft's pipeline network, which includes transport, dispatch, pumping, loading, charge-discharge, transshipment and other services. The FTS sets tariffs for each separate route of the pipeline network, so the overall expense for the transport of crude oil primarily depends on the length of the transport route from the producing field to the ultimate destination, transportation direction and other factors.

Crude oil transportation tariffs were increased in September and November 2011 on average by approximately 2.9% and 5.0%, respectively, and most recently in November 2012 on average by approximately 5.5%.

#### *Stable Gas Condensate, LPG and Oil Products*

Our stable gas condensate (currently, to the Port of Vitino on the White Sea), LPG and oil products are transported by rail, which is owned and operated by RZD, Russia's state-owned monopoly railway operator. Our transportation tariffs for transport by rail are set by the FTS and vary depending on product and length of transport route. The FTS has set discount multiples to the regular tariffs applicable to certain deliveries of our liquid hydrocarbons by rail; the mechanics of multiples vary for stable gas condensate and LPG deliveries and have changed over time.

In February 2009, the FTS announced discount multiples to be applied to then existing railroad transportation tariffs related to certain export deliveries of LPG and stable gas condensate shipped from the Limbey rail station, located in close proximity to our Purovsky Plant. In 2009, a multiple of 0.72 was applied to then existing rail tariff for our stable gas condensate volumes shipped to export markets from 7 April 2009 and a multiple of 0.35 for our LPG export deliveries for the volumes in excess of 90 mmt, which threshold we reached in the middle of April 2009. The above discount multiples remained in effect throughout 2009.

In December 2009, the FTS revised discount multiples to then existing railroad transportation tariffs related to certain export deliveries of stable gas condensate and LPG shipped from the Limbey rail station. The discount multiple for stable gas condensate was set at 0.89, provided that the annual volumes shipped to export markets equaled or exceeded 2,235 mmt. Our stable gas condensate export volumes in 2010 exceeded this threshold, which allowed us to apply the discount multiple. The discount multiple for our LPG export deliveries was set at 0.35 for the volumes in excess of 105 mmt, which we reached in the middle of April 2010.

In December 2010, the FTS revised the discount multiples to then existing railroad transportation tariffs related to certain export deliveries of stable gas condensate and LPG shipped from the Limbey rail station in 2011. The discount multiple for stable gas condensate was set at 0.89, provided that the annual volumes shipped to export markets equaled or exceeded 2,600 mmt. Our stable gas condensate export volumes in 2010 exceeded this threshold, which allowed us to apply the discount multiple. The discount multiple for our LPG export deliveries was set at 0.68,

provided that the annual volumes shipped to export markets equaled or exceeded 415 mmt. Our LPG export volumes in 2011 exceeded this threshold, which allowed us to apply the discount multiple.

In December 2011, the FTS revised the discount multiple to the existing railroad transportation tariffs related to certain export deliveries of stable gas condensate and LPG shipped from the Limbey rail station in 2012. The discount multiples for stable gas condensate and LPG are set at 0.89 and 0.71, respectively, provided that the annual volumes shipped to export markets equal or exceed 3,000 mmt and 445 mmt, respectively. We have applied these discount multiples for both gas condensate and LPG export deliveries in the nine months ended 30 September 2012.

We deliver our stable gas condensate and oil products produced from our unstable 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 the Asian-Pacific region, Europe, the United States and South America. The costs associated with tanker transportation are determined by the distance to the final destination, tanker availability, seasonality of deliveries and standard shipping terms.

### ***Our Tax Burden***

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax (see “—*Income Tax Expense*” under the discussion on results of operations), significant taxes to which we are subject include the UPT, property tax and export duties. Payments to non-budget funds (formerly known as social taxes) and other contributions also affect our results of operations. Effective from 1 January 2012, the social insurance tax rate for contributions to the Pension Fund of the Russian Federation decreased from 26% to 22% in terms of base remuneration, but the maximum base salary per employee was increased from RUB463 thousand to RUB512 thousand, and a new tax rate of 10% applies to amounts in excess of the RUB512 thousand base.

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 returns, 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 a tax audit of their activities for a period of three calendar years immediately preceding the year in which the audit is conducted. Previous audits do not completely exclude subsequent claims relating to the audited period. In addition, in some instances, new tax regulations have been given retroactive effect. See “*Risk Factors—Risks Relating to the Russian Taxation System*”.

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

### ***UPT***

Other than income tax, UPT represents our principal tax liability.

In the nine months ended 30 September 2012, we incurred RUB10,903 million of UPT expense, as compared with RUB10,546 million in the corresponding period of 2011. In 2011, our UPT expense was RUB14,523 million in 2011, compared to RUB7,861 million in 2010 and RUB6,699 million in 2009.

In 2009 and 2010, our UPT rate for natural gas was RUB147 per mcm. Effective 1 January 2011, our UPT rate increased to RUB237 per mcm. Effective 1 January 2012, our UPT rate has been RUB251 per mcm (consisting of a base rate of RUB509 per mcm and a reducing co-efficient for an independent gas producer of 0.493). Increases to the UPT rate for natural gas have recently been passed into law, as per the 2012 UPT Amendments. See “*Risk Factors—Risks Relating to the Russian Taxation System—The Russian taxation system is not well-developed and is subject to frequent changes, which could have an adverse effect on us*”. In addition, the Government is currently considering replacing the existing approach for calculating the UPT rate for natural gas with a formula that takes into account field location, reserves specifics, access to export markets and dynamics in regulated prices and transportation tariffs. A restructuring of the way in which the UPT rate is calculated may take place in the future. However, the precise nature of this restructuring is currently unclear and therefore it is impossible to predict the impact any such restructuring would have on our financial condition, results of operations and prospects.

In 2009, 2010 and 2011, the UPT rate for gas condensate was levied at a rate of 17.5% of the value of the extracted gas condensate, based on the revenues recognized by the producing entities, that has undergone preparatory separation and condensation and separation of light fractions and other impurities. From 2012, the taxation of the gas condensate production changed and, for 2012, the UPT rate for gas condensate is set at RUB556 per ton, which, according to the currently effective Tax Code, will be increased to RUB590 per ton in 2013 and RUB647 per ton in 2014. According to the 2012 UPT Amendments, starting from 1 January 2015, the UPT rate for the extraction of gas condensate will increase to RUB679 per ton. See “*Risk Factors—Risks Relating to the Russian Taxation System—The*

*Russian taxation system is not well-developed and is subject to frequent changes, which could have an adverse effect on us”.*

UPT for crude oil is calculated by reference to an average price for the Urals blend and an average exchange rate for the relevant tax period. It changes every month.

The Tax Code provides for reduced or zero UPT rates for crude oil produced in certain geographical areas. We did not use the reduced or zero UPT rates on the production of crude oil prior to 1 January 2012. Effective 1 January 2012, a zero UPT rate was set for crude oil produced at fields located in YNAO north of the 65<sup>th</sup> parallel. Our East-Tarkosalinskoye and Khancheyskoye fields are located in this area, and, therefore, we applied the zero UPT rate for crude oil produced at these fields from 1 January 2012.

The UPT rate for associated gas extracted from oil wells is currently zero.

#### *Property Tax*

Our property, plant and equipment are subject to property tax. In the nine months ended 30 September 2012, our property tax expense was RUB1,304 million, as compared to RUB1,298 million in the corresponding period of 2011. In 2011, our property tax expense was RUB1,742 million, compared to RUB1,482 million in 2010 and RUB1,155 million in 2009. The increase in our property tax in the periods under review is mainly attributable to additions of property, plant and equipment at our production subsidiaries.

#### *Export Duties*

We are subject to export duties on our exports of LPG, stable gas condensate and crude oil. Our exports of oil products, which we ceased in 2009, were also subject to export duty. The export duties for LPG, stable gas condensate, crude oil and oil products are set by the Government on a monthly basis in advance of each calendar month and are effective from the first calendar day of the respective month. The rate for crude oil and stable gas condensate is based on the average Urals crude oil price for the period from the 15<sup>th</sup> calendar day in the month to the 14<sup>th</sup> calendar day of the following month. Export duties for crude oil and stable gas condensate shall not exceed the maximum rates established by law, which are linked to the level of the average Urals crude oil price. The rate of export duties for LPG is calculated according to the formula established by Government Resolution No. 1155 dated 27 December 2010 “On Calculation of Rates of Export Customs Duties for Certain Categories of Goods Produced from Crude Oil”. According to this formula, the rates for LPG are based on the average price of LPG at the border with Poland (DAF Brest) for the period from the 15<sup>th</sup> calendar day in a month to the 14<sup>th</sup> calendar day of the following month.

In the nine months ended 30 September 2012, we incurred RUB29,676 million of export duties in aggregate for our exports of stable gas condensate, LPG and crude oil, as compared to RUB26,446 million in the nine months ended 30 September 2011. In 2011, we incurred RUB38,543 million of export duties in aggregate for our exports of stable gas condensate, LPG, crude oil and oil products, as compared to RUB20,558 million and RUB12,296 million in overall export duties in 2010 and 2009, respectively. The increase in the export customs duties paid was primarily due to the increase in the volumes of LPG, crude oil and stable gas condensate being exported from 2009 through the nine months ended 30 September 2012, as well as an increase in the duty rates applicable to our exports in the relevant periods.

#### *Certain Acquisitions and Dispositions*

From 2009 to date, we have made several acquisitions, as well as disposals, that have had a significant impact on our reserves base and that we expect will have a significant impact on our results of operations, financial condition and reserves base in the future. See “—Gas and Liquids Reserves” below.

The following represent our most significant acquisitions and disposals since 1 January 2009. See Note 4 of our Unaudited Financial Statements, Note 5 of our 2011 Audited Financial Statements and Note 5 of our 2010 Audited Financial Statements for further description of these, as well as other, acquisitions and disposals.

#### *Nortgas*

See “—Recent Developments” for information on the recent acquisition of a 49% stake in Nortgas.

#### *Gazprom mezhregiongaz Chelyabinsk*

In November 2011, we acquired a 100% stake in OOO Gazprom mezhregiongaz Chelyabinsk for RUB1,550 million. Gazprom mezhregiongaz Chelyabinsk, since merged into our wholly-owned subsidiary NOVATEK-Chelyabinsk, is responsible for the sale of natural gas to industrial customers and households in the Chelyabinsk region.

#### *Yamal LNG*

In June 2009, we acquired 51% of the shares in Yamal LNG, an exploration stage gas and oil company located in the north-east of the Yamal peninsula, from affiliates of Volga Resources. In September 2011, we increased our

stake in Yamal LNG to 100% through the exercise of a call option acquired in 2009 to purchase a 23.9% stake for U.S.\$450 million, in addition to U.S.\$10 million consideration for the option, and a call option acquired in 2011 to purchase a 25.1% stake for U.S.\$526 million. We purchased the remaining 49% stake for the reported consideration of RUB31,670 million, of which RUB14,817 million was paid in 2011 and RUB16,290 million was paid in the first half of 2012. As a result of the acquisition of this 49% stake, we reduced our non-controlling interest by RUB19,920 million and recorded a difference of RUB11,750 million directly to retained earnings in our Unaudited Financial Statements. See Note 4 of our Unaudited Financial Statements.

In October 2011, we sold a 20% stake to an affiliate of TOTAL for total consideration of RUB36,893 million, realizing a gain of RUB62,831 million, net of associated income tax of RUB117 million. We also recorded a disposal of RUB45,867 million (including RUB39,714 million of costs relating to mineral rights) in property, plant and equipment as a result of this sale. Total consideration for the 20% stake consisted of: (i) a cash payment of U.S.\$425 million in October 2011; (ii) an 80% share of a cash payment of U.S.\$375 million through additional equity contributions to the share capital of Yamal LNG, of which U.S.\$204 million was received in 2011 and the remainder in 2012; (iii) an 80% share of an additional cash payment of up to U.S.\$500 million, depending on the amount of capital expenditures needed at Yamal LNG, which is to be determined based on the result of the final investment decision, expected to be made in the near future, and (iv) an 80% share of U.S.\$11 million, which TOTAL, via an affiliate, contributed to the share capital of Yamal LNG to compensate certain costs which we incurred in respect of the Yamal LNG project prior to the sale of the 20% stake. In October 2011, we entered into a shareholders' agreement with Total E&P YAMAL SAS, an affiliate of TOTAL, establishing the framework for joint cooperation in exploring and developing the South-Tambeyskoe field, which is held by Yamal LNG. The shareholders' agreement stipulates that additional financing for Yamal LNG, if needed, will be partly in the form of disproportional loans from shareholders. The shareholders' agreement also stipulates that we may reduce our shareholding in Yamal LNG to 51% based on certain terms and conditions. Although we currently retain an 80% stake in Yamal LNG, the shareholders' agreement stipulates that key strategic, operational and financial decisions are subject at present to approval by eight out of nine members of the board of directors of Yamal LNG. Because Total has two members on Yamal LNG's board of directors, our effective control over Yamal LNG has ceased from October 2011. We account for Yamal LNG as a joint venture under the equity method. See Note 5 of our 2011 Audited Financial Statements.

#### *Sibneftegas*

In December 2010, through our wholly-owned subsidiary, OOO NOVATEK Severo-Zapad, we acquired a 51% interest in Sibneftegas for RUB25,826 million, excluding the assumption of the seller's loan to Sibneftegas in the amount of RUB11,038 million. We account for the acquisition of Sibneftegas under the equity method.

#### *SeverEnergia*

On 30 November 2010, Yamal Development, our 50/50 joint venture with Gazprom Neft, acquired a 51% interest in SeverEnergia from Gazprom for RUB48,715 million, excluding the assumption of the seller's loan to SeverEnergia in the amount of RUB7,532 million. Our *pro rata* portion of the cash purchase price, excluding the assumption of total debt of SeverEnergia (representing our 50% interest in Yamal Development) was RUB24,357 million and our *pro rata* portion of the reimbursement of Gazprom's historical expenses in connection with the financing of SeverEnergia's operational needs was RUB3,766 million, which effectively increased our aggregate cost of the acquisition to RUB28,123 million. We provided a loan to Yamal Development of RUB28,123 million to cover these costs. The remaining 49% interest in SeverEnergia is held by Artic Russia B.V., a 60/40 joint venture of Eni, the Italian multinational oil and gas company and Enel, an Italian multinational energy producer. Accordingly, our effective ownership in SeverEnergia is 25.5%. We account for the acquisition of the assets of SeverEnergia by Yamal Development under the equity method.

#### *NOVATEK-Polymer*

In September 2010, we sold OOO NOVATEK-Polymer (“NOVATEK-Polymer”), a producer of anti-corrosive insulating materials for pipes used in the oil and gas industry, as well as pipes and polypropylene film wrap, to CJSC SIBUR Holding (together with its successor entity, OJSC SIBUR Holding, “SIBUR”). The reported consideration for the sale of NOVATEK-Polymer was RUB2,019 million (discounted) payable on a quarterly basis throughout September 2013, and we recognized a loss on the sale of RUB279 million, net of associated income tax of RUB25 million. The disposal of our industrial manufacturing subsidiary is consistent with our strategy to focus on our core natural gas and gas condensate production and processing activities. We now have no subsidiaries pursuing non-core businesses.

#### *Tambeyneftegas*

In July 2010, we acquired 100% of the shares of Tambeyneftegas, an exploration stage oil and gas company located in the southern portion of the Yamal peninsula for RUB312 million, of which 75% was acquired from related parties for RUB234 million. See “*Related Party Transactions*”. Tambeyneftegas holds the license for geological study and production on the Malo-Yamalskoye field (which expires in 2019) and has estimated natural gas and gas condensate reserves in accordance with the Russian reserves classification (categories C1 + C2) amounting to



161 bcm and 14.4 mmt as of 1 January 2012, respectively. See “*Classification of Reserves—Russian Reserves System*”.

#### *Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas*

In February 2010, we increased our participation interest in each of OOO Oiltechproduct-Invest (“**Oiltechproduct-Invest**”), OOO Petra Invest-M (“**Petra Invest-M**”) and OOO Tailiksneftegas (“**Tailiksneftegas**”) to 51% through the acquisition of an additional 26% participation in each company for the total cash consideration of RUB1,297 million. These entities were exploration stage oil and gas companies and held geological study licenses to a number of fields and areas located in YNAO. In December 2010, Oiltechproduct-Invest was merged into NOVATEK-Tarkosaleneftegas. In November 2011, Tailiksneftegas was merged into NOVATEK-Yurkharovneftegas. To date, some of their licenses were re-issued to our other subsidiaries, e.g., a geological study license for the North-Russkoye field is held by NOVATEK-Tarkosaleneftegas. At present, Petra Invest-M holds a geological study license for the Zapadno-Tazovskiy subsoil area in YNAO.

In April 2010, we increased our participation interests in Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas to 82.4%, 92.6% and 94.2%, respectively, through an additional capital contribution to the charter capital of these entities. Furthermore, in May 2010, we brought our participation interest in the charter capital of each of the above mentioned companies to 100% through the acquisition of the remaining participation interests. As a consequence of these transactions we paid cash of RUB629 million, reduced non-controlling interests by RUB2,368 million and recorded a difference of RUB1,739 million directly to retained earnings.

#### *Terneftegas*

In February 2010, we transferred a 28% interest in Terneftegas, our wholly-owned subsidiary holding the license for exploration and production of natural gas and gas condensate at the Termokarstovoye field, to Total Termokarstovoye B.V., an affiliate of TOTAL, for reported consideration of RUB705 million (discounted). As a result of an additional share issuance of Terneftegas, TOTAL’s share in Terneftegas increased to 49% for total consideration of U.S.\$18.0 million. The sale of the Terneftegas stake to TOTAL, the subsequent increase of the interest through the additional share issuance and the establishment of the resulting joint venture are part of our framework agreement with TOTAL executed in June 2009 for joint cooperation in exploring and developing our Termokarstovoye gas condensate field in the YNAO.

In February 2010, we recorded a disposal of a 49% ownership interest in Terneftegas for total consideration of RUB982 million, realizing a gain of RUB1,466 million, net of the associated income tax of RUB117 million. A significant portion of the gain relates to the revaluation of our 51% retained interest in Terneftegas. See Note 5 of our 2010 Audited Financial Statements.

#### *OOO EkropromStroy*

In June 2009, we acquired a 100% participation interest in OOO EkropromStroy from several members of our key management personnel for total cash consideration of RUB1,999 million. The company managed the construction of our office building in Moscow and has no activities other than the ownership of this building.

## Operational Highlights

### Hydrocarbon Sales Volumes

#### Natural Gas Sales Volumes

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(mmcm)				
<b>Production by the Group from:</b>					
Yurkharovskoye field.....	24,649	23,464	32,035	24,436	17,751
East-Tarkosalinskoye field.....	9,706	8,698	12,151	9,735	11,509
Khancheykskoye field.....	2,709	2,367	3,263	3,013	3,043
Other fields <sup>(1)</sup> .....	48	56	72	77	70
<b>Total natural gas production by the Group</b> .....	<b>37,112</b>	<b>34,585</b>	<b>47,521</b>	<b>37,261</b>	<b>32,373</b>
Purchases from Joint Ventures.....	4,016	4,013	5,384	—	—
<b>Total production by the Group and purchases from the Joint Ventures<sup>(1)</sup></b> .....	<b>41,128</b>	<b>38,598</b>	<b>52,905</b>	<b>37,261</b>	<b>32,353</b>
Other purchases <sup>(2)</sup> .....	2,540	—	841	—	1,000
<b>Total production and purchases by the Group<sup>(1)</sup></b> .....	<b>43,668</b>	<b>38,598</b>	<b>53,746</b>	<b>37,261</b>	<b>33,373</b>
Purovsky Plant and own usage.....	(83)	(75)	(109)	(98)	(64)
Decrease (increase) in Gazprom's UGSFs, UGSS and own pipeline infrastructure.....	(581)	(435)	30	(46)	(372)
<b>Natural gas sales:</b>					
Sold to end-customers.....	29,252	20,509	29,332	23,745	14,751
Sold ex-field.....	13,752	17,579	24,335	13,372	10,518
Sold to traders in remote points.....	—	—	—	—	7,668
<b>Total natural gas sales volumes</b> .....	<b>43,004</b>	<b>38,088</b>	<b>53,667</b>	<b>37,117</b>	<b>32,937</b>

<sup>(1)</sup> The line item does not include equity share of the Group in the production by the Joint Ventures.

<sup>(2)</sup> In December 2011, we purchased 841 mmcm of natural gas from third parties in the Chelyabinsk region, the price of which included the cost of transportation to this region, through Gazprom mezhregiongas Chelyabinsk, a regional gas trader which we acquired in November 2011 and recently merged into our wholly-owned subsidiary NOVATEK-Chelyabinsk. The purchases were made according to pre-existing contractual obligations, and effective January 2012 we no longer purchase natural gas under these agreements. In 2009, we purchased 1,000 mmcm of natural gas primarily from Itera. From 1 January 2012, we started purchasing natural gas from SIBUR. See "Related Party Transactions".

In the nine months ended 30 September 2012, our total natural gas production (including our *pro rata* share in the production of Sibneftegas, one of our Joint Ventures) increased by 2,530 mmcm, or 6.6%, compared to the corresponding period of 2011, due to an increase in production at our Core Fields. The increase in production at the East-Tarkosalinskoye and Khancheykskoye fields was due to the increased demand for natural gas that required a greater utilization of the fields' production capacity. The increase in natural gas production at the Yurkharovskoye field was due to the field's ongoing development activities.

In 2011, our total natural gas production (including our *pro rata* share in the production of Sibneftegas, one of our Joint Ventures) increased by 15,644 mmcm, or 42.0%, to 52,905 mmcm from 37,261 mmcm in 2010 primarily due to an increase in production at our Yurkharovskoye and East-Tarkosalinskoye fields, as well as the acquisition of Sibneftegas in December 2010. We were able to increase natural gas production at the Yurkharovskoye field due to the launch of the third stage of the field's second phase development in October 2010. The increase in natural gas production at the East-Tarkosalinskoye field was due to increased demand in 2011 resulting in a greater utilization of the field's production capacity. In 2011, our total natural gas sales volumes increased by 16,550 mmcm, or 44.6%, to 53,667 mmcm from 37,117 mmcm in 2010 because of the increase in own production as well as the purchase of 5,384 mmcm of natural gas from Sibneftegas, our Joint Venture with Itera/Rosneft in which we hold a 51% stake.

In 2010, our total natural gas production increased by 4,888 mmcm, or 15.1%, to 37,261 mmcm from 32,373 mmcm in 2009 due to an increase in production at our Yurkharovskoye field resulting from the launches of second and third stages of the field's second phase development in October 2009 and October 2010. The decrease in natural gas production at our East-Tarkosalinskoye field in 2010 was due to a greater focus on the Yurkharovskoye field by further optimizing unstable gas condensate production at the latter.

Liquids Sales Volumes

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(Thousands of tons)				
<b>Production from:</b>					
Yurkharovskoye field.....	1,969	2,008	2,718	2,099	1,484
East-Tarkosalinskoye field.....	712	600	808	852	896
Khancheyevskoye field.....	383	425	560	635	618
Other fields .....	15	20	25	31	40
<b>Total liquids production.....</b>	<b>3,079</b>	<b>3,053</b>	<b>4,111</b>	<b>3,617</b>	<b>3,038</b>
Purchases from Joint Ventures.....	131	—	—	—	—
<b>Total production and purchases from the Joint Ventures.....</b>	<b>3,210</b>	<b>3,053</b>	<b>4,111</b>	<b>3,617</b>	<b>3,038</b>
Other purchases <sup>(1)</sup> .....	9	4	6	12	13
<b>Total production and purchases .....</b>	<b>3,219</b>	<b>3,057</b>	<b>4,117</b>	<b>3,629</b>	<b>3,051</b>
Losses and own usage <sup>(2)</sup> .....	(36)	(28)	(37)	(39)	(26)
Gas condensate pipeline line fill and de-ethanization .....	—	—	—	(36)	—
Decreases (increases) in liquids inventory balances.....	(49)	(66)	31	(153)	103
<b>Total liquids available for sale.....</b>	<b>3,134</b>	<b>2,963</b>	<b>4,111</b>	<b>3,401</b>	<b>3,128</b>
<b>Liquid sales:</b>					
Stable gas condensate export .....	2,131	2,134	2,981	2,326	2,115
Stable gas condensate domestic .....	24	3	3	4	55
<b>Subtotal stable gas condensate .....</b>	<b>2,155</b>	<b>2,137</b>	<b>2,984</b>	<b>2,330</b>	<b>2,170</b>
LPG export.....	352	343	453	434	405
LPG CIS.....	—	1	1	—	9
LPG domestic.....	236	248	336	397	321
LPG sold through domestic retail and small wholesale stations .....	76	62	90	45	14
<b>Subtotal LPG .....</b>	<b>664</b>	<b>654</b>	<b>880</b>	<b>876</b>	<b>749</b>
Crude oil export .....	107	68	93	71	69
Crude oil domestic .....	201	100	149	114	129
<b>Subtotal crude oil.....</b>	<b>308</b>	<b>168</b>	<b>242</b>	<b>185</b>	<b>198</b>
Oil products export .....	—	—	—	—	1
Oil products domestic .....	7	4	5	10	10
<b>Subtotal oil products.....</b>	<b>7</b>	<b>4</b>	<b>5</b>	<b>10</b>	<b>11</b>
<b>Total liquids sales volumes .....</b>	<b>3,134</b>	<b>2,963</b>	<b>4,111</b>	<b>3,401</b>	<b>3,128</b>

<sup>(1)</sup> In April 2012, we commenced purchasing unstable gas condensate from SeverEnergiya, one of our Joint Ventures, after the launch of the first stage of its Samburgskoye field.

<sup>(2)</sup> Losses associated with processing at the Purovsky Plant and Surgutsky refinery as well as during rail road, trunk pipeline and tanker transportation.

In the nine months ended 30 September 2012, our liquids production (excluding any production by Joint Ventures) increased by 26 mt, or 0.9%, to 3,079 mt compared to 3,053 mt in the corresponding period of 2011, primarily due to an increase in crude oil production at the East-Tarkosalinskoye and Khancheyevskoye fields that was partially offset by a decrease in gas condensate production at our core producing fields. Natural declines in the concentrations of gas condensate at our mature fields are expected due to decreasing reservoir pressure at the current gas condensate producing horizons.

In 2011, our liquids production increased by 494 thousand tons, or 13.7%, to 4,111 thousand tons from 3,617 thousand tons in 2010, primarily due to the expansion of unstable gas condensate production capacity at our Yurkharovskoye field resulting from the launch of the third stage of the field's second phase development in October 2010. The reduced liquids production at the Khancheyevskoye and East-Tarkosalinskoye fields was due to lower concentration of gas condensate in the extracted gas.

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

In recent periods, our liquids have represented an increasingly important part of our business and an increasingly important source of our total revenues. In the nine months ended 30 September 2012, our liquids production (including our *pro rata* share in the production of our Joint Ventures) was 26.1 mboe, or 8.8% of our total

production, as compared to 25.7 million boe, or 9.2%, respectively, in the corresponding period of 2011. In 2011, our liquids production (including our *pro rata* share in the production of our Joint Ventures) was 34.6 million boe, or 9.1%, of our total production, as compared to 30.4 million boe, or 11.1%, respectively, in 2010 and 25.4 million boe, or 10.7%, respectively, in 2009 .

In light of the netbacks received and, with respect to the stable gas condensate, the sales capacity of the international markets, we export almost all our gas condensate production and most of our LPG production, but sell a substantial portion of our crude oil domestically. In the nine months ended 30 September 2012, sales of our liquids accounted for 33.4% of our total revenues, as compared to 37.3% in the corresponding period of 2011. We keep our focus on increasing the liquids production and sales in accordance with our strategy (see “*Business—Business Strategy—Efficiently monetize our reserves of liquid hydrocarbons*”). In 2011, sales of our liquids accounted for 36.8% of our total revenues, as compared to 37.8% and 37.0% in 2010 and 2009, respectively.

### **Gas and Liquids Production Costs**

Our gas and oil production costs are derived from our results of operations for gas and oil producing activities as reported in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements. Gas and oil production costs do not include general corporate overheads or their associated tax effects. The following tables set forth certain operating information with respect to our gas and oil production costs during the years presented in millions of Roubles and on a boe basis in Roubles and U.S. Dollars:

	Year ended 31 December		
	2011	2010	2009
	<i>(RUB millions)</i>		
Lifting costs .....	5,180	4,469	3,798
Taxes other than income tax .....	17,287	9,831	7,840
Transportation expenses.....	46,064	37,187	28,482
<b>Total production costs before DDA.....</b>	<b>68,531</b>	<b>51,487</b>	<b>40,120</b>
Depreciation, depletion and amortization (DDA) .....	8,878	6,384	5,139
<b>Total production costs .....</b>	<b>77,409</b>	<b>57,871</b>	<b>45,259</b>

	Year ended 31 December		
	2011	2010	2009
	<i>(RUB per boe)</i>		
<b>Production costs:</b>			
Lifting cost.....	15.0	16.3	16.0
Taxes other than income tax .....	50.1	35.9	33.1
Transportation expenses.....	133.6	135.8	120.1
<b>Total production costs before DDA.....</b>	<b>198.7</b>	<b>188.0</b>	<b>169.2</b>
Depreciation, depletion and amortization (DDA) .....	25.8	23.3	21.7
<b>Total production costs .....</b>	<b>224.5</b>	<b>211.3</b>	<b>190.9</b>

	Year ended 31 December		
	2011	2010	2009
	<i>(U.S.\$ per boe)<sup>(1)</sup></i>		
<b>Production costs:</b>			
Lifting cost.....	0.51	0.54	0.50
Taxes other than income tax .....	1.71	1.18	1.04
Transportation expenses.....	4.55	4.46	3.78
<b>Total production costs before DDA.....</b>	<b>6.77</b>	<b>6.18</b>	<b>5.32</b>
Depreciation, depletion and amortization (DDA) .....	0.88	0.76	0.68
<b>Total production costs .....</b>	<b>7.65</b>	<b>6.94</b>	<b>6.00</b>

<sup>(1)</sup> Converted at the average Rouble/U.S.Dollar exchange rate for the period, see “*Currencies and Exchange Rates*”.

Production costs consist of amounts directly related to the extraction of natural gas, gas condensate and crude oil from the reservoir and other related costs, including lifting costs, taxes other than income tax (production taxes) and transportation expenses, i.e., shipping, transportation and handling costs, to end-customers. The average production cost on a boe basis is calculated by dividing the applicable costs by the respective barrel of oil equivalent of our hydrocarbons produced during the year. Natural gas, gas condensate and crude oil volumes produced by our fields are converted to a barrel of oil equivalent based on the relative energy content of each field’s hydrocarbons. See “*Presentation of Financial and Other Information—Conversion Measures*”.

Our lifting costs, as presented in the tables above, differ from lifting costs as reflected in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements, in that the lifting costs as presented in our Audited Financial Statements include changes in balances of natural gas and hydrocarbon liquids to more

appropriately match costs incurred to revenues under IFRS matching principles. A reconciliation of lifting costs as reflected in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements is set forth below:

	<b>Year ended 31 December</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<i>(RUB millions)</i>		
Lifting costs per “Unaudited Supplemental Oil and Gas Disclosures” .....	5,236	4,854	3,646
Change in balances of natural gas and hydrocarbon liquids stated at cost in the consolidated statement of financial position .....	56	385	(152)
Lifting costs presented in “Gas and Oil Production Costs” above .....	5,180	4,469	3,798

### **Gas and Liquids Reserves**

In December 2008, the SEC released the Final Rule for the Modernization of Gas and Oil Reporting, which requires the disclosure of gas and oil proved reserves by significant geographic area, using a 12-month average beginning-of-the-month price for the year, rather than year-end prices, and allows the use of reliable technologies to estimate proved gas and oil reserves, if the technologies have demonstrated reliable estimates about reserves. Furthermore, companies are required to report on the independence and qualifications of its reserves preparer or appraiser.

We do not file with the SEC nor are we obliged to report our reserves in compliance with these standards. However, we have consistently disclosed proved gas and liquids reserves as unaudited supplemental information in the Audited Financial Statements. We have also provided additional information about our hydrocarbon reserves based on the widely-used industry PRMS reserves reporting classification, which in addition to total proved reserves discloses information on our probable reserves. See “*Classification of Reserves*”.

Our proved reserves estimates are appraised by our independent petroleum engineers, D&M. See “*Presentation of Financial and Other Information—Natural Gas and Liquids Reserves Data*”. Our total proved reserves, comprised of proved developed and proved undeveloped reserves as of 31 December 2011, 2010 and 2009, were appraised using both reporting and disclosure requirements promulgated by the SEC and PRMS. Proved reserves disclosed in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements are presented under SEC reserves reporting methodology, which requires that 100% of the reserves attributable to all consolidated subsidiaries (even if not wholly-owned) shall be included for the reporting year, as well as our proportionate share of proved reserves of affiliates accounted for by the equity method. The Group and JV Reserves, as reported in the 2011 Reserves Reports and presented in the tables below, do not match the proved reserves disclosed in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements due to differences in reporting with respect to:

- our 51% interest in our consolidated subsidiary, OOO Yargeo (“**Yargeo**”); and
- our 51% interest in Yamal LNG as at 31 December 2009 and 2010 (Yamal LNG ceased to be our consolidated subsidiary in 2011, and was accounted for as an equity investment as of 31 December 2011).

The Group and JV Reserves include 51% of the reserves attributable to Yargeo, whereas the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements include 100% of Yargeo's reserves. Similarly, the Group and JV Reserves as at 31 December 2010 and 2009 include 51% of the reserves attributable to Yamal LNG, whereas the Unaudited Supplemental Oil and Gas Disclosures in the 2010 Audited Financial Statements include 100% of Yamal LNG's reserves.

The tables below provide the comparison of our estimated reserves under SEC and PRMS reserves classifications attributable to the Group and JV Reserves, rather than 100% of the reserves attributable to all consolidated subsidiaries (even if not wholly-owned). The tables below also do not include reserves attributable to our acquisitions in 2011 of four new licenses in the Yamal and Gydan peninsulas, which are expected to be appraised in future reserves reports, when the study and exploration of the respective fields commence. Our reserves are all located in the Russian Federation, in YNAO in Western Siberia, thereby representing one geographical area.

	Natural gas			
	SEC		PRMS	
	bcf	bcm	bcf	bcm
	<i>(Based on our equity ownership interest in the fields)</i>			
<b>Total proved reserves of consolidated subsidiaries at 31 December 2009</b> .....	<b>34,150</b>	<b>967</b>	<b>38,124</b>	<b>1,080</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries.....	2,392	68	2,597	73
Disposals <sup>(1)</sup> .....	(426)	(12)	(426)	(12)
Reclassifications <sup>(2)</sup> .....	(444)	(13)	(444)	(13)
Production.....	(1,314)	(37)	(1,314)	(37)
<b>Total proved reserves of consolidated subsidiaries at 31 December 2010</b> .....	<b>34,358</b>	<b>973</b>	<b>38,519</b>	<b>1,091</b>
<i>Equity share of total proved JV Reserves as of 31 December 2010</i> .....	<i>6,057</i>	<i>171</i>	<i>7,726</i>	<i>219</i>
<b>Grand total proved reserves at 31 December 2010</b> .....	<b>40,415</b>	<b>1,144</b>	<b>46,245</b>	<b>1,310</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries.....	2,238	64	2,918	82
Acquisitions <sup>(3)</sup> .....	8,161	231	11,861	336
Disposals <sup>(1)</sup> .....	(3,331)	(95)	(4,841)	(137)
Reclassifications <sup>(2)</sup> .....	(13,323)	(377)	(19,364)	(548)
Production.....	(1,676)	(48)	(1,676)	(48)
<b>Total proved reserves of consolidated subsidiaries at 31 December 2011</b> .....	<b>26,427</b>	<b>748</b>	<b>27,417</b>	<b>776</b>
<i>Equity share of total proved JV Reserves as of 31 December 2011</i> .....	<i>20,236</i>	<i>573</i>	<i>28,562</i>	<i>809</i>
<b>Grand total proved reserves at 31 December 2011</b> .....	<b>46,663</b>	<b>1,321</b>	<b>55,979</b>	<b>1,585</b>

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

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

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

	Crude oil, gas condensate and natural gas liquids			
	SEC		PRMS	
	mmboe	mmt	mmboe	mmt
	<i>(Based on our equity ownership interest in the fields)</i>			
<b>Total proved reserves of consolidated subsidiaries at 31 December 2009</b> .....	<b>529</b>	<b>63</b>	<b>650</b>	<b>79</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries.....	43	6	66	9
Disposals <sup>(1)</sup> .....	(20)	(2)	(20)	(2)
Reclassifications <sup>(2)</sup> .....	(20)	(3)	(20)	(3)
Production.....	(31)	(4)	(31)	(4)
<b>Total proved reserves of consolidated subsidiaries at 31 December 2010</b> .....	<b>501</b>	<b>60</b>	<b>645</b>	<b>79</b>
<i>Equity share of total proved JV Reserves as of 31 December 2010</i> .....	<i>103</i>	<i>13</i>	<i>116</i>	<i>14</i>
<b>Grand total proved reserves at 31 December 2010</b> .....	<b>604</b>	<b>73</b>	<b>761</b>	<b>93</b>
Changes attributable to:				
Revisions of previous estimates, extensions and discoveries.....	91	11	91	10
Acquisitions <sup>(3)</sup> .....	84	10	125	15
Disposals <sup>(1)</sup> .....	(34)	(4)	(51)	(6)
Reclassifications <sup>(2)</sup> .....	(138)	(16)	(204)	(24)
Production.....	(35)	(4)	(35)	(4)
<b>Total proved reserves of consolidated subsidiaries at 31 December 2011</b> .....	<b>469</b>	<b>57</b>	<b>571</b>	<b>70</b>
<i>Equity share of total proved JV Reserves as of 31 December 2011</i> .....	<i>283</i>	<i>34</i>	<i>399</i>	<i>48</i>
<b>Grand total proved reserves at 31 December 2011</b> .....	<b>752</b>	<b>91</b>	<b>970</b>	<b>118</b>

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

- (2) Reclassifications represent reserves attributable to an equity stake in a subsidiary reclassified to a joint venture due to a loss of control.  
(3) Acquisitions represent reserves attributable to an acquired equity stake in a subsidiary.

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

	Combined natural gas, crude oil, gas condensate and natural gas liquids	
	SEC	PRMS
<b>Total proved reserves:</b>	<i>(Based on our equity ownership interest in the fields, mmmboe)</i>	
At 31 December 2009 .....	6,853	7,711
At 31 December 2010 .....	8,088	9,325
<i>including subsidiaries</i> .....	6,863	7,779
<i>including equity share of JV Reserves</i> .....	1,225	1,546
At 31 December 2011 .....	9,393	11,337
<i>including subsidiaries</i> .....	5,363	5,649
<i>including equity share of JV Reserves</i> .....	4,030	5,688

As of 31 December 2011, our PRMS proved Group and JV Reserves amounted to approximately 1.59 tcm of natural gas and 118 mmt of gas condensate and crude oil. Combined, these proved Group and JV Reserves represented approximately 11.3 billion boe. Our total PRMS proved Group and JV Reserves increased by 21.6% during 2011 primarily due to: (i) the 29% increase in our equity stake in Yamal LNG in 2011, (ii) revisions of previous estimates and (iii) organic growth at our Core Fields.

As of December 31, 2010, our PRMS proved Group and JV Reserves amounted to approximately 1.31 tcm of natural gas and 93 mmt of gas condensate and crude oil. Combined, these proved Group and JV Reserves represented approximately 9.3 billion boe. Our total PRMS proved Group and JV Reserves increased by 20.9% during 2010 due to: (i) the acquisition by our joint venture Yamal Development of a 51% participation interest in SeverEnergiya in November 2010, (ii) the acquisition of 51% of ordinary shares of Sibneftegas in December 2010 and (iii) organic growth at our Core Fields.

As of December 31, 2009, our PRMS proved Group and JV Reserves aggregated approximately 1.08 tcm of natural gas and 79 mmt of gas condensate and crude oil. Combined, these proved Group and JV Reserves represented approximately 7.7 billion boe. The increase of our total PRMS proved Group and JV Reserves during 2009 was primarily due to the acquisition in June 2009 of our 51% equity stake in Yamal LNG, the holder of the license to the South-Tambeyskoye field, and the ongoing development activities at the Yurkharovskoye field.

As we continue to invest capital into the development of our fields, we anticipate that we will increase our resource base as well as re-classify reserves among the reserves categories.

PRMS reserves classification standards allow for the reporting of reserves estimates for probable reserves, as presented in the following table:

	Natural gas		Crude oil, gas condensate and natural gas liquids	
	bcf	bcm	mbbl	mmt
	<i>(Under PRMS classification (based on our equity ownership interest in the fields))</i>			
<b>Probable reserves:</b>				
At 31 December 2009 .....	13,520	383	375	46
At 31 December 2010 .....	18,748	531	587	73
<i>including subsidiaries</i> .....	13,152	372	343	42
<i>including equity share of JV Reserves</i> .....	5,596	159	244	31
At 31 December 2011 .....	18,471	523	652	81
<i>including subsidiaries</i> .....	8,944	253	365	46
<i>including equity share of JV Reserves</i> .....	9,527	270	287	35

The below table contains information about our reserve-to-production ratio for the years ended 31 December 2011, 2010 and 2009 under both reserves reporting methodologies based on our equity ownership interest:

	At 31 December					
	SEC			PRMS		
	2011	2010	2009	2011	2010	2009
	<i>(Number of years (based on our equity ownership interest in the fields))</i>					
Total proved reserves to production .....	25	30	29	30	34	33
Total proved and probable reserves to production	—	—	—	40	49	45

The decrease in our total proved reserves to production in 2011, as compared to 2010 and also 2009, was primarily due to an increase in our production. See “—Operational Highlights—Hydrocarbon Sales Volumes”.

Apart from the acquisition of assets, we expand our reserves base through exploration, production and development activities at our undeveloped fields and license areas. Our finding and development costs (calculated as total costs incurred in exploration and development activities less costs of proved property acquisitions), including our *pro rata* share in the finding and development costs of our Joint Ventures, were RUB35,044 million, RUB53,657 million and RUB16,925 million in 2011, 2010 and 2009, respectively, as derived from our oil and gas exploration and development costs in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements.

The following table presents our finding and development costs, on a per boe basis for the periods indicated:

	Year ended 31 December			Average for
	2011	2010	2009	2009-2011
Finding and development costs, U.S.\$ per boe <sup>(1)</sup> .....	1.22	2.86	0.67	1.46

<sup>(1)</sup> Our finding and development costs, calculated as set above, divided by the total boe reserves changes for the period associated with extensions and discoveries, revisions in estimates and improved recoveries (excluding purchases of reserves).

For the three years ended 31 December 2011, our three-year average reserves replacement ratio was 597%, on a boe basis, as measured based on proved reserves under SEC reserves methodology. The three-year average reserves replacement ratio is calculated by taking our total reserves changes for the period as the numerator and dividing it by our production for the period.

Our total reserves replacement costs (calculated as total costs incurred in exploration and development activities, comprising proved and unproved property acquisition cost, exploration cost and development cost during the applicable period), including our *pro rata* share in the reserves replacement costs of our Joint Ventures, were RUB35,044 million, RUB110,159 million and RUB56,822 million in 2011, 2010 and 2009, respectively, as reported in our oil and gas exploration and development costs in the Unaudited Supplemental Oil and Gas Disclosures in the Audited Financial Statements.

The following table presents our reserves replacement costs on a per boe basis for the periods indicated:

	Year ended 31 December			Average for
	2011	2010	2009	2009-2011
Reserves replacement costs, U.S.\$ per boe .....	1.22	1.97	0.53	1.06

<sup>(1)</sup> Our total reserves replacement costs, calculated as set above, divided by the total boe reserves changes for the period associated with extensions and discoveries, revisions in estimates and improved recoveries (excluding purchases of reserves).

Our gas and oil estimation and reporting process involves an annual independent third party appraisal as well as internal technical appraisals of reserves. We maintain our own internal reserves estimates that are calculated by qualified technical staff working directly with the gas and oil properties. We periodically update reserves estimates during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

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

Our Reserves Management and Assessment Group (the “**RMAG**”) is comprised of qualified technical staff from various departments, such as geological and geophysical, gas and liquids commercial operations, capital construction, production, financial planning and analysis and includes technical and financial representatives from our subsidiaries, which are the principal holders of our mineral licenses. The person responsible for overseeing the work of the RMAG is a member of our Management Board. The approval of the final reserves estimates is the sole responsibility of senior management. See “*Presentation of Financial and Other Information—Natural Gas and Liquids Reserves Data*” and “*Business—Reserves and Resources*”.

### Segment Information

Until 30 June 2012, our operations consisted of one segment: the exploration, production and marketing of natural gas and liquid hydrocarbons. In the third quarter of 2012, we entered into a series of long-term natural gas purchase and sales contracts with European counterparts as part of our strategy to gain a foothold in natural gas and LNG trading activities on the European market. The contracts were signed for a 10-year period, effective 1 October 2012, and our trading activities are to be exercised through our wholly owned subsidiary Novatek Gas & Power



GmbH (“Novatek Gas & Power”). In the third quarter of 2012, we established a second segment – natural gas foreign trading activities – to account for our European trading operations. For the three months ended 30 September 2012, the new segment did not include any results as there were no operations in this period. See “Business—Sales and Marketing—Sales of natural gas” for a discussion of our foreign trading activities and Note 23 of our Unaudited Financial Statements.

### Results of Operations for the Nine Months Ended 30 September 2012 Compared to the Nine Months Ended 30 September 2011

The following table is a summary of our consolidated results of operations for the nine months ended 30 September 2012 and 2011. Each line item is also shown as a percentage of our total revenues.

	Nine months ended 30 September			
	2012	% of total revenues	2011	% of total revenues
	<i>(RUB millions, except percentages)</i>			
<b>Total revenues (net of VAT and export duties)</b> .....	<b>152,249</b>	<b>100.0%</b>	<b>125,553</b>	<b>100.0%</b>
including:				
natural gas sales .....	100,899	66.3%	78,390	62.4%
liquids sales .....	50,799	33.4%	46,875	37.3%
Total operating expenses .....	(88,476)	(58.1%)	(68,838)	(54.8%)
Other operating income (loss) .....	344	0.2%	(9)	(0%)
<b>Profit from operations</b> .....	<b>64,117</b>	<b>42.1%</b>	<b>56,706</b>	<b>45.2%</b>
Total finance income (expense) .....	2,372	1.6%	(2,079)	(1.7%)
Share of profit (loss) of associates net of income tax .....	(1,813)	(1.2%)	(2,521)	(2.0%)
<b>Profit before income tax</b> .....	<b>64,676</b>	<b>42.5%</b>	<b>52,106</b>	<b>41.5%</b>
Total income tax expense .....	(13,784)	(9.1%)	(11,032)	(8.8%)
<b>Profit (loss)</b> .....	<b>50,892</b>	<b>33.4%</b>	<b>41,074</b>	<b>32.7%</b>
Profit attributable to:				
non-controlling interest .....	(19)	(0.0%)	(353)	(0.3%)
shareholders of NOVATEK .....	50,911	33.4%	41,427	33.0%

### Revenues

Our total revenues comprise natural gas sales, liquid hydrocarbon sales and other revenues. Total revenues increased by RUB26,696 million, or 21.3%, to RUB152,249 million for the nine months ended 30 September 2012 compared to RUB125,553 million for the corresponding period in 2011. The following table sets forth our sales revenues (net of VAT and export duties, where applicable) for the nine months ended 30 September 2012 and 2011:

	Nine months ended 30 September		
	2012	2011	Change
	<i>(RUB millions)</i>		
			%
<b>Natural gas sales:</b>			
End-customer .....	80,571	53,918	49.4%
Ex-field sales .....	20,328	24,472	(16.9%)
<b>Natural gas sales</b> .....	<b>100,899</b>	<b>78,390</b>	<b>28.7%</b>
<b>Stable gas condensate sales:</b>			
Export .....	34,872	33,755	3.3%
Domestic .....	299	46	550%
<b>Stable gas condensate sales</b> .....	<b>35,171</b>	<b>33,801</b>	<b>4.1%</b>
<b>Liquefied petroleum gas sales:</b>			
Export .....	7,611	7,251	4.96%
CIS .....	-	10	(100%)
Domestic .....	4,253	3,989	6.6%
<b>Liquefied petroleum gas sales</b> .....	<b>11,864</b>	<b>11,250</b>	<b>5.5%</b>
<b>Crude oil sales:</b>			
Export .....	1,298	719	80.5%
Domestic .....	2,210	963	129.5%
<b>Crude oil sales</b> .....	<b>3,508</b>	<b>1,682</b>	<b>108.6%</b>
<b>Oil and gas products sales:</b>			
Domestic .....	256	142	80.3%
<b>Oil and gas products sales</b> .....	<b>256</b>	<b>142</b>	<b>80.3%</b>
<b>Total oil and gas sales</b> .....	<b>151,698</b>	<b>125,265</b>	<b>21.1%</b>
Other revenues .....	551	288	91.3%
<b>Total revenues</b> .....	<b>152,249</b>	<b>125,553</b>	<b>21.3%</b>

Revenues from our core oil and gas business increased by RUB26,433 million, or 21.1%, for the nine months ended 30 September 2012 compared to the corresponding period in 2011, primarily due to the increase in sales volumes and prices of natural gas and, to a lesser extent, of liquid hydrocarbons. Our natural gas and liquids (stable gas condensate, crude oil, LPG and methanol) sales volumes (expressed as boe) increased for the nine months ended 30 September 2012 by 12.9% and 4.8%, respectively, compared to the corresponding period in 2011, primarily due to an increase in natural gas and crude oil production, as well as purchases of natural gas and liquids.

#### *Natural Gas Sales*

In the nine months ended 30 September 2012, our revenues from sales of natural gas increased by RUB22,509 million, or 28.7%, compared to the corresponding period in 2011 due to an increase in both our average realized natural gas price and total sales volumes. Revenues from the sale of natural gas accounted for 66.3% and 62.4% of our total revenues in the nine months ended 30 September 2012 and 2011, respectively. Our average realized natural gas price increased mainly as a result of two factors: an increase in the regulated FTS price for natural gas by 15% effective from 1 July 2012, which in turn affected the pricing of our natural gas sales, and the growth of end-customer sales as a proportion of total natural gas sales volumes, in keeping with our strategy to increase the share of end-customer sales of natural gas. The sales volumes increased as a result of a growth in natural gas production and purchases. See “—*Certain Factors Affecting Our Results of Operations—Natural Gas Prices*”, “*Risk Factors—Risks Relating to Our Business and Industry—State regulation keeps Gazprom’s domestic natural gas prices lower than its international natural gas prices, and we have limited ability to set domestic prices higher than those charged by Gazprom*” and “*Business—Business Strategy—Maximize Risk-Adjusted Margins on Sales of Natural Gas and Liquids and Expand Our Customer Base*”.

Our proportion of natural gas sold to end-customers to total natural gas sales volumes increased from 53.8% in the nine months ended 30 September 2011 to 68.0% in the corresponding period in 2012. The increase was primarily due to greater natural gas deliveries to the Chelyabinsk region through our regional natural gas trader NOVATEK-Chelyabinsk acquired in November 2011. In the nine months ended 30 September 2012, our natural gas sales volumes representing more than 10% of total end-customer sales volumes by region of destination were to the Chelyabinsk and Perm regions. In the corresponding period in 2011, natural gas sales representing more than 10% of end-customer sales volumes were to the Perm, Chelyabinsk, Orenburg and Moscow regions.

In the nine months ended 30 September 2012, our average netback price on end-customer sales, excluding volumes purchased for resale in the location of our end-customers, increased by 8.5% compared to the corresponding period of 2011, while our average realized end-customer sales price increased by 4.7%. In 2012, the increase in the regulated FTS price for natural gas was postponed from 1 January until 1 July 2012 (see “—*Certain Factors Affecting Our Results of Operations—Natural Gas Prices*”). Accordingly, the 8.5% increase in our average realized end-customers sales netback price was due to a 15% increase in the regulated FTS price effective from 1 July 2012, combined with a lower 7% increase in the average transportation tariff set by the FTS effective from 1 July 2012 (see “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs*”). Our average realized ex-field price in the nine months ended 30 September 2012 was 6.2% higher than in the corresponding period of 2011 due to the postponed increase in FTS regulated prices for natural gas to 1 July 2012.

In the nine months ended 30 September 2012 and 2011, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies, representing 58.6% and 32.3%, respectively, of total natural gas sales volumes to end-customers in the nine months ended 30 September 2012, compared to 75.7% and 20.7%, respectively, in the nine months ended 30 September 2011.

#### *Stable Gas Condensate Sales*

In the nine months ended 30 September 2012, our revenues from sales of stable gas condensate increased by RUB1,370 million, or 4.1%, compared to the corresponding period in 2011 due to an increase in our average realized prices in Roubles resulting from a depreciation of the Rouble during the nine months ended 30 September 2012, compared to the corresponding period in 2011, and to a lesser extent, an increase in volumes sold.

In the nine months ended 30 September 2012, our average realized price, excluding export duties, for stable gas condensate sold on the export market decreased by USD23.9 per ton, or 4.3%, to USD526.0 per ton (delivered CFR, DES, DAP and CIF) from USD549.9 per ton (delivered CIF, DAP, CFR, DAT and DES) in the corresponding period of 2011 period, but the average realized price, excluding export duties, converted to Roubles increased by RUB541 per ton, or 3.4%, to RUB16,360 per ton due to overall depreciation of the Rouble against the U.S. Dollar during the nine months ended 30 September 2012, compared to the corresponding period in 2011.

In the nine months ended 30 September 2012, our total stable gas condensate sales volumes increased by 18 mt, or 0.8%, compared with the corresponding period in 2011, in particular, due to additional unstable gas condensate purchases from one of our Joint Ventures, which offset a decrease in gas condensate production at our Core Fields. In the nine months ended 30 September 2012, we exported 2,131 mt of stable gas condensate, or 98.9% of our total sales volumes, to markets in the Asian-Pacific region, Europe, the United States and South America, with the remaining 24 mt sold domestically. In the nine months ended 30 September 2011, we exported 2,134 mt of stable

gas condensate, or 99.9% of our total sales volumes, to markets in the Asian-Pacific region, Europe and the United States, with the remaining 3 mt sold domestically.

We delivered our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers. We are currently building a new gas condensate transshipment and fractionation complex at the Ust-Luga terminal on the Baltic Sea, which in the future we plan to use instead of the Port of Vitino for deliveries of our stable gas condensate and products refined from our stable gas condensate to international markets. See “*Business—Production—Ust-Luga project*”.

#### *LPG Sales*

In the nine months ended 30 September 2012, our revenues from the sales of LPG increased by RUB614 million, or 5.5%, compared to the corresponding period in 2011, primarily due to an increase in our average realized prices in Roubles resulting from a depreciation of the Rouble during the nine months ended 30 September 2012, compared to the corresponding period in 2011, as well as an increase in volumes sold.

In the nine months ended 30 September 2012, our total LPG sales volumes increased by 10 mt, or 1.5%, to 664 mt from 654 mt in the corresponding period in 2011. In the nine months ended 30 September 2012, we sold 352 mt of LPG, or 53.0% of our total LPG sales volumes, to export markets as compared to 343 mt, or 52.4%, in the corresponding period in 2011. In the nine months ended 30 September 2012, as well as in the corresponding period in 2011, our export sales volumes of LPG representing more than 10% of our total LPG export volumes by country of destination were to Poland and Finland.

Our average realized LPG export price (excluding export duties) decreased by USD41.3 per ton, or 5.6%, to USD 694.3 per ton in the nine months ended 30 September 2012 (delivered DAP, CPT and FCA), compared to USD 735.6 per ton in the corresponding period in 2011 primarily due to a 3.3% decrease in our average contract price, as well as a 5.5% increase in our average export duty per ton. The reduction in our average contract price was due to a decrease in the underlying benchmark prices on international markets used in the price formulas in the nine months ended 30 September 2012 compared to the corresponding period in 2011. However, the average realized price, excluding export duties, converted to Roubles increased by RUB429 per ton, or 2.0%, to RUB21,592 per ton due to overall depreciation of the Rouble against the U.S. Dollar during the nine months ended 30 September 2012, compared to the corresponding period in 2011.

We sold the remaining volumes of LPG domestically at an average price of RUB13,623 per ton (FCA, excluding VAT) in the nine months ended 30 September 2012, representing an increase of RUB767 per ton, or 6.0%, compared to the corresponding period in 2011.

#### *Crude Oil Sales*

In the nine months ended 30 September 2012, our revenues from the sales of crude oil increased by RUB1,826 million, or 108.6%, compared to the nine months ended 30 September 2011, primarily due to an increase in our sales volumes and, to a lesser extent, an increase in our average realized prices.

Our crude oil sales volumes increased by 140 mt, or 83.3%, to 308 mt in the nine months ended 30 September 2012 from 168 mt in the corresponding period in 2011, primarily due to an increase in crude oil production at our East-Tarkosalinskoye and Khancheyskoye fields.

The majority of our crude oil sales volumes, representing 65.3% in the nine months ended 30 September 2012, were sold domestically at an average price of RUB11,000 per ton (excluding VAT), representing an increase of RUB1,433 or 15.0%, compared to the corresponding period in 2011. The increase in our average realized domestic price was due to the overall increase in crude oil prices in the domestic market in the nine months ended 30 September 2012, compared to the nine months ended 30 September 2011. The remaining 34.7% of our crude oil volumes in the nine months ended 30 September 2012 were exported at an average price of USD388.9 per ton (delivered DAF, excluding export duties) representing a slight increase of USD15.4, or 4.1%, compared to the nine months ended 30 September 2011. The increase in our average realized export price (excluding export duties) was the result of a 2.7% decrease in our average export duty per ton that was partially offset by a 0.2% decrease in our average export contract price.

#### *Oil and Gas Products Sales*

In the nine months ended 30 September 2012, our revenues from the sales of oil and gas products increased by RUB114 million, or 80.3%, compared to the nine months ended 30 September 2011, primarily due to an increase in volumes sold and in sales prices.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RUB65 million to RUB178 million in the nine months ended 30 September 2012, compared to the corresponding period in 2011, primarily due to an increase in volumes sold and in sales prices. In the nine months ended 30 September 2012 and 2011, we sold 6.5 mt and 4.2 mt of oil products (diesel fuel and petrol) for an average price of RUB28,593 and RUB26,805 per ton, respectively.

In the nine months ended 30 September 2012, our revenues from methanol sales increased by RUB49 million, or 169.0%, to RUB78 million from RUB29 million in the corresponding period of 2011 primarily due to an increase in volumes sold.

In the nine months ended 30 September 2012, all of our oil products and methanol sales were to customers in the Russian Federation.

#### *Other Revenues*

Other revenues include geological and geophysical research services, rent, sublease, transportation, handling, storage and other services. In the nine months ended 30 September 2012, other revenues increased by RUB263 million, or 91.3%, to RUB551 million from RUB288 million in the corresponding period in 2011. The increase was primarily due to a RUB157 million increase in revenues from transportation, handling and storage services, as well as a RUB79 million increase in revenues from geological and geophysical research services provided primarily to our Joint Ventures.

#### *Operating Expenses*

In the nine months ended 30 September 2012, our total operating expenses increased by RUB19,638 million, or 28.5%, to RUB88,476 million compared to RUB68,838 million in the nine months ended 30 September 2011, primarily due to an increase in transportation expenses and purchases of natural gas and liquid hydrocarbons. As a percentage of total operating expenses, our non-controllable expenses, consisting of transportation expenses and taxes other than income tax, decreased to 64.1% in the nine months ended 30 September 2012 compared to 69.1% in the corresponding period in 2011. Total operating expenses increased as a percentage of total revenues to 58.1% in the nine months ended 30 September 2012 compared to 54.8% in the corresponding period in 2011, as shown in the table below. The increase in our operating expenses as a percentage of total revenues was mainly due to two reasons. First, in January 2012, we started purchasing natural gas, which included the cost of transportation, for subsequent resale to the regions where our end-customers are located and, as such, received lower margins on these volumes sold. Second, effective 1 January 2012, the UPT rate for natural gas increased, while an increase of the regulated FTS price for natural gas was postponed until 1 July 2012.

	<b>Nine months ended 30 September</b>			
	<b>2012</b>	<b>% of total revenues</b>	<b>2011</b>	<b>% of total revenues</b>
	<i>(RUB millions, except %)</i>			
Transportation expenses.....	43,649	28.7%	34,788	27.7%
Taxes other than income tax .....	13,108	8.6%	12,809	10.2%
<b>Subtotal non-controllable expenses.....</b>	<b>56,757</b>	<b>37.3%</b>	<b>47,597</b>	<b>37.9%</b>
Purchases of natural gas and liquid hydrocarbons	11,606	7.6%	2,833	2.3%
Depreciation, depletion and amortization.....	7,588	5.0%	6,307	5.0%
General and administrative expenses .....	7,235	4.8%	5,872	4.7%
Materials, services and other.....	5,138	3.4%	4,394	3.5%
Exploration expenses .....	629	0.4%	1,639	1.3%
Net impairment expenses .....	49	0.0%	682	0.5%
Change in natural gas, liquid hydrocarbons, and work in progress .....	(526)	n/m	(486)	n/m
<b>Total operating expenses.....</b>	<b>88,476</b>	<b>58.1%</b>	<b>68,838</b>	<b>54.8%</b>

#### *Non-Controllable Expenses*

A significant proportion of our operating expenses are characterized as non-controllable expenses, since we are unable to control the increase in the regulated tariffs for transportation of our hydrocarbons or the tax rates imposed by federal, regional or local authorities. See “*Risk Factors—Risks Relating to Our Business and Industry—We are dependent on state authorities to set tariffs for transportation of our key products, and such tariffs are expected to continue to increase.*”

In the nine months ended 30 September 2012, our non-controllable expenses on transportation and taxes other than income tax increased by RUB9,160 million, or 19.2%, to RUB56,757 million from RUB47,597 million in the corresponding period in 2011. The change in transportation expenses was primarily due to an increase in the natural gas transportation tariff and volumes sold to end-customers where we were responsible for such expenses. Taxes other than income tax increased primarily due to an increase in natural gas production volumes, as well as a 5.9% increase in the UPT rate for natural gas effective from 1 January 2012, which was partially offset by the application of a 0% UPT rate for our crude oil production from 1 January 2012 (see “*Certain Factors Affecting Our Results of Operations—Our Tax Burden*”). As a percentage of total revenues, our non-controllable expenses remained relatively stable in the nine months ended 30 September 2012 and 2011 at 37.3% and 37.9%, respectively.

### Transportation Expenses

In the nine months ended 30 September 2012, our total transportation expenses increased by RUB 8,861 million, or 25.5%, compared to the corresponding period in 2011. The following table presents our transportation expenses for each of our products for the periods indicated:

	Nine months ended 30 September		Change %
	2012	2011	
	<i>(RUB millions)</i>		
Natural gas transportation to customers <sup>(1)</sup> .....	32,447	24,819	30.7%
Liquid hydrocarbons transportation by rail .....	7,864	7,022	12.0%
Liquid hydrocarbons transportation by tankers .....	2,873	2,660	8.0%
Crude oil transportation to customers <sup>(2)</sup> .....	367	194	89.2%
Other transportation costs .....	98	93	5.4%
<b>Total transportation expenses</b> .....	<b>43,649</b>	<b>34,788</b>	<b>25.5%</b>

<sup>(1)</sup> Via the UGSS.

<sup>(2)</sup> Via the Transneft pipeline network.

In the nine months ended 30 September 2012, our transportation expenses for natural gas increased by RUB7,628 million, or 30.7%, to RUB32,447 million from RUB24,819 million in the corresponding period in 2011. The increase was due to a 30.2% increase in our sales volumes of natural gas delivered directly to end-customers, for which we incurred transportation expenses, as well as a 7% average increase effective 1 July 2012 in the natural gas transportation tariff set by the FTS. See “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Natural Gas*”. We do not incur transportation expenses in respect of natural gas volumes purchased for resale in the location of our end-customers, as the purchase price includes the cost of transportation. An increase in the FTS transportation tariff for natural gas at a lower annual rate than in the FTS regulated price for natural gas incentivizes us to expand our customer base geographically in Russia and our domestic natural gas supplies to penetrate into new regions. Our average transportation distance for natural gas sold to end-customers fluctuates period-to-period and depends on the location of end-customers and the specific routes of transportation.

In the nine months ended 30 September 2012, total expenses for liquids transportation by rail increased by RUB842 million, or 12.0%, to RUB7,864 million from RUB7,022 million in the corresponding period in 2011 primarily due to higher average transportation tariffs for liquids and, to a lesser extent, an increase in our stable gas condensate volumes sold and transported via rail. In the nine months ended 30 September 2012, our weighted average transportation tariff for liquids delivered by rail increased by 10.9% to RUB2,791 per ton from RUB2,516 per ton in the corresponding period in 2011, primarily due to a 6.0% increase in rail tariffs for the domestic market set by the FTS effective 1 January 2012, as well as an increase in rail tariffs for LPG deliveries through the territory of the CIS to export markets. Our weighted average transportation tariff for liquids delivered by rail fluctuates period-on-period and depends on the type of product and the geography of deliveries. See “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Stable Gas Condensate, LPG and Oil Products*”.

In the nine months ended 30 September 2012, our combined liquids volumes sold and transported via rail slightly increased by 25 mt, or 0.9%, to 2,816 mt from 2,791 mt in the corresponding period in 2011, which led to a decrease in the stable gas condensate inventory balance in the nine months ended 30 September 2012 as compared to the corresponding period in 2011. The transportation costs incurred in respect of liquids volumes recognized as part of our inventory balance or in transit are capitalized as part of current assets until the recognition of such volumes as sold.

Our total transportation expense for delivery of liquids by tankers to international markets increased by RUB213 million, or 8.0%, to RUB2,873 million in the nine months ended 30 September 2012 from RUB2,660 million in the corresponding period in 2011. The increase was due to an increase in average freight rates reflecting a change in the mix of geographical regions where we sold our stable gas condensate. In the nine months ended 30 September 2012, our total stable gas condensate export sales were split geographically as follows (as a percentage of our export revenues and including export duties): 54.2% to the Asian-Pacific Region, 28.8% to Europe, 14.0% to the United States and 3.0% to South America, whereas in the corresponding period in 2011 we sold 43.7% to the Asian-Pacific region, 34.4% to Europe and 21.9% to the United States.

In the nine months ended September 2012, our total transportation expense related to the delivery of crude oil, which comprises primarily the fees of Transneft, increased by RUB173 million, or 89.2%, to RUB367 million from RUB194 million in the corresponding period in 2011. The change was due to the 83.3% increase in our sales of crude oil (by volume) in the nine months ended 30 September 2012, compared to the corresponding period in 2011.

## Taxes Other Than Income Tax

	Nine months ended 30 September		Change %
	2012	2011	
	(RUB millions)		
Unified natural resources production tax (UPT) .....	10,903	10,546	3.4%
Property tax.....	1,304	1,298	0.5%
Excise and fuel taxes.....	714	754	(5.3)%
Other taxes.....	187	211	(11.4)%
<b>Total taxes other than income tax .....</b>	<b>13,108</b>	<b>12,809</b>	<b>2.3%</b>

In the nine months ended 30 September 2012, taxes other than income tax increased by RUB299 million, or 2.3%, primarily due to an increase in the UPT, partially offset by a decrease in excise and fuel taxes and in taxes other than property tax.

In the nine months ended 30 September 2012, our UPT expense for natural gas increased by RUB1,135 million, or 13.8%, due to an increase in our natural gas production volumes, as well as a 5.9% increase in the UPT rate for natural gas effective 1 January 2012 (RUB251 per mcm in the nine months ended 30 September 2012, compared with RUB237 per mcm in the corresponding period in 2011). In addition, our UPT expense for gas condensate increased by RUB76 million, or 5.3%, due primarily to a change in the applicable UPT rate.

In the nine months ended 30 September 2012, we applied a 0% UPT rate for crude oil produced at our East-Tarkosalinskoye and Khancheyskoye fields due to changes in the Russian Tax Code applicable from 1 January 2012 (see “—*Certain Factors Affecting Our Results of Operations—Our Tax Burden*”). In the corresponding period in 2011, we incurred RUB854 million of UPT expense for crude oil.

In the nine months ended 30 September 2012, our excise and fuel taxes spent in respect of LPG export sales through our subsidiary Novatek Polska Sp. z o.o. (“**Novatek Polska**”) decreased by RUB40 million, or 5.3%, as a result of an increase in the proportion of sales volumes not subject to excise and fuel taxation, as well as the depreciation of the Polizh zloty against the Rouble. This decrease was partially offset by an increase in certain LPG export sales through Novatek Polska, in respect of which excise and fuel taxes are payable when LPG enters the territory of Poland.

See “—*Certain Factors Affecting Our Results of Operations—Our Tax Burden*” for further discussion of trends in the taxes imposed on our operations.

### *Purchases of Natural Gas and Liquid Hydrocarbons*

In the nine months ended 30 September 2012, our purchases of natural gas and liquid hydrocarbons increased by RUB8,773 million, or more than three-fold, to RUB11,606 million from RUB2,833 million in the corresponding period in 2011. RUB7,551 million of this increase was due to purchases of natural gas, including purchases of natural gas from SIBUR, a related party, starting from 1 January 2012 and a 34.3% increase in natural gas purchases from Sibneftegas, one of our Joint Ventures as compared to the corresponding period in 2011. See “*Related Party Transactions—Transactions with our associates and joint ventures*” and “*Related Party Transactions—Transactions with parties under significant influence or control of key management personnel—Transactions with parties under control of key management personnel*”.

In April 2012, we commenced purchasing unstable gas condensate from SeverEnergia, one of our Joint Ventures, at ex-field prices based on benchmark crude oil and oil products market quotes adjusted for quality and tariffs for transportation and processing, which accounted for a RUB1,129 million increase as compared to the corresponding period in 2011. See “*Related Party Transactions—Transactions with our associates and joint ventures*”. The remaining balance of RUB93 million related to oil products (diesel fuel and petrol) and LPG purchases, which were subsequently resold on the domestic market through our wholly-owned subsidiary NOVATEK-AZK.

### *Depreciation, Depletion and Amortization*

In the nine months ended 30 September 2012, our depreciation, depletion and amortization (“**DDA**”) expense increased by RUB1,281 million, or 20.3%, compared to the corresponding period in 2011, as a result of a 6.7% increase in our total hydrocarbon production (excluding our proportionate share in the production of our Joint Ventures) in barrels of oil equivalent, as well as an increase in our depletable cost base. We recognize depreciation and depletion using the “units of production” method for producing assets and straight-line method for other facilities.

In the nine months ended 30 September 2012, our DDA per boe was RUB24.0 compared to RUB21.5 in the corresponding period in 2011. The increase in our DDA charge calculated on a boe basis was due to the capitalization of costs related to the ongoing development at our East-Tarkosalinskoye and Yurkharovskoye fields, as well as a decrease in our proved reserves estimates as of 31 December 2011 in our producing subsidiaries, used as the denominator in the calculation of the DDA under the “units of production” method.

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

#### *General and Administrative Expenses*

In the nine months ended 30 September 2012, our general and administrative expenses increased by RUB1,363 million, or 23.2%, to RUB7,235 million compared to RUB5,872 million in the corresponding period in 2011. The main components of these expenses were administrative employees' compensation, social expenses and compensatory payments, and legal, audit and consulting services, which, in aggregate, comprised 82.2% and 80.2% of our total general and administrative expenses in the nine months ended 30 September 2012 and 2011, respectively.

	<b>Nine months ended 30 September</b>		<b>Change</b>
	<b>2012</b>	<b>2011</b>	
	<i>(RUB millions)</i>		<i>%</i>
Employee compensation .....	4,728	3,351	41.1%
Social expenses and compensatory payments .....	735	951	(22.7%)
Legal, audit, and consulting services .....	483	406	19.0%
Depreciation of administrative buildings .....	245	129	89.9%
Business trip expenses .....	196	155	26.5%
Fire safety and security expense .....	148	133	11.3%
Rent expense .....	82	125	(34.4%)
Insurance expense .....	60	29	106.9%
Bank charges .....	55	35	57.1%
Other .....	503	558	(9.9%)
<b>Total general and administrative expenses .....</b>	<b>7,235</b>	<b>5,872</b>	<b>23.2%</b>

Our administrative employees' compensation increased by RUB1,377 million, or 41.1%, to RUB4,728 million in the nine months ended 30 September 2012 as compared to RUB3,351 million in the corresponding period in 2011. The increase was due to several factors: (i) increase in bonuses paid for the results achieved in 2011 and accrued for the results achieved in 2012; (ii) an indexation of base salaries by 6.0% effective 1 July 2012 and 9.6% effective 1 July 2011; (iii) an increase in the average number of administrative employees resulting from the acquisition of OOO Gazprom Mezhregiongas Chelyabinsk in November 2011 and the expansion of the activities of NOVATEK-Ust-Luga; (iv) an increase in our social insurance contributions to the non-budget funds in the nine months ended 30 September 2012, compared to the corresponding period in 2011, due to the legislative change in the taxable base and rates of payments to the Pension Fund of the Russian Federation effective from 1 January 2012 (see "*Certain Factors Affecting Our Results of Operations—Our Tax Burden*").

In the nine months ended 30 September 2012, our social expenses and compensatory payments decreased by RUB216 million, or 22.7%, to RUB735 million compared to RUB951 million in the corresponding period in 2011, and were primarily related to our donations to sport clubs and activities and to schools, as well as continued support for charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the funding needs and the implementation schedules of specific programs we support in the regions where we operate.

In the nine months ended 30 September 2012, legal, audit, and consulting services expenses increased by RUB77 million, or 19.0%, to RUB483 million compared to RUB406 million in the corresponding period in 2011, due to reserves appraisal services and consulting services related to infrastructure development activity at our recently acquired Salmanovskoye (Utrenneye) and Geofizicheskoye fields, as well as an increased volume of services to maintain and acquire software for our core subsidiaries.

In the nine months ended 30 September 2012, the depreciation of administrative buildings increased by RUB116 million, or 89.9%, compared to the corresponding period in 2011 due to the completion and opening of our new Moscow head-office in the second quarter of 2011, and to the depreciation of other fixed assets of an administrative nature, launched in the nine months ended 30 September 2012. Fixed assets of an administrative nature are depreciated on a straight-line basis over their estimated useful lives.

In the nine months ended 30 September 2012, our fire safety and security expenses increased by RUB15 million, or 11.3%, compared to the corresponding period in 2011, as a result of the opening of our new Moscow head-office in the second quarter of 2011 and the increase in rates charged for security services.

In the nine months ended 30 September 2012, our rent expense decreased by RUB43 million, or 34.4%, compared to the corresponding period in 2011, due to the relocation of employees to our new Moscow head-office in May 2011. This decrease was partially offset by an increase in rent expenses resulting from our acquisition of OOO Gazprom Mezhregiongaz Chelyabinsk in November 2011 (since merged into NOVATEK-Chelyabinsk), as it rents office space for its employees.

Our insurance expense increased by RUB31 million, or 106.9%, in the nine months ended 30 September 2012, compared with the corresponding period in 2011, due to the insuring of recently launched fixed assets at our production subsidiaries.

In the nine months ended 30 September 2012, other general and administrative expenses decreased by RUB55 million, or 9.9%, primarily due to the increase in expenses related to our participating in international economic forums and exhibitions, advertising and other immaterial expense items of an administrative nature, which was partially offset by the decrease in expenses related to the termination of the concession agreement at El-Arish concession area in Egypt at the end of 2011.

#### *Materials, Services and Other*

In the nine months ended 30 September 2012, our materials, services and other expenses increased by RUB744 million, or 16.9%, to RUB5,138 million compared to RUB4,394 million in the corresponding period in 2011. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 53.3% and 21.5%, respectively, of our total materials, services and other expenses in the nine months ended 30 September 2012, compared with 52.2% and 21.4%, respectively, in the nine months ended 30 September 2011.

	<b>Nine months ended 30 September</b>		<b>Change</b>
	<b>2012</b>	<b>2011</b>	
	<i>(RUB millions)</i>		<i>%</i>
Employee compensation.....	2,741	2,295	19.4%
Repair and maintenance services.....	1,105	941	17.4%
Electricity and fuel.....	325	300	8.3%
Materials and supplies.....	275	222	23.9%
Security expenses.....	205	180	13.9%
Transportation expenses.....	132	130	1.5%
Processing fees.....	74	74	0.0%
Rent expenses.....	45	34	32.4%
Other.....	236	218	8.3%
<b>Total materials, services and other.....</b>	<b>5,138</b>	<b>4,394</b>	<b>16.9%</b>

In the nine months ended 30 September 2012, our operational employee compensation increased by RUB446 million, or 19.4%, to RUB2,741 million compared to RUB2,295 million in the corresponding period in 2011. The increase was primarily due to: (i) an indexation of base salaries by 6.0% effective 1 July 2012 and 9.6% effective 1 July 2011, as well as payment of additional bonuses for results achieved in 2011; and (ii) an increase in the average number of operational employees, which followed the acquisition of OOO Gazprom Mezhregiongas Chelyabinsk in November 2011 and the expansion of our trading activities at NOVATEK-AZK and NOVATEK-Ust-Luga.

Our expenses for repair and maintenance services increased by RUB164 million, or 17.4%, to RUB1,105 million in the nine months ended 30 September 2012 compared to RUB941 million in the corresponding period in 2011, primarily in connection with on-going repair works at our wholly-owned subsidiary NOVATEK-Tarkosalenftegas and at the Purovsky Plant, which are consistent with our maintenance schedules.

Electricity and fuel expenses increased by RUB25 million, or 8.3%, to RUB325 million in the nine months ended 30 September 2012 compared to RUB300 million in the corresponding period in 2011, primarily due to an increase in energy consumption by our production subsidiaries resulting from recently completed infrastructure projects, as well as higher electricity rates in the nine months ended 30 September 2012 compared to the corresponding period in 2011.

Materials and supplies expense increased by RUB53 million, or 23.9%, mainly due to an increase in repair works at our production assets.

Our security expenses increased by RUB25 million, or 13.9%, to RUB205 million in the nine months ended 30 September 2012 from RUB180 million in the nine months ended 30 September 2012, largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

#### *Exploration expenses*

In the nine months ended 30 September 2012, we incurred RUB629 million of exploration expenses related to 2-D seismic activities at our fields in early stages of development.

In the nine months ended 30 September 2011, we incurred RUB1,639 million of exploration expenses: in particular, we expensed RUB414 million of capitalized cost of the three exploratory wells at the Raduzhnoye and Yarudeyskoye fields and RUB407 million of the cost of two exploratory wells written off at the El-Arish (Egypt) and Radyzhnyi license areas.



### *Net Impairment Expenses*

In the nine months ended 30 September 2012, our net impairment expenses amount to RUB49 million compared to the net impairment expenses of RUB682 million in the corresponding period in 2011. During the nine months ended 30 September 2011, we wrote off assets at the Middle-Chaselskiy license area in the amount of RUB499 million due to negative future cash flows expected from those assets and RUB119 million related to the impairment of our investment at the El-Arish (Egypt) project.

### *Change in Natural Gas, Liquid Hydrocarbons and Work-in-Progress*

In the nine months ended 30 September 2012, we recorded a reversal of RUB526 million to change in inventory expense, as compared to a reversal of RUB486 million in the corresponding period in 2011:

	Nine months ended 30 September	
	2012	2011
	<i>(RUB millions)</i>	
Natural gas .....	(315)	(287)
Stable gas condensate.....	(233)	(133)
Other .....	22	(66)
<b>Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress</b>	<b>(526)</b>	<b>(486)</b>

In the nine months ended 30 September 2012, we recorded a reversal to our operating expenses of RUB315 million due to a net increase in our natural gas inventory balance of 581 mmcm. Our volumes of natural gas injected into Gazprom's UGSFs fluctuate period-to-period depending on market conditions, storage capacity constraints and our development plans to sustain and/or grow production during periods of seasonality.

In addition, in the nine months ended 30 September 2012, we recorded a reversal of RUB233 million to our operating expenses due to an increase in our inventory balance of stable gas condensate in transit and storage of 49 mt.

The following table highlights movements in our inventory balances:

	2012			2011		
	At 30 September	At 1 January	Increase/ (decrease)	At 30 September	At 1 January	Increase/ (decrease)
<i>Inventory balances in transit or in storage</i>						
<b>Natural gas (mmcm)</b> .....	<b>1,341</b>	<b>760</b>	<b>581</b>	<b>1,225</b>	<b>790</b>	<b>435</b>
including UGSF .....	1,309	732	577	1,194	761	433
<b>Liquid hydrocarbons (mt)</b> .....	<b>374</b>	<b>325</b>	<b>49</b>	<b>422</b>	<b>356</b>	<b>66</b>
including stable gas condensate .....	268	228	40	325	264	61

### *Other Operating Income (Loss) and Net Gain (Loss) on Disposals*

In the nine months ended 30 September 2012, we recognized other operating income in the amount of RUB344 million, of which RUB322 million of net income related to a change in a fair value of our long-term natural gas purchase and sales contracts on the European market which were classified as derivative instruments in accordance with IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39").

### *Profit from Operations*

As a result of the factors discussed above, our profit from operations increased by RUB7,411 million, or 13.1%, to RUB64,117 million in the nine months ended 30 September 2012, compared to RUB56,706 million in the corresponding period in 2011. In the nine months ended 30 September 2012, our profit from operations as a percentage of total revenues decreased to 42.1% compared to 45.2% in the relevant 2011 period primarily due to an increase in purchases of natural gas for resale in the regions where our end-customers are located and lower margins we received for these volumes.

### *Finance Income (Expense)*

In the nine months ended 30 September 2012, we recorded net finance income of RUB2,372 million compared to net finance expense of RUB2,079 million in the corresponding period in 2011, primarily due to the appreciation of the Rouble relative to the U.S. Dollar during most of the nine months ended 30 September 2012, compared to the depreciation of the Rouble during the nine months ended 30 September 2011.

In the nine months ended 30 September 2012, our accrued interest expense, including the interest capitalized, decreased to RUB3,826 million compared to RUB4,004 million in the corresponding period in 2011. During the nine months ended 30 September 2012 and 2011, we capitalized RUB1,848 million and RUB2,855 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with our accounting policy. In addition, we recognized RUB172 million and RUB173 million related to the unwinding of the

present value discount related to provisions of asset retirement obligations as part of interest expense in the nine months ended 30 September 2012 and 2011, respectively, and also RUB212 million related to the fair value remeasurement of financial instruments as part of our interest expense in the nine months ended 30 September 2011. Accordingly, in the nine months ended 30 September 2012, our total interest expense increased to RUB2,150 million compared to RUB1,534 million in the corresponding period in 2011.

Interest income decreased by RUB1,293 million, or 51.1%, to RUB1,237 million in the nine months ended 30 September 2012 from RUB2,530 million in the corresponding period in 2011, due to a decrease in loans provided to our Joint Ventures. In February 2012, the loan in the amount of RUB16,348 million from the total amount of RUB28,123 million provided to Yamal Development in November 2011 and the accrued interest for this loan, were converted into charter capital. See *“Related Party Transactions—Transactions with our associates and joint ventures”*.

In the nine months ended 30 September 2012, we recorded a net foreign exchange gain of RUB3,285 million as compared to a net loss of RUB3,075 million in the corresponding period in 2011, due primarily to the revaluation of our U.S. Dollar denominated borrowings. In nominal terms, the Rouble appreciated by 4.0% against the U.S. Dollar for the nine months ended 30 September 2012, compared to its depreciation by 4.6% for the corresponding period in 2011. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio. See *“Risk Factors—Risks Related to Our Business and Industry—We face foreign exchange risks that could have a material adverse effect on our business, financial condition, results of operations and prospects”* and *“—Certain Factors Affecting Our Results of Operations—Impact of the Global Financial Crisis and Current Financial Market Conditions”*.

#### ***Share of Income (Loss) of Joint Ventures, Net of Income Tax***

In the nine months ended 30 September 2012, our proportionate share in losses of our Joint Ventures decreased to RUB1,813 million compared to RUB2,521 million in the corresponding period in 2011 due to a combination of factors.

In the nine months ended 30 September 2012, we recognized a share of losses in our Joint Venture Yamal LNG of RUB1,457 million, due to payments by Yamal LNG to the YNAO government to undertake socio-economic programs related to the Yamal LNG project. In 2011, we did not recognize any share of losses in Yamal LNG, as Yamal LNG was our consolidated subsidiary until October 2011. However, in the nine months ended 30 September 2012, we recognized lower losses in our Joint Ventures Sibneftegas and Yamal Development, compared to the corresponding period in 2011. The lower losses recognized in Yamal Development were due, in particular, to the conversion of loans obtained from its participants into charter capital in February 2012, resulting in a decrease in interest expense of Yamal Development. The decrease in losses of Sibneftegas was due to an increase in natural gas sales prices.

#### ***Income Tax Expense***

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 21.3% and 21.2% for the nine months ended 30 September 2012 and 2011, respectively. The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses and non-taxable income.

#### ***Profit Attributable to NOVATEK's Shareholders and Earnings per Share***

As a result of the factors discussed above, profit for the period increased by RUB9,818 million, or 23.9%, to RUB50,892 million in the nine months ended 30 September 2012 from RUB41,074 million in the corresponding period in 2011. The profit attributable to NOVATEK shareholders increased by RUB9,484 million, or 22.9%, to RUB50,911 million in the nine months ended 30 September 2012 from RUB41,427 million in the corresponding period in 2011.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to NOVATEK shareholders, increased by RUB3.12 per share, or 22.8%, to RUB16.78 per share in the nine months ended 30 September 2012 from RUB13.66 per share in corresponding period in 2011.

## Results of Operations for the Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2011 and 2010. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December			
	2011 <sup>(1)</sup>	% of total revenues	2010 <sup>(1)</sup>	% of total revenues
	<i>(RUB millions, except percentages)</i>			
<b>Total revenues (net of VAT and export duties)</b>	<b>176,271</b>	<b>100%</b>	<b>117,165</b>	<b>100%</b>
including:				
natural gas sales .....	110,932	62.9%	71,060	60.6%
liquids sales.....	64,877	36.8%	44,243	37.8%
Total operating expenses.....	(97,818)	(55.5%)	(68,616)	(58.5%)
Net gain on disposal of interest in subsidiaries .....	62,948	35.7%	1,329	1.1%
Other operating income (loss).....	207	0.1%	353	0.3%
<b>Profit from operations .....</b>	<b>141,608</b>	<b>80.3%</b>	<b>50,231</b>	<b>42.9%</b>
Total finance income (expense) .....	(2,703)	(1.5%)	1,197	1.0%
Share of profit (loss) of associates net of income tax .....	(3,880)	(2.2%)	(346)	(0.4%)
<b>Profit before income tax.....</b>	<b>135,025</b>	<b>76.6%</b>	<b>51,082</b>	<b>43.6%</b>
Total income tax expense.....	(15,734)	(8.9%)	(10,804)	(9.2%)
<b>Profit (loss) .....</b>	<b>119,291</b>	<b>67.7%</b>	<b>40,278</b>	<b>34.4%</b>
profit attributable to:				
non-controlling interest .....	(364)	(0.2%)	(255)	(0.2%)
shareholders of NOVATEK .....	119,655	67.9%	40,533	34.6%

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2011 and 2010 differs from the presentation in the 2011 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see "Presentation of Financial and Other Information—Impact of Changes in Presentation".

### Revenues

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

	Year ended 31 December		Change %
	2011 <sup>(1)</sup>	2010 <sup>(1)</sup>	
	<i>(RUB millions)</i>		
<b>Natural gas sales:</b>			
End-customer .....	77,046	54,860	40.4%
Ex-field sales.....	33,886	16,200	109.2%
<b>Natural gas sales.....</b>	<b>110,932</b>	<b>71,060</b>	<b>56.1%</b>
<b>Stable gas condensate sales:</b>			
Export .....	46,732	29,720	57.2%
Domestic .....	46	34	35.3%
<b>Stable gas condensate sales.....</b>	<b>46,778</b>	<b>29,754</b>	<b>57.2%</b>
<b>Liquefied petroleum gas sales:</b>			
Export .....	9,697	8,052	20.4%
CIS .....	10	9	11.1%
Domestic .....	5,727	4,827	18.6%
<b>Liquefied petroleum gas sales.....</b>	<b>15,434</b>	<b>12,888</b>	<b>19.8%</b>
<b>Crude oil sales:</b>			
Export .....	1,021	603	69.3%
Domestic .....	1,458	855	70.5%
<b>Crude oil sales.....</b>	<b>2,479</b>	<b>1,458</b>	<b>70.0%</b>
<b>Oil products sales:</b>			
Domestic .....	186	143	30.1%
<b>Oil products sales.....</b>	<b>186</b>	<b>143</b>	<b>30.1%</b>
<b>Total gas and oil sales .....</b>	<b>175,809</b>	<b>115,303</b>	<b>52.5%</b>
Sales of polymer and insulation tape.....	—	1,699	n/a
Other revenues .....	462	163	183.4%
<b>Total revenues .....</b>	<b>176,271</b>	<b>117,165</b>	<b>50.4%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2011 and 2010 differs from the presentation in the 2011 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the

### *Natural Gas Sales*

In 2011, our revenues from sales of natural gas increased by RUB39,872 million, or 56.1%, compared to 2010 largely due to an increase in sales volumes and, to a lesser extent, an increase in natural gas prices. Revenues from the sales of natural gas accounted for 62.9% and 60.6% of our total revenues in 2011 and 2010, respectively.

In 2011, our sales volumes of natural gas increased by 16,550 mmcm, or 44.6%, to 53.667 mmcm from 37,117 mmcm in 2010 because of a combination of increased production at our Core Fields and purchases of natural gas from Sibneftegas. Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased to 54.7% in 2011 from 64.0% in 2010. The decrease was due to the increase of sales volumes to one of our main gas traders and the commencement from January 2011 of natural gas sales, ex-field, to Itera (which, since August 2012, is a joint venture held 51% by Rosneft and 49% by Itera Group), a Russian gas and oil company, under a long-term contract signed in April 2010 for annual volumes of approximately four billion cubic meters. There were no corresponding sales of natural gas to Itera in 2010.

The average realized prices of our natural gas sold directly to end-customers (including transportation expense and excluding trading activities) and sold ex-field were higher by 13.7% and 14.9%, respectively, in 2011 compared to 2010.

In 2011, as well as in 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies. In addition, in December 2011, we commenced natural gas sales to a new end-customer segment – household customers – in the Chelyabinsk region, as a result of our acquisition of 100% of the equity of Gazprom mezhregiongas Chelyabinsk (since merged into our wholly-owned NOVATEK-Chelyabinsk) in November 2011.

In 2011 and 2010, all of our total external revenues from the sale of natural gas were to customers in the Russian Federation.

### *Stable Gas Condensate Sales*

In 2011, our revenues from sales of stable gas condensate increased by RUB17,024 million, or 57.2%, compared to 2010 due to both an increase in volumes sold and an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the standard price formulation for condensate sales.

Our total stable gas condensate sales volumes increased by 655 thousand tons, or 28.2%, due to an increase in our unstable gas condensate production and a decrease in the stable gas condensate inventory balance in 2011 after an increase in 2010. In 2011, we exported 2,981 thousand tons of stable gas condensate, or 99.9% of our total sales volumes, to the Asian-Pacific region, Europe and the United States, with the remaining three thousand tons sold domestically. In 2010, we exported 2,326 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to the United States, the Asian-Pacific region, Europe and South America, with the remaining four thousand tons sold domestically. We delivered our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers.

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

In 2011, the Asian-Pacific region accounted for 43.6% of our total external revenues (including export duties) from the sale of stable gas condensate; Europe accounted for 34.5% of such revenues; the U.S. for 21.9% of such revenues.

In 2010, the United States accounted for 53.1% of our total external revenues (including export duties) from the sale of stable gas condensate; the Asian-Pacific region accounted for 25.9% of such revenues; Europe for 13.5% of such revenues; other export markets for 7.5% of such revenues.

### *LPG Sales*

In 2011, our revenues from sales of LPG increased by RUB2,546 million, or 19.8%, compared to 2010, primarily due to an increase in our average realized prices.

In 2011, we sold 453 thousand tons of LPG, or 51.5% of our total LPG sales volumes, to export markets, compared to 434 thousand tons, or 49.5% of our total LPG sales volumes, in 2010. In 2011, our export sales volumes

of LPG representing more than 10% of our total LPG sales volumes by country of destination were to Poland and Finland and in 2010 to Poland, Finland and Turkey.

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

In 2011, we sold 426 thousand tons of LPG, or 48.4% of our total LPG sales volumes, on the domestic market at an average price of RUB13,458 per ton (FCA, excluding VAT) representing an increase of RUB2,530 per ton, or 23.2%, compared to 2010.

In 2011, Europe accounted for 67.7% of our total external revenues (including export duties) from LPG sales, Russia accounted for 32.2% of such revenues and CIS accounted for 0.1% of such revenues. In 2010, Europe accounted for 64.6% of our total external revenues (including export duties) from LPG sales, Russia accounted for 35.3% of such revenues and CIS accounted for 0.1% of such revenues.

#### *Crude Oil Sales*

In 2011, our revenues from sales of crude oil increased by RUB1,021 million, or 70.0%, due to an increase in sales volumes and, to a lesser extent, an increase in our average realized prices.

In 2011, our crude oil sales volumes increased by 57 thousand tons, or 30.8%, to 242 thousand tons from 185 thousand tons in 2010 primarily due to an increase in crude oil production at our East-Tarkosalinskoye field. The majority of our crude oil sales volumes, representing 61.6% in 2011, was sold domestically at an average price of RUB9,792 per ton (excluding VAT) representing an increase of RUB2,269 per ton, or 30.2%, compared to 2010. The remaining 38.4% of our crude oil volumes were sold to export markets at an average price of U.S.\$373.7 per ton (delivered DAP, excluding export duties) representing an increase of U.S.\$92.5 per ton, or 32.9%, compared to 2010.

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

In 2011, Europe accounted for 59.5% of our total external revenues (including export duties) from the sale of crude oil and Russia accounted for 40.5% of such revenues. In 2010, Europe accounted for 58.2% of our total external revenues (including export duties) from the sale of crude oil and Russia accounted for 41.8% of such revenues.

#### *Oil Products Sales*

In 2011, our revenue from the sales of gas and oil products increased by RUB43 million, or 30.1%, to RUB186 million from RUB143 million in 2010.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RUB37 million to RUB147 million in 2011, compared to RUB110 million in 2010, due to an increase in sales prices. In 2011 and 2010, we sold approximately 5.4 thousand tons and 4.8 thousand tons of oil products (diesel fuel and petrol) for an average price of RUB27,232 and RUB22,951 per ton, respectively.

In 2011, we had no revenues from domestic sales of oil products produced at the Surgutsky refinery, compared to revenues of RUB33 million in 2010, due to the cessation of deliveries of our unstable gas condensate to the Surgutsky refinery starting in September 2010. In August 2010, we launched our own unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant, eliminating the need for third-party transportation and processing.

In 2011, we sold approximately 4 thousand tons of methanol to our Joint Venture Sibneftegas and recorded revenues of RUB39 million from such sale.

In 2011 and 2010, all of our oil products sales were to customers in the Russian Federation.

#### *Sales of Polymer and Insulation Tape*

In 2011, we had no revenues from the sales of polymer and insulation tape, compared to revenues of RUB1,669 million in 2010, following the disposal of our polymer and insulation tape production subsidiary OOO NOVATEK-Polymer in September 2010.

#### *Other Revenues*

In 2011, other revenues increased by RUB299 million, or 183.4%, to RUB462 million from RUB163 million in 2010. The increase was primarily comprised of RUB131 million for the sublet of leased tankers as well as a RUB81 million increase in revenue from transportation, handling and storage services.

## Operating Expenses

In 2011, our total operating expenses increased by RUB29,202 million, or 42.6%, to RUB97,818 million compared to RUB68,616 million in 2010, primarily due to an increase in transportation expenses, taxes other than income tax and purchases of natural gas. As a percentage of total operating expenses, our non-controllable expenses, decreased to 67.4% in 2011 compared to 69.0% in 2010. Total operating expenses decreased as a percentage of total revenues to 55.5% in 2011 compared to 58.6% in 2010, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas and liquids volumes and sales prices, as well as cost optimization after the launch of our own transport and processing infrastructure in August 2010.

	Year ended 31 December			
	2011 <sup>(1)</sup>	% of total revenues	2010 <sup>(1)</sup>	% of total revenues
	<i>(RUB millions, except percentages)</i>			
Transportation expenses.....	48,329	27.4%	37,298	31.8%
Taxes other than income tax .....	17,557	10.0%	10,077	8.6%
<b>Subtotal non-controllable expenses.....</b>	<b>65,886</b>	<b>37.4%</b>	<b>47,375</b>	<b>40.4%</b>
Depreciation, depletion and amortization.....	9,277	5.3%	6,616	5.6%
General and administrative expenses .....	8,218	4.7%	6,733	5.7%
Purchases of natural gas and liquid hydrocarbons	5,994	3.4%	154	0.1%
Materials, services and other.....	5,947	3.4%	6,072	5.2%
Exploration expenses .....	1,819	1.0%	1,595	1.4%
Net impairment expenses .....	782	0.4%	541	0.5%
Change in natural gas, liquid hydrocarbons, and polymer products and work in progress .....	(105)	n/m	(470)	n/m
<b>Total operating expenses.....</b>	<b>97,818</b>	<b>55.5%</b>	<b>68,616</b>	<b>58.6%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2011 and 2010 differs from the presentation in the 2011 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see “Presentation of Financial and Other Information—Impact of Changes in Presentation”.

## Non-Controllable Expenses

A significant proportion of our operating expenses are characterized as non-controllable expenses, since we are unable to control the increase in regulated tariffs for transportation of our hydrocarbons or the tax rates imposed by federal, regional or local authorities.

In 2011, non-controllable expenses of transportation and taxes other than income tax increased by RUB18,511 million, or 39.1%, to RUB65,886 million from RUB47,375 million in 2010. The change in transportation expenses was primarily due to an increase in natural gas sales volumes, as well as the increase in the natural gas and liquids transportation tariffs. Taxes other than income tax increased primarily due to a 61.2% increase in the UPT rate effective 1 January 2011, as well as higher natural gas and liquids production volumes. As a percentage of total revenues, our non-controllable expenses decreased to 37.4% in 2011 from 40.4% in 2010.

### Transportation expenses

In 2011, our total transportation expenses increased by RUB11,031 million, or 29.6%, compared to 2010.

The following table presents our transportation expenses for each of our products for the periods indicated:

	Year ended 31 December		
	2011	2010	Change
	<i>(RUB millions)</i>		
Natural gas transportation to customers <sup>(2)</sup> .....	34,441	26,569	29.6%
Liquids transportation by rail .....	9,791	7,448	31.5%
Liquids transportation by tankers .....	3,647	2,771	31.6%
Crude oil transportation to customers <sup>(3)</sup> .....	281	190	47.9%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines .....	—	307	n/a
Other transportation costs .....	169	13	n/a
<b>Total transportation expenses .....</b>	<b>48,329</b>	<b>37,298</b>	<b>29.6%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2011 and 2010 differs from the presentation in the 2011 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see “Presentation of Financial and Other Information—Impact of Changes in Presentation”.

<sup>(2)</sup> Via the UGSS.

(3) Via the Transneft pipeline network.

In 2011, our transportation expenses for natural gas increased by RUB7,872 million, or 29.6%, to RUB34,441 million from RUB26,569 million in 2010. The change was mainly due to a 20.0% increase in our sales volumes of natural gas to end-customers, for which we incurred transportation expense, as well as a 9.3% increase in the natural gas transportation tariff by the FTS.

In 2011, total expenses for liquids transportation by rail increased by RUB2,343 million, or 31.5%, to RUB9,791 million from RUB7,448 million in 2010 due to an increase in our aggregate liquids volumes sold and transported via rail, as well as higher average liquids transportation tariffs. In 2011, our combined liquids volumes sold and transported via rail increased by 662 thousand tons, or 20.7%, to 3,864 thousand tons from 3,202 thousand tons in 2010. In 2011, our weighted average transportation tariff for liquids delivered by rail increased by 10.4% to RUB2,534 per ton from RUB2,295 per ton in 2010 primarily due to an 8.0% increase in rail tariffs set by the FTS effective from 1 January 2011.

In 2011, as well as in 2010, as set by the FTS, we applied a discount multiple of 0.89 to the existing rail tariff for our stable gas condensate deliveries to export markets. In addition, in 2011, we applied a discount multiple of 0.68 to the existing rail tariff for LPG export deliveries compared to a multiple of 0.35, applicable from the middle of April 2010. See “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Stable Gas Condensate, LPG and Oil Products*”.

Our total transportation expense for liquids delivered by tankers to international markets increased by RUB876 million, or 31.6%, to RUB3,647 million in 2011 from RUB2,771 million in 2010. The change was primarily due to a 28.2% increase in volumes sold, as well as a slight increase in average freight rates. In 2011, we sold 43.4% of our total stable gas condensate export volumes to the Asian-Pacific region, 34.3% to Europe and 22.3% to the United States, whereas in 2010, we sold 53.4% to the United States, 26.1% to the Asian-Pacific region, 12.9% to Europe and 7.6% to South America.

Our total transportation expense related to the delivery of crude oil, which primarily comprises the fees of Transneft, increased by RUB91 million, or 47.9%, to RUB281 million from RUB190 million in 2010. The change was due to a 30.8% increase in our sales of crude oil (by volume) and an increase in the FTS regulated tariffs for utilization of the Transneft network.

Since August 2010, we no longer incur expenses related to transportation of unstable gas condensate transportation from the fields to the processing facilities due to the launch of our own unstable gas condensate pipeline connecting the Yurkharovskoye field with the Purovsky Plant, as well as an unstable gas condensate de-ethanization facility at the Yurkharovskoye field. The launch of this infrastructure allowed us to process and transport all of the unstable gas condensate produced at the Yurkharovskoye field to the Purovsky Plant without utilizing third-party facilities.

#### *Taxes other than Income Tax*

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

In 2011, taxes other than income tax increased by RUB7,480 million, or 74.2%, primarily due to an increase in the unified natural resources production tax expense and a slight increase in the property tax expense.

In 2011, our UPT for natural gas increased by RUB5,850 million, or 106.6%, due to a 61.2% increase in the natural gas production tax rate effective 1 January 2011 (from RUB147 to RUB237 per mcm), and an increase in our natural gas production volumes. The remaining increase in UPT expenses of RUB812 million related to the UPT for gas condensate and crude oil and was primarily due to an increase in the crude oil tax rate and production volumes. Our average UPT rate for crude oil is linked to the Urals benchmark crude oil price and increased to RUB4,490 per ton in 2011 from RUB3,099 per ton in 2010.

In 2011, our property tax expense increased by RUB260 million, or 17.5%, to RUB1,742 million from RUB1,482 million in 2010, primarily due to additions of property, plant and equipment at our production subsidiaries.

In 2011, our excise and fuel taxes expense in respect of LPG export sales through our subsidiary Novatek Polska increased by RUB544 million, or 119.8%, due to an increase in our LPG export sales through this subsidiary. The excise and fuel taxes are payable when LPG enters Polish territory.

### *Depreciation, Depletion and Amortization (DDA)*

In 2011, our DDA expense increased by RUB2,661 million, or 40.2%, to RUB9,277 million from RUB6,616 million in 2010 as a result of an increase in our depletable cost base, as well as a 26.0% increase in our total hydrocarbon production (excluding our proportionate share in the production of Joint Ventures) in barrels of oil equivalent.

In 2011, our DDA per boe was RUB23.1 compared to RUB20.5 in 2010. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the third stage of the second phase development at the Yurkharovskoye field in October 2010, as well as other costs capitalized during 2011.

### *General and Administrative Expenses*

In 2011, our general and administrative expenses increased by RUB1,485 million, or 22.1%, to RUB8,218 million, compared to RUB6,733 million in 2010. The main components of these expenses were administrative employees' compensation; social expenses and compensatory payments; and legal, audit and consulting services; which, in aggregate, comprised 80.7% and 76.5% of total general and administrative expenses in 2011 and 2010, respectively.

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

In 2011, our employee compensation increased by RUB776 million, or 20.0%, to RUB4,650 million as compared to RUB3,874 million in 2010 primarily due to a RUB530 million in bonuses paid for the results achieved in 2010 and accrued for the results achieved in 2011. In addition, an increase of RUB298 million was due to an increase in the indexation of the base salaries by 9.6% from 1 July 2011. The increase was partially offset by a decrease in the recognition of charges related to NOVATEK's share-based compensation program for our senior and key management from RUB400 million in 2010 to RUB235 million in 2011.

In 2011, our social expenses and compensatory payments increased by RUB438 million, or 56.6%, to RUB1,212 million compared to RUB774 million in 2010 primarily due to the commencement in 2011 of direct payments to the YNAO government to undertake new socio-economic programs related to the Yamal LNG project.

Legal, audit, and consulting services expenses increased by RUB270 million, or 53.6%, to RUB774 million compared to RUB504 million in 2010 largely due to an increase in legal and consulting services connected with the development of the Yamal LNG project.

In 2011, depreciation of administrative buildings increased by RUB57 million, or 40.4%, due to the completion and opening of our new Moscow head-office in the second quarter of 2011.

Fire safety and security expenses increased by RUB29 million, or 19.5%, to RUB178 million in 2011 from RUB149 million in 2010 as a result of the opening of our new Moscow head-office in May 2011.

In 2011, our rent expense decreased by RUB130 million, or 48.1%, to RUB140 million from RUB270 million in 2010 due to the relocation to our new Moscow head-office in May 2011.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El-Arish concession area located in Egypt). In 2011, our expenses related to concession management services decreased by RUB62 million, or 49.6%, compared to 2010 due to the termination of the concession agreement in 2011.

In 2011, other general and administrative expenses increased by RUB145 million, or 30.3%, to RUB624 million from RUB479 million in 2010. As part of that increase, RUB77 million related to the statutory requirement to maintain a bank guarantee in respect of a mandatory tender offer made following the acquisition of a



51% stake in Sibneftegas. In addition, our materials and repair expenses related primarily to the maintenance of our new head-office in Moscow increased by RUB46 million and RUB22 million, respectively.

#### *Purchases of Natural Gas and Liquid Hydrocarbons*

In 2011, our purchases of natural gas and liquid hydrocarbons amounted to RUB5,994 million, of which RUB5,854 million related to natural gas purchases from our joint venture Sibneftegas and under contracts with third parties we inherited upon our acquisition of Gazprom mezhregiongas Chelyabinsk in November 2011. In 2010, our purchases of natural gas from third parties were insignificant. The remaining purchases of RUB140 million in 2011 related to oil products (diesel fuel and petrol) which we resold. In 2010, our purchases of RUB154 million related to liquid hydrocarbons purchased for resale.

#### *Materials, Services and Other*

In 2011, our materials, services and other expenses decreased by RUB125 million, or 2.1%, to RUB5,947 million compared to RUB6,072 million in 2010. The main components of this expense category were employee compensation and repair and maintenance services, which comprised 49.7% and 24.1%, respectively, of our total materials, services and other expenses in 2011.

	<b>Year ended 31 December</b>		<b>Change</b>
	<b>2011</b>	<b>2010</b>	
	<i>(RUB millions)</i>		<i>%</i>
Employee compensation .....	2,953	2,572	14.8%
Repair and maintenance services .....	1,435	640	124.2%
Electricity and fuel .....	405	388	4.4%
Materials and supplies .....	309	1,386	(77.7%)
Security expenses .....	237	179	32.4%
Transportation expenses .....	184	106	73.6%
Processing fees .....	99	566	(82.5%)
Other .....	325	235	38.3%
<b>Total materials, services and other .....</b>	<b>5,947</b>	<b>6,072</b>	<b>(2.1%)</b>

In 2011, our operational employee compensation increased by RUB381 million, or 14.8%, to RUB2,953 million compared to RUB2,572 million in 2010 primarily due to a 9.6% indexation of the base salaries effective 1 July 2011.

In 2011, repair and maintenance services increased by RUB795 million, or 124.2%, to RUB1,435 million compared to RUB640 million in 2010. The increase was primarily related to on-going repair works at our production assets and was consistent with our maintenance schedules.

In 2011, electricity and fuel expenses increased by RUB17 million, or 4.4%, to RUB405 million from RUB388 million in 2010. The increase was primarily due to an increase in electricity volumes used by our production subsidiaries resulting from recently completed infrastructure projects, as well as higher electricity rates in 2011 compared to 2010, which were partially offset by cost savings due to the disposal of NOVATEK-Polymer in September 2010.

Materials and supplies expense decreased by RUB1,077 million, or 77.7%, mainly due to a cessation of purchases of raw materials required for the production of polymer and insulation tape products as a result of the disposal of NOVATEK-Polymer in September 2010, which accounted for RUB1,100 million of the total decrease in materials and supplies expense.

Security expenses increased by RUB58 million, or 32.4%, to RUB237 million in 2011 from RUB179 million in 2010 largely due to additional security services related to recently completed infrastructure projects at our production subsidiaries.

Transportation expenses related to the delivery of materials and equipment to our fields increased by RUB78 million, or 73.6%, to RUB184 million in 2011 from RUB106 million in 2010 primarily due to an increase in scheduled repair and maintenance works at our production subsidiaries.

Processing fees decreased by RUB467 million, or 82.5%, to RUB99 million in 2011, from RUB566 million in 2010 primarily due to the launch of our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010 that allowed us to cease contracting similar third party services.

#### *Exploration Expenses*

In 2011, our exploration expenses increased by RUB224 million, or 14.0%, to RUB1,819 million from RUB1,595 million in 2010 primarily due to an increase in seismic works. In 2011, we expensed the capitalized cost of three exploratory wells in accordance with our accounting policy aggregating RUB806 million at the Raduzhnoye and

Yarudeyskoye fields compared to the expensing of two exploratory wells aggregating RUB821 million at the El Arish (Egypt) and Anomalny license areas in 2010.

*Net impairment expenses*

In 2011, we recorded a net impairment expense of RUB782 million, of which RUB548 million was recognized in respect of oil and gas properties and equipment. We recorded a net impairment expense of RUB541 million in 2010, which was mainly due to writing off assets at the Middle-Chaselsky license area.

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

In 2011, we recorded a reversal of RUB105 million to change in inventory expense compared to a reversal of RUB470 million in 2010:

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

In 2011, we recorded a decrease in operating expenses of RUB112 million primarily due to an increase in the cost of natural gas balances reflecting the higher UPT rate in 2011 as compared to 2010, which was partially offset by a 30 mmcm decrease in our natural gas inventory balance.

In addition, in 2011, we recorded a charge of RUB91 million to our operating expenses due to a 36 thousand tons decrease in our inventory balance of stable gas condensate in transit and storage.

The following table highlights movements in our inventory balances:

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

***Other Operating Income and Net Gain on Disposals***

In 2011, we recognized other operating income of RUB207 million, of which RUB192 million related to insurance compensation received in 2011 in respect of an insured accident that occurred in 2010. In 2010, we recognized other operating income of RUB353 million, of which RUB317 million resulted from the contribution from the depositary under our GDR program.

In 2011, we realized a net gain of RUB62,948 million on the disposal of a 20% participation interest in Yamal LNG to an affiliate of TOTAL, our strategic partner in the Yamal LNG project. The net gain is comprised of a net gain on disposal of RUB28,685 million and a gain of RUB34,263 million due to the revaluation to fair value of our remaining 80% participation interest.

In 2010, we realized a net gain of RUB1,583 million on the disposal of a 49% participation interest in our subsidiary Terneftegas to an affiliate of TOTAL, which is comprised of a net income on disposal of RUB776 million and a gain of RUB807 million due to the revaluation to fair value of our remaining 51% participation interest. In 2010, we recognized a net loss on the disposal of our non-core wholly-owned subsidiary, NOVATEK-Polymer, in the amount of RUB254 million.

For the information regarding certain reclassifications that affected the presentation of information on other operating income and net gain on disposals for the years ended 31 December 2011 and 2010, see “*Presentation of Financial and Other Information—Impact of Changes in Presentation*”.

***Profit from Operations***

As a result of the factors discussed above, our profit from operations increased by RUB91,377 million, or 181.9%, to RUB141,608 million in 2011, compared to RUB50,231 million in 2010. Our profit from operations, adjusted for the net gain on disposal of interests in subsidiaries, increased by RUB29,758 million, or 60.9%, to RUB78,660 million in 2011 from RUB48,902 million in 2010. In 2011, our profit from operations, excluding the net gain on disposal of interests in subsidiaries, as a percentage of total revenues, increased to 44.6% compared to 41.7% in 2010 primarily due to higher natural gas and liquids sales volumes and prices.

### ***Finance Income (Expense)***

In 2011, we recorded a net finance expense of RUB2,703 million primarily due to an increase in a non-cash foreign exchange loss from the depreciation of the Rouble relative to the US Dollar, as compared to a net finance gain of RUB1,197 million in 2010 due to a non-cash foreign exchange gain.

In 2011, our total accrued interest expense increased to RUB5,422 million compared to RUB2,192 million in 2010 as a result of an increase in our average borrowings. In 2011 and 2010, we capitalized RUB3,709 million and RUB2,166 million, respectively, of interest expense to the cost of our property, plant and equipment construction account in accordance with the Group's accounting policy. In addition, we recognized RUB437 million and RUB411 million related to the fair value remeasurement of financial instruments and the unwinding of the present value discount related to provisions of asset retirement obligations as part of interest expense in 2011 and 2010, respectively.

Interest income increased to RUB3,392 million in 2011 from RUB598 million in 2010 primarily due to an increase in interest income on loans provided to our Joint Ventures.

In 2011, we recorded a net foreign exchange loss of RUB3,945 million compared to a net foreign exchange gain of RUB1,036 million in 2010 due primarily to the revaluation of our US Dollar denominated borrowings. In nominal terms, the Rouble depreciated by 5.6% against the US Dollar during 2011 compared to 0.8% depreciation in 2010. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the currency denomination of our debt portfolio. See "*Risk Factors—Risks Related to Our Business and Industry—We face foreign exchange risks that could have a material adverse effect on our business, financial condition, results of operations and prospects*" and "*—Certain Factors Affecting Our Results of Operations—Impact of the Global Financial Crisis and Current Financial Market Conditions*".

### ***Share of Income (Loss) of Joint Ventures, net of income tax***

Our proportionate share in the loss of equity investments in our Joint Ventures increased from RUB346 million in 2010 to RUB3,880 million in 2011, a significant portion of which was related to our Joint Ventures Sibneftegas and Yamal Development. The losses we recognized in Sibneftegas were primarily due to the revaluation of gas and oil properties acquired to fair value and the subsequent amortization of those costs under IFRS. See *Note 2 to the Unaudited Financial Statements ("Basis of Presentation")*. The losses related to Yamal Development resulted from the recognition of interest expense on loans obtained by Yamal Development.

### ***Income Tax Expense***

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 11.7% and 21.2% for the years ended 31 December 2011 and 2010, respectively. After excluding the effect of the 20% disposal of Yamal LNG, our effective income tax rate for the year ended 31 December 2011 was 21.7%.

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

### ***Profit Attributable to Shareholders and Earnings per Share***

As a result of the factors discussed above, the profit for 2011 increased by RUB79,013 million, or 196.2%, to RUB119,291 million from RUB40,278 million in 2010. The profit attributable to our shareholders increased by RUB79,122 million, or 195.2%, to RUB119,655 million in 2011 from RUB40,533 million in 2010. The profit attributable to our shareholders, adjusted to exclude the net gain on disposal of subsidiaries, increased by RUB17,503 million, or 44.6%, to RUB56,707 million in 2011 from RUB39,204 million in 2010.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to our shareholders, increased by RUB26.08 per share, or 195.1%, to RUB39.45 per share in 2011 from RUB13.37 per share in 2010. Our weighted average basic and diluted earnings per share, calculated from the profit attributable to our shareholders, adjusted to exclude the net gain on disposal of subsidiaries, increased by RUB5.76 per share, or 44.6%, to RUB18.69 per share in 2011 from RUB12.93 per share in 2010.

## Results of Operations for the Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

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

	Year ended 31 December			
	2010 <sup>(1)</sup>	% of total revenues	2009 <sup>(1)</sup>	% of total revenues
	<i>(RUB millions, except percentages)</i>			
<b>Total revenues (net of VAT and export duties)</b> .....	<b>117,165</b>	<b>100.0%</b>	<b>90,007</b>	<b>100.0%</b>
including:				
natural gas sales .....	71,060	60.6%	53,623	59.6%
liquids sales.....	44,243	37.8%	33,333	37.0%
Operating expenses .....	(68,616)	(58.6%)	(56,166)	(62.4%)
Net gain on disposal of interest in subsidiaries .....	1,329	1.1%	52	0.1%
Other operating income (loss) .....	353	0.3%	(360)	(0.4%)
<b>Profit from operations</b> .....	<b>50,231</b>	<b>42.9%</b>	<b>33,533</b>	<b>37.3%</b>
Finance income (expense).....	1,197	1.0%	(831)	(0.9%)
Share of income (loss) of associated companies .....	(346)	(0.3%)	(202)	(0.2%)
<b>Profit before income tax</b> .....	<b>51,082</b>	<b>43.6%</b>	<b>32,500</b>	<b>36.1%</b>
Total income tax expense.....	(10,804)	(9.2%)	(6,778)	(7.5%)
<b>Profit (loss)</b> .....	<b>40,278</b>	<b>34.4%</b>	<b>25,722</b>	<b>28.6%</b>
profit attributable to:				
non-controlling interest.....	(255)	(0.2%)	(321)	(0.4%)
shareholders of NOVATEK .....	40,533	34.6%	26,043	28.9%

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2010 and 2009 differs from the presentation in the 2010 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see "Presentation of Financial and Other Information—Impact of Changes in Presentation".

### Revenues

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

	Year ended 31 December		Change
	2010 <sup>(1)</sup>	2009 <sup>(1)</sup>	
	<i>(RUB millions)</i>		<i>%</i>
<b>Natural gas sales:</b>			
End-customer .....	54,860	28,513	92.4%
Traders in remote points .....	—	14,080	n/a
<b>Subtotal of end-customers sales</b> .....	<b>54,860</b>	<b>42,593</b>	<b>28.8%</b>
Ex-field sales.....	16,200	11,030	46.9%
<b>Natural gas sales</b> .....	<b>71,060</b>	<b>53,623</b>	<b>32.5%</b>
<b>Stable gas condensate sales:</b>			
Export .....	29,720	23,245	27.9%
Domestic .....	34	354	(90.4%)
<b>Stable gas condensate sales</b> .....	<b>29,754</b>	<b>23,599</b>	<b>26.1%</b>
<b>Liquefied petroleum gas sales:</b>			
Export .....	8,052	5,429	48.3%
CIS .....	9	100	(91%)
Domestic .....	4,827	2,777	73.8%
<b>Liquefied petroleum gas sales</b> .....	<b>12,888</b>	<b>8,306</b>	<b>55.2%</b>
<b>Crude oil sales:</b>			
Export .....	603	554	8.8%
Domestic .....	855	781	9.5%
<b>Crude oil sales</b> .....	<b>1,458</b>	<b>1,335</b>	<b>9.2%</b>
<b>Oil products sales:</b>			
Export .....	—	10	n/a
Domestic .....	143	83	72.3%
<b>Oil products sales</b> .....	<b>143</b>	<b>93</b>	<b>53.8%</b>
<b>Total gas and oil sales</b> .....	<b>115,303</b>	<b>86,956</b>	<b>32.6%</b>
Sales of polymer and insulation tape.....	1,699	1,873	(9.3%)
Other revenues .....	163	1,178	(86.2%)
<b>Total revenues</b> .....	<b>117,165</b>	<b>90,007</b>	<b>30.2%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2010 and 2009 differs from the presentation in the 2010 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see “*Presentation of Financial and Other Information—Impact of Changes in Presentation*”.

### *Natural Gas Sales*

In 2010, our revenues from sales of natural gas increased by RUB17,437 million, or 32.5%, compared to 2009 largely due to an increase in natural gas prices and, to a lesser extent, an increase in sales volumes. Revenues from the sale of natural gas for 2010 and 2009 remained relatively stable expressed as percentages of our total revenues and accounted for 60.6% and 59.6% of our total revenues in 2010 and 2009, respectively.

In 2010, our sales volumes of natural gas increased by 4,180 mmcm, or 12.7%, to 37,117 mmcm from 32,937 mmcm in 2009 because of an increased production. Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased from 68.1% in 2009 (including traders in remote points) to 64.0% in 2010.

In 2010, our average realized natural gas price per mcm increased by RUB286 per mcm, or 17.6%, to RUB1,914 per mcm from RUB1,628 per mcm in 2009. The average realized prices of our natural gas sold directly to end-customers and traders in remote points (including transportation expense) and sold ex-field were higher by 21.6% and 15.4%, respectively, in 2010 compared to 2009.

In 2010, our sales of natural gas to end-customers were primarily to energy utility companies and large industrial companies, while in 2009 the majority of natural gas volumes sold to end-customers was delivered to energy utility companies and traders in remote points, the latter of which we ceased deliveries to effective 1 January 2010.

In 2009, all of our total external revenues from the sale of natural gas were to customers in the Russian Federation.

### *Stable Gas Condensate Sales*

In 2010, our revenues from sales of stable gas condensate increased by RUB6,155 million, or 26.1%, compared to 2009, primarily due to an increase in our average realized prices resulting from an increase in the underlying benchmark crude oil prices used in the price formulation and, to a lesser extent, an increase in volumes sold.

In 2010, our total stable gas condensate sales volumes increased by 160 thousand tons, or 7.4%, due to an increase in our unstable gas condensate production that was partially offset by an increase in stable gas condensate inventory balance during the period. In 2010, we exported 2,326 thousand tons of stable gas condensate, or 99.8% of our total sales volumes, to the United States, the Asian-Pacific region, Europe and South America, with the remaining four thousand tons sold domestically. In 2009, we exported 2,115 thousand tons of stable gas condensate, or 97.5% of our total sales volumes, to markets in the United States, the Asian-Pacific region and Europe, and the remaining 55 thousand tons were sold domestically. We delivered our stable gas condensate to international markets using the loading and storage facilities at the Port of Vitino on the White Sea and via leased tankers.

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

In 2009, the United States accounted for 60.5% of our total external revenues (including export duties) from the sale of stable gas condensate; the Asian-Pacific region accounted for 29.2% of such revenues; Europe for 9.3%; and the Russian Federation for 1.0%.

### *LPG Sales*

In 2010, our revenues from the sales of LPG increased by RUB4,582 million, or 55.2%, compared to 2009, due to an increase in both our average realized prices and volumes sold. In 2010, our total LPG sales volumes increased by 127 thousand tons, or 17.0%, to 876 thousand tons from 749 thousand tons in 2009. The growth in LPG sales volumes was mainly due to an increase in unstable gas condensate throughput at the Purovsky Plant and the corresponding increase in LPG output.

In 2010, we sold 434 thousand tons of LPG, or 49.5% of our total LPG sales volumes (including approximately three thousand tons purchased and resold through our then wholly-owned subsidiary Intergaz-System), to the export markets, compared to 405 thousand tons, or 54.1% of our total LPG sales volumes, in 2009.

In 2010, our average realized export price for LPG of U.S.\$611.0 per ton, excluding export duties, increased by U.S.\$188.1 per ton, or 44.5%, from U.S.\$422.9 per ton (delivered DAF, CPT and FCA) in 2009. The increase in our average realized export prices (excluding export duties) was primarily due to a 41.0% increase in our average contract

price that was partially offset by an increase in our average export duty per ton as a result of the cancellation of the zero export duty rate from 1 December 2009 (a zero export duty rate for LPG was effective from 1 January to 1 December 2009).

In 2010, we sold 442 thousand tons of LPG, or 50.5% of our total LPG sales volumes, on the domestic market at an average price of RUB10,928 per ton (FCA, excluding VAT) representing an increase of RUB2,645 per ton, or 31.9%, compared to 2009.

In 2009, Europe accounted for 65.8% of our total external revenues (including export duties) from LPG sales and Russia accounted for 33.0% of such revenues. A small portion of our LPG revenues were from customers in other geographical regions.

#### *Crude Oil Sales*

In 2010, our revenues from the sales of crude oil increased by RUB123 million, or 9.2%, compared to 2009, due to an increase in our average realized prices that was partially offset by a decrease in sales volumes. In 2010, our crude oil sales volumes decreased by 13 thousand tons, or 6.6%, to 185 thousand tons from 198 thousand tons in 2009.

In 2010, 61.6% of our crude oil volumes were sold domestically at an average price of RUB7,523 per ton (excluding VAT) representing an increase of RUB1,472 per ton, or 24.3%, compared to 2009. The increase was due to a change in the customers' composition. The remaining 38.4% of our crude oil volumes were sold to the export markets at an average price of U.S.\$281.2 per ton (DAF, excluding export duties) representing an increase of U.S.\$26.1 per ton, or 10.2%, compared to 2009. The increase in the average realized export price (excluding export duties) was the result of a 26.3% increase in our average export contract price that was partially offset by a 48.6% increase in our average export duty per ton. The increase in our average realized contract price was due to an overall increase in crude oil and related commodity prices on international markets in 2010 compared to 2009.

In 2009, Europe accounted for 54.8% of our total external revenues (including export duties) from sales of crude oil and Russia accounted for 45.2% of such revenues.

#### *Oil Products Sales*

In 2010, our revenue from the sales of oil products increased by RUB50 million, or 53.8%, to RUB143 million from RUB93 million in 2009 due primarily to an increase in oil products trading operations through our retail stations on the domestic market.

Our revenues from oil products trading operations through our retail stations on the domestic market increased by RUB73 million to RUB110 million in 2010 compared to RUB37 million in 2009. In 2010, we sold approximately five thousand tons of oil products (diesel fuel and petrol) for an average price of RUB22,951 per ton compared to two thousand tons for an average price of RUB22,356 per ton in 2009.

In 2010, our revenues from oil products produced at the Surgutsky refinery and sold on the domestic market decreased to RUB33 million from RUB46 million in 2009 due to a decrease in volumes sold. In 2010, we sold five thousand tons of oil products produced from our unstable gas condensate at the Surgutsky refinery at an average price of RUB6,773 per ton compared to eight thousand tons at RUB5,419 per ton in 2009. The decrease in volumes sold was due to the cessation of deliveries of our unstable gas condensate to the Surgutsky Refinery starting in September 2010 as a result of the launch of our own gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant in August 2010.

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

#### *Sales of Polymer and Insulation Tape*

Our revenues from the sales of polymer and insulation tape decreased by RUB174 million, or 9.3%, to RUB1,699 million in 2010 compared to RUB1,873 million in 2009 due to the disposal of our polymer and insulation tape production subsidiary NOVATEK-Polymer in September 2010.

#### *Other Revenues*

In 2010, other revenues decreased by RUB1,015 million, or 86.2%, to RUB163 million from RUB1,178 million in 2009. The decrease in other revenues was primarily related to a RUB779 million decrease in revenues from geological and geophysical research services provided primarily to our associates. The decrease was due to the acquisition in February 2010 of a controlling interest in our then associated companies (Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas) and the subsequent consolidation of their activities. See "*Certain Factors Affecting Our Results of Operations—Certain Acquisitions and Dispositions—Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas*". In addition, rent services sales decreased by RUB258 million, or 74.8%, to RUB87 million in 2010.

## Operating Expenses

In 2010, our total operating expenses increased by RUB12,450 million, or 22.2%, to RUB68,616 million compared to RUB56,166 million in 2009, due primarily to an increase in transportation expenses and taxes other than income tax. As a percentage of total operating expenses, our non-controllable expenses increased to 69.0% in 2010 compared to 66.1% in 2009. Total operating expenses decreased as a percentage of total revenues to 58.6% in 2010 compared to 62.4% in 2009, as shown in the table below. The decrease in our operating expenses as a percentage of total revenues was primarily due to an increase in our natural gas sales prices and volumes, as well as liquids sales prices.

	Year ended 31 December			
	2010 <sup>(1)</sup>	% of total revenues	2009 <sup>(1)</sup>	% of total revenues
	<i>(RUB millions, except percentages)</i>			
Transportation expenses.....	37,298	31.8%	29,062	32.3%
Taxes other than income tax .....	10,077	8.6%	8,042	8.9%
<b>Subtotal non-controllable expenses .....</b>	<b>47,375</b>	<b>40.4%</b>	<b>37,104</b>	<b>41.2%</b>
General and administrative expenses .....	6,733	5.7%	5,126	5.7%
Depreciation, depletion and amortization.....	6,616	5.6%	5,588	6.2%
Materials, services and other.....	6,072	5.2%	6,259	7.0%
Exploration expenses .....	1,595	1.4%	566	0.6%
Net impairment expenses .....	541	0.5%	125	0.1%
Purchases of natural gas and liquid hydrocarbons	154	0.1%	1,143	1.3%
Change in natural gas, liquid hydrocarbons, and polymer products and work in progress .....	(470)	(0.4%)	255	0.3%
<b>Total operating expenses.....</b>	<b>68,616</b>	<b>58.6%</b>	<b>56,166</b>	<b>62.4%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2010 and 2009 differs from the presentation in the 2010 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see "Presentation of Financial and Other Information—Impact of Changes in Presentation".

## Non-Controllable Expenses

In 2010, non-controllable expenses of transportation and taxes other than income tax increased by RUB10,271 million, or 27.7%, to RUB47,375 million from RUB37,104 million in 2009. The change in transportation expenses was primarily due to an increase in the natural gas transportation tariff and sales volumes. Taxes other than income tax increased primarily due to higher liquids and natural gas production volumes and the corresponding impact on the UPT incurred as well as excise and fuel taxes incurred in 2010 with the commencement of commercial activities in Poland. As a percentage of total revenues, our non-controllable expenses marginally decreased to 40.4% in 2010 compared to 41.2% in 2009.

### Transportation Expenses

In 2010, our total transportation expenses increased by RUB8,236 million, or 28.3%, compared to 2009. The following table presents our transportation expenses for each of our products for the periods indicated:

	Year ended 31 December		
	2010 <sup>(1)</sup>	2009 <sup>(1)</sup>	Change
	<i>(RUB millions)</i>		
Natural gas transportation to customers <sup>(2)</sup> .....	26,569	20,019	32.7%
Liquids transportation by rail .....	7,448	5,856	27.2%
Liquids transportation by tankers .....	2,771	2,675	3.6%
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines.....	307	340	(9.7%)
Crude oil transportation to customers <sup>(3)</sup> .....	190	160	18.8%
Other transportation costs .....	13	12	8.3%
<b>Total transportation expenses .....</b>	<b>37,298</b>	<b>29,062</b>	<b>28.3%</b>

<sup>(1)</sup> The presentation of certain line items for the years ended 31 December 2010 and 2009 differs from the presentation in the 2010 Audited Financial Statements due to reclassifications in order to present these items in a manner that is consistent with the presentation in the Unaudited Financial Statements. For additional details, see "Presentation of Financial and Other Information—Impact of Changes in Presentation".

<sup>(2)</sup> Via the UGSS.

<sup>(3)</sup> Via the Transneft pipeline network.

In 2010, our transportation expenses for natural gas increased by RUB6,550 million, or 32.7%, to RUB26,569 million from RUB20,019 million in 2009. The change was primarily due to an increase in the average natural gas transportation tariff by 22.9% overall in 2010, compared to the average transportation tariff in 2009

(see “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Natural Gas*”) and, to a lesser extent, by a 5.9% increase in our sales volumes of natural gas delivered directly to end-customers, where the cost of transportation is included in the sales price.

Total expenses for liquids transportation by rail increased by RUB1,592 million, or 27.2%, from RUB5,856 million in 2009 to RUB7,448 million in 2010 due primarily to an increase in liquids volumes sold and higher rail transportation tariffs (see “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Stable Gas Condensate, LPG and Oil Products*”). In 2010, our combined liquids volumes sold and transported via rail increased by 269 thousand tons, or 9.2%, to 3,202 thousand tons from 2,933 thousand tons in 2009.

Our weighted average transportation tariff for liquids delivered by rail increased by 15.7% to RUB2,295 per ton in 2010 from RUB1,984 per ton in 2009 primarily due to an increase in rail tariffs by 9.4% effective 1 January 2010 and an application of a higher multiple to the existing rail tariff for stable gas condensate deliveries to export markets. In 2010, we applied a multiple of 0.89 to the existing rail tariff for our stable gas condensate deliveries to export markets, compared to a multiple of 0.72 in 2009. In addition, we applied a multiple of 0.35 to the existing rail tariff for LPG export deliveries in both periods. See “—*Certain Factors Affecting Our Results of Operations—Transportation Tariffs—Stable Gas Condensate, LPG and Oil Products*”.

Total transportation expense for liquids delivered by tankers to international markets increased by RUB96 million, or 3.6%, to RUB2,771 million in 2010 from RUB2,675 million in 2009. The change was due to a 10.0% increase in volumes sold that was partially offset by a slight decrease in average freight rates. In 2010, we delivered 53.4% of our stable gas condensate export volumes to United States markets compared to 66.5% in 2009.

In 2010, our crude oil transportation expenses, primarily comprising the fees of Transneft, increased by RUB30 million, or 18.8%, from RUB160 million to RUB190 million in 2009. The change was primarily due to an increase in the FTS-regulated tariffs for the utilization of the Transneft network.

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

#### *Taxes other than Income Tax*

	Year ended 31 December		Change
	2010	2009	
	<i>(RUB millions)</i>		<i>%</i>
Unified natural resources production tax (UPT) .....	7,861	6,699	17.3%
Property tax .....	1,482	1,155	28.3%
Excise and fuel taxes .....	454	—	n/a
Other taxes .....	280	188	48.9%
<b>Total taxes other than income tax .....</b>	<b>10,077</b>	<b>8,042</b>	<b>25.3%</b>

In 2010, taxes other than income tax increased by RUB2,035 million, or 25.3%, primarily due to an increase in the UPT expense and excise and fuel taxes incurred at our trading subsidiaries in Poland.

In 2010, our UPT for natural gas and gas condensate increased by RUB730 million and RUB275 million, respectively, due to an increase in production volumes. The UPT rate for natural gas remained unchanged in 2010 and 2009 at RUB147 per mcm. The increase in our UPT for crude oil of RUB157 million was due primarily to an increase in our average crude oil production tax rate, which is linked to the Urals benchmark crude oil price. Our average UPT rate for crude oil increased from RUB2,255 per ton in 2009 to RUB3,099 per ton in 2010.

In 2010, our property tax expense increased by RUB327 million, or 28.3%, to RUB1,482 million from RUB1,155 million in 2009, primarily due to additions of property, plant and equipment at our production subsidiaries.

In 2010, we expensed RUB454 million of excise and fuel taxes in respect of LPG export sales through our subsidiaries Novatek Polska and Intergaz-System. The excise and fuel taxes are payable when LPG enters the territory of Poland.



### *General and Administrative Expenses*

In 2010, our general and administrative expenses increased by RUB1,607 million, or 31.3%, to RUB6,733 million compared to RUB5,126 million in 2009. The main components of these expenses were employee compensation and charitable contributions, which, in aggregate, comprised 69.0% and 65.8% of total general and administrative expenses in 2010 and 2009, respectively.

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

Our employee compensation increased by RUB1,034 million, or 36.4%, to RUB3,874 million in 2010 as compared to RUB2,840 million in 2009 primarily due to an increase in bonus payments by RUB480 million made in 2010 related to performance achieved. In addition, we increased basic salaries by 10% indexation effective 1 July 2010 resulting in an additional RUB225 million in payroll expenses. Moreover, in 2010, we recognized RUB400 million in employee compensation due to the initiation of our share-based compensation program for a limited number of our senior and key management, as well as high-potential managers, but excluding the members of the Management Board.

In 2010, our charitable contributions increased by RUB241 million, or 45.2%, to RUB774 million compared to RUB533 million in 2009, and were primarily related to our donations to sport clubs and activities as well as continued support for charities and social programs in the regions where we operate.

Legal, audit, and consulting services expenses increased by RUB203 million, or 67.4%, to RUB504 million compared to RUB301 million in 2009 due to an increase in consulting and legal services related to our acquisitions in 2010 as well as legal services connected with the development of the Yamal LNG project.

In 2010, our rent expense increased by RUB25 million, or 10.2%, to RUB270 million from RUB245 million in 2009 due to the rent of additional office space in Moscow.

Concession management services represent administrative expenses incurred by Tharwa Petroleum Company S.A.E (the operator of the El Arish concession area located in Egypt). In 2010, our expenses related to concession management services decreased by RUB100 million, or 44.4%, compared to 2009. The decrease in costs associated with concession management services in 2010 was consistent with our approved plan to exit this project in 2011, when the respective concession agreement was terminated.

In 2010, other general and administrative expenses increased by RUB166 million, or 42.3%, compared to 2009, of which RUB55 million related to the remuneration of the Board of Directors and payments to members of our revision committee. In addition, our administrative staff training expenses increased by RUB22 million. The remaining increase of RUB89 million was allocated among different expense categories within other general and administrative expenses which, taken individually, changed immaterially.

### *Depreciation, Depletion and Amortization*

In 2010, our DDA expense increased by RUB1,028 million, or 18.4%, compared to 2009 as a result of an increase in our depletable cost base, as well as a 15.5% increase in our hydrocarbon production in barrels of oil equivalent (boe).

In 2010, our DDA per boe was RUB20.5 compared to RUB19.4 in 2009. The increase in our DDA charge calculated on a boe basis was primarily due to an increase in our depletable cost base as a result of completing the capital expansion program related to the second and third stages of the second phase development at the Yurkharovskoye field in October 2009 and October 2010, respectively, as well as costs capitalized during 2010.

### *Materials, Services and Other*

In 2010, our materials, services and other expenses decreased by RUB187 million, or 3.0%, to RUB6,072 million compared to RUB6,259 million in 2009. The main components of this expense category were

operational employee compensation and materials and supplies, which comprised 42.4% and 22.8%, respectively, of total materials, services and other expenses in 2010.

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

In 2010, our materials, services and other expenses, excluding operator services expense, increased by RUB436 million, or 7.7%, to RUB6,071 million compared to RUB5,635 million in 2009.

Our operational employee compensation increased by RUB115 million, or 4.7%, to RUB2,572 million compared to RUB2,457 million in 2009 primarily due to an increase in basic salaries by 10% indexation effective 1 July 2010.

Materials and supplies expense decreased by RUB69 million, or 4.7%, mainly due to a decrease in purchases of raw materials required for the production of polymers and insulation tape products as a result of the disposal of NOVATEK-Polymer, which accounted for RUB56 million, or 81.2%, of the total decrease in materials and supplies expense.

Repair and maintenance services increased by RUB244 million, or 61.6%, to RUB640 million in 2010 compared to RUB396 million in 2009. The increase was primarily related to the current repair works at our production assets and was consistent with our on-going maintenance schedules.

Tolling and processing fees increased by RUB10 million, or 1.8%, to RUB566 million in 2010 from RUB556 million in 2009. In 2010, our costs related to the preparation of crude oil produced at our East-Tarkosalinskoye field for transportation increased by RUB84 million due to the initiation of such services starting from the fourth quarter 2009. In addition, we launched our own unstable gas condensate de-ethanization facility at the Yurkharovskoye field in August 2010, which resulted in a savings of RUB70 million on external processing fees. Tolling and processing fees at the Surgutsky refinery decreased by RUB4 million.

Electricity and fuel expenses increased by RUB57 million, or 17.2%, from RUB331 million in 2009 to RUB388 million in 2010 primarily due to an increase in energy consumption at the Yurkharovskoye field resulting from the commencement of operations at new production assets.

Operator services expenses mainly refer to the geological and geophysical research provided to our associated companies. In 2010, operator services expenses decreased by RUB623 million, or 99.8%, due to the acquisition in February 2010 of a controlling interest in our associates OOO "Oiltechproduct-Invest", OOO "Petra Invest-M" and OOO "Tailiksneftgas" and the subsequent consolidation of these companies' activities.

#### *Exploration Expenses*

In 2010, our exploration expenses increased by RUB1,029 million, or 181.8%, to RUB1,595 million from RUB566 million in 2009. In 2010, we wrote off the capitalized cost of two exploratory wells in accordance with our accounting policy in the total amount of RUB821 million at the El-Arish (Egypt) and Anomalny license areas.

#### *Purchases of Natural Gas and Liquid Hydrocarbons*

Purchases of natural gas and liquid hydrocarbons decreased by RUB989 million, or 86.5%, to RUB154 million in 2010, from RUB1,143 million in 2009, primarily due to decreases in purchases of natural gas from third parties by RUB1,021 million and crude oil by RUB61 million. The decrease in gas purchases was partially offset by an increase in oil products and LPG purchases by RUB93 million.

#### *Net impairment expenses*

In 2010, we recorded a net impairment expense of RUB541 million, which was mainly due to a write-off of assets at the Middle-Chaselsky license area. In 2009, we recorded a net impairment expense of RUB125 million.

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

In 2010, we recorded a reversal of RUB470 million to change in inventory expense as compared to a charge of RUB255 million in 2009:

	Year ended 31 December	
	2010	2009
	<i>(RUB millions)</i>	
Natural gas .....	2	(127)
Stable gas condensate.....	(379)	281
Polymer and insulation tape .....	(56)	82
Other .....	(37)	19
<b>Increase (decrease) in operating expenses due to change in inventory balances and work-in-progress.....</b>	<b>(470)</b>	<b>255</b>

In 2010, we recorded a decrease of RUB379 million primarily due to an increase in our inventory balance of stable gas condensate in transit and storage by 153 thousand tons.

The following table highlights movements in our inventory balances:

	2010			2009		
	At 31 December	At 1 January	Increase / (decrease)	At 31 December	At 1 January	Increase / (decrease)
<i>Inventory balances in transit or in storage</i>						
<b>Natural gas (mmcm).....</b>	790	744	46	744	372	372
including UGSF.....	761	584	177	584	300	284
<b>Liquid hydrocarbons (mt).....</b>	356	167	189	167	270	(103)
including stable gas condensate.....	264	111	153	111	220	(109)

*Other Operating Income (Loss) and Net Gain (Loss) on Disposals*

In 2010, we recognized other operating income of RUB353 million, of which RUB317 million were contributions from the depositary under our GDR program.

In 2009, we realized other operating loss of RUB360 million, of which RUB190 million was related to commodity derivative instruments that did not qualify as hedge transactions under IAS 39, Financial Instruments: Recognition and Measurement and RUB303 million was related to disposal of assets under construction, primarily at our subsidiary JSC “Energy Northern Company”. This other operating loss in 2009 was partially offset by other operating income of RUB150 million, which was primarily related to penalties from our customers due to non-compliance of their contractual obligations and other profit and loss items.

In 2010, we realized a net gain of RUB1,583 million on the disposal of a 49% participation interest in our subsidiary Terneftegas to an affiliate of TOTAL, which consisted of net income on disposal of RUB776 million and a gain of RUB807 million due to revaluation to fair value of the remaining 51% participation interest. In 2010, we recognized a net loss on the disposal of our non-core, wholly-owned subsidiary, NOVATEK-Polymer, in the amount of RUB254 million largely due to the discounting of future payments.

In 2009, we recognized other income of RUB52 million due to the disposal of our subsidiary OOO Purneft in April 2009.

For the information regarding certain reclassifications that affected the presentation of information on other operating income and net gain on disposals for the years ended 31 December 2010 and 2009, see “*Presentation of Financial and Other Information—Impact of Changes in Presentation*”.

***Profit from Operations***

As a result of the factors discussed above, our profit from operations increased by RUB16,698 million, or 49.8%, to RUB50,231 million in 2010, compared to RUB33,533 million in 2009. In 2010, our profit from operations as a percentage of total revenues increased to 42.9% compared to 37.3% in 2009, due primarily to higher prices for natural gas and liquids and an increase in natural gas sales volumes.

***Finance Income (Expense)***

In 2010, we recorded a net finance income of RUB1,197 million, which was primarily due to non-cash foreign exchange gains, compared to a net finance loss of RUB831 million in 2009 due to non-cash foreign exchange loss.

In 2010, our total accrued interest expense increased to RUB2,192 million compared to RUB1,790 million in 2009 as a result of an increase in our average borrowings. During 2010 and 2009, we capitalized RUB2,166 million and RUB1,280 million, respectively, of interest expense to cost of additions in our property, plant and equipment account in accordance with our accounting policy.

Interest income increased by RUB71 million, or 13.5%, to RUB598 million in 2010 from RUB527 million in 2009 primarily due to an increase in interest income on loans issued to our associated companies that was partially offset by a decrease in interest income on bank deposits.

In 2010, we recorded a net foreign exchange gain of RUB1,036 million compared to a net foreign exchange loss of RUB539 million in 2009 due to the revaluation of our foreign currency denominated borrowings. In nominal terms, the Rouble depreciated by 0.8% and 2.9% during 2010 and 2009, respectively. We will continue to record foreign exchange gains and losses each period based on the movements between exchange rates and the composition of our debt position. See “*Risk factors—Risks Related to Our Business and Industry—We face foreign exchange risks that could have a material adverse effect on our business, financial condition, results of operations and prospects*” and “*—Certain Factors Affecting Our Results of Operations—Impact of the Global Financial Crisis and Current Financial Market Conditions*”.

#### **Share of Income (Loss) of Joint Ventures**

In 2010, our proportionate share in the loss of our Joint Ventures increased by RUB144 million, or 71.3%, to RUB346 million compared to RUB202 million recorded in 2009, due to expensing in our Joint Ventures of finance costs on external debts as well as geological and geophysical research expenditures under the successful efforts accounting policy.

#### **Income Tax Expense**

Our overall consolidated effective income tax rates (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) were 21.2% and 20.9% for 2010 and 2009, respectively. The Russian statutory income tax rate for both periods was 20%. The difference between our effective and statutory income tax rates is primarily due to certain non-deductible expenses.

#### **Profit Attributable to Shareholders and Earnings per Share**

As a result of the factors discussed above, profit for the period increased by RUB14,556 million, or 56.6%, to RUB40,278 million in 2010 from RUB25,722 million in 2009. The profit attributable to our shareholders increased by RUB14,490 million, or 55.6%, to RUB40,533 million in 2010 from RUB26,043 million in 2009.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to our shareholders, increased by RUB4.78 per share, or 55.6%, to RUB13.37 per share in 2010 from RUB8.59 per share in 2009.

#### **Liquidity and Capital Resources**

Our primary sources of liquidity are the cash provided from operating activities and debt financing, including both bank financing and raising funds on capital markets. Our plan is to finance our budgeted capital expenditures, interest expense and dividend payments mainly out of operating cash flows, supplemented by additional borrowings where needed.

#### **Cash Flows**

The following table shows our net cash flows from operating, investing and financing activities for the nine months ended 30 September 2012 and 2011, and for the years ended 31 December 2011, 2010 and 2009:

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	<i>(RUB millions)</i>				
Net cash provided by operating activities .....	57,644	46,883	71,907	44,863	34,847
Net cash provided by (used for) investing activities .....	(27,260)	(51,314)	(46,643)	(68,842)	(36,185)
Net cash provided by (used in) financing activities.....	(37,134)	11,021	(11,735)	23,782	761

#### **Net Cash Provided by Operating Activities**

In the nine months ended 30 September 2012, our net cash provided by operating activities increased by RUB10,761 million, or 23.0% , to RUB57,644 million compared to RUB46,883 million in the corresponding period of 2011. The increase in our net cash provided by operating activity was due primarily to the increase in natural gas and liquids prices and natural gas sales volumes. See “*—Results of Operations for the Nine Months Ended 30 September 2012 Compared to the Nine Months Ended 30 September 2011*”.

In 2011, our net cash provided by operating activities increased by RUB27,044 million, or 60.3%, to RUB71,907 million compared to RUB44,863 million in 2010. The increase was primarily due to an increase in natural gas and liquids sales volumes and prices, and was partially offset by an increase in income tax payments. See “*—Results of Operations for the Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010*”.

In 2010, our net cash provided by operating activities increased by RUB10,016 million, or 28.7%, to RUB44,863 million compared to RUB34,847 million in 2009. The increase in our net cash provided by operating activities was primarily due to the increase in natural gas and liquids prices and natural gas sales volumes, which was partially offset by an increase in the income tax paid. See “—*Results of Operations for the Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009*”.

#### *Net Cash Provided by (Used for) Investing Activities*

In the nine months ended 30 September 2012, our net cash used in investing activities decreased by RUB24,054 million, or 46.9%, to RUB27,260 million as compared to RUB51,314 million in the corresponding period in 2011, primarily due to the payment in 2011 for the 51% stake in Sibneftegas, one of our Joint Ventures, which was acquired in 2010, and a decrease in loans provided to our Joint Ventures.

In 2011, our net cash used in investing activities decreased by RUB22,199 million, or 32.2%, to RUB46,643 million as compared to RUB68,842 million in 2010 primarily due to a decrease in loans provided to our Joint Ventures, which was partially offset by the deferred payment in 2011 for our 51% stake in Sibneftegas, which we acquired in 2010, as well as the payment of RUB6.9 billion for four licenses in YNAO. See “*Business—Strategic Acquisitions—Licenses in the Gydan Peninsula and the Gulf of Ob*.”

In 2010, our net cash used in investing activities increased by RUB32,657 million, or 90.3%, to RUB68,842 million as compared to RUB36,185 million in 2009 primarily due to a significant increase in long-term loans provided to our Joint Ventures Yamal Development and Sibneftegas. See “*Related Party Transactions—Transactions with our associates and joint ventures*.”

In 2009, we used RUB17,114 million in cash for the purchase of a 51% stake in Yamal LNG, and made payments in connection with then ongoing work at our Yurkharovskoye field and Purovsky Plant. See “*Business—Description of Our Fields—Producing Fields—Yurkharovskoye Field*” and “*Business—Gas Condensate Processing at Our Purovsky Plant*.”

#### *Net Cash Provided by (Used in) Financing Activities*

In the nine months ended 30 September 2012, we used RUB37,134 million primarily to repay our debt and interest, as well as to repay the remaining balance of RUB16.3 billion for the 49% stake in Yamal LNG acquired in September 2011. See “—*Certain Factors Affecting Our Results of Operations—Certain Acquisitions and Dispositions—Yamal LNG*”. In the nine months ended 30 September 2011, our cash proceeds from long-term borrowings exceeded the repayment of borrowings and dividends, thus resulting in net cash provided by financing activities of RUB11,021 million.

In 2011, the cash used in repayment of debt and dividends, as well as cash paid to increase our equity interest in Yamal LNG from 51% to 100%, exceeded the cash provided by new loans by RUB11,735 million. See “—*Certain Factors Affecting Our Results of Operations—Certain Acquisitions and Dispositions—Yamal LNG*”.

In 2010, our cash provided by new loans and borrowings exceeded the cash used for repayment of loans and distribution of dividends, which resulted in a net cash inflow from financing activities of RUB23,782 million. A significant portion of this net cash inflow in 2010 was related to a bridge loan facility, which was used to finance the acquisition by our Joint Venture Yamal Development of a 51% participation interest in SeverEnergiya. See “—*Certain Factors Affecting Our Results of Operations—Certain Acquisitions and Dispositions—SeverEnergiya*”.

In 2009, the net cash provided by financing activities of RUB761 million related to the proceeds we received from long-term and short-term borrowings, as well as contributions from minority shareholders, which, in aggregate, exceeded the repayments of borrowings throughout the year as well as our payment of dividends.

Our net cash provided by or used in financing activities varies year-to-year, depending on the level of the borrowings we receive or the repayment of short- and/or long-term debt, either on schedule or ahead of schedule in accordance with our budget and management decisions.

#### **Working Capital**

Our net working capital position (current assets less current liabilities) at 30 September 2012 was positive RUB14,833 million compared to positive RUB8,202 million at 31 December 2011. The strengthening of our net working position was primarily due to the repayment of accounts payable related to our acquisition of Yamal LNG in September 2011, that was partially offset by a decrease in cash and cash equivalents.

Our net working capital position at 31 December 2011 was positive RUB8,202 million compared to negative RUB27,876 million at 31 December 2010. The strengthening of our net working capital position was due to a decrease of short-term debt and accounts payable, as well as an increase in balance of cash and cash equivalents and trade and other accounts receivable.

Our net working capital position at 31 December 2010 was negative RUB27,876 million compared to positive RUB3,274 million at 31 December 2009. The change in our net working capital position was mainly due to a

significant increase in our short-term debt and accounts payable resulting from the acquisitions of stakes in gas and oil companies in the fourth quarter of 2010. At 31 December 2010, we had an outstanding short-term bridge loan facility for the financing of the acquisition by our Joint Venture Yamal Development of a 51% participation interest in SeverEnergiya of RUB18,200 million, as well as accounts payable to Gazprombank of RUB21,176 million due to the acquisition of a 51% stake in Sibneftegas. The bridge facility was fully repaid ahead of its scheduled maturity in February 2011, together with RUB16,000 million of the accounts payable, through the issuance of long-term Eurobonds in February 2011. The remaining RUB5,176 million of accounts payable was repaid in March 2011. See “—Debt Obligations—Long-Term Debt as of 30 September 2012.”

Due to the high costs of debt during the nine months ended 30 September 2009, we decided not to undertake significant borrowings in that period, and instead used existing cash to fund certain operational activities as well as the acquisition of a 51% interest in Yamal LNG, although bank financing generally remained available to us. As the market conditions for raising funds improved over 2009, we raised long-term debt financing of RUB16,926 million from various international and Russian banks. See “—Debt Obligations.”

Our management believes that we have and will continue to have the ability to generate sufficient cash flows (from operating and financing activities) to repay all current liabilities and finance our capital construction programs.

### Capital Expenditures

Total capital expenditures on property, plant and equipment for the nine months ended 30 September 2012 and 2011, and the years ended 31 December 2011, 2010 and 2009 were as follows:

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(RUB millions)				
<b>Capital expenditures:</b>					
Exploration, production and marketing.....	31,269	21,480	31,143	25,701	17,823
Polymer production and marketing.....	—	—	—	329	49
<b>Total capital expenditures</b> .....	<b>31,269</b>	<b>21,480</b>	<b>31,143</b>	<b>26,030</b>	<b>17,872</b>
Acquisition of mineral licenses .....	—	6,888 <sup>(1)</sup>	6,888 <sup>(1)</sup>	76	—
<b>Total additions to property, plant and equipment</b> <sup>(2)</sup> .....	<b>31,269</b>	<b>28,368</b>	<b>38,031</b>	<b>26,106</b>	<b>17,872</b>

<sup>(1)</sup> In 2011, we purchased via a tender exploration and production licenses for the Salmanovskoye (Utreneye) and the Geofizicheskoye fields and geological studies and a production license for the North-Obskiy and East-Tambeyskiy license areas for a total payment of RUB6,870 million.

<sup>(2)</sup> See Note 5 of the Unaudited Financial Statements and Note 6 of the Audited Financial Statements.

For 2009 – 2011 and the nine months ended 30 September 2012, expenditures on property, plant and equipment represent our investments in exploring and developing our gas and oil properties, as well as infrastructure facilities. The majority of our capital expenditures has related to the ongoing development and exploration activities at our three Core Fields, as well as the construction of processing assets at Ust-Luga. The following table shows our capital expenditures for exploration, production and marketing for the nine months ended 30 September 2012 and 2011, and the years ended 31 December 2011, 2010 and 2009.

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(RUB millions)				
Yurkharovskoye field .....	9,184	8,056	11,403	15,375	11,401
South-Tambeyskoye field <sup>(1)</sup> .....	—	4,033	4,148	1,678	—
Gas Condensate Fractionation Complex and Transshipment Facility (Ust-Luga) .....	8,800	1,852	3,923	664	—
East-Tarkosalinskoye field .....	4,525	1,701	2,430	1,058	2,024
Purovsky Plant .....	547	1,056	1,369	1,292	1,168
Khancheyskoye field .....	1,017	354	612	87	432
North-Ruskiy license area .....	629	447	574	399	—
West-Urengoykiy license area.....	263	370	515	33	—
Olimpiyskiy license area .....	334	305	345	424	681
Other .....	5,970	3,306	5,824	4,691	2,117
including:					
purchases of equipment .....	2,438	1,734	3,253	1,572	1,881
<b>Exploration, production and marketing</b> .....	<b>31,269</b>	<b>21,480</b>	<b>31,143</b>	<b>25,701</b>	<b>17,823</b>

<sup>(1)</sup> Data for the period prior to October 2011, when we sold a 20% interest in Yamal LNG to TOTAL and we started accounting for Yamal LNG under the equity method. “—Certain Factors Affecting Our Results of Operations—Certain Acquisitions and Dispositions—Yamal LNG”.

Capital expenditures on our gas and oil properties, as well as infrastructure facilities, increased by RUB9,789 million in the nine months ended 30 September 2012 compared to the nine months ended 30 September 2011 because of the ongoing implementation of the Ust-Luga project, ongoing development activities at our Yurkharovskoye field and further development on the crude oil layers at the East-Tarkosalinskoye and Khancheyskoye fields. The increase was partially offset by a decrease in capital expenditures related to the South-Tambeyskoye field as a result of the disposal of a 20% interest in Yamal LNG to TOTAL in October 2011 since which time we have accounted for Yamal LNG under the equity method. Capital expenditures on our gas and oil properties, as well as infrastructure facilities, increased by RUB5,442 million in 2011 compared to 2010 primarily due to expenditures at fields in the early stages of development, such as the South-Tambeyskoye field and the West-Urengoyevskiy license area, to further development of crude oil deposits at the East-Tarkosalinskoye field and to capitalized repair works at the Khancheyskoye field. Capital expenditures on our gas and oil properties, as well as infrastructure facilities, increased by RUB7,878 million in 2010 compared to 2009 mainly due to ongoing development and exploration activities at our Core Fields and at the Purovsky Plant.

At 30 September 2012, we had contractual capital expenditure commitments of RUB16,964 million (compared to RUB17,805 million at 31 December 2011), mainly for ongoing development activities at the Yurkharovskoye field (through 2014); new field development at the North-Russkoye field (through 2014), the Salmanovskoye field (through 2016), the Geofizicheskoye field (through 2016) and the Yarudeyskoye field (through 2013); phase three construction of the Purovsky Plant (through 2013); construction of the terminal for the transshipment and fractionation of stable gas condensate at Ust-Luga (through 2013); and ongoing field development at the East-Tarkosalinskoye and Khancheyskoye fields (through 2013).

Furthermore, our share in capital commitments for our interests in the Joint Ventures equals RUB14,459 million at 30 September 2012 (compared to RUB5,850 million at 31 December 2011) for the development of the South-Tambeyskoye field (through 2014), the Samburgskoye field (through 2012), the Urengoyevskoye field (through 2012) and the Termokarstovoye field (through 2013).

Total capital expenditures for the Yamal LNG project, based on current FEED (front-end engineering design) projections, are expected to be on the order of approximately U.S.\$20 billion. Actual capital expenditures, however, may vary depending on many factors, and are subject to our making a final investment decision on the project, which we plan to make in the near future. Our financial contribution to the project will also depend on, among other factors, our equity interest in the Yamal LNG project, which currently stands at 80%, on cash flows from the project and on the amount of project financing provided by the banks. See *“Forward-Looking Statements”*.

For further information regarding our actual and planned capital expenditures, see *“Business-Description of Our Fields—Producing fields”*, *“Business—Description of Our Fields—Prospective fields—South-Tambeyskoye field and the Yamal LNG project”*, *“Business—Exploration and Development Activities”*, *“Business—Production—Gas Condensate Processing at Our Purovsky Plant”* and *“Business—Production—Ust-Luga Project”*.

### **Debt Obligations**

We utilize a variety of financial instruments to ensure the flexibility of our financing strategy. This includes maintaining a debt portfolio with a balance of short-term and long-term financing, a mix of fixed interest rate and floating interest rate instruments and a debt portfolio denominated in Roubles or U.S. Dollars. As of 30 September 2012, 58.9% of our total debt was denominated in U.S. Dollars and 41.1% in Roubles.

#### *Overview*

Our total debt decreased by RUB10,819 million to RUB84,659 million at 30 September 2012 from RUB95,478 million at 31 December 2011. Our total debt increased by RUB23,252 million to RUB95,478 million at 31 December 2011 from RUB72,226 million at 31 December 2010. Our total debt increased by RUB34,523 million to RUB72,226 million at December 31, 2010 from RUB37,703 million at 31 December 2009. Our borrowings have been primarily used to supplement our internally generated cash flows for the financing of capital expenditures related to the development of our fields, investments in processing assets such as the Purovsky Plant and Ust-Luga, as well as acquisitions of new gas and oil assets. For discussion of the interest rate profile of our debt, see Note 20 to our Unaudited Financial Statements, Note 27 to our 2011 Audited Financial Statements and Note 27 to our 2010 Audited Financial Statements.

Our total debt position (net of unamortized transaction costs) at 30 September 2012 and at 31 December 2011, 2010 and 2009 was as follows:

	As at 30 September	As at 31 December		
	2012	2011	2010	2009
		<i>(RUB millions)</i>		
<b>Short-term debt</b>				
U.S. Dollar denominated loans .....	—	—	18,200	—
Current portion of long-term debt.....	18,938	20,298	6,952	13,827
<b>Total short-term debt and current portion of long-term debt.....</b>	<b>18,938</b>	<b>20,298</b>	<b>25,152</b>	<b>13,827</b>
<b>Long-term debt</b>				
Rouble denominated loans .....	24,821	24,966	24,948	11,030
Rouble denominated bonds .....	9,986	9,971	9,949	—
U.S. Dollar denominated loans .....	11,421	20,559	19,129	26,673
U.S. Dollar denominated bonds .....	38,431	39,982	—	—
Less current portion of long-term debt.....	(18,938)	(20,298)	(6,952)	(13,827)
<b>Total long-term debt .....</b>	<b>65,721</b>	<b>75,180</b>	<b>47,074</b>	<b>23,876</b>
<b>Total debt .....</b>	<b>84,659</b>	<b>95,478</b>	<b>72,226</b>	<b>37,703</b>

#### *Maturities of long-term debt*

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

	As at 30 September	As at 31 December		
	2012	2011	2010	2009
Year ended 31 December		<i>(RUB millions)</i>		
2010 .....	n/a	n/a	—	—
2011 .....	n/a	—	—	11,726
2012 .....	—	—	16,082	12,150
2013 .....	17,449	35,198	30,992	—
2014 .....	9,841	—	—	—
2015 .....	—	—	—	—
2016 .....	18,465	19,206	—	—
Thereafter.....	19,966	20,776	—	—
<b>Total long-term debt.....</b>	<b>65,721</b>	<b>75,180</b>	<b>47,074</b>	<b>23,876</b>

#### *Short-Term Debt and Current Portion of Long-Term Debt as at 30 September 2012*

At 30 September 2012, our short-term debt and current portion of long-term debt consisted only of the current portion of long-term debt in the amount of RUB18,938 million.

#### *Long-Term Debt as at 30 September 2012*

*Rouble denominated loans:* On 16 December 2010, we obtained a RUB15 billion loan from Sberbank for general corporate purposes including the financing of capital expenditures. The loan bears an interest rate of 7.5% per annum and is repayable in December 2013. At 30 September 2012, the outstanding loan amount was RUB14,980 million, net of unamortized transaction costs of RUB20 million.

In December 2011, we obtained a RUB40 billion credit line facility from Sberbank of Russia (the “**2011 Sberbank Facility**”). In June 2012, we withdrew RUB10 billion under the 2011 Sberbank Facility at an interest rate of 8.9% per annum repayable in December 2014; the remainder of the 2011 Sberbank Facility may be withdrawn on or prior to 31 December 2012. The 2011 Sberbank Facility includes certain restrictive financial covenants. At 30 September 2012, the outstanding amount was RUB9,841 million, net of unamortized transaction costs of RUB159 million.

*U.S. Dollar denominated loans:* On 5 April 2011, we obtained a U.S.\$300 million credit line facility with Sumitomo Mitsui Banking Corporation Europe Limited at an interest rate of LIBOR plus 1.45% per annum (which was equal to 1.81% at 30 September 2012). In April 2011, the Group drew the full amount of the U.S.\$300 million credit line facility with final maturity in December 2013. The loan facility includes certain restrictive financial covenants. At 30 September 2012, the outstanding amount was RUB4,620 million (U.S.\$149 million), net of unamortized transaction costs of RUB17 million.

On 16 November 2010, we obtained a U.S.\$200 million credit line facility with OAO Nordea Bank. The facility has a three-year tenure, an interest rate of LIBOR plus 1.9% per annum (which was equal to 2.13% at 30



September 2012) and includes certain restrictive financial covenants. At 30 September 2012, the outstanding amount was RUB6,183 million (U.S.\$200 million). This facility is secured by a surety of NOVATEK-Yurkharovneftegas.

In October 2009, we obtained a U.S. Dollar denominated loan from ZAO UniCredit Bank in the amount of U.S.\$200 million at an interest rate of LIBOR plus 3.25% per annum (which was equal to 3.48% at 30 September 2012). At 30 September 2012, the outstanding amount was RUB618 million (U.S.\$20 million). As of the date of this Prospectus, the loan was fully repaid.

*Rouble denominated bonds.* In June 2010, we issued non-convertible Rouble denominated bonds in the amount of RUB10 billion due in 2013 with an annual coupon rate of 7.5%, payable semi-annually, under our RUB30 billion Rouble denominated bonds program. Each bond has a nominal value of RUB1,000. At 30 September 2012, the outstanding amount was RUB9,986 million, net of unamortized part of the transaction costs of RUB14 million.

*U.S. Dollar denominated bonds:* In February 2011, we placed Eurobonds in an aggregate amount of U.S.\$1,250 million. The Eurobonds were issued at par in two tranches, a five-year U.S.\$600 million bond with a coupon rate of 5.326% per annum and a ten-year U.S.\$650 million bond with a coupon rate of 6.604% per annum. The coupons are payable semi-annually. At 30 September 2012, the outstanding amount under these bonds was RUB38,431 million (U.S.\$1,243 million), net of unamortized transaction costs of RUB215 million.

#### *Available Facilities*

We have the following available undrawn facilities as of the date of this Prospectus:

*BNP Paribas.* In September 2011, we entered into a revolving credit line agreement for up to U.S.\$100 million with BNP Paribas. As of the date of this Prospectus, the available amount under the agreement is U.S.\$100 million. The availability period ends in August 2013, and the agreement expires in August 2014.

*Sberbank of Russia.* See “—Long-Term Debt as at 30 September 2012—Rouble denominated loans”.

*ZAO Unicredit Bank.* In August 2010, we entered into a general terms agreement with ZAO Unicredit Bank. As of the date of this Prospectus, the available amount under the agreement is U.S.\$350 million. The availability period ends in August 2015, and the facility expires in August 2015 as well. The amount of each loan and applicable interest rate are to be agreed by us and Unicredit Bank at the time of each drawdown.

*Credit Agricole Corporate and Investment Bank.* In June 2009, we entered into a general terms agreement with Credit Agricole Corporate and Investment Bank (formerly Calyon Rusbank Corporate and Investment Bank) on opening a credit line. As of the date of this Prospectus, the available amount under the agreement is U.S.\$100 million. The availability period ends in June 2013, and the facility expires in June 2013 as well. The amount of each loan and the applicable interest rate are to be agreed by us and Credit Agricole Corporate and Investment Bank at the time of each drawdown.

*Overdraft facilities.* We have three overdraft facilities: a U.S.\$100 million overdraft facility with BNP Paribas (Suisse) SA, and two overdraft facilities of U.S.\$75 million and EUR50 million with ING Belgium. As of the date of this Prospectus, there are no outstanding amounts under either facility.

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

#### *Certain Provisions and Terms of Debt Obligations*

Our debt arrangements contain standard market terms, including certain financial and other restrictive covenants. Our most onerous financial covenants include the following: (i) maintaining a ratio of consolidated total net debt to consolidated EBITDA not exceeding 3; (ii) maintaining a ratio of consolidated EBITDA to consolidated net interest expense of at least 3; and (iii) procuring that the aggregate amount of the equity attributable to NOVATEK shareholders is at least RUB70 billion. Some of our financings contain restrictions on acquisitions and/or disposals of assets, incurrence of indebtedness and payment of dividends, and contain negative pledge and change of control provisions. In addition, certain facilities require us and some of our subsidiaries to maintain a certain level of revenues on a quarterly basis, require us to keep our key hydrocarbon licenses and prohibit us from disposing, including in the form of pledge, any of our participation interests in NOVATEK-Yurkharovneftegas and NOVATEK-Tarkosaleneftegas. Most of our financings contain cross-default provisions, allowing the lender to accelerate the facility if we fail to discharge our other indebtedness exceeding a certain threshold. The lowest threshold we have is U.S.\$25 million.

#### *Derivative contracts*

We classify our natural gas foreign trading contracts as derivative instruments because these contracts include pricing terms that are based on the prices of a variety of commodities and on a variety of indices and volume flexibility options. The contracts are recognized at fair value at each period end, and the changes in fair value are recognized as profit or loss for the period.

As of 30 September 2012, we recognized RUB345 million of assets and RUB23 million of liabilities in connection with these contracts. In the nine months ended 30 September 2012, we recognized a gain of RUB322 million within other operating income due to an increase in the fair value of these contracts.

### **Contingencies**

We are subject to various lawsuits, claims and proceedings related to matters incidental to our business activities. Accruals of probable cash outflows are made based on an assessment of a combination of litigation and settlement strategies. It is possible that results of operations in any future period could be materially affected by changes in assumptions or by the effectiveness of these strategies.

### **Taxation**

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to our transactions and activities may be challenged by the relevant regional and federal authorities. Furthermore, events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances, reviews may cover longer periods. Our management believes that its interpretation of the relevant legislation is appropriate and that it is probable that our tax, currency and customs positions will be sustained.

### **Mineral Licenses**

Our gas and oil fields and license areas are situated on land located in YNAO. Licenses are issued by the Federal Agency for the Use of Natural Resources under the MNR, and we pay UPT to extract crude oil, natural gas and unstable condensate from these fields and contributions for exploration of license areas. We are subject to periodic reviews of our activities by state authorities with respect to the requirements of our mineral licenses. Our management cooperates with state authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitation, suspension or revocation. See *"Risk Factors—Risks Relating to Our Business and Industry—Our licenses may be suspended, amended or terminated prior to their expiration, and we may be unable to obtain or maintain various other permits or authorizations"*.

Our principal licenses and their expiry dates are as follows:

<b>Field / License Area</b>	<b>License holder</b>	<b>License expiry date</b>
<i>Subsidiaries:</i>		
Yurkharovskoye .....	NOVATEK-Yurkharovneftegas	2034
Salmanovskoye (Utrenneye) .....	NOVATEK-Yurkharovneftegas	2031
Geofizicheskoye .....	NOVATEK-Yurkharovneftegas	2031
East-Tarkosalinskoye .....	NOVATEK-Tarkosaleneftegas	2043
Urengoykoye (within the Olimpiyskiy license area) .....	NOVATEK-Tarkosaleneftegas	2026
Khancheyskoye .....	NOVATEK-Tarkosaleneftegas	2044
North-Russkoye .....	NOVATEK-Tarkosaleneftegas	2031
Malo-Yamalsky .....	Tambeyneftegas	2019
<i>Joint Ventures:</i>		
South-Tambeyskoye .....	Yamal LNG	2045
Termokarstovoye .....	Terneftegas	2021
Yaro-Yakhinskoye	Arcticgas	2018
Urengoykoye (within the Samburgskiy and Yevo-Yakhinskiy license areas) .....	Arcticgas	2018
North-Chaselskiy .....	Arcticgas	LOF
Beregovoy .....	Sibneftegas	2023
Pyreinyi .....	Sibneftegas	2021

Our management expects to be in a position to extend our licenses beyond the initial expiration date under existing legislation and intends to do so on all of our fields, where the remaining economic life of the field exceeds the term of the license. We have been successful in extending the license terms for the Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye and South-Tambeyskoye fields. See also *"Risk Factors—Risks Relating to Our Business and Industry—Some of our reserves have been booked and reported in this Prospectus on the basis that the respective licenses will be extended, although the licensing regime does not provide an absolute legal right to such an extension"*.

### *Environmental Liabilities*

We and our predecessor entities have operated in the gas and oil industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. We periodically evaluate our obligations under environmental regulations and, as obligations are determined, they are recognized as an expense immediately if no future benefit is discernible. Potential liabilities which might arise as a result of a change in interpretation of existing regulations, civil litigation or changes in legislation cannot be estimated. Our management is of the opinion that we have met the Government's requirements concerning environmental matters, and therefore we do not have any material environmental liabilities. Under existing legislation, our management believes there are no probable environmental liabilities, which will have a material adverse effect on our financial position, results of operations or cash flows.

### *Legal Contingencies*

We are the subject of, or party to a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding which could have a material effect on our results of operations or financial position and which have not been accrued or disclosed in the Financial Statements.

### *Qualitative and Quantitative Disclosures and Market Risks*

We are exposed to market risk from, among others, changes in foreign currency exchange rates, interest rates and commodity prices, in addition to credit and liquidity risks. We are exposed to foreign exchange risk to the extent that a portion of our sales revenues, costs, receivables and loans are denominated in currencies other than Roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. We are exposed to commodity price risk because our prices for crude oil, stable gas condensate and LPG that we export are linked to international crude oil prices, as well as from our gas trading activities on the European market. We are also exposed to risks relating to pipeline access and our continuing ability to reinvest our revenues into capital expenditures. See Note 20 of our Unaudited Financial Statements and Note 27 of Audited Financial Statements for further description of these risks.

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. Aside from our natural gas trading activities (see "*—Derivative contracts*", above), we currently are not a party to any material derivative transaction. In the Financial Statements, all derivative instruments are recorded at their fair values. Unrealized gains or losses on derivative instruments are recognized within other operating income (loss), unless the underlying arrangement qualifies as a hedge.

### *Foreign Currency Risk*

Our principal exchange rate risk involves the depreciation of the Rouble relative to the U.S. Dollar. As of 30 September 2012, 58.9% of our total debt was denominated in U.S. Dollars, as compared to 63.4% of our total debt as of 31 December 2011, 51.7% of our total debt as of 31 December 2010 and 70.7% of our total debt as of 31 December 2009. A depreciation of the Rouble relative to the U.S. Dollar will increase our foreign currency-denominated costs and expenses and our debt service obligations for foreign currency-denominated borrowings in Rouble terms as well as receivables at our foreign subsidiaries. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a portion of our total revenues, 25.8% in the nine months ended 30 September 2012, is denominated in U.S. Dollars, which operates as a natural hedge. In 2011, 29.8% of our total revenues were denominated in U.S. Dollars. In nominal terms, during the nine months ended 30 September 2012, the Rouble appreciated by approximately 4.0% against the U.S. Dollar. During 2011, the Rouble depreciated by approximately 5.6% against the U.S. Dollar since 31 December 2010 (in nominal terms).

A hypothetical and instantaneous 10% depreciation of the Rouble in relation to the U.S. Dollar as of 30 September 2012 would have resulted in an estimated foreign exchange loss of RUB4,985 million on foreign currency denominated borrowings held at that date. See Note 20 to the Unaudited Financial Statements.

### *Interest Rate Risk*

We are subject to interest rate risk on financial liabilities with variable interest rates. We do not have a formal policy of determining how much of our exposure should be to fixed or variable interest rates; nevertheless, we regularly assess the interest rate environment to determine whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. As of 30 September 2012, 86.5% of our debt is subject to fixed interest rates and 13.5% to variable interest rates. For discussion of the interest rate profile of our debt, see Note 20 to our Unaudited Financial Statements and Note 27 to our 2011 Audited Financial Statements and Note 27 to our 2010 Audited Financial Statements.

## *Commodity Risk*

*Natural gas supplies on the Russian domestic market.* As an independent natural gas producer, we are generally not subject to government regulation of natural gas prices. Nevertheless, our prices for natural gas sold are strongly influenced by prices set by the FTS for Government-owned producers.

Substantially all of our crude oil, stable gas condensate and LPG export sales are sold under spot contracts. The price of our crude oil exports is based on benchmark reference crude oil prices of Brent dated, less a discount. The prices of our stable gas condensate and LPG exports is based on benchmark reference crude oil prices of WTI, Brent IPE and Dubai (or a combination thereof) or Naphtha Japan and Naphtha CIF NWE, less a margin or discount, depending on current market conditions. Therefore, external factors that affect benchmark reference crude oil prices, such as geopolitical developments, weather, including natural disasters, and the actions of OPEC, affect our export prices.

*Natural gas foreign trading activities.* We purchase and sell natural gas on the European market under long-term supply contracts based on formulas with reference to benchmark natural gas prices quoted for the North-Western European natural gas hubs, crude oil and oil products prices and/or a combination thereof. As a result, the Group's results from natural gas trading are subject to commodity price volatility based on fluctuations or changes in the respective benchmark reference prices. See Note 20 to the Unaudited Financial Statements.

## *Credit Risk*

We are exposed to potential financial losses as a result of a counterparty defaulting on its contractual obligations. We manage our credit risk in a number of ways. We deposit our cash and cash equivalents only with banks that we consider at the time of deposit to have minimal risk of default. We manage the risks associated with customer defaults in the following manner: all domestic sales of liquid hydrocarbons are made on a 100% prepayment basis. We also require 100% prepayment from small customers of natural gas sales, other than households, and partial advances from larger customers. With respect to export sales of liquid hydrocarbons, most of our sales are made to customers with independent external credit ratings. In the event a customer has a credit rating below BBB, we require collateral in the form of a letter of credit from a bank with an investment grade rating. As at 30 September 2012, 89% and 11%, respectively, of our cash and cash equivalents were deposited in banks with an investment grade rating and banks with non-investment grade rating (compared to 82% and 18%, respectively, as of 31 December 2011). We are exposed to credit risk in that two major customers – INTER RAO and Gazprom – have historically accounted for a significant part of our revenue base. In the nine months ended 30 September 2012 and in 2011, INTER RAO accounted for 27% and 32% of our revenues for natural gas sales, respectively, and Gazprom accounted for 15% and 22% of our revenues for natural gas sales, respectively. See “*Risk Factors—Risks Related to Our Business and Industry—Russian state authorities, directly and through the control of Gazprom, which owns and operates the gas pipeline network transporting our gas (the UGSS) and which beneficially owns 9.99% of our shares, effectively control the Russian natural gas industry and could significantly restrict the activities and operations of independent natural gas producers such as ourselves*”.

As at 30 September 2012, 14% and 36%, respectively, of our trade and other receivables reflect sales to counterparties with a non-investment grade rating and counterparties with no external rating (compared to 9% and 36%, respectively, as of 31 December 2011). The remainder of sales was made to customers with investment credit grade ratings. As a result of our acquisition of Gazprom mezhregiongas Chelyabinsk (since merged into our wholly-owned subsidiary NOVATEK-Chelyabinsk) and YamalEnergoGaz (since merged into our wholly-owned subsidiary NOVATEK-Perm) our exposure to small- and medium-sized industrial users and individuals has increased. See “*Risk Factors—Risks Relating to Our Business and Industry—Government policies to ensure sufficient supplies of hydrocarbons in the domestic market could impact our ability to sell our products at the best available prices and disrupt our relations with our customers*”.

## *Liquidity Risk*

Liquidity risk is the risk that we will not be able to meet our financial obligations when due. We manage our liquidity risk by maintaining adequate cash reserves and debt facilities, regularly monitoring forecast and actual cash flows and matching profiles of financial assets and liabilities. To ensure that we meet short-term financing needs, we have entered into a number of short-term credit lines and overdraft facilities. To meet longer-term financing needs, we normally raise long-term debt both on international and domestic markets.

## *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. See “*Risk Factors—Risks Related to Our Business and Industry—We rely on third parties,*

*primarily state-owned monopolies, to transport our products—We are dependent on Gazprom for the transportation of our natural gas”.*

#### *Ability to Reinvest*

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

#### *Off Balance Sheet Activities*

As of 30 September 2012, 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.

#### **Critical Accounting Estimates and Judgments**

The Financial Statements reflect the selection and application of accounting policies that require management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Financial Statements, and the reported amounts of revenues and expenses during the reporting period. We believe that the following are the most critical accounting policies that currently affect our financial condition and results of operations.

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

Judgments and estimates that have the most significant effect on the amounts reported in the Financial Statements and have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are described below.

#### *Oil and gas properties*

The Group follows the successful efforts method of accounting for its oil and gas properties and equipment whereby property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overheads and all exploration costs other than exploratory drilling and license acquisition costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

#### *Exploration costs*

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

#### *Useful lives of property, plant and equipment*

Management assesses the useful life of an asset by considering the expected usage, estimated technical obsolescence, residual value, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future depreciation rates and expenses for the period.

#### *Fair values of financial assets and liabilities*

The fair value of financial assets and liabilities, other than financial instruments that are traded in an active market, is determined by applying various valuation methodologies. Management uses its judgment to make assumptions based on market conditions existing at each balance sheet date. Discounted cash flow analysis is used for various loans and receivables as well as debt instruments that are not traded in active markets. The effective interest rate is determined by reference to the interest rates of instruments available to us in active markets. In the absence of

such instruments, the effective interest rate is determined by reference to the interest rates of active market instruments available adjusted for our specific risk premium estimated by management.

#### ***Deferred income tax asset recognition***

Management assesses deferred income tax assets at each balance sheet date and determines the amount recorded to the extent that realization of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments and applies estimations based on prior years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

#### ***Estimation of gas and liquids reserves***

Engineering estimates of gas and oil reserves are inherently uncertain and are subject to future revisions. We estimate our gas and oil reserves in accordance with rules promulgated by the SEC for proved reserves. Accounting measures such as depreciation, depletion and amortization (DDA) charges, impairment assessments and asset retirement obligations that are based on the estimates of proved reserves are subject to change based on future changes to estimates of gas and oil reserves.

Proved reserves are estimated by reference to available reservoir and well information, including production and pressure trends for producing reservoirs. Furthermore, estimates of proved reserves only include volumes for which access to market is assured with reasonable certainty. All proved reserves estimates are subject to revision, either upward or downward, based on new information such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans.

Proved reserves are defined as the estimated quantities of gas and oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are substantially developed and depleted. As those fields are further developed, new information may lead to further revisions in reserves estimates.

Gas and oil reserves have a direct impact on certain amounts reported in the Financial Statements, most notably depreciation, depletion and amortization (DDA) as well as impairment expenses. Depreciation rates on gas and oil assets using the units of production method for each field are based on proved developed reserves for development costs, and total proved reserves for costs associated with the acquisition of proved properties. Assuming all variables are held constant, an increase in proved developed reserves for each field decreases depreciation, depletion and amortization (DDA) expenses. Conversely, a decrease in the estimated proved developed reserves increases depreciation, depletion and amortization (DDA) expenses. Moreover, estimated proved reserves are used to calculate future cash flows from gas and oil properties, which serve as an indicator in determining whether or not property impairment is present.

Although the possibility exists for changes or revisions in estimated reserves to have a critical effect on depreciation, depletion and amortization (DDA) charges and, therefore, reported net profit for the year, it is expected that in the normal course of business the diversity of our asset portfolio should mitigate the likelihood of this occurring.

#### ***Impairment of non-financial assets***

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

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

#### ***Impairment provision for trade receivables***

The impairment provision for trade receivables is based on management's assessment of the probability of collection of individual customer accounts receivable. Significant financial difficulties of the customer, probability that the customer will enter bankruptcy or financial reorganization, and default or delinquency in payments are

considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

When there is no expectation of recovering additional cash for an amount receivable, the expected amount receivable is written off against the associated provision.

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

#### ***Pension obligations***

The cost of defined benefit pension plans and related current service costs are determined using actuarial valuations. The actuarial valuations involve making demographic assumptions (mortality rates, age of retirement, employee turnover and disability) as well as financial assumptions (discount rates, expected rates of return on assets, inflation forecasts, future salary and pension increases). Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

#### ***Asset retirement obligations***

Management makes provision for the future costs of decommissioning gas and oil production facilities, pipelines and related support equipment based on the best estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future. Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

We also assess our liabilities for site restoration at each consolidated statement of financial position period in accordance with the guidelines of IFRIC 1, "Changes in Existing Decommissioning, Restoration and Similar Liabilities". The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the balance sheet date based on current legislation where our respective operating assets are located, and is also subject to change because of modifications, revisions and changes in laws and regulations and the interpretation thereof. As a result of the subjectivity of these provisions, there is uncertainty regarding both the amount and estimated timing of incurring such costs.

#### ***Fair value assessment of OAO Yamal LNG***

The Group ceased control of Yamal LNG effective 6 October 2011, but retained joint control and, consequently, was required to fair value the remaining interest in Yamal LNG in accordance with IFRS. The fair value of the investment in Yamal LNG was calculated based on a discounted cash flow model for the Yamal LNG project. The significant assumptions in the discounted cash flow model are:

- forecasted prices for LNG (future LNG prices were based on estimated Brent prices using growth rates as forecasted by the World Bank);
- anticipated production volumes (future production was based on estimates of proved and probable reserves);
- future capital expenditures required to build necessary infrastructure and drill production wells (future capital expenditure over the life of the project has been estimated based on preliminary engineering and costing estimates); and
- the discount factor used in the fair value calculation (the discount rate was assumed to be 11.9%, in U.S. Dollar terms).

#### ***Associated companies and joint ventures***

Associated companies and joint ventures are entities over which we have significant influence or joint control, respectively, but which we do not control. Generally, significant influence exists when we have between 20 and 50% of voting rights over the entity; furthermore, we have elected to account for some joint ventures in which we have over 50% of the voting rights, as we share control over such entities with our joint venture partners. Associated companies and joint ventures are accounted for using the equity method, initially recognized at cost and subsequently adjusted for our share of post-acquisition income less dividends received, together with any loans of a long-term investment nature. Where necessary, adjustments are made to the financial statements of associated companies and joint ventures to bring the accounting policies used into line with ours. Unrealized gains on transactions between us and our associated companies and joint ventures are eliminated to the extent of our interest in them. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

***Derivative instruments***

The estimated fair values of derivative financial instruments are determined with reference to various market information and other valuation methodologies as considered appropriate, however considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts that we could realize in a current market situation.

**Recent accounting pronouncements**

Recent accounting pronouncements are described in the notes to the Financial Statements.



## BUSINESS

### Business Overview

We are Russia's largest independent natural gas producer and the second-largest natural gas producer in Russia after Gazprom, in each case according to the CDU-TEK for the nine months ended 30 September 2012. We are principally engaged in the exploration, production, processing, marketing and resale of natural gas and liquid hydrocarbons and have over 17 years of operational experience in the Russian oil and natural gas sector. In 2011 and the nine months ended 30 September 2012, we accounted for approximately 8% and 9%, respectively, of the natural gas produced in Russia, providing approximately 15% and 17%, respectively, of total natural gas deliveries through the UGSS to the domestic market, according to the CDU-TEK. In 2012, we started trading activities on the European gas market, by selling and purchasing natural gas.

Our core strategy is to maintain our position as the leading independent natural gas producer in Russia, based on reserves and production, by increasing our hydrocarbon production on a sustainable and profitable basis, while efficiently expanding our hydrocarbon resource base, developing our marketing channels and exploring complementary and value added projects. We supply natural gas to Russia's domestic market and are focused on meeting the anticipated growing demand in Russia (as forecasted by the International Energy Agency), and, as such, we expect to benefit from future increases in regulated prices for natural gas sold and in power generation capacity and infrastructure investments in Russia, as projected by the Ministry of Economic Development of the Russian Federation.

Our exploration, development, production and processing of natural gas and liquid hydrocarbons are conducted within the Russian Federation and our operating areas are concentrated in YNAO, in Western Siberia. According to the YNAO Administration, the MER and the BP Statistical Review of World Energy (June 2012), YNAO is the leading gas producing region in Russia, accounting for approximately 90% of Russia's natural gas production and approximately 17% of the global natural gas production in 2011.

As of 31 December 2011, we had 9,393 mmmboe of proved reserves (including our *pro rata* share in reserves of our Joint Ventures), of which approximately 92% were natural gas reserves, under SEC reserves methodology. For the three years ended 31 December 2011, our three-year average reserves replacement ratio was 597%, on a boe basis, based on proved reserves under SEC reserves methodology. The reserve life of our proved reserves under SEC reserves methodology was 25 years based on our annual production in 2011.

During the periods under review, we have consistently increased our hydrocarbon production, and we expect to continue increasing our production levels in the future. In the nine months ended 30 September 2012, we produced 41.4 bcm of natural gas and 3.1 mmt of liquid hydrocarbons, an increase of 7.3% and 2.0%, respectively, compared to the nine months ended 30 September 2011. Our natural gas and liquid hydrocarbons production totaled 52.9 bcm and 4.1 mmt, respectively, in 2011, 37.3 bcm and 3.6 mmt, respectively, in 2010, and 32.4 bcm and 3.0 mmt, respectively, in 2009.

Our Core Fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheykoye) accounted for 52.5% of our total proved reserves, under SEC reserves methodology, as of 31 December 2011, and approximately 90% of our gas production volumes in 2011. A significant portion of our total hydrocarbon proved reserves and production is contributed by our Joint Ventures for which we account under the equity method, as we share control over these entities with our joint venture partners.

Our Joint Ventures accounted, collectively, for 42.9% of our proved reserves, under SEC reserves methodology, as of 31 December 2011. In particular, our 25.5% economic interest in SeverEnergia and 51% stake in Sibneftegas together accounted for 14.1% of our proved reserves as of 31 December 2011; and our 80% economic interest in Yamal LNG accounted for 27.7% of our proved reserves as of 31 December 2011. Production at SeverEnergia commenced in April 2012; in 2011, our share in Sibneftegas' production accounted for 10.2% of our total natural gas production volumes. Yamal LNG has not yet started production. We also hold licenses for as yet undeveloped fields in the Gydan peninsula.

We generate revenues primarily from natural gas and gas condensate sales and, to a lesser extent, sales of other liquid hydrocarbons. In the nine months ended 30 September 2012, our sales of (i) natural gas accounted for 66.3% of our total revenues, (ii) stable gas condensate for 23.1% and (iii) LPG, crude oil and oil related products for 10.3%. In 2011, our sales of (i) natural gas accounted for 62.9% of our total revenues, (ii) stable gas condensate for 26.5% and (iii) LPG, crude oil and oil related products accounted for 10.3%. For the nine months ended 30 September 2012, we had total revenues of RUB152.2 billion and EBITDA of RUB69.9 billion. In 2011, we generated total revenues of RUB176.3 billion and EBITDA of RUB148.3 billion.

In accordance with Russian law, we currently sell all our natural gas production to customers in the Russian Federation. Our customers are primarily power generation companies, industrial users, regional gas distributors and wholesale gas traders. We also sell some of our gas to households. As an independent natural gas producer, we are not subject to the Government's regulation of natural gas prices except for our sales to households, which represent

a minor share of our total sales volumes. Nevertheless, the regulated price as set by the FTS significantly influences the market conditions in our regions of delivery as well as the price in our natural gas contracts with end-customers and wholesale traders. The FTS-regulated wholesale price has been increasing in recent years, including the latest increase of 15% which took effect on 1 July 2012.

We transport our natural gas through our pipelines into the UGSS, which we use to deliver our gas to end-customers in accordance with the relevant transportation contracts we enter into with Gazprom. The UGSS transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. UGSS transportation tariffs are set by the FTS.

Substantially all of our stable gas condensate is sold internationally, whereas our other liquid hydrocarbons, including LPG, crude oil and oil related products, are sold domestically and internationally. Gas condensate is produced in an unstable form and requires processing before it can be delivered to customers. We currently process all of our de-ethanized gas condensate at our Purovsky Plant, the capacity of which we are currently expanding from 5 mmt to 11 mmt per annum. In the nine months ended 30 September 2012 and in 2011, we processed 2.9 mmt and 3.9 mmt, respectively, of de-ethanized gas condensate. Following processing, we export substantially all of our stable gas condensate to international markets, via the Port of Vitino on the White Sea in the Murmansk region. In the nine months ended 30 September 2012 and in 2011, we sold 2.2 mmt and 3.0 mmt, respectively, of stable gas condensate. We are currently building a new gas condensate transshipment and fractionation complex at the Ust-Luga terminal on the Baltic Sea. We expect that the completion of this project will allow us to partially replace sales of stable gas condensate with sales of a range of petroleum products, as well as to replace the Port of Vitino for deliveries of our gas condensate and products made from it to the international markets. The terminal is expected to begin operations in 2013.

NOVATEK has pursued, and continues to consider, participating in natural gas projects outside Russia. In 2007-2011, we pursued the El-Arish offshore gas and oil project in Egypt; when initial exploratory works and drilling failed to confirm sufficient commercially recoverable reserves we ended our participation in this project, expensing our capital costs. With our strategic partner TOTAL and Gazprombank, we are currently pursuing an offshore natural gas project in the Republic of Cyprus via a joint venture, in which we have a 25% stake, TOTAL 65% and Gazprombank 10%. The joint venture is currently in negotiations with the Cypriot authorities regarding the terms of exploration and production on a block of the Cypriot shelf under a production sharing agreement.

We are currently rated “Baa3” (stable outlook) by Moody’s, “BBB-” (stable outlook) by S&P and “BBB-” (stable outlook) by Fitch. To maintain our credit rating, we have established certain financial targets and coverage ratios that we monitor on a quarterly and annual basis. A securities rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating organization.

### **Competitive Strengths**

We believe the following competitive strengths distinguish our past operational and financial performance and our future growth prospects from other independent natural gas producers in Russia:

#### *High-Quality Asset Base*

Our substantial upstream asset base includes 35 license areas (held by our subsidiaries and Joint Ventures) in YNAO, with most of our reserves and resources attributed to the conventional category (capable of being exploited using conventional technologies, in contrast to unconventional gas deposits such as shale gas). The reserve life of our proved reserves, under SEC reserves methodology, was 25 years based upon our annual production in 2011. Our Core Fields, together with a majority of our other fields and exploration blocks, are strategically located in the Nadym-Pur-Taz region of YNAO. This region is the traditional center of the Russian gas production, well served by the UGSS and one of the most significant gas producing regions in Russia and the world. Our Core Fields have estimated proved reserves of 4,935 mmbœ (out of our total proved reserves of 9,393 mmbœ), as of 31 December 2011, under SEC reserves methodology.

Seven of the licenses (held by our subsidiaries and Joint Ventures) are for fields in the Yamal and Gydan peninsulas of Russia. Based on the reported reserves estimates under the Russian reserves system as of 1 January 2012, these are new and highly promising gas production regions of Russia. For example, the South-Tambeyskoye field on the Yamal peninsula, owned by our Yamal LNG Joint Venture, accounted for 27.7% of our total SEC proved reserves as of 31 December 2011. Other fields and license areas in these regions to which we have the exploration and production rights represent a significant potential for expanding our reserves base.

Our existing reserves base has enabled us to become the largest independent producer of natural gas in Russia and we estimate that it will enable us to continue sustainable production growth in the future in a cost effective manner. In 2011 and the nine months ended 30 September 2012, we accounted for 8.0% and 8.8%, respectively, of Russian gas production, according to data from the CDU-TEK.

Since 1 January 2012, our crude oil production has been subject to a zero UPT rate, as a result of a change in legislation exempting fields north of the 65<sup>th</sup> parallel from such tax. We anticipate that this change in legislation will

lead to an acceleration in the development of our crude oil reserves and thus will contribute to future growth in our overall production.

The majority of our upstream asset base is located in close proximity to the existing natural gas transportation infrastructure, and we operate our wholly-owned gas condensate de-ethanization and processing units as well as our own gas condensate transportation infrastructure.

#### *Strategic Location with Access to Infrastructure and Attractive Markets*

Our Core Fields are located in relatively close proximity to, and feed into, the UGSS. The UGSS, originally constructed to transport natural gas from Gazprom's main producing fields located in YNAO, has increasing amounts of available capacity as some of Gazprom's producing properties in the area are experiencing natural declines in production volumes. Given the close proximity of our fields to the UGSS, we can benefit from the UGSS' additional spare capacity by increasing our sales of natural gas to meet growing domestic demand, as forecasted by the International Energy Agency. We expect this geographic concentration and favorable location of our resource base to facilitate production increases and reserves additions in a cost effective manner.

In addition, the location of the South-Tambeyskoye field, one of our major fields and an integral part of the Yamal LNG project, offshore in the Gulf of Ob allows for efficient shipment of LNG to international markets through the Port of Sabetta, which is currently under construction.

#### *Integrated Operations and Logistics Capabilities*

We benefit from the capital investments we have made to ensure our operations are fully integrated, and we have sufficient logistical capabilities to market our hydrocarbon products. We own and operate a significant part of the infrastructure necessary for our operations, including the Purovsky Plant, a fleet of rail cars, storage facilities at the Port of Vitino and methanol production units. In 2010, we completed the construction of our own unstable gas condensate de-ethanization unit at the Yurkharovskoye field and a dedicated pipeline from the Yurkharovskoye field to the Purovsky Plant. In 2012, we completed all the necessary infrastructure to link the Samburgskoye field (developed and operated by SeverEnergiya, one of our Joint Ventures) to the gas condensate pipeline and the UGSS. In addition, we are in the process of finalizing the first stage construction of a gas condensate transshipment and fractionation complex at the Port of Ust-Luga, which will further enhance our vertical integration and allow us to optimize logistics. Construction of the first stage of this facility is expected to be completed by the end of 2012.

We rely on the UGSS for gas transportation and on Transneft's pipelines for oil transportation. At the same time, we own and operate a significant portion of our infrastructure-related assets. We believe this provides us with significant benefits, including reduced reliance on third parties to process and transport our products, enhanced ability to coordinate and determine optimal marketing channels for our products, operating flexibility and control over the quality of the gas condensate we process, and decrease of third party charges for transportation and processing.

#### *Low-Cost and Disciplined Producer*

We believe we are one of the lowest cost producers of hydrocarbons in the global oil and gas industry based on data regarding our domestic and international peers' performance from IHS Herold for 2005-2011. In 2011, our total production cost was U.S.\$7.65 per boe, of which U.S.\$4.55 per boe was transportation cost, U.S.\$1.71 per boe was taxes other than income, U.S.\$0.88 per boe was depreciation, depletion and amortization and U.S.\$0.51 per boe was lifting costs. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Operational Highlights—Gas and Liquids Production Costs*". In terms of expanding and/or replacing our reserves base, our reserves replacement cost was U.S.\$1.22 per boe in 2011. We believe that our strong cost control discipline and the economies of scale resulting from the geographic concentration of our resource base, together with the relatively early stage of development and strong production capacity of our fields, will allow us to maintain our low production, finding and development and reserves replacement costs. Since inception, we have sought to employ strong cost control measures across all of our operations.

#### *Strong Relationships with a Diversified Customer Base*

We have developed strong relationships with a geographically and operationally diverse customer base. Our range of natural gas customers include power generation companies, industrial consumers, households, regional distributors and wholesale gas traders whereas our liquids' products customers are major independent energy companies, petroleum refineries and companies in the petrochemical industry. We believe we have established a strong reputation as a reliable supplier by focusing on the needs of our customers, providing high-quality products and consistently delivering contracted volumes of hydrocarbons on a timely basis. We have an active commercial marketing department, and we believe we are well positioned to penetrate new markets and diversify and grow our customer base. Most of our sales of natural gas are made pursuant to long-term contracts, and we have been generally successful in renewing contracts, expanding the duration of such contracts and retaining our existing customers. During the nine months ended 30 September 2012, our major natural gas customers, by volume, included

Gazprom, INTER RAO and a Russian subsidiary of E.ON. We recently signed several new gas supply contracts with major industrial and energy customers, see “—Sales and Marketing—Natural Gas—Sales of natural gas”.

#### *Financial Strength and Flexibility*

We believe we have established a strong financial and operational track record. We have recorded increases in revenues and net income over each of the last five years, and our production volumes and reserves base have also increased over the corresponding period. This financial and operational performance record has enhanced our ability to access the international and domestic debt capital markets providing us with additional flexibility to meet our capital requirements. We also believe that our solid financial position and operational track record will facilitate future development as well as the receipt of state support for new project implementation. For example, our participation in the Yamal LNG project has received Government support with the passing of a Government decree outlining a special privileged taxation and customs incentives system for the Yamal LNG project. See “—Description of Our Fields—Prospective Fields—South-Tambeyskoye field and Yamal LNG project”. Moreover, our conservative capital structure, strong internally-generated cash flows and long-lived asset base will continue to provide us with important financial flexibility and enable us to access additional financing in the future.

#### *Experienced Management Team*

We have an experienced and knowledgeable executive management team with a wealth of experience in the Russian oil and gas sector and with a significant direct and indirect ownership interest in our business. We were formed by our key management team in 1994. We believe our experienced management team allows us to compete more effectively in the markets in which we operate. See “Management” and “Principal Shareholders”.

#### *Strong Relationship with Gazprom*

We believe our relationship with Gazprom and its affiliates provides us with numerous benefits that are important to our continued long-term success, including a network of strong relationships throughout the Russian oil and natural gas sector and access to the UGSS for the transportation of our natural gas. As at the date of this Prospectus, Gazprom and/or its affiliates own 9.99% of our shares. Two members of our Board of Directors were elected upon Gazprom’s nomination. We collaborate closely with Gazprom as one of our principal wholesale customers and together seek to further develop the Russian gas industry as evidenced by the Memorandum of Cooperation we signed with Gazprom in April 2012, which outlines the possibility of establishing a joint venture to increase LNG production capacity on the Yamal peninsula and jointly developing hydrocarbon resources on the Gydan peninsula. We accordingly believe that Gazprom’s equity interest in us serves to promote our interests.

### **Business Strategy**

Our strategic objective is to leverage our competitive strengths to increase our hydrocarbon production on a sustainable and profitable basis, while efficiently expanding our hydrocarbon resource base and processing capacities, developing our marketing channels, exploring complementary and value added projects and operating in a socially and environmentally responsible manner.

#### *Increase Our Resource Base and Manage Reserves Effectively*

We intend to manage our resource base in order to grow our proved reserves as we explore and develop hydrocarbons in our fields and license areas. We intend to maintain our reserves replacement rate (including through acquisitions) at above 100%, which is an important factor contributing to sustainable, long-term production growth. We believe our established resource base in the Nadym-Pur-Taz region of YNAO, and its proximity to the existing gas transportation and processing infrastructure, as well as our significant resources in the Yamal and Gydan peninsulas and in the Gulf of Ob will enable us to leverage our experience in exploring and developing complex hydrocarbon reserves to further expand our resource base both organically and through potential acquisitions.

#### *Substantially Increase Our Production of Hydrocarbons*

Despite the recent economic slowdown globally and in Russia, industry experts, including the International Energy Agency, estimate that long-term demand for natural gas will be greater than current supply. We believe we are well positioned to supply a significant portion of the expected growth in incremental natural gas demand on the Russian domestic market due to the proximity of our core fields to pipeline infrastructure, the successful development of our fields, and our commercial marketing capabilities.

We estimate that our natural gas production will more than double in the period from 2011 to 2020 (subject to favorable macroeconomics and timely final investment decisions on our projects in the Yamal and Gydan peninsulas) and to exceed 110 bcm per annum, including our share in the production of our Joint Ventures. Our liquids production is estimated to more than triple within the same period of time to reach 13 mmt per annum, including our share in the production of Joint Ventures. The growth is based on our existing reserves, and we plan to continue making targeted capital investments and to prioritize our investment program so as to focus on the expansion of our fields’ production capacity. In 2013, we expect our largest field in terms of production – the Yurkharovskoye field – to contribute to our production growth compared with 2012, while in the mid-term we

anticipate that most of our growth will come from other fields of the Nadym-Pur-Taz region, SeverEnergiya and Nortgas. In the long-term, we expect production growth to be supported by the development of reserves on the Yamal and Gydan peninsulas.

We are also carefully assessing potential acquisition opportunities of producing assets or assets with a short- and/or mid-term production start, provided that these acquisitions will be value accretive.

#### *Maintain Our Low Cost Structure*

We intend to maintain our low cost track record through the prudent use of modern technology and production techniques across our hydrocarbon resource base. In the past few years, our three-year average lifting cost, our finding and development costs and our reserves replacement costs remained among the lowest in the global oil and gas industry, according to our assessment based on data regarding our domestic and international peers' performance from IHS Herold for 2005-2011. Furthermore, we expect that the quality and geographic concentration of our core resource base, which is in close proximity to the UGSS, the Purovsky Plant and our production infrastructure, and the resulting economies of scale will continue to be a major factor in helping us maintain our low-cost structure in the mid-term. In the longer term, we do not anticipate any material pressure on our basic costs in real terms as the estimated lifting cost and finding and development cost of our assets in the Yamal and Gydan peninsulas (excluding estimated cost of the LNG plant) are in line with the low-cost level at our Core Fields in the Nadym-Pur-Taz region. Moreover, we strive to maintain consistently low costs in all other areas of our business operations and tightly control administrative overhead costs.

#### *Efficiently monetize our reserves of liquid hydrocarbons*

The largest part of our proved gas reserves is wet gas, which is a mixture of natural gas and unstable gas condensate. Unstable gas condensate is separated from gas and de-ethanized at our fields and then processed into stable gas condensate and LPG at our Purovsky Plant. We export almost all our stable gas condensate, and our sales of LPG are relatively balanced between international and domestic markets. We also have substantial proved crude oil reserves and sell the crude oil both domestically and internationally. We sell our liquid hydrocarbons at international or domestic prices; our gas prices correlate to regulated prices set by the Government, which to date have been materially below export netback prices. As a result, our sales of liquid hydrocarbons account for 33.3% of our total revenues, while contributing only 8.7% to our production volumes, according to data for the nine months ended 30 September 2012.

To efficiently monetize our reserves of liquid hydrocarbons, we strive to maximize our reserves recovery rate by optimizing development projects at our fields and constructing related infrastructure. To this end, we have built and are now expanding our Purovsky Plant, which processes all our gas condensate, and have developed infrastructure in the Port of Vitino to export our gas condensate. We are now in the process of constructing a fractionation and transshipment complex at the Ust-Luga terminal on the Baltic Sea for the processing of gas condensate into petroleum products, which we expect will allow us to capture additional margins.

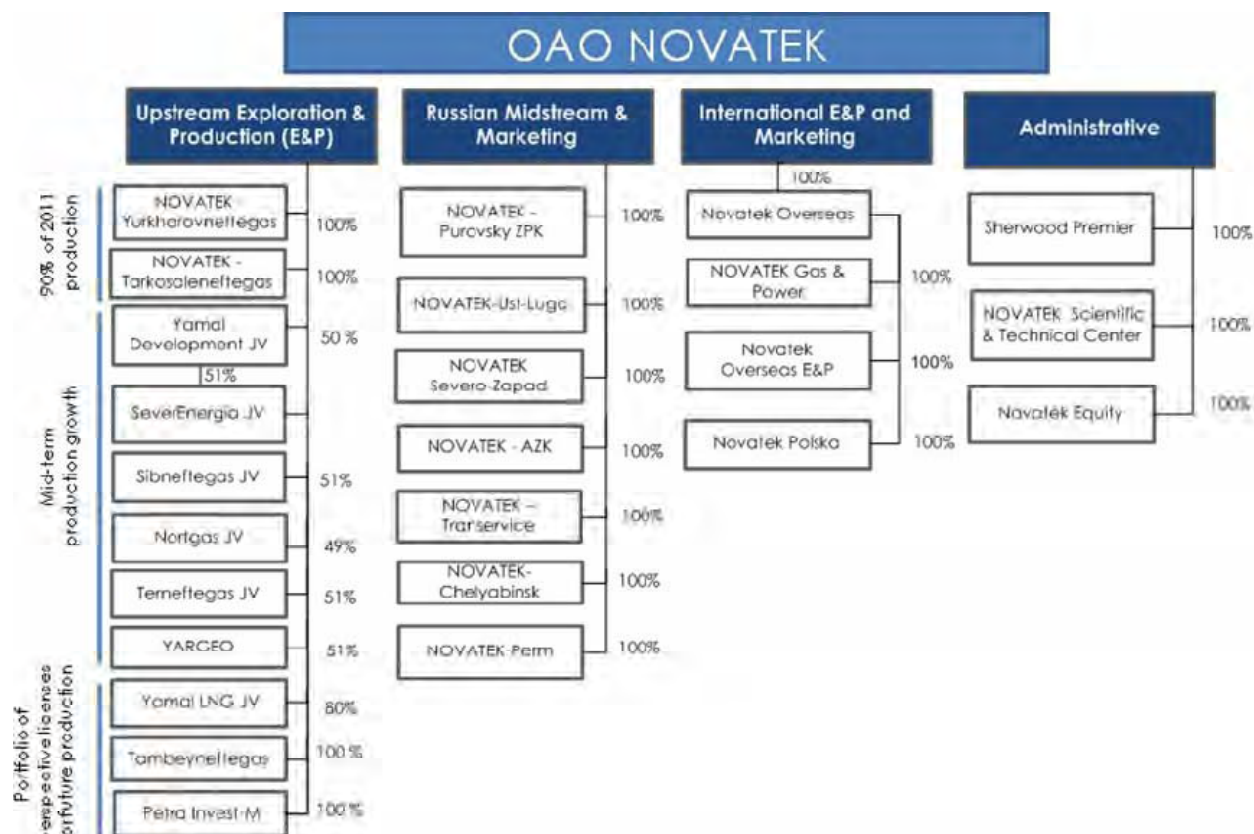
We are also working on monetizing our crude oil reserves, which has become more attractive following amendments to Russian tax legislation that provide UPT tax holidays for crude oil produced from reservoirs (such as ours) located to the north of the 65th parallel.

#### *Maximize Risk-Adjusted Margins on Sales of Natural Gas and Liquids and Expand Our Customer Base*

Our marketing and sales teams continue to optimize our sales of natural gas between end-customers and wholesale traders and our sales of liquid products between export and domestic markets in order to realize superior risk-adjusted margins. We intend to penetrate new regional markets and increase the proportion of our natural gas sales made under long-term contracts as well as maintain our leading position among independent gas producers. In addition, as we increase the production of liquid hydrocarbons, we intend to continue to geographically diversify our stable gas condensate and LPG markets and expand our customer base, while at the same time develop deeper refining capabilities. As part of this process, we are investing capital into the construction of the Ust-Luga transshipment and fractionation complex for processing of our stable gas condensate, allowing us to further enhance refining depth and capture additional margins on end products, as well as expand our marketing capabilities and product offerings. In addition, we expect our participation in the Yamal LNG project will allow us to diversify and expand our customer base across different geographical markets and benefit from relatively higher international gas prices.

## Corporate Structure

We conduct all of our operations through our subsidiaries and Joint Ventures. The diagram set forth below depicts our current corporate structure:



## Our History

We were formed in August 1994 by a group of individuals, led by Mr. Leonid V. Mikhelson, the Chairman of our Management Board and a member of our Board of Directors, as an open joint stock company, under the laws of the Russian Federation with the name AOOT FIK "Novafininvest"; in March 2003, we changed our name to OAO NOVATEK. We were initially formed to provide management services and obtain financing for construction projects in the oil and gas industry and subsequently began exploration and production activities to search for and produce hydrocarbons in Russia. We acquired our first operating business in January 1995 when we acquired a controlling interest in AOOT SNP NOVA ("NOVA"), an enterprise specializing in oil and natural gas pipeline construction.

Following our acquisition of a controlling interest in NOVA, we began to expand and diversify our operations by acquiring interests in oil and gas companies holding exploration and production licenses in YNAO. These licenses generally covered oil and gas fields in the early stages of development. The most important initial assets acquired were the equity interests in OAO Purneftegasgeologiya ("Purneftegasgeologiya"), OAO Tarkosaleneftegas ("Tarkosaleneftegas") and OAO Khancheyneftegas ("Khancheyneftegas") which were succeeded by NOVATEK-Tarkosaleneftegas, and OAO Yurkharovneftegas ("Yurkharovneftegas") which was succeeded by NOVATEK-Yurkharovneftegas, as these entities held exploration rights for oil and gas fields in what are now our core producing areas.

In 2009, we acquired a 51% stake in the Yamal LNG project, which we increased to 100% in 2011 and then decreased to 80% by way of sale to our joint venture partner, TOTAL. The Yamal LNG project is potentially one of our key long-term production drivers, which may facilitate our access to international gas markets. In 2010, we acquired a 51% stake in Sibneftegas and a 25.5% effective interest in SeverEnergiya, which has allowed us to increase our reserves base and production volumes and to raise estimated production growth rates. In 2011, we acquired several licenses for the areas located on the Yamal and Gydan peninsulas, which represent a potentially important source of production growth in the long term. In 2012, we acquired a 49% stake in Nortgas, which is expected to increase our hydrocarbon production in the short term.

A brief history of each of these acquired companies is outlined below.

## **Strategic Acquisitions**

### *Purneftegasgeologiya*

Purneftegasgeologiya was formed in April 1994 by the privatization of the state owned geological enterprise Purneftegasgeologiya, originally organized in 1965. Purneftegasgeologiya held several exploration and production licenses, including licenses for the East-Tarkosalinskoye and Khancheynskoye fields, which were granted in March 1993 and February 1994, respectively, and the Olimpiyskiy license area which was granted in April 2001. These licenses were subsequently transferred to Tarkosalenftegas and Khancheynftegas, as described below. In 1994, certain of our shareholders began to acquire shares of Purneftegasgeologiya from its shareholders and, in 2007, we increased our shareholding to 100% of the outstanding shares.

In 2008, we liquidated Purneftegasgeologiya after the Olimpiyskiy license was reissued to NOVATEK-Tarkosalenftegas and, as a result, Purneftegasgeologiya ceased to exist as a company.

### *Tarkosalenftegas*

Tarkosalenftegas was formed as an open joint stock company in March 1994 by NOVA, Purneftegasgeologiya and a subsidiary of Gazprom, OOO Surgutgazprom. Tarkosalenftegas holds an exploration and production license for the East-Tarkosalinskoye field, which license was transferred from Purneftegasgeologiya to Tarkosalenftegas in December 1995. In December 1996 NOVA sold all of its shares in Tarkosalenftegas to us, and Mr. Mikhelson became the Chairman of the board of directors of Tarkosalenftegas, a position which he held until Tarkosalenftegas was converted into a limited liability company in March 2005. In June 2005, the license for the East-Tarkosalinskoye field was reissued to Tarkosalenftegas, and in February 2007 the license was re-issued to NOVATEK-Tarkosalenftegas. We currently hold the exploration and production license for the East-Tarkosalinskoye field until 2043.

From 1997 to 2000, Tarkosalenftegas carried out several new share issuances in order to finance development work at the East-Tarkosalinskoye field. We participated in these new share issuances. In 2003, we acquired additional shares in Tarkosalenftegas and, following the acquisition of the remaining interest in Tarkosalenftegas in December 2004, we obtained a 100% ownership interest in this entity.

### *Khancheynftegas*

Khancheynftegas was formed as an open joint stock company in February 1999 by Purneftegasgeologiya, which held a 51% interest in the company, and OAO Nordpipes, which held the remaining 49% interest. An exploration and production license for the Khancheynskoye field was transferred from Purneftegasgeologiya to Khancheynftegas in November 2000. Khancheynftegas was converted into a limited liability company in June 2002. In 2002-2003, Purneftegasgeologia transferred a 43% equity interest in Khancheynftegas to NOVATEK in a series of transactions and, following the purchase of the remaining interest and the equity consolidation of this asset in December 2004, we obtained a 100% interest in Khancheynftegas.

In May 2005, we merged Khancheynftegas into Tarkosalenftegas. The license for the Khancheynskoye field was re-issued to Tarkosalenftegas in July 2005, and we currently hold the production license until 2044.

### *Yurkharovnftegas*

Yurkharovnftegas was formed as an open joint stock company in July 1998 as the result of a spin off from OAO Zapolyarneftegasgeologiya, a former state owned geological enterprise, which was privatized in April 1993. An exploration and production license for the Yurkharovskoye field was transferred from OAO Zapolyarneftegasgeologiya to Yurkharovnftegas in February 1999. Yurkharovnftegas was converted into a limited liability company in January 2002. In March 2004 we acquired 100% of Yurkharovnftegas through a series of transactions. Currently, NOVATEK-Yurkharovnftegas holds an exploration and production license for the Yurkharovskoye field until 2034.

### *Yamal LNG*

In 2009, we acquired a 51% interest in Yamal LNG. We also entered into two call option agreements pursuant to which we had the right to purchase an additional 23.9% and 25.1% interest, respectively, in Yamal LNG. In September 2011, we exercised the options and increased our share in Yamal LNG to 100%. In October 2011, we sold a 20% stake in Yamal LNG to TOTAL, our strategic partner. Currently, we own an 80% equity stake in the joint venture.

Yamal LNG holds the license for exploration and production at the South-Tambeyskoye field located on the Yamal peninsula. Yamal LNG is currently engaged in the design and construction work of an onshore integrated LNG facility at the license area, and once completed, will be the operator of the facility. The feedstock for the LNG facility is based on the resources of the South-Tambeyskoye field. The final investment decision on the Yamal LNG project is expected to be made in the near future. See “*Business—Exploration and Production—Prospective fields—South-Tambeyskoye field and the Yamal LNG project*”.

### *Sibneftegas*

OAo Sibneftegas was formed in 1994 as an oil and gas company for exploration and production operations in YNAO. In 2006, Gazprombank, through its subsidiary, OOO Status (“**Status**”), indirectly acquired a 51% interest in Sibneftegas. In December 2010, our wholly-owned subsidiary NOVATEK Severo-Zapad acquired this stake from Gazprombank. The remaining stake in Sibneftegas is directly and through a 100% subsidiary owned by Itera (48.9%) and Gasenergofinance (0.06%). The 48.9% equity stake of Itera is subject to a joint venture arrangement between Rosneft (51%) and Itera Group (49%). See “*Risk Factors—Risks Relating to Our Business and Industry—Global and domestic shifts in the pricing of natural gas could increase competition on the domestic market*”. Sibneftegas holds subsoil exploration and production licenses for the Beregovoy, Pyreinyi and Khadyryakhinskiy license areas, and it is currently engaged in commercial production at the Beregovoye and Pyreinoeye fields, while the Khadyryakhinskiy license area is in the exploration stage. The fields and license areas are located in close proximity to our core assets and infrastructure.

### *SeverEnergiya*

In 2007, Italian companies Eni and Enel established OOO Enineftegas (which was later renamed OOO SeverEnergiya), which acquired at auction 100% of OAo Arcticgas, 100% of ZAO Urengoil and 100% of OAo Neftegaztehnologiya, then the holders of licenses for the Samburgskiy, Yaro-Yakhinskiy and North-Chaselskiy license areas and the Yevo-Yakhinskoye field in YNAO. In 2009, Gazprom acquired a 51% stake in SeverEnergiya.

In July 2010, we entered into a 50/50 joint venture, Yamal Development, with Gazprom neft, to jointly develop potential hydrocarbon assets in YNAO. In November 2010, Gazprom sold its 51% share in SeverEnergiya to Yamal Development. SeverEnergiya’s fields and license areas are in close proximity to our Core Fields and our transportation and processing infrastructure. In 2012, the licenses to the Yaro-Yakhinskiy and North-Chaselskiy license areas previously held by Urengoil and Neftegaztehnologiya were reissued to Arcticgas following the merger of Urengoil and Neftegaztehnologiya into Arcticgas.

### *Licenses in the Gydan Peninsula and the Gulf of Ob*

In 2011, our wholly-owned subsidiary, NOVATEK-Yurkharovneftegas, acquired four licenses through a tender organized by the Government for the Salmanovskoye (Utrenneye) and Geofizicheskoye fields on the Gydan Peninsula and the North-Obskiy and East-Tambeyskiy license areas located offshore in the Gulf of Ob. These license areas are anticipated to serve as a future platform for natural gas and gas condensate production in this hydrocarbon-rich zone.

### *Nortgas*

See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Nortgas*”.

### **Milestones in Our History Include the Following:**

#### **1994**

- Establishment of Novafininvest as an open joint stock company.

#### **1995**

- Acquisition of NOVA, our first operating business.
- Expansion into the oil and gas industry through the acquisition of companies holding exploration and production licenses in YNAO.

#### **1998**

- Commencement of natural gas production at the East-Tarkosalinskoye field.

#### **2002**

- Commencement of natural gas sales to end-customers.
- Commissioning of the gas-condensate production facilities at the East-Tarkosalinskoye and Khancheyevskoye fields.

#### **2003**

- Launch of production at the Yurkharovskoye field.



## 2004

- Completion of the full consolidation of Tarkosalenftegas and Khancheyneftegas and disposal of our interests in non-core business activities involved in oil and gas construction services, including NOVA, and telecommunications.
- Completion of the first phase of development at the Yurkharovskoye field with production capacity of 9 bcm of natural gas per annum.
- Placement of two tranches of credit linked notes for a total amount of U.S.\$300 million.
- Placement of a debut one billion Rouble bond with a two-year maturity.

## 2005

- Commissioning of the Purovsky Plant.
- Initial placement of 19% of our shares in the form of GDRs on the London Stock Exchange in an initial public offering and a subsequent increase of the permitted headroom of our GDR program to 29.99% of our shares.
- Launch of new storage and loading facilities at the Port of Vitino specially designed to handle stable gas condensate delivered from our Purovsky Plant.

## 2007

- Corporate rating upgraded to investment grade Baa3 (stable outlook) by Moody's.
- Discovery of the Severo-Khancheiskoye gas condensate field.

## 2008

- Entered into a U.S.\$800 million syndicated term loan facility with a three year tenor.
- Launch of the first stage of the second phase of development at our Yurkharovskoye field, increasing our total natural gas production capacity to 37 bcm per annum.
- Launch of the second phase expansion at our Purovsky Plant, increasing processing capacity from 2 mmt per annum to 5 mmt per annum, enabling us to produce approximately 3.7 mmt of stable gas condensate and 1.3 mmt of LGP per annum.
- Discovery of four new fields – Yarudeyskoye, West-Yurkharovskoe, Raduzhnoye and Zapadno-Chaselskoye.

## 2009

- Acquisition of a 51% interest in Yamal LNG, which holds the license for geological study and production at the South-Tambeyskoye field.
- Signing of a sale and purchase and shareholders agreement with TOTAL, a major French oil and gas company, establishing the framework for joint cooperation in exploring and developing the Termokarstovoye gas condensate field owned by Terneftegas.
- Launch of the second stage of the second phase of development at the Yurkharovskoye field, with the potential to increase annual productive capacity at the field by 7 bcm of natural gas and approximately 600 mt of unstable gas condensate.
- Establishment of a wholly-owned subsidiary in Poland, NOVATEK Polska, thus expanding our LPG trading activities in Poland.
- Obtained an investment grade BBB- corporate credit rating (stable outlook) from Fitch.

## 2010

- Signing of a cooperation agreement with Gazprom for LNG production in the Yamal peninsula as well as a long-term agency agreement between OOO Gazprom Export ("**Gazprom Export**") and Yamal LNG, providing for the export of LNG produced at the South-Tambeyskoye field.
- Placement of RUB10 billion of domestic bonds with a three-year maturity.
- Corporate rating upgraded to BBB- (stable outlook) by S&P, thus securing our third investment grade corporate rating (along with Moody's and Fitch).

- Establishment of a 50/50 joint venture, Yamal Development, with Gazprom neft to jointly develop potential hydrocarbon assets in YNAO.
- Launched the unstable gas condensate de-ethanization facility at our Yurkharovskoye field and the unstable gas condensate pipeline from the Yurkharovskoye field to the Purovsky Plant.
- Launched the third stage of the Yurkharovskoye field's second phase development, increasing the field's production capacity to 33 bcm per annum and our total production capacity to 52 bcm per annum.
- Disposal of our 100% interest in NOVATEK-Polymer to SIBUR.
- First successful delivery of stable gas condensate to China via the Arctic Ocean's Northern sea route.
- Acquisition of a 51% interest in SeverEnergiya by Yamal Development, our 50/50 joint venture with Gazprom neft.
- Closing of the acquisition of a 51% interest in Sibneftegas developing oil and gas condensate fields within YNAO.
- Discovery of two new fields, North-Russkoye and Ukrainsko-Yubileinoe.

## 2011

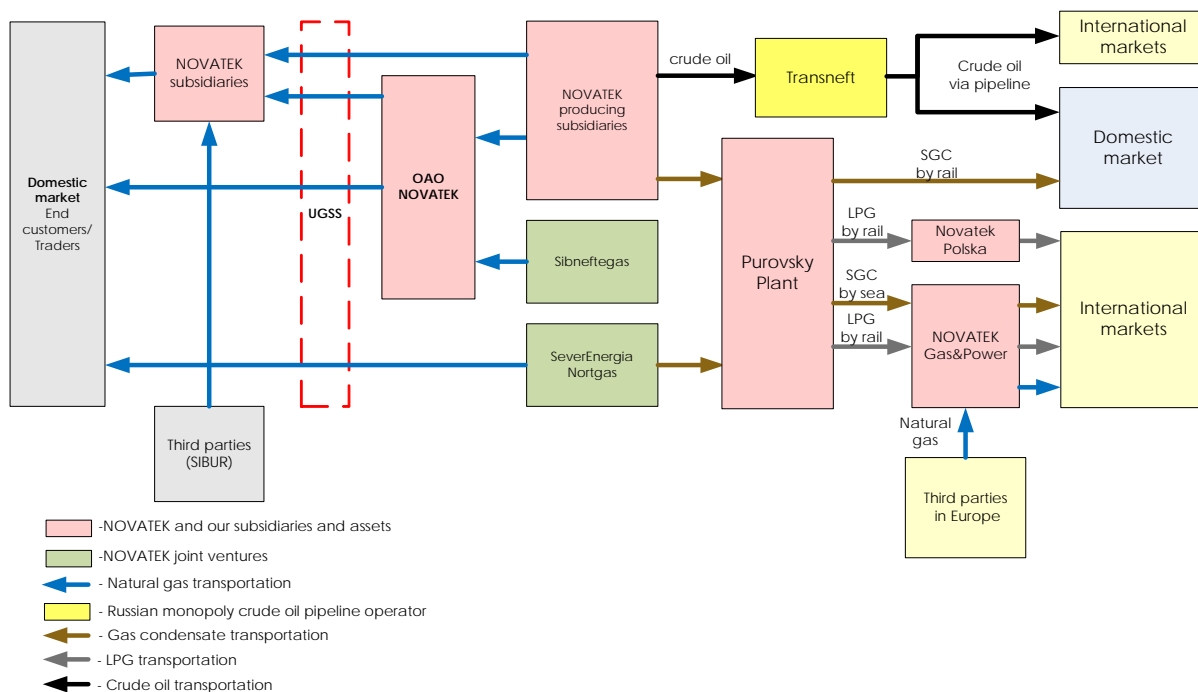
- Acquisition of four new license areas (two on the Gydan peninsula and two offshore in the Gulf of Ob) for exploration and production, significantly increasing our resource base.
- Establishing a new record for the longest use of the Arctic Ocean's Northern sea route – from June till November.
- Acquired a 100% stake in the regional gas distributor Gazprom mezhregiongas Chelyabinsk, thereby allowing us to supply 100% of the Chelyabinsk region's demand for gas.
- Increased our equity interest in Yamal LNG from 51% to 100% and subsequently disposed of a 20% stake in the company to TOTAL, our strategic partner.
- Closed our debut 5 and 10-year maturity Eurobond issuances in the aggregate amount of U.S.\$1.25 billion.
- Delivered our Corporate Strategy Day Presentation in London, with the senior management providing operational guidance through 2020.

## 2012

- Commercial production started at the Samburgskoye field, part of SeverEnergiya.
- Officially started the construction at the Port of Sabetta, which is the key element in the transport infrastructure of the Yamal LNG project.
- Completed the construction of the fourth and last stage of the Yurkharovskoye field's second phase development, which is expected to allow us to reach peak production at the field of 36.5 bcm per annum.
- Completed the construction of the first stage of a compressor booster station with a capacity of 75 MW at the Yurkharovskoye field, allowing us to maintain peak production at the field.
- Commissioned a central oil gathering facility at the East-Tarkosalinskoye field.
- Concluded a set of long-term contracts for gas sales with end-customers, including 15-year contracts with the Russian subsidiaries of Fortum and E.ON, a 10.5-year contract with Magnitogorsk Iron and Steel Works and a five-year contract with Severstal.
- Commenced gas supplies to German company EnBW under a gas sales contract for the supply of 2 bcm of gas per annum.
- Placed RUB20 billion of domestic bonds with a three-year maturity.
- Entered into an Agreement on Strategic Cooperation with RZD, providing for the rail transportation of our production from the Purovsky Plant until 2020.
- Acquired a 49% stake in Nortgas. See *“Overview” and “Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Nortgas”*.

## Our Operations

The following diagram illustrates our operations, including our core producing fields, our Purovsky Plant, the various methods of transportation of our gas, gas condensate and other liquid hydrocarbon products, including pipeline, rail and sea transportation, and our domestic and international customer markets as of the date of this Prospectus:



## Exploration and Production

### Overview

We are Russia's largest independent natural gas producer and the second largest producer of natural gas in Russia after Gazprom in the nine months ended 30 September 2012, as reported by CDU-TEK. Our fields and license areas are located in YNAO in Western Siberia. In 2011, YNAO accounted for approximately 17% of the global natural gas production based on the data from the YNAO Administration and the BP Statistical Review of World Energy (June 2012). According to CDU-TEK, in 2011 and the nine months ended 30 September 2012, we accounted for 8.0% and 8.8%, respectively, of total natural gas produced in Russia, while our supplies accounted for approximately 15% and 17%, respectively, of natural gas deliveries through the UGSS to the domestic market.

As of 31 December 2011, we had 9,393 mm boe of proved reserves, of which approximately 92% were natural gas reserves, as appraised under SEC reserves methodology. The reserve life of our proved reserves, under SEC reserves methodology, was 25 years based on our annual production in 2011.

Since 2007, we have consistently increased our production of hydrocarbons. Our natural gas/liquid hydrocarbons production totaled 28.3 bcm/2.4 mmt in 2007, 30.4 bcm/2.6 mmt in 2008, 32.4 bcm/3.0 mmt in 2009, 37.3 bcm/3.6 mmt in 2010 and 52.9 bcm/4.1 mmt in 2011. In the nine months ended 30 September 2012, we produced 41.4 bcm of natural gas and 3.1 mmt of liquids, an increase of 7.3% and 2.0%, respectively, compared to the nine months ended 30 September 2011.

Our Core Fields accounted for approximately 90% of our natural gas and liquid hydrocarbons production in 2011 as well as in the nine months ended 30 September 2012, comprising 52.5% of our total proved reserves under SEC reserves methodology as of 31 December 2011. Each of these important fields is located in close proximity to the UGSS and production and processing infrastructure.

We also hold a 25.5% effective interest in SeverEnergia, one of our Joint Ventures, and a 51% stake in Sibneftegas, another Joint Venture, which, in total, accounted for 14.1% of our proved reserves under SEC reserves methodology as of 31 December 2011. Sibneftegas accounted for 10% of our gas production volumes in 2011; production at SeverEnergia commenced in April 2012. We hold an 80% stake in Yamal LNG, which accounted for 27.7% of our proved reserves under SEC reserves methodology as of 31 December 2011. Our Utrenneye and Geofizicheskoye fields located on the Gydan peninsula hold 979 bcm of C1 + C2 reserves of natural gas, under the

Russian reserves system as of 1 January 2012. These reserves were not included in our 2011 Reserves Reports under SEC or PRMS reserves methodologies and thus represent an expected material upside for our reserves base.

We remain focused on expanding our reserves base through exploration activities at our license areas and fields in YNAO, as well as through acquisitions. Over 2009 – 2011, our three-year average reserves replacement ratio was 597%, on a boe basis, based on proved reserves under SEC reserves methodology. In terms of expanding and/or replacing our reserves base, our reserves replacement cost was \$1.22 per boe in 2011.

In our assessment based on data regarding our domestic and international peers' performance from IHS Herold for 2005-2011, we are one of the lowest cost producers of hydrocarbons in the global oil and gas industry. In 2011, our total production cost was U.S.\$7.65 per boe, of which U.S.\$4.55 per boe was transportation cost, U.S.\$1.71 per boe was taxes other than income, U.S.\$0.88 per boe was depreciation, depletion and amortization and U.S.\$0.51 per boe was lifting costs.

#### *Licenses*

A license from state authorities is required to explore for and produce natural gas, gas condensate and oil from our fields. As of 30 September 2012, we and our Joint Ventures held 35 licenses, of which 29 licenses provide a right for subsoil production (in certain cases, combined with a right for geological study and exploration) and six licenses provide a right for geological study. None of the existing production or combined geological study, exploration and production licenses will, under their existing terms, expire before early 2018. Our production licenses grant us the exclusive right to explore and extract the hydrocarbons from fields in a defined area during the term set in the license. For more information on the Russian regulatory regime governing the use and operation of subsoil licenses, see *“State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK”*.

We actively monitor the terms of each of our licenses to ensure full compliance with our obligations under each of these licenses, thereby minimizing the risk that our licenses may expire or be prematurely revoked. Our production licenses may be extended, generally, for the economic life of the field, provided that we comply with certain license terms. These license terms typically include production volume requirements and commitments to make timely payments of levies and taxes. In addition, we believe that each of our geological study licenses may be extended or converted into, respectively, exploration and production or production licenses (assuming commercial quantities of hydrocarbons are discovered in relation to such license), as long as we meet certain conditions, including compliance with the license terms. For more information on the risks relating to our licenses, see *“Risk Factors—Risks Relating to Our Business and Industry—We encounter intense competition from other gas and oil companies in all areas of our operations”* and *“Risk Factors—Risks Relating to Our Business and Industry--Our licenses may be suspended, amended or terminated prior to their expiration, and we may be unable to obtain or maintain various other permits or authorizations”*.

We monitor upcoming auctions for new licenses and aim to tender for licenses we believe may add value to our resource base and which are consistent with our strategy and business focus. With respect to our existing portfolio of licenses, we monitor our compliance with the key delivery targets provided for in each license and seek to obtain any necessary amendments or renewals of the license's terms, including design documentation and mineral extraction permissions. We also focus our efforts on the licenses we deem most profitable and productive, while identifying and then divesting those licenses we deem unproductive. As at the date of this Prospectus, we have been able to successfully extend the terms of all our main production licenses.

The table below sets forth certain information relating to each of our existing licenses:

No	License	License Holder	License Type <sup>(1)</sup>	Date of expiration	Stage of works
1.	Yurkharovskoye field	NOVATEK-Yurkharovneftegas	Geological study and production	24.11.2034	Exploration and production
2.	East-Tarkosalinskoye field	NOVATEK-Tarkosaleneftegas	Geological study and development (production)	31.12.2043	Exploration and production
3.	Khancheyevskoye field	NOVATEK-Tarkosaleneftegas	Geological study and development (production)	09.02.2044	Exploration and production
4.	Olimpiyskiy subsoil area	NOVATEK-Tarkosaleneftegas	Geological study and production	01.04.2026	Exploration and production
5.	South-Tambeyskoye field	Yamal LNG	Geological study and production	31.12.2045	Exploration

6.	Termokarstovoye field	Terneftegas	Geological study and production	15.04.2021	Exploration
7.	West-Yurkharovskoye field	NOVATEK-Yurkharovneftegas	Exploration and production	01.07.2029	Exploration
8.	North-Khancheyeskoye field	NOVATEK-Tarkosaleneftegas	Exploration and production	01.07.2029	Exploration
9.	Yarudeyskoye field	Yargeo	Exploration and production	01.07.2029	Exploration
10.	Raduzhnoye field	NOVATEK-Yurkharovneftegas	Exploration and production	01.07.2029	Exploration
11.	New-Yurkharovskiy area	NOVATEK-Yurkharovneftegas	Geological study	29.03.2014	Geological study
12.	Yumantilskiy area	NOVATEK-Tarkosaleneftegas	Geological study, search and production	21.02.2024	Exploration; non-producing due to maintenance works
13.	West-Urengoyevskiy area	NOVATEK-Yurkharovneftegas	Geological study, exploration and production	31.12.2031	Exploration
14.	Severo-Yubileynoye field	OOO NOVATEK-Yurkharovneftegas	Exploration and production	01.06.2030	Exploration
15.	Severo-Termokarstoviy area	Terneftegas	Geological study	01.09.2014	Geological study
16.	North-Russkiy subsoil area	NOVATEK-Tarkosaleneftegas	Geological study	31.12.2014	Geological study
17.	North-Russkoye field	NOVATEK-Tarkosaleneftegas	Exploration and production	01.06.2031	Exploration
18.	Zapadno-Tazovskiy subsoil area	Petra Invest-M	Geological study	31.12.2014	Geological study
19.	Severo-Yamsoveyskiy subsoil area	NOVATEK-Yurkharovneftegas	Geological study	31.12.2014	Geological study
20.	Pilyalkinskiy area	OOO NOVATEK-Tarkosaleneftegas	Geological study, exploration and production	31.12.2034	Exploration
21.	Malo-Yamalskoye field	Tambeyneftegas	Geological study and development (production)	31.12.2019	Exploration
22.	Zapadno-Chaselskoye field	NOVATEK-Tarkosaleneftegas	Exploration and production	01.02.2030	Exploration
23.	Beregovoy area	Sibneftegas	Geological study, search and production	31.12.2023	Exploration and production
24.	Pyreinoye field	Sibneftegas	Geological study and production	28.02.2021	Exploration and production
25.	Khadyryakhinskiy area	Sibneftegas	Geological study, exploration and production	25.09.2031	Exploration

26.	Samburgskiy license area	Arcticgas	Exploration and production	27.06.2018	Exploration and production
27.	Yevo-Yakhinskoye field	Arcticgas	Geological study and production	27.06.2018	Exploration
28.	Yaro-Yakhinskiy area	Arcticgas	Geological study and production	31.12.2018	Exploration
29.	North-Chaselskiy subsoil area	Arcticgas	Geological study and production	Economic life of the field	Exploration
30.	Salmanovskoye (Utrenneye) field	NOVATEK-Yurkharovneftegas	Exploration and production	31.08.2031	Exploration
31.	Geofizicheskoye field	NOVATEK-Yurkharovneftegas	Exploration and production	31.08.2031	Exploration
32.	North-Obskiy subsoil area	NOVATEK-Yurkharovneftegas	Exploration and Production	31.08.2041	Exploration
33.	East-Tambeyskiy subsoil area	NOVATEK-Yurkharovneftegas	Geological study, exploration and production	31.08.2041	Exploration
34.	Severo-Tasiyskiy area	NOVATEK-Yurkharovneftegas	Geological study	01.09.2016	Geological study
35.	Ukrainsko-Yubileynoye field	NOVATEK-Yurkharovneftegas	Exploration and production	20.07.2031	Exploration
36.	North-Urengoyeskoye field	Nortgas	Production	31.12.2018	Exploration and production

<sup>(1)</sup> A production license entitles its holder for exploration and production at the respective subsoil area, unless otherwise stated in the license.

### *Our Fields and License Areas*

The map below indicates the location of each of our producing fields and license areas as well as our pipeline infrastructure and our Purovsky Plant as at the date of this Prospectus:



1. Yurkharovskoye field	13. West-Urengoyskiy area	25. Pyreinoye field
2. East-Tarkosalinskoye field	14. Severo-Yubileynoye field	26. Khadyryakhinskiy area
3. Khancheyskoye field	15. Severo-Termokarstoviy area	27. Samburgskiy license area
4. Olimpiyskiy subsoil area	16. North-Russkiy subsoil area	28. Yevo-Yakhinskoye field
5. South-Tambeyskoye field	17. North-Russkoye field	29. Yaro-Yakhinskiy area
6. Termokarstovoye field	18. Zapadno-Tazovskiy subsoil area	30. North-Chaselskiy subsoil area
7. West-Yurkharovskoye field	19. Severo-Yamsoveyskiy subsoil area	31. Salmanovskoye (Utrenneye) field
8. North-Khancheyskoye field	20. Ukrainsko-Yubileynoye field	32. Geofizicheskoye field
9. Yarudeyskoye field	21. Pilyalkinskiy area	33. North-Obskiy subsoil area
10. Raduzhnoye field	22. Malo-Yamalskoye field	34. East-Tambeyskiy subsoil area
11. New-Yurkharovskiy area	23. Zapadno-Chaselskoye field	35. Severo-Tasiyskiy area
12. Yumantilskiy area	24. Beregovoy area	36. North-Urengoyskoye field

## Reserves and Resources

We use two generally accepted global reserves classification methodologies for external reserves reporting and internal reserves management:

- SEC reserves methodology, and
- PRMS reserves methodology.

Our natural gas and liquids reserves are independently appraised on an annual basis by D&M, our independent reserves engineer, in accordance with SEC and PRMS reserves methodologies. See “*Classification of Reserves*”. Unless otherwise specified, any information contained in this Prospectus about our appraised natural gas and liquids reserves has been derived or extracted from the 2009, 2010 and 2011 Reserves Reports. See “*Appendix A—Summary Reserves Reports*” for the Summary Reserves Reports. The reserves estimates are based upon existing economic and operating conditions using costs (as defined by the reserves methodologies) as at the date the appraisals were made, as well as various assumptions as to capital expenditures and availability of funds. Estimated natural gas reserves are presented in terms of sales gas, which is the deliverable quantity of gas available for sale after deducting various losses and fuel usage. In addition, sales gas volumes include ethane that is separated from the field condensate stream during processing and reintroduced into the gas stream for processing and sales. The process of estimating hydrocarbon reserves is complex and inherently uncertain. We must project production rates and timing of development and analyze geological, geophysical, production, engineering and economic data for each reservoir and field. The extent, quality and reliability of this data may vary, and the accuracy of reserves data is also a function of the quality and quantity of other available data, engineering and geological interpretation and judgment. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Estimates and Judgments—Estimation of gas and liquids reserves*” and “*Classification of Reserves*”. See also “*Risk Factors—Risks Relating to Our Business and Industry—The natural gas and liquids reserves data in this Prospectus are only estimates, and our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates*”.

In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034. The other two Core Fields—East-Tarkosalinskoye and Khancheyskoye—have exploration and production licenses until 2043 and 2044, respectively. The South-Tambeyskoye geological study and production license is valid until 2045, while exploration and production licenses for two other major subsoil fields, Utrenneye and Geofizicheskoye, are valid through 2031. If needed, we plan to file applications to extend our licenses for each of the North-Russkiy, Zapadno-Tazovskiy, Severo-Yamsoveyskiy and New-Yurkharovskiy areas to complete our geological study, and, if hydrocarbons are found, apply for combined exploration and production licenses valid for the life of the respective field or subsoil area. While there is no absolute legal right to extend our licenses, we believe that we have the ability to extend them, which is supported by a significant demonstrated history of extension and by specific terms in the legislation. Our arguments are accepted by D&M (although not confirmed by SEC ruling), and this allows us to use

the SEC-LOF basis in the estimation of our proved reserves. See “*Classification of Reserves—SEC Standards*”. All reserves disclosed herein under SEC reserves methodology are calculated pursuant to the SEC-LOF system.

The following tables set forth estimates of our proved reserves, including proved developed and proved undeveloped reserves under SEC reserves methodology and proved and probable reserves under PRMS reserves methodology as of 31 December 2011, 2010 and 2009 based on our equity ownership in the respective fields:

### 2011

		SEC			PRMS		
		Proved Developed	Proved Undeveloped	Total Proved	Total Proved	Total Probable	Proved and Probable
Natural gas .....	bcm	654	667	1,321	1,585	523	2,108
	tcf	23	24	47	56	18	74
Liquids .....	mmt	34	57	91	118	81	199
	mmbbls	281	469	752	970	652	1,622
<b>Total .....</b>	<b>mmbobe<sup>(1)</sup></b>	<b>4,561</b>	<b>4,832</b>	<b>9,393</b>	<b>11,337</b>	<b>4,072</b>	<b>15,409</b>

<sup>(1)</sup> Mmboe calculated in accordance with the conversion measures enumerated in “*Presentation of Financial and Other Information—Conversion Measures*”.

### 2010

		SEC			PRMS		
		Proved Developed	Proved Undeveloped	Total Proved	Total Proved	Total Probable	Proved and Probable
Natural gas .....	bcm	709	435	1,144	1,310	531	1,840
	tcf	25	15	40	49	18	67
Liquids .....	mmt	36	37	73	93	73	166
	mmbbls	304	300	604	761	587	1,348
<b>Total .....</b>	<b>mmbobe<sup>(1)</sup></b>	<b>4,943</b>	<b>3,145</b>	<b>8,088</b>	<b>9,325</b>	<b>4,061</b>	<b>13,386</b>

<sup>(1)</sup> Mmboe calculated in accordance with the conversion measures enumerated in “*Presentation of Financial and Other Information—Conversion Measures*”.

### 2009

		SEC			PRMS		
		Proved Developed	Proved Undeveloped	Total Proved	Total Proved	Total Probable	Proved and Probable
Natural gas .....	bcm	584	383	967	1,080	383	1,462
	tcf	21	14	34	38	14	52
Liquids .....	mmt	33	31	63	79	46	124
	mmbbls	272	257	529	650	375	1,025
<b>Total .....</b>	<b>mmbobe<sup>(1)</sup></b>	<b>4,089</b>	<b>2,764</b>	<b>6,853</b>	<b>7,711</b>	<b>2,878</b>	<b>10,589</b>

<sup>(1)</sup> Mmboe calculated in accordance with the conversion measures enumerated in “*Presentation of Financial and Other Information—Conversion Measures*”.

In 2011, we achieved significant growth in our proved gas and gas condensate reserves due to ongoing production drilling at the Yurkharovskoye field, exploration work at the South-Tambeyskoye, North-Russkiy, Samburgskiy and Yaro-Yakhinskiy fields and license areas, as well as an increase in NOVATEK’s equity interest in Yamal LNG. The increase in our crude oil reserves was due to positive exploration results at the Yarudeyskoye field and ongoing production drilling at the East-Tarkosalinskoye field.

## Geology

Our Core Fields, together with a majority of our other fields, are located in the north-eastern part of the West Siberian basin in an area known as the Nadym-Pur-Taz region of YNAO. We also hold licenses (through our subsidiaries and Joint Ventures) for areas and fields located onshore on the Yamal and Gydan peninsulas and offshore in the Gulf of Ob. This region is located north of our core assets, but is also part of the West Siberian oil and gas basin.

The West Siberian oil and gas basin extends from the Kara Sea in the north to the Kazakhstan highlands in the south, and from the Urals Mountains in the west to the Siberian plateau in the east, and covers roughly four million square kilometers.

The Nadym-Pur-Taz region covers an area of approximately 340,000 square kilometers and is home to several giant gas fields, the largest of which in terms of currently estimated volumes of reserves is the Urengoykoye field, principally owned and operated by Gazprom (with certain portions of the field extending over



the license areas of SeverEnergiya and ourselves). Major gas accumulations in the Nadym-Pur-Taz region are in the Aptian Cenomanian Pokur Formation, which is estimated to contain approximately 90% of the gas reserves in the region.

The Yamal peninsula covers an area of approximately 122,000 square kilometers and is an important new gas production region for Russia. Several large fields are located in this region, with the Bovanenkovskoye field owned and operated by Gazprom being the largest one. The Yamal LNG joint venture owns a license for the South-Tambeyskoye field, located on the Yamal peninsula and partially offshore in the Gulf of Ob.

The Gydan peninsula, which runs approximately 400 km in length, is one of the less explored regions of Russia. Geologically, the region is part of the West Siberian oil and gas basin, and we consider it to be promising in terms of hydrocarbon resources. We hold licenses for the Utrenneye field, the largest of the fields discovered in the region to date (in terms of reserves), and the Geofizicheskoye field.

Natural gas, gas condensate and crude oil deposits are found in geological horizons located at varying depths. These horizons are generally classified according to depth and referred to as the Cenomanian horizon (up to 1,500 meters), the Valanginian horizon (1,500 to 3,000 meters), the Achimov horizon (3,000 to 4,000 meters) and the Jurassic horizon (4,000 to 4,500 meters). The horizons names refer to the geological period during which they were initially formed. In general, the Cenomanian horizons yield mostly dry gas, primarily methane, and Valanginian horizons yield mostly wet gas, a mixture of natural gas and unstable gas condensate. Wet gas must be separated into dry gas and unstable gas condensate in a low temperature separation unit, usually located at the field. Unstable gas condensate must, in turn, be de-ethanized and further stabilized prior to being used commercially, which steps can occur at the field or in another location connected by pipeline. The Achimov and Jurassic horizons contain mostly natural gas and unstable gas condensate, with a higher content of gas condensate compared to Valanginian.

Our D&M appraised reserves at our Core Fields are mainly found in the Cenomanian and Valanginian horizons. The table below sets forth a breakdown of these reserves by horizon as of 31 December 2011.

<b>Reserves by Horizon</b>	<b>SEC Proved</b>	<b>PRMS Proved</b>	<b>PRMS Proved-plus- Probable</b>
Cenomanian .....	28.8%	24.8%	20.2%
Valanginian.....	66.7%	70.7%	74.2%
Achimov and Jurassic.....	4.5%	4.5%	5.6%
<b>Total</b> .....	<b>100%</b>	<b>100%</b>	<b>100%</b>

## **Description of Our Fields**

### **Producing fields**

#### ***Yurkharovskoye Field***

The Yurkharovskoye field is a natural gas, gas condensate and crude oil field and is our largest production asset. In 2011, the field accounted for approximately 34% of our SEC proved natural gas reserves and over 60% of our natural gas production according to our operating data. The development of this field is expected to be one of the main drivers for our production growth in 2013.

#### ***General Description of Property***

The Yurkharovskoye field, discovered in 1970, is located within the Arctic Circle, in the southeastern part of the Tazov peninsula in the Nadym-Pur-Taz region. The field is approximately 200 square kilometers in area and lies 50 kilometers east of Gazprom's Yamburgskoye field and approximately 300 kilometers north of the city of Noviy Urengoi. The western part of the field lies on the Tazov peninsula, while the central and eastern parts of the field are situated offshore in the Tazov Bay where water depths average four meters. The offshore part of the field is being developed from onshore locations using wells with long horizontal parts.

The field has one dry gas layer, 22 gas condensate layers and three gas condensate-crude oil layers. The hydrocarbon depth ranges from approximately 1,000 to 2,950 meters, with the Valanginian horizon, characterized by permeable sandstone, our principal area of focus. The producing layers are located over a small geographical area, which we believe enhances the efficiency of reserves development and exploitation in terms of both capital expenditures and operating costs.

## Reserves

The following table sets forth reserves information for the Yurkharovskoye field as of 31 December 2011.

Reserves	SEC			PRMS		
	Proved Developed	Proved Undeveloped	Total Proved	Proved	Probable	Proved and Probable
Natural gas..... bcm	366	80	446	446	182	628
Liquids ..... mmt	20	4	24	24	11	35
<b>Total .....</b> m mboe	<b>2,566</b>	<b>556</b>	<b>3,122</b>	<b>3,123</b>	<b>1,285</b>	<b>4,408</b>

## Well Information

The following table sets forth the number of natural gas and gas condensate wells at the Yurkharovskoye field as at 30 September 2012.

Production wells	Total
Gas wells.....	5
Gas condensate wells .....	64

## History

Production drilling at the field commenced in May 2002, and commercial production of natural gas and gas condensate began in January 2003. Other key milestones in the field's development include:

- December 2002: Completion of our natural gas pipeline and gas condensate pipeline connecting the field to the UGSS and Gazprom's gas condensate pipeline network.
- January 2003: Commissioning of a 5.4 bcm per annum gas treatment facility. The facility is capable of treating Cenomanian and Valanginian gases by low temperature separation.
- May 2004: Commissioning of a 3.6 bcm per annum gas treatment facility, bringing the total gas treatment capacity to 9 bcm per annum. We also completed the construction of a 16 kilometer spur gas pipeline connecting our existing pipeline to an additional point on the UGSS.
- September 2007: Launched a 12.5 mt per annum pilot methanol production plant.
- September 2008: Completion of the first stage of the second phase of the Yurkharovskoye field infrastructure development with total productive capacity of 7 bcm of natural gas and 600 mt of unstable gas condensate per annum. The first stage included the commissioning of 10 new horizontal wells at the field and the construction of two processing units, a natural gas separation plant and a condensate preparation unit, each with an initial capacity of 20 mmcm per day.
- October 2009: Completion of the second stage of the second phase of development at the Yurkharovskoye field, which further increased production capacities and facilities for natural gas and unstable gas condensate production with nine new horizontal wells.
- 2009: Modernized the gas condensate de-ethanization unit at the Yurkharovskoye field, which was part of the first phase of the field's development, increasing unstable gas condensate production capacity by approximately 5 mt per annum.
- April 2010: Launched a 40 mt per annum methanol plant located on the territory of the Yurkharovskoye field, thus eliminating the need to transport methanol to the field and decreasing our operating costs and potential environmental risks related to its transportation. We used the experience gained from the launch in September 2007 of the 12.5 mt per annum pilot methanol production plant to improve the design of our new plant. Our new plant uses higher quality anti-corrosive steel as well as a more efficient gas compressor unit.
- August 2010: Launched our unstable gas condensate de-ethanization unit at the field and a 326 kilometer unstable gas condensate pipeline connecting the field with our Purovsky Plant, both of which have capacities of 3 mmt per annum. We believe the construction and commissioning of these new facilities have enabled us to improve the quality of our gas condensate and reduce third-party expenses.
- October 2010: Completion of the third stage of the second phase of development at the field, increasing its total production capacity per annum to 33 bcm of natural gas and approximately 3 mmt of unstable gas condensate per year.
- October 2012: First well drilled as part of the realization of the pilot oil rims development project.

- November 2012: Completed the construction of the fourth and last stage of the second phase of development at the field, which we expect to allow us to reach the field's peak production of 36.5 bcm of natural gas per year.
- November 2012: Completed the construction of the first stage of a compressor booster station with capacity of 75 MW.

We have optimized the field's development by drilling larger diameter wells with longer horizontal runs and by utilizing multilateral wells, which decreased the number of wells required to exploit the field. This development program reduced overall costs and minimized potential environmental risks. The new wells usually have a diameter of up to 245 mm, horizontal runs of more than 1,000 meters and initial production flows of up to 4.5 mmcm per day. In October 2012, we completed the drilling of another horizontal well at the field with a borehole measuring 6,820 meters in length and 1,250 meters at its horizontal part.

#### *Infrastructure and Transportation*

The field is connected to the UGSS and the Purovsky Plant via our own pipeline infrastructure, capable of transporting all of our production from the field. We arrange for further transportation of gas to wholesale purchasers through transportation contracts with Gazprom as operator of the UGSS. The unstable gas condensate is de-ethanized at the field using our own facilities with a capacity of up to 3 mmt per annum.

#### *Sales Production*

The Yurkharovskoye field's historical marketable production results are shown in the table below.

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
Natural gas sales production ..... mmcm	24,649	23,464	32,035	24,436	17,731
Liquids sales production ..... mt	1,969	2,008	2,718	2,099	1,484

#### *Capital Expenditure and Strategic Development Plans*

The following table sets forth our actual and planned capital expenditures at the Yurkharovskoye field (net of VAT) for the periods indicated, according to our operational data.

	2009	2010	2011	2012
	(actual)	(actual)	(actual)	(estimated)
Capital expenditures (RUB millions).....	11,401	15,375	11,403	15,546

We continued to invest in the expansion of the Yurkharovskoye field and completed the construction of the fourth stage of the second phase of development in October 2012, which we expect will allow us to reach peak production at the field of 36.5 bcm of natural gas per annum. It is expected that the production at the field will remain at that level in the mid-term.

Future drilling and development plans at the Yurkharovskoye field include:

- the commissioning of 20 new production wells;
- potential drilling of four injection wells in order to connect Cenomanian and Valanginian deposits and thereby increase our gas condensate recovery rate;
- the construction and launch of the second and third stages of the compressor booster station and the construction of facilities for the development of the Jurassic and Achimov deposits; and
- realization of the oil rims trial development project.

#### **East-Tarkosalinskoye Field**

The East-Tarkosalinskoye field, discovered in 1971, produces natural gas, gas condensate and crude oil and is located in the northern central area of the West Siberian lowlands, the Purovsky region of the Nadym-Pur-Taz region.

#### *General Description of Property*

The field is approximately 1,314 square kilometers and lies 40 kilometers north-east of the town of Tarko-Sale. We are developing the Cenomanian and Valanginian horizons in this field, which are characterized by permeable sandstone reservoirs. The East-Tarkosalinskoye field is our most mature field, and it reached its peak level in terms of natural gas and gas condensate production in 2008. We expect the field's gas and gas condensate production profile to gradually decline. At the same time, the field has potential to produce more crude oil, which we started to actively develop in 2012 following changes in the Russian tax code that provide for UPT relief for oil

produced at fields located in the YANAO north of the 65<sup>th</sup> parallel. Development of crude oil reserves is expected to allow us to increase the production of liquids at the field in the mid-term.

The East-Tarkosalinskoye field has one Cenomanian dry gas layer, with an area of approximately 950 square kilometers, and the top of the crest occurs at a depth of approximately 1,200 meters. The field also has 13 gas condensate layers, with occurrence at depths of 2,850 meters to 3,000 meters, the largest of which has an area of approximately 125 square kilometers. The field's 11 crude oil layers occur at depths of between 3,000 meters to 3,200 meters over an area of approximately 1,100 square kilometers.

#### Reserves

The following table sets forth reserves information for the East-Tarkosalinskoye field as of 31 December 2011.

Reserves		SEC			PRMS		
		Proved Developed	Proved Undeveloped	Total Proved	Proved	Probable	Proved and Probable
Natural gas .....	bcm	194	18	212	214	17	231
Liquids .....	mmt	9	13	22	28	13	41
<b>Total .....</b>	<b>mmboc</b>	<b>1,343</b>	<b>217</b>	<b>1,560</b>	<b>1,616</b>	<b>212</b>	<b>1,828</b>

#### Well Information

The following table sets forth the number of natural gas, gas condensate and crude oil production wells at the East-Tarkosalinskoye field as at 30 September 2012.

Production wells	Total
Gas wells.....	85
Gas condensate wells .....	32
Oil wells.....	68

#### History

Production drilling in the Cenomanian horizon commenced in May 1998, and commercial production of natural gas began in December 1998. Production drilling in the Valanginian horizon commenced in May 2000, and commercial production of gas condensate began in February 2001. Other key milestones in the field's development include:

- December 1998: Completion of the natural gas pipeline connecting the field to the UGSS.
- December 1998: Commissioning of a 2 bcm per annum Cenomanian gas preparation unit.
- December 2000: Expansion of the capacity of the Cenomanian gas preparation unit to 12.5 bcm per annum.
- May 2000: Commencement of production drilling in the Valanginian (deeper, wet gas) horizon.
- May 2001: Completion of a gas condensate pipeline connecting the field to Gazprom's gas condensate pipeline network.
- December 2002: Commissioning of a 2.3 bcm per annum low temperature separation unit for separating gas and unstable gas condensate from the Valanginian gas production.
- June 2004: Commissioning of a 1.5 mmt per annum de-ethanization unit consisting of two technological lines: one for de-ethanization of unstable gas condensate from this field and the other for de-ethanization of unstable gas condensate from our Khancheykoye field.
- May 2006: Commissioning the first stage compressor booster station at the East-Tarkosalinskoye's Cenomanian (dry) gas field with a capacity of 48 MW.
- November 2009: Upgrade of our gas condensate de-ethanization units servicing the East-Tarkosalinskoye and Khancheykoye fields resulting in an increase in capacity to approximately 1.8 mmt per annum and a related increase in the quality of de-ethanized gas condensate produced.
- December 2009: Launching the second stage compressor booster station at the East-Tarkosalinskoye's Cenomanian (dry) gas field with a capacity of 48 MW.
- April 2010: Commissioning the first stage compressor booster station at the field's Valanginian layer with a capacity of 8 MW.

- July 2012: Commissioning of the central oil gathering facility (which includes an oil treatment unit and a compressor booster station for the associated petroleum gas) with annual capacity of 1.5 mmt and the completion of the reconstruction and expansion of oil pipelines.

#### *Infrastructure and Transportation*

The field is connected to the UGSS via our own pipeline which enables the transport of up to 20 bcm of natural gas from the East-Tarkosalinskoye and the Khancheyskoye fields per annum. Unstable gas condensate is de-ethanized at the field and is transported via our pipeline to our Purovsky Plant. Our pipeline has transportation capacity of up to 2.4 mmt per annum.

Crude oil is transported via our pipeline collection system to our central gathering facility for further transportation via Transneft pipeline system.

#### *Sales Production*

The East-Tarkosalinskoye field's historical marketable production results are shown in the table below.

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	Natural gas sales production ..... mcm	9,706	8,698	11,509	9,735
Liquids sales production ..... mt	712	600	896	852	808

#### *Capital Expenditure and Strategic Development Plans*

The following table sets forth our actual and planned capital expenditures for exploration and development at the East-Tarkosalinskoye field (net of VAT) for the periods indicated, according to our operational data.

	2009	2010	2011	2012
	(actual)	(actual)	(actual)	(estimated)
Capital expenditures (RUB millions).....	2,024	1,058	2,430	7,171

The East-Tarkosalinskoye field has reached its peak production capacity for natural gas and unstable gas condensate. Future development plans at the East-Tarkosalinskoye field include:

- minimizing the rates of decline in the production of natural gas and unstable gas condensate, including drilling of side-tracks at existing wells;
- drilling of new wells for the development of the field's crude oil reservoirs; and
- the development of a reservoir pressure maintenance system.

#### **Khancheyskoye Field**

The Khancheyskoye field, discovered in 1990, is a natural gas, gas condensate and crude oil field situated in the Nadym-Pur-Taz region and located 65 kilometers east of our East-Tarkosalinskoye field. The field is approximately 116 square kilometers in area. We are developing the Cenomanian and Valanginian horizons at this field, which are characterized by sandy porous reservoirs. The field reached its peak level in terms of natural gas and gas condensate production in 2010 – 2011. We expect the field's gas and gas condensate production profile to gradually decline. At the same time, the field has crude oil production potential, which we started to actively develop in 2012 following changes in the Russian tax code providing for UPT relief for oil produced at fields located in the YANAO north of the 65<sup>th</sup> parallel. Development of crude oil reserves is expected to allow us to increase the production of liquids at the field in the mid-term.

#### *General Description of Property*

The field has 36 reservoirs, of which four are dry gas, four are crude oil, 21 are gas condensate, and seven are gas condensate with crude oil rims. The layers occur at depths of approximately 1,100 meters to 3,200 meters. The producing reservoirs are located over a small area which enhances the efficiency of the development of these reserves both in terms of capital expenditures and operating costs.

#### *Reserves*

The following table sets forth reserves information for the Khancheyskoye field as of 31 December 2011.

Reserves	SEC			PRMS		
	Proved Developed	Proved Undeveloped	Total Proved	Proved	Probable	Proved and Probable
Natural gas..... bcm	28	6	34	34	22	56
Liquids ..... mmt	4	0	4	4	4	8
<b>Total</b> .....	<b>212</b>	<b>41</b>	<b>253</b>	<b>253</b>	<b>177</b>	<b>430</b>

### Well Information

The following table sets forth the number of gas condensate and crude oil production wells at the Khancheyskoye field as at 30 September 2012.

<b>Production wells</b>	<b>Total</b>
Gas condensate wells .....	26
Oil wells.....	3

### History

Development drilling at the field commenced in July 2001, and commercial production of gas condensate and natural gas began in February 2002 and October 2003, respectively. Other key milestones in the field's development include:

- May 2001: Completion of an unstable gas condensate pipeline connecting the field to our East-Tarkosalinskoye field's low temperature separation unit. The pipeline has an annual capacity of up to 1.2 mmt.
- April 2003: Completion of a natural gas pipeline connecting the field to our East-Tarkosalinskoye field's gas preparation unit. The pipeline has an annual capacity of 5.8 bcm.
- October 2003: Commissioning of a 2.6 bcm per annum gas preparation unit.
- 2005 – 2008: Discovery of nine new gas horizons, including six new gas and gas condensate deposits in the southern and western parts of the Khancheyskiy license area.
- June 2006: Commissioning of the second phase of the gas preparation unit, increasing the total capacity of the unit to 5.2 bcm per annum.
- 2007: Commencement of oil production.
- June 2009: Launching of a compressor booster station at the Khancheyskoye's Valanginian (wet) gas condensate field with a capacity of 20 MW.
- November 2009: Upgrade of our gas condensate de-ethanization units servicing the East-Tarkosalinskoye and Khancheyskoye fields, resulting in an increase in capacity to approximately 1.8 mmt per annum and a related increase in the quality of de-ethanized gas condensate produced.
- 2012: Commencement of the construction of new gas and gas condensate production and development facilities in the southern part of the Khancheyskoye field with a capacity of 0.4 bcm per annum.

### Infrastructure and Transportation

All of the field's natural gas production is transported via our pipeline to our East-Tarkosalinskoye field, and then further transported to customers using the East-Tarkosalinskoye field's connection to the UGSS. The pipeline's current capacity is 7.5 bcm per annum.

All of the field's unstable gas condensate production is transported via our pipeline to our East-Tarkosalinskoye field, where it is de-ethanized and further transported to our Purovsky Plant using the East-Tarkosalinskoye field's unstable gas condensate pipeline, which has a capacity of 2.5 mmt per annum.

Crude oil is transported together with gas condensate to the East-Tarkosalinskoye field and then to our Purovsky Plant.

### Sales Production

The Khancheyskoye field's historical marketable production results are shown in the table below.

	<b>Nine months ended 30 September</b>		<b>Year ended 31 December</b>		
	<b>2012</b>	<b>2011</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Natural gas sales production .....	2,709	2,367	3,263	3,013	3,043
Liquids sales production .....	382	425	560	635	618

### Capital Expenditure and Strategic Development Plans

The following table sets forth our actual and planned capital expenditures for exploration and development at the Khancheyskoye field (net of VAT) for the periods indicated, according to our operational data.

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
	<b>(actual)</b>	<b>(actual)</b>	<b>(actual)</b>	<b>(estimated)</b>
Capital expenditures (RUB millions).....	432	87	612	1,058

We plan to continue investing in the development of the Khancheyskoye field, which has reached peak production capacity for natural gas and stable gas condensate, and our future activities include the construction of a compressor booster station and crude oil gathering and processing facilities, which is expected to allow us to increase crude oil production at the field.

### **Other producing fields**

Our Core Fields accounted for approximately 90% of our annual production in 2011. Our remaining production volumes come from the following five fields: the Beregovoy area, the Pyreinoye and Samburgskoye fields, the Sterkhovoye field (part of the Olimpiskiy subsoil area) and the Yumantilskoye field. All of these fields are located in close proximity to our existing transportation and processing infrastructure.

In the nine months ended 30 September 2012, nearly all of our total natural gas production – apart from our Core Fields – came from the Beregovoy area and the Pyreinoye field owned by Sibneftegas, in which NOVATEK owns a 51% share. The Beregovoy area is the largest of Sibneftegas' fields in terms of reserves and has 38 natural gas, gas condensate and oil deposits. The total proved gross reserves of the Beregovoy area as at 31 December 2011 under SEC reserves methodology are estimated at 160 bcm of natural gas and 5.8 mmbbls of liquid hydrocarbons, of which our share is 81.6 bcm of natural gas and 2.95 mmbbls of liquid hydrocarbons. Commercial production of natural gas at the field began in 2007. The field is connected to the UGSS by pipeline with capacity of up to 12.5 bcm per annum. Interpretation of 3D seismic results have been recently completed, and the existing geological model has been updated to optimize field development plans. The field is an important component of our production growth in the mid-term, and its estimated peak production exceeds 10 bcm per year. The geological study, search and production license for the Beregovoy area is valid until 2023. Sibneftegas plans to invest in the drilling of new wells in order to increase production at the field.

The Pyreinoye gas condensate field has proved gross gas reserves of 16.5 bcm, as estimated under SEC reserves methodology at 31 December 2011. Our share in the proved reserves is 8.4 bcm of natural gas. Commercial production of gas began in 2009, and the field is connected to the UGSS by way of a 36 kilometer natural gas pipeline with a capacity of 2.5 bcm per annum. Interpretation of 3D seismic exploration data at the field has been completed, and the existing geological model has been updated to optimize further field development. Provided new wells are drilled, production at the field is estimated to grow in the mid-term to over 1.2 bcm per annum. The geological study and production license for the Pyreinoye field is valid until 2021.

The Samburgskoye field is located within the Samburgskiy license area in YNAO, which also encompasses four other fields (Severo-Yesetinskoye, Vostochno-Urengoyeskoye and Severo-Purovskoye fields, as well as a part of the Urengoyeskoye field). The exploration and production license for the Samburgskoye field is valid through 2018 and is owned by Arcticgas, a wholly owned subsidiary of SeverEnergiya, in which we have a 25.5% economic interest through our participation in Yamal Development. The Samburgskoye field has proved gross gas reserves of 96.1 bcm and reserves of liquid hydrocarbons of 156.3 mmbbls, as estimated under SEC reserves methodology at 31 December 2011. Our share in the proved reserves of the field as at 31 December 2011 under SEC reserves methodology is estimated to equal 24.5 bcm of natural gas and 45.9 mmbbls of liquid hydrocarbons. In 2012, SeverEnergiya completed the first stage of the construction of the gas treatment unit at the Samburgskoye field, which has an annual capacity of 2.3 bcm of gas and 360 thousand tons of unstable gas condensate, as well as the construction of a 46 kilometer gas pipeline with a capacity of 10 bcm per annum connecting the treatment unit to the UGSS and a 20 kilometer de-ethanized gas condensate pipeline with an annual capacity of 10 bcm, connecting the field to the Yurkharov-Purovsky Plant pipeline. As a result, Arcticgas could start commercial production at the field in April 2012. Gas condensate produced at the field is delivered to our Purovsky Plant for processing. By the end of 2012, SeverEnergiya plans to launch the second stage of the gas treatment unit, which is expected to double the unit's existing capacity. SeverEnergiya also plans to start commercial crude oil production at the field by the end of 2012. SeverEnergiya will continue investing in the development of the field, including the drilling of new wells and further expansion of the gas treatment unit. In the mid-term, production at the field is expected to equal at least 7 bcm of gas and 3 mmt of liquids per annum.

The Sterkhovoye field located within the Olimpiyskiy license area consists of two gas condensate layers occurring at depths between 3,400 to 3,600 meters. The Sterkhovoye field has proved gas reserves of 1.4 bcm and reserves of liquid hydrocarbons of 3.2 mmbbls under SEC reserves methodology at 31 December 2011. The field is connected to the UGSS by a 14 kilometer natural gas pipeline with transportation capacity of 3.1 bcm per annum, which will also be used to transport gas produced at the Dobrovolskoye and Urengoyeskoye fields, also located within the Olimpiyskiy license area. De-ethanized gas condensate from the field is sent to the Purovsky Plant via a 12 kilometer portion of the gas condensate pipeline connecting the Yurkharovskoye field with the Purovsky Plant. Production at the field began in 2009, and the field produced 0.07 bcm of gas in 2011 and 0.05 bcm of gas in the nine months ended 30 September 2012. The geological study and production license for the Olimpiyskiy license area is valid until 2026.

The geological study, search and production license for the Yumantilskiy area is held by NOVATEK-Tarkosalenftegas and is valid until 2024. The ABC1+C2 reserves of the field under Russian reserves system

amounted to 5.0 bcm of gas and 0.8 mmt of liquid hydrocarbons as at 1 January 2012 (the area was not appraised under SEC and PRMS reserves methodologies in 2011). Commercial production at the Yumantilskiy area began in 2001, but has been periodically interrupted due to well maintenance. This field is currently not producing. Its production might restart after the appropriate geological and technical works are carried out and the economics for further field development are assessed.

#### Reserves

The following table sets forth reserves information for the Beregovoy area (the Beregovoye/S. Geologicheskoye field) and the Pyreinoye, Samburgskoye and Sterkhovoye fields. It does not include the Yumantilskiy area, as its reserves were not assessed under SEC or PRMS reserves methodologies, as of 31 December 2011.

Reserves		SEC			PRMS		
		Proved Developed	Proved Undeveloped	Total Proved	Proved	Probable	Proved and Probable
Natural gas	bcm	67	48	115	152	28	180
Liquids	mmt	0	6	6	8	8	16
<b>Total</b>	<b>mmboc</b>	<b>440</b>	<b>370</b>	<b>810</b>	<b>1,056</b>	<b>248</b>	<b>1,304</b>

#### Well Information

The following table sets forth the number of natural gas, gas condensate and crude oil production wells at the above-mentioned five fields as at 30 September 2012. The table reflects 100% of wellstock at the fields developed by our Joint Ventures.

Production wells	Total
Gas wells	76
Gas condensate wells	32
Oil wells	2

#### Sales Production

The five fields' historical marketable production results are shown in the table below.

		Nine months ended 30 September		Year ended 31 December		
		2012	2011	2011	2010	2009
Natural gas sales production	mmcm	4,318	4,068	5,456	77	63
Liquids sales production	mt	48	20	25	31	32

#### Prospective fields

We hold stakes in a number of prospective fields, which are now in various stages of exploration and development and which we plan to launch in the future.

The fields in the Nadym Pur-Taz region are located in close proximity to our existing transportation and processing infrastructure and the infrastructure of the Purovsky Plant. The South-Tambeyskoye field, which is an integral part of the Yamal LNG project, is located on the coast of the Gulf of Ob, enabling efficient shipment of LNG to the international markets through the Port of Sabetta, construction of which is expected to be partially financed by the Government as it is a strategic port for the development of the Arctic region. The Nakhodka – Yamburg and Bovanenkovo – Ukhta pipelines are the nearest pipelines to the Utrenneye and Geofizicheskoye fields, and the Utrenneye field is in close proximity of the South-Tambeyskoye field.

#### SeverEnergia

Arcticgas, a subsidiary of SeverEnergia, holds the exploration and production license for the Samburgskiy license area (which includes the Samburgskoye, Severo-Yesetinskoye, Vostochno-Urengoykoye and Severo-Purovskoye fields, as well as a part of the Urengoykoye field) and for the Yaro-Yakhinskoye, North-Chaselskoye and Yevo-Yakhinskoye fields. As at 31 December 2011, the proved gross reserves of the non-producing fields of SeverEnergia (as of the date of this Prospectus) under SEC reserves methodology were estimated at 339.7 bcm of gas and 478.8 mmbbls of liquid hydrocarbons, and the largest non-producing fields in terms of reserves are Urengoykoye, Yaro-Yakhinskoye and North-Chaselskoye. Our equity share in the reserves of SeverEnergia is 25.5%. All the fields are located in the proximity of our existing transportation and processing infrastructure and the UGSS.

SeverEnergia is currently implementing a complex exploration and development program to efficiently launch commercial hydrocarbon production at its fields. In April 2012, commercial production began at the Samburgskoye field. Also in 2012, SeverEnergia began preparatory works for the construction of key infrastructure



at the Urengoykoye field, including a gas treatment facility, gas pipeline to link the field to the UGSS and a gas condensate pipeline to link the field to the Yurkharov – Purovsky Plant pipeline. SeverEnergiya is currently tendering equipment supplies for the Yaro-Yakhinskoye field, which requires oil and gas treatment facilities as well as gas, gas condensate and oil pipelines. Construction works at the Yaro-Yakhinskoye field are estimated to start in the near future. SeverEnergiya is also working on development plans for other fields and performing necessary exploration works. The fields of SeverEnergiya are expected to be an important source of our future production growth.

#### ***Termokarstovoye field***

We hold our interest in the Termokarstovoye field through Terneftegas, our joint venture with TOTAL, in which we hold a 51% stake and TOTAL holds the remaining 49% stake. In June 2009, we signed a framework agreement with TOTAL providing for joint cooperation in the exploration and development of the Termokarstovoye field. The geological study and production license is valid until 2021.

The Termokarstovoye field, which was discovered in 1988, is approximately 140 square kilometers in area and is located 30 kilometers away from the town of Krasnoselkup in YNAO. The field has five gas condensate reservoirs, with an occurrence depth ranging from approximately 2,550 to 3,000 meters, and its proved gross reserves as at 31 December 2011 are estimated to equal 24.6 bcm of gas and 39.6 mmbbl of liquids, using a SEC reserves methodology. Our equity share in the proved reserves stands at 12.6 bcm of gas and 20.2 mmbbl of liquids.

In 2010 and 2011, we completed a series of preliminary exploration and other studies of the field and made the decision to proceed with commercial production in the mid-term; we expect annual peak production at the field to exceed 2 bcm of gas and 0.5 mmt of gas condensate.

#### ***North-Khancheykoye field***

The exploration and production license for the North-Khancheykoye field is held by NOVATEK-Tarkosalenftegas and is valid until 2029. In 2011, as a result of exploration works carried out at the field, two new gas deposits were discovered. As at 31 December 2011, the proved reserves of the field under SEC reserves methodology are estimated to equal 2.0 bcm of gas. We are currently creating a geological field model that will allow us to finalize the field development plan.

#### ***Yarudeyskoye field***

Yargeo, in which NOVATEK has a 51% stake, holds the exploration and production license for the Yarudeyskoye field, which is valid until 2029. Most of the field's reserves are located in oil-rich deposits. As at 31 December 2011, the proved gross reserves of the field under SEC reserves methodology are estimated to equal 6.9 bcm of gas and 32.8 mmbbl of liquid hydrocarbons. Our share in the reserves is 3.5 bcm of natural gas and 16.7 mmbbl of liquid hydrocarbons. In 2011, additional exploration work was done, and we are currently in the process of finalizing the field development plan in order to be able to launch the commercial production.

#### ***North-Russkoye field***

Our exploration and production license for the North-Russkoye field is valid until 2031. In 2011, following exploration works at the field, one new gas deposit was discovered. As a result, the field's resource base potential has increased significantly. Proved reserves at the North-Russkoye field as at 31 December 2011 under SEC reserves methodology are estimated to equal 22.5 bcm of gas and 15.6 mmbbl of liquids. The field development plan was completed in 2011, and commercial production at the field is estimated to start in the mid-term.

#### ***Olimpiyskiy license area***

Our geological study and production license for the Olimpiyskiy subsoil area is valid until 2026. Apart from the Sterkhovoye field (discussed above), which has commenced production, the Olimpiyskiy license area also includes the Dobrovolskoye field and a part of the Urengoykoye field. As at 31 December 2011, proved reserves of the Urengoykoye, Sterkhovoye and Dobrovolskoye fields are estimated at 27.4 bcm of gas and 20.9 mmbbl of liquid hydrocarbons under SEC reserves methodology.

In 2011, two gas condensate deposits and one gas deposit were discovered as a result of exploration activities at the license area, which significantly increased the reserves base of the Dobrovolskoye field and of the Cenomanian deposits at the Urengoykoye field. A development plan for the fields has been established.

#### ***South-Tambeyskoye field and the Yamal LNG project***

We own an 80% stake in Yamal LNG, which holds the license for the South-Tambeyskoye field and which is a joint venture between us and TOTAL, our strategic partner.

The South-Tambeyskoye field was discovered in 1974 and is located in the north-eastern portion of the Yamal peninsula. As of 31 December 2011, the field was estimated to contain 471.6 bcm of proved natural gas reserves and 172.0 mmbbl of proved liquid hydrocarbon reserves, under SEC reserves methodology (on a gross basis). Our equity share in the reserves of the field is 377.3 bcm of gas reserves and 137.6 mmbbl of liquid

hydrocarbons. Based on proved gross reserves, the South-Tambeyskoye field is the largest field in our reserves portfolio. Its production potential exceeds 25 bcm of gas per annum.

Together with TOTAL, we are now in the final stages of evaluating the construction of an LNG plant to monetize the reserves of the South-Tambeyskoye field, and expect to make a final investment decision on the project in the near future.

The Government has indicated that the Yamal LNG project is strategically important for the positioning of Russia's global gas and LNG industry. In October 2010, a Government decree was passed outlining a privileged taxation and customs incentives system for the Yamal LNG project. In particular, the project will be exempt from UPT for the first 250 bcm of natural gas production and 20 mmt of gas condensate production and will benefit from certain exemptions from the customs duty on stable gas condensate and LNG. See "*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK—Overview—Applicable Laws, Rules and Regulations*". The Government also confirmed that, as part of its plans to develop the Arctic region it will partially finance the construction of the port and harbor infrastructure at the Port of Sabetta.

In June 2010, we entered into a cooperation agreement with Gazprom, setting out key parameters for joint activity in the implementation and development of the Yamal LNG project, including the scope of construction and development and subsequent use of related infrastructure, including the energy and transportation systems and LNG production facilities. In conjunction with this cooperation agreement, and in light of Gazprom's exclusive right to export LNG from Russia, Yamal LNG signed a long-term agency agreement with Gazprom's subsidiary Gazprom Export, pursuant to which Gazprom Export will act as an agent for export sales of LNG between Yamal LNG and Yamal LNG's wholly-owned international sales subsidiary.

Since the start of the Yamal LNG project, we have collected 1,210 square kilometers of 3D seismic data and 1,173 linear kilometers of 2D seismic data, and three exploration wells have been drilled. We have also completed geological modeling of the South-Tambeyskoye field and are now optimizing the development plan. We estimate the field has five shallow gas horizons and 37 deeper gas condensate horizons. The depth of the horizons varies from between 900 to 2,850 meters.

The field development project provides for the drilling of gas production wells and the construction of a gas gathering system, a gas complex processing facility and a gas condensate processing unit. The LNG plant is estimated to include three trains of approximately five million tons capacity each as well as storage facilities. The shipment infrastructure is expected to include a jetty with two tanker loading berths at the Port of Sabetta equipped with ice protection facilities. Tankers of special design are expected to be used to transport the LNG to international markets.

In 2011 and 2012, we completed a pre-Front End Engineering and Design concept (pre-FEED), as well as FEED, and are now working on optimizing its technical part. We have conducted a tender for choosing a contractor to perform the drilling of production wells and have selected a consultant on corporate and social responsibility issues. We have recently completed pre-qualification of shipping companies and preliminary work in preparation for the ship-construction tender. We have also selected the contractor for the preparatory stage of construction of the Sabetta port and have commenced the process for certifying the Yamal LNG integrated management system in accordance with international standards ISO 14001:2004 and OHSAS 18001:2007. Work is also underway in connection with holding an EPC tender for the LNG plant, marketing the field's expected LNG production and arranging the necessary project financing.

Total capital expenditures for the Yamal LNG project, based on current FEED (front-end engineering design) projections, are expected to be on the order of approximately U.S.\$20 billion. Actual capital expenditures, however, may vary depending on many factors, and are subject to our making a final investment decision on the project, which we plan to make in the near future. Our financial contribution to the project will also depend on, among other factors, our equity interest in the Yamal LNG project, which currently stands at 80%, on cash flows from the project and on the amount of project financing provided by the banks. See "*Forward-Looking Statements*".

#### ***Geofizicheskoye and Salmanovskoye (Utrenneye) fields***

In August 2011, our wholly-owned subsidiary, NOVATEK-Yurkharovneftegas, won a tender for licenses to explore and develop the Geofizicheskoye and Salmanovskoye (Utrenneye) fields in the Gydan peninsula.

The Geofizicheskoye oil and gas condensate field, located in the middle part of the Gydan peninsula on the shores of the Gulf of Ob, was discovered in 1975 and contains 17 commercially productive layers, including 11 gas deposits, three gas condensate deposits and three oil deposits. Under the Russian reserves system, the ABC1+C2 reserves of the field as of 1 January 2012 are estimated to equal 212 bcm of gas and 12 mmt of liquids.

The Salmanovskoye (Utrenneye) field, located in the northern part of the Gydan peninsula on the shores of the Gulf of Ob in close proximity to the South-Tambeyskoye field, was discovered in 1980. It contains 34 commercially productive layers, including 16 gas deposits, 15 gas condensate deposits, two oil and gas condensate

deposits and one oil deposit. Under the Russian reserves system, the ABC1+C2 reserves of the field of 1 January 2012 are estimated to equal 767 bcm of gas and 34 mmt of liquids.

Geological modeling of these fields is currently underway, which will allow us to better define their production potential. Following completion of the geological modeling, we expect to begin preparing a development plan for these fields. We consider the development of these fields to be an important factor in our long-term plans to increase production.

In April 2012, we signed a memorandum of cooperation with Gazprom to consider establishing a joint venture to increase LNG production capacity on the Yamal peninsula and to jointly develop hydrocarbon resources on the Gydan peninsula. According to this memorandum of cooperation, we and Gazprom have plans to establish a 50-50 joint venture to develop certain existing assets located on the Gydan peninsula.

## Exploration and Development Activities

### Development Activities

We continue to focus on the development of our Core Fields and the fields held by Sibneftegas and SeverEnergiya, two of our Joint Ventures. The following table sets forth the number of production wells drilled and completed at these assets for the nine months ended 30 September 2012 and 2011 and the years ended 31 December 2011, 2010 and 2009 (including, for presentation purposes, 100% of wells drilled by our Joint Ventures).

Number of production wells	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
East-Tarkosalinksoye field.....	15	4	4	1	—
Khancheykoye field.....	2	—	2	—	—
Yurkharovskoye field.....	5	8	11	14	11
Pyreinoye field.....	1	—	—	—	3
Samburgskoye field.....	6	2	4	18	—
Olimpiyskiy license area .....	—	—	—	—	1
<b>Subtotal</b> .....	<b>29</b>	<b>14</b>	<b>21</b>	<b>33</b>	<b>15</b>

### Exploration Activities

We seek to increase our hydrocarbon resource base through geological and geophysical exploration of our fields and license areas. We employ modern geological and hydrodynamic modeling as well as new well drilling and completion techniques in an attempt to maximize the ultimate recovery of hydrocarbons in a cost effective manner. Currently, our principal areas of exploration activity include the Yurkharovskoye, West-Yurkharovskoye, Khancheykoye, North-Khancheykoye, South-Tambeyskoye, Yarudeyskoye fields and the Olimpiyskiy, New-Yurkharovskiy and North-Russkiy areas. In 2012, we started exploration works at the newly acquired areas on the Gydan peninsula and offshore in the Gulf of Ob.

We have established a research center with highly-qualified personnel working on all stages of geological study, including geological and hydrodynamic modeling and estimating reserves. We use Schlumberger IS software to process and interpret seismic materials and to develop 3D geological and hydrodynamic models of our major fields, enabling us to utilize horizontal and deviated wells to more effectively develop our natural gas and gas condensate fields. The ability to better understand the subsurface geology reduces the need for development wells.

The following table sets out certain information derived from our operational data about the exploration activities of the Group and Joint Ventures (including, for presentation purposes, 100% of the respective activities and associated expenses at our Joint Ventures) for the nine months ended 30 September 2012 and 2011 and the years ended 31 December 2011, 2010 and 2009.

Exploration Activities	Units	Nine months ended 30 September		Year ended 31 December		
		2012	2011	2011	2010	2009
Exploration wells drilled .....		6	14	15	5	8
Exploration drilling .....	Meters	29,505	28,715	41,287	15,116	10,845
	<b>RUB mln</b>	<b>2,423</b>	<b>2,663</b>	<b>3,936</b>	<b>1,880</b>	<b>1,511</b>
2D Seismic .....	Km	6,187	376	376	322	456
	<b>RUB mln</b>	<b>505</b>	<b>130</b>	<b>155</b>	<b>149</b>	<b>148</b>
3D Seismic .....	square km	2,802	1,146	1,689	522	349
	<b>RUB mln</b>	<b>2,217</b>	<b>976</b>	<b>1,585</b>	<b>424</b>	<b>294</b>
Seismic interpretation /assessment.....	<b>RUB mln</b>	<b>430</b>	<b>235</b>	<b>481</b>	<b>283</b>	<b>227</b>
<b>Total</b> .....	<b>RUB mln</b>	<b>5,575</b>	<b>4,004</b>	<b>6,157</b>	<b>2,736</b>	<b>2,180</b>
Including:						
Exploration activities at consolidated subsidiaries .....	RUB mln	4,199	3,301	4,284	2,683	2,180
Exploration activities at the Joint Ventures.....	RUB mln	1,376	703	1,873	53	0

### Exploration and Development Capital Expenditures

The following table sets forth total planned capital expenditures for exploration, drilling and development (net of VAT) at our consolidated subsidiaries, according to our operational data.

	(actual)			(estimated)
	RUB millions			
	2009	2010	2011	2012
Yurkharovskoye field.....	11,401	15,375	11,403	15,546
East-Tarkosalinskoye field.....	2,024	1,058	2,430	7,171
Purovsky Plant .....	1,168	1,292	1,369	1,354
Olimpiyskiy license area .....	681	424	345	1,206
Khancheyskoye field.....	432	87	612	1,058
Ust-Luga .....	—	664	3,923	11,852
Other .....	2,166	7,130	11,061	6,236
<b>Total</b> .....	<b>17,872</b>	<b>26,030</b>	<b>31,143</b>	<b>44,423</b>

According to our preliminary plans, our total capital expenditures at all our consolidated subsidiaries for 2013 are expected to be in the range of RUB50 billion. Our final business plan for 2013 is subject to approval by our Board of Directors in December 2012. The main development projects for 2013 are expected to be the Yurkharovskoye field, the Ust-Luga complex and the Purovsky Plant.

See “—Description of Our Fields—Prospective Fields—South-Tambeyevskoye field and the Yamal LNG project” regarding capital expenditures associated with the Yamal LNG project and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures” regarding our share in the capital commitments for our interests in the Joint Ventures.

### Production

We currently produce natural gas, gas condensate and crude oil at the following fields in YNAO:

Product	Fields
Natural gas	Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye, Samburgskoye, Sterkhovoye, Beregovoye, Pyreinoye
Gas condensate	Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye, Samburgskoye, Sterkhovoye, Urengoyevskoye
Crude oil	East-Tarkosalinskoye, Khancheyskoye, Samburgskoye

The following table sets forth our production of natural gas, gas condensate and crude oil for the nine months ended 30 September 2012 and 2011 and the years ended 31 December 2011, 2010 and 2009 (including our *pro rata* share in the Joint Ventures’ production).

Production <sup>(1)</sup>		Nine months		Year ended 31 December		
		ended 30 September		2011	2010	2009
		2012	2011			
Natural gas .....	bcm	41.4	38.6	52.9	37.3	32.4
	bcf	1,461	1,363	1,868	1,316	1,143
Gas condensate.....	mmt	2.8	2.9	3.8	3.4	2.9
	mmbbls	23.4	24.2	32.5	29.0	24.1
Crude oil .....	mmt	0.4	0.2	0.3	0.2	0.2
	mmbbls	2.7	1.5	2.1	1.3	1.3
<b>Total</b> .....	mamboe	<b>296.7</b>	<b>278.1</b>	<b>380.6</b>	<b>274.1</b>	<b>237.1</b>
<b>Total</b> .....	mboepd <sup>(1)</sup>	<b>1,087</b>	<b>1,019</b>	<b>1,043</b>	<b>751</b>	<b>649</b>

<sup>(1)</sup> Based on a calendar year of 365 days and nine months consisting of 273 days.

## Gas Condensate Processing at Our Purovsky Plant

### Overview

Gas condensate is produced at our own fields and fields of our Joint Ventures in an unstable form and requires further processing before it can be delivered to our customers. Our primary gas condensate processing asset is our Purovsky Plant, which has total processing capacity of 5 mmt of de-ethanized gas condensate per annum, which, in turn, allows us to produce approximately 3.7 mmt of stable gas condensate and 1.3 mmt of LPG per annum. The Purovsky Plant is located in YNAO, in close proximity to the East-Tarkosalinskoye field.

When processed at our Purovsky Plant, de-ethanized gas condensate separates into two phases, stable gas condensate and wide-range light hydrocarbons (“WRLH”), which is further processed into LPG. During the refining process, the de-ethanized gas condensate is pressurized to 1.6 Mpa and subjected to temperatures of up to 160°C.

Our Purovsky Plant is an important link in our midstream operational chain that provides us operational control over our processing needs and access to higher-yielding marketing channels for our stable gas condensate. We believe that such operational control allows us to produce stabilized gas condensate and LPG that are of higher-quality than the output that would result from third-party processing.

### History

In June 2005, we commissioned the Purovsky Plant located in the Purovsky region, close to our producing fields and existing infrastructure. We migrated the processing of all of our gas condensate to this plant. In June 2005, we also commissioned our own storage reservoirs at the Port of Vitino on the White Sea in the Murmansk region, where our stable gas condensate is supplied to by railway, stored and loaded onto ocean tankers.

In conjunction with the completion of the first stage of the second phase of development at the Yurkharovskoye field, we launched the second phase expansion at the Purovsky Plant in November 2008. The commissioning of the second phase expansion enabled us to increase processing capacity from 2 mmt to 5 mmt of de-ethanized gas condensate per annum allowing us to continue processing our unstable gas condensate production. We also increased our on-site storage facilities for stable gas condensate from 30 mcm to 90 mcm as part of the expansion program.

In 2010, we launched a 326 kilometer pipeline from the Yurkharovskoye field to the Purovsky Plant. The commissioning of this pipeline allowed us to increase the quality of our processed products by eliminating the quality dilution, which occurred when gas condensate from the Yurkharovskoye field was mixed with other producers’ gas condensate during delivery to the Purovsky Plant using Gazprom’s trunk pipeline.

### Current Operations

As of the date of this Prospectus, the Purovsky Plant receives feedstock from six fields: East-Tarkosalinskoye, Khancheykoye, Yurkharovskoye, Sterkhovoye, Samburgskoye and North-Urengoykoye.

In 2011, the Purovsky Plant processed 3.9 mmt of de-ethanized unstable gas condensate, resulting in the commercial production of 2.9 mmt of stable gas condensate and 883 mt of LPG, as well as 16 mt of methanol produced during the LPG scrubbing process. In the nine months ended 30 September 2012, the plant processed 2.9 mmt of de-ethanized unstable gas condensate, resulting in the commercial production of 2.2 mmt of stable gas condensate and 666 mt of LPG, as well as 12 mt of methanol produced during the LPG scrubbing process. In the nine months ended 30 September 2012, the Purovsky Plant operated at approximately 77% of its full capacity, providing us with the ability to continue developing our gas condensate fields.

Substantially all of the stabilized gas condensate produced at our Purovsky Plant is delivered by rail to the Port of Vitino where it is loaded onto ocean tankers for further transportation to international markets. The Purovsky Plant has storage facilities for stable gas condensate (90 mcm), LPG (25.2 mcm) and raw materials (13.6 mcm). The

Purovsky Plant also has facilities for loading stable condensate and LPG onto rail tank cars. Our railway line connects the Purovsky Plant to the RZD railway network at the Limbey rail station.

#### *Expansion of capacity*

In anticipation of the expected increase in our gas condensate production (see “—*Business Strategy—Efficiently monetize our reserves of liquid hydrocarbons*”), we are expanding the processing capacity of the Purovsky Plant by an additional 6 mmt per annum through two new processing trains of 3 mmt capacity each, with one to be built in 2013 and the other in 2014.

The expansion of the processing capacity of the Purovsky Plant does not involve the construction of any additional capacity for LPG production. Under our agreement with SIBUR (as of the date of this Prospectus, subject to approval by the General Meeting of Shareholders (as defined below) scheduled for January 2013), 100% of volumes of the WRLH (which serves as the raw material for LPG production) will be transported to SIBUR’s Tobolsk Petrochemical Complex. SIBUR will process up to 1.2 mmt of the WRLH on tolling terms and will redeliver the produced LPG to us for distribution via our existing marketing network; we will sell the remaining volumes of the WRLH to SIBUR on an “ex-plant” basis.

During the nine months ended 30 September 2012, we expanded the storage facilities at the Purovsky Plant and carried out planning and surveying work in preparation for the construction works at the plant.

The following table sets forth our actual and planned capital expenditures (net of VAT) at our Purovsky Plant for the periods indicated, according to our operational data.

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
	(actual)	(actual)	(actual)	(estimated)
Capital expenditures (RUB millions).....	1,168	1,292	1,369	1,354

#### *Ust-Luga Project*

As part of our goal to increase processing depth, we are building a new gas condensate transshipment and fractionation complex at the Ust-Luga terminal, located on the Baltic Sea.

After completion of the complex, we plan to redirect our deliveries of stable gas condensate from the Port of Vitino to Ust-Luga. A substantial portion of the stable gas condensate to be supplied to the Ust-Luga complex by rail will be used as feedstock at the fractionation unit for processing into naphtha, jet fuel, diesel and heating oil, while the remaining portion of the stable gas condensate will be exported via tankers. The complex will be built in two stages of 3 mmt of annual capacity each and, when completed, is expected to process up to 6 mmt of stable gas condensate per annum.

Our subsidiary, NOVATEK-Ust-Luga, is expected to be the operator of this complex upon its completion and the owner of the related port infrastructure.

In the nine months ended 30 September 2012, we built loading berths, gas condensate processing facilities, storage facilities for raw materials and finished products, administrative buildings, waste water treatment facilities and communication networks at the Ust-Luga complex. We plan to finalize construction of the first phase of the complex by the end of 2012 and to launch the second phase by the end of 2013.

The following table sets forth our actual and planned capital expenditures at the Ust-Luga complex for the periods indicated, according to our operational data.

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
	(actual)	(actual)	(actual)	(estimated)
Capital expenditures (RUB millions), net of VAT .....	—	664	3,923	11,852

### **Transportation of Our Production**

#### *Natural Gas Transportation*

We use the UGSS for the transportation of all of our natural gas sold to end-customers (our wholesale sales are made on an “ex-field” basis). The UGSS is an integrated gas transportation and supply network owned and operated by Gazprom, and used by Gazprom and all other Russian natural gas producers and wholesalers for the transportation of substantially all of the commercial volumes of natural gas produced within Russia (as well as shipments of gas from neighboring countries). Our natural gas producing fields are located in the Nadym-Pur-Taz region and are connected by our pipelines to the UGSS’ main corridors. See “—*Description of Our Fields—Producing Fields*”. Before contracting with Gazprom for the transportation of natural gas through the UGSS, we are required to obtain certain technical permissions from Gazprom, allowing us to inject specified annual volumes of natural gas into the UGSS within specified time periods. We are then permitted to transport natural gas from our fields, through the UGSS pipeline system, to the local gas distribution stations. The natural gas we inject into the UGSS pipeline system must be compliant with certain technical parameters as to its quality.

### *Access to the UGSS*

In accordance with Russian legislation and the terms of our licenses, we submit a development plan for each of our fields to the MNR. A development plan for a field includes the expected production levels from identified resources in the field over the life of the field, and its approval is a prerequisite to field development. Field development plans typically specify the full production cycle expected at each field, with the time to prepare the plan varying, depending on the specific characteristics of each field. The development plans for our fields, as approved by the MNR, then serve as a basis for Gazprom to issue technical approvals for access to the UGSS at a specified entry point. These approvals, which specify the annual volume of natural gas intake to the UGSS over the life of the field, do not have an expiration date, and we are not required to renew these approvals unless we intend to increase the volume of natural gas to be injected into the UGSS. Moreover, the continuation of these existing permitted and allocated volumes is not tied to the production from specific fields. Accordingly, approved volumes for intake may include production at nearby fields feeding into intra-field pipelines that then feed into the allocated entry point.

When we expect our production levels to increase beyond the approved injection volumes, we submit a revised development plan for our fields to Gazprom in order to obtain a new technical approval permitting us to increase our injection volume levels entering the UGSS.

The natural gas volumes approved by technical permission serve as a basis for requesting access to the UGSS for the transport of particular batches of natural gas to our consumers. The request to use the UGSS must specify the following:

- exact entry point;
- exit point;
- quantity to be transported from the entry point to the exit point;
- transportation period;
- confirmation of the consumer's readiness to accept gas (copies of the relevant supply contract, protocol of intent, offer, etc.); and
- confirmation by a gas distribution station of its readiness to accept and transport our natural gas through their transportation network from the gas distribution station to end consumer.

Provided that there is available transport capacity and the quality of our natural gas meets technical standards, Gazprom is required by law to consider our request to access the UGSS, issue technical approvals for connection to the UGSS and enter into the relevant transportation contract. As at the date of this Prospectus, we inject our gas at the following collection points:

- *Yamburg Compressor Station (OOO Gazprom Transgas Yugorsk)*. From this point we have access to the Central and Northern Corridors of the UGSS, which carry gas to our consumers in the Central and North European parts of Russia and Northern Urals. Our Yurkharovskoye field is connected to this point by a 103 kilometer pipeline with a capacity to transport up to 37 bcm of natural gas per annum. Volumes delivered to end-customers and traders through this connection point totaled 24.6 bcm in the nine months ended 30 September 2012 and 32.0 bcm in 2011.
- *The Urengoi-Chelyabinsk Gas Pipeline (128<sup>th</sup> kilometer point)*. The Urengoi-Chelyabinsk Gas Pipeline is part of the Southern Corridor of the UGSS, which carries gas southward from Western Siberia to the industrial regions of the Southern Urals. Our East-Tarkosalinskoye field is connected to this point by our 22.4 kilometer intra-field pipeline with a capacity of up to 20 bcm of natural gas per annum. Production at our Khancheyskoye field is transported to the East-Tarkosalinskoye field through our pipelines with a capacity of 7.5 bcm per annum and then transported to the UGSS connection point for delivery to end-customers and wholesale traders. Volumes delivered through this connection point to end-customers and wholesale traders totaled 12.3 bcm in the nine months ended 30 September 2012 and 15.3 bcm in 2011.
- *The Urengoi-Chelyabinsk Gas Pipeline (101st kilometer point)*. This is our second point of access to the Southern Corridor of the UGSS. Our Sterkhovoye field within the Olimpiyskiy license area is 14 kilometers away from this connection point, and is connected to the UGSS by our intra-field pipelines with a capacity of 3.1 bcm of natural gas per annum. Delivery volumes through this connection point were 0.05 bcm in the nine months ended 30 September 2012 and 0.07 bcm in 2011.
- *Purtazovskaya compressor station (OOO Gazprom transgaz Surgut)*. From this point we have access to the Central, Southern and Northern corridors. The Beregovoye field of Sibneftegas is connected to this point via a 32.9 km pipeline to the UGSS with a capacity of 12.6 bcm per annum. Volumes delivered through this connection point totaled 3.7 bcm in the nine months ended 30 September 2012 and 4.9 bcm in 2011.

- *The Urengoi-Chelyabinsk Gas Pipeline (102th kilometer point)*. The Pyreinoie field, which is being developed by Sibneftegas, is connected to this point via a 36.1 km pipeline with a capacity of 1.7 bcm per annum. Volumes delivered through this connection point totaled 0.4 bcm in the nine months ended 30 September 2012 and 0.5 bcm in 2011.

In 2003, we entered into a transportation contract for an indefinite term with Gazprom, under which we annually file with Gazprom our requests for increased natural gas transportation volumes (usually on a mid-term basis) for the following three years.

The distribution of agreed volumes across the various UGSS connection points is made on an ongoing basis, based on the actual demand of our customers as well as technical characteristics of UGSS' operations.

Although we have been successful in the past in obtaining technical approvals from Gazprom to increase our injection volumes, there can be no assurance that Gazprom will fully approve all of our future requests. This is taken into account as we form our natural gas realization strategy. See *“Risk Factors—Risks Relating to Our Business and Industry—We rely on third parties, primarily state-owned monopolies, to transport our products to customers—We are dependent on Gazprom for the transportation of our natural gas”*.

We sell gas to end-customers and wholesale gas traders. In the nine months ended 30 September 2012, 68.0% of our natural gas sales were to end-customers requiring transportation contracts with Gazprom. The remainder of our natural gas sales is made to wholesale gas traders on an “ex-field” basis.

Wholesale gas traders purchasing gas from us on an “ex-field” basis then arrange for transportation with Gazprom themselves, in which case the buyer is directly responsible for the payment of gas transportation tariffs. Accordingly, we believe our sales to wholesale gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses. The transportation of natural gas to end-customers, however, usually requires the inclusion of certain transportation volumes in a separate amendment to our contract with Gazprom. Transportation is usually arranged from the UGSS entry point to the local gas distribution station to which the end-customer has access. Depending on our contractual arrangement with the end-customer, gas transportation from the local gas distribution station to its facilities can either be at the customer's or our expense.

#### *Transportation Tariffs for Natural Gas*

The transportation tariffs for natural gas are set by the FTS and are charged by Gazprom for natural gas transportation through the UGSS. In 2011 and the first half of 2012, our average transportation tariff was RUB56.15 per mcm per 100 kilometers (excluding VAT) for delivery to customers located within the Russian Federation. Tariffs were increased from 1 July 2012, and our average transportation tariff in the three months ended 30 September 2012 amounted to RUB60.08 per mcm per 100 kilometers (excluding VAT). Generally, the increases in regulated transportation tariffs are passed on to our end-customers pursuant to delivery terms in the majority of our contracts.

#### *Gas Supply Agreements with Customers*

Under our standard form gas supply agreement, end consumers accept our natural gas at the agreed-upon local gas distribution station, at which point title to the natural gas being delivered passes to the customer. The customer then at its own expense arranges for further transportation of natural gas from the gas distribution station (through the local gas distribution networks) to its operating facilities, except for certain contracts where the title passes upon reaching the exit point of the local gas distribution network, in which case we bear transportation costs.

#### *Natural Gas Storage*

Our natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with monthly sales peaking in the winter months December through February and troughing in the summer months of July and August. To better optimize our sales and production across all seasons, we have entered into a service agreement with Gazprom to utilize the spare capacity in its UGSFs. In periods of low seasonal demand, we inject gas into the UGSFs and subsequently withdraw these volumes during peak demand periods to supplement our production.

During the nine months ended 30 September 2012, we withdrew 732 mmcm and injected 1,309 mmcm of natural gas into UGSFs and, as of 30 September 2012, we had 1,309 mmcm of natural gas in storage and available for withdrawal in future periods. In 2011, we withdrew 1,199 mmcm of natural gas from UGSFs during periods of high demand and injected 1,171 mmcm in periods of low demand. At the end of 2011, we had 732 mmcm of natural gas in storage.

#### *Gas Condensate and LPG Transportation*

Substantially all of the stabilized gas condensate produced at our Purovsky Plant is delivered by rail to the Port of Vitino on the White Sea in the Murmansk region. At the Port of Vitino, the stable gas condensate is loaded onto ocean tankers for transportation to international markets. During the winter months, we charter ice-class tankers and ice-breaking vessels to transport stable gas condensate from the Port of Vitino to a location where the



product may be transferred to non-ice-class vessels for delivery to international markets. We have our own storage facilities for stabilized gas condensate at the Port of Vitino, including four storage reservoirs with a total capacity of 120 mcm. We believe the efficient use of our storage facilities enables us to ensure stability of gas condensate deliveries to our customers in international markets.

We ship our LPG produced at our Purovsky Plant via rail and, as part of our logistics, we own a fleet of 420 LPG railway tank cars. We also lease additional railway tank cars for LPG transportation from third-party providers. See also *“Risk Factors—Risks Related to Our Business and Industry—We rely on third parties, primarily state-owned monopolies, to transport our products to customers—We are dependent on RZD for the transportation of our liquid hydrocarbons”*.

All aspects of the gas condensate and LPG transportation process are coordinated and managed from our head office in Moscow. This centralized process enables us to avoid substantial delays in transportation and ensures the delivery of our liquid products to our customers in a timely manner.

RZD transports our gas condensate and LPG under a framework agreement which is effective until 2022. This agreement provides for the transport of specified product volumes and, accordingly, we coordinate any plans for increasing our production volumes with RZD to ensure sufficient transportation capacity.

After completion of the Ust-Luga transshipment and fractionation complex, we plan to stop delivering our stable gas condensate through the Port of Vitino and redirect it to Ust-Luga. See *“Production—Ust-Luga Project”*.

### ***Oil Transportation***

We transport most of our crude oil through the pipeline system operated by Transneft, Russia’s state-owned monopoly crude oil pipeline operator. Access to Transneft’s network is regulated by law, and the transportation capacity is required to be allocated on a non-discriminatory basis to all network users meeting certain technical requirements. If the network capacity is insufficient for all the users, domestic oil transportation generally takes precedence over export supplies, and the transportation capacity for supplies of the same priority is allocated pro rata to the users’ intended volumes of such supplies, as indicated in their annual transportation orders to Transneft. Export pipeline capacity is allocated to oil producers by the MER on a quarterly basis, provided there exists sufficient capacity for domestic supplies. We enter into annual agreements with Transneft on the provision of oil transportation services. Tariff rates for using Transneft pipelines are set by the FTS. The overall price per ton for the transport of crude oil depends on the length of the route used to transport the oil from the field to the ultimate destination.

The crude oil that we transport through Transneft is blended with oil produced by other oil companies. The resulting blend is sold to customers as Urals blend.

### **Sales and Marketing**

We generate revenue by selling natural gas within the Russian Federation to end-customers and wholesale traders, and liquid hydrocarbons both domestically and for export to customers located primarily in the Asian-Pacific, European, U.S. and South American markets.

In the nine months ended 30 September 2012 and the year ended 31 December 2011, 71.2% and 67.3%, respectively, of our revenue was comprised of domestic sales denominated in Roubles, whereas 28.8% and 32.7%, respectively, was comprised of export sales of liquid hydrocarbons denominated in foreign currency, primarily in U.S. Dollars. We expect that we will continue to generate foreign currency earnings through increased production and exports of stable gas condensate and LPG to international markets, as well as export sales of petroleum products produced at the Ust-Luga transshipment and fractionation complex, which is now being built. See *“—Production—Ust-Luga Project”*. We expect to begin producing petroleum products in 2013. Our stable gas condensate customers include ExxonMobil, SK Energy International, Statoil, Samsung Total, and Braskem; and our international LPG customers include Borealis, Neste, Orlen and Bulmarket. One of our important strategic initiatives is the potential construction, together with TOTAL, of LNG facilities on the Yamal peninsula, with output to be sold on the international markets. See *“—Description of Our Fields—Prospective Fields—South-Tambeyskoye field and the Yamal LNG project.”*

### ***Natural Gas***

#### *Sales of natural gas*

We are an independent gas producer and our pricing policy is not regulated by the Government, except for our sales to households. In accordance with the Gas Export Law, Gazprom or its wholly-owned subsidiaries have the exclusive right to export gas outside the Russian Federation (except for natural gas produced under certain grandfathered production sharing agreements). Therefore, we sell 100% of our natural gas, including natural gas purchased from third parties in Russia, in the Russian domestic market, primarily to power generation companies, regional gas distributors, industrial users and wholesale traders, including Gazprom. See *“State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK”*. In 2011, we delivered natural gas to over 33

constituent entities (territories, regions, cities, semi-autonomous regions and republics) of the Russian Federation, and our customers were located primarily in the regions of Perm, Chelyabinsk, Orenburg, Sverdlovsk, Moscow, Kostroma, Kirov and Tyumen, St-Petersburg, as well as YNAO and Khanty-Mansyisk autonomous regions. In the nine months ended 30 September 2012, we delivered natural gas to 36 constituent entities of the Russian Federation.

We believe we have a strong reputation among regional gas consumers for supplying and delivering uninterrupted volumes of natural gas throughout the year. Our natural gas marketing strategy has the following objectives:

- optimize sales to ensure the most appropriate balance of end-customers and wholesale gas traders;
- become the major regional supplier of gas wherever possible;
- increase the number of the constituent entities of the Russian Federation to which we supply our gas;
- increase the number of customers for whom we are the primary or sole gas supplier; and
- increase supplies to the growing power generation sector as a result of increased capacities and infrastructure investments.

We sell our natural gas in two ways:

- *End-customer sales.* We negotiate gas prices directly with the end-customer and then apply to Gazprom for use of the UGSS to transport the gas to the local gas distribution center near the end-customer. The prices are usually set on a delivery basis, with provisions to allow us to pass any tariff increases to the customer. The terms of these gas supply agreements generally range from one to five years.
- *Sales to wholesale traders on an “ex-field” basis.* Wholesale gas traders purchase gas at the entry point to the UGSS for further transportation to their counterparties. In such arrangements, these wholesale customers take title to the natural gas at the time it enters the UGSS at the relevant entry point. In the nine months ended 30 September 2012, our largest wholesale customers were Gazprom and Itera, one of the largest independent producers and traders of natural gas in Russia (which in August 2012 contributed its gas assets into a joint venture with Rosneft).

The following table sets forth sales of natural gas to different categories of customers for the periods indicated:

	Nine months ended 30 September				Year ended 31 December					
	2012		2011		2011		2010		2009	
Gas Sales, mcm	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
End-customers: <sup>(1)</sup>										
Power generation providers .....	17,149	40%	15,530	41%	21,478	40%	17,918	48%	8,734	27%
Regional gas distributors.....	398	1%	299	1%	381	1%	1,003	3%	10,648	32%
Large industrial users.....	9,458	22%	3,996	10%	6,089	11%	4,074	11%	2,614	8%
Other consumers .....	1,748	4%	685	2%	1,267	2%	751	2%	423	1%
Households .....	499	1%		0%	117	0%		0%		0%
<b>Total End-customers .....</b>	<b>29,252</b>	<b>68%</b>	<b>20,510</b>	<b>54%</b>	<b>29,332</b>	<b>55%</b>	<b>23,746</b>	<b>64%</b>	<b>22,419<sup>(2)</sup></b>	<b>68%</b>
Traders:										
Gazprom .....	9,381	22%	12,577	33%	17,200	32%	10,474	28%	0	0%
Itera.....	2,383	6%	2,437	6%	3,520	7%	0	0%	7,420	23%
Others .....	1,988	5%	2,565	7%	3,616	7%	2,898	8%	3,098	9%
<b>Total Traders.....</b>	<b>13,752</b>	<b>32%</b>	<b>17,579</b>	<b>46%</b>	<b>24,336</b>	<b>45%</b>	<b>13,372</b>	<b>36%</b>	<b>10,518</b>	<b>32%</b>
<b>Total .....</b>	<b>43,004</b>		<b>38,089</b>		<b>53,669</b>		<b>37,118</b>		<b>32,937</b>	

<sup>(1)</sup> Including end-customers purchasing our natural gas on an “ex-field” basis.

<sup>(2)</sup> Including sales to traders in remote points.

In the nine months ended 30 September 2012, our largest customers (in terms of volumes) were Gazprom, accounting for 21.8% of our total natural gas supplies and INTER RAO, accounting for 22.8% of our total natural gas supplies. In the nine months ended 30 September 2012, we delivered our natural gas to 3,200 off-takers, with 68.0% of our total volumes sold to end-customers and 32.0% to wholesale natural gas traders. In 2011, we delivered our natural gas to 2,500 off-takers, with 54.6% of total volumes sold to end-customers and 45.1% to wholesale natural gas traders. See “Risk Factors—Risks Relating to Our Business and Industry—We are dependent to a certain extent on the Russian power generation sector for sales of our natural gas and also sell our stable gas condensate to a limited number of customers”. We believe that any concentration risk associated with Gazprom being one of our major customers is in part mitigated by the strategic partnership we have in place with Gazprom. In addition, as at

the date of this Prospectus, Gazprom holds a 9.99% interest in NOVATEK. Our gas supply contracts with INTER RAO are effective through 2015. We expect to be able to sell the relevant volumes of natural gas to other customers upon expiration of the existing contracts with INTER RAO.

In 2012, we added a number of significant customers to our portfolio or renewed contracts with the existing major customers. In June 2012, we concluded a 10.5 year natural gas supply contract with Magnitogorsk Iron and Steel Works through 31 December 2022. We estimate that over 50 bcm of gas will be delivered over the life of this contract. In August 2012, we concluded a 15-year natural gas supply contract with the Russian subsidiary of E.ON and extended our existing contract with the Russian subsidiary of Fortum for another 15 years. We estimate that over 180 bcm of gas will be delivered pursuant to these contracts to a number of power generating stations, which are controlled by E.ON and Fortum, respectively.

In October 2012, we signed a five-year natural gas supply contract with OAO Severstal, effective 1 January 2013. The total volume to be supplied under these contracts is estimated to reach approximately 12 bcm. We will be delivering natural gas under this contract to a number of production assets of the Severstal group.

The table below sets forth our sales volumes for the nine months ended 30 September 2012 to end-customers by region and to wholesale traders.

	<b>Sales Volume</b> (mmcm)
End-customers by regions:	
Chelyabinsk region .....	11,023
Perm region.....	4,718
Orenburg region.....	2,810
Moscow region .....	2,372
Khanty-Mansyisk autonomous region .....	1,881
Sverdlovsk region .....	1,823
St-Petersburg .....	763
Kirov region .....	499
Komi republic.....	467
Kostroma region .....	461
Tyumen region.....	430
Other .....	2,005
<b>Total end-customers</b> .....	<b>29,252</b>
Wholesale gas traders:	
Gazprom .....	9,381
Itera.....	2,383
Other .....	1,988
<b>Total wholesale gas traders</b> .....	<b>13,752</b>
<b>Total</b> .....	<b>43,004</b>

We price our natural gas based on a combination of factors, including supply-demand balance in the region where the customer is located, the regulated minimum and maximum wholesale prices for natural gas in that region and the price level of fuel oil (mazut) and coal in that region. In addition, the price, where applicable, includes a charge to cover the tariff for use of the UGSS. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Certain Factors Affecting Our Results of Operations—Natural Gas Prices*”. In the region of Chelyabinsk, we sell our natural gas to households at the regulated tariffs.

When our end-customers take delivery of less than agreed upon volumes of gas, we attempt to locate alternative customers for such excess gas. Should a customer not take full delivery of gas supplies, as provided for in the relevant supply contract, we generally relieve such customer from their obligation to pay for such gas, should we be informed sufficiently in advance.

We use similar forms of gas supply agreements for a majority of our sales to wholesale traders and end-customers, which differ primarily in payment terms. The standard agreement specifies, among other things, the price and volume of gas to be delivered during the term of the agreement. A majority (by volume) of our gas supply agreements are made for the three- to five-year term, with most agreements with end-customers having a duration of five years and some of the recently signed agreements with end-customers having a duration of 10-15 years. Our contract delivery terms with end-customers in Russia comply with Government Decree No. 816 “On Introduction of Amendments to the Acts of the Government of the Russian Federation with Respect to Improvement of the Procedure for Settlements for Electrical Energy (Capacity), Thermal Energy and Natural Gas”, dated 17 October 2009, which requires that 85% of the gas supplied must be paid for within the month of delivery, with the remainder to be paid within one month after delivery. Prices are established for one year and are recalculated to reflect any changes in regulated wholesale prices, VAT, UPT rate or Gazprom’s transportation tariffs. A refusal of access to the UGSS is included as a force majeure event in all our gas supply agreements. Our gas supply

agreements are also regulated by and contain terms required by Russian law and applicable regulations. See “*State Regulation of the Russian Gas Industry Applicable to the Activity of NOVATEK*”.

#### *Purchases of natural gas*

From January 2011, we started purchasing natural gas from Sibneftegas, one of our Joint Ventures, which is currently producing gas at the Beregovoye and Pyreinoe fields in YNAO, *pro rata* to our 51% stake in Sibneftegas. In the nine months ended 30 September 2012, we purchased 4,016 mcm of natural gas from Sibneftegas. See “*Related Party Transactions—Transactions with our associates and joint ventures*”.

In January 2012, we began purchasing natural gas from SIBUR (through our subsidiary NOVATEK Chelyabinsk) at a price which includes the cost of transportation. The purchased volumes are sold to our customers in Chelyabinsk region. In the nine months ended 30 September 2012, we purchased 2,540 mcm of natural gas from SIBUR. See “*Related Party Transactions—Transactions with parties under control of key management personnel*”. According to a long-term contract signed with SIBUR in 2012, we committed to purchase up to 70 bcm of natural gas from SIBUR in 2013 – 2022.

In July 2012, we signed two contracts for the supply of natural gas to EnBW, a German energy and utility company: one short-term contract through October 2013 and one long-term contract from October 2013 through October 2022. In order to meet our supply obligations under these contracts, we have entered into a series of contracts to purchase natural gas from European suppliers. We commenced trading activities on the European market in October 2012; currently these activities are limited to the purchase and sale of natural gas. See “*Management's Discussion and Analysis of Financial Condition and Results of Operations—Qualitative and Quantitative Disclosures and Market Risks—Commodity Risk—Natural gas foreign trading activities*”. We have also established a new business segment to account for these foreign trading activities. See “*Management's Discussion and Analysis of Financial Condition and Results of Operations—Segment Information*”. A principal reason for our decision to enter the European gas trading market is to build a customer base and establish a market presence, which we, in turn, plan to leverage in the event we begin LNG production at Yamal. A final investment decision on the Yamal LNG project is expected to be made in the near future. See “*Description of Our Fields—Prospective fields—South-Tambeyskoe field and the Yamal LNG project*”. We believe that the experience gained on the European gas trading market will put us in good position to secure a share of the LNG trading market in the future.

#### **Liquid Hydrocarbons and Oil Sales**

Our primary liquid hydrocarbon sales consist of stable gas condensate and LPG. Stable gas condensate is primarily used in the petrochemical and oil refining industries as an alternative to naphtha and light crude oil. Our LPG is sold to both the chemical processing industry, as a feedstock, and household and wholesale fuel markets, where its high energy content, environmental safety and ease of storage and transportation make it an attractive fuel source for automobiles and household usage. We also sell relatively small amounts of crude oil and oil products.

We export our stable gas condensate directly to international markets, primarily the Asian-Pacific region, Western Europe, the United States and South America, while LPG and crude oil are generally delivered to both international and domestic markets. As a result of our marketing strategy, we have developed stable relationships with off-takers of stable gas condensate in all the main international markets. The diversification of our stable gas condensate sales provides us with enhanced revenue stability, access to new markets and potential opportunities for higher margins. Stable gas condensate is transported by rail from the Purovsky Plant to the loading and storage facilities at the Port of Vitino.

In April 2012, we started purchasing de-ethanized gas condensate from SeverEnergia, which produces both natural gas and gas condensate. Our effective interest in SeverEnergia is 25.5%; however, we currently purchase 100% of gas condensate it produces. The purchased de-ethanized gas condensate is transported to our Purovsky Plant where it is processed together with gas condensate produced by other NOVATEK fields.

In November 2012, we started purchasing de-ethanized gas condensate from Nortgas.

The main export markets for our LPG sales are Poland, Finland and Turkey, and our main customers are BP Polska, Borealis AG, Neste and Bulmarket.

We conduct our export sales of liquid hydrocarbons through our trading subsidiary Novatek Gas & Power GmbH, also using our subsidiary NOVATEK Polska, which was established to expand our LPG sales in Poland on small wholesale and household markets and commenced commercial operations in January 2010.

We aim to adapt to volatile commodity prices and supply-demand realities in the market through continued optimization of our customer portfolio, targeting off-takers within our geographical reach, and expanding and maintaining our liquids logistics infrastructure. We are near the completion of the new facility in Ust-Luga, which includes a gas condensate fractionation unit for the production of higher value added petroleum products and a transshipment terminal. See “*Production—Ust-Luga project*”.

We seek to increase the volumes of our LPG sales on the domestic market through our network of refueling stations. Currently, we own 62 auto refueling stations and four wholesale commercial refueling stations in the Chelyabinsk, Rostov and Volgograd regions. Our largest network of auto refueling stations is located in the Chelyabinsk region, in close proximity to our processing facilities.

As of 30 September 2012, our inventory of rolling stock for the transportation of liquid hydrocarbons consisted of 5,900 leased and owned rail cars, of which 2,585 were used to transport LPG (420 of which we own) and the remaining were used to transport stable gas condensate.

Our liquid hydrocarbon marketing strategy includes:

- producing high-quality refined products and increasing margins on the sales of liquid hydrocarbons;
- increasing profitability of liquids sales by optimizing logistics infrastructure to preserve quality and increase flexibility; and
- achieving economies of scale to reduce processing and commercial costs.

The following table sets forth, by volume, our sales of stable gas condensate, LPG, crude oil and oil products on the domestic and export markets for the periods indicated:

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
	(thousand tons)				
<b>Export Sales, mt</b>					
Stable gas condensate .....	2,131	2,134	2,981	2,326	2,115
LPG (including CIS) .....	352	344	454	434	414
Crude oil .....	107	68	93	71	69
Oil products .....	0	0	0	0	1
<b>Total .....</b>	<b>2,590</b>	<b>2,546</b>	<b>3,528</b>	<b>2,831</b>	<b>2,599</b>
<b>Domestic Sales, mt</b>					
Stable gas condensate .....	24	3	3	4	55
LPG .....	312	310	426	442	335
Crude oil .....	201	100	149	114	129
Oil products .....	7	4	5	10	10
<b>Total .....</b>	<b>544</b>	<b>417</b>	<b>583</b>	<b>570</b>	<b>529</b>

For information regarding our sales of liquid hydrocarbons by revenues, see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Operational Highlights—Hydrocarbon Sales Volumes—Liquids Sales Volumes*”.

## Competition

The oil and gas industry is intensely competitive, and we compete with other major Russian and international natural gas and oil companies. Many of our competitors have substantially greater financial resources than us and have been operating in a market-based, competitive economic environment for much longer than we have. Some of our domestic competitors are state-owned or state-controlled. The key activities in which we face competition include:

- the acquisition of exploration and production licenses at auctions or tenders by Russian state authorities;
- the acquisition of other companies already owning licenses or existing hydrocarbon producing assets;
- the engagement of leading third party service providers whose capacity to provide key services may be limited;
- the purchase of equipment which may be scarce;
- the employment of the best qualified and most experienced staff; and
- the availability of sufficient transportation capacity.

See “*Risk Factors—Risks Relating to Our Business and Industry—We encounter intense competition from other gas and oil companies in all areas of our operations*”. See also “*Risk Factors—Risks Relating to Our Business and Industry—Global shifts in the pricing of natural gas and the expectation of convergence of Russian gas prices to international levels could lead to greater competition on the domestic market*” for more information about the risks related to our ability to compete effectively with Russian and international energy companies.

As a result of numerous factors, we expect competition in the natural gas industry to intensify. A number of other Russian gas and oil companies, as well as foreign companies, are permitted to compete for licenses and offer services in Russia, increasing our domestic competition. We also expect domestic competition to increase due to the

limited quantities of unexploited and unallocated hydrocarbon reserves remaining in Russia and the effects of, and financial resources provided by, increasing levels of foreign investment into Russian projects. Internationally, we compete with oil and gas companies outside of Russia. In some cases, we may be at a significant disadvantage because foreign-domiciled companies may have access to greater financial, technical and other resources, giving them a competitive advantage on the specific projects and markets in which we compete. Domestically, we compete with Russian natural gas producers and oil companies, including Gazprom, Rosneft (which has recently acquired a 51% interest in Itera, a 49% partner in our Sibneftegas joint venture), LUKOIL, TNK-BP (which Rosneft is in the process of acquiring) and Surgutneftegas. Our main LPG competitors are SIBUR (which is controlled by one of the Principal Shareholders), LUKOIL, Gazprom and Kazakh producers. We compete with international stable gas condensate producers from Algeria, Australia, Guinea, Libya, Iran, Norway, Qatar and East Timor.

The natural gas industry is currently subject to several important influences which are continually impacting the industry's competitive landscape. In recent years, the oil and gas industry has experienced consolidation, as well as increased deregulation and integration in strategic markets. Our ability to remain competitive will require, among other things, management's continued focus on reducing unit costs and improving efficiency, maintaining long-term growth in our reserves and production through continued technological innovation and our ability to capture international and domestic opportunities. In the face of this increasing competition, oil and gas companies are also facing growing demands to conduct their operations in a manner consistent with environmental and social goals. Investors, customers and governments are more actively following the oil and gas industry's performance on environmental responsibility and human rights, including performance with respect to the development of alternative and renewable fuel resources.

### **Health, Safety and Environment**

Our operations are subject to various health, safety and environmental laws and regulations in Russia. These laws govern, among other things, the composition of and limits on emissions released into the atmosphere, water use and wastewater discharge and discharges to the sea, the use, handling and disposal of hazardous substances and waste, soil and groundwater contamination, land reclamation, and employee health and safety. Our business activities are subject to certain environmental risks. We must comply with applicable requirements of Russian environmental laws and regulations in performing our business activities. Infringements may, following a court judgment, lead to the suspension of our production operations until such infringements are rectified.

We are committed to operating in an environmentally responsible and safe manner and have implemented programs and policies designed to keep our pipelines, plants and other facilities and assets in compliance with existing environmental laws and regulations. Our Environment, Health and Safety ("**EHS**") Policy (the "**EHS Policy**") complies with the principles and practices of the International Finance Corporation and other international environmental, health and safety standards. We continually develop and improve the EHS management system for implementation of the EHS Policy through industrial environmental control (soil, air, snow, surface and groundwater sampling), regular internal and external audits and periodic analysis of the system's efficiency.

We have issued three Sustainability Reports on the Territory of the Russian Federation (the "**Sustainability Reports**") covering the period from 2004 to 2010. The Sustainability Reports disclose our operational performance and achievements in the areas of environmental and social responsibility and reaffirm our commitment to transparency and best practices.

We believe that our operations are generally in compliance with applicable health, safety and environmental regulations. To date, we have not had any accidents that have had a material environmental impact.

We strive to prevent, or otherwise minimize, mitigate and remediate, harmful effects of our operations on the environment, and employ sustainable business practices throughout our operations.

### **Environmental Protection**

The development of the energy sector, a global increase in energy consumption and increased public interest in the problem of climate change are creating fast-growing markets for low-carbon energy sources. We consider our participation in these markets as an important part of our business strategy and, in 2011 and 2012, NOVATEK continued its participation in the global Carbon Disclosure Project ("**CDP**"). This project is an international investment partnership, in close cooperation with the Global Reporting Initiative, which is intended to simplify the dialogue between shareholders and corporations by providing high-quality information on operations and energy-efficient production.

Since 2011, NOVATEK has been participating in the CDP Water Disclosure Project which discloses information on the use of water resources and the assessment of water-related risks. We support the CDP's initiatives to promote environmentally safe solutions during the implementation of investment projects.

We actively incorporate alternative energy sources into our producing activities. For example, wind generators and solar panels generate the necessary power to run the telemechanic system of the gas condensate

pipeline from the Yurkharovskoye field to the Purovsky Plant. Implementation of this project has allowed us to abandon construction of a fixed power line to service the 326 kilometer pipeline system.

In the first quarter of 2010, we launched a 40 mt per annum methanol plant located on the territory of the Yurkharovskoye field to eliminate the need to transport methanol to the field, thereby decreasing operating costs and the associated environmental risks related to its transportation. We used the experience gained from the launch of the 12.5 mt per annum pilot methanol production plant in 2007 to improve the design of the new plant. In particular, the new plant uses higher quality anti-corrosive steel as well as a more efficient gas compressor unit. In 2011, we completed the modernization of the multi-stage water purification unit at the new methanol plant, which has led to a reduction in the costs of water purification.

In conducting our environmental policies, we generally seek to adhere to international standards for environmental protection and monitor our compliance with these principles. We work to implement government regulations and meet safety standards. In order to continuously improve our environmental performance, we conduct systematic in-house environmental audits covering all aspects of our environmental activities. We are committed to developing our own environmental management system. In the nine months ended 30 September 2012 and in 2011, our producing and processing facilities successfully passed compliance and recertification audits of their environmental management systems in accordance with ISO 14001:2004 standards, and our subsidiary NOVATEK-Transervice was certified in accordance with ISO 14001:2004. ISO 14001 standards were designed to assist companies in reducing their negative impact on the environment. Based on the comprehensive on-site audit results, we were certified to extend our environmental management systems for a further three-year period.

### **Labor Protection and Industrial Safety**

We are committed to the integration of high quality environmental and occupational health and safety management systems. Our industrial safety and labor protection activities are based on programs developed in conformity with our internal Environmental Protection, Industrial Safety and Labor Protection Policy and the ISO standards of the Integrated Environmental Protection, Industrial Safety and Labor Protection Management System.

In 2010, a second compliance audit carried out, confirming our compliance with OHSAS 18001-2007 standards, and our subsidiary NOVATEK-Transervice was certified in accordance with OHSAS 18001-2007 international standards.

Pursuant to the requirements of the laws of the Russian Federation and our internal policy, we have developed, approved and implemented the following regulations, measures and programs:

- regulations on organizing and carrying out real-time oversight of our hazardous production facilities to ensure compliance with the relevant industrial safety requirements;
- measures to improve and enhance working conditions in the workplace, taking into consideration occupational risks;
- workplace certification measures; and
- production facility monitoring programs.

We are prepared for possible accidents and incidents, and our production facilities undergo annual comprehensive inspections. Since 2009, we have not had any industrial accidents with fatalities other than the explosion at the compressor booster station at our Khancheyskoye field in 2010 (see *“Risk Factors—Risks Related to Our Business and Industry—There are numerous operating risks inherent in the gas and oil industry, and insurance may not be adequate, affordable or available to protect us against all these risks”*).

In order to reduce fire risk, our emergency response services successfully completed fire safety team exercises. The exercises enabled our fire safety divisions to develop measures to ensure the safety of employees and implement up-to-date fire prevention and fire suppression techniques. From 1 January 2009 to 30 September 2012 there were no fires or serious fire safety violations.

All of our emergency response personnel periodically undergo training designed to prevent localized oil and petroleum product spills or gas emissions. Each of our operating subsidiaries has put into place an emergency response plan and periodically carries out emergency response drills.

### **Insurance**

Exploration for and production, processing and transportation of natural gas, gas condensate and crude oil are hazardous activities. Natural disasters, operator error or other occurrences can result in gas leaks and fires, oil spills, blowouts, cratering, equipment failure and loss of well control, which can injure or kill people, damage or destroy wells and production facilities, and damage property and the environment. As required by law, we have mandatory insurance for third-party liability in connection with all our facilities which are deemed hazardous objects under law.

Apart from mandatory third-party liability insurance, the production equipment held by NOVATEK-Yurkharovneftegas, NOVATEK-Tarkosaleneftegas and NOVATEK-Purovsky ZPK is insured against property loss with Russian insurers. See *“Risk Factors—Risks Relating to Our Business and Industry—There are numerous operating risks inherent in the gas and oil industries and insurance may not be adequate, affordable or available to protect us against all these risks”*.

### Litigation

We are involved in legal and regulatory proceedings from time to time that arise in the ordinary course of business. In the opinion of management, none of these proceedings, if adversely determined, could have a material adverse effect on our financial position, results of operations or cash flows. Nevertheless, the amounts we may ultimately be responsible for paying in connection with these matters could differ materially from amounts we have accrued for such payments.

### Employees

We employed 5,202 employees at our head office and key subsidiaries as of 30 September 2012, of which approximately 42% were engaged in exploration and production and 47% were engaged in refining and marketing. Approximately 67% of our employees were members of a trade union at such date.

The following table sets out the number of employees at our key subsidiaries as of 30 September 2012 and as of 31 December 2011, 2010, and 2009, respectively.

	30 September		31 December	
	2012	2011	2010	2009
OAQ NOVATEK.....	517	508	475	474
NOVATEK-Yurkharovneftegas.....	772	740	723	575
NOVATEK-Tarkosaleneftegas .....	1,284	1,230	1,206	1,318
NOVATEK-Purovsky Plant.....	640	628	601	592
NOVATEK-Transervice .....	273	271	271	247
NOVATEK-AZK.....	659	478	283	151
NOVATEK Scientific and Technical Centre.....	93	67	38	-
Purovsky Terminal.....	114	97	75	-
NOVATEK Ust-Luga .....	174	83	36	15
NOVATEK-Polymer <sup>(1)</sup> .....	—	—	—	822
NOVATEK Chelyabinsk <sup>(2)</sup> .....	510	529	13	-
Yamal LNG <sup>(3)</sup> .....	-	-	174	114
Novatek Overseas AG.....	21	16	19	14
Novatek Polska .....	58	51	42	-
Others.....	87	76	92	95
<b>TOTAL .....</b>	<b>5,202</b>	<b>4,774</b>	<b>4,048</b>	<b>4,417</b>

<sup>(1)</sup> Sold in September 2010.

<sup>(2)</sup> Acquired in December 2010.

<sup>(3)</sup> Joint Venture since October 2011.

We have not experienced any work stoppages or other significant labor disputes, and we consider our relationship with our employees to be good. We make mandatory contributions to the governmental pension scheme in the Russian Federation.



## CLASSIFICATION OF RESERVES

The estimation of reserves of natural gas, gas condensate and crude oil can be broken down into two components: (i) geological reserves, or the quantities of natural gas, gas condensate and crude oil contained in the subsoil and (ii) extractable reserves, or the portion of geological reserves whose extraction from the subsoil as of the date the reserves are calculated is economically efficient given market conditions and rational use of modern extraction equipment and technologies and taking into account compliance with the requirements of subsoil and environmental protection.

The Russian reserves system differs significantly from SEC and PRMS reserves methodologies, in particular with respect to the manner in which and the extent to which commercial factors are taken into account in calculating reserves. Reserves that are calculated using different methods cannot be accurately reconciled. The following is a description of principal differences (although the description does not include all of the differences and some differences not described may be material).

### **Russian Reserves System**

The Russian reserves system is based solely on the analysis of geological attributes. Explored reserves are represented by categories A, B, and C1; preliminarily estimated reserves are represented by category C2; potential resources are represented by category C3; and forecasted resources are represented by categories D1 and D2. Natural gas reserves in categories A, B and C1 are considered to be fully extractable. For reserves of oil and gas condensate, a predicated coefficient of extraction is calculated based on geological and technical factors. We have included in this Prospectus only information about our reserves falling into categories A, B, C1 and C2.

Category A reserves are calculated for the portion of a deposit that has been drilled in accordance with an approved development project for the oil or natural gas field. They represent reserves that have been analyzed in sufficient detail to define comprehensively the type, shape and size of the deposit; the level of hydrocarbon saturation; the reservoir type; the nature of changes in the reservoir characteristics; the hydrocarbon saturation of the productive strata of the deposit; the content and characteristics of the hydrocarbons; and the major features of the deposit that determine the conditions of its development (mode of operations, well productivity, strata pressure, natural gas, gas condensate and crude oil balance, hydro and piezo-conductivity and other features).

Category B represents the reserves of a deposit (or portion thereof), the oil or natural gas content of which has been determined on the basis of commercial flows of oil or natural gas obtained in wells at various hypsometric depths. The type, shape and size of the deposit; the effective oil and natural gas saturation depth and type of the reservoir; the nature of changes in the reservoir characteristics; the oil and natural gas saturation of the productive strata of the deposit; the composition and characteristics of crude oil, natural gas and gas condensate under in-situ and standard conditions and other parameters; and the major features of the deposit that determine the conditions of its development have been studied in sufficient detail to draw up a project to develop the deposit. Category B reserves are calculated for a deposit (or a portion thereof) that has been drilled in accordance with either a trial industrial development project in the case of a natural gas field or an approved technological development scheme in the case of an oil field.

Category C1 represents the reserves of a deposit (or of a portion thereof) for which the oil or natural gas content has been determined on the basis of commercial flows of oil or natural gas obtained in wells (with some of the wells having been probed by a formation tester) and positive results of geological and geophysical exploration of non-probed wells. The type, shape and size of the deposit and the formation structure of the oil- and gas-bearing reservoirs are determined from the results of drilling exploration and production wells and by the geological and geophysical exploration techniques that have been field-tested for the applicable area. The lithological content, reservoir type and characteristics, oil and natural gas saturation, oil displacement ratio and effective oil and natural gas saturation depth of the productive strata have been studied based on drill cores and geophysical well exploration materials. The composition and characteristics of crude oil, natural gas and gas condensate under in-situ and standard conditions have been studied on the basis of well testing data. For an oil and natural gas deposit, the commercial potential of its oil-bearing fringe is determined. Well productivity, hydro- and piezo-conductivity of the stratum, stratum pressures and crude oil, natural gas and gas condensate temperatures and yields are studied on the basis of well testing and well exploration results. The hydro-geological and geocryological conditions are determined on the basis of well drilling results and comparisons with neighboring explored fields. Category C1 reserves are calculated on the basis of results of geological exploration work and production drilling and must have been studied in sufficient detail to yield data from which to draw up either a trial industrial development project in the case of a natural gas field or a technological development scheme in the case of an oil field.

Category C2 reserves are preliminarily estimated reserves of a deposit calculated on the basis of geological and geophysical research of unexplored sections of deposits adjoining sections of a field

containing reserves of higher categories and of untested deposits of explored fields. The shape, size, structure, level, reservoir types, content and characteristics of the hydrocarbon deposit are determined in general terms based on the results of the geological and geophysical exploration and information on the more fully explored portions of a deposit. Category C2 reserves are used to determine the development potential of a field and to plan geological, exploration and production activities.

The evaluation of natural gas reserves in newly discovered natural gas or oil-and-gas deposits is carried out under the Russian reserves system using the volume method. The volume method determines the volume of reserves by examining the filtration and capacitive parameters of the deposit based on (i) the area of the deposit; (ii) the effective depth of hydrocarbon saturation; and (iii) the porousness of the deposit and the level of saturation of the hydrocarbons, taking into account thermobaric conditions.

The evaluation of natural gas reserves in deposits already under development is carried out under the Russian reserves system using both the volume method and the material balance method. The material balance method takes into account temporal changes in the effective reservoir pressure as a result of the extraction of the hydrocarbons and the resultant influx of water.

In accordance with the Law on Subsoil, mineral reserves in Russia are subject to mandatory state examination, and subsoil users cannot be granted a production license with respect to a field that was not examined. The state examination of reserves is conducted by organizations subordinate to Rosnedra, including the State Reserves Commission, Central Reserves Commission and its regional departments. If the commercial feasibility of certain reserves is approved by any such organization, the reserves are included into the State Balance of Mineral Products. Once a subsoil user is granted a geological study, exploration and/or production license, it is required to file annual statistical reports reflecting changes in reserves. In addition, subsoil users' reserves reports are submitted annually for examination and approval by the Central Reserves Commission or its regional organizations or, if there has been a substantial change in reserves, by the State Reserves Commission. We retain an independent research institute to prepare such reports for us. In addition to annual reports, our licenses may require us to estimate our reserves in certain years or upon completion of certain phases of a field's development. Such estimations are submitted for examination and approval by the State Reserves Commission. Estimations of reserves, as examined by the state expert organizations and reflected in subsoil users' annual statistical reports, are accumulated in the State Balance of Mineral Products.

### **PRMS Reserves Methodology**

While the Russian reserves system focuses on the actual physical presence of hydrocarbons in geological formations, and reserves are estimated based on the probability of such physical presence, PRMS standards take into account not only the probability that hydrocarbons are physically present in a given geological formation but also the economic viability of recovering the reserves (including such factors as exploration and drilling costs, ongoing production costs, transportation costs, taxes, prevailing prices for the products, and other factors that influence the economic viability of a given deposit).

Under PRMS standards, reserves are those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions. Reserves must further satisfy four criteria: they must be discovered, recoverable, commercial, and remaining (as of the evaluation date) based on the development project(s) applied. Reserves are further categorized in accordance with the level of certainty associated with the estimates and may be sub-classified based on project maturity and/or characterized by development and production status. The information in this Prospectus about our proved and probable reserves under PRMS standards is based on the evaluations of our fields by D&M.

*Proved reserves.* Proved reserves are those quantities of petroleum which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under defined economic conditions, operating methods, and government regulations. If deterministic methods are used, the term reasonable certainty is intended to express a high degree of confidence that the quantities will be recovered. If probabilistic methods are used, there should be at least a 90% probability that the quantities actually recovered will equal or exceed the estimate.

*Probable reserves.* Probable reserves are those additional reserves which analysis of geoscience and engineering data indicate are less likely to be recovered than proved reserves but more certain to be recovered than possible reserves. It is equally likely that actual remaining quantities recovered will be greater than or less than the sum of the estimated proved plus probable reserves ("2P"). In this context, when probabilistic methods are used, there should be at least a 50% probability that the actual quantities recovered will equal or exceed the 2P estimate.

An evaluation of proved and probable reserves naturally involves multiple uncertainties. The accuracy of any reserves evaluation depends on the quality of available information and engineering and geological

interpretation. Based on the results of drilling, testing and production after the appraisal date, reserves may be significantly restated upwards or downwards. Changes in the price of natural gas, gas condensate or crude oil may also affect our proved and probable reserves estimates, as well as estimates of its future net revenues and net present worth, because the reserves are evaluated, and the future net revenues and net present worth are estimated, based on prices and costs as of the appraisal date.

### **SEC Reserves Methodology**

SEC standards differ in certain material respects from PRMS standards. The principal difference is the production period used for reserves projection. Under PRMS standards, proved reserves are projected to the economic production life of the evaluated fields. Under the SEC-LE basis, quantities of gas and oil deposits are required to be limited to quantities expected to be produced during the term of the license. The SEC-LE basis is used by those companies which are obliged to fully comply with the SEC rules. Other companies may use the SEC-LOF basis, which allows the inclusion into reserves estimates of the quantities expected to be produced beyond the term of the license subject to the existence of a right to renew the license as well as a track record of obtaining such renewals.

Our reserves reports are based upon the SEC-LOF basis, as we believe that current legislation allows us (or the respective Joint Ventures) to initiate the extension of mineral licenses. D&M accepted our representations that, upon completion of the primary term of our current licenses, we intend to extend the licenses to the end of the economic life of the associated fields and that we intend to proceed accordingly with the development and operations of those fields. We prepare and submit for approval by state authorities development plans for our fields based on the economic life of the field, even where this life exceeds the primary term of the associated license. We believe we are currently in material compliance with our licenses, which is the most significant factor in granting the application to extend a license to the full economic lives of the associated field upon the expiration of the initial term of the license. Our licenses (i.e., the licenses of our subsidiaries and Joint Ventures) expire between 2014 and 2045, with the production licenses to the Core Fields (the Yurkharovskoye, East-Tarkosalinskoye and Khancheyevskoye fields) expiring in 2034, 2043 and 2044, respectively, and, as such, our management intends to extend our licenses for properties expected to produce beyond the license expiry dates. See “*Business—Our Operations—Licenses*”.

Based upon our representations, D&M included as proved reserves, using SEC reserves methodology, those volumes that are estimated to be economically producible from the fields after the expiration of the primary term of the licenses. Consequently, information relating to our estimated proved natural gas, gas condensate and crude oil reserves as determined under the SEC-LOF standards is not necessarily indicative of information that would be reported under the SEC-LE standards that are required to be included in an offering document registered with the SEC.

SEC Regulation S-X Rule 4-10 paragraph (a) defines proved reserves as follows:

*Proved gas and oil reserves.* Proved gas and oil reserves are those quantities of gas and oil, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

- (i) The area of the reservoir considered as proved includes:
  - (A) the area identified by drilling and limited by fluid contacts, if any; and
  - (B) adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.
- (ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establish a lower contact with reasonable certainty.
- (iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.
- (iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:

- (A) successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and
  - (B) the project has been approved for development by all necessary parties and entities, including governmental entities.
- (v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

*Developed gas and oil reserves.* Developed gas and oil reserves are reserves of any category that can be expected to be recovered:

- (i) through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and
- (ii) through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

*Undeveloped gas and oil reserves.* Undeveloped gas and oil reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

- (i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.
- (ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time.
- (iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined in paragraph (a)(2) of Rule 4-10 of Regulation S-X promulgated under the Securities Act, or by other evidence using reliable technology establishing reasonable certainty.

## MANAGEMENT

### Governance Bodies

The management structure of NOVATEK consists of the General Meeting of Shareholders (the “**General Meeting of Shareholders**”), the Board of Directors, the Management Board and the CEO (Chairman of the Management Board) (the “**CEO**”).

The CEO and the Management Board are responsible for our day-to-day management and report to the Board of Directors and the General Meeting of Shareholders.

### General Meeting of Shareholders

The powers of the General Meeting of Shareholders are set forth in Federal Law No. 208-FZ “On Joint Stock Companies” of 26 December 1995, as amended (the “**Joint Stock Companies Law**”) and in our Charter.

### Board of Directors

Our Board of Directors is responsible for directing and managing our business activities under the provisions stipulated by the Joint Stock Companies Law and our Charter. The Board of Directors is accountable to our shareholders for creating and delivering sustainable shareholder value by executing its management responsibilities in an effective and efficient manner.

As well as oversight responsibility for financial performance, internal controls and risk management, the Board of Directors is responsible for a number of other matters specified in our Charter and Regulation on the Board of Directors (but not matters designated by law as being the exclusive responsibility of the General Meeting of Shareholders). Other matters for which our Board of Directors is responsible include, but are not limited to, defining our strategy review and approval of significant transactions, approval of long-term and annual business plans and investment projects, recommendations on dividends and the convening of Annual and Extraordinary General Meetings of Shareholders.

Our Board of Directors currently consists of nine members elected at each annual General Meeting of Shareholders through cumulative voting. Our directors have a wide range of expertise as well as significant experience in strategic, financial, commercial and gas and oil activities. The Board of Directors is chaired by Mr. Alexander Natalenko. Directors may be re-elected an unlimited number of times. Six of our directors are considered independent as defined by the Joint Stock Companies Law and two of our directors are considered independent as defined by the UKLA Combined Code on Corporate Governance. The Board of Directors is responsible for our overall management, except for matters reserved for our shareholders or the Management Board.

As of the date of this Prospectus, the Board of Directors consists of the following nine members elected at the Annual General Meeting of Shareholders on 27 April 2012:

<u>DIRECTOR</u>	<u>COMMITTEE MEMBERSHIP</u>
Andrei I. Akimov <sup>(2)</sup> .....	Audit Committee (Chairman)
Burkhard Bergmann <sup>(2)</sup> .....	Corporate Governance and Remuneration Committee, Strategy and Investments Committee
Ives Louis Darricarrere <sup>(2)</sup> .....	Strategy and Investments Committee
Mark A. Gyetvay .....	Strategy and Investments Committee (Chairman)
Leonid V. Mikhelson.....	Not assigned to any Committee
Alexander Y. Natalenko <sup>(1)</sup> .....	Audit Committee, Corporate Governance and Remuneration Committee
Kirill G. Seleznev <sup>(2)</sup> .....	Strategy and Investments Committee
Gennady N. Timchenko <sup>(2)</sup> .....	Strategy and Investments Committee
Ruben K. Vardanian <sup>(1),(2)</sup> .....	Corporate Governance and Remuneration Committee (Chairman), Audit Committee

<sup>(1)</sup> Denotes independent Board of Directors member according to the definition contained in the UKLA Combined Code on Corporate Governance.

<sup>(2)</sup> Denotes independent Board of Directors member according to the definition contained in the Joint Stock Companies Law.

## Management Board

Our day-to-day activities are managed by the Management Board, which is led by the Chairman of the Management Board. Our Management Board consists of eight members. The Chairman of the Management Board acts as our chief executive officer. The Chairman is elected by the General Meeting of Shareholders for a term of five years. Other members of the Management Board are elected for five years by the Board of Directors at the suggestion of the Chairman of the Management Board. Both the Chairman and the Management Board report to the Board of Directors and the General Meeting of Shareholders. The Chairman heads the Management Board, organizes its work and conducts its meetings. In addition, the Chairman is responsible for control over the implementation of resolutions adopted by the General Meeting of Shareholders and our Board of Directors.

Currently, the Management Board consists of the following members:

<u>Name</u>	<u>Position</u>
Vladimir A. Baskov.....	Deputy Chairman of the Management Board, Director of Project Supervision Department
Alexander M. Fridman .....	Deputy Chairman of the Management Board
Mark A. Gyetvay.....	Deputy Chairman of the Management Board, Member of the Board of Directors, Chief Financial Officer
Tatyana S. Kuznetsova.....	Deputy Chairman of the Management Board, Director of Legal Department
Iosif L. Levinzon .....	Deputy Chairman of the Management Board
Leonid V. Mikhelson.....	Chairman of the Management Board, Member of the Board of Directors
Mikhail V. Popov .....	First Deputy Chairman of the Management Board, Commercial Director
Kirill N. Yanovskiy .....	Member of the Management Board, Director of Finance and Strategy Development

Brief biographies of the Board of Directors members are set forth below:

### **Mr. Andrei I. Akimov**

- Non-executive Director
- Chairman of Audit Committee

Mr. Akimov graduated from the Moscow Financial Institute in 1975 where he specialized in international economics. From 1974 to 1987, Mr. Akimov held various executive positions in the Bank of Foreign Trade (“**Vneshtorgbank**”) of the USSR. From 1985 to 1987, he served as Deputy General Director of Vneshtorgbank’s branch in Zurich (Switzerland) and from 1987 to 1990, Mr. Akimov headed Donau Bank in Vienna (Austria). From January 1991 to November 2002 he was Managing Director of the financial company IMAG GmbH Vienna (Austria) and, at the same time, served as an adviser to the Chairman of Vneshtorgbank. Since 2003, Mr. Akimov has been the Chairman of the Management Board of Gazprombank. He is also Chairman of the Supervisory Board of Gazprombank (Switzerland) Ltd and a member of the board of directors of ZAO Gerosgaz and Carbon Trade & Finance SICAR S.E. Since 2011, he has been a member of the board of directors of Gazprom.

Since December 2006, he has been a member of our Board of Directors. Mr. Akimov is the Chairman of our Audit Committee.

### **Dr. Burkhard Bergmann**

- Non-executive Director
- Member of Corporate Governance and Remuneration Committee
- Member of Strategy and Investments Committee

Dr. Bergmann studied physics at the Freiburg and Aachen Universities from 1962 to 1968 and was awarded a Doctorate in Engineering by Aachen University of Technology in 1970. From 1968 to 1969, Dr. Bergmann worked at the German Federal Ministry for Research and Technology and from 1969 to 1972 at the Jülich Nuclear Research Center. In 1972, Dr. Bergmann joined Ruhrgas AG (from 1 July 2004, E.ON Ruhrgas AG), heading the LNG Purchasing Department. In 1978, he became Head of the Gas Purchasing Division responsible for gas purchasing, commercial aspects of gas transmission and storage, as well as gas billing. In 1980, he was elected as a member of the Management Board of E.ON Ruhrgas AG, serving from June 1996 as its Vice-Chairman and from June 2001 to February 2008 as its Chairman. From

March 2003 to February 2008, he was also a member of the Management Board of E.ON AG.

Dr. Bergmann is also a member of the board of directors (Supervisory Board) of: Allianz Lebensversicherungs-AG, Commerzbank AG, E.ON Energie AG, Contilia GmbH, and Telenor ASA. In addition, he is a member of the Advisory Boards for Dana Gas International, Akkumulatorenwerke Hoppecke Carl Zoeffner & Sohn GmbH, and IVG Immobilien AG. He has been elected as Chairman of the Advisory Board of Jaeger Beteiligungsgesellschaft mbH & Co KG.

Dr. Bergmann holds the following distinctions: Commander of the Royal Norwegian Order of Merit (1997); a Foreign Member of the Academy of Technological Sciences of the Russian Federation (2003); Order of Merit of the State of North Rhine-Westphalia (2004); Director of the Year, Moscow (2007); and Federal Cross of Merit of the Federal Republic of Germany (2008).

**Mr. Ives Louis Darricarrere**

- Non-executive Director
- Member of Strategy and Investments Committee

Mr. Darricarrere received his higher education with a Masters of Economics from The École Nationale Supérieure des Mines de Paris. He has held various managerial positions in TOTAL Group over the last five years. In 2002-2003, Mr. Darricarrere served as Senior Vice President for Exploration & Production in the Northern Europe where he served on the Management Board. He was a member of TOTAL Group's Executive Committee from 2003 to 2007 during which time he also served as President of Total Gas & Power. Since 2007 to present, he has been President of Total Exploration & Production.

**Mr. Mark A. Gyetvay**

- Chief Financial Officer of NOVATEK – Executive Director
- Chairman of Strategy and Investments Committee

Mr. Gyetvay studied at Arizona State University (Bachelor of Science, Accounting, 1981) and later at Pace University, New York (Graduate Studies in Strategic Management, 1995). After graduation, Mr. Gyetvay worked in various capacities at a number of independent gas and oil companies (Champlin Petroleum Co., Texas, Ensource Inc. and MAG Enterprises, Colorado, and Amerada Hess Corporation, New Jersey) where he specialized in financial and economic analysis for both upstream and downstream segments of the petroleum industry.

In 1994, Mr. Gyetvay began his work at Coopers and Lybrand, New York, as Director, Strategic Energy Advisory Services working for gas and oil companies in the United States and abroad. He subsequently moved to Moscow in 1995 with Coopers & Lybrand to lead the gas and oil practice. He was admitted as a partner of PricewaterhouseCoopers Global Energy where he assumed the role of client service engagement partner, Utilities and Mining Practice, based in Russia (Moscow office). Mr. Gyetvay was an engagement partner on various energy and mining clients providing overall project management, financial and operational expertise, maintaining and supporting client service relationships as well as serving as concurring partner on transaction services to the petroleum sector.

Mr. Gyetvay is a Certified Public Accountant, a member of the American Institute of Certified Public Accountants and an associate member of the Society of Petroleum Engineers.

In 2003, Mr. Gyetvay became a member of our Board of Directors and is also the Chairman of the Strategy and Investments Committee of our Board of Directors. Since 2004, he has been our Chief Financial Officer and in 2005 Mr. Gyetvay was elected to our Management Board and in 2008 he became Deputy Director of our Management Board.

**Mr. Leonid V. Mikhelson**

- Executive Director
- Chairman of the Management Board

Mr. Mikhelson received his primary degree from the Samara Institute of Civil Engineering in 1977, where he specialized in Industrial Civil Engineering. That same year, Mr. Mikhelson began his career as foreman of a construction and assembling company in Surgut, Tyumen region, where he worked on the construction of the first section of Urengoi-Chelyabinsk gas pipeline. In 1985, Mr. Mikhelson was appointed Chief Engineer of Ryazantruboprovodstroy. In 1987, he

became General Director of Kuibishevtruboprovodstroy, which in 1991 was the first company in the region to sell its shares and became a private company, AO SNP NOVA. Mr. Mikhelson remained SNP NOVA's Managing Director from August 1987 through October 1994. Subsequently, he became a General Director of the management company "Novafininvest", the holding and finance structure which included SNP NOVA as an asset, amongst others, and is the predecessor of NOVATEK.

Since 2002, Mr. Mikhelson has served as a member of our Board of Directors and the Chairman of our Management Board. From March 2008 to December 2010, he has been a member of the board of directors of OAO Stroytransgas and from 2008 to 2011 a member of the board of directors of OOO Art Finance. Since April 2011, Mr. Mikhelson has served as Chairman of the board of directors of ZAO SIBUR Holding and since June 2011, as a member of the Supervisory Board of Russian Regional Development Bank. Mr. Mikhelson is the recipient of the Russian Federation's Order of the Badge of Honor.

**Mr. Alexander Y. Natalenko**

- Chairman of the Board of Directors
- Member of Audit Committee
- Member of Corporate Governance and Remuneration Committee

Mr. Natalenko completed his studies at the Irkutsk State University in 1969 with a primary focus in Geological Engineering. Subsequently, he worked with the Yagodinskaya, Bagdarinskaya, Berelekhskaya, Anadirskaya and East-Chukotskaya geological expeditions. In 1986, Mr. Natalenko headed the North-East Industrial and Geological Association and, in 1992, he was elected president of AI "Magadan Gold & Silver Company". He subsequently held various executive positions in Russian and foreign geological organizations. From 1996 to 2001, Mr. Natalenko held the position of Deputy Minister of Natural Resources of the Russian Federation. He is a member of the board of directors of ZAO GC VERTEX and OAO Rusgeologiya.

Currently, Mr. Natalenko is the Chairman of our Board of Directors.

Mr. Natalenko is the recipient of the State Prize of the Russian Federation and an Honored Geologist of Russia.

**Mr. Kirill G. Seleznev**

- Non-executive Director
- Member of Strategy and Investments Committee

Mr. Seleznev, graduated from the D.F. Ustinov Baltic State Institute of Technology in 1997 and, in 2002, received a degree in Finance and Credit from the St. Petersburg State University. Upon completion of his university studies, Mr. Seleznev managed OOO Baltic Finance Company, OAO Investment and Financial Group Management Investments Development and OAO St. Petersburg Sea Port, all of which are located in St. Petersburg, Russia. In 2000, Mr. Seleznev was appointed as Chief of the Tax Group at IAI "Baltic Pipeline System", St. Petersburg, Russia. In 2001-2002, Mr. Seleznev held the position of Deputy Chief of Staff of the Management Board and Assistant to Chief Executive Officer of Gazprom, in Moscow, Russia. Since 2002, he has been the head of the Gas and Liquid Hydrocarbons Marketing and Processing Department of Gazprom and a Member of the Gazprom Management Board. Since 2003, Mr. Seleznev has been the General Director of OOO Mezhregiongaz.

Mr. Seleznev is also a member of the board of directors and Supervisory Board of several other entities. Since 2006, Mr. Seleznev has been a member of our Board of Directors.

**Mr. Gennady Timchenko**

- Non-executive Director
- Member of Strategy and Investments Committee

In 1976, Mr. Timchenko graduated with a Masters of Science from the Mechanical University in Leningrad. He began his career at the Izjorskii Factory in Leningrad, an industrial plant which made components for the energy industry. From 1982 to 1988, he was a Senior Engineer at the Ministry of Foreign Trade. Mr. Timchenko has more than 20 years of experience in the Russian and international energy sectors and he has built interests in related companies carrying out trading, logistics and transportation.

In 1988, Mr. Timchenko became a vice president of Kirishineftekhimexport, the export and trading arm of the Kirishi



refinery in the Leningrad region. In 1991, he worked for Urals Finland which specialized in oil and petrochemical trading. From 1994 to 2001, Mr. Timchenko was managing Director of IPP OY Finland and IPP AB Sweden. In 1997, he co-founded Gunvor, a leading independent oil-trading company. Mr. Timchenko has been a member of the board of directors of Transoil, SIBUR, OOO BaltransService and Airfix Aviation Oy. Since 2009, he has been a member of our Board of Directors.

**Mr. Ruben K. Vardanian**

- Non-executive Director
- Chairman of Corporate Governance and Remuneration Committee
- Member of Audit Committee

Ruben Vardanian is the co-Head of Sberbank CIB. Prior to the merger with Sberbank in January 2012, he served as Chairman of the board of directors of Troika Dialog, where he had worked since the company's founding.

Mr. Vardanian is a board member at a number of entities: OJSC AvtoVAZ (the largest car manufacturer in Eastern Europe), OJSC KAMAZ (the largest truck manufacturer in Eastern Europe), CJSC SIBUR Holding (a petrochemical firm in Russia and Eastern Europe), and Joule Unlimited, Inc. (a producer of liquid fuel from solar energy). He is also a member of the Supervisory Board for the closed-end mutual venture investment fund Skolkovo-Nanotec and a member of the Investment Committee of Avica Property Investors International (Asset Management Company of Romanov Property Holdings Fund). Mr. Vardanian is also Chairman of the boards of directors of OJSC Rosgosstrakh (a major insurance player on the Russian market) and AmeriaBank (a leading bank in Armenia).

Mr. Vardanian served as CEO at Rosgosstrakh from 2002–2004 and as Chairman of Rosgosstrakh's board of directors from April 2004 to July 2005 and was Chairman of the board at Sukhoi Civil Aircraft from 2005 to 2009. Additionally, from February until September 2012, he served on the board of directors of IG Seismic Services Ltd. (a joint venture between the Integra Group and Schlumberger).

Mr. Vardanian is a founding partner of the SKOLKOVO Moscow School of Management and a member of its Coordination Council. The school was founded at the initiative of Mr. Vardanian and a number of leading Russian private investors with the objective to form a benchmark-setting educational establishment focused on training the next generation of local and international entrepreneurs. From 2006 to 2011, Mr. Vardanian was the President of SKOLKOVO. As part of the school's Coordination Council he currently heads its Committee on International Cooperation and Strategic Partnerships.

In 2011 the President of the Republic of Armenia awarded Mr. Vardanian with the Order of St. Mesrop Mashtots in recognition of his substantial contribution to defending the national interests of Armenia and his extensive and productive work performed in the name of the country.

Mr. Vardanian is a graduate of Moscow State University, where he earned a degree in economics, graduating with honors. His post-graduate resume includes training at Banca CRT in Turin, Italy, Merrill Lynch's Emerging Markets Training Program in New York City (1992), as well as courses at INSEAD (Fontainebleau, France) and the Harvard Business School (2001 and 2005).

**Loans to Directors and Officers**

We have not extended any loans to our directors and members of the Management Board.

**Board Committees**

On 25 March 2005, our Board of Directors approved the establishment of three Board committees: Audit; Strategy and Investments; and Corporate Governance and Remuneration. Each of these committees has been established in accordance with best practices and standards of corporate governance.

The committees play a vital role in ensuring that high standards of corporate governance are maintained.

### ***Strategy and Investments Committee of the Board of Directors***

Our strategy and investments committee consists of Mark Gyetvay (chairman), Kirill Seleznev, Burkhard Bergmann, Gennady Timchenko and Yves Louis Darricarrere. The objectives and powers of this committee include:

- identify high priority strategy and investment areas for the business;
- evaluate the efficiency of potential investment projects and their impact on increasing our value;
- analyze our concepts, programs and strategic development plans; and
- make recommendations to our Board of Directors with respect to our capitalization and borrowings.

### ***Audit Committee of the Board of Directors***

Our audit committee consists of Andrei Akimov (chairman), Ruben Vardanian and Alexander Natalenko. The objectives and powers of this committee include:

- make recommendations to the Board of Directors with respect to the selection of an independent auditor, as well as the annual audit of the financial statements;
- oversight of our financial and economic activities;
- develop internal control procedures; and
- evaluate internal control efficiency and prepare proposals for its improvement.

### ***Corporate Governance and Remuneration Committee of the Board of Directors***

Our corporate governance committee consists of Ruben Vardanian (chairman), Alexander Natalenko and Burkhard Bergmann. The objectives and powers of this committee include:

- develop and regularly review our corporate governance documents and our documents regulating corporate conflicts;
- develop recommendations with respect to our dividend policy; and
- develop procedures for and perform an annual appraisal of the performance of work by our Board of Directors.

We comply with the corporate governance rules established by Russian law.

### **Internal Audit**

Our Internal Audit Division, in cooperation with our Board of Directors and our management, takes part in providing objective assurance on the adequacy and effectiveness of our systems for risk management and internal control and provides recommendations to improve those systems. The Internal Audit Division has adopted the Institute of Internal Auditors' Code of Ethics as well as international auditing standards and international professional standards of internal audit.

In performing its functions, the Internal Audit Division is guided by the principles of independence and objectivity. Our internal standards envisage full access of the Internal Audit division employees to all our functions, records, property and personnel in implementing their audit tasks. The division's employees regularly update their qualifications and professional development as an integral part of the internal audit quality assurance.

### **Revision Commission**

As of the date of this Prospectus, the Revision Commission consisted of Maria Panasenko, Igor Ryaskov, Sergey Fomichev and Nikolay Shulikin, elected at the Annual General Meeting of Shareholders on 27 April 2012. The Revision Commission is an internal control body responsible for oversight of our financial and business activities, officers, divisions, departments, branches, and representative offices. The Revision Commission verifies the accuracy of our financial reporting under Russian law and audits our financial and business performance for the year, as well as for any other period as may be decided by its members or other persons authorized to do so in accordance with Russian law and the Regulations on the Revision Commission, and presents the review (revision) results in the form of an opinion. The members of our Revision Commission are elected by the General Meeting of Shareholders for a term of one year. Members of our Board of Directors may not simultaneously serve as members of the Revision Commission.

### **Key Management Compensation**

The aggregate amount of remuneration, including salary and bonuses and excluding dividends, paid by us to our key management personnel (the members of our Board of Directors and our Management Board, some of whom have also direct and indirect interests in us) collectively as a group for services rendered to us in all capacities is

presented below. Key management compensation includes personal income tax and is net of payments that we make to non-budget funds.

	Nine months ended 30 September		Year ended 31 December		
	2012	2011	2011	2010	2009
			<i>(RUB million)</i>		
Board of Directors.....	86	85	103	93	38
Management Board.....	1,172	1,123	1,242	1,049	624
<b>Total compensation</b> .....	<b>1,258</b>	<b>1,208</b>	<b>1,345</b>	<b>1,142</b>	<b>662</b>

The procedure and criteria for determining fees payable and expenses reimbursable to the Members of the Board of Directors are set forth in our Charter and the Regulations on the Board of Directors. The remuneration for serving on our Board of Directors is subject to approval by the General Meeting of Shareholders in accordance with the Regulation on Remuneration and Compensations Payable to Members of the Board of Directors. Employment contracts with our directors do not provide for special benefits upon termination of employment.

The procedure and criteria for determining fees payable and expenses reimbursable to the Chairman of the Management Board and Members of the Management Board are set forth in NOVATEK's Regulations on the Management Board and employment agreements entered into between the company and the individual Board members.

Some members of the Management Board and the Board of Directors have direct and/or indirect holdings of our shares, and receive dividends under general conditions based on their respective shareholdings.

#### **Share-Based Compensation Program**

On 12 February 2010, our Management Board approved a 3-year share-based compensation program (the "ESOP") for a limited number of our senior and key management as well as high-potential managers, but excluding the members of the Management Board. The ESOP aims to encourage its members to take an active interest in our future development and to provide material incentives to create shareholder value in NOVATEK. We account for share-based compensation in accordance with IFRS. The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense.

The ESOP is expected to terminate in 2013, and NOVATEK is working on the key terms of a new share-based compensation program.

#### **Litigation Statement about Directors and Officers**

At the date of this Prospectus, none of our Directors or members of our Management Board for at least the previous five years:

- has any convictions in relation to fraudulent offenses; nor
- has held an executive function in the form of a senior manager or a member of the administrative, management or supervisory bodies, of any company at the time of or preceding any bankruptcy, or related receivership or liquidation; nor
- has been subject to any official public incrimination and/or sanction by any statutory or regulatory authority (including any designated professional body) nor has ever been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of a company or from acting in the management or conduct of the affairs of any company.

#### **Conflict of Interest**

Contracts with our Directors do not provide for special benefits upon termination of their directorship.

Certain of our Directors and members of our Management Board have direct and/or beneficial interests in our shares. See "Shareholders".

As set out in the biographies above, certain of our Directors also serve as directors or officers of some of our competitors and have direct or beneficial interests in companies with which we have engaged in transactions, including those in the ordinary course of business. As a result, potential conflicts of interest exist between these directors' duties to us and their duties arising from their positions with or interests in such other entities. Specifically, Mr. Seleznev, a member of our Board of Directors, serves as a member of the Management Board and Head of the Gas and Liquid Hydrocarbons Marketing and Processing Department at Gazprom and the chief executive officer at OOO Gazprom mezhregiongas, our direct competitors. Mr. Akimov, a member of our Board of Directors, serves as a member of the Board of Directors of Gazprom. Mr. Mikhelson is the controlling shareholder

of SIBUR, with which we compete in the LPG market. See also “*Related Party Transactions*”. Messrs. G. Timchenko and R. Vardanian also serve on the board of directors of SIBUR.

Except as stated above and disclosed in “*Related Party Transactions*” and “*Plan of Distribution*”, there are no potential conflicts of interest between any duties owed to us by any member of the Board of Directors or the Management Board and his or her private interests.

## RELATED PARTY TRANSACTIONS

The following is a summary of transactions with related parties as defined in IAS 24 “Related Parties Disclosure”, in accordance with IFRS. For further details of these transactions, see Note 30 of the 2011 Audited Financial Statements, Note 30 of the 2010 Audited Financial Statements and Note 22 of the Unaudited Financial Statements. For more information on the related parties described in this section, see “Shareholders” and “Business— Our History”.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions, as defined under IAS 24, “Related Party Disclosures”. Related parties may enter into transactions that unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. We enter into transactions with related parties based on market or regulated prices.

### **Gazprom**

From 2006 until 20 December 2010, Gazprom was a beneficial owner of 19.39% of our shares and a related party. On 20 December 2010, Gazprom sold 9.4% of our shares to a third party, decreasing its stake in us to 9.99%. Consequently, Gazprom ceased to be our related party from that date.

We have engaged in transactions with Gazprom and Gazprom’s subsidiaries both before and after we deemed it a related party. In particular, we transport substantially all of our natural gas through the UGSS, which is owned and operated by Gazprom. See “Business—Transportation of Our Production—Natural Gas Transportation”. Transactions and balances with Gazprom and its subsidiaries for the years ended 31 December 2010 and 2009 are presented below:

### **Related parties – Gazprom and subsidiaries**

	Year ended 31 December	
	2010	2009
	<i>(RUB millions)</i>	
<b>Transactions</b>		
<b>Gazprom</b>		
Natural gas sales .....	12,935	-
Natural gas transportation to customers .....	(26,550)	(19,930)
Other expenses .....	(25)	(3)
<b>OOO Gazprom mezhregiongaz (formerly OOO Mezhregiongaz):</b>		
Natural gas sales .....	1,055	15,791
<b>Other Gazprom subsidiaries</b>		
Sales of polymer and insulation tape .....	22	37
Unstable gas condensate transportation .....	(307)	(340)
Processing fees .....	(458)	(532)
Natural gas transportation .....	(4)	(3)
Other operating income (loss) .....	9	-
Other expenses .....	(34)	(33)
<b>Balances</b>		
<b>Gazprom</b>		
Trade payables and accrued liabilities .....	—	530
<b>OOO Gazprom mezhregiongaz</b>		
Trade and other receivables .....	—	784
<b>Other Gazprom subsidiaries</b>		
Trade and other receivables .....	—	16
Trade payables and accrued liabilities .....	—	157

### **Transactions with our associates and joint ventures**

We have certain transactions with our associates and joint ventures, which occur in the ordinary course of business and include, among others, natural gas and liquids purchases and financings.

We engaged in the following transactions in the ordinary course of business with our associates and joint ventures in the nine months ended 30 September 2012, and in the years ended 31 December 2011, 2010 and 2009:

	Nine months ended 30 September	Year ended 31 December		
	2012	2011	2010	2009
<i>(RUB millions)</i>				
<b>Related parties – equity investments</b>				
<b>OAo Sibneftegas</b>				
Interest income on loans issued.....	687	1,023	45	—
Oil and gas sales.....	32	39	—	—
Purchases of natural gas.....	(3,666)	(3,661)	—	—
<b>OOO Yamal Development</b>				
Interest income on loans issued.....	—	1,325	191	—
<b>OOO SeverEnergia</b>				
Purchases of unstable gas condensate .....	(1,129)	-	—	—
Interest income on loans issued.....	145	247	—	—
<b>OAo Yamal LNG<sup>(1)</sup></b>				
Interest income on loans issued.....	—	167	—	—
Other revenues (operators revenues sales) .....	68	15	—	—
<b>Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas<sup>(2)</sup></b>				
Other revenues .....	—	—	—	773
Interest income.....	—	—	—	76
<b>Balances</b>				
<b>OAo Sibneftegas</b>				
Long-term loans receivable .....	8,377	9,103	10,070	—
Interest on long-term loans receivable .....	1,330	775	33	—
Short-term loans receivable .....	186	634	967	—
Trade payables and accrued liabilities .....	1,001	387	-	—
<b>OOO Yamal Development</b>				
Long-term loans and receivables .....	—	16,348	27,886	—
Interest on long-term loans receivable .....	—	—	191	—
<b>OOO SeverEnergia</b>				
Short-term loans receivable .....	—	6,225	—	—
Interest on short-term loans receivable .....	—	94	—	—
Trade payables and accrued liabilities.....	338	—	—	—
<b>ZAO Terneftegas<sup>(3)</sup></b>				
Long-term loans receivable .....	667	220	102	—
Interest on long-term loans receivable .....	24	5	-	—
<b>Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas</b>				
Long-term loans and receivable .....	—	—	—	108
Trade and other receivables .....	—	—	—	80
Short-term loans receivable.....	—	—	—	837
<b>OAo Yamal LNG</b>				
Long-term receivables .....	2,706	3,955	—	—

<sup>(1)</sup> In October 2011, our effective control over OAo Yamal LNG ceased; therefore, subsequent to that event, our balances and transactions with this entity are disclosed as related parties - equity investments.

<sup>(2)</sup> Until February 2010, we accounted for Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas as related parties. In February 2010, we increased our participation interest in these companies to 51%, and as a result these entities are fully consolidated effective February 2010 and are not accounted for as related parties as at the date of this Prospectus.

<sup>(3)</sup> In February 2010, our effective control over Terneftegas ceased; therefore, subsequent to that event, our balances and transactions with this entity were disclosed as related parties – equity investments.

#### **Transactions with parties under significant influence or control of key management personnel**

We have certain transactions with parties under significant influence or control of our key management personnel, including commercial bank OAo Pervobank (“**Pervobank**”). Before 2009, Pervobank was a related party under significant influence of key management personnel. At the end of March 2009, due to an increase of our key management personnel’s interest in the bank, Pervobank become a related party under the control of key management personnel. Our bank accounts are serviced by Pervobank on market terms. Our transactions with parties under significant influence of our key management personnel occur in the ordinary course of business.

*Transactions with parties under significant influence of key management personnel*

We engaged in the following transactions with parties under significant influence of our key management personnel:

	(RUB millions)			
	Nine months ended 30 September 2012	2011	Year ended 31 December 2010      2009	
<b>Related parties – under significant influence of key management personnel</b>				
<b>OOO Nova (formerly SNP NOVA)<sup>(1)</sup></b>				
Purchases of construction services (capitalized within property, plant and equipment) .....	—	—	3,825	2,245
Oil products sales .....	—	—	17	28
Other revenues .....	—	—	7	20
<b>OAO Tambeyneftegas<sup>(2)</sup></b>				
Other operating income (loss) .....	—	—	(11)	-
Other expenses .....	—	—	(15)	(16)
Interest income on loans issued .....	—	—	44	79
<b>Aldi trading Limited, Orsel Consultant Limited, Innecto Ventures Limited<sup>(1)</sup></b>				
Finance income (expense) .....	—	—	(221)	(41)
<b>Balances</b>				
<b>OOO Nova (formerly SNP NOVA)</b>				
Trade and other receivables .....	—	—	20	11
Advances for construction .....	—	—	278	137
Trade payables and accrued liabilities .....	—	—	312	188
<b>Tambeyneftegas</b>				
Trade and other receivables .....	—	—	-	184
Short-term loans receivable .....	—	—	-	636
<b>SIBUR<sup>(3)</sup></b>				
Trade and other receivables .....	—	—	218	-
Long-term receivable .....	—	—	1,548	-
Trade payables and accrued liabilities .....	—	—	11	-
<b>Aldi Trading Limited, Orsel Consultant Limited, Innecto Ventures Limited</b>				
Other non-current liabilities .....	—	—	—	2,636
Trade payables and accrued liabilities .....	—	—	2,836	-

(1) Until 1 January 2011, we accounted for OOO Nova as a related party under significant influence of our key management personnel. Effective 1 January 2011, we adopted the revised standard IAS 24, Related Party Disclosures, which adjusted the definition of the related party. In accordance with the revised standard, parties under significant influence of key management personnel are not our related parties. Thus, OOO Nova and certain other entities (Aldi Trading Limited, Orsel Consultant Limited and Innecto Ventures Limited) are no longer considered to be our related parties.

(2) We accounted for Tambeyneftegas as a related party under significant influence of our key management personnel until July 2010, when we acquired 100% of the shares of the company, including 75% of shares in Tambeyneftegas from related parties for RUB234 million. As a result, Tambeyneftegas is fully consolidated effective 1 July 2010 and is not accounted for as a related party as at the date of this Prospectus.

(3) In December 2010, the Chairman of our Management Board acquired an effective 25% stake in SIBUR. As a result, our balances and transactions with this company and its subsidiaries are disclosed from that date as related parties – parties under significant influence of key management personnel. See also “—Transactions with parties under control of key management personnel”.

In addition, in June 2010, we paid RUB30 million of transaction fees to Investment Company Troika Dialog, a party under significant influence of a member of our Board of Directors, for services related to the issuance of Rouble denominated bonds. This transaction cost was capitalized within long-term debt and will be amortized over the bonds' term.

*Transactions with parties under control of key management personnel*

We engaged in the following transactions in the ordinary course of business with parties under control of our key management personnel:

	Nine months ended 30 September	Year ended 31 December		
	2012	2011	2010	2009
<i>(RUB millions)</i>				
<b>Related parties – parties under control of key management personnel</b>				
<b>  OAO Pervobank</b>				
Finance income (expense) .....	51	16	18	30
<b>  SIBUR and its subsidiaries</b>				
Natural gas sales .....	1,438	—	—	—
Purchases of natural gas .....	(6,614)	—	—	—
Purchases of liquid hydrocarbons .....	(34)	—	—	—
<b>Balances</b>				
<b>  OAO Pervobank</b>				
Cash and cash equivalents .....	1,906	4,066	1,760	845
<b>  SIBUR and its subsidiaries</b>				
Long-term receivable .....	—	1,424	-	-
Trade payables and accrued liabilities .....	616	—	—	—
Trade and other receivables .....	1,636	248	—	—
Prepayments and other current assets .....	1,690	—	—	—

In September 2011, the Chairman of our Management Board acquired a controlling stake in SIBUR. As a result, our balances with this company and its subsidiaries at 31 December 2011 were disclosed as related parties – parties under control of key management personnel.

#### **Compensation for Key Management Personnel**

For information on compensation paid to key management personnel, see “*Management—Key Management Compensation*” and “*Management—Share-Based Compensation Program*”.



## SHAREHOLDERS

### Shareholdings

The following table sets forth the shareholders of record of NOVATEK as of 30 September 2012:

Holder of Record	% of shares
ZAO Depository and Clearing Company <sup>(1)</sup> .....	45.79%
OOO Deutsche Bank <sup>(1)</sup> .....	29.98%
OAO Gazprombank <sup>(1)</sup> .....	9.99%
OOO Levit <sup>(2)</sup> .....	7.32%
Other .....	6.92%
<b>TOTAL</b> .....	<b>100.0%</b>

<sup>(1)</sup> Nominee holder.

<sup>(2)</sup> OOO Levit is majority-owned (78%) by Mr. L.V. Mikhelson, the Chairman of our Management Board and a member of our Board of Directors.

### Principal Shareholders

As of the date of this Prospectus, according to the disclosure in the mandatory filings made to us and the FSFM, the following persons have reported voting rights to 5% or more of our shares:

Beneficial Owner	% of shares
Mr. Leonid V. Mikhelson.....	24.76%
Mr. Gennady N. Timchenko .....	23.49%
Total E&P Arctic Russia B.V. <sup>(1)</sup> .....	15.16%
Gazprom.....	9.99%
<b>TOTAL</b> .....	<b>73.40%</b>

<sup>(1)</sup> A majority-owned subsidiary of TOTAL.

Our principal beneficial shareholders include our commercial partners, Gazprom and TOTAL. NOVATEK believes that its relations with these commercial partners give it significant benefits and that these shareholdings support these relationships.

### NOVATEK Directors and Their Interests

As indicated above, two of our directors / officers have significant beneficial holdings of our shares: Mr. Leonid V. Mikhelson, the Chairman of our Management Board and a member of our Board of Directors, controls 24.76% of our shares, and Mr. Gennady N. Timchenko, a member of our Board of Directors, controls 23.49% of our shares. Collectively, they are in position to exercise significant control over us. See *“Risk Factors—Risks Related to Our Business and Industry—Two individual shareholders collectively hold a substantial number of our shares. The interests of such shareholders may conflict with those of the Noteholders”*. Other members of our Board of Directors and Management Board in aggregate own less than 1% of our shares.

### Public Trading

In 2005, we carried out an initial public offering (“**IPO**”) in which shareholders placed existing shares (no new shares were issued) and pursuant to which global depository receipts (the “**GDRs**”) evidencing our shares were listed on the regulated market of the London Stock Exchange. Our shares have been listed on two major Russian stock exchanges, the Moscow Interbank Currency Exchange and Russian Trading System (which have since combined their operations as the Moscow Exchange), since October 2004 and April 2005, respectively. In the IPO, 524,453 shares were placed. OOO Deutsche Bank acts as the local custodian for our GDR program (as well as acting as custodian in respect of shares not deposited in the GDR program). Under our permit from the FSFM, at most 910,589,000 shares, representing 29.99% of our shares, may be deposited into the GDR program.

### Buy-back Program

On 7 June 2012, our Board of Directors approved a buyback program for the purchase of our shares and GDRs in an aggregate amount of up to U.S.\$600 million; at current market pricing this could result in the purchase of roughly 2% of our shares. Purchases under our buyback program are authorized to be made during the 12-month period commencing 7 June 2012. On 16 November 2012, we announced that we have begun to execute purchases under the program. As of 30 November 2012, we have spent approximately U.S.\$10 million in the buyback. These purchases are made by our wholly-owned subsidiary Novatek Equity (Cyprus) Limited, which holds the repurchased

GDRs and shares as treasury stock. As of 1 December 2012, Novatek Equity (Cyprus) Limited held 2,893,530 of our shares (in the form of shares and GDRs). The GDRs and shares purchased as part of the buyback program retain all rights attributable to our GDRs and shares, including the right to receive dividends, but are not voted, and may be used to finance our operations or fund our compensation and incentive program for management and key employees.

Previously, in 2008 Novatek Equity (Cyprus) Limited purchased GDRs, and then sold 222,380 GDRs in 2010-2011 for an aggregate price of RUB877 million. As of 30 September 2012, Novatek Equity (Cyprus) Limited held as non-voting treasury stock 196,853 GDRs.

#### **Dividend Policy**

Pursuant to our dividend policy, we expect to pay out dividends equal to at least 30% of our annual net income calculated in accordance with Russian accounting standards. In any one year, however, the aggregate annual dividends paid to shareholders may be lower or higher than 30%, reflecting our view of market conditions, as well as our operating cash flows, financing requirements, capital investments and such other factors as we may deem relevant to maintaining a flexible capital structure.

The total approved dividend distributions for 2011, 2010 and 2009 amounted to RUB18,218 million, RUB12,145 million and RUB8,350 million, respectively, exceeding our 30% target in each of these years. In October 2012, our shareholders approved an interim dividend in respect of the six months ended 30 June 2012 of RUB9,109 million.

Dividend payments, if any, must be recommended by our Board of Directors and approved by our shareholders and are subject to certain conditions as set forth in the Joint Stock Companies Law and our Charter.

## THE ISSUER

### Description of the Issuer

The Issuer is a special purpose vehicle incorporated in Ireland as a private limited company, registered number 489576 under the name Novatek Finance Limited under the Companies Acts 1963 to 2009 of Ireland, as amended (the “**Companies Acts**”) on 29 September 2010. The registered office of the Issuer is 12, Merrion Square, Dublin 2 and its telephone number is +353 1 631 6000.

The authorized share capital of the Issuer is EUR 100 divided into 100 ordinary shares of par value EUR1 each (the “**Issuer Shares**”). The Issuer has issued 1 Issuer Share, which is fully paid and is held on trust by IFG Trust Company Limited (the “**Share Trustee**”) under the terms of a declaration of trust (the “**Declaration of Trust**”) dated 27 October 2010, under which the Share Trustee holds the Issuer Share on trust for charity. The Share Trustee has no beneficial interest in and derives no benefit (other than any fees for acting as Share Trustee) from its holding of the Issuer Share. The Share Trustee will apply any income derived from the Issuer solely for the above purposes.

IFG Managed Services Limited (the “**Corporate Services Provider**”), an Irish company, acts as the corporate services provider for the Issuer. The office of the Corporate Services Provider in Dublin serves as the general business office of the Issuer. Through the office and pursuant to the terms of the corporate services agreement entered into on 27 October 2010 between the Issuer and the Corporate Services Provider (the “**Corporate Services Agreement**”), the Corporate Services Provider performs various management functions on behalf of the Issuer, including the provision of certain clerical, reporting, accounting, administrative and other services until termination of the Corporate Services Agreement. In consideration of the foregoing, the Corporate Services Provider receives various fees and other charges payable by the Issuer at rates agreed upon from time to time plus expenses. The terms of the Corporate Services Agreement provide that either party may terminate the Corporate Services Agreement upon the occurrence of certain stated events, including any material breach by the other party of its obligations under the Corporate Services Agreement, which is either incapable of remedy or which is not cured within 30 days from the date on which it was notified of such breach. In addition, either party may terminate the Corporate Services Agreement at any time by giving at least 90 days written notice to the other party.

The Corporate Services Provider’s principal office is Universal House, Shannon, County Clare.

### Business

The principal objects of the Issuer are set forth in clause 2 of its Memorandum of Association (as currently in effect) and permit the Issuer, inter alia, to lend money and give credit, secured or unsecured, to issue debentures, enter into derivatives and otherwise to borrow or raise money and to grant security over its property for the performance of its obligations or the payment of money.

The Issuer is organized as a special purpose company. The Issuer was established to raise capital by the issue of debt securities and to use an amount equal to the proceeds of each such issuance to advance loans to the Borrower.

On 3 February 2011, the Issuer issued (i) U.S.\$600,000,000 5.326% Loan Participation Notes due 2016, and (ii) U.S.\$650,000,000 6.604% Loan Participation Notes due 2021 (the “**2011 Notes**”), for the sole purpose of financing corresponding loans to NOVATEK. Save for the issue of the 2011 Notes, since its incorporation the Issuer has not engaged in material activities other than those incidental to its registration as a private company under the Companies Acts and those related to the issue of debt securities, including the Notes. The Issuer has no employees.

### Directors and Company Secretary

The Issuer’s Articles of Association provide that the Board of Directors of the Issuer consist of at least two Directors.

The Directors of the Issuer and their business addresses are as follows:

Oonagh Hayes                                      12, Merrion Square, Dublin 2, Ireland

Paddy O’Halloran                                      12, Merrion Square, Dublin 2, Ireland

The Company Secretary is IFG Secretaries Limited.

### Financial Statements

The Issuer has prepared and published a Directors’ Report and Financial Statements for the period from 29 September 2010 (date of incorporation) to 31 December 2011, together with the audit report thereon. The Issuer’s fiscal year ends on 31 December of each year. The Issuer does not prepare interim financial statements.

Each year, a copy of the audited profit and loss account and balance sheet of the Issuer together with a report of the directors and the auditors thereon is required to be filed with the Irish Companies Registration Office within

28 days of the annual return date of the Issuer and is available for inspection. The profit and loss account and balance sheet can be obtained free of charge from the registered office of the Issuer.

MKO Partners, the Issuer's auditors, are chartered accountants and members of the Institute of Chartered Accountants in Ireland and registered auditors qualified to practice in Ireland, and with registered address of 6 The Courtyard Building, Carmanhall Road, Sandyford, Dublin 18, Ireland.

## TERMS AND CONDITIONS OF THE NOTES

*The following is the text of the Terms and Conditions of the Notes, which will be attached to the Notes in definitive form, if any, and (subject to the provisions thereof) will apply to the Global Note Certificates.*

The U.S.\$1,000,000,000 4.422 per cent. Loan Participation Notes due 2022 (the “**Notes**” which expression includes any further Notes issued pursuant to Condition 14 and forming a single series herewith), without coupons, of Novatek Finance Limited (the “**Issuer**”) are constituted by, are subject to, and have the benefit of a trust deed (the “**Trust Deed**”, which expression includes such trust deed as from time to time modified in accordance with the provisions therein contained and any deed or other document expressed to be supplemental thereto, as from time to time so modified) dated 13 December 2012 and made between the Issuer and Citicorp Trustee Company Limited (the “**Trustee**”, which expression shall include any successor as trustee) as trustee for the holders of the Notes (the “**Noteholders**”).

The Issuer has authorised the creation, issue and sale of the Notes for the sole purpose of financing a U.S.\$ 1,000,000,000 loan (the “**Loan**”) to OAO “Novatek” (“**NOVATEK**”). The terms of the Loan are set forth in a loan agreement (the “**Loan Agreement**”) dated 10 December 2012 between the Issuer and NOVATEK.

In each case where amounts of principal, interest and additional amounts (if any) are stated herein or in the Trust Deed to be payable in respect of the Notes, the obligations of the Issuer to make any such payment shall constitute an obligation only to account to the Noteholders on each date upon which such amounts of principal, interest and additional amounts (if any) are due in respect of the Notes, for an amount equivalent to sums of principal, interest and additional amounts (if any) actually received by or for the account of the Issuer pursuant to the Loan Agreement, less any amounts in respect of the Reserved Rights (as defined in the Trust Deed). Noteholders must therefore rely solely and exclusively on the covenant to pay under the Loan Agreement and the credit and financial standing of NOVATEK. Noteholders shall have no recourse (direct or indirect) to any other asset of the Issuer.

The Issuer has charged, by way of first fixed charge in favour of the Trustee for the benefit of itself and the Noteholders, certain of its rights and interests as lender under the Loan Agreement and under the Account (as defined in the Trust Deed) as security for its payment obligations in respect of the Notes and under the Trust Deed (the “**Charge**”) and has assigned absolutely certain other rights under the Loan Agreement to the Trustee (the “**Assigned Rights**” and, together with the Charge, the “**Security Interests**”), in each case excluding the Reserved Rights.

In certain circumstances, the Trustee can (subject to it being indemnified and/or secured and/or prefunded to its satisfaction) be required by Noteholders holding in aggregate at least 25 per cent. of the principal amount of the Notes outstanding (as defined in the Trust Deed) or by an Extraordinary Resolution (as defined in the Trust Deed) of the Noteholders to exercise certain of its powers under the Trust Deed (including those arising under the Security Interests).

Payments in respect of the Notes will be made (subject to the receipt of the relevant funds from NOVATEK under the Loan Agreement) pursuant to a paying agency agreement (the “**Paying Agency Agreement**”) dated 10 December 2012 and made between the Issuer, NOVATEK, Citibank, N.A., London Branch, as the principal paying agent, and a transfer agent (the “**Principal Paying Agent**”, a “**Transfer Agent**”, which expressions shall include any successors), Citigroup Global Markets Deutschland AG as the registrar (the “**Registrar**”, which expression shall include any successors) and the Trustee. References herein to the “**Agents**” are to the Registrar, the Paying Agents and the Transfer Agents and any reference to an “**Agent**” is to any one of them.

Copies of the Trust Deed, the Loan Agreement and the Paying Agency Agreement are available for inspection during normal business hours at (i) the registered office of the Trustee being, at the date hereof, Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB; (ii) the registered office of the Issuer being, at the date hereof, 12 Merrion Square, Dublin 2, Ireland; and (iii) at the specified office of the Principal Paying Agent, the initial specified office of which is set out below.

Certain provisions of these terms and conditions (the “**Conditions**”) are summaries or restatements of, and are subject to, the detailed provisions of the Trust Deed, the Loan Agreement (the form of which is scheduled to and incorporated in the Trust Deed) and the Paying Agency Agreement. Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of all the provisions of the Loan Agreement and the Paying Agency Agreement that are applicable to them.

Unless otherwise stated, terms not defined herein shall have the same meanings given to them in the Trust Deed.

## 1 Status

The Notes are limited recourse secured obligations of the Issuer.

The sole purpose of the issue of the Notes is to provide the funds for the Issuer to finance the Loan. The Notes constitute the obligation of the Issuer to apply the proceeds from the issue of the Notes solely for financing the Loan and to account to the Noteholders for an amount equivalent to sums of principal, interest and additional amounts (if any) actually received by or for the account of the Issuer pursuant to the Loan Agreement less any amount in respect of the Reserved Rights.

The Trust Deed provides that payments in respect of the Notes equal to the sums actually received by or for the account of the Issuer by way of principal, interest or additional amounts (if any) pursuant to the Loan Agreement, less any amount in respect of the Reserved Rights (after deduction or withholding of such taxes or duties as may be required to be made by the Issuer by law in respect of each such sum to the extent that the Issuer has not received a corresponding payment in respect thereof) will be made *pro rata* among all Noteholders (subject to Condition 7), on the date of, and in the currency of, and subject to the conditions attaching to, the equivalent payment pursuant to the Loan Agreement. The Issuer shall not be liable to make any payment in respect of the Notes other than as expressly provided herein and in the Trust Deed. As provided therein, the Issuer shall be under no obligation to exercise in favour of the Noteholders any rights of set-off or to combine accounts or counterclaim that may arise out of other transactions between the Issuer and NOVATEK.

Noteholders have notice of, and have accepted, these Conditions and the contents of the Trust Deed, the Paying Agency Agreement and the Loan Agreement. It is hereby expressly provided that, and Noteholders are deemed to have accepted that:

- (a) neither the Issuer nor the Trustee makes any representation or warranty in respect of, or shall at any time have any responsibility for, or, (in the case of the Issuer) save as otherwise expressly provided in the Trust Deed, in Condition 1(f) below or in the Loan Agreement, any liability or obligation in respect of the performance and observance by NOVATEK of its obligations under the Loan Agreement or the recoverability of any sum of principal or interest (or any additional amounts) due or to become due from NOVATEK under the Loan Agreement save that nothing in this Condition shall absolve the Trustee from responsibility and liability for performance of its trusts, duties and obligations pursuant to, and subject to the terms of, the Trust Deed;
- (b) neither the Issuer nor the Trustee shall at any time have any responsibility for, or obligation or liability in respect of, the condition (financial or otherwise), creditworthiness, affairs, status, nature or prospects of NOVATEK;
- (c) neither the Issuer nor the Trustee shall at any time be liable for any representation or warranty or any act, default or omission of NOVATEK under or in respect of the Loan Agreement;
- (d) neither the Issuer nor the Trustee shall at any time have any responsibility for, or liability or obligation in respect of, the performance and observance by the Agents of their respective obligations under the Paying Agency Agreement;
- (e) the payment of principal, interest and other amounts, if any, under, and performance of the terms, of the Notes depend solely and exclusively upon performance by NOVATEK of its obligations under the Loan Agreement, and NOVATEK's covenants to make payments under the Loan Agreement and NOVATEK's credit and financial standing. NOVATEK has represented and warranted to the Issuer that the Loan Agreement constitutes legal, valid and binding obligations of NOVATEK;
- (f) the Issuer and the Trustee shall be entitled to rely on delivery to them of Officers' Certificates (as defined in the Trust Deed) and/or any other certificates (whether or not addressed to the Issuer or the Trustee) from NOVATEK as a means of monitoring whether NOVATEK is complying with its obligations under the Loan Agreement or as to the identity of NOVATEK's Material Subsidiaries (as defined in the Loan Agreement) and shall not otherwise be responsible for investigating any aspect of NOVATEK's performance in relation thereto and, (in the case of the Issuer) subject as further provided in the Trust Deed, neither the Issuer as lender under the Loan Agreement nor the Trustee will be liable for any failure to make the usual or any investigations which might be made by a lender or a security holder (as applicable) in relation to the property which is subject to the Security Interests and held by way of security for the Notes, and shall not be bound to enquire into or be liable for any defect or failure in the right or title of the Issuer to the property which is subject to the Security Interests whether such defect or failure was known to the Trustee or might have been discovered upon examination or enquiry or whether capable of remedy or not, nor will the Trustee have any liability for the enforceability of the security created by the Security Interests whether as a result of any failure, omission or defect in registering or filing or otherwise protecting or perfecting such security; the Trustee has no responsibility for the value of such security;

- (g) neither the Trustee nor the Issuer shall at any time be required to expend or risk its own funds or otherwise incur any financial liability in the performance of its obligations or duties or the exercise of any right, power, authority or discretion pursuant to these Conditions until the Issuer, or the Trustee, as the case may be, has received an indemnity and/or security to its satisfaction and/or the funds that are necessary to cover the costs and expenses in connection with such performance or exercise, or has been (in its sole discretion) sufficiently assured that it will receive such funds; and
- (h) the Issuer will not be liable to make any payments to compensate for any withholding or deduction required to be made by or on behalf of the Issuer in respect of any payment relating to the Notes, or for any payment for or on account of tax required to be made by the Issuer on or in relation to any sum received by it under the Loan Agreement which will or may affect payments made or to be made by NOVATEK under the Loan Agreement, save to the extent that it has received additional amounts under the Loan Agreement in respect of such withholding or deduction or payment, and the Issuer shall, furthermore, not be obliged to take any actions or measures as regards such deduction or withholding or payment, other than those set out in this context in the Loan Agreement. The Trustee shall have no liability in respect of any such deduction, withholding or payment.

Under the Trust Deed, the obligations of the Issuer in respect of the Notes rank *pari passu* and rateably without any preference among themselves.

In the event that the payments under the Loan Agreement are made by NOVATEK to, or to the order of, the Trustee or (subject to the provisions of the Trust Deed) the Principal Paying Agent, they will *pro tanto*, to the extent of such payment, satisfy the obligations of the Issuer in respect of the Notes, except to the extent there is a failure in its subsequent payment to the relevant Noteholders.

Save as otherwise expressly provided herein and in the Trust Deed, no proprietary or other direct interest in the Issuer's right under or in respect of the Loan Agreement or the Loan (each as defined in the Trust Deed) exists for the benefit of the Noteholders. Subject to the terms of the Trust Deed, no Noteholder will have any entitlement to enforce the Loan Agreement or direct recourse to NOVATEK except through action by the Trustee pursuant to the relevant Security Interests granted to the Trustee in the Trust Deed. Neither the Issuer nor, following the enforcement of the Security Interests created in the Trust Deed, the Trustee shall be required to take any steps, actions or proceedings to enforce payment under the Loan Agreement unless it has been indemnified and/or secured and/or prefunded by the Noteholders to its satisfaction.

As provided in the Trust Deed, and notwithstanding any other provision hereof, the obligations of the Issuer are solely to make payments of amounts in aggregate equal to each sum actually received by or for the account of the Issuer pursuant to the Loan Agreement from NOVATEK in respect of principal, interest, additional amounts (if any), as the case may be, (less any amount in respect of the Reserved Rights) (after deduction or withholding of such taxes or duties as may be required to be made by the Issuer by law in respect of each such sum or in respect of the Notes and for which the Issuer has not received a corresponding payment (also after deduction or withholding of such taxes or duties as may be required to be made by the Issuer) in respect thereof pursuant to the Loan Agreement), the right to which is being charged and assigned by way of security to the Trustee as aforesaid. Accordingly, all payments to be made by the Issuer under the Notes will be made only from and to the extent of such sums received or recovered by or on behalf of the Issuer or the Trustee (following a Relevant Event (as defined in the Trust Deed) or (if applicable) an Event of Default (as defined in the Trust Deed)). Noteholders shall look solely to such sums for payments to be made by the Issuer under the Notes, the obligation of the Issuer to make payments in respect of the Notes will be limited to such sums and Noteholders will have no further recourse to the Issuer or any of the Issuer's other assets (other than those subject to the Security Interests) in respect thereof. Noteholders must therefore rely upon the covenant to pay under the Loan Agreement and the credit and financial standing of NOVATEK and no other assets of the Issuer (other than those subject to the Security Interests) will be available to the Noteholders.

Notwithstanding any other provisions of these Conditions and the provisions in the Trust Deed, the Trustee and the Noteholders shall have recourse only to the Security Interests in accordance with Clause 4 of the Trust Deed. After enforcement and/or realisation of the Security Interests which have become enforceable and distribution of the proceeds in accordance with Clause 8 of the Trust Deed, the obligations of the Issuer with respect to the Trustee and the Noteholders in respect of the Notes shall be satisfied and none of the foregoing parties may take any further steps against the Issuer to recover any further sums in respect thereof and the right to receive any such sums shall be extinguished. In particular, none of the Noteholders, the Trustee, nor any other person acting on behalf of any of them shall be entitled at any time to institute against the Issuer, or join in any institution against the Issuer of, any bankruptcy, administration, moratorium, reorganisation, controlled management, arrangement, insolvency, examinership, winding-up or liquidation proceedings or similar insolvency proceedings under any applicable bankruptcy or similar law in connection with any obligation of the Issuer relating to the Notes or otherwise owed to the creditors or the

Trustee, save for lodging a claim in the liquidation of the Issuer which is initiated by another party or taking proceedings to obtain a declaration or judgment as to the obligations of the Issuer.

No Noteholder or the Trustee shall have any recourse against any director, shareholder, or officer of the Issuer in respect of any obligations, covenants or agreement entered into or made by the Issuer in respect of the Notes except to the extent that any such person acts in bad faith or is negligent or is in default in the context of its obligations.

## **2 Form, Denomination, Register and Transfers**

### **2.1 Form and denomination**

Notes are in registered form, in the denominations of U.S.\$200,000 or integral multiples of U.S.\$1,000 in excess thereof (an “**Authorised Holding**”), without coupons attached.

### **2.2 Register**

The Registrar will maintain a register (the “**Register**”) in respect of the Notes in accordance with the provisions of the Paying Agency Agreement. In these Conditions the “**holder**” of a Note means the person in whose name such Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and “**Noteholder**” shall be construed accordingly. A certificate (a “**Certificate**”) will be issued to each Noteholder in respect of its registered holding of Notes.

### **2.3 Title**

Title to the Notes will pass by and upon registration in the Register. The holder of each Note shall (except as otherwise required by law) be treated as the absolute owner of such Note for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Certificate) and no person shall be liable for so treating such holder.

### **2.4 Transfers**

Subject to Condition 2.6, a Note may be transferred upon surrender of the relevant Certificate, with the endorsed form of transfer duly completed, at the specified office of the Registrar or at the specified office of the Transfer Agent, together with such evidence as the Registrar or the Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals who have executed the form of transfer; provided however, that a Note may not be transferred unless the principal amount of the Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred are Authorised Holdings. Where not all the Notes represented by the surrendered Certificates are the subject of the transfer, a new Certificate in respect of the balance of the Notes not transferred will be issued to the transferor.

### **2.5 Registration and delivery of Definitive Notes**

Subject to Condition 2.6, within five business days of the surrender of a Certificate in accordance with the immediately preceding paragraph above, the Registrar will register the transfer in question and deliver a new Certificate to each relevant holder at its specified office or (at the request and risk of such relevant holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant holder. In this paragraph, “**business day**” means a day on which commercial banks are open for business (including dealings in foreign currencies) in the city where the Registrar has its specified office. In the case of the transfer of only a part of the Notes, a new Certificate in respect of the balance of the Notes not transferred will be so delivered or (at the risk and, if mailed at the request of the transferor otherwise than by ordinary uninsured mail, at the expense of the transferor) sent by mail to the transferor.

The transfer of Notes will be effected without charge but against such indemnity as the Registrar or the Transfer Agent, as applicable, may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.

Noteholders may not require transfers to be registered during the period of 15 days ending on the due date for any payment of principal or interest in respect of the Notes.

### **2.6 Regulations concerning Transfers and Registration**

All transfers of Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Notes scheduled to the Paying Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Trustee and the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholders who requests in writing a copy of such regulations.



### 3 Restrictive Covenant

As provided in the Trust Deed, so long as any of the Notes remains outstanding (as defined in the Trust Deed), the Issuer will not (other than in respect of Reserved Rights), without the prior written consent of the Trustee or an Extraordinary Resolution or a Written Resolution (each as defined in the Trust Deed), agree to any amendment to or any modification or waiver of, or authorise any breach or proposed breach of, or agree any novation, assignment, rescission, cancellation or termination of the terms of the Loan Agreement (other than in respect of Reserved Rights) and will act at all times in accordance with any instructions of the Trustee from time to time with respect to the Loan Agreement, except as otherwise expressly provided in the Trust Deed or Loan Agreement. Any such amendment, modification, waiver, authorisation, novation, assignment, rescission, cancellation or termination made with the consent of the Trustee shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any such amendment or modification shall be notified by the Issuer to the Noteholders in accordance with Condition 13.

Save as provided above, so long as any Note remains outstanding, the Issuer, without the prior written consent of the Trustee or an Extraordinary Resolution or a Written Resolution, shall not, *inter alia*, incur any other indebtedness for borrowed moneys other than the issue of Notes and any further notes in accordance with Condition 14, the issue of notes on a limited recourse basis secured on assets of the Issuer other than the assets over which the Security Interests have been created, the assets on which any other obligations of the Issuer are secured and the Issuer's share capital, engage in any business (other than entering into any agreements related to the Notes or any other issue of notes as aforesaid and performing any acts incidental to or necessary in connection with the Notes or such related agreements (including the holding of any security in connection therewith), making the Loan to NOVATEK pursuant to the Loan Agreement or any future loans to NOVATEK in connection with the issue of notes as aforesaid and performing any act incidental to or necessary in connection therewith), declare any dividends, have any subsidiaries or employees (save for its directors), purchase, own, lease or otherwise acquire any real property (including office premises or like facilities), consolidate or merge with any other person or convey or transfer its properties or assets substantially as an entirety (to the extent the same is within control of the Issuer) to any person (otherwise than as contemplated in these Conditions and the Trust Deed), issue any further shares (other than those required to convert the Issuer's status to that of a public limited company or are in issue as at the date of the Trust Deed) (to the extent the same is within the control of the Issuer) or make any distribution to its shareholders, give any guarantee or assume any other liability, or, subject to the laws of Ireland, petition for any winding-up or bankruptcy.

### 4 Interest

On each Interest Payment Date (or such later date as amounts equivalent to amounts of interest due on such date are received) the Issuer shall account to the Noteholders for an amount equal to the amount of interest actually received by or for the account of the Issuer pursuant to the Loan Agreement which interest under the Loan is payable at a rate of 4.422 per cent. per annum as set out in Clause 4 of the Loan Agreement.

Interest shall cease to accrue on each Note on the due date for redemption unless, upon due presentation, payment is improperly withheld or refused, in which event interest shall accrue (after as well as before judgment) at the rate of interest and until the time set out in Clause 4 of the Loan Agreement.

In these Conditions, "**Interest Payment Date**" means 13 June and 13 December of each year commencing on 13 June 2013.

### 5 Redemption and Purchase

#### 5.1 Final Redemption

Unless previously prepaid or repaid pursuant to Clauses 5.2, 5.3, 5.4 or 11 of the Loan Agreement, NOVATEK will be required to repay the Loan on 13 December 2022 (the "**Repayment Date**") and, subject to such repayment, as set forth in the Loan Agreement, all the Notes then remaining outstanding will on the Repayment Date be redeemed or repaid by the Issuer at 100 per cent. of the principal amount thereof together with accrued interest.

#### 5.2 Early Redemption

Under the Loan Agreement:

- (i) NOVATEK may, in the circumstances set out in Clause 5.2 of the Loan Agreement prepay the Loan in whole but not in part; or
- (ii) the Issuer may require NOVATEK to prepay the Loan in whole but not in part in the circumstances set out in Clause 5.3 of the Loan Agreement.

If the Loan should become repayable pursuant to Clauses 5.2, 5.3 or 11 of the Loan Agreement prior to the Repayment Date, as set forth in the Loan Agreement, all Notes then remaining outstanding will thereupon become due and redeemable or repayable at 100 per cent. of the principal amount together with accrued interest and (subject to the Loan being repaid together with accrued interest and such amounts actually being received by the Issuer) shall be redeemed or repaid by the Issuer on the date specified pursuant to the Loan Agreement and the Issuer will endeavour to give not less than 14 days' notice thereof to the Trustee and the Noteholders in accordance with Condition 13.

### 5.3 Purchases

The Loan Agreement provides that the Issuer, NOVATEK or any member of the Group (as defined in the Loan Agreement) may, among other things, purchase Notes from time to time, in the open market or by tender or by private agreement at any price. Such Notes may be held, reissued, resold or, at the option of NOVATEK or any such member of the Group, delivered to the Issuer together with a request for the Issuer to redeem and thereafter cancel such Notes on not more than 60 and not less than 30 days notice, whereupon the Issuer shall, pursuant to the Paying Agency Agreement, instruct the Registrar, subject to the satisfaction of certain conditions set out in the Loan Agreement, to cancel such Notes. Upon the cancellation of such Notes, the Loan shall be treated as prepaid by NOVATEK in an amount corresponding to the aggregate principal amount of the Notes surrendered for cancellation, together with accrued interest (if any) thereon, and no further payment shall be made or required to be made by the Issuer in respect of such Notes.

The Issuer may compel any beneficial owner of a Rule 144A Definitive Certificate under the Securities Act to certify that it is a qualified institutional buyer (as defined in Rule 144A under the Securities Act) and a qualified purchaser (as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act of 1940) and may compel any such beneficial owner to sell its interest in such Notes, or may sell such interest on behalf of such holder, if such holder is a U.S. person that is not a qualified institutional buyer (as defined in Rule 144A under the Securities Act) and a qualified purchaser (as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act of 1940).

## 6 Payments

### 6.1 Principal

Payments of principal shall be made by U.S. Dollar cheque drawn on, or, upon request by the holder of a Note to the specified office of the Principal Paying Agent, by transfer to a U.S. Dollar account maintained by the payee with, a bank in New York City upon surrender of the relevant Certificates at the specified office of the Principal Paying Agent or at the specified office of the Transfer Agent.

### 6.2 Interest

Payments of interest shall be made by U.S. Dollar cheque drawn on, or by transfer to, a U.S. Dollar account maintained by the payee with a bank in New York City and (in the case of interest payable on redemption) upon surrender of the relevant Certificates at the specified office of the Principal Paying Agent or at the specified office of the Transfer Agent.

### 6.3 Payments subject to fiscal law

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 7. No commissions or expenses shall be charged to the Noteholders in respect of such payments.

### 6.4 Payments on business day

A Note may only be presented for payment on a day which is a business day in the place of presentation. If the due date for payment of interest or principal is not a business day, the holder of a Note shall not be entitled to payment of the amount due until the next following business day and shall not be entitled to any further interest or other payment in respect of any such delay. In this paragraph, "**business day**" means a day on which (i) the London interbank market is open for dealings between banks generally and (ii) if on that day a payment is to be made hereunder, commercial banks generally are open for business in New York City, Moscow and in the city where the specified office of the Principal Paying Agent is located.

### 6.5 Record Date

Each payment in respect of a Note will be made to the person shown as the holder in the Register at the opening of business (in the place of the Registrar's specified office) on the fifteenth day before the due date for each payment (the "**Record Date**"). Where payment in respect of a Note is to be made by cheque, the cheque will be, at the expense of the Issuer, mailed to the address shown as the address of the Noteholder in the Register at the opening of business on the relevant Record Date.

## 6.6 Agents

The Paying Agency Agreement provides that the Issuer may at any time, with the prior written approval of the Trustee appoint a successor Registrar or Principal Paying Agent and/or additional or successor paying agents or transfer agents provided that for so long as the Notes are listed on the Irish Stock Exchange (the “**Stock Exchange**”), the Issuer will ensure that it maintains (i) a Paying Agent in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting on 26-27 November 2000; and (ii) a Registrar. Any such appointment of successor or other Agents shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not more than 45 days’ and not less than 30 days’ notice thereof shall have been given to the continuing Agents, NOVATEK, the Trustee and to the Noteholders in accordance with Condition 13.

In acting under the Paying Agency Agreement and in connection with the Notes, the Agents act solely as agents of the Issuer and (to the extent provided therein) the Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

## 6.7 Payments by NOVATEK

Save as directed by the Trustee at any time after the Security Interests created in the Trust Deed become enforceable, the Issuer will require NOVATEK to make all payments of principal, interest and any additional amounts to be made pursuant to the Loan Agreement to the Principal Paying Agent to an account in the name of the Issuer with the Principal Paying Agent. Pursuant to the Charge, the Issuer will charge by way of first fixed charge, all its rights, title and interest in and to all sums of money (with the exception of sums relating to the Reserved Rights) then or in the future so deposited in such account and the debts represented thereby to the Trustee for the benefit of the Trustee and the Noteholders.

## 6.8 Currency other than U.S. Dollars

In respect of the Issuer’s obligations under Conditions 4, 5 and 7, and subject to the following sentence, if the Issuer receives any amount under the Loan Agreement in a currency other than U.S. Dollars, the Issuer’s obligation under the relevant Condition shall be fully satisfied by paying such sum (after deducting any costs of exchange) as the Issuer receives upon conversion of such sum into U.S. Dollars in accordance with customary banking practice in the spot market on the Business Day (as defined in the Paying Agency Agreement) immediately following the day on which such sum is received by the Issuer, provided that the Issuer shall use its best efforts to procure any payments due from NOVATEK pursuant to Clause 13.8 of the Loan Agreement. If the Issuer receives any payment from NOVATEK pursuant to Clause 13.8 of the Loan Agreement with respect to amounts due under the Notes, the Issuer shall pay such sum to the Noteholders in accordance with this Condition 6.

## 7 Taxation

All payments in respect of the Notes by or on behalf of the Issuer shall be made free and clear of and without deduction or withholding for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied, collected, withheld or assessed by or on behalf of Ireland or any political subdivision or any authority thereof or therein having the power to tax, unless the deduction or withholding of such taxes or duties is required by law.

In such event, the Issuer shall make such additional payments as shall result in the receipt by the Noteholders of such amount as would have been received by them if no such withholding or deduction had been required. However, the Issuer shall only be required to make such additional payments to the extent and at such time as it shall receive equivalent sums from NOVATEK under the Loan Agreement. To the extent that the Issuer does not receive any such equivalent sum, the Issuer shall account to the relevant Noteholder for an additional amount equivalent to a *pro rata* proportion of such additional amount (if any) as is actually received by, or for the account of, the Issuer pursuant to the provisions of the Loan Agreement on the date of, in the currency of, and subject to any conditions attaching to the payment of such additional amount to the Issuer provided that no such additional amount will be payable:

- (i) to a Noteholder who is liable for such taxes or duties by reason of his having some connection with Ireland other than the mere holding of such Notes or the receipt of payments in respect thereof;
- (ii) in respect of a Note presented for payment of principal or interest more than 30 days after the Relevant Date except to the extent that such additional payment would have been payable if such Note had been presented for payment on such thirtieth day;
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of

savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

- (iv) in respect of a Note held by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by arranging to receive the relevant payment through another Paying Agent in a Member State of the European Union.

As used herein, “**Relevant Date**” means the later of (i) the date on which the equivalent payment under the Loan Agreement first becomes due and (ii) if the full amount payable by NOVATEK corresponding to such payment has not been received by, or for the account of, the Issuer pursuant to the Loan Agreement on or prior to such date, it means the date on which such full amount shall have been so received and notice to that effect shall have been duly given to the Noteholders by or on behalf of the Issuer in accordance with Condition 13.

Any reference herein or in the Trust Deed to payments in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable in accordance with the Trust Deed and this Condition 7 or any undertaking given in addition thereto or in substitution therefor pursuant to the Trust Deed. If the Issuer becomes subject to any taxing jurisdiction other than or in addition to Ireland, references in these Conditions to Ireland shall be construed as references to Ireland and/or such other jurisdiction.

## **8 Enforcement**

The Trust Deed provides that only the Trustee may pursue the remedies under the general law, the Trust Deed or the Notes to enforce the rights of the Noteholders and no Noteholder will be entitled to pursue such remedies unless the Trustee (having become bound to do so in accordance with the terms of the Trust Deed) fails to do so within a reasonable period and such failure is continuing.

The Trust Deed also provides that, in the case of an Event of Default, or of a Relevant Event, the Trustee may, and shall, if requested in writing to do so by Noteholders holding at least 25 per cent. in principal amount of the Notes outstanding, or if directed to do so by an Extraordinary Resolution, and, in any such case, subject to it being secured and/or indemnified and/or prefunded to its satisfaction, institute such steps, actions or proceedings as it may think fit to enforce the rights of the Noteholders and the provisions of the Trust Deed, including to declare all amounts payable under the Loan Agreement by NOVATEK to be immediately due and payable (in the case of an Event of Default), or exercise any rights under the Security Interests created in the Trust Deed in favour of the Trustee (in the case of a Relevant Event). Upon repayment of the Loan following an Event of Default and a declaration as provided herein, the Notes will be redeemed or repaid at their principal amount together with accrued interest thereon and thereupon shall cease to be outstanding.

## **9 Meetings of Noteholders; Modification of Notes, Trust Deed and Loan Agreement; Waiver; Substitution of the Issuer**

The Trust Deed contains provisions for convening meetings of Noteholders to consider any matter affecting their interests, including any modification of, or any arrangement in respect of, the Notes, the Loan Agreement or the Trust Deed. Noteholders will be entitled to one vote per U.S.\$1,000 in principal amount of Notes held by them. Such a meeting may be convened by the Issuer, NOVATEK or the Trustee and shall be convened by the Issuer or by the Trustee, subject to its being indemnified and/or secured and/or prefunded to its satisfaction, upon the request in writing of holders of the Notes holding not less than one tenth of the principal amount of the outstanding Notes. The Trust Deed provides that special quorum provisions apply for meetings of Noteholders convened for the purpose of amending certain terms concerning, *inter alia*, the amount payable on, and the currency of payment in respect of, the Notes and the amounts payable and currency of payment under the Loan Agreement. Under the terms of the Trust Deed, an Extraordinary Resolution means a resolution passed at a meeting of the Noteholders duly convened and held in accordance with the provisions contained therein by (i) the affirmative vote of holders of outstanding (as defined in the Trust Deed) Notes present in person or represented by proxy or representative owning in the aggregate more than half in principal amount of the outstanding Notes owned by the Noteholders who are so present or represented at the meeting or (ii) in respect of an Extraordinary Resolution the business of which includes the modification of certain terms, conditions and provisions as listed in the proviso to paragraph 5 (Powers of Meetings) of Schedule 4 (Provisions for Meetings of the Noteholders) of the Trust Deed the affirmative vote of holders of outstanding Notes present in person or represented by proxy or representative owning in aggregate not less than two-thirds in principal amount of the outstanding Notes owned by the Noteholders who are present or represented at the meeting. Any resolution duly passed at a meeting of Noteholders will be binding on all the Noteholders, whether present or not.

The Trust Deed provides that a resolution in writing signed by or on behalf of the holders of not less than 75 per cent. in principal amount of the Notes outstanding shall for all purposes be as valid and effective as an

Extraordinary Resolution passed at a meeting of Noteholders duly convened and held. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

The Trustee may agree, without the consent of the Noteholders, to any modification of the Notes and the Trust Deed, the Paying Agency Agreement or, following the creation of any Security Interests, the Loan Agreement (subject, in the case of the Loan, to the following paragraph) which, in the opinion of the Trustee is of a formal, minor or technical nature, is made to correct a manifest error or (other than as mentioned in the Trust Deed) in the opinion of the Trustee is not materially prejudicial to the interests of the Noteholders.

The Trustee may also waive or authorise or agree to the waiving or authorising of any breach or proposed breach by the Issuer of the Conditions or the Trust Deed or, following the creation of the Security Interests, by NOVATEK of the terms of the Loan Agreement or determine that any event which would or might otherwise give rise to a right of acceleration under the Loan Agreement or any Relevant Event shall not be treated as such (in each case other than any such breach or proposed breach in respect of Reserved Rights), if in the opinion of the Trustee, to do so would not be materially prejudicial to the interests of the Noteholders, provided always that the Trustee may not exercise such power of waiver in contravention of a written request given by holders of 25 per cent. in aggregate principal amount of the Notes then outstanding or any express direction by Extraordinary Resolution. Any such modification, waiver, authorisation or determination shall be binding on the Noteholders and, unless the Trustee agrees otherwise, shall be promptly notified to the Noteholders in accordance with Condition 13.

The Trust Deed contains provisions to the effect that the Issuer may, with the consent of NOVATEK, and further provided certain conditions have been met (as further set out in the Trust Deed), and subject to having complied with the requirements set out in the Trust Deed and such requirements as the Trustee may direct in the interest of Noteholders, substitute any entity in place of the Issuer as creditor under the Loan Agreement, as issuer and principal obligor in respect of the Notes and as obligor under the Trust Deed, subject to the substitute's rights under the Loan Agreement being charged and assigned to the Trustee as security for the payment obligations of the substitute obligor under the Trust Deed and the Notes. Not later than 14 days after compliance with the aforementioned requirements, notice thereof shall be given by the Issuer to the Noteholders in accordance with Condition 13, failing which the Issuer shall use its best endeavours to ensure that the substitute obligor does so.

In connection with the exercise of any of its powers, trusts, authorities or discretions, the Trustee shall have regard to the interests of the Noteholders as a class and, in particular, shall not have regard to the consequences of such exercise for individual Noteholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory. No Noteholder is entitled to claim from the Issuer or the Trustee any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders.

## **10 Prescription**

Notes will become void unless presented for payment within 10 years (in the case of principal) or five years (in the case of interest) from the due date for payment in respect thereof.

## **11 Indemnification of Trustee**

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility in certain circumstances, including provisions relieving it from taking steps, actions or proceedings to enforce payment unless indemnified and/or secured and/or prefunded to its satisfaction, and to be paid its costs and expenses in priority to any claims of Noteholders. In addition, the Trustee is entitled to enter into business transactions with the Issuer and/or NOVATEK and any entity relating to the Issuer and/or NOVATEK without accounting for any profit.

The Trustee's responsibilities are solely those of trustee for the Noteholders on the terms of the Trust Deed. Accordingly, the Trustee makes no representations and assumes no responsibility for the validity or enforceability of the Loan Agreement or the security created in respect thereof or for the performance by the Issuer of its obligations under or in respect of the Notes and the Trust Deed or by NOVATEK in respect of the Loan Agreement. The Trustee is entitled to assume that NOVATEK is performing all of its obligations pursuant to the Loan Agreement and that the Issuer is performing its obligations under the Notes, the Loan Agreement and the Trust Deed (and shall have no liability for doing so) until it has actual knowledge to the contrary.

The Trustee shall have no liability to any Noteholder or any other person for any shortfall it may suffer if it is liable for tax in respect of any payments received by it or as a result of the Security Interests being enforced by it.

## **12 Replacement of Notes**

If a Certificate shall become mutilated, defaced, lost, stolen or destroyed it may, subject to all applicable laws and regulations and requirements of the Stock Exchange, be replaced at the specified offices of the Transfer Agents in London on payment of such costs, expenses, taxes and duties as may be incurred in connection therewith and on such terms as to evidence, security and indemnity and otherwise as may reasonably be required by or on behalf of the Issuer and/or the Transfer Agents. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

## **13 Notices**

All notices to Noteholders shall be deemed to have been validly given if (i) published in a leading newspaper having general circulation in Dublin (which is expected to be the *Irish Times*) or, if in the opinion of the Trustee such publication shall not be practicable, in an English language newspaper of general circulation in Europe or (ii) so long as the Notes are listed and/or admitted to trading on the Stock Exchange and the rules of that exchange so require, published on the Regulatory News Service via the Companies Announcements Office of the Stock Exchange. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which such publication is made.

In case by reason of any other cause it shall be impracticable to publish any notice to Noteholders as provided above, then such notification to such Noteholders as shall be given with the approval of the Trustee in accordance with the rules of the Stock Exchange shall constitute sufficient notice to such Noteholders for every purpose hereunder.

## **14 Further Issues**

The Issuer may from time to time, with the consent of NOVATEK but without the consent of the Noteholders, create and issue, as provided in Condition 3, either (1) limited recourse notes or bonds or (2) further notes or bonds having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) so as to be consolidated and form a single series with the Notes, provided, however, that, unless such further notes or bonds are issued under a separate CUSIP or ISIN, either such further notes or bonds, as the case may be, and the Notes are part of the same "issue" within the meaning of United States Treasury Regulation Section 1.1275-1(f) (including, for the avoidance of doubt, being part of a "qualified reopening" within the meaning of U.S. Treasury Regulation Section 1.1275-2(k)) or neither the Notes nor such notes or bonds are issued with original issue discount for U.S. federal income tax purposes. Such further notes shall be issued under a deed supplemental to the Trust Deed containing such provisions as the Trustee may require. In relation to any further issue which is to be consolidated and form a single series with the Notes, the Issuer will enter into a loan agreement with NOVATEK on the same terms as the Loan Agreement (or the same terms except for the first payment of interest) and supplemental to the Loan Agreement, or may amend and restate the same with NOVATEK on substantially the same terms as the Loan Agreement. The Issuer will provide a first fixed charge in favour of the Trustee in respect of certain of its rights and interests under such loan agreement and will assign absolutely to the Trustee certain of its rights under such loan agreement, which will secure both the Notes and such further notes and which will supplement the Security Interests in relation to the existing Notes or may amend and supplement the Security Interests for such purpose. Any further securities forming a single series with the outstanding securities of any series (including the Notes) constituted by the Trust Deed or any deed supplemental to it shall, and any other securities may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of securities of other series where the Trustee so decides. Application will be made for such further notes or bonds to be listed and admitted to trading on the stock exchange on which the Notes are from time to time listed or quoted.

## **15 Contracts (Rights of Third Parties) Act 1999**

No person shall have any right to enforce any term or condition of the Notes or the Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

## **16 Governing Law**

The Notes, these Conditions, the Trust Deed and any non-contractual obligations arising out of or in connection therewith, are governed by, and shall be construed in accordance with, English law. The Issuer has submitted in the Trust Deed to the jurisdiction of the courts of England and has appointed an agent for the service of process in England.

Without prejudice to the foregoing provisions, the Issuer has, in the Trust Deed agreed that any dispute, be it contractual or non-contractual, arising out of or in connection with the Trust Deed, the Notes or the Conditions, including any question regarding their formation, existence, validity or termination shall be

referred to and finally resolved by arbitration under the Rules of Arbitration of the London Court of International Arbitration (“**LCIA**”) (the “**Rules**”). The Rules are deemed to be incorporated by reference into the Trust Deed. The number of arbitrators shall be three, each party having the right to nominate one arbitrator. If one party fails to appoint an arbitrator within 30 days of receiving notice of the appointment of an arbitrator by the other party, then that arbitrator shall be appointed by the LCIA. The third arbitrator, who shall act as chairman of the tribunal, shall be chosen by the two arbitrators chosen by or on behalf of the parties. If he is not chosen and appointed within 15 days of the date on which the later of the two-party appointed arbitrators is appointed, he shall be appointed by the LCIA. The seat of arbitration shall be London, England where all hearings and meetings shall be held, unless the parties agree otherwise. The language to be used in the arbitral proceedings shall be English. The arbitrators shall have no authority to award exemplary or punitive damages of any type under any circumstances whether or not such damages may be available under the relevant applicable law, the parties waive their right, if any, to recover such damages. The parties have agreed that the arbitrators shall have power to award on a provisional basis any relief that they would have power to grant on a final award. The arbitration clause, including its validity and scope, shall be governed by English law. Nothing in Clause 32 of the Trust Deed shall be construed as preventing a party from seeking conservatory or similar interim relief in any court of competent jurisdiction nor shall anything in Clause 32 of the Trust Deed prohibit a party from bringing an action to enforce a money judgment in any other jurisdiction.

## THE LOAN AGREEMENT

*The following is the text of the Loan Agreement that has been entered into between the Borrower and the Issuer.*

**This Agreement** is made on 10 December 2012 **between:**

- (1) **AOO “NOVATEK” (“NOVATEK”);** and
- (2) **NOVATEK FINANCE LIMITED** (the “**Lender**”).

**Whereas:**

The Lender has at the request of NOVATEK agreed to make available to NOVATEK a loan facility in the amount of U.S.\$1,000,000,000 on the terms and subject to the conditions of this Agreement.

**Now it is hereby agreed** as follows:

### **1 Definitions and Interpretation**

#### **1.1 Definitions**

In this Agreement (including the recitals), the following terms shall have the meanings indicated:

“**Account**” means the account in the name of the Lender with the Principal Paying Agent, account number 11659596 (or such other account as may from time to time be agreed by the Lender with the Trustee and NOVATEK pursuant to the Trust Deed and notified to NOVATEK in writing at least five Business Days in advance of such change);

“**Advance**” means the advance to be made under Clause 3 of the sum equal to the amount of the Facility;

“**Affiliate**” of any specified person means any other person, directly or indirectly, controlling, controlled by, or under direct or indirect common control with, such specified person. For the purposes of this definition, “**control**” (including with correlative meanings, the terms “**controlling**”, “**controlled by**” and “**under common control with**”), as applied to any person, means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such person, whether through the ownership of voting securities, by contract or otherwise; provided that direct or indirect beneficial ownership of 10 per cent. or more of the Capital Stock with voting power of a person shall be deemed to be control;

“**Agency**” means any agency, authority, central bank, department, committee, government, legislature, minister, ministry, official or public or statutory person (whether autonomous or not);

“**Agreement**” means this Agreement as originally executed or as it may be amended from time to time;

“**Board of Directors**” means, as to any person, the board of directors, management board or equivalent competent governing body of such person, or any duly authorised committee thereof;

“**Business Day**” means a day on which (a) the London interbank market is open for dealings between banks generally and (b) if on that day a payment is to be made hereunder, commercial banks generally are open for business in New York City, Moscow and in the city where the specified office of the Principal Paying Agent is located;

“**Capital Stock**” of any person means any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents of or interests in (however designated) equity of such person, including any preferred stock, but excluding any debt securities convertible or exchangeable into such equity;

“**Closing Date**” means 13 December 2012;

“**Consolidated Assets**” means the total amount of assets appearing on the consolidated balance sheet of NOVATEK, prepared in accordance with IFRS, as of the date of the most recently prepared consolidated financial statements;

“**Definitive Certificate**” means the definitive certificates in registered form representing the Notes, to be issued in limited circumstances pursuant to the Trust Deed;

“**Dollars**”, “**U.S.\$**” and “**U.S. Dollars**” means the lawful currency of the United States of America;

“**Domestic Relevant Indebtedness**” means any Relevant Indebtedness which is denominated and payable in Russian Roubles, is not quoted, listed or ordinarily dealt in or traded on any stock exchange, over the counter or other recognised securities market outside the Russian Federation and a substantial part of which on issue was placed within the Russian Federation;

“**Event of Default**” has the meaning assigned to such term in sub-clause 11.1 hereof;



“**Extraordinary Resolution**” has the meaning set out in paragraph 7 of Schedule 4 of the Trust Deed;

“**Facility**” means the facility specified in Clause 2;

“**Global Certificate**” means the Regulation S Global Certificate and the Rule 144A Global Certificate;

“**Group**” means the companies which are consolidated in the most recent accounts of NOVATEK prepared in accordance with IFRS;

“**IFRS**” means the International Financial Reporting Standards (formerly International Accounting Standards) issued by the International Accounting Standards Board (“**IASB**”) and interpretations issued by the International Financial Reporting Interpretations Committee (as amended, supplemented or re-issued from time to time);

“**Indebtedness**” means, in respect of any person, any indebtedness for, or in respect of, moneys borrowed; any amount raised by acceptance under any credit facility; any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument; any amount raised pursuant to any issue of shares which are expressed to be redeemable; any amount of money raised under any other transaction (including any forward sale or purchase agreement) having the commercial effect of a borrowing; the amount of any liability in respect of a capital lease that would at that time be required to be capitalised on a balance sheet in accordance with IFRS and (without double counting) the amount of any liability in respect of any guarantee or indemnity (whether on or off balance sheet) for any of the items referred to above; provided that, for the avoidance of doubt, Indebtedness shall not include moneys raised by way of the issue of share capital (whether or not for cash consideration and excluding shares which are expressed to be redeemable) and any premium on such share capital; and provided further that Indebtedness shall not include Indebtedness among NOVATEK and Subsidiaries; and provided further that Indebtedness shall not include any trade credit extended to such person in connection with the acquisition of goods and/or services on arm’s length terms and in the ordinary course of trading of that person;

“**Interest Payment Date**” means 13 June and 13 December of each year, commencing on 13 June 2013;

“**Loan**” means, at any time, an amount equal to the aggregate principal amount of the Facility granted by the Lender pursuant to this Agreement;

“**Material Adverse Effect**” means a material adverse effect on (a) the financial condition or operations of NOVATEK or the Group, or (b) NOVATEK’s ability to perform its obligations under the NOVATEK Agreements or (c) the validity, legality or enforceability of this Agreement or the rights or remedies of the Lender under this Agreement;

“**Material Subsidiary**” means any Subsidiary of NOVATEK:

- (i) whose external revenues (as used in the consolidated financial statements of NOVATEK prepared in accordance with IFRS) equal or exceed 10 per cent. of the external revenues of the Group; or
- (ii) whose net income equals or exceeds 10 per cent. of the net income of the Group; or
- (iii) whose net assets equal or exceed 10 per cent. of the net assets of the Group,

all as shown in the most recent audited accounts (consolidated or aggregated if available) of the Subsidiary and the Group taking into account on a pro-forma basis any consolidation, amalgamation or merger referred to in Clause 10.2;

“**Noteholder**” means, in relation to a Note, the person in whose name such Note is for the time being registered in the register of Noteholders (or, in the case of a joint holding, the first named holder thereof);

“**Notes**” means the loan participation notes proposed to be issued by the Lender;

“**Officers’ Certificate**” means a certificate signed by two officers of NOVATEK, one of whom shall be the principal executive officer, a member of the management board, principal accounting officer or principal financial officer of NOVATEK;

“**Opinion of Counsel**” means a written opinion from international legal counsel who is acceptable to the Lender and the Trustee;

“**Paying Agency Agreement**” means the paying agency agreement to be dated on or about 10 December 2012, as amended, varied or supplemented relating to the Notes;

“**Paying Agent**” shall have the meaning attributed to it in the Paying Agency Agreement;

“**Permitted Security Interest**” means:

- (a) any Security Interest existing on the Closing Date;

- (b) any Security Interest created or existing in respect of Domestic Relevant Indebtedness;
- (c) any Security Interest existing on any property, income or assets of any company at the time such company becomes a Subsidiary of NOVATEK or such property, income or assets are acquired by NOVATEK or any Subsidiary provided that such Security Interest was not created in contemplation of such event and that no such Security Interest shall extend to other property, income or assets of such company or the Group;
- (d) any Security Interest created or existing in respect of Relevant Indebtedness the principal amount of which (when aggregated with the principal amount of any other Relevant Indebtedness which has the benefit of a Security Interest or Security Interests) does not exceed 20 per cent. of Consolidated Assets, as determined by reference to the most recently available consolidated financial statements prepared in accordance with IFRS of NOVATEK; or
- (e) any Security Interest created or existing in respect of any Indebtedness that is not Relevant Indebtedness;

“**person**” means any individual, corporation, partnership, joint venture, association, joint stock company, trust, unincorporated organisation, limited liability company or government or other entity;

“**Potential Event of Default**” means an event or circumstance which could with the giving of notice, the lapse of time, the issue of a certificate and/or the fulfilment of any other requirement provided for in Clause 11 become an Event of Default;

“**Principal Paying Agent**” means Citibank, N.A., London Branch;

“**Prospectus**” means the prospectus of even date herewith prepared in connection with the issue of the Notes;

“**Rate of Interest**” has the meaning assigned to such term in Clause 4.1;

“**Regulation S Global Certificate**” means the single, permanent global certificate in fully registered form without interest coupons representing the Notes to be issued pursuant to Clause 3.1 of the Trust Deed outside the United States to non-U.S. persons in reliance on Regulation S under the Securities Act;

“**Relevant Indebtedness**” means any present or future Indebtedness in the form of, or represented by, notes, debentures, bonds or other securities (but for the avoidance of doubt, excluding term loans (whether syndicated or unsyndicated), credit facilities, credit agreements and other similar facilities and evidence of indebtedness under such loans, facilities or credit agreements) which either are by their terms payable, or confer a right to receive payment, in any currency and are for the time being, or ordinarily are quoted, listed or ordinarily dealt in or traded on any stock exchange, over-the-counter or other securities market, save that bonds issued by OAO Yamal LNG (“**Yamal LNG**”) or a subsidiary of Yamal LNG or a special purpose vehicle, in each case for the purposes of financing all or part of the costs of acquisition, construction or development of the Yamal LNG project (the “**Yamal LNG Project**”) where the person or persons providing such financing expressly agree to look to the Yamal LNG Project and the revenues derived from the Yamal LNG Project together with any applicable credit support (which, in the case of NOVATEK and its Subsidiaries, will be only as permitted below) as the primary source of payment for the monies advanced and where any security created by NOVATEK or its Subsidiaries or any credit support created or provided by NOVATEK or its Subsidiaries in respect of such bonds is limited to the assets and revenues of the Yamal LNG Project or Yamal LNG and its subsidiaries (including security over any receivables due from them) and to shares of Yamal LNG owned directly or indirectly by NOVATEK, together with any guarantees issued by NOVATEK, its Subsidiaries or third parties in respect of such bonds or other financing in connection with the Yamal LNG Project where such guarantees are not secured by any other assets except as described above, shall not constitute Relevant Indebtedness;

“**Repayment Date**” means 13 December 2022;

“**Reserved Rights**” has the meaning specified in the Trust Deed;

“**Rule 144A Global Certificate**” means the single, permanent global certificate in fully registered form without interest coupons representing the Notes to be issued pursuant to Clause 3.1 of the Trust Deed to qualified institutional buyers (as defined in Rule 144A under the Securities Act) that are also qualified purchasers (as defined in Section 2(a)(51)(A) of the U.S. Investment Company Act of 1940) in reliance on the exemption from registration under the Securities Act provided by Rule 144A thereunder;

“**Russian Roubles**” means the lawful currency of the Russian Federation;

“**Same-Day Funds**” means Dollar funds settled through the New York Clearing House Interbank Payments System or such other funds for payment in Dollars as the Lender may at any time determine to be

customary for the settlement of international transactions in New York City of the type contemplated hereby;

“**Securities Act**” means the U.S. Securities Act of 1933, as amended;

“**Security Interest**” means any mortgage, charge, pledge, lien or other form of encumbrance or security interest;

“**Subscription Agreement**” means the subscription agreement dated 10 December 2012 between the Lender as Issuer, NOVATEK and the Joint Lead Managers named therein;

“**Subscription Support Agreement**” means the subscription support agreement dated 10 December 2012 between the Lender as Issuer and the Joint Lead Managers named therein;

“**Subsidiary**” means any corporation or other business entity of which NOVATEK owns or controls (either directly or through one or more Subsidiaries) more than 50 per cent. of the issued share capital or other ownership interest having ordinary voting power to elect a majority of the directors, managers or trustees of such corporation or other business entity;

“**Taxes**” means any present or future taxes, levies, imposts or duties (including interest or penalties thereon) imposed, assessed, charged, collected, demanded, withheld or claimed by the Russian Federation, Ireland or any tax authority thereof or therein provided, however, that for the purposes of this definition the references to Ireland shall, upon the occurrence of a Relevant Event (as this term is defined in the Trust Deed), be deemed to be references to the jurisdiction in which the Trustee is domiciled for tax purposes; and the term “**Taxation**” shall be construed accordingly;

“**Trust Deed**” means the trust deed between the Lender and the Trustee as amended, varied or supplemented from time to time;

“**Trustee**” means Citicorp Trustee Company Limited as trustee under the Trust Deed and any successor thereto as provided thereunder; and

“**U.S. Dollar Equivalent**” means with respect to any amount denominated in a currency other than U.S. Dollars, at any time for the determination thereof, the amount of U.S. Dollars obtained by converting such other currency involved into U.S. Dollars at the spot rate for the purchase of U.S. Dollars with such other currency as most recently published under “Currency Rates” in the section of the Financial Times entitled “Currencies, Bonds & Interest Rates”.

## 1.2 **Other Definitions**

Unless the context otherwise requires, terms used in this Agreement which are not defined in this Agreement but which are defined in the Trust Deed, the Notes, the Paying Agency Agreement or the Subscription Agreement shall have the meanings assigned to such terms therein, provided that in the case of terms defined or references herein to documents to which NOVATEK is not a party, NOVATEK has been sent an up-to-date copy of such documents by the Lender as soon as reasonably practicable (including any amendments thereto that may affect the meaning or interpretation of any such term or reference).

## 1.3 **Interpretation**

Unless the context or the express provisions of this Agreement otherwise require, the following shall govern the interpretation of this Agreement:

- 1.3.1 all references to “Clause” or “sub-clause” are references to a Clause or sub-clause of this Agreement.
- 1.3.2 the terms “hereof”, “herein” and “hereunder” and other words of similar import shall mean this Agreement as a whole and not any particular part hereof.
- 1.3.3 words importing the singular number include the plural and vice versa.
- 1.3.4 the table of contents and the headings are for convenience only and shall not affect the construction hereof.
- 1.3.5 a reference to “this agreement” or to any other agreement or document referred to in this agreement is a reference to this agreement or such other document or agreement as varied or novated (in each case, other than in breach of the provisions of this agreement) from time to time.
- 1.3.6 a reference to a statute or statutory provision shall include all subordinate legislation under that statute or statutory provision, or replacement or substitution of such legislation, made from time to time.

## **2 Facility**

### **2.1 Facility**

On the terms and subject to the conditions set forth herein, the Lender hereby agrees to lend NOVATEK, and NOVATEK hereby agrees to borrow from the Lender, U.S.\$1,000,000,000.

### **2.2 Purpose**

The proceeds of the Advance will be used for the purposes as set out in the Prospectus, but the Lender shall not be concerned with the application thereof.

### **2.3 Facility Fee**

NOVATEK shall pay a fee to the Lender in consideration of the arrangement of the Facility of U.S.\$3,451,007.70 (the "**Facility Fee**").

## **3 Drawdown**

### **3.1 Drawdown**

On the terms and subject to the conditions set forth herein, on the Closing Date the Lender shall make the Advance to NOVATEK and NOVATEK shall make a single drawing in the full amount of the Facility (less any amount to be deducted (if any) in accordance with sub-clause 3.2).

### **3.2 Payment of the Facility Fee**

The Lender shall provide Novatek with a written request for payment of the Facility Fee and NOVATEK agrees to pay the Facility Fee to the Lender in Same-Day Funds by 11.00 a.m. (London time) one Business Day prior to the Closing Date to the account in the name of the Lender with the Principal Paying Agent, account number 11659588. In the event that the Lender has not received from NOVATEK by 11.00 a.m. (London time) on the day prior to the Closing Date an amount in respect of the Facility Fee, NOVATEK agrees that an amount equal to the Facility Fee may be deducted from the amount of the Advance.

### **3.3 Disbursement**

Subject to the conditions set forth herein, on the Closing Date the Lender shall transfer the amount of the Advance (less any amount to be deducted (if any) in accordance with sub-clause 3.2 above) to NOVATEK's account number as follows: ZAO Citibank Moscow, SWIFT address CITIRUMX, correspondent account number 36087478 with Citibank N.A., New York, SWIFT address CITIUS33, ABA number 021000089, for account of OAO NOVATEK, account number 40702840400702035006.

### **3.4 Ongoing Fees and Expenses**

In consideration of the Lender (i) making available the Loan to NOVATEK; and (ii) supporting such a continuing facility, NOVATEK shall pay in one or more instalments on demand to the Lender each year an additional fee equating to all ongoing fees, taxes and documented expenses of the Lender as set forth in an invoice from the Lender to NOVATEK. Before such payment is made by NOVATEK, the Lender shall submit an invoice providing, in reasonable detail, the nature and calculation of the relevant payment or expense, and shall provide NOVATEK with an executed act of acceptance (an "**Act of Acceptance**"), the form of which NOVATEK shall provide to the Lender in advance.

## **4 Interest**

### **4.1 Rate of Interest**

NOVATEK will pay interest in U.S. Dollars to the Lender on the outstanding principal amount of the Loan from time to time hereunder at the rate of 4.422 per cent. per annum (the "**Rate of Interest**").

### **4.2 Payment**

Interest at the Rate of Interest shall accrue from day to day, starting from (and including) the Closing Date and shall be paid in respect of each Interest Period in arrear not later than 10.00 a.m. (New York City time) one Business Day prior to each Interest Payment Date to the Account. Interest on the Loan will cease to accrue from the due date for repayment thereof unless payment of principal is improperly withheld or refused, in which event interest will continue to accrue (before or after any judgment) at the Rate of Interest to but excluding the date on which payment in full of the principal thereof is made. The amount of interest payable in respect of the Loan for any Interest Period shall be calculated by applying the Rate of Interest to the Loan, dividing the product by two and rounding the resulting figure to the nearest cent (half a cent being rounded upwards). If interest is required to be calculated for any other period, it will be calculated on the basis of a 360 day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of actual days elapsed.

“**Interest Period**” means each period beginning on (and including) the Closing Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date.

## **5 Repayment and Prepayment**

### **5.1 Repayment**

Except as otherwise provided herein, NOVATEK shall repay the Loan not later than 10.00 a.m. (New York City time) one Business Day prior to the Repayment Date.

### **5.2 Special Prepayment**

If, (i) either (a) as a result of the application of any amendments to or change in the double tax treaty between the Russian Federation and Ireland or the laws or regulations of the Russian Federation or Ireland or of any political sub-division thereof or any authority having power to tax therein (including as a result of a judgment of a court of competent jurisdiction) or a change in the application or official interpretation of such laws or regulations or double tax treaty which change or amendment becomes effective on or after the date of this Agreement or (b) as a result of the enforcement of the security provided for in the Trust Deed, NOVATEK would thereby be required to make or increase any payment due hereunder as provided in sub-clauses 6.2 or 6.3, or (ii) (for whatever reason) NOVATEK would have to or has been required to pay additional amounts pursuant to Clause 8, then NOVATEK may (without premium or penalty), upon not more than 60 and not less than 30 days’ notice to the Lender (which notice shall be irrevocable), prepay the Loan in whole (but not in part).

### **5.3 Illegality**

If, at any time, by reason of the introduction of any change after the date of this Agreement in any applicable law, regulation, regulatory requirement or directive of any agency of any state the Lender reasonably determines (setting out in reasonable detail the nature and extent of the relevant circumstances) (following receipt of such determination NOVATEK may request from the Lender an Opinion of Counsel with the cost of such Opinion of Counsel being borne solely by NOVATEK) that it is or would be unlawful or contrary to such applicable law, regulation, regulatory requirement or directive for the Lender to allow all or part of the Loan or the Notes to remain outstanding or for the Lender to maintain or give effect to any of its obligations in connection with this Agreement or the Notes and/or to charge or receive or to be paid interest at the rate then applicable to the Loan or the Notes, then upon notice by the Lender to NOVATEK in writing, NOVATEK and the Lender shall consult in good faith as to a basis which eliminates the application of such circumstances; provided, however, that the Lender shall be under no obligation to continue such consultation if a basis has not been determined within 30 days of the date on which it so notified NOVATEK. If such a basis has not been determined within the 30 days, then upon notice by the Lender to NOVATEK in writing, NOVATEK shall prepay the Loan in whole (but not in part) on the next Interest Payment Date or on such earlier date as the Lender shall certify on not less than 15 days notice to be necessary to comply with such requirements.

### **5.4 Prepayment of Loan Upon Redemption and Cancellation of Notes**

The Lender, NOVATEK or any member of the Group may from time to time, in accordance with the terms and conditions of the Notes, purchase Notes in the open market or by tender or by a private agreement at any price. The Lender, NOVATEK or any such member of the Group may, at its option, hold, reissue, resell or, in the case of NOVATEK or such member of the Group, from time to time deliver to the Lender Notes together with a request (a “**Request**”) for the Lender to present such Notes to the Registrar for cancellation or from time to time procure the delivery to the Registrar of instructions (“**Instructions**”) to redeem and thereafter cancel a specified aggregate principal amount of Notes represented by a Global Certificate in each case upon not less than 30 and no more than 60 days’ notice. Any Instructions shall be accompanied by evidence satisfactory to the Issuer and Registrar that the Lender, NOVATEK or any such Subsidiary of NOVATEK is entitled to give such Instructions or Request (which, for the avoidance of doubt in the case of Notes represented by a Global Certificate, will be satisfied by the provision of copies of account entries in the records of a clearing system and associated nominees (if relevant) reflecting the Lender’s, NOVATEK’s or such Subsidiary of NOVATEK’s beneficial interest in such part of the relevant Global Certificate) and further provided that an Officers’ Certificate is given by NOVATEK to the Lender and the Trustee certifying that any person giving any Request or Instructions on behalf of the Lender, NOVATEK or such other member of the Group is entitled to do so. Upon receipt of a Request or Instruction the Lender shall request and NOVATEK shall procure that in the case of Notes represented by a Global Certificate the relevant clearing system requests the Registrar to cancel such Notes on the date specified in the Request and NOVATEK shall promptly procure that in the case of Notes represented by a Global Certificate the account entries in the records of the relevant clearing system reflecting the Lender’s, NOVATEK’s or such Subsidiary of NOVATEK’s beneficial interest in such part of the relevant Global Certificate are updated to reflect such cancellation and the Register shall be updated. On the date specified in any Request or, as the

case may be, Instructions, the Loan shall be deemed to be prepaid for all purposes in an amount as corresponds to the aggregate principal amount of Notes presented with a Request or specified in Instructions and no further interest shall be payable with respect thereto provided that no such Request or Instruction may specify a date between the Record Date (as defined in the Notes) and the following Interest Payment Date.

## **5.5 Payment**

If the Loan is to be prepaid by NOVATEK pursuant to any of the provisions of Clauses 5.2 or, 5.3:

5.5.1 one Business Day prior to the due date for such prepayment, NOVATEK shall deposit in the Account an amount in cash equal to the amount required to be paid on such due date; and

5.5.2 NOVATEK shall, simultaneously with such prepayment or reduction, pay to the Lender (by deposit in the Account) accrued but unpaid interest thereon to the date of such prepayment and all other sums payable by NOVATEK pursuant to this Agreement in relation to the amount to be prepaid.

## **5.6 Provisions Exclusive**

NOVATEK may not voluntarily prepay the Loan except in accordance with the express terms of this Agreement. Any amount prepaid may not be re-borrowed.

## **6 Payments**

### **6.1 Making of Payments**

All payments of principal and interest and other amounts payable under Clause 6.2 hereof (other than those in respect of Reserved Rights) to be made by NOVATEK under this Agreement shall be made unconditionally by credit transfer to the Lender not later than 10.00 a.m. (New York City time) one Business Day prior to each Interest Payment Date, the Repayment Date or any other due date for redemption (as the case may be) in Same-Day Funds to the Account, or as the Trustee may otherwise direct following the occurrence of a Relevant Event (as defined in the Trust Deed).

The Lender agrees with NOVATEK that the Lender will not deposit any other monies into the Account and that no withdrawals shall be made from the Account other than for payments to be made in accordance with the Trust Deed and Paying Agency Agreement.

### **6.2 No Set-Off, Counterclaim or Withholding; Gross-Up**

All payments to be made by NOVATEK under this Agreement (including any amounts payable under Clause 6.3) shall be (i) made in full without set-off or counterclaim and (except to the extent required by law) free and clear of and without deduction or withholding for or on account of any Taxes and (ii) made only from the Russian Federation, Ireland or such other jurisdiction which would not require any deductions or withholding from any such payment. If NOVATEK shall be required by applicable law to make any deduction or withholding from any payment under this Agreement for or on account of any such Taxes, it shall, on the due date of such payment, increase any payment due hereunder to such amount as may be necessary to ensure that the Lender receives a net amount in Dollars equal to the full amount which it would have received had payment not been made subject to such Taxes, it shall account to the relevant authorities for the relevant amount of such Taxes so withheld or deducted within the time allowed for such payment under the applicable law and shall deliver to the Lender without undue delay evidence satisfactory to the Lender of such deduction or withholding and of the accounting therefor to the relevant taxing authority. If the Lender pays any amount in respect of any Taxes, including penalties or interest, NOVATEK shall reimburse the Lender in Dollars, for such payment on demand.

Any notification by the Lender to NOVATEK in connection with this Clause 6.2 shall be given as soon as reasonably practicable after the Lender becomes aware of any obligation on it to make any such withholding or deduction or pay any Taxes. The Lender shall, as soon as reasonably practicable following request by NOVATEK, provide NOVATEK (at NOVATEK's expense) with reasonable detail in writing as to the reasons for such withholding or deduction or payment of Taxes. Nothing in this paragraph shall prejudice in any way the obligation to gross up contained in this Clause 6.2.

### **6.3 Withholding on the Notes**

If the Lender notifies NOVATEK (setting out in reasonable detail the nature and extent of the obligation and providing, upon the request of NOVATEK, an Opinion of Counsel in respect of the existence of such obligation, with the cost of such Opinion of Counsel to be borne solely by NOVATEK) that it has become obliged to make any withholding or deduction for or on account of any Taxes imposed or levied, collected, withheld or assessed by or on behalf of Ireland or any political subdivision or any authority thereof or therein having the power to tax from any payment which it is obliged to make, or would otherwise be obliged to make but for the imposition of any such withholding or deduction for or on account of any such

Taxes, under or in respect of the Notes, NOVATEK agrees to pay into the Account for the benefit of the Lender, not later than 10.00 a.m. (New York City time) one Business Day prior to the date on which payment is due to the Noteholders in Same-Day Funds, such additional amounts as are equal to the said additional amounts which the Lender would be required to pay in order that the net amounts received by the Noteholders after such withholding or deduction will equal the respective amounts which would have been received by the Noteholders in the absence of such withholding or deduction; provided, however, that the Lender shall immediately upon receipt from any Paying Agent of the reimbursement of any sums paid pursuant to this provision, to the extent that the Noteholders, as the case may be, are not entitled to such additional amounts pursuant to the terms and conditions of the Notes, pay such additional amounts to NOVATEK (it being understood that neither the Lender, nor the Principal Paying Agent nor any Paying Agent shall have any obligation to determine whether any Noteholder is entitled to such additional amounts).

#### 6.4 **Reimbursement**

To the extent that the Lender subsequently obtains and uses any tax credit or allowance or obtains any other reimbursements or refunds relating to a deduction or withholding or payment of Taxes with respect to which NOVATEK has made a payment pursuant to this Clause 6, the Lender shall promptly pay to NOVATEK so much of the benefit or refund it received as will leave the Lender in the same position as it would have been had no additional amount been required to be paid by NOVATEK pursuant to this Clause 6; provided, however, that the question of whether any such benefit or refund has been received, and accordingly, whether any payment should be made to NOVATEK, the amount of any such payment and the timing of any such payment, shall be determined reasonably by the Lender, provided that the Lender shall notify NOVATEK promptly upon determination that it has received any such benefit or refund.

#### 6.5 **Mitigation**

If at any time either party hereto becomes aware of circumstances which would or might, then or thereafter, give rise to an obligation on the part of NOVATEK to make any deduction, withholding or payment as described in sub-clauses 6.2 or 6.3, then, without in any way limiting, reducing or otherwise qualifying the Lender's rights, or NOVATEK's obligations, under such sub-clauses, such party shall as soon as reasonably practicable upon becoming aware of such circumstances notify the other party, and, thereupon the parties shall consider and consult with each other in good faith with a view to finding, agreeing upon and implementing a method or methods by which any such obligation may be avoided or mitigated and, to the extent that both parties can do so without taking any action which in the reasonable opinion of such party is prejudicial to its own position, take such reasonable steps as may be available to it to avoid such obligation or mitigate the effect of such circumstances. NOVATEK agrees to reimburse the Lender for all properly incurred costs and expenses (including but not limited to legal fees) incurred by the Lender in connection with this sub-clause.

#### 6.6 **Tax Treaty Relief**

6.6.1 The Lender shall once in each calendar year prior to the first Interest Payment Date in that calendar year, use best endeavours to obtain and deliver to NOVATEK, at the expense of NOVATEK, no later than 30 Business Days prior to such Interest Payment Date, a tax residency certificate issued or certified by (as applicable) the competent authorities of Ireland confirming that the Lender is resident for tax purposes in Ireland in the calendar year of such Interest Payment Date. At the cost of NOVATEK, the residency certificate shall be apostilled at the Irish Department of Foreign Affairs. The Lender shall not be responsible for any failure to provide, or any delays in providing, such tax residency certificate as a result of any action or inaction of any authority of Ireland, but shall notify NOVATEK as soon as practicable about any such failure or delay with an indication of the actions taken by the Lender to obtain such tax residency certificate.

6.6.2 If Russian legislation regulating the procedures for obtaining an exemption from Russian withholding tax on income changes, the Lender shall use its reasonable and timely efforts to assist NOVATEK to obtain relief from such tax pursuant to the double taxation treaty between the Russian Federation and Ireland.

6.6.3 Notwithstanding Clause 6.4, if NOVATEK makes a withholding or deduction for or on account of Taxes from a payment under or in respect of this Agreement, NOVATEK may apply on behalf of the Lender to the relevant taxing authority of the Russian Federation (the "**Russian Taxing Authority**") for a payment to be made by such authority to the Lender with respect to such Tax. If, whether following a claim made on its behalf by NOVATEK or otherwise, the Lender receives such a payment ("**Russian Tax Payment**") from the Russian Taxing Authority with respect to such Taxes, it will as soon as reasonably possible notify NOVATEK that it has received that payment (and the amount of such payment); whereupon, provided that NOVATEK has notified the Lender in writing of the details of an account (the "**Borrower Account**") to which a payment or transfer

should be made, and that the Lender is able to make a payment or transfer under applicable laws and regulations, the Lender will pay or transfer an amount equal to the Russian Tax Payment to the Borrower Account.

6.6.4 The Lender agrees promptly, upon becoming aware thereof, to notify NOVATEK if it ceases to be resident in Ireland for tax purposes or if any of the representations set forth in sub-clause 9.2 of this Agreement are no longer true and correct.

6.6.5 Subject to Clauses 6.5 and 8.2, the Lender agrees that it shall maintain its residency for tax purposes only in Ireland.

## **7 Conditions Precedent**

The obligation of the Lender to make the Advance (less any deduction (if any) in accordance with sub-clause 3.2) shall be subject to the further conditions precedent that as of the Closing Date (a) the representations and warranties made and given by NOVATEK in Clause 9 shall be true and accurate as if made and given on the Closing Date with respect to the facts and circumstances then existing, (b) no Potential Event of Default or Event of Default shall have occurred and be continuing, (c) NOVATEK shall not be in breach of any of the terms, conditions and provisions of this Agreement, (d) the Subscription Agreement, the Subscription Support Agreement, the Trust Deed and the Paying Agency Agreement shall have been executed and delivered, (e) the Lender shall have received the proceeds of the issue of the Notes pursuant to the Subscription Agreement and the Subscription Support Agreement and (f) the Lender shall have received the Facility Fee or shall have agreed with NOVATEK to deduct such amount from the Advance.

## **8 Change in Law; Increase in Cost**

### **8.1 Compensation**

In the event that after the date of this Agreement there is any change in or introduction of any tax, law, regulation, regulatory requirement or official directive (whether or not having the force of law but, if not having the force of law, the observance of which is in accordance with the generally accepted financial practice of financial institutions in the country concerned) or in the interpretation or application thereof by any person charged with the administration thereof and/or any compliance by the Lender in respect of the Loan or the Facility with any request, policy or guideline (whether or not having the force of law but, if not having the force of law, the observances of which is in accordance with the generally accepted financial practice of financial institutions in the country concerned) from or of any central or other fiscal, monetary or other authority, agency or any official of any such authority, which:

8.1.1 subjects or will subject the Lender to any Taxes with respect to payments of principal of or interest on the Loan or any other amount payable under this Agreement (other than any Taxes payable by the Lender on its overall net income (except to the extent that the Lender is unable to obtain a deduction for tax purposes on payments to the Noteholders which offsets any tax liability on equivalent amounts received under this Agreement) or any Taxes referred to in sub-clauses 6.2 or 6.3); or

8.1.2 increases or will increase the taxation of or changes or will change the basis of taxation of payments to the Lender of principal of or interest on the Loan or any other amount payable under this Agreement (other than any such increase or change which arises by reason of any increase in the rate of tax payable by the Lender on its overall net income (except to the extent that the Lender is unable to obtain a deduction for tax purposes on payments to the Noteholders which offsets any tax liability on equivalent amounts received under this Agreement) or as a result of any Taxes referred to in sub-clauses 6.2 or 6.3); or

8.1.3 imposes or will impose on the Lender any other condition affecting this Agreement, the Facility or the Loan,

and if as a result of any of the foregoing:

(i) the cost to the Lender of making, funding or maintaining the Loan or the Facility is increased; or

(ii) the amount of principal, interest or other amount payable to or received by the Lender hereunder is reduced; or

(iii) the Lender makes any payment or foregoes any interest or other return on or calculated by reference to the gross amount of any sum receivable by it from NOVATEK hereunder or makes any payment or foregoes any interest or other return on or calculated by reference to the gross amount of the Loan,



then subject to the following, and in each such case:

- (a) the Lender shall, as soon as practicable after becoming aware of such increased cost, reduced amount or payment made or foregone, give written notice to NOVATEK, together with a certificate signed by one authorised official of the Lender describing in reasonable detail the introduction or change or request which has occurred and the country or jurisdiction concerned and the nature and date thereof and demonstrating the connection between such introduction, change or request and such increased cost, reduced amount or payment made or foregone, and setting out in reasonable detail the basis on which such amount has been calculated, and all relevant supporting documents evidencing the matters set out in such certificate; and
- (b) NOVATEK, in the case of paragraphs (i) and (iii) above, shall on demand by the Lender, pay to the Lender such additional amount as shall be necessary to compensate the Lender for such increased cost, and, in the case of paragraph (ii) above, at the time the amount so reduced would otherwise have been payable, pay to the Lender such additional amount as shall be necessary to compensate the Lender for such reduction, payment or foregone interest or other return; provided, however, the amount of such increased cost, reduced amount or payment made or foregone shall be deemed not to exceed an amount equal to the proportion thereof which is directly attributable to this Agreement,

provided that this sub-clause 8.1 will not apply to or in respect of any matter for which the Lender has already been compensated under sub-clauses 6.2 or 6.3.

## **8.2 Mitigation**

In the event that the Lender becomes entitled to make a claim pursuant to sub-clause 8.1, the Lender shall consult in good faith with NOVATEK and shall use reasonable efforts (based on the Lender's reasonable interpretation of any relevant tax, law, regulation, requirement, official directive, request, policy or guideline) to reduce, in whole or in part, NOVATEK's obligations to pay any additional amount pursuant to such sub-clause, except that nothing in this sub-clause 8.2 shall obligate the Lender to incur any costs or expenses in taking any action which, in the reasonable opinion of the Lender, is prejudicial to its interests.

## **9 Representations and Warranties**

### **9.1 NOVATEK's Representations and Warranties**

NOVATEK represents and warrants to the Lender as follows, with the intent that such shall form the basis of this Agreement at the date hereof and shall be deemed to be repeated by NOVATEK on the Closing Date:

- 9.1.1 NOVATEK has taken all necessary corporate, legal and other action required to authorise the borrowing of the Advance on the terms, subject to the conditions of this Agreement, to authorise the execution and delivery of this Agreement and all other documents to be executed and/or delivered by it in connection with this Agreement, to authorise the performance of this Agreement in accordance with its terms;
- 9.1.2 this Agreement has been duly executed and delivered by NOVATEK and constitutes legal, valid and binding obligations of NOVATEK, enforceable in accordance with its terms, subject to applicable bankruptcy, insolvency, moratorium and similar laws affecting creditors' rights generally, and subject, as to enforceability, (i) to general principles of equity, (ii) to the fact that the gross-up provisions may not be enforceable under Russian law and (iii) with respect to the enforceability of a judgment, to the laws of the relevant jurisdiction where such judgment must be enforced and whether there is a treaty in force relating to the mutual recognition of foreign judgments;
- 9.1.3 the execution, delivery and performance of this Agreement by NOVATEK will not conflict with or result in any breach or violation of (i) any law or regulation or any order of any governmental, judicial, arbitral or public body or authority, (ii) the constitutive documents, rules and regulations of NOVATEK or any of its Subsidiaries or (iii) any agreement or other undertaking or instrument to which NOVATEK or any of its Subsidiaries is a party or which is binding upon NOVATEK or any of its Subsidiaries or any of their respective properties or assets, nor result in the creation or imposition of any Security Interest on any of their respective properties or assets pursuant to the provisions of any such agreement or other undertaking or instrument;

- 9.1.4 NOVATEK's obligations under the Loan rank at least *pari passu* with all its other unsecured and unsubordinated indebtedness, except as otherwise provided by mandatory provisions of applicable law;
- 9.1.5 all consents, licences, notifications, authorisations or approvals of, or filings with, any governmental, judicial or public bodies or authorities, if any, required in order to ensure (i) the due execution, delivery and performance by NOVATEK of this Agreement, and (ii) the legality, validity, enforceability, and admissibility in evidence of this Agreement have been obtained or effected and are and shall remain in full force and effect;
- 9.1.6 the execution, delivery and enforceability of this Agreement is not subject to any tax, duty, fee or other charge, including, but without limitation to, any documentary, registration or transfer tax, stamp duty or similar levy, imposed by or within the Russian Federation or any political subdivision or taxing authority thereof or therein;
- 9.1.7 neither NOVATEK nor any of its property has any right of immunity from suit, execution, attachment or other legal process on the grounds of sovereignty or otherwise in respect of any action or proceeding relating in any way to this Agreement;
- 9.1.8 subject to the performance by the relevant parties of the relevant established procedures in connection with the obtaining of an applicable withholding tax exemption for payments hereunder, as outlined further in Clause 6.6, no withholding in respect of any Russian Taxes is required to be made from any payment by NOVATEK under this Agreement;
- 9.1.9 NOVATEK is subject, without reservation, to civil and commercial law with respect to its obligations under this Agreement, and its execution of this Agreement constitutes, and its exercise of its rights and performance of its obligations hereunder will constitute, private and commercial acts done and performed for private and commercial purposes; and
- 9.1.10 all acts, conditions and things, as required to be done, fulfilled and performed to make this Agreement admissible in evidence in the Russian Federation (whether in arbitration proceedings or otherwise) have been done, fulfilled and performed.

## 9.2 Lender's Representations and Warranties

The Lender represents and warrants to NOVATEK as follows:

- 9.2.1 the Lender is duly incorporated under the laws of Ireland and has full power and capacity to execute this Agreement and to undertake and perform the obligations expressed to be assumed by it herein and the Lender has taken all necessary action to approve and authorise the same;
- 9.2.2 the execution of this Agreement and the undertaking and performance by the Lender of the obligations expressed to be assumed by it herein will not conflict with, or result in a breach of or default under, the laws of Ireland, any agreement or instrument to which it is a party or by which it is bound or in respect of Indebtedness in relation to which it is a surety or the memorandum and articles of association of the Lender;
- 9.2.3 this Agreement has been duly authorised and executed by the Lender and constitutes a legal, valid and binding obligation of the Lender enforceable against the Lender in accordance with its terms, subject to applicable bankruptcy, insolvency, moratorium and similar laws affecting creditors' rights generally, and subject, as to enforceability, (i) to principles of law and equity of general application, and (ii) with respect to the enforceability of a judgment, to the laws of the relevant jurisdiction where such judgment must be enforced and whether there is a treaty in force relating to the mutual recognition of foreign judgments;
- 9.2.4 all authorisations, consents and approvals required by the Lender in Ireland for or in connection with the execution of this Agreement and the performance by the Lender of the obligations expressed to be undertaken by it herein have been obtained and are in full force and effect;
- 9.2.5 the Lender is a resident of Ireland for taxation purposes and subject to taxation in Ireland not merely on the basis of the source of its income or location of its property but on the basis of its registration as a legal entity, location of its management body or other similar criteria. The Lender is entitled to the benefits of tax treaties signed by Ireland, including the double tax treaty concluded on 29 April 1994 between Ireland and the Russian Federation. At the date hereof, the Lender reasonably believes that it does not have a permanent establishment or presence in the Russian Federation, save for any which may be created solely as a result of the Lender entering into this Agreement or any other loan agreement with NOVATEK and perfecting the transactions contemplated therein;

- 9.2.6 the Loan will be treated as an asset under generally accepted accounting practice applicable in Ireland;
- 9.2.7 the Lender does not own, either directly or indirectly, any shares of NOVATEK;
- 9.2.8 the Lender has taken no action (other than entering into loan arrangements with NOVATEK and the documents and transactions connected therewith) which would cause it to become registered in the Russian Federation for VAT purposes;
- 9.2.9 there is no reference to the territory of the Russian Federation as the actual place of the Lender's activity in the memorandum or articles of association of the Lender; and
- 9.2.10 each member of the Board of Directors of the Lender is resident in Ireland for tax purposes.

## **10 Covenants**

The covenants in this Clause 10 shall remain in force from the date of this Agreement for so long as the Loan or any amount hereunder is outstanding.

### **10.1 Negative Pledge**

NOVATEK will:

- (a) not, and will procure that no Subsidiary will, create or permit to subsist any Security Interest other than a Permitted Security Interest upon the whole or any part of its undertaking, property, assets or revenues, present or future, to secure for the benefit of the holders of any Relevant Indebtedness:
  - (i) payment of any sum due in respect of any such Relevant Indebtedness;
  - (ii) any payment under any guarantee of any such Relevant Indebtedness; or
  - (iii) any payment under any indemnity or other like obligation relating to any such Relevant Indebtedness;
- (b) procure that no Affiliate gives any guarantee of, or indemnity in respect of, any of NOVATEK's Relevant Indebtedness to the holders thereof,

without in any such case at the same time or prior thereto procuring that the Loan (x) is secured equally and rateably with such Relevant Indebtedness for so long as such Relevant Indebtedness is so secured or (y) have the benefit of such other guarantee, indemnity or other like obligations or such other security (in each case) as the Lender in its absolute discretion shall deem to be not materially less beneficial or (z) as shall be approved by the Lender.

### **10.2 Mergers**

NOVATEK shall not enter into or become subject to, and shall not permit any Material Subsidiary to enter into or become subject to, any reorganisation (including, without limitation, any amalgamation, demerger, merger or corporate reconstruction) or to change its corporate structure if such a reorganisation or change would have a Material Adverse Effect.

### **10.3 Payment of Taxes**

NOVATEK shall, and shall ensure that its Subsidiaries shall, pay or discharge or cause to be paid or discharged, before the same shall become overdue, all taxes, assessments and governmental charges levied or imposed upon, or upon the income, profits or assets of NOVATEK or any Subsidiary, provided, however, that none of NOVATEK nor any of its Subsidiaries shall be required to pay or discharge or cause to be paid or discharged any such tax, assessment, charge or claim (x) whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which adequate reserves in accordance with IFRS or other appropriate provision has been made or (y) if such failure to pay or discharge shall not have a Material Adverse Effect.

### **10.4 Delivery of Information**

10.4.1 NOVATEK will deliver to the Lender and the Trustee as soon as they become available, but in any event within 180 days after the end of each of its financial years, copies of NOVATEK's consolidated financial statements for such financial year, in each case audited and prepared in accordance with IFRS consistently applied with the corresponding financial statements for the preceding period prepared in accordance with IFRS.

10.4.2 NOVATEK shall as soon as the same become available, but in any event within 150 days after the end of the first half of each of its financial years, deliver to the Lender and the Trustee copies of NOVATEK's consolidated financial statements for such period, in each case reviewed and prepared

in accordance with IFRS consistently applied with the corresponding financial statements for the preceding period prepared in accordance with IFRS.

- 10.4.3 NOVATEK will ensure that each set of consolidated financial statements delivered by it pursuant to this Clause 10.4 is accompanied by a report thereon of its auditors (including accompanying notes).
- 10.4.4 NOVATEK will deliver to the Lender and the Trustee on each Interest Payment Date an Officers' Certificate stating that, to the best of the knowledge, information and belief of the signatories to such Officers' Certificate, having made all reasonable enquiries, NOVATEK has kept, observed, performed and fulfilled its obligations under, and complied with, this Agreement and that there has not been, as at a date (the "**Certification Date**") not more than 5 Business Days before the date of such certificate, an Event of Default or Potential Event of Default since the Certification Date of the last certificate or, if none, the date of this Agreement (or if an Event of Default or Potential Event of Default shall have occurred, describing all such Events of Default or Potential Events of Default).
- 10.4.5 Subject to any restrictions under applicable law (including regarding insider dealing or market abuse), NOVATEK hereby undertakes that it will deliver to the Lender and the Trustee, without undue delay, such additional information as it or the Trustee reasonably requires for the purposes of the discharge of the duties and discretions vested in it under this Loan Agreement or Trust Deed, including providing, without limitation (a) an Officers' Certificate certifying (i) those Subsidiaries which would be treated as Material Subsidiaries pursuant to this Agreement and (ii) as to the Notes held by or on behalf of NOVATEK or any member of the Group as at the date of such certificate, such Officers' Certificate to be provided within 14 days of NOVATEK's audited and consolidated accounts being made available, and (b) a notification whenever it or any member of the Group has purchased and retained Notes for its own account.
- 10.4.6 NOVATEK undertakes to furnish to the Lender such information as the Irish Stock Exchange Limited (or any other or further stock exchange or stock exchanges or any relevant authority or authorities on which the Notes may, from time to time, be listed or admitted to trading) may require as necessary in connection with the listing or admission to trading on such stock exchange or relevant authority of such instruments.
- 10.4.7 NOVATEK consents that any information provided to the Lender pursuant to this Clause 10.4 may also be provided to the Trustee, if so requested by the Trustee, without violating any duty of confidentiality or secrecy that the Lender may owe to NOVATEK under the laws of Ireland.

## **11 Events of Default**

### **11.1 Events of Default**

If one or more of the following events shall occur and be continuing (each, an "**Event of Default**"), the Lender shall be entitled to the remedies set forth in sub-clause 11.3:

- 11.1.1 NOVATEK fails to pay any amount of principal, interest or other amounts payable hereunder within seven Business Days (in the case of principal) or fourteen Business Days (in the case of interest or other amounts) of when the same ought to have been paid; or
- 11.1.2 a default is made by NOVATEK in the performance or observance of any of its other obligations under this Agreement and except where such default is not capable of remedy, such default remains unremedied for the period of 45 days after written notice thereof, addressed to NOVATEK by the Lender, has been delivered to NOVATEK; or
- 11.1.3 (i) any Indebtedness of Novatek or any Material Subsidiary is not paid in full when due and payable (as the case may be), taking into account any applicable grace periods; or (ii) any present or future Indebtedness of NOVATEK or any Material Subsidiary becomes due and payable prior to its stated maturity otherwise than at the option of NOVATEK, the relevant Material Subsidiary (as the case may be) or (provided that no event of default, howsoever described, has occurred) any person entitled to such Indebtedness, taking into account any applicable grace periods; provided that, either, (x) the individual amount of the relevant Indebtedness, guarantee or indemnity in respect of which one or more of the events mentioned above in this sub-Clause 11.1.3 has occurred and is continuing equals or exceeds U.S.\$50,000,000 or (y) the aggregate amount of the relevant Indebtedness, guarantees and indemnities in respect of which one or more of the events mentioned above in this sub-Clause 11.1.3 has occurred and is continuing equals or exceeds U.S.\$150,000,000 or, in the case of an amount specified in (x) or (y) above, its U.S. Dollar Equivalent; or
- 11.1.4 an effective resolution is passed or an order of a court of competent jurisdiction is made that NOVATEK be wound-up or dissolved otherwise than for the purposes of or pursuant to and

followed by a consolidation, amalgamation, merger or reconstruction the terms of which shall have previously been approved in writing by the Lender; or

- 11.1.5 an effective resolution is passed or an order of a court of competent jurisdiction is made for the winding-up or dissolution of any Material Subsidiary except (i) for the purposes of or pursuant to and followed by a consolidation or amalgamation with or merger into NOVATEK or any other Subsidiary (provided such Subsidiary will be a Material Subsidiary following such consolidation, amalgamation or merger), (ii) for the purposes of or pursuant to and followed by a consolidation, amalgamation, merger or reconstruction (other than as described in (i) above) the terms of which shall have previously been approved in writing by the Lender or (iii) by way of a voluntary winding-up or dissolution and there are surplus assets in any Material Subsidiary and such surplus assets attributable to NOVATEK and/or any Material Subsidiary are distributed to NOVATEK and/or any other Subsidiary (provided such Subsidiary will be a Material Subsidiary following such consolidation, amalgamation or merger); or
- 11.1.6 an encumbrancer takes possession or a receiver is appointed of the whole or (in the opinion of the Lender) a material part of the assets or undertaking of NOVATEK or any Material Subsidiary and such possession or appointment is not discharged or rescinded within 120 days thereof (or such longer period as the Lender may consider appropriate in relation to the jurisdiction concerned) provided that at all times during such period NOVATEK or such Material Subsidiary, as the case may be, is contesting such possession or appointment in good faith; or
- 11.1.7 a distress, execution or seizure before judgment is levied or enforced upon or sued upon or sued out against a part of the property of NOVATEK or any Material Subsidiary which is (in the opinion of the Lender) material in its effect upon the operations of NOVATEK or such Material Subsidiary (as the case may be) and is not stayed or discharged within 120 days thereof (or such longer period as the Lender may consider appropriate in relation to the jurisdiction concerned); or
- 11.1.8 NOVATEK or any Material Subsidiary (i) through an official action of the board of directors of NOVATEK or such Material Subsidiary (as the case may be) announces its intention not or (ii) is unable to pay all or (in the opinion of the Lender) any material part of its debts as and when they fall due; or
- 11.1.9 proceedings shall have been initiated against NOVATEK or any Material Subsidiary for its liquidation, insolvency, bankruptcy or dissolution under any applicable bankruptcy, reorganisation or insolvency law and such proceedings shall not have been discharged or stayed within a period of 120 days (or such longer period as the Lender may consider appropriate in relation to the jurisdiction concerned) unless, and for so long as, the Lender is satisfied that it is being contested in good faith and diligently; or
- 11.1.10 NOVATEK or any Material Subsidiary shall initiate or consent to proceedings for its liquidation, insolvency, bankruptcy or dissolution relating to itself under any applicable bankruptcy, reorganisation or insolvency law or make a general assignment for the benefit of, or enter into any general composition with, its creditors; or
- 11.1.11 a moratorium is agreed or declared in respect of any Indebtedness of NOVATEK or any Material Subsidiary or any governmental authority or agency condemns, seizes, compulsorily purchases, transfers or expropriates all or (in the opinion of the Lender) a material part of the assets, licences or shares of NOVATEK or any Material Subsidiary; or
- 11.1.12 any event occurs which under the laws of Ireland, the Russian Federation or, in the case of a Material Subsidiary, the jurisdiction of its incorporation (if different), has an analogous effect to any of the events referred to in Clauses 11.1.4 to 11.1.11 above.

## 11.2 **Notice of Default**

NOVATEK shall deliver to the Lender, promptly after the occurrence thereof, written notice in the form of an Officers' Certificate of any event which is an Event of Default, or a Potential Event of Default, its status and what action NOVATEK is taking or proposes to take with respect thereto.

## 11.3 **Default Remedies**

If any Event of Default shall occur and be continuing, the Lender may, by notice in writing to NOVATEK, (a) declare the obligations of the Lender hereunder to be immediately terminated, whereupon such obligations shall terminate, and (b) declare all amounts payable hereunder by NOVATEK that would otherwise be due after the date of such termination to be immediately due and payable, whereupon all such amounts shall become immediately due and payable, all without diligence, presentment, demand of payment, protest or notice of any kind, which are expressly waived by NOVATEK.

#### 11.4 **Rights Not Exclusive**

The rights provided for herein are cumulative and are not exclusive of any other rights, powers, privileges or remedies provided by law.

#### 11.5 **Right of Set-off**

If any amount payable by NOVATEK hereunder is not paid as and when due, NOVATEK authorises the Lender to proceed, to the fullest extent permitted by applicable law, without prior notice, by right of set-off, banker's lien, counterclaim or otherwise, against any assets of NOVATEK in any currency that may at any time be in the possession of the Lender (except for any assets of NOVATEK in repayment of loans substantially similar to this Loan Agreement), at any branch or office, to the full extent of all amounts payable to the Lender hereunder.

### 12 **Indemnity**

#### 12.1 **Indemnification**

NOVATEK undertakes to the Lender, that if the Lender or any of its Affiliates, or any director, officer, employee or agent of the Lender or any such Affiliate and each person controlling the Lender (each an "**indemnified party**") incurs any loss, liability, claim, demand or damage, charge or expense (including without limitation taxes and legal fees, costs and expenses) (a "**Loss**") as a result of or in connection with the Loan or this Agreement (or enforcement thereof), and/or the issue, constitution, sale, listing and/or enforcement of the Notes and/or the Notes being outstanding (excluding a Loss that is the subject of the undertakings contained in Clauses 6.2, 6.3, 8 and 13.8 of this Agreement (it being understood that the Lender may not recover twice in respect of the same Loss)), NOVATEK shall pay to the Lender on demand an amount equal to such Loss and all costs, charges and expenses which it or any indemnified party may pay or incur in connection with investigating, disputing or defending any such action or claim as such costs, charges and expenses are incurred unless such Loss was either caused by such indemnified party's gross negligence or wilful misconduct or arises out of a breach of the representations and warranties of the Lender contained in this Agreement. The Lender shall not have any duty or obligation whether as fiduciary or trustee for any indemnified party or otherwise, to recover any such payment or to account to any other person for any amounts paid to it under this Clause.

#### 12.2 **Independent Obligation**

Sub-clause 12.1 constitutes a separate and independent obligation of NOVATEK from its other obligations under or in connection with this Agreement and shall not affect, or be construed to affect, any other provision of this Agreement.

#### 12.3 **Evidence of Loss**

A certificate of the Lender setting forth the amount of Loss described in Clause 12.1 and specifying in full detail the basis therefor shall be *prima facie* evidence of the amount of such losses, expenses and liabilities.

#### 12.4 **Survival**

The obligations of NOVATEK pursuant to Clauses 6.2, 6.3, 8, 12.1, 13.2 and 13.8 shall survive the execution and delivery of this Agreement, the drawdown of the Facility and the repayment of the Loan, in each case by NOVATEK.

### 13 **General**

#### 13.1 **Evidence of Debt**

The entries made by the Lender in the accounts maintained by the Lender in accordance with its usual practice and evidencing the amounts from time to time lent by and owing to it hereunder shall, in the absence of manifest error, be *prima facie* evidence of the existence and amounts of NOVATEK's obligations recorded herein.

#### 13.2 **Stamp Duties**

NOVATEK shall pay all stamp, registration and documentary taxes or duties (if any) imposed on or payable by NOVATEK or the Lender in the United Kingdom, the Russian Federation, Luxembourg, Belgium or Ireland which may be payable or determined to be payable in connection with the execution, delivery, performance, enforcement or admissibility in evidence of this Agreement. NOVATEK shall indemnify the Lender against any and all costs and expenses which may be incurred or suffered by the Lender with respect to, or resulting from, delay or failure by NOVATEK to comply with its obligation under this Clause 13.2 to pay such taxes or similar charges.

### 13.3 VAT

Where a sum is payable under this Agreement to the Lender, NOVATEK will, in addition, pay in respect of VAT:

- 13.3.1 where the payment (or any part of it) constitutes the consideration (or any part thereof) for any supply of services made to NOVATEK, such amounts as equal any VAT properly chargeable thereon on receipt of a valid VAT invoice;
- 13.3.2 where the payment is to reimburse or indemnify the Lender for any cost, charge or expense incurred by it (except where the payment falls within sub-clause 13.3.3 below), such amount as equals any VAT, which the Lender represents in good faith is not recoverable by it or by the representative member of any VAT group of which it is a member, charged to or incurred by the Lender in respect of any cost, charge or expense which gives rise to or is reflected in the payment on production of relevant invoices or equivalent evidence of such payment having been made; and
- 13.3.3 where the payment is in respect of costs or expenses incurred by the Lender as agent for NOVATEK and except where section 47(3) of the United Kingdom Value Added Tax Act 1994 or section 28(1) of the Value-Added Tax Consolidation Act 2010 of Ireland (or any equivalent legislation in a jurisdiction outside the United Kingdom or Ireland) applies, such amount as equals the amount included in the costs or expenses in respect of VAT and in such case the Lender shall use reasonable efforts to procure that the actual supplier of goods or services which the Lender received as agent issues a valid VAT invoice directly to NOVATEK in respect of the relevant supply.

### 13.4 Payment Gross-Up

Where any payment is made under this Agreement to the Lender pursuant to an indemnity, compensation or reimbursement provision, the sum payable shall take into account (i) any charge to Taxation in the hands of the Lender in respect of such payment and (ii) any tax relief available to the Lender in respect of the matter giving rise to the payment and which may be offset against the charge to Taxation, such that the Lender shall be left with a sum equal to the sum that it would have retained in the absence of such a charge to Taxation and such tax relief.

### 13.5 Waivers

No failure to exercise and no delay in exercising, on the part of the Lender or NOVATEK, any right, power or privilege hereunder and no course of dealing between NOVATEK and the Lender shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or privilege preclude any other or further exercise thereof, or the exercise of any other right, power or privilege. The rights and remedies herein provided are cumulative and not exclusive of any rights, or remedies provided by applicable law.

### 13.6 Notices

#### 13.6.1 Method

Each communication under this Agreement shall be made by fax or otherwise in writing. Each communication or document to be delivered to any party under this Agreement shall be sent to that party at the fax number or postal address, and marked for the attention of the person (if any), from time to time designated by that party to each other party for the purpose of this Agreement. The initial telephone number, fax number, postal address and person so designated by the parties under this Agreement are set out below:

if to NOVATEK:

Address	2, Udaltsova Street Moscow Russian Federation 119415
Fax:	+7 495 721 2248
Tel:	+7 495 730 6000
Attention:	M. Gyetvay/K. Yanovskiy

if to the Lender:

Address        Novatek Finance Limited  
                  12 Merrion Square  
                  Dublin 2  
                  Ireland

Fax:            +353 1 631 6009

Tel:            +353 1 631 6052

Attention:     Paddy O'Halloran/Oonagh Hayes

or to such other address or fax number as any party may hereafter specify in writing to the other.

### 13.6.2 **Deemed Receipt**

Any communication from any party to any other under this Agreement shall be effective, (if by fax) when the relevant delivery receipt is received by the sender and, (if in writing) when delivered; provided that any communication which is received (or deemed to take effect in accordance with the foregoing) outside business hours or on a non-business day in the place of receipt shall be deemed to take effect at the opening of business on the next following business day in such place. Any communication delivered to any party under this Agreement which is to be sent by fax will be written legal evidence.

## 13.7 **Assignment**

- 13.7.1 Subject to Clause 13.7.2, this Agreement shall inure to the benefit of and be binding upon the parties, their respective successors and any permitted assignee or transferee of some or all of a party's rights under this Agreement. Any reference in this Agreement to any party shall be construed accordingly and, in particular, references to the exercise of any rights, benefits and discretions or the making of any determination (including forming an opinion) by, and the delivery of notices, certificates and information to, the Lender, shall include references to the exercise of any such rights, benefits or discretions by or the making of such determination (including forming an opinion) by the Trustee (as Trustee). Notwithstanding the foregoing, the Trustee shall not be entitled to participate in any determinations by, and the delivery of notices, certificates and information to, the Lender or any discussions between the Lender and NOVATEK or any agreements of the Lender or NOVATEK, pursuant to Clauses 6.4, 6.5 or 8.
- 13.7.2 NOVATEK shall not assign or transfer all or any part of its rights or obligations hereunder to any other party or person.
- 13.7.3 Subject to the provisions of Clause 17 of the Trust Deed, the Lender may not assign or transfer, in whole or in part, any of its rights, obligations and benefits under this Agreement other than the Reserved Rights except that the Lender may charge by way of first fixed charge in favour of the Trustee (as Trustee) of certain of the Lender's rights and benefits under this Agreement and assign absolutely to the Trustee certain rights, interests and benefits under this Agreement, in each case, as set out in Clause 4 of the Trust Deed.

## 13.8 **Currency Indemnity**

To the fullest extent permitted by law, the obligation of NOVATEK in respect of any amount due in Dollars under this Agreement shall, notwithstanding any payment in any other currency (whether pursuant to a judgment or otherwise), be discharged only to the extent of the amount in Dollars that the Lender may, in accordance with normal banking procedures, purchase with the sum paid in such other currency (after any premium and costs of exchange) on the Business Day immediately following the day on which the Lender receives such payment. If the amount in Dollars that may be so purchased for any reason falls short of the amount originally due (the "**Due Amount**"), NOVATEK hereby agrees to indemnify and hold harmless the Lender against any deficiency in Dollars. Any obligation of NOVATEK not discharged by payment in Dollars shall, to the fullest extent permitted by applicable law, be due as a separate and independent obligation and, until discharged as provided herein, shall continue in full force and effect. If the amount in Dollars that may be purchased exceeds that Due Amount the Lender shall promptly pay the amount of the excess to NOVATEK.



### 13.9 **Contracts (Rights of Third Parties) Act 1999**

Except as otherwise specifically provided herein, a person who is not a party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Agreement. This Agreement may be terminated and any term may be amended or waived without the consent of any such person so expressly provided for under this Agreement.

### 13.10 **Governing Law**

This Agreement and any non-contractual obligations arising out of or in connection with it will be governed by and construed in accordance with English law.

### 13.11 **Jurisdiction**

Any dispute, be it contractual or non-contractual, arising out of or in connection with this Agreement, including any question regarding its formation, existence, validity or termination shall be referred to and finally resolved by arbitration under the Rules of Arbitration of the London Court of International Arbitration (“**LCIA**”) (the “**Rules**”).

13.11.1 The Rules are deemed to be incorporated by reference into this Clause 13.11.

13.11.2 The number of arbitrators shall be three, each party having the right to nominate one arbitrator. If one party fails to appoint an arbitrator within 30 days of receiving notice of the appointment of an arbitrator by the other party, then that arbitrator shall be appointed by the LCIA.

13.11.3 The third arbitrator, who shall act as chairman of the tribunal, shall be chosen by the two arbitrators chosen by or on behalf of the parties. If he is not chosen and appointed within 15 days of the date on which the later of the two-party appointed arbitrators is appointed, he shall be appointed by the LCIA.

13.11.4 The seat of arbitration shall be London, England where all hearings and meetings shall be held, unless the parties agree otherwise. The language to be used in the arbitral proceedings shall be English.

13.11.5 It is agreed that the arbitrators shall have no authority to award exemplary or punitive damages of any type under any circumstances whether or not such damages may be available under the relevant applicable law, the parties hereby waiving their right, if any, to recover such damages.

13.11.6 The parties agree that the arbitrators shall have power to award on a provisional basis any relief that they would have power to grant on a final award.

13.11.7 This arbitration clause, including its validity and scope, shall be governed by English law.

Nothing in this Clause 13.11 shall be construed as preventing a party from seeking conservatory or similar interim relief in any court of competent jurisdiction nor shall anything in this Clause 13.11 prohibit a party from bringing an action to enforce a money judgment in any other jurisdiction.

### 13.12 **Waiver of Immunity**

To the extent that NOVATEK or the Lender may now or hereafter be entitled, in any jurisdiction in which any proceedings may at any time be commenced with respect to this Agreement, to claim for itself or any of its undertaking, properties, assets or revenues present or future any immunity (sovereign or otherwise) from suit, jurisdiction of any tribunal, attachment prior to judgment, attachment in aid of execution of a judgment, execution of a judgment or award or from set-off, banker’s lien, counterclaim or any other legal process or remedy with respect to its obligations under this Agreement and/or to the extent that in any such jurisdiction there may be attributed to NOVATEK or the Lender any such immunity (whether or not claimed), NOVATEK and the Lender hereby irrevocably agree not to claim, and hereby waive, any such immunity.

### 13.13 **Severability**

In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

### 13.14 **Counterparts**

This Agreement may be executed in any number of counterparts and all of such counterparts taken together shall be deemed to constitute one and the same agreement.

### 13.15 **Language**

The language which governs the interpretation of this Agreement is the English language.

### 13.16 Amendments

Except as otherwise provided by its terms, this Agreement may not be varied except by an agreement in writing signed by the parties.

### 13.17 Partial Invalidity

The illegality, invalidity or unenforceability to any extent of any provision of this Agreement under the law of any jurisdiction shall affect its legality, validity or enforceability in such jurisdiction to such extent only and shall not affect its legality, validity or enforceability under the law of any other jurisdiction, nor the legality, validity or enforceability of any other provision.

### 13.18 Prescription

In the event that the Notes become void pursuant to Condition 10 of the Notes, the Lender shall forthwith repay to NOVATEK the principal amount of such Notes subject to the Lender having previously received from NOVATEK, and being in possession of, a corresponding amount in respect of principal pursuant to this Agreement.

### 13.19 Limited Recourse and Non Petition

NOVATEK hereby agrees that, notwithstanding any other provisions hereof, it shall have recourse in respect of any claim against the Lender only to sums in respect of principal, interest or other amounts (if any), as the case may be, received by or for the account of the Lender pursuant to this Agreement (after deduction or withholding of such taxes as may be required to be made by the Lender by law in respect of each such sum or in respect of the Notes and for which the Lender has not received a corresponding payment (also after deduction or withholding of such taxes or duties as may be required to be made by the Lender) in respect thereof pursuant to this Agreement) (the “**Lender Assets**”), subject always to (i) the Security Interests and (ii) to the fact that any claims of the Joint Lead Managers (as defined in the Subscription Support Agreement) shall rank in priority to any claims of NOVATEK hereunder and that any such claim by any and all such Joint Lead Managers or NOVATEK shall be reduced pro rata so that the total of all such claims does not exceed the aggregate value of the Lender Assets after meeting claims secured on them.

Neither NOVATEK nor any person acting on behalf of it shall be entitled to take any further steps against the Lender to recover any further sums and no debt shall be owed by the Lender to NOVATEK in respect of any such further sum. In particular, neither NOVATEK nor any other person acting on behalf of it shall be entitled at any time to institute against the Lender, or join in any institution against the Lender of any bankruptcy, administration, moratorium, reorganisation, controlled management, arrangement, insolvency, examinership, winding-up or liquidation proceedings or similar insolvency proceedings under any applicable bankruptcy or similar law in connection with any obligation of the Lender relating to the Notes or otherwise owed to the creditors, save for lodging a claim in the liquidation of the Lender which is initiated by another party or taking proceedings to obtain a declaration or judgment as to the obligations of the Lender.

No party to this Agreement shall have any recourse against any director, shareholder, or officer of the Lender in respect of any obligations, covenants or agreement entered into or made by the Lender in respect of this Agreement, except to the extent that any such person acts in bad faith or is negligent or is wilfully in default in the context of its obligations.

**In witness whereof**, the parties hereto have caused this Agreement to be executed on the date first written above

**For and on behalf of OAO “NOVATEK”:**

By:

Title:

By:

Title: Chief Accountant

**Signed by a duly authorised attorney of NOVATEK FINANCE LIMITED:**

By:

Title:

## SUMMARY OF THE PROVISIONS RELATING TO THE NOTES IN GLOBAL FORM

### The Global Note Certificates

The Regulation S Notes will be evidenced on issue by the Regulation S Global Note Certificate registered in the name of a nominee for, and deposited with a common depository on behalf of, Euroclear and Clearstream, Luxembourg. Beneficial interests in the Regulation S Global Note Certificate may be held only through Euroclear or Clearstream, Luxembourg at any time. See “*Clearing and Settlement—Book-Entry Procedures for the Global Note Certificates*”. By acquisition of a beneficial interest in the Regulation S Global Note Certificate, the purchaser thereof will be deemed to represent, among other things, that it is not a U.S. person, that it is located outside the United States and that, if it determines to transfer such beneficial interest prior to the expiration of the “**distribution compliance period**” (as such terms are defined in Rules 902 and 903 of Regulation S), deemed to include the 40-day period after commencement of the Offering or the Closing Date, whichever is later, it will transfer such interest only (a) to a non-U.S. person in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (b) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB that is also a QP purchasing for its own account or the account of a QIB that is also a QP, in each case in accordance with any applicable securities laws of any state of the United States. See “*Transfer Restrictions*”.

The Rule 144A Notes will be evidenced on issue by the Rule 144A Global Note Certificate deposited with a custodian for, and registered in the name of a nominee of, DTC. Beneficial interests in the Rule 144A Global Note Certificate may only be held through DTC at any time. See “*Clearing and Settlement—Book-Entry Procedures for the Global Note Certificates*”. By acquisition of a beneficial interest in the Rule 144A Global Note Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB that is also a QP purchasing for its own account or the account of a QIB that is also a QP and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Trust Deed. See “*Transfer Restrictions*”.

Beneficial interests in the Global Note Certificates will be subject to certain restrictions on transfer set forth therein and in the Trust Deed and the Global Note Certificates will bear the applicable legends regarding the restrictions set forth under “*Transfer Restrictions*”. A beneficial interest in the Regulation S Global Note Certificate may be transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate only in denominations greater than or equal to the minimum denominations applicable to interests in the Rule 144A Global Note Certificate and only upon receipt by the Registrar (as defined in the “*Terms and Conditions of the Notes*”) of a written certification (in the form provided in the Paying Agency Agreement (as defined in the “*Terms and Conditions of the Notes*”)) to the effect that the transferor reasonably believes that the transferee is a QIB that is also a QP purchasing for its own account or the account of a QIB that is also a QP and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. Beneficial interests in the Rule 144A Global Note Certificate may be transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note Certificate only upon receipt by the Registrar of a written certification (in the form provided in the Paying Agency Agreement) from the transferor to the effect that the transfer is being made in an offshore transaction in accordance with Regulation S.

Any beneficial interest in the Regulation S Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate will, upon transfer, cease to be an interest in the Regulation S Global Note Certificate and become an interest in the Rule 144A Global Note Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Rule 144A Global Note Certificate for as long as it remains such an interest. Any beneficial interest in the Rule 144A Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note Certificate will, upon transfer, cease to be an interest in the Rule 144A Global Note Certificate and become an interest in the Regulation S Global Note Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Regulation S Global Note Certificate for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of Notes, but the Registrar may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Except in the limited circumstances described below, owners of beneficial interests in the Global Note Certificates will not be entitled to receive physical delivery of Definitive Certificates. The Notes are not issuable in bearer form.

### Exchange for Definitive Certificates

#### *Exchange*

Subject to receipt by the Issuer of the funds necessary to cover the cost realized from NOVATEK, each Global Note Certificate will be exchangeable, free of charge to the holder, on or after its Exchange Date (as defined below), in whole but not in part, for Notes in definitive form if: (i) a Global Note Certificate is held by or on behalf of (A) DTC, and DTC notifies the Issuer that it is no longer willing or able to discharge properly its responsibilities

as depository with respect to such Global Note Certificate or ceases to be a “clearing agency” registered under the Exchange Act or if at any time it is no longer eligible to act as such, and the Issuer is unable to locate a qualified successor within 90 days of receiving notice or becoming aware of such ineligibility on the part of DTC or (B) Euroclear or Clearstream, Luxembourg, as the case may be, is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention to permanently cease business or does in fact do so, by the holder giving notice to the Registrar or any Transfer Agent (as defined in the “*Terms and Conditions of the Notes*”) and the Issuer or (ii) the Issuer would suffer a material disadvantage in respect of the Notes as a result of a change in the laws or regulations (taxation or otherwise) of any jurisdiction referred to in Condition 8 of the “*Terms and Conditions of the Notes*”, which would not be suffered were the Notes in definitive form and a notice to such effect signed by the requisite number of signatories of the Issuer is delivered to the Trustee by the Issuer giving notice to the Registrar or any Transfer Agent and the Noteholders of its intention to exchange a Global Note Certificate for Definitive Certificates on or after the Exchange Date (as defined below) specified in the notice or (iii) the Trustee has instituted or has been directed to institute any judicial proceeding in a court to enforce the rights of the Noteholders under the Notes and the Trustee has been advised by counsel that in connection with such proceeding it is necessary or appropriate for the Trustee to obtain possession of the Notes, by the Trustee giving notice to the Registrar or any Transfer Agent and the Noteholders.

The Registrar will not register the transfer of, or exchange of interests in, a Global Note Certificate for Definitive Certificates for a period of 15 calendar days ending on the date for any payment of principal or interest in respect of the Notes.

If, in respect of the Notes, only one of the Global Note Certificates (the “**Exchanged Global Note Certificate**”) becomes exchangeable for Definitive Certificates in accordance with the above paragraphs, transfers of Notes may not take place between, on the one hand, persons holding Definitive Certificates issued in exchange for beneficial interests in the Exchanged Global Note Certificate and, on the other hand, persons wishing to purchase beneficial interests in the other Global Note Certificate.

“**Exchange Date**” means a day falling not later than 90 days after that on which the notice requiring exchange is given and on which banks are open for business in the city in which the specified office of the Registrar and any Transfer Agent is located.

#### ***Delivery***

In such circumstances, a Global Note Certificate shall be exchanged in full for Definitive Certificates and the Issuer will, at the cost of the Issuer (and against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Definitive Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Noteholders. A person having an interest in a Global Note Certificate must provide the Registrar with (a) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Notes and (b) in the case of the Rule 144A Global Note Certificate only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a QIB that is also a QP. Definitive Certificates issued in exchange for a beneficial interest in the Rule 144A Global Note Certificate shall bear the legend applicable to transfer pursuant to Rule 144A, as set forth under “*Transfer Restrictions*”.

#### ***Legends***

The holder of a Definitive Certificate may transfer the Notes evidenced thereby in whole or in part in the applicable minimum denomination by surrendering it at the specified office of the Registrar or any Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Rule 144A Definitive Certificate bearing the legend referred to under “*Transfer Restrictions*”, or upon specific request for removal of the legend on a Rule 144A Definitive Certificate, the Issuer will deliver only Rule 144A Definitive Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act and the Investment Company Act.

In addition, each Global Note Certificate will contain provisions which modify the “*Terms and Conditions of the Notes*” as they apply to the Notes evidenced by the relevant Global Note Certificate. The following is a summary of these provisions:

#### ***Notices***

Notwithstanding Condition 13 of the “*Terms and Conditions of the Notes*”, so long as a Global Note Certificate is held by or on behalf of DTC, Euroclear, Clearstream, Luxembourg, or any other clearing system (an “**Alternative Clearing System**”), notices to Noteholders represented by the Global Note Certificate may be

given by delivery of the relevant notice to DTC, Euroclear, Clearstream, Luxembourg or (as the case may be) such Alternative Clearing System and such notices shall be deemed to have been given with the same effect as if they had been given in accordance with Condition 13, provided that while the Notes are listed on the Irish Stock Exchange, notices will also be given in accordance with the guidelines of the Irish Stock Exchange.

#### *Record Date*

Notwithstanding Condition 6.5 of the “*Terms and Conditions of the Notes*”, “**Record Date**” shall mean the Clearing System Business Day before the due date for payment, where “**Clearing System Business Day**” means (i) in respect of a Global Note Certificate held on behalf of Euroclear or Clearstream, Luxembourg, a day when Euroclear or Clearstream, Luxembourg is open for business, and (ii) in respect of a Global Note Certificate held on behalf of DTC, a day when DTC is open for business.

#### *Payment*

Payments of principal and interest in respect of the Global Note Certificates shall be made to the person who appears at the relevant time on the register of Noteholders as holder of a Global Note Certificate against presentation (in the case of payment of principal) and (if no further payment falls to be made on it) surrender thereof to or to the order of the Principal Paying Agent (or to or to the order of such other Paying Agent as shall have been notified to the Noteholders for this purpose) which shall endorse such payment or cause such payment to be endorsed in the relevant schedule thereto (such endorsement being *prima facie* evidence that the payment in question has been made). No person shall however be entitled to receive any payment on a Global Note Certificate falling due after the Exchange Date, unless the exchange of such Global Note Certificate for Definitive Certificates is improperly withheld or refused by or on behalf of the Issuer.

#### *Meetings*

The holder of a Global Note Certificate will be treated as being one person for the purposes of any quorum requirements of, or the right to demand a poll at, a meeting of Noteholders and in any such meeting as having one vote in respect of each Note for which the relevant Global Note Certificate may be exchangeable.

#### *Trustee’s Powers*

In considering the interests of Noteholders while a Global Note Certificate is held on behalf of a clearing system, the Trustee may have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to such Global Note Certificate and may consider such interests as if such accountholders were the holders of such Global Note Certificate.

#### *Cancellation*

Cancellation of any Note required by the “*Terms and Conditions of the Notes*” to be cancelled will be effected by reduction in the principal amount of the relevant Global Note Certificate by a record made in the Register.

## STATE REGULATION OF THE RUSSIAN GAS INDUSTRY APPLICABLE TO THE ACTIVITY OF NOVATEK

### Overview

#### *Applicable Laws, Rules and Regulations*

The regulation of legal and economic relations in the Russian natural gas industry is primarily based on:

- the Constitution of the Russian Federation;
- the Civil Code of the Russian Federation;
- the Subsoil Law;
- Federal Law No. 147-FZ dated 17 August 1995 “On Natural Monopolies” (as amended) (the “**Natural Monopoly Law**”);
- Federal Law No. 187-FZ dated 30 November 1995 “On the Continental Shelf of the Russian Federation” (as amended) (the “**Continental Shelf Law**”);
- the Gas Supply Law;
- the SIL, which regulates the access of foreign investors to certain sectors of the Russian economy, including the development of major gas fields and other mineral deposits that fall under the category of “strategic deposits”; and
- Federal Law No. 58-FZ dated 29 April 2008 “On Amendment to Certain Legislative Acts of the Russian Federation as Ceasing to be in Force due to Adoption of the Strategic Investments Law”.

The Gas Supply Law establishes a regulatory framework for natural gas supply in the Russian Federation. Under the Gas Supply Law, Russian federal authorities have jurisdiction over natural gas supplies, including the development and implementation of the Government policy on natural gas supply; the regulation of strategic natural gas reserves; control over the industrial and environmental safety of the industrial sites of the natural gas supply systems; metrological support; and standardization and certification in the gas industry. Under the Gas Supply Law, the Government: (i) sets the procedure for formation and approval of the projected natural gas production levels and the sales balance in Russia; (ii) determines the principles of natural gas prices and natural gas transportation tariffs; (iii) approves rules on natural gas deliveries; (iv) approves procedures for providing independent organizations with access to the natural gas transportation and distribution networks; and (v) defines the categories of customers to whom natural gas deliveries cannot be restricted or suspended.

In addition to the Government, the principal Russian federal authorities regulating the Russian gas industry include the Ministry of Finance, the Ministry of Economic Development, the Ministry of Industry and Trade, and the MNR. The federal services and agencies that regulate the gas industry include Rosnedra, Rosprirodnadzor, the Federal Service for Environmental, Technological and Nuclear Supervision (“**Rostekhnadzor**”), FAS and FTS.

The MNR and agencies under its auspices, including Rosnedra, Rosprirodnadzor and Rostekhnadzor, implement subsoil legislation and are responsible for granting, monitoring and terminating subsoil licenses. FAS is authorized to pursue state policy aimed at promoting the development of the commodity markets and competition, at exercising state control over the observance of antimonopoly legislation and at preventing and terminating monopolistic activity, unfair competition and other actions restricting competition. FTS is a regulatory body with the power to set prices and tariffs on certain goods and services, including tariffs for gas transportation by pipelines.

#### *Subsoil Licensing*

Rights to use the subsoil are granted under the following types of mineral licenses issued by Rosnedra:

- licenses for geological survey, including prospecting and evaluation of deposits;
- licenses for the exploration and production of mineral resources; and
- combined licenses for the geological survey, exploration and production of mineral resources.

The term of a license is set out in the license. Prior to January 2000, geological survey licenses had a maximum term of five years, exploration and production licenses a maximum term of 20 years, and combined geological survey, exploration and production licenses a maximum term of 25 years. Since January 2000, the maximum term for a geological survey license is five years (or ten years if the geological survey works are carried out on subsoil plots located within internal sea waters, the territorial sea or the continental shelf of the Russian Federation), while a production license is issued for the term of the expected workout of the subsoil deposit calculated on the basis of a feasibility study for rational subsoil use and protection of the subsoil. In practice, production licenses are usually issued for 20 years. The Subsoil Law does not expressly provide for a combined

geological survey/exploration/production term; however, in practice, the licensing authorities usually issue combined licenses for 25 years. The Subsoil Law provides that a license to use a field may be extended by the relevant authorities pursuant to an application of the license holder if an extension is necessary to finish production in the field, *provided that* the license holder's field development program has been approved in accordance with proper procedure and the license holder has not violated the terms of its license.

Production licenses and combined licenses are granted following a tender or auction conducted by Rosnedra. In a tender process, the bidder who submits the most technically competent, financially attractive and environmentally sound proposal that meets published tender terms and conditions wins. In an auction process, the bidder who submits the highest price wins. Production licenses may also be issued without holding an auction or tender to holders of geological survey licenses who discover mineral resource deposits through geological survey work conducted at their own expense. Offshore licenses may be granted without a tender or auction in certain cases. Geological survey licenses are generally awarded without a tender or auction by a special commission formed by Rosnedra (or its regional department), which includes the participation of representatives of the relevant regional authority. The MNR maintains an official list of subsoil plots in respect of which geological survey licenses can be issued. If the deposit is listed, an application can be made to Rosnedra for a geological survey license with respect to such subsoil plot. If only one application is received, the special commission considers the application and takes a decision as to whether to award the license. Where more than one application is received with respect to a geological survey license, Rosnedra sets up an auction for a combined license (geological survey, exploration and production) for the subsoil plot.

Licenses may only be transferred in certain limited circumstances under the Subsoil Law, including when the licensee changes its organizational form, merges with another legal entity, undergoes a division or spin-off or, in certain circumstances, is deemed insolvent. A licensee may also transfer its subsoil license to a newly-created subsidiary, its parent company or a "sister" company, provided that certain conditions established by the Subsoil Law are met. The ability to transfer licenses for strategic deposits to entities under non-Russian control and/or with non-Russian participants is restricted. See "*—Strategic Investments—Restrictions Related to Strategic Deposits*".

A license holder generally has the right to develop and sell gas extracted from the licensed area. However, the Russian Federation retains ownership of the subsoil resources prior to extraction; the license holder only has rights to the resource (e.g., gas) upon extraction. Licenses generally require the license holder to make various commitments, including:

- conducting agreed geological exploratory and other activities for development of the deposit;
- extracting an agreed target amount of reserves annually;
- protecting the environment;
- providing geological information and data to the relevant authorities;
- submitting formal progress reports to regional authorities on a regular basis; and
- paying tax when due.

Rosprirodadzor and its regional divisions monitor license holders' compliance with the terms of their licenses and subsoil legislation. A license holder can be fined for failing to comply with the terms of its license. In addition, Rosnedra can revoke a license or suspend or limit the right to use subsoil in certain circumstances, including:

- failure by the license holder to commence operations or to produce the required volumes as specified in its license;
- breach or violation by the license holder of material terms and conditions of the license;
- repeated violation by the license holder of the subsoil regulations;
- failure to submit reporting data in accordance with applicable law;
- the occurrence of an emergency situation;
- a direct threat to the life or health of people working or residing in the area affected by the operations under the license;
- liquidation of the legal entity that held the right to subsoil use.

If the circumstances giving rise to the suspension or limitation of the right to use the subsoil are ended, the right may be restored and the period of suspension shall not be included in the general term of the license, provided there is no fault on the part of the license holder.

In addition, under the Subsoil Law, a license automatically terminates in certain cases stipulated in the license or in the event of a purported transfer of the license in breach of the procedure set out in the Subsoil Law.

On the expiry of a license or termination of subsoil use, all facilities in the relevant license area, including underground facilities, must be removed or properly abandoned. All site facilities, including wells, must be maintained so that they are safe for the surrounding population, the environment, buildings and other facilities. Abandonment procedures must also ensure the conservation of the relevant gas fields, mining facilities and wells.

### *Payments for Subsoil Use*

The Subsoil Law provides for the following types of payments related to the use of subsoil:

- one-time payments are due upon the occurrence of events specified and in the amounts indicated in the subsoil license;
- regular payments for subsoil use; and
- fees for the participation in a tender or auction.

In addition, subsoil users pay other taxes and tariffs as established by legislation of the Russian Federation.

The rates for such payments are generally set forth in the relevant license by Russian federal authorities within a range of minimum and maximum rates established by the Subsoil Law.

### *Strategic Investments*

#### *Strategic Companies*

The SIL establishes certain restrictions and special procedures for foreign investments in sectors of strategic importance to the Russian Federation by imposing restrictions on the acquisition of “control” over (where, as discussed below, “control” may be deemed to occur by holding less than 50% of the equity of the strategic company) strategic companies and by establishing an approval procedure for the acquisition of such control. In particular, it sets forth a general prohibition on transactions resulting in the acquisition of “control” over strategic companies by foreign states and international organizations or an organization controlled by any of these (“**Foreign Sovereign Acquirers**”) and requires other foreign investors to obtain consent of the SIL Commission for the acquisition of “control” over strategic companies.

Recent amendments to the SIL introduced exemptions from the clearance requirements. In particular, they provide that the SIL shall not apply to transactions concerning strategic companies made between entities under control of the Russian Federation or citizens of the Russian Federation who are its tax residents, except for individuals with dual citizenship, i.e., if both the seller and the buyer are ultimately controlled by the Russian Federation or such Russian citizens. Furthermore, these amendments exempt from the clearance requirement transactions by international financial organizations established in accordance with international treaties to which the Russian Federation is a party and international financial organizations with which the Russian Federation entered into a treaty. The Government publishes the list of such organizations, which currently includes, *inter alios*, the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development and the International Finance Corporation. This exemption does not affect, however, the aforementioned general prohibition under the SIL for Foreign Sovereign Acquirers to acquire control over the strategic companies.

#### *Strategic Deposits*

The SIL defines a number of activities that are considered to be strategically important for Russia, including geological survey and/or exploration and production of mineral resources within deposits of federal significance. As defined in the Subsoil Law, deposits of federal significance include subsoil deposits (i) that contain 70 million tons or more of recoverable oil reserves and/or 50 billion cubic meters or more of gas reserves; (ii) that are located in internal waters, territorial waters or on the continental shelf of the Russian Federation; and/or (iii) whose use requires the use of land plots designated for defense or security purposes.

The list of deposits of federal significance has been published in an official publication of the Russian Federation. Once a subsoil deposit has been included in such list, it will retain its status as a deposit of federal significance, notwithstanding any changes resulting from amendments to the Subsoil Law.

#### *Approval Requirements*

The SIL generally requires a prior approval of the SIL Commission for the acquisition of direct or indirect control over strategic companies by an entity that is under foreign control. The SIL imposes a stricter definition of control (and therefore threshold for approval) in relation to a strategic company holding a license for a deposit of federal significance (“**Strategic Subsoil License Holder**”) than applied to other types of strategic companies. A person is deemed to control a Strategic Subsoil License Holder if such person: (i) has (direct or indirect) control over 25% or more of the voting shares of the Strategic Subsoil License Holder; (ii) has the right (pursuant to an



agreement or otherwise) to determine decisions of the Strategic Subsoil License Holder, including the terms of its business operations; (iii) has the right to appoint the Strategic Subsoil License Holder's general director or 25% or more of the members of its management board; (iv) has an unconditional ability to procure the election of 25% or more of the members of the Strategic Subsoil License Holder's board of directors or other management body; or (v) acts as a management company for the Strategic Subsoil License Holder.

Moreover, the SIL requires prior approval of acquisitions by a Foreign Sovereign Acquirer of direct or indirect control over more than 5% of the voting shares/participatory interests of the Strategic Subsoil License Holder or the ability to block decisions of the management bodies of such entity.

At the same time, the SIL allows for foreign investment (other than by Foreign Sovereign Acquirers) without any prior approval into Strategic Subsoil License Holder when the Russian Federation controls, directly or indirectly, 50% or more of its voting shares.

#### *Restrictions Related to Strategic Deposits*

Deposits of federal significance may be developed only by legal entities established under the laws of the Russian Federation. Deposits of federal significance located on or extending into the continental shelf of the Russian Federation may be developed only by Russian legal entities (i) which have no less than five years' experience developing continental shelf deposits in Russia; and (ii) in which the Russian Federation holds or otherwise controls more than 50% of its voting shares. The Government may impose restrictions on the right of a Russian entity with any direct or indirect foreign participation to participate in any auction or tender for the right of subsoil use in a deposit of federal significance. Such restrictions may be established for entities in which foreign investors have any amount of equity interest.

The Subsoil Law also contains restrictions on the transfer, and additional grounds for the termination of, geological survey and combined geological survey and production licenses for deposits of federal significance.

Thus, the Subsoil Law restricts the ability to transfer the right to use a deposit of federal significance to a Russian legal entity in which a foreign investor, or a group of persons that includes a foreign investor, have:

- direct or indirect control over 10% or more of its voting shares;
- the right (pursuant to an agreement or otherwise) to determine decisions of such legal entity, including the terms of its business operations;
- the right to appoint such legal entity's general director or 10% or more of the members of its management board;
- the right to appoint a chief executive officer and/or 10% or more of the members of a collective executive body of such a company; and/or
- an unconditional ability to procure the election of 10% or more of the members of such legal entity's board of directors or other management body.

In respect of deposits of federal significance, only production and combined (geological study, exploration and production) licenses may be issued. Production licenses and combined licenses are issued pursuant to a decision of the Government based either on the results of a tender or auction, or upon the discovery of a deposit of federal significance. Under a combined license, advanced exploration and production operations in a strategic deposit may only commence after the geological study operations are fully completed, and commencement of advanced exploration and production in the deposit of federal significance is authorized by a Government decision. This is different from the general rule applicable to other deposits under a combined license which allows advanced exploration and production to be conducted simultaneously with geological study.

Geological study licenses may be issued for subsoil deposits that do not qualify as deposits of federal significance. If in the course of geological study a discovery is made and the relevant deposit meets the criteria of a deposit of federal significance, the Government may deny the issuance of an advanced production license to the subsoil user that made the discovery if a foreign investor has a direct or indirect interest in the license holder and a threat to the national defense and security of Russia is deemed to have arisen. If the relevant discovery is made under a combined license by an entity in which a foreign investor has an interest, the Government has the right to terminate the license.

If issuance of the exploration and production license is denied, or a combined license is terminated, the affected license holder is entitled to be reimbursed for certain costs it incurred in the exploration and appraisal of the discovered deposit and, in the case of the termination of a combined license, a one-time payment made under the terms of such license. This reimbursement and certain other compensation are paid from the federal budget pursuant to a procedure established by the Government.

The provisions outlined above do not apply retroactively to subsoil deposits discovered before 7 May 2008 and subsoil deposits with respect to which the subsoil user completed geological study and commenced exploration and production operations pursuant to a combined license had before 7 May 2008.

#### ***Land Use Permits and Ground Allotments***

A license holder must have surface rights to the license area. Russian legislation prohibits any commercial activity, including mineral extraction activities, on a land plot without appropriate land use rights. Subsoil licenses do not grant surface rights; therefore they must be obtained separately.

Under the Land Code of the Russian Federation No. 136-FZ dated 25 October 2001, as amended (the “**Land Code**”), companies may have one of the following rights with regard to land in the Russian Federation: (i) ownership; (ii) lease; (iii) right of free use for a fixed term; or (iv) right of perpetual use. Rights of free use for a fixed term are now less common, and those companies that obtained a right of perpetual use over land prior to the enactment of the Land Code are required, by 1 July 2012, either to purchase the land from, or to enter into a land lease agreement with, the relevant federal, regional or municipal authority owning the land.

Most land in the Russian Federation is owned by federal, regional or municipal authorities, which can sell, lease or grant other use rights to the land to third parties through public auctions or tenders or private negotiations. Under the Land Code, the land that is in state and municipal ownership and required for the subsoil use is leased to subsoil users without holding an auction or a tender.

Surface rights are typically granted for specified areas, upon the submission of standardized reports, technical studies, pre-feasibility studies, budgets and impact statements. Documents that grant surface rights generally require that the holder make lease payments and return the land plot to a condition sufficient for future use, at the license holder’s expense, upon the expiry of the permit.

The procedure for allocation of forest plots for geological survey and development of subsoil deposits is regulated by the Forest Code of the Russian Federation (Federal law No. 200-FZ dated 4 December 2006). Plots located within the boundaries of the forest are federal property.

#### ***Natural Gas Supply and Transportation***

##### *The UGSS*

The Gas Supply Law defines the UGSS as the nation’s centrally managed, technologically and economically regulated system of gas production, processing, transportation, storage and supply. Gazprom is currently the owner of the UGSS. To ensure reliable gas supply and compliance with international treaties of the Russian Federation and gas delivery contracts, Gazprom, as the owner of the UGSS, is obliged to: maintain and develop the UGSS network; monitor the function of its facilities; procure the use of equipment and process for energy efficiency and environmental safety for the UGSS; take action to ensure industrial and ecological safety within the UGSS; and operate disaster management systems.

In accordance with Government Resolution No. 858 “On Provision of Access of Independent Companies to the Gas Transportation System of OAO Gazprom”, dated 14 July 1997, Gazprom, as the owner of the UGSS, is obligated to provide independent gas producers access to its natural gas transportation system in Russia subject to the availability of capacity in the UGSS, the compliance of the gas being transported with established quality and technical parameters and the availability of connecting and branch pipelines to end customers.

Similar access rights to regional gas supply systems are established pursuant to Government Resolution No. 1370 “On Approval of Regulation on Ensuring Access of Organizations to Local Gas Supply Systems” dated 24 November 1998. According to this Resolution, any legal entity within the territory of the Russian Federation has the right of non-discriminatory access to the regional gas supply systems for transportation of gas to customers.

Government Resolution No. 872 dated 29 October 2010 established the standards for disclosure of information by Gazprom as operator of the UGSS.

##### *Transportation and Supply of Gas*

The relationship between natural gas suppliers and off-takers is governed by the Regulation on Natural Gas Supplies in the Russian Federation approved by Government Resolution No. 162 “On Approval of Rules of Gas Supplies in the Russian Federation”, dated 5 February 1998 (as amended).

A right of priority to enter into natural gas supply agreements is given to off-takers that purchase natural gas for state needs and municipal/domestic services and to certain off-takers wishing to extend their existing natural gas supply agreements.

In accordance with the Gas Supply Law, consumers are obliged to pay for natural gas supplies and transportation services. If consumers fail to make such payments, suppliers have the right to limit or suspend natural gas supplies to such consumers in accordance with specific procedures provided for by several Government

resolutions (although the Government has issued resolutions regulating the restriction or suspension of suppliers to certain customers, such as military institutions and fire prevention services).

### *Gas Prices and Tariffs*

Natural gas prices and transportation tariffs in Russia are regulated pursuant to the Natural Monopoly Law and the Gas Supply Law, as well as pursuant to several Government resolutions. Government Resolution No. 1021 “On State Regulation of Gas Prices and Tariffs for Gas Transportation within the Territory of the Russian Federation”, dated 29 December 2000 (as amended) sets forth the main provisions for regulating the wholesale price of natural gas and transportation tariffs.

FTS regulates (i) the price of gas extracted by Gazprom and its affiliates (including any entity in which it has 20% or more equity ownership) – but not the wholesale price of natural gas produced by independent gas suppliers such as NOVATEK – and (ii) the tariff charged to independent gas producers such as NOVATEK to transport their gas through the UGSS. The principles of pricing include the recovery of economically reasonable expenses by suppliers and transportation companies, maintenance of reasonable operating margins and satisfaction of the demand for gas.

### *Export of Gas*

Pursuant to the Gas Export Law, Gazprom, as the owner of the UGSS, or its wholly-owned subsidiary Gazexport has the exclusive right to export gas outside the Russian Federation. The law covers the export of gas both in gaseous form and in the form of liquefied natural gas (LNG), which is the reason why NOVATEK intends to use Gazexport as an agent for export sales for the Yamal LNG project. The law does not apply to the export of gas produced in accordance with production sharing agreements that were entered into prior to the entry into force of this law.

### *Environmental Protection*

Operations related to the extraction, processing and transportation of gas are subject to extensive federal and regional environmental laws and regulations. These laws and regulations set various standards for health and environmental quality, provide for penalties and other liabilities for the violation of such standards, and establish, in certain circumstances, obligations to compensate for environmental damage and restore environmental conditions. Issues of environmental protection in Russia are regulated primarily by the Federal Law No. 7-FZ of 10 January 2002 “On Environmental Protection” as amended (the “**Environmental Protection Law**”), as well as by other federal laws and regulations.

### *Permit Regime*

Federal Law No. 99-FZ dated 4 May 2011 “On Licensing of Certain Types of Activities” (as amended) (the “**Licensing Law**”), Federal Law No. 96-FZ dated 4 May 1999 “On Protection of the Atmospheric Air” (as amended), Federal Law No. 89-FZ dated 24 June 1998 “On Industrial and Consumption Waste” (as amended), and other laws and regulations on environmental protection collectively list activities that can only be performed subject to a special permit or license issued by the relevant Russian authorities and establish the procedures for issuing such licenses and permits. In particular, to conduct its operations, a company may be required to hold the following licenses and permits:

- permit for emissions of harmful substances into the atmosphere;
- permit for the discharge of polluting substances into bodies of water;
- license for the collection, use, neutralization, transportation or placement of hazardous waste;
- permit approving limits for disposal of production and consumption waste;
- license for operation of explosive/inflammable or chemically hazardous industrial facilities; and
- license for fire extinguishing.

Licensing regulations and the terms of our licenses and permits require us to comply with industrial standards, employ qualified personnel, maintain certain equipment and a system of quality control, maintain insurance coverage, monitor operations, make appropriate filings and upon request submit specified information to the state authorities that control and inspect our activities.

### *Payment for Negative Impact on Environment*

The Environmental Protection Law establishes a “pay-to-pollute” regime administered by federal and local authorities. The MNR establishes standards relating to the permissible impact on the environment and resource extraction, while Rosprirodnadzor establishes limits for the emission (disposal) of polluting substances into the environment. A company may obtain an approval for exceeding the established standards and limits from the federal or regional authorities, depending on the type and scale of environmental impact. As a condition of such approval, a

plan for the reduction of the emissions or disposals must be developed by the company and cleared with the appropriate state authority. Fees, as set forth in Government Decree No. 344 “On Rates of Payments for Pollutant Emissions into the Air by Stationary and Mobile Sources, Pollutant Disposals into Surface and Underground Waters, Disposal of Production and Consumption Waste”, dated 12 June 2003 (as amended), are assessed on a sliding scale for generally applicable standards and for individually-approved limits on emissions and effluents and for pollution in excess of these limits, whereby the lowest fees are imposed for pollution within accepted standards and limits, intermediate fees are imposed for pollution within temporarily approved standards and limits and the highest fees are imposed for pollution exceeding such standards and limits. Payments of such fees do not relieve a company from its responsibility to take environmental protection measures and undertake restoration and clean-up activities.

Natural resources development activities are subject to periodic evaluation in terms of their impact on the environment. If the operations of a company violate environmental law or cause harm to the environment or any individual or legal entity, the environmental authorities may suspend such operations or a court action may be brought to limit, suspend or ban such operations and require the company to remedy the effects of the violation. Any company or employee who fails to comply with environmental law may be subject to administrative and/or civil liability and individuals (including managers of legal entities) may be held criminally liable. Courts may also impose clean-up obligations on violators in lieu of or in addition to imposing fines. The statute of limitations period for compensation claims regarding damage caused by pollution is 20 years.

#### *Soil Contamination*

The Environmental Protection Law and the Land Code of the Russian Federation contain provisions relating to the payment of compensation for damage with respect to soil disturbance or contamination of the soil. According to Article 14 of the Land Code, if a company’s activities cause chemical contamination of the soil, making it impossible to use such land for a “*designated purpose*”, or reduce its quality generally, the relevant company must pay compensation to the owner of the land in respect of such damage, any agricultural losses and costs of cleaning up the land so that it can again be used for its “*designated purpose*”.

Companies that damage the fertile soil layer of land are required to restore the land at the end of their activities at their own expense and in accordance with restoration programs approved in the prescribed procedure, pursuant to Government Resolution “On Restoration of Land and Removal, Storage and Use of the Fertile Soil Layer” No. 140, dated 23 February 1994 .

#### *Health and Safety*

The principal law regulating industrial safety is Federal Law No. 116-FZ of 21 July 1997 “On Industrial Safety of Hazardous Industrial Facilities” (as amended) (the “**Safety Law**”). The Safety Law applies to industrial facilities and sites where certain activities related to exploration and production of gas are carried out. The Safety Law also contains a comprehensive list of hazardous substances and their permitted concentrations, and extends to facilities and sites where these substances are used.

Our activities include operation of certain hazardous industrial sites regulated by the Rostekhnadzor. Any construction, reconstruction, wind-up or other activities in relation to such regulated industrial sites is subject to a state industrial safety review. Any deviation from project documentation in the process of construction, reconstruction and wind-up of regulated industrial sites is prohibited unless reviewed by a licensed expert and approved by Rostekhnadzor. Companies that operate such industrial facilities and sites have a wide range of obligations under the Safety Law and the Labor Code of the Russian Federation (the “**Labor Code**”). In particular, they must limit access to such sites to certified specialists, maintain industrial safety controls and carry insurance for third-party liability for injuries caused in the course of operating regulated industrial sites. The Safety Law also requires these companies to enter into contracts with professional demolition companies or create their own demolition services in certain cases, conduct personnel training programs, create systems to cope with and inform state authorities of accidents and maintain these systems in good working order. In certain cases, companies operating regulated industrial sites must also prepare declarations of industrial safety, which summarize the risks associated with operating the particular site and the measures the company has taken and will take to mitigate such risks and use such site in accordance with applicable industrial safety requirements. Such declaration must be adopted by the chief executive officer of the company, who is personally responsible for the completeness and accuracy of the data contained therein, and approved and registered with Rosprirodnadzor.

In case of an accident, a special commission led by a representative of Rostekhnadzor conducts a technical investigation of the cause. The company operating the industrial facility where the accident took place must bear all costs of the investigation. The officials of Rostekhnadzor have the right to access industrial sites and may inspect documents to ensure a company’s compliance with safety rules. Rostekhnadzor may suspend or terminate a company’s operations or impose administrative liability on a company or its officials.

Technical devices that are used at hazardous industrial facilities, including those of foreign manufacture, must comply with the Russian industrial safety requirements and, therefore, are subject to confirmation that they

conform to such requirements. In addition, the use of such technical devices is subject to permission by Rostekhnadzor or its territorial branches (depending on the type of technical device).

Any company or individual violating industrial safety rules may incur administrative and/or civil liability, and individuals may also incur criminal liability. A company that violates safety rules in a way that adversely impacts the health of an individual may also be liable to compensate the individual for lost earnings, as well as health-related damages and in certain cases its activity may be suspended.

### ***Employment and Labor Regulation***

Labor matters in Russia are primarily governed by the Labor Code. In addition to this core legislation, relationships between employers and employees are regulated by various federal laws.

In respect to certain territories with harsh climatic conditions, such as YNAO, Russian legislation establishes additional regulations to protect the interest of employees. Under Law of the Russian Federation No. 4520-1 “On State Guarantees and Compensation for Persons Working and Residing in the Far North Regions and Areas of Equal Status” dated 19 February 1993, employees working in certain territories with harsh climatic conditions are entitled to certain additional benefits including higher salaries and bonuses and additional vacation days.

## TAXATION

*The following is a general description of certain tax considerations relating to the Notes and the Loan and does not purport to be a comprehensive discussion of the tax treatment of the Notes or the Loan.*

*Prospective purchasers of the Notes are advised to consult their own tax advisers as to the consequences arising in their particular circumstances under the tax laws of countries of which they are residents of a purchase and holding of Notes, including, but not limited to, the consequences of the receipt of interest and the sale or redemption of Notes. This summary is based upon the law as in effect on the date of this Prospectus.*

*The information and analysis contained within this section are limited to tax issues, and prospective investors should not apply any information or analysis set out below to other areas, including (but not limited to) the legality of transactions involving the Notes or the Loan.*

### United States

TO ENSURE COMPLIANCE WITH U.S. TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE INVESTORS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF U.S. FEDERAL TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY PROSPECTIVE INVESTORS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THEM UNDER THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE “U.S. TAX CODE”); (B) SUCH DISCUSSION IS INCLUDED HEREIN BY THE ISSUER IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE ISSUER OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) PROSPECTIVE INVESTORS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

The following is a summary of certain U.S. federal income tax consequences of the acquisition, ownership and disposition of the Notes by a U.S. Holder (as defined below). This summary deals only with purchasers of Notes that (i) are U.S. Holders, (ii) will hold the Notes as capital assets and (iii) acquired the Notes upon their initial issuances at the original offering price. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Notes by particular investors, and does not address state, local, foreign or other tax laws. In particular, this summary does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as financial institutions, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organizations, dealers in securities or currencies, traders in securities who elect to mark their securities to market, investors that will hold the Notes as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. Dollar).

As used herein, the term “U.S. Holder” means a beneficial owner of Notes that is, for U.S. federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation created or organized under the laws of the United States or any state thereof, or (iii) any person otherwise subject to U.S. federal income taxation on a net income basis in respect of the Notes.

The U.S. federal income tax treatment of a partner in an entity taxable as a partnership for U.S. federal income tax purposes that holds Notes will depend on the status of the partner and the activities of the partnership. Prospective purchasers that are partnerships for U.S. federal income tax purposes should consult their tax adviser concerning the U.S. federal income tax consequences to their partners of the acquisition, ownership and disposition of Notes by the partnership.

The summary is based on the tax laws of the United States including the U.S. Tax Code, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as currently in effect and all subject to change at any time, possibly with retroactive effect.

**THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE NOTES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW**

### *Payments of Interest*

Interest on a Note (including any non-U.S. withholding tax imposed on, and additional amounts paid with respect to, such interest), whether payable in U.S. Dollars or a currency, composite currency or basket of currencies other than U.S. Dollars (a “foreign currency”), will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the holder’s method of accounting for tax purposes.

Interest paid by the Issuer on the Notes generally will constitute income from sources outside the United States. A U.S. Holder may be able, subject to certain generally applicable limitations, to claim a foreign tax credit (or, alternatively, a deduction if the U.S. Holder has elected to deduct all foreign income taxes for that taxable year) for any non-U.S. withholding taxes imposed on payments of interest. Prospective purchasers should consult their tax advisers concerning the applicability of the foreign tax credit and source of income rules to income attributable to the Notes.

### ***Substitution of Issuer***

The terms of the Notes provide that, in certain circumstances, the obligations of the Issuer under the Notes may be assumed by another entity. Any such assumption might be treated for U.S. federal income tax purposes as a deemed disposition of Notes by a U.S. Holder in exchange for new notes issued by the new obligor. As a result of this deemed disposition, a U.S. Holder could be required to recognize capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the issue price of the new notes (as determined for U.S. federal income tax purposes), and the U.S. Holder's tax basis in the Notes. U.S. Holders should consult their tax advisers concerning the U.S. federal income tax consequences to them of a change in obligor with respect to the Notes.

### ***Sale, Exchange, Redemption or Other Disposition of Notes***

A U.S. Holder will generally recognize gain or loss on the sale, exchange, redemption or other disposition of a Note equal to the difference between the amount realized on such sale, exchange, redemption or other disposition and the U.S. Holder's tax basis of the Note. A U.S. Holder's tax basis in a Note will generally be its U.S. Dollar cost. The amount realized does not include the amount attributable to accrued but unpaid interest, which will be taxable as interest income to the extent not previously included in income. Except to the extent attributable to changes in exchange rates (as discussed below), gain or loss recognized on the sale, exchange, redemption or other disposition of a Note will be capital gain or loss and will be long-term capital gain or loss if the U.S. Holder's holding period in the Notes exceeds one year. The ability of a U.S. Holder to offset capital losses against ordinary income is limited.

Gain or loss realized by a U.S. Holder on the sale, exchange, retirement or other disposition of a Note generally will be U.S. source gain or loss for U.S. federal income tax purposes. Accordingly, if non-U.S. withholding tax is imposed on the sale or disposition of the Notes, a U.S. Holder may not be able to fully utilize its U.S. foreign tax credits in respect of such tax unless such U.S. Holder has other foreign-source income. Prospective investors should consult their own tax advisers as to the U.S. tax and foreign tax credit implications of such sale, exchange, retirement or other disposition of a Note.

### ***Foreign Currency Notes***

#### ***Interest***

If an interest payment is denominated in, or determined by reference to, a foreign currency, the amount of income recognized by a cash basis U.S. Holder will be the U.S. Dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. Dollars.

An accrual basis U.S. Holder may determine the amount of income recognized with respect to an interest payment denominated in, or determined by reference to, a foreign currency in accordance with either of two methods. Under the first method, the amount of income accrued will be based on the average exchange rate in effect during the interest accrual period (or, in the case of an accrual period that spans two taxable years of a U.S. Holder, the part of the period within the taxable year).

Under the second method, the U.S. Holder may elect to determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period (or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year), or on the date that you receive the interest payment if that date is within five business days of the end of the accrual period. Any such election will apply to all debt instruments held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and will be irrevocable without the consent of the IRS.

In the case of an accrual basis U.S. Holder, upon receipt of an interest payment (including a payment attributable to accrued but unpaid interest upon the sale or retirement of a Note) denominated in, or determined by reference to, a foreign currency, the U.S. Holder may recognize U.S. source exchange gain or loss (taxable as ordinary income or loss) equal to the difference between the amount received (translated into U.S. Dollars at the spot rate on the date of receipt) and the amount previously accrued, regardless of whether the payment is in fact converted into U.S. Dollars.

### *Sale or Retirement*

As discussed above under “—*Sale, Exchange, Redemption or Other Disposition of Notes*”, a U.S. Holder will generally recognize gain or loss on the sale or retirement of a Note equal to the difference between the amount realized on the sale, exchange, redemption or other disposition and its tax basis in the Note. A U.S. Holder’s tax basis in a Note that is denominated in a foreign currency will be determined by reference to the U.S. Dollar cost of the Note. The U.S. Dollar cost of a Note purchased with foreign currency will generally be the U.S. Dollar value of the purchase price on the date of purchase, or the settlement date for the purchase, in the case of Notes traded on an established securities market, as defined in the applicable Treasury Regulations, that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects).

The amount realized on a sale, exchange, redemption or other disposition for an amount in foreign currency will be the U.S. Dollar value of this amount on the date of such sale or other disposition, or the settlement date for the sale or other disposition, in the case of Notes traded on an established securities market, as defined in the applicable Treasury Regulations, sold by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects). Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the IRS.

A U.S. Holder will recognize U.S. source exchange rate gain or loss (taxable as ordinary income or loss) on the sale, exchange, redemption or other disposition of a Note equal to the difference, if any, between the U.S. Dollar values of the U.S. Holder’s purchase price for the Note (i) on the date of sale, exchange, redemption or other disposition and (ii) on the date on which the U.S. Holder acquired the Note. Any such exchange rate gain or loss will be realized only to the extent of total gain or loss realized on the sale or retirement (including any exchange gain or loss with respect to the receipt of accrued but unpaid interest).

### *Disposition of Foreign Currency*

Foreign currency received as interest on a Note or on the sale, exchange, redemption or other disposition of a Note will have a tax basis equal to its U.S. Dollar value at the time the foreign currency is received. Foreign currency that is purchased will generally have a tax basis equal to the U.S. Dollar value of the foreign currency on the date of purchase. Any gain or loss recognized on a sale or other disposition of a foreign currency (including its use to purchase Notes or upon exchange for U.S. Dollars) will be U.S. source ordinary income or loss.

### ***Backup Withholding and Information Reporting***

In general, payments of interest on, and the proceeds of a sale, redemption or other disposition of, the Notes payable to a U.S. Holder by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup withholding will apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

### **Russian Federation**

#### ***Taxation of the Notes***

##### *General*

**The following is an overview of certain Russian tax considerations relevant to the purchase, ownership and disposal of the Notes, as well as the taxation of interest income on the Loan. The overview is based on the laws of the Russian Federation in effect on the date of this Prospectus, which are subject to potential change (possibly with retroactive effect). The overview does not seek to address the applicability of, and procedures in relation to, taxes levied by regions, municipalities or other non-federal authorities of the Russian Federation, nor does it seek to address the availability of double tax treaty relief in respect of the Notes, and it should be noted that there may be practical difficulties, including satisfying certain documentation requirements, involved in claiming double tax treaty relief. Prospective investors should consult their own advisers regarding the tax consequences of investing in the Notes. No representations with respect to the Russian tax consequences of investing, owning or disposing of the Notes to any particular Noteholder is made hereby.**

The provisions of the Russian Tax Code applicable to Noteholders and transactions involving the Notes are ambiguous and lack interpretive guidance. Both the substantive provisions of the Russian Tax Code applicable to financial instruments and the interpretation and application of those provisions by the Russian tax authorities may be more inconsistent and subject to more rapid and unpredictable change than in jurisdictions with more developed capital markets or more developed taxation systems. In particular, the interpretation and application of such provisions will in practice rest substantially with local tax inspectorates.



In practice, interpretation by different tax inspectorates may be inconsistent or contradictory and may constitute the imposition of conditions, requirements or restrictions not provided for by existing legislation. Similarly, in the absence of binding precedents, court rulings on tax or related matters by different Russian courts relating to the same or similar circumstances may also be inconsistent or contradictory.

According to the Russian Tax Code, a tax resident is an individual who spent in Russia not less than 183 days within 12 consecutive months (days of medical treatment and education outside of the Russian Federation are also counted as Russian days if the individual departed from the Russian Federation for these purposes for less than six months).

The interpretation of this definition by the Ministry of Finance of the Russian Federation states that for tax withholding purposes an individual's tax residence status should be determined on the date of income payment (based on the number of Russian days in the 12-month period preceding the date of payment). The individual's final tax liability in the Russian Federation for the reporting calendar year should be determined based on his/her tax residence status for such calendar year, i.e., based on the number of Russian days in the 12-month period as of the end of such period.

For the purposes of this overview, a "non-resident Noteholder" means (i) an individual Noteholder who has not established Russian tax residence status for the reporting calendar year as discussed above; or (ii) a legal entity or organization in each case not organized under Russian law that holds and disposes of the Notes otherwise than through a permanent establishment in Russia.

For the purposes of this overview, a "Russian resident Noteholder" means (i) an individual Noteholder who has established a Russian tax residence status for the reporting calendar year as discussed above; or (ii) a legal entity or organization which is a Noteholder but is not qualified a non-resident Noteholder as defined in the previous paragraph.

The Russian tax treatment of interest payments made by us to the Issuer under the Loan Agreement may affect the holders of the Notes. See "*—Tax Treaty Relief—Taxation of Interest Income on the Loan*" below.

#### *Non-Resident Noteholders*

Generally, any non-resident Noteholder should not be subject to any Russian taxes on receipt from the Issuer of amounts payable in respect of principal, premium or interest on the Notes, subject to what is stated in "*—Taxation of Interest Income on the Loan*" below.

In respect of gain or other income realized on redemption, sale or disposal of the Notes a non-resident Noteholder generally should not be subject to any Russian taxes, unless the proceeds of such redemption, sale or other disposal of the Notes are received from a source within the Russian Federation.

In the event that proceeds from sales, redemption or a disposal of Notes are viewed as received from a source within the Russian Federation, the Russian tax implications should be as outlined below.

#### *Legal entities*

A non-resident Noteholder that is a legal entity or organization should not be subject to Russian tax in respect of such proceeds, provided that no portion thereof is attributable to accrued interest. There is a risk that any portion of such sales proceeds attributable to accrued interest may be subject to Russian withholding tax on income at the rate of 20%, subject to any available double tax treaty relief, even if the disposal itself results in a capital loss. In order to enjoy the benefits of an applicable double tax treaty, documentary evidence is required prior to payment being made to confirm the applicability of the double tax treaty under which benefits are claimed. Non-resident Noteholders that are legal entities or organizations should consult their own tax advisers with respect to possibility of obtaining a respective double tax treaty relief.

#### *Individuals*

If proceeds from sales, redemption or other disposal of the Notes are received from a Russian source, a non-resident Noteholder who is an individual will generally be subject to tax at a rate of 30% subject to any available double tax treaty relief as discussed below, in respect of gross proceeds from such disposal less any available cost deduction (which includes the purchase price of the Notes). Any portion of the above proceeds from sale, redemption or other disposal of the Notes attributable to accrued interest income under the Notes which is received by a non-resident Noteholder from the Russian sources may be subject to tax at a rate of 30% subject to any available double tax treaty relief as discussed below. In this regard, if the Notes are disposed of in the Russian Federation, for Russian personal income tax purposes, the proceeds of such disposition (including any portion of such proceeds attributable to accrued interest income under the Notes) are likely to be regarded as received from a Russian source. In certain circumstances, if the disposal proceeds (including the interest income portion) are payable by a Russian legal entity, individual entrepreneur or a Russian permanent establishment of a foreign organization, the payer may be required to withhold this tax. Unless the tax is withheld by the payer, the non-resident individual Noteholder would be liable to pay the tax to the Russian budget.

In such a situation, there is a risk that the taxable base may be affected by fluctuations in the exchange rates between the currency of acquisition of the Notes, the currency of sale of the Notes and Roubles. Non-resident Noteholders who are individuals should consult their own tax advisers with respect to the tax consequences of the receipt of proceeds from a source within the Russian Federation in respect of a disposition of the Notes.

#### *Resident Noteholders*

A Russian resident Noteholder is subject to all applicable Russian taxes and responsible for complying with any documentation requirements that may be established by law or practice in respect of gains from disposal of the Notes and interest income received on the Notes.

##### *Legal entities and organizations*

A Russian resident Noteholder that is a legal entity or organization should, *prima facie*, be subject to Russian income tax at the rate of 20% on interest (coupon) income on the Notes as well as on the capital gains from sales, redemption or other disposal of the Notes. Generally, Russian resident Noteholders that are Russian legal entities are required to submit Russian income tax returns, assess and pay tax on capital gains and interest (coupon) income.

##### *Individuals*

A Russian resident Noteholder who is an individual should generally be subject to personal income tax at a rate of 13% on deemed income resulting from acquisition of the Notes at a price below their market value, on interest (coupon) income on the Notes and capital gains from sales, redemption or other disposal of the Notes. Russian resident Noteholders who are individuals are required to submit annual personal income tax returns, assess and personally pay tax unless the above mentioned income is received via Russian asset manager, broker or another entity which acts as the Noteholder's agent based on a relevant contract and this entity withholds and pays in full Russian income tax on behalf of the Noteholder.

Resident Noteholders should consult their own tax advisers with respect to their tax position regarding the Notes.

#### ***Tax Treaty Relief***

##### *Advance Treaty Relief*

Where proceeds from the disposal of the Notes are received from a Russian source, in order for the non-resident Noteholders, whether an individual, legal entity or organization, to receive the benefits of an applicable double tax treaty, documentary evidence is required to confirm the applicability of the double tax treaty for which benefits are claimed.

Currently, a non-resident Noteholder – legal entity or organization should present to the payer of income an apostilled or legalised confirmation of its tax residence, attaching a notarised translation in Russian. The confirmation should be presented before any payment is made and should be certified by the competent authority of the country of the Noteholder's tax residence. Such confirmation is valid for the calendar year in which it is issued. Non-resident Noteholders that are legal entities or organizations should consult their own tax advisers with respect to the possibilities to enjoy any double tax treaty relief and the relevant Russian procedures.

For non-resident individual Noteholders, procedures for advance treaty clearance are not specifically provided for by current Russian legislation. Therefore, from a practical point of view, it is unlikely that for non-resident individual Noteholders an advance reduction of the Russian withholding income tax or advance exemption from such tax provided by a respective double tax treaty between Russia and the country of the tax residence of such non-resident individual Noteholder could be obtained. Non-resident individual Noteholders should consult their own tax advisers with respect to the possibilities to enjoy any double tax treaty relief or tax refund and the relevant Russian procedures.

##### *Refund of Tax Withheld*

For a non-resident Noteholder which is not an individual and for which double tax treaty relief is available, if Russian withholding tax on income was withheld by the source of payment, a refund of such tax is possible within three years from the end of the tax period in which the tax was withheld. In order to obtain a refund, the tax documentation confirming the right of the non-resident recipient of the income to double tax treaty relief is required.

If non-resident individual Noteholders do not obtain double tax treaty relief at the time the proceeds from a disposal of the Notes are paid to such non-resident individual Noteholders and income tax is withheld by a Russian payer of the income, such non-resident individual Noteholders may apply for a refund within one year from the end of the tax period in which the tax was withheld. The documentation requirements to obtain such a refund would include a confirmation of the income received and the taxes paid in the country of tax residence of the non-resident individual Noteholders as confirmed by the relevant tax authorities of such countries. However, there can be no assurance that the refund of any taxes withheld or double tax treaty relief (as described above) will be available for such non-resident individual Noteholders.

The Russian tax authorities may, in practice, require a wide variety of documentation confirming the right to benefits under a double tax treaty. Such documentation, in practice, may not be explicitly required by the Russian Tax Code.

Obtaining a refund of Russian tax withheld may be a time consuming process and can involve considerable practical difficulties, including the possibility that a tax refund may be denied for various reasons.

#### *Taxation of Interest Income on the Loan*

In general, interest payments on borrowed funds made by a Russian legal entity to a non-resident legal entity or organization are subject to Russian withholding income tax at a rate of 20% (or 30% in respect of non-resident individuals), subject to reduction or elimination pursuant to the terms of an applicable double tax treaty.

There is a risk that under Russia's thin capitalization rules in certain circumstances where parties related to us (i.e., the Related Parties) hold Notes part or all of the interest to be paid by us under the Loan could be reclassified as dividends for Russian tax purposes. This would occur if the overall amount of our "controlled debt" calculated on an individual Related Party basis exceeded three times our capital, calculated in accordance with the requirements of the Russian Tax Code. Interest on the amount of such excess would be reclassified as dividends for Russian tax purposes. Under the Russian Tax Code, there is a risk that our "controlled debt" may include all or part of the Loan to the extent that certain Related Parties acquire any portion of the Notes.

Such reclassification of all or a portion of the interest as dividends could potentially lead to the imposition of Russian withholding tax on such reclassified interest at the rate of 15%, that might be subject to exemption under the double tax treaty between the Russian Federation and Ireland, and the non-deductibility of such interest for Russian profits tax purposes by us.

Based on the assumption that the amount of our "controlled debt" calculated in accordance with the requirements of Article 269 of the Russian Tax Code will not exceed three times the amount of our "own capital" ("*sobstvenniy kapital*") calculated on an individual Related Party basis, the Russian thin capitalization rules should not apply currently to the interest on the Loan. However, changes in these assumptions could result in all or a portion of such interest being subject to the thin capitalization rules in the future so as to treat "excess interest" related to the Loan as a dividend under the double tax treaty between the Russian Federation and Ireland subject to 15% withholding tax applicable to dividends (subject to possible tax treaty relief, if any) rather than zero withholding tax applicable to interest.

The Tax Code Amendments should allow the interest on the Loan not to be subject to withholding. In particular, the Tax Code Amendments introduce into the Russian Tax Code an exemption from the obligation to withhold tax from interest paid under transactions similar to the transactions described herein. The Tax Code Amendments were recently approved by the Russian State Duma, the Russian Council of the Federation and the President of the Russian Federation and entered into force starting from 1 July 2012.

According to the Tax Code Amendments, in respect of bonds issued prior to 1 January 2014, Russian borrowers are exempted from the obligation to withhold Russian withholding income tax from interest payments made to foreign companies on debt obligations arising in connection with placement by these foreign companies of quoted bonds, provided that (i) there is a double tax treaty between the Russian Federation and the jurisdiction of tax residence of the issuer, and (ii) the issuer duly confirms its tax residence. The Tax Code Amendments do not provide tax exemption for the holders of Eurobonds from Russian tax on interest payments, although at present there is no mechanism or requirement for non-residents to self-assess and pay the tax.

For the purpose of the Tax Code Amendments, "quoted bonds" mean bonds and other debt obligations which passed the listing procedure and/or were admitted to circulation on one or more foreign stock exchanges and/or rights to which are recorded by a foreign depositary-clearing organization, provided such foreign stock exchanges and depositary-clearing organizations are specified in the list approved by the FSFM in consultation with the Ministry of Finance of the Russian Federation. Until such list is adopted, bonds and other debt obligations which passed the listing procedure and/or were admitted to circulation on one or more foreign stock exchanges and/or rights to which are recorded by any foreign depositary-clearing organization are to be recognized as "quoted bonds". From publicly available information, the draft of this list has been released, but not officially adopted and or yet enforced.

According to the Tax Code Amendments, the above exemption established for the interest payments is also applicable to (i) income payable by a Russian legal entity in connection with a guarantee, surety or other security granted by such Russian organization with respect to a debt obligation to a foreign organization and/or with respect to quoted bonds and (ii) to other income payable by a Russian organization providing that the payment of such income is established by the provisions of the respective debt obligation or such income is paid due to a change in the terms and conditions of the respective quoted bonds and/or debt obligations including the cases of their early repurchase or redemption.

The Tax Code Amendments address Russian withholding tax treatment of interest payments or other above payments to be made to foreign companies on debt obligations arising in connection with the issuance by these foreign companies of quoted bonds before 1 January 2014. The Tax Code Amendments do not address Russian tax treatment of payments under the quoted bonds issued on or after 1 January 2014.

If the payments under the Loan are subject to any withholding taxes for any reason (as a result of which the Issuer would reduce payments under the Notes in the amount of such withholding taxes), we are required to increase payments as may be necessary so that the Issuer receives the net amount equal to the full amount it would have received in the absence of such withholding. It should be noted, however, that tax gross-up provisions in contracts may not be enforceable in the Russian Federation. In the event of our failure to increase the payments, such failure would constitute an event of default under the Loan Agreement. If we are obliged to increase payments, we may prepay the Loan in full. In such case, all outstanding Notes would be redeemable at par with accrued interest.

Russian VAT is not applied to the rendering of financial services involving the provision of a loan in monetary form. Therefore, no VAT will be payable in the Russian Federation on any payment of interest or principal in respect of the Loan.

## **Ireland**

### ***Introduction***

**The following is a summary of the principal Irish tax consequences for individuals and companies of ownership of the Notes based on the laws and practice of the Irish Revenue Commissioners currently in force in Ireland and may be subject to change. It deals with Noteholders who beneficially own their Notes as an investment. Particular rules not discussed below may apply to certain classes of taxpayers holding Notes, such as dealers in securities, trusts, etc. The summary does not constitute tax or legal advice and the comments below are of a general nature only. Prospective investors in the Notes should consult their professional advisers on the tax implications of the purchase, holding, redemption or sale of the Notes and the receipt of interest thereon under the laws of their country of residence, citizenship or domicile.**

### ***Taxation of Noteholders***

#### ***Withholding Tax***

In general, tax at the standard rate of income tax (currently 20%), is required to be withheld from payments of Irish source interest which should include interest payable on the Notes. The Issuer will not be obliged to make a withholding or deduction for or on account of Irish income tax from a payment of interest on a Note where:

- (a) the Notes are quoted Eurobonds, i.e. securities which are issued by a company (such as the Issuer), which are listed on a recognized stock exchange (such as the Irish Stock Exchange) and which carry a right to interest; and
- (b) the person by or through whom the payment is made is not in Ireland, or if such person is in Ireland, either:
  - (i) the Notes are held in a clearing system recognized by the Irish Revenue Commissioners (DTC, Euroclear and Clearstream, Luxembourg are, amongst others, so recognized); or
  - (ii) the Noteholder is not resident in Ireland and has made a declaration to a relevant person (such as a paying agent located in Ireland) in the prescribed form; and
- (c) one of the following conditions is satisfied:
  - (i) the Noteholder is resident for tax purposes in Ireland; or
  - (ii) the Noteholder is subject, without any reduction computed by reference to the amount of such interest, premium or other distribution, to a tax in a relevant territory which generally applies to profits, income or gains received in that territory, by persons, from sources outside that territory; or
  - (iii) the Noteholder is not a company which, directly or indirectly, controls the Issuer, is controlled by the Issuer, or is controlled by a third company which also directly or indirectly controls the Issuer, and neither the Noteholder, nor any person connected with the Noteholder, is a person or persons:
    - (A) from whom the Issuer has acquired assets;
    - (B) to whom the Issuer has made loans or advances; or
    - (C) with whom the Issuer has entered into a swap agreement,

where the aggregate value of such assets, loans, advances or swap agreements represents not less than 75% of the assets of the Issuer; or

- (iv) at the time of issue of the Notes, the Issuer was not in possession, or aware, of any information which could reasonably be taken to indicate whether or not the beneficial owner of the Notes would be subject to tax on any interest payments.

where the term:

“relevant territory” means a member state of the EU (other than Ireland) or a country with which Ireland has signed a double tax treaty (“**Relevant Territory**”); and

“swap agreement” means any agreement, arrangement or understanding that—

- I. provides for the exchange, on a fixed or contingent basis, of one or more payments based on the value, rate or amount of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and
- II. transfers to a person who is a party to the agreement, arrangement or understanding or to a person connected with that person, in whole or in part, the financial risk associated with a future change in any such value, rate or amount without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred.

Thus, so long as the Notes continue to be quoted on the Irish Stock Exchange, are held in DTC, Euroclear and/or Clearstream, Luxembourg, and one of the conditions set out in paragraph (c) above is met, interest on the Notes can be paid by any paying agent acting on behalf of the Issuer free of any withholding or deduction for or on account of Irish income tax. If the Notes continue to be quoted but cease to be held in a recognized clearing system, interest on the Notes may be paid without any withholding or deduction for or on account of Irish income tax provided such payment is made through a paying agent outside Ireland and one of the conditions set out in paragraph (c) above is met.

#### ***Encashment Tax***

In certain circumstances, Irish tax will be required to be withheld at the standard rate of income tax (currently 20%) from interest on any Note, where such interest is collected or realized by a bank or encashment agent in Ireland on behalf of any Noteholder. There is an exemption from encashment tax where the beneficial owner of the interest is not resident in Ireland and has made a declaration to this effect in the prescribed form to the encashment agent or bank.

#### ***Income Tax, PRSI and Universal Social Charge***

Notwithstanding that a Noteholder may receive interest on the Notes free of withholding tax, the Noteholder may still be liable to pay Irish tax with respect to such interest. Noteholders resident or ordinarily resident in Ireland who are individuals may be liable to pay Irish income tax, social insurance (PRSI) contributions and the universal social charge in respect of interest they receive on the Notes.

Interest paid on the Notes may have an Irish source and therefore may be within the charge to Irish income tax. In the case of Noteholders who are non-resident individuals such Noteholders may also be liable to pay the universal social charge in respect of interest they receive on the Notes.

Ireland operates a self-assessment system in respect of tax and any person, including a person who is neither resident nor ordinarily resident in Ireland, with Irish source income comes within its scope.

There are a number of exemptions from Irish income tax available to certain non-residents. Firstly, interest payments made by the Issuer are exempt from income tax so long as the Issuer is a qualifying company for the purposes of Section 110 of the Taxes Consolidation Act, 1997 (“TCA”), the recipient is not resident in Ireland and is resident in a Relevant Territory and, the interest is paid out of the assets of the Issuer. Secondly, interest payments made by the Issuer in the ordinary course of its trade or business to a company are exempt from income tax provided the recipient company is not resident in Ireland and is either resident for tax purposes in a Relevant Territory which imposes a tax that generally applies to interest receivable in that territory by companies from sources outside that territory or the interest is exempted from the charge to Irish income tax under the terms of a double tax agreement which is either in force or which will come in to force once all ratification procedures have been completed. Thirdly, interest paid by the Issuer free of withholding tax under the quoted Eurobond exemption is exempt from income tax where the recipient is a person not resident in Ireland and resident in a Relevant Territory. Finance Act 2012 extends the quoted Eurobond exemption to companies which are under the control, whether directly or indirectly, of person(s) who by virtue of the law of a Relevant Territory are resident for the purposes of tax in a Relevant Territory and are not under the control of person(s) who are not so resident, and to 75% subsidiary companies of a company or companies the principal class of shares in which is substantially and regularly traded on a recognized stock exchange. For the purposes of these exemptions and where not specified otherwise, residence is determined under the terms of the relevant double taxation agreement or in any other case, the law of the country in which the

recipient claims to be resident. Interest falling within the above exemptions is also exempt from the universal social charge.

Notwithstanding these exemptions from income tax, a corporate recipient that carries on a trade in Ireland through a branch or agency in respect of which the Notes are held or attributed, may have a liability to Irish corporation tax on the interest.

Relief from Irish income tax may also be available under the specific provisions of a double tax treaty between Ireland and the country of residence of the recipient.

Interest on the Notes which does not fall within the above exemptions is within the charge to income tax, and, in the case of Noteholders who are individuals, the charge to the universal social charge. In the past the Irish Revenue Commissioners have not pursued liability to income tax in respect of persons who are not regarded as being resident in Ireland except where such persons have a taxable presence of some sort in Ireland or seek to claim any relief or repayment in respect of Irish tax. However, there can be no assurance that the Irish Revenue Commissioners will apply this treatment in the case of any Noteholder.

### ***Capital Gains Tax***

A holder of Notes will not be subject to Irish tax on capital gains on a disposal of Notes unless such holder is either resident or ordinarily resident in Ireland or carries on a trade or business in Ireland through a branch or agency in respect of which the Notes were used or held.

### ***Capital Acquisitions Tax***

A gift or inheritance comprising Notes will be within the charge to capital acquisitions tax (which subject to available exemptions and reliefs, will be levied at 30%) if either (i) the disponer or the donee/successor in relation to the gift or inheritance is resident or ordinarily resident in Ireland (or, in certain circumstances, if the disponer is domiciled in Ireland irrespective of his residence or that of the donee/successor) on the relevant date or (ii) if the Notes are regarded as property situated in Ireland (i.e., if the Notes are physically located in Ireland or if the register of the Notes is maintained in Ireland).

### ***Stamp Duty***

No stamp duty or similar tax is imposed in Ireland (on the basis of an exemption provided for in Section 85(2)(c) of the Irish Stamp Duties Consolidation Act, 1999 so long as the Issuer is a qualifying company for the purposes of Section 110 of the TCA and the proceeds of the Notes are used in the course of the Issuer's business), on the issue, transfer or redemption of the Notes.

### ***Implementation of the EU Savings Directive in Ireland***

Ireland has implemented Council Directive 2003/48/EC on the taxation of savings income (the "EU Savings Directive") into national law. Accordingly, any Irish paying agent making an interest payment on behalf of the Issuer to an individual or certain residual entities resident in another Member State of the EU or certain associated and dependent territories of a Member State will have to provide details of the payment and certain details relating to the Noteholder (including the Noteholder's name and address) to the Irish Revenue Commissioners who in turn is obliged to provide such information to the competent authorities of the state or territory of residence of the individual or residual entity concerned.

The Issuer, or any person or agent acting on behalf of the Issuer, shall be entitled to require Noteholders to provide any information regarding their tax status, identity or residency in order to satisfy the disclosure requirements in Directive 2003/48/EC and Noteholders will be deemed by their subscription for Notes to have authorized the automatic disclosure of such information by the Issuer, or any person or agent acting on behalf of the Issuer, to the relevant tax authorities.

### ***EU Savings Directive***

Under the EU Savings Directive, each Member State of the EU is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entities established in, that other Member State. However, for a transitional period, Austria and Luxembourg will (unless during such period they elect otherwise) instead operate a withholding system in relation to such payments. Under such a withholding system, the beneficial owner of the interest payment must be allowed to elect that certain provision of information procedures should be applied instead of withholding. The rate of withholding is 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to exchange of information procedures relating to interest and other similar income.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within their respective jurisdictions to, or secured by such a person for, an individual beneficial owner

resident in, or certain limited types of entities established in, a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those countries and territories in relation to payments made by a person in a Member State to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entities established in, one of those countries or territories.

A proposal for amendments to the EU Savings Directive has been published, including a number of suggested changes which, if implemented, would broaden the scope of the rules described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment under the Notes were to be made by a person in a Member State or another country or territory which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to the EU Savings Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts under the terms of such Notes as a result of the imposition of such withholding tax. The Issuer is, however, required, for so long as the Notes are listed on the Irish Stock Exchange, to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the EU Savings Directive or any such law.

### **United Kingdom Provision of Information Requirements**

The comments below are of a general nature and are based on current United Kingdom (“**UK**”) tax law and published practice of HM Revenue & Customs (“**HMRC**”), the UK tax authorities. Such law may be repealed, revoked or modified (possibly with retrospective effect) and such practice may change, resulting in UK tax consequences different from those discussed below. The comments below deal only with UK rules relating to information that may need to be provided to HMRC in respect of certain payments on the Notes. They do not deal with any other UK tax consequences of acquiring, owning or disposing of the Notes. Each prospective investor should seek advice based on its particular circumstances from an independent tax adviser.

Persons in the UK (i) paying interest to or receiving interest on behalf of another person who is an individual or a partnership containing individuals, or (ii) paying amounts due on redemption of any Notes which constitute deeply discounted securities as defined in Chapter 8 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 to or receiving such amounts on behalf of another person who is an individual or a partnership containing individuals, may be required to provide certain information to HMRC regarding the identity of the payee or person entitled to the interest and, in certain circumstances, such information may be exchanged with tax authorities in other jurisdictions.

However, in relation to amounts payable on the redemption of any Notes which constitute deeply discounted securities, HMRC published guidance indicates that HMRC will not exercise its power to obtain information where such amounts are paid on or before 5 April 2013. There is no guarantee that equivalent guidance will be published in respect of future years.

## TRANSFER RESTRICTIONS

*Because of the following restrictions, you are advised to consult legal counsel prior to making any offer, resale or other transfer offered hereby.*

### Rule 144A Notes

Each purchaser of Rule 144A Notes, by accepting delivery of this Prospectus and the relevant Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is (a) a QIB that is also a QP, (b) not a broker-dealer that owns and invests on a discretionary basis less than U.S.\$25 million in securities of unaffiliated issuers, (c) not a participant-directed employee plan, such as a 401(k) plan, (d) acquiring such Notes for its own account, or for the account of one or more QIBs each of which is also a QP, (e) not formed for the purpose of investing in the Notes or the Issuer, and (f) aware, and each beneficial owner of such Notes has been advised, that the seller of such Notes to it may be relying on Rule 144A.
2. It will (a) along with each account for which it is purchasing, hold and transfer beneficial interests in the relevant Rule 144A Notes in a principal amount that is not less than U.S.\$200,000, and (b) provide notice of these transfer restrictions to any subsequent transferees. In addition, it understands that the Issuer may receive a list of participants holding positions in its securities from one or more book-entry depositories.
3. It understands that the Rule 144A Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB that is also a QP purchasing for its own account or for the account of one or more QIBs that are also QPs each of which is purchasing not less than U.S.\$200,000 principal amount of Notes or (b) in an offshore transaction to a person that is not a U.S. person (within the meaning of Regulation S) in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act, and in each case in accordance with any applicable securities laws of any State or other jurisdiction of the United States.
4. It understands that the Issuer has the power under the Trust Deed to compel any beneficial owner of Rule 144A Notes that is not a QIB and a QP to sell its interest in the relevant Rule 144A Notes, or may sell such interest on behalf of, or purchase such interest from, such owner at a price equal to the least of (x) the purchase price therefor paid by the beneficial owner, (y) 100% of the principal amount thereof or (z) the fair market value thereof. The Issuer has the right to refuse to honor the transfer of an interest in the Rule 144A Notes to a U.S. person who is not a QIB and a QP.
5. It understands that the Rule 144A Notes, unless otherwise agreed between the Issuer and the Trustee in accordance with applicable law, will bear a legend to the following effect:

THIS NOTE AND THE LOAN IN RESPECT THEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE “**SECURITIES ACT**”) OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT (“**RULE 144A**”) TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT (A “**QIB**”) THAT IS A QUALIFIED PURCHASER (A “**QP**”) WITHIN THE MEANING OF SECTION 2(a)(51) OF THE U.S. INVESTMENT COMPANY ACT OF 1940 (THE “**INVESTMENT COMPANY ACT**”) PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QIB THAT IS ALSO A QP WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT SUCH OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT, AND IN AN AMOUNT FOR EACH ACCOUNT OF NOT LESS THAN U.S.\$200,000 PRINCIPAL AMOUNT OF NOTES OR (2) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT (“**REGULATION S**”), AND IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES, AND THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER FROM IT OF THE NOTES IN RESPECT HEREOF OF THE RESALE RESTRICTIONS REFERRED TO ABOVE. ANY TRANSFER IN VIOLATION OF THE FOREGOING WILL BE OF NO FORCE OR EFFECT, WILL BE VOID *AB INITIO* AND WILL NOT OPERATE TO TRANSFER ANY RIGHTS TO THE TRANSFEREE, NOTWITHSTANDING ANY INSTRUCTIONS TO THE CONTRARY TO THE ISSUER OF THIS NOTE, THE TRUSTEE OR ANY INTERMEDIARY. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF ANY EXEMPTION UNDER THE SECURITIES ACT FOR REALES OF THIS NOTE.



IF THE BENEFICIAL OWNER HEREOF IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S, SUCH BENEFICIAL OWNER HEREOF REPRESENTS THAT (1) IT IS A QIB THAT IS ALSO A QP; (2) IT IS NOT A BROKER-DEALER THAT OWNS AND INVESTS ON A DISCRETIONARY BASIS LESS THAN U.S.\$25,000,000 IN SECURITIES OF UNAFFILIATED ISSUERS; (3) IT IS NOT A PARTICIPANT-DIRECTED EMPLOYEE PLAN, SUCH AS A 401 (k) PLAN; (4) IT IS HOLDING THIS NOTE FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QIB THAT IS ALSO A QP; (5) IT WAS NOT FORMED FOR THE PURPOSE OF INVESTING IN THE ISSUER OR THIS NOTE; (6) IT, AND EACH ACCOUNT FOR WHICH IT HOLDS NOTES, WILL HOLD AND TRANSFER AT LEAST U.S.\$200,000 IN PRINCIPAL AMOUNT OF NOTES; (7) IT UNDERSTANDS THAT THE ISSUER MAY RECEIVE A LIST OF PARTICIPANTS HOLDING POSITIONS IN ITS SECURITIES FROM ONE OR MORE BOOK-ENTRY DEPOSITORY AND (8) IT WILL PROVIDE NOTICE OF THE FOREGOING TRANSFER RESTRICTIONS TO ITS SUBSEQUENT TRANSFEREES.

THE BENEFICIAL OWNER HEREOF HEREBY ACKNOWLEDGES THAT, IF AT ANY TIME WHILE IT HOLDS AN INTEREST IN THIS NOTE IT IS A PERSON WHO IS NOT A QIB THAT IS ALSO A QP, THE ISSUER MAY (A) COMPEL IT TO SELL ITS INTEREST IN THIS NOTE TO A PERSON (1) WHO IS ALSO A QIB THAT IS ALSO A QP AND WHO IS OTHERWISE QUALIFIED TO PURCHASE THIS NOTE IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE SECURITIES ACT OR (2) IN AN OFFSHORE TRANSACTION TO A PERSON THAT IS NOT A U.S. PERSON IN ACCORDANCE WITH RULE 903 OR 904 OF REGULATION S OR (B) COMPEL THE BENEFICIAL OWNER TO SELL ITS INTEREST IN THIS NOTE TO THE ISSUER OR AN AFFILIATE OF THE ISSUER OR TRANSFER ITS INTEREST IN THIS NOTE TO A PERSON DESIGNATED BY OR ACCEPTABLE TO THE ISSUER AT A PRICE EQUAL TO THE LEAST OF (X) THE PURCHASE PRICE THEREFOR PAID BY THE BENEFICIAL OWNER, (Y) 100% OF THE PRINCIPAL AMOUNT THEREOF OR (Z) THE FAIR MARKET VALUE THEREOF. THE ISSUER HAS THE RIGHT TO REFUSE TO HONOR A TRANSFER OF AN INTEREST IN THIS NOTE TO A PERSON WHO IS NOT A QIB AND A QP. THE ISSUER HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE INVESTMENT COMPANY ACT. EACH BENEFICIAL OWNER HEREOF OR OF ANY INTEREST HEREIN IS DEEMED TO REPRESENT, WARRANT AND AGREE THAT FOR SO LONG AS IT HOLDS THIS NOTE OR ANY INTEREST HEREIN (1) IT IS NOT AND IS NOT USING ASSETS OF A BENEFIT PLAN INVESTOR (AS DEFINED IN SECTION 3(42) OF ERISA), (2) IF IT IS A GOVERNMENTAL, CHURCH OR NON-U.S. PLAN THAT IS SUBJECT TO ANY FEDERAL, STATE, LOCAL OR NON-U.S. LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF SECTION 406 OF ERISA OR SECTION 4975 OF THE CODE OR ANY ENTITY WHOSE ASSETS ARE TREATED AS ASSETS OF ANY SUCH PLAN, THE PURCHASE AND HOLDING OF THIS NOTE OR ANY INTEREST HEREIN DOES NOT VIOLATE ANY STATUTE, REGULATION, ADMINISTRATIVE DECISION, POLICY OR ANY OTHER LEGAL AUTHORITY APPLICABLE TO SUCH PLAN AND WILL NOT SUBJECT THE ISSUER TO ANY SUCH STATUTE, REGULATION, ADMINISTRATIVE DECISION, POLICY OR OTHER LEGAL AUTHORITY, AND (3) IT WILL NOT SELL OR OTHERWISE TRANSFER THIS NOTE OR ANY INTEREST THEREIN TO ANY PERSON WITHOUT FIRST OBTAINING THESE SAME FOREGOING DEEMED REPRESENTATIONS, WARRANTIES AND AGREEMENTS. "BENEFIT PLAN INVESTORS" INCLUDE (1) ANY EMPLOYEE BENEFIT PLAN (AS DEFINED IN SECTION 3(3) OF ERISA), THAT IS SUBJECT TO PART 4 OF TITLE I OF ERISA, (2) ANY PLAN TO WHICH SECTION 4975 OF THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE") APPLIES, INCLUDING, WITHOUT LIMITATION, INDIVIDUAL RETIREMENT ACCOUNTS AND KEOGH PLANS (EACH OF (1) AND (2) A "PLAN"), AND (3) ANY ENTITY WHOSE UNDERLYING ASSETS INCLUDE PLAN ASSETS BY REASON OF A PLAN'S INVESTMENT IN THE ENTITY PURSUANT TO THE PLAN ASSET REGULATION ISSUED BY THE UNITED STATES DEPARTMENT OF LABOR, 29 C.F.R. SECTION 2510.3-101, AS MODIFIED BY SECTION 3(42) OF ERISA (INCLUDING, FOR THIS PURPOSE, THE GENERAL ACCOUNT OF AN INSURANCE COMPANY, ANY OF THE UNDERLYING ASSETS OF WHICH CONSTITUTE "PLAN ASSETS" UNDER SECTION 401(c) OF ERISA, OR A WHOLLY OWNED SUBSIDIARY THEREOF).

THE ISSUER MAY COMPEL EACH BENEFICIAL OWNER HEREOF TO CERTIFY PERIODICALLY THAT SUCH OWNER IS A QIB AND A QP.

6. At the time of its purchase and throughout the period in which it holds such Notes or any interest therein: (1) it is not and is not using assets of a Benefit Plan Investor (as defined in Section 3(42) of ERISA), (2) if it is a governmental, church or non-U.S. plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code or any entity whose assets are treated as assets of any such plan, the purchase and holding of the Notes or any interest therein (x) does not violate any statute, regulation, administrative decision, policy or any other legal authority applicable to such plan, (y) and will not subject the Issuer to any such statute, regulation, administrative

decision, policy or other legal authority, and (z) it will not sell or otherwise transfer any such note or interest to any person without first obtaining these same foregoing deemed representations, warranties and agreements. “Benefit Plan Investors” include (1) any employee benefit plan (as defined in Section 3(3) of ERISA), that is subject to Part 4 of Subtitle B of Title I of ERISA, (2) any plan to which Section 4975 of the U.S. Tax Code applies, including, without limitation, individual retirement accounts and Keogh plans (each of (1) and (2) a “Plan”), and (3) any entity whose underlying assets include plan assets by reason of a Plan’s investment in the entity pursuant to the Plan Asset Regulation issued by the United States Department of Labor, 29 C.F.R. Section 2510.3-101, as modified by Section 3(42) of ERISA (including, for this purpose, the general account of an insurance company, any of the underlying assets of which constitute “plan assets” under section 401(c) of ERISA, or a wholly-owned subsidiary thereof). It acknowledges that the Issuer, NOVATEK, the Registrar, the Joint Lead Managers and their respective affiliates, and others will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Rule 144A Notes is no longer accurate, it shall promptly notify the Issuer, NOVATEK and the Joint Lead Managers. If it is acquiring any Notes as a fiduciary or agent for one or more investor accounts who are QIBs that are also QPs, it represents that it has sole investment discretion with respect to each such account, and that it has full power to make the above acknowledgements, representations and agreements on behalf of each such account.

The purchaser and any fiduciary causing it to acquire an interest in any Notes agrees to indemnify and hold harmless the Issuer, the Joint Lead Managers and Citicorp Trustee Company Limited as trustee and their respective affiliates, from and against any cost, damage or loss incurred by any of them as a result of any of the foregoing representations and agreements being or becoming false.

In the event that the Issuer determines that any Note is held by a Benefit Plan Investor, the Issuer may cause a sale or transfer of such Note.

Any purported acquisition or transfer of any Note or beneficial interest therein to an acquirer or transferee that does not comply with the requirements of this paragraph 6 shall be null and void *ab initio*.

7. It understands that the Rule 144A Notes will be evidenced by the Rule 144A Global Note Certificate. Before any interest in the Rule 144A Global Note Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note Certificate, it will be required to provide a Transfer Agent with a written certification (in the form provided in the Paying Agency Agreement) as to compliance with applicable securities laws.

**Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.**

#### **Regulation S Notes**

Each purchaser of Regulation S Notes, by accepting delivery of this Prospectus and the relevant Regulation S Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is, or at the time Regulation S Notes are purchased will be, the beneficial owner of such Regulation S Notes and (a) it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S) and (b) it is not an affiliate of the Issuer, NOVATEK or a person acting on behalf of such an affiliate.
2. It understands that the Regulation S Notes have not been and will not be registered under the Securities Act and that, prior to the expiration of the distribution compliance period (as such terms are defined in Rule 902 of Regulation S), which is deemed to include the 40-day period after commencement of the Offering or the Closing Date, whichever is later, it will not offer, sell, pledge or otherwise transfer such Notes except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believes is a QIB that is also a QP purchasing for its own account or for the account of a QIB that is also a QP or (b) in an offshore transaction to a person that is not a U.S. person within the meaning of Regulation S in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in the case of (a) and (b), in accordance with any applicable securities laws of any state or other jurisdiction of the United States.
3. It understands that the Regulation S Notes will be evidenced by the Regulation S Global Note Certificate. Before any interest in the Regulation S Global Note Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate, it will be required to provide a Transfer Agent with a written certification (in the form provided in the Paying Agency Agreement) as to compliance with applicable securities laws.
4. At the time of its purchase and throughout the period in which it holds such Notes or any interest therein: (1) it is not and is not using assets of a Benefit Plan Investor (as defined in Section 3(42) of ERISA), (2) if it is a governmental, church or non-U.S. plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code or any entity

whose assets are treated as assets of any such plan, the purchase and holding of the Notes or any interest therein (x) does not violate any statute, regulation, administrative decision, policy or any other legal authority applicable to such plan, (y) and will not subject the Issuer to any such statute, regulation, administrative decision, policy or other legal authority, and (z) it will not sell or otherwise transfer any such note or interest to any person without first obtaining these same foregoing representations and warranties. “Benefit Plan Investors” include a Plan (as defined above) and any entity whose underlying assets include plan assets by reason of a Plan’s investment in the entity pursuant to the Plan Asset Regulation issued by the United States Department of Labor, 29 C.F.R. Section 2510.3-101, as modified by Section 3(42) of ERISA (including, for this purpose, the general account of an insurance company, any of the underlying assets of which constitute “plan assets” under section 401(c) of ERISA, or a wholly-owned subsidiary thereof). It acknowledges that the Issuer, NOVATEK, the Registrar, the Joint Lead Managers and their affiliates and others will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Notes is no longer accurate, it shall promptly notify the Issuer, NOVATEK and the Joint Lead Managers. If it is acquiring any Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each of those accounts and that it has full power to make the above acknowledgements, representations and agreements on behalf of each account.

The purchaser and any fiduciary causing it to acquire an interest in any Notes agrees to indemnify and hold harmless the Issuer, the Joint Lead Managers and Citicorp Trustee Company Limited as trustee and their respective affiliates, from and against any cost, damage or loss incurred by any of them as a result of any of the foregoing representations and agreements being or becoming false.

In the event that the Issuer determines that any Note is held by a Benefit Plan Investor, the Issuer may cause a sale or transfer of such Note. Any purported acquisition or transfer of any Note or beneficial interest therein to an acquirer or transferee that does not comply with the requirements of this paragraph 4 shall be null and void *ab initio*.

## PLAN OF DISTRIBUTION

Each of Barclays Bank PLC (“**Barclays**”) and Goldman Sachs International (“**Goldman Sachs**”) has, in a subscription agreement with respect to the Notes dated 10 December 2012 among the Issuer, the Borrower, Barclays and Goldman Sachs (the “**Subscription Agreement**”) upon the terms and subject to the conditions contained therein, severally agreed to subscribe and pay for the aggregate principal amounts of the Notes as set out opposite its name below at their issue price of 100% of their principal amount. Each of GPB-Financial Services Ltd (“**GPB FS**”) and SIB (CYPRUS) LIMITED (“**SIB**”) has, in a subscription support agreement with respect to the Notes dated 10 December 2012 among the Issuer and the Joint Lead Managers (the “**Subscription Support Agreement**”) upon the terms and subject to the conditions contained therein, severally agreed to subscribe and pay for the aggregate principal amounts of the Notes as set out opposite its name below at their issue price of 100% of their principal amount.

<b>Joint Lead Manager</b>	<b>Principal Amount of the Notes</b>
	<i>(U.S.\$ million)</i>
Barclays Bank PLC .....	250,000,000
Goldman Sachs International.....	250,000,000
GPB-Financial Services Ltd.....	250,000,000
SIB (CYPRUS) LIMITED .....	250,000,000
<b>Total</b> .....	<b>1,000,000,000</b>

The Joint Lead Managers shall make any offers and sales into the United States, to the extent necessary, through their U.S. registered broker-dealer affiliates.

Barclays and Goldman Sachs are entitled to commissions and reimbursement of certain expenses pursuant to the Subscription Agreement and GPB FS and SIB are entitled to commissions and reimbursement of certain expenses pursuant to the Subscription Support Agreement, which, in aggregate, are estimated to be U.S.\$3,369,907.70. Barclays and Goldman Sachs are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

### **Selling Restrictions**

#### **United States**

The Notes and the Loan have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except in certain transactions exempt from the registration requirements of the Securities Act.

Each Joint Lead Manager has agreed, severally and not jointly, that, except as permitted by the Subscription Agreement and/or the Subscription Support Agreement, as applicable, it will not offer or sell the Notes (1) as part of its distribution at any time or (2) otherwise until completion of the distribution compliance period, which is deemed to include the 40-day period after commencement of the Offering or the Closing Date, whichever is later, within the United States to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells Notes (other than a sale pursuant to Rule 144A) during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States in reliance on Regulation S. The Subscription Agreement and/or the Subscription Support Agreement, as applicable, provide(s) that the Joint Lead Managers may directly or through their respective U.S. broker-dealer affiliates arrange for the offer and resale of the relevant Notes in the United States only to persons whom they reasonably believe are QIBs and QPs who can represent that (a) they are QPs who are QIBs within the meaning of Rule 144A; (b) they are not broker-dealers that own and invest on a discretionary basis less than U.S.\$25 million in securities of unaffiliated issuers; (c) they are not participants in directed employee plans, such as a 401(k) plan; (d) they are acting for their own account, or the account of one or more QIBs each of which is a QP; (e) they are not formed for the purpose of investing in the Issuer or the Notes; (f) each account for which they are purchasing will hold and transfer at least U.S.\$200,000 in principal amount of the Notes at any time; (g) they understand that the Issuer may receive a list of participants holding positions in its securities from one or more book-entry depositaries; and (h) they will provide notice of the transfer restrictions set forth in this Prospectus to any subsequent transferees.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer that is participating in the offering may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

The Issuer and the Joint Lead Managers reserve the right to reject any offer to purchase the Notes, in whole or in part, for any reason. This Prospectus does not constitute an offer to any person in the United States or to any

U.S. person other than any QIB who is also a QP and to whom an offer has been made directly by one of the Joint Lead Managers or its relevant U.S. broker-affiliate. Distribution of this Prospectus by any non-U.S. person outside the United States or by any QIB who is a QP within the United States to any U.S. person or any person within the United States other than any QIB who is a QP, and those persons, if any, retained to advise such person outside the United States or QIB who is a QP with respect thereto, is unauthorized and any disclosure without the prior written consent of the Issuer of any of its contents to any such U.S. person or any person within the United States other than any QIB who is a QP and those persons, if any, retained to advise such non-U.S. person outside the United States or QIB who is a QP, is prohibited.

### **United Kingdom**

Each Joint Lead Manager has severally and not jointly nor jointly and severally agreed that:

1. it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and
2. it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

### **Russian Federation**

Each Joint Lead Manager has severally and not jointly nor jointly and severally agreed that the Notes will not be offered, transferred or sold as part of their initial distribution or at any time thereafter to or for the benefit of any persons (including legal entities) resident, incorporated, established or having their usual residence in the Russian Federation or to any person located within the territory of the Russian Federation unless and to the extent otherwise permitted under Russian Law.

### **Ireland**

Each Joint Lead Manager has severally and not jointly nor jointly and severally agreed that:

- (a) it will not underwrite the issue of, or place the Notes, otherwise than in conformity than with the provisions of the European Communities (Markets in Financial Instruments) Regulations 2007, as amended (Nos. 1 to 3), including, without limitation, Regulations 7 and 152 thereof and any codes of conduct used in connection therewith and the provisions of the Investor Compensation Act 1998;
- (b) it will not underwrite the issue of, or place, the Notes, otherwise than in conformity with the provisions of the Central Bank Acts 1942-2011 (as amended) and any codes of conduct rules made under Section 117(1) of the Central Bank Act 1989;
- (c) it will not underwrite the issue of, or place, or do anything in Ireland in respect of the Notes otherwise than in conformity with the provisions of the Prospectus (Directive 2003/71/EC) Regulations 2005, as amended, and any rules issued under Section 51 of the Investment Funds, Companies and Miscellaneous Provisions Act 2005, by the Central Bank; and
- (d) it will not underwrite the issue of, place or otherwise act in Ireland in respect of the Notes, otherwise than in conformity with the provisions of the Market Abuse (Directive 2003/6/EC) Regulations 2005, as amended, and any rules issued under Section 34 of the Investment Funds, Companies and Miscellaneous Provisions Act 2005 by the Central Bank.

### **Other Relationships**

The Joint Lead Managers and their respective affiliates have engaged in transactions with NOVATEK in the ordinary course of their banking business and have performed various investment banking, financial advisory, and other services for NOVATEK, for which they received customary fees. The Joint Lead Managers and their respective affiliates may provide such services in the future.

## CLEARING AND SETTLEMENT

### **Book-Entry Procedures for the Global Note Certificates**

Custodial and depository links are to be established between Euroclear, Clearstream, Luxembourg and DTC to facilitate the initial issue of the Notes and cross-market transfers of the Notes associated with secondary market trading. See “—*Book-Entry Ownership*” and “—*Settlement and Transfer of Notes*”.

#### ***Euroclear and Clearstream, Luxembourg***

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book-entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodial relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Investors may hold their interests in the Regulation S Global Note Certificate directly through Euroclear or Clearstream, Luxembourg if they are accountholders (“**Direct Participants**”) or indirectly (“**Indirect Participants**”), and together with Direct Participants, “**Participants**”) through organizations which are accountholders therein.

#### ***DTC***

DTC has advised the Issuer as follows: DTC is a limited-purpose trust company organized under the laws of the State of New York, a “banking organization” under the laws of the State of New York, a member of the U.S. Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants (“**DTC Participants**”) and facilitate the clearance and settlement of securities transactions between DTC Participants through electronic computerized book-entry changes in accounts of its DTC Participants, thereby eliminating the need for physical movement of certificates. DTC Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly.

Investors may hold their interests in the Rule 144A Global Note Certificate directly through DTC if they are DTC Participants in the DTC system or indirectly through organizations which are DTC Participants in such system.

DTC has advised the Issuer that it will take any action permitted to be taken by a holder of Notes only at the direction of one or more DTC Participants and only in respect of such portion of the aggregate principal amount of the relevant Rule 144A Global Note Certificate as to which such DTC Participant or DTC Participants has or have given such direction.

### **Book-Entry Ownership**

#### ***Euroclear and Clearstream, Luxembourg***

The Regulation S Global Note Certificate will have an ISIN and a Common Code and will be registered in the name of a nominee for, and deposited with a common depository on behalf of, Euroclear and Clearstream, Luxembourg.

The address of Euroclear is 1 Boulevard du Roi Albert 11, B-1210 Brussels, Belgium, and the address of Clearstream, Luxembourg is 42 Avenue J.F. Kennedy, L-1855, Luxembourg.

#### ***DTC***

The Rule 144A Global Note Certificate will have a CUSIP number, an ISIN and a Common Code and will be deposited with a custodian (the “**Custodian**”) for, and registered in the name of a nominee of, DTC. The Custodian and DTC will electronically record the principal amount of the Notes held within the DTC system. The address of DTC is 55 Water Street, New York, New York 10041, United States of America.

### **Relationship of Participants with Clearing Systems**

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or DTC as the holder of a Note evidenced by a Global Note Certificate must look solely to Euroclear, Clearstream, Luxembourg or DTC (as the case may be) for his share of each payment made by the Issuer to the holder of such Global Note Certificate and in relation to all other rights arising under that Global Note Certificate, subject to and in accordance with the

respective rules and procedures of Euroclear, Clearstream, Luxembourg or DTC (as the case may be). The Issuer expects that, upon receipt of any payment in respect of Notes evidenced by a Global Note Certificate, the common depositary by whom such Note is held, or nominee in whose name it is registered, will immediately credit the relevant participants' or accountholders' accounts in the relevant clearing system with payments in amounts proportionate to their respective beneficial interests in the principal amount of the relevant Global Note Certificate as shown on the records of the relevant clearing system or its nominee. The Issuer also expects that payments by Direct Participants or DTC Participants (as the case may be) in any clearing system to owners of beneficial interests in such Global Note Certificate held through such Direct Participants or DTC Participants (as the case may be) in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are evidenced by such Global Note Certificate and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of such Global Note Certificate in respect of each amount so paid. None of the Issuer, the Trustee or any Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in any Global Note Certificate or for maintaining, supervising or reviewing any records relating to such ownership interests.

### **Settlement and Transfer of Notes**

Subject to the rules and procedures of each applicable clearing system, purchases of Notes held within a clearing system must be made by or through Direct Participants or DTC Participants (as the case may be), which will receive a credit for such Notes on the clearing system's records. The ownership interest of each actual purchaser of each such Note (the "**Beneficial Owner**") will in turn be recorded on the Direct Participant's, Indirect Participant's or DTC Participant's records (as the case may be).

Beneficial Owners will not receive written confirmation from any clearing system of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct Participant, Indirect Participant or DTC Participant (as the case may be) through which such Beneficial Owner entered into the transaction.

Transfers of ownership interests in Notes held within the clearing system will be affected by entries made on the books of Direct Participants, Indirect Participants or DTC Participants (as the case may be) acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in such Notes, unless and until interests in any Global Note Certificate held within a clearing system are exchanged for Definitive Certificates.

No clearing system has knowledge of the actual Beneficial Owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants or DTC Participants (as the case may be) to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Direct Participants or the DTC Participants (as the case may be) will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants or DTC Participants (as the case may be), by Direct Participants to Indirect Participants, and by Direct Participants, Indirect Participants or DTC Participants (as the case may be) to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in the Global Note Certificates to such persons may be limited. In particular, because DTC can only act on behalf of DTC Participants the ability of a person having an interest in a Rule 144A Global Note Certificate to pledge such interest to persons or entities that do not participate in DTC, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

### **Trading between Euroclear and/or Clearstream, Luxembourg Participants**

Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional Eurobonds.

### **Trading between DTC Participants**

Secondary market sales of book-entry interests in the Notes between DTC Participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to U.S. corporate debt obligations in DTC's Same-Day Funds Settlement system in same-day funds, if payment is effected in U.S. Dollars, or free of payment, if payment is not effected in U.S. Dollars. Where payment is not effected in U.S. Dollars, separate payment arrangements outside DTC are required to be made between DTC Participants.

### **Trading between DTC Seller and Euroclear/Clearstream, Luxembourg Purchaser**

When book-entry interests in Notes are to be transferred from the account of a DTC Participant holding a beneficial interest in the Rule 144A Global Note Certificate to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the Regulation S Global Note Certificate (subject to the certification procedures provided in the relevant Paying Agency Agreement), the DTC Participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12:00 p.m., New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC Participant and the relevant Euroclear or Clearstream, Luxembourg Participant. On the settlement date, the custodian of the Rule 144A Global Note Certificate will instruct the Registrar to (1) decrease the amount of Notes registered in the name of Cede & Co. and evidenced by such Rule 144A Global Note Certificate and (2) increase the amount of Notes registered in the name of the nominee of the common depository for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note Certificate. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

### **Trading between Euroclear/Clearstream, Luxembourg Seller and DTC Purchaser**

When book-entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC Participant wishing to purchase a beneficial interest in a Rule 144A Global Note Certificate (subject to the certification procedures provided in the Paying Agency Agreement), the Euroclear or Clearstream, Luxembourg accountholder must send to Euroclear or Clearstream, Luxembourg delivery free of payment instructions by 7:45 p.m., Brussels / Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depository for Euroclear and Clearstream, Luxembourg and the Registrar to arrange delivery to the DTC Participant on the settlement date. Separate payment arrangements are required to be made between the DTC Participant and the relevant Euroclear or Clearstream, Luxembourg accountholder, as the case may be. On the settlement date, the common depository for Euroclear and Clearstream, Luxembourg will (a) transmit appropriate instructions to the custodian of the Rule 144A Global Note Certificate who will in turn deliver such book-entry interests in the Notes free of payment to the relevant account of the DTC Participant and (b) instruct the Registrar to (1) decrease the amount of Notes registered in the name of the nominee of the common depository for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note Certificate; and (2) increase the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note Certificate.

Although Euroclear, Clearstream, Luxembourg and DTC have agreed to the foregoing procedures in order to facilitate transfers of beneficial interest in Global Note Certificates among participants and accountholders of Euroclear, Clearstream, Luxembourg and DTC, they are under no obligation to perform or continue to perform such procedure, and such procedures may be discontinued at any time. None of the Issuer, the Trustee or any Agent will have the responsibility for the performance, by Euroclear, Clearstream, Luxembourg or DTC or their respective Direct Participants, Indirect Participants or DTC Participants, as the case may be, of their respective obligations under the rules and procedures governing their operations.

### **Pre-issue Trades Settlement**

It is expected that delivery of Notes will be made against payment therefor on the Closing Date, which could be more than three business days following the date of pricing. Settlement procedures in different countries will vary. Purchasers of Notes may be affected by such local settlement practices, and purchasers of Notes between the relevant date of pricing and the Closing Date should consult their own advisers.



## CERTAIN U.S. EMPLOYEE BENEFIT PLAN CONSIDERATIONS

Notes are not permitted to be acquired by employee benefit plans as described in Section 3(3) of ERISA that are subject to Title I of ERISA (collectively, “**ERISA Plans**”), plans not subject to ERISA but subject to Section 4975 of the U.S. Tax Code, including IRAs, Keogh Plans which cover only self-employed persons and their spouses and other employee benefit plans which cover only the owners of a business (collectively, “**4975 Plans**”), or by entities whose underlying assets include plan assets by reason of an investment in the entity by ERISA Plans or 4975 Plans or otherwise (collectively, “**Plan Asset Entities**”). ERISA Plans, 4975 Plans and Plan Asset Entities are collectively referred to as “**Benefit Plan Investors**”. Subject to certain restrictions described below, Notes are permitted to be acquired by governmental, church or non-U.S. plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the U.S. Tax Code or any entity whose assets are treated as assets of any such plan (collectively, “**Non-ERISA Plans**”).

ERISA imposes fiduciary standards and certain other requirements on ERISA Plans and on those persons who are fiduciaries with respect to ERISA Plans. 4975 Plans are subject to certain restrictions similar to ERISA’s prohibited transaction rules. Non-ERISA Plans are subject to applicable state, local, federal or non-U.S. law, as well as the restrictions of duties of common law, and may also be subject to prohibited transaction provisions that operate similarly to those under ERISA.

Under the regulations issued by the U.S. Department of Labor (“**DOL**”), as modified by Section 3(42) of ERISA (the “**Plan Assets Regulations**”), unless certain exceptions apply, if a Benefit Plan Investor invests in an “equity interest” of an entity, its assets include both the equity interest and an undivided interest in each of the entity’s underlying assets. This “look through” rule will only apply where Benefit Plan Investors own 25% or more of the value of any class of equity interest in the entity. For purposes of this 25% determination, the value of equity interests held by persons (other than Benefit Plan Investors) that have discretionary authority or control with respect to the assets of the entity or that provide investment advice for a fee (direct or indirect) with respect to such assets (or any affiliate of such person) is disregarded. An equity interest does not include debt (as determined by applicable local law) which does not have substantial equity features. To the extent that the value of a Benefit Plan Investor’s equity interest in an entity relates solely to identified property of the entity, such property may be treated as the sole property of a separate entity.

If the underlying assets of an entity are deemed to be plan assets, those with discretionary authority or control over the entity would be fiduciaries with respect to the entity’s assets. The assets of the entity would also be subject to the prohibited transaction rules of ERISA and Section 4975 of the U.S. Tax Code, as well as other rules applicable to plan assets.

The Issuer believes that the Notes should be treated as debt rather than equity for purposes of the Plan Assets Regulations. The DOL, however, may take a contrary view or may view the Notes as having substantial equity features. Furthermore, the Issuer will not be able to monitor the Noteholders’ status as Benefit Plan Investors. Accordingly, the Notes are not permitted to be acquired by any Benefit Plan Investor.

Non-ERISA Plans and entities that include the assets of Non-ERISA Plans are permitted to acquire the Notes subject to certain restrictions described below. In addition, the fiduciary of a Non-ERISA Plan must consider applicable state, local, federal or non-U.S. laws, if any, imposed upon such plan before purchasing a Note or any interest therein.

BY ITS PURCHASE AND HOLDING OF A NOTE OR ANY INTEREST THEREIN, THE PURCHASER AND/OR HOLDER THEREOF AND EACH TRANSFEREE WILL BE DEEMED TO HAVE REPRESENTED AND WARRANTED AT THE TIME OF ITS PURCHASE AND THROUGHOUT THE PERIOD THAT IT HOLDS SUCH NOTE OR INTEREST THEREIN, THAT (1) IT IS NOT AND WILL NOT BE (A) AN EMPLOYEE BENEFIT PLAN AS DESCRIBED IN SECTION 3(3) OF ERISA THAT IS SUBJECT TO THE PROVISIONS OF TITLE I OF ERISA, (B) A PLAN TO WHICH SECTION 4975 OF THE U.S. TAX CODE APPLIES OR (C) AN ENTITY WHOSE UNDERLYING ASSETS INCLUDE PLAN ASSETS BY REASON OF AN INVESTMENT IN THE ENTITY BY A PERSON DESCRIBED IN (A) OR (B) ABOVE OR OTHERWISE, (2) IF IT IS A GOVERNMENTAL, CHURCH OR NON-U.S. PLAN THAT IS SUBJECT TO ANY FEDERAL, STATE, LOCAL OR NON-U.S. LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF SECTION 406 OF ERISA OR SECTION 4975 OF THE CODE OR ANY ENTITY WHOSE ASSETS ARE TREATED AS ASSETS OF ANY SUCH PLAN, THE PURCHASE AND HOLDING OF THIS NOTE OR ANY INTEREST HEREIN DOES NOT VIOLATE ANY STATUTE, REGULATION, ADMINISTRATIVE DECISION, POLICY OR ANY OTHER LEGAL AUTHORITY APPLICABLE TO SUCH PLAN AND WILL NOT SUBJECT THE ISSUER TO ANY SUCH STATUTE, REGULATION, ADMINISTRATIVE DECISION, POLICY OR OTHER LEGAL AUTHORITY, AND (3) IT WILL NOT SELL OR OTHERWISE TRANSFER THIS NOTE OR ANY INTEREST THEREIN TO ANY PERSON WITHOUT FIRST OBTAINING THESE SAME FOREGOING DEEMED REPRESENTATIONS, WARRANTIES AND AGREEMENTS.

The foregoing is not intended to be exhaustive and the law governing investments by Benefit Plan investors and Non-ERISA Plans is subject to extensive administrative and judicial interpretations. The foregoing discussion should not be construed as legal advice. Any potential purchaser of Notes should consult counsel with respect to issues arising under ERISA, the U.S. Tax Code and other applicable laws and make their own independent decisions.

## LEGAL MATTERS AND INDEPENDENT AUDITORS

### Legal Matters

Certain legal matters in connection with the offering of the Notes will be passed upon for us with respect to Russian and U.S. law by Cleary Gottlieb Steen & Hamilton LLC and English law by Cleary Gottlieb Steen & Hamilton LLP. Certain legal matters in connection with the offering of the Notes will be passed upon for the Joint Lead Managers with respect to English and U.S. law by Linklaters LLP and Russian law by Linklaters CIS. Certain legal matters in connection with the offering of the Notes will be passed upon for the Issuer with respect to Irish law by Arthur Cox.

### Independent Auditors

The Audited Financial Statements included in this Prospectus have been audited by ZAO PricewaterhouseCoopers Audit (“PwC”), independent accountants, of Butyrsky Val 10, 125047 Moscow, Russian Federation, as stated in their reports appearing herein. With respect to the Unaudited Financial Statements included in this Prospectus, PwC reported that they have applied limited procedures in accordance with professional standards for review of such information. However, PwC’s report dated 8 November 2012, appearing herein, states that they did not audit and they do not express an opinion on the Unaudited Financial Statements. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PwC is a member of the Russian Chamber of Auditors (*Auditorskaya palata Rossii*) and the Institute of Professional Accountants of Russia (*Institut professionalnih buhgalterov Rossii*).

## GENERAL INFORMATION

1. The Notes have been accepted for clearance through Euroclear, Clearstream, Luxembourg and DTC.
2. The Common Code, CUSIP and ISIN numbers for the Regulation S Notes are 086438372, G66749 AC9 and XS0864383723, respectively.
3. The Common Code, CUSIP and ISIN numbers for the Rule 144A Notes are 086451611, 66989P AC4, and US66989PAC41, respectively.
4. The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium, the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy, L-1855 Luxembourg and the address for DTC is 55 Water Street, New York, NY 10041, United States of America.
5. It is expected that listing of the Notes on the Official List of the Irish Stock Exchange and admission of the Notes to trading on the Main Securities Market of the Irish Stock Exchange will be granted on or before 13 December 2012, subject only to the issue of the Notes.
6. Copies of the following documents may be inspected in hard copy at the registered office of the Issuer and at the offices of the Principal Paying Agent in London during usual business hours on any weekday (Saturdays and public holidays excepted) for so long as the Notes are listed on the Irish Stock Exchange:
  - (a) a copy of this Prospectus, together with any supplement to this Prospectus;
  - (b) the memorandum and articles of association of the Issuer;
  - (c) the Financial Statements;
  - (d) the Directors' Report and Financial Statements of the Issuer for the period from 29 September 2010 (date of incorporation) to 31 December 2011, together with the audit report thereon;
  - (e) the Summary Reserves Reports, attached as Appendix A to this Prospectus;
  - (f) the Loan Agreement;
  - (g) the Paying Agency Agreement; and
  - (h) the Trust Deed, which includes the forms of the Global Note Certificates and Definitive Certificates.
9. The Directors' Report and Financial Statements of the Issuer for the period from 29 September 2010 (date of incorporation) to 31 December 2011, together with the audit report thereon have been filed with the Irish Stock Exchange and shall be deemed to be incorporated in, and to form part of, this Prospectus. The financial statements may be obtained from the website of the Irish Stock Exchange at <http://www.ise.ie/app/announcementDetails.aspx?ID=11389243>.
10. The Loan Agreement has been authorized by a decision of the Board of Directors of the Borrower (minutes dated 19 November 2012). The issue of the Notes and the Loan Agreement were authorized by resolutions of the board of directors of the Issuer on 7 December 2012.
11. No consents, approvals, authorizations or orders of any regulatory authorities other than as disclosed in the Prospectus are required by the Issuer under the laws of Ireland for maintaining the Loan or for issuing the Notes.
12. Since 31 December 2011, there has been no material adverse change in the financial position or prospects of the Issuer. The Issuer has no subsidiaries.
13. Save for the fees payable to the Joint Lead Managers, the Trustee and the Agents, so far as the Issuer is aware, no person involved in the issue of the Notes has an interest that is material to the issue of the Notes.
14. Except as disclosed in the Prospectus, there has been no significant change in our financial or trading position since 30 September 2012, nor has there been any material adverse change in our prospects since 30 September 2012.
15. There have been no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which any of the Issuer or NOVATEK is aware), during the previous 12 months in relation to the Issuer or NOVATEK, which may have, or have had in the recent past, significant effects on the Issuer's or our financial position or profitability.
16. The Trust Deed provides, *inter alia*, that the Trustee may rely on any certificate or report prepared by accountants pursuant to the Trust Deed (whether or not addressed to the Trustee), notwithstanding whether or not the accountants' liability in respect thereof is limited by a monetary cap or otherwise.
17. We have obtained all necessary consents, approvals and authorizations in the Russian Federation in connection with our entry into, and performance of our obligations under, the Loan Agreement.

18. Citicorp Trustee Company Limited is a professional trustee company, which is providing its services in relation to the Notes on an arm's length basis in consideration of a fee. Under the terms of the Trust Deed, the power of appointing new trustees is vested in the Issuer (with the prior written consent of NOVATEK) but a trustee so appointed must in the first place be approved by an Extraordinary Resolution of Noteholders. The Noteholders have the power, exercisable by Extraordinary Resolution, to remove any trustee or trustees. The removal of any trustee is only effective if following the removal there remains a trustee (being a trust corporation) in office after such removal. In addition, Citicorp Trustee Company Limited or any other trustee duly appointed may retire at any time upon giving not less than three months notice in writing to the Issuer (copied to NOVATEK). The retirement of any trustee is only effective if, following the retirement, there remains a trustee (being a trust corporation) in office after such retirement. If the trustee has given notice of its desire to retire and the Issuer is unable to procure a new trustee to be appointed and the Issuer has not by the expiry of such notice (with the prior written consent of NOVATEK) appointed a new trustee, the trustee shall have the power of appointing new trustee(s).
19. Arthur Cox Listing Services Limited is acting solely in its capacity as listing agent for Novatek Finance Limited in connection with the Notes and is not itself seeking admission of the Notes to trading on the Main Securities Market of the Irish Stock Exchange.
20. The estimated expenses associated with the admission to trading on the Main Securities Market of the Irish Stock Exchange of the Notes are expected to be approximately €5,000.
21. The Issuer does not intend to provide any post-issuance transaction information regarding the Notes or the Loan.
22. The language of the Prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under applicable law.
23. The reports reproduced in Appendix A—*Summary Reserves Reports* were produced by DeGolyer and MacNaughton, Gas and Oil Consultants, acting through their office at 5001 Spring Valley Road, Suite 800, East Dallas, Texas 75244, United States, were signed by a Senior Vice President and Licensed Professional Engineer of D&M, and are reproduced herein in the form and context in which they appear with their consent. D&M does not have any material interest in the Issuer or NOVATEK.

## GLOSSARY OF GAS AND OIL TERMS

“**Associated gas**”: Natural gas found in association with oil, either dissolved in the oil or as a cap of free gas above the oil.

“**Cenomanian gas**”: Dry largely methane gas produced from shallow reservoirs of average depth from 1,200 to 1,800 meters.

“**Condensate**”: Light hydrocarbons produced with natural gas which condenses into a liquid at normal temperatures and pressures.

“**Development well**”: A well drilled within a proven area of an oil or gas reservoir to a depth known to be productive.

“**Diesel fuel**”: Hydrocarbon mixture that is heavier than gasoline or jet fuel that is used primarily in diesel engines (fuel ignited by compression rather than by a spark).

“**Exploratory well**”: A well drilled to find and produce oil or gas in an unproved area, to find a new reservoir in a field previously found to produce oil from another reservoir, or to extend a known reservoir.

“**Field**”: An area consisting of either a single reservoir or multiple reservoirs, all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

“**Finding and development costs**”: Capital costs incurred in the acquisition, exploitation and exploration of proved oil and natural gas reserves divided by proved reserves additions and revisions to proved reserves.

“**Fractionation**”: a process by which the component parts of natural gas liquids are distilled once the liquids have been removed from a natural gas stream. This occurs by heating the natural gas liquid stream and boiling off the various fractions, starting from the lighter to the heavier hydrocarbons. The hydrocarbons are ethane, propane and butane.

“**Fuel oil (mazut)**”: Heavier hydrocarbons than in gasoline, diesel or jet fuel and used to generate heat and commercial electric power.

“**Gasoline**”: Light hydrocarbon mixture used mainly in internal combustion engines.

“**Horizons**”: Areas in which oil is located at various depths within a well.

“**Hydrocarbon**”: Naturally occurring organic substances composed of carbon and hydrogen, including gas and oil, occurring in subsoil, which is recoverable as well as that which has already been extracted.

“**Jet fuel (kerosene)**”: Heavier hydrocarbons than gasoline, but lighter than diesel fuel and used for jet engines, heating and illumination.

“**License area**” or “**LA**”: The particular subsoil plot specified in the subsoil license issued by the applicable Russian federal authority, which the license holder has the right to use for the purpose and on the terms specified in the subsoil license. A license area may contain one or more fields or may encompass only a portion of a field.

“**LPG**”: Liquefied petroleum gas.

“**natural gas**”: Hydrocarbons that are gaseous at one atmosphere of pressure at 20 degrees Celsius. It can be divided into lean gas, primarily methane but often containing some ethane and smaller quantities of heavier hydrocarbons (also called sales gas) and wet gas, primarily ethane, propane and butane as well as smaller amounts of heavier hydrocarbons; partially liquid under atmospheric pressure.

“**Oil rim**”: An oil rim field is an oil field with a relatively thin oil zone below a gas cap. This creates an area at the edge of the reservoir where the top of the reservoir is below the gas/oil contact, thus forming a “rim” containing only oil, with no overlying gas.

“**Recompletion of well**”: The modification of an existing well for the purpose of producing oil from a different producing formation.

“**Reservoir**”: A porous and permeable underground formation containing a natural accumulation of producible oil or gas that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

“**Ton of crude oil**”: A ton of crude oil is 6.5 to 8.5 barrels, depending on the oil’s specific gravity. For rough approximation, 7.5 barrels equals a mt or long tonne, 1,000 kilograms or 2,204.6 pounds.

“**Valanginian gas**”: means wet gas produced from the gas condensate reservoirs usually found at depths from 2,200 to 2,800 meters.

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**OAO NOVATEK**

**IFRS CONSOLIDATED INTERIM CONDENSED  
FINANCIAL INFORMATION (UNAUDITED)**

**AS OF AND FOR THE THREE AND  
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## ***Report on review of consolidated interim condensed financial information***

To the shareholders and Board of Directors of OAO NOVATEK

### **Introduction**

1. We have reviewed the accompanying consolidated interim condensed statement of financial position of OAO NOVATEK and its subsidiaries (the "Group") as of 30 September 2012 and the related consolidated interim condensed statements of income and comprehensive income for the three and nine months then ended, and the related consolidated interim condensed statements of cash flows and changes in equity for the nine months then ended. Management is responsible for the preparation and presentation of this consolidated interim condensed financial information in accordance with International Accounting Standard No. 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on this consolidated interim condensed financial information based on our review.

### **Scope of Review**

2. We conducted our review in accordance with International Standard on Review Engagements No. 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

3. Based on our review, nothing has come to our attention that causes us to believe that the accompanying consolidated interim condensed financial information is not prepared, in all material respects, in accordance with International Accounting Standard No. 34, *Interim Financial Reporting*.

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
8 November 2012

**OAQ NOVATEK**

**Consolidated Interim Condensed Statement of Financial Position (unaudited)**

(in millions of Russian roubles)

	Notes	At 30 September 2012	At 31 December 2011
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	5	190,032	166,784
Investments in joint ventures	6	144,026	123,029
Long-term loans and receivables	7	13,456	32,130
Other non-current assets		3,007	3,173
<b>Total non-current assets</b>		<b>350,521</b>	<b>325,116</b>
<b>Current assets</b>			
Inventories		2,580	1,683
Current income tax prepayments		288	1,153
Trade and other receivables		15,260	16,699
Prepayments and other current assets	8	13,102	14,950
Cash and cash equivalents		17,472	23,831
<b>Total current assets</b>		<b>48,702</b>	<b>58,316</b>
<b>Total assets</b>		<b>399,223</b>	<b>383,432</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Non-current liabilities</b>			
Long-term debt	9	65,721	75,180
Deferred income tax liabilities		13,933	12,805
Asset retirement obligations		2,609	2,734
Other non-current liabilities		857	917
<b>Total non-current liabilities</b>		<b>83,120</b>	<b>91,636</b>
<b>Current liabilities</b>			
Short-term debt and current portion of long-term debt	10	18,938	20,298
Trade payables and accrued liabilities	11	9,985	24,922
Current income tax payable		1,358	611
Other taxes payable		3,588	4,283
<b>Total current liabilities</b>		<b>33,869</b>	<b>50,114</b>
<b>Total liabilities</b>		<b>116,989</b>	<b>141,750</b>
<b>Equity attributable to OAO NOVATEK shareholders</b>			
Ordinary share capital		393	393
Treasury shares		(281)	(281)
Additional paid-in capital		31,220	31,220
Currency translation differences		(24)	193
Asset revaluation surplus on acquisitions		5,617	5,617
Retained earnings		244,162	203,871
<b>Total equity attributable to OAO NOVATEK shareholders</b>	12	<b>281,087</b>	<b>241,013</b>
<b>Non-controlling interest</b>		<b>1,147</b>	<b>669</b>
<b>Total equity</b>		<b>282,234</b>	<b>241,682</b>
<b>Total liabilities and equity</b>		<b>399,223</b>	<b>383,432</b>

The accompanying notes are an integral part of this consolidated interim condensed financial information.

Approved for issue and signed on behalf of the Board of Directors on 8 November 2012:



L. Mikhelson  
General Director



M. Gyetyay  
Financial Director

**OAO NOVATEK**
**Consolidated Interim Condensed Statement of Income (unaudited)**

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

	Notes	Three months ended 30 September:		Nine months ended 30 September:	
		2012	2011	2012	2011
<b>Revenues</b>					
Oil and gas sales	14	52,562	39,888	151,698	125,265
Other revenues		169	145	551	288
<b>Total revenues</b>		<b>52,731</b>	<b>40,033</b>	<b>152,249</b>	<b>125,553</b>
<b>Operating expenses</b>					
Transportation expenses	15	(14,235)	(11,795)	(43,649)	(34,788)
Taxes other than income tax	16	(4,120)	(4,443)	(13,108)	(12,809)
Purchases of natural gas and liquid hydrocarbons	17	(4,832)	(938)	(11,606)	(2,833)
Depreciation, depletion and amortization	5	(2,560)	(2,291)	(7,588)	(6,307)
General and administrative expenses		(2,245)	(1,760)	(7,235)	(5,872)
Materials, services and other		(1,716)	(1,572)	(5,138)	(4,394)
Exploration expenses		(330)	(640)	(629)	(1,639)
Net impairment (expenses) reversals		15	(51)	(49)	(682)
Change in natural gas, liquid hydrocarbons and work-in-progress		178	569	526	486
<b>Total operating expenses</b>		<b>(29,845)</b>	<b>(22,921)</b>	<b>(88,476)</b>	<b>(68,838)</b>
Other operating income (loss)		339	18	344	(9)
<b>Profit from operations</b>		<b>23,225</b>	<b>17,130</b>	<b>64,117</b>	<b>56,706</b>
<b>Finance income (expense)</b>					
Interest expense	18	(697)	(376)	(2,150)	(1,534)
Interest income	18	338	801	1,237	2,530
Foreign exchange gain (loss)		2,704	(6,315)	3,285	(3,075)
<b>Total finance income (expense)</b>		<b>2,345</b>	<b>(5,890)</b>	<b>2,372</b>	<b>(2,079)</b>
Share of profit (loss) of joint ventures, net of income tax	6	(301)	(835)	(1,813)	(2,521)
<b>Profit before income tax</b>		<b>25,269</b>	<b>10,405</b>	<b>64,676</b>	<b>52,106</b>
<b>Income tax expense</b>					
Current income tax expense		(4,823)	(1,473)	(12,830)	(9,083)
Net deferred income tax expense		(450)	(789)	(954)	(1,949)
<b>Total income tax expense</b>	19	<b>(5,273)</b>	<b>(2,262)</b>	<b>(13,784)</b>	<b>(11,032)</b>
<b>Profit (loss)</b>		<b>19,996</b>	<b>8,143</b>	<b>50,892</b>	<b>41,074</b>
Profit (loss) attributable to:					
Non-controlling interest		(7)	(179)	(19)	(353)
<b>Shareholders of OAO NOVATEK</b>		<b>20,003</b>	<b>8,322</b>	<b>50,911</b>	<b>41,427</b>
Basic and diluted earnings per share (in Russian roubles)		6.59	2.74	16.78	13.66
<i>Weighted average number of shares outstanding (in thousands)</i>		<i>3,034,338</i>	<i>3,033,184</i>	<i>3,034,338</i>	<i>3,033,184</i>

The accompanying notes are an integral part of this consolidated interim condensed financial information.

**ОАО NOVATEK****Consolidated Interim Condensed Statement of Comprehensive Income (unaudited)**

(in millions of Russian roubles)

	Three months ended		Nine months ended	
	30 September:		30 September:	
	2012	2011	2012	2011
<b>Other comprehensive income (loss) after income tax:</b>				
Currency translation differences	(288)	425	(217)	239
<b>Other comprehensive income (loss)</b>	<b>(288)</b>	<b>425</b>	<b>(217)</b>	<b>239</b>
<b>Profit (loss)</b>	<b>19,996</b>	<b>8,143</b>	<b>50,892</b>	<b>41,074</b>
<b>Total comprehensive income (loss)</b>	<b>19,708</b>	<b>8,568</b>	<b>50,675</b>	<b>41,313</b>
Total comprehensive income (loss) attributable to:				
Non-controlling interest	(7)	(179)	(19)	(353)
<b>Shareholders of ОАО NOVATEK</b>	<b>19,715</b>	<b>8,747</b>	<b>50,694</b>	<b>41,666</b>

The accompanying notes are an integral part of this consolidated interim condensed financial information.

**OAO NOVATEK**
**Consolidated Interim Condensed Statement of Cash Flows (unaudited)**

(in millions of Russian roubles)

	Notes	Nine months ended 30 September:	
		2012	2011
<b>Profit before income tax</b>		<b>64,676</b>	<b>52,106</b>
<b>Adjustments to profit before income tax:</b>			
Depreciation, depletion and amortization		7,833	6,436
Net impairment expenses		49	682
Net foreign exchange loss (gain)		(3,285)	3,075
Net loss (gain) on disposal of assets		74	163
Interest expense		2,150	1,534
Interest income		(1,237)	(2,530)
Share of loss (profit) in joint ventures, net of income tax		1,813	2,521
Net change in other non-current assets and long-term receivables		211	1,125
Other adjustments		(72)	74
<b>Working capital changes</b>			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(2,020)	(5,840)
Decrease (increase) in inventories		(898)	(612)
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends payable		258	450
Increase (decrease) in other taxes payable		(190)	555
<b>Total effect of working capital changes</b>		<b>(2,850)</b>	<b>(5,447)</b>
Income taxes paid		(11,718)	(12,856)
<b>Net cash provided by operating activities</b>		<b>57,644</b>	<b>46,883</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(26,800)	(17,134)
Prepayments for participation in tender for mineral licenses		-	(6,888)
Purchases of inventories intended for construction		(1,009)	(361)
Acquisition of subsidiaries net of cash acquired		(112)	(3,234)
Capital contribution to joint ventures	7	(5,213)	(21,176)
Proceeds from disposals of subsidiaries net of cash disposed		157	176
Interest paid and capitalized		(1,848)	(2,663)
Loans provided		(1,019)	(5,352)
Repayments of loans provided		8,102	4,674
Interest received		482	644
<b>Net cash (used for) provided by investing activities</b>		<b>(27,260)</b>	<b>(51,314)</b>
<b>Cash flows from financing activities</b>			
Proceeds from long-term debt		9,859	44,891
Proceeds from short-term debt		-	3,700
Repayments of long-term debt		(18,409)	(7,592)
Repayments of short-term debt		-	(21,321)
Interest paid		(2,171)	(652)
Dividends paid	12	(10,620)	(7,583)
Acquisition of non-controlling interest	4	(16,290)	(422)
Capital contributions to the Group's subsidiaries by non-controlling shareholders		497	-
<b>Net cash (used for) provided by financing activities</b>		<b>(37,134)</b>	<b>11,021</b>
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		391	64
<b>Net increase (decrease) in cash, cash equivalents and bank overdrafts</b>		<b>(6,359)</b>	<b>6,654</b>
Cash and cash equivalents at beginning of the period		23,831	10,238
<b>Cash, cash equivalents and bank overdrafts at end of the period</b>		<b>17,472</b>	<b>16,892</b>

The accompanying notes are an integral part of this consolidated interim condensed financial information.

**ОАО НОВАТЕК**  
**Consolidated Interim Condensed Statement of Changes in Equity (unaudited)**  
(in millions of Russian roubles, except for number of shares)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Asset revaluation surplus on acquisitions	Currency translation differences	Retained earnings	Equity attributable to ОАО НОВАТЕК shareholders	Non- controlling interest	Total equity
<i>For the nine months ended 30 September 2011</i>										
<b>1 January 2011</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>5,617</b>	<b>(120)</b>	<b>110,810</b>	<b>147,119</b>	<b>20,667</b>	<b>167,786</b>
Currency translation differences	-	-	-	-	-	239	-	239	-	239
Profit (loss)	-	-	-	-	-	-	41,427	41,427	(353)	41,074
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>239</b>	<b>41,427</b>	<b>41,666</b>	<b>(353)</b>	<b>41,313</b>
Dividends (Note 12)	-	-	-	-	-	-	(7,583)	(7,583)	-	(7,583)
Equity call option reclassification	-	-	-	-	-	-	284	284	-	284
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	286	286
Acquisition of non-controlling interest (Note 4)	-	-	-	-	-	-	(11,750)	(11,750)	(19,920)	(31,670)
<b>30 September 2011</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>5,617</b>	<b>119</b>	<b>133,188</b>	<b>169,736</b>	<b>680</b>	<b>170,416</b>

The accompanying notes are an integral part of this consolidated interim condensed financial information.

**ОАО НОВАТЕК**  
**Consolidated Interim Condensed Statement of Changes in Equity (unaudited)**  
(in millions of Russian roubles, except for number of shares)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Asset revaluation surplus on acquisitions	Currency translation differences	Retained earnings	Equity attributable to ОАО НОВАТЕК shareholders	Non- controlling interest	Total equity
<i>For the nine months ended 30 September 2012</i>										
<b>1 January 2012</b>	<b>3,034,338</b>	<b>393</b>	<b>(281)</b>	<b>31,220</b>	<b>5,617</b>	<b>193</b>	<b>203,871</b>	<b>241,013</b>	<b>669</b>	<b>241,682</b>
Currency translation differences	-	-	-	-	-	(217)	-	(217)	-	(217)
Profit (loss)	-	-	-	-	-	-	50,911	50,911	(19)	50,892
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(217)</b>	<b>50,911</b>	<b>50,694</b>	<b>(19)</b>	<b>50,675</b>
Dividends (Note 12)	-	-	-	-	-	-	(10,620)	(10,620)	-	(10,620)
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	497	497
<b>30 September 2012</b>	<b>3,034,338</b>	<b>393</b>	<b>(281)</b>	<b>31,220</b>	<b>5,617</b>	<b>(24)</b>	<b>244,162</b>	<b>281,087</b>	<b>1,147</b>	<b>282,234</b>

The accompanying notes are an integral part of this consolidated interim condensed financial information.



## ОАО NOVATEK

### Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)

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

## 1 ORGANIZATION AND PRINCIPAL ACTIVITIES

ОАО NOVATEK (hereinafter referred to as “NOVATEK”) and its subsidiaries (hereinafter jointly referred to as the “Group”) is an independent oil and gas company engaged in the acquisition, exploration, development, production and processing of hydrocarbons with its core oil and gas operations located and incorporated in the Yamal-Nenets Autonomous Region (“YNAO”) of the Russian Federation.

The Group sells its natural gas on the Russian domestic market at unregulated market prices (except for deliveries to residential customers); however, the majority of natural gas sold on the domestic market is sold at prices regulated by the Federal Tariff Service, a governmental agency. The Group’s stable gas condensate and crude oil sales volumes are sold on both the Russian domestic and international markets, and are subject to fluctuations in benchmark crude oil prices. Additionally, the Group’s natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in the winter months of December and January and troughing in the summer months of July and August. The Group’s liquids sales volumes comprising stable gas condensate, crude oil and oil and gas products remain relatively stable from period to period.

In January and May 2012, the Group merged its wholly owned subsidiaries ООО YamalEnergGaz and ООО Gazprom mezhregiongas Chelyabinsk into its wholly owned subsidiaries ООО NOVATEK-Perm and ООО NOVATEK-Chelyabinsk, respectively. The mergers did not affect the Group’s consolidated financial and operational results.

In the third quarter 2012, the Group signed long-term natural gas purchase and sales contracts with third parties to commence trading activities in the European market. The contracts were signed for a total period of ten years starting from 1 October 2012 with the total volume of natural gas traded over this period of approximately 20 billion cubic meters (see Notes 20, 23).

## 2 BASIS OF PRESENTATION

The consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard No. 34, *Interim Financial Reporting* and should be read in conjunction with the Group’s consolidated financial statements for the year ended 31 December 2011 prepared in accordance with International Financial Reporting Standards (“IFRS”).

**Use of estimates and judgments.** The critical accounting estimates and judgments followed by the Group in the preparation of consolidated interim condensed financial information are consistent with those disclosed in the audited consolidated financial statements for the year ended 31 December 2011. Estimates have principally been made in respect to useful lives of property, plant and equipment, fair values of assets and liabilities, deferred income taxes, estimation of oil and gas reserves, impairment provisions, pension obligations and assets retirement obligations.

Management reviews these estimates and judgments on a continuous basis, by reference to past experiences and other factors considered as reasonable which form the basis for assessing the book values of assets and liabilities. Adjustments to accounting estimates are recognized in the period in which the estimate is revised if the change affects only that period or in the period of the revision and subsequent periods, if both periods are affected. Actual results may differ from such estimates if different assumptions or circumstances apply; however, management considers that the effect of any changes in these estimates would not be significant.

**Functional and presentation currency.** Exchange rates used in preparation of this consolidated interim condensed financial information for the entities whose functional currency is not the Russian rouble were as follows:

Russian roubles to one currency unit	At 30 September 2012	At 31 December 2011	Average rate for the nine months ended 30 September:	
			2012	2011
US dollar (“USD”)	30.92	32.20	31.10	28.77
Polish zloty (“PLN”)	9.70	9.47	9.47	10.08

## **2 BASIS OF PRESENTATION (CONTINUED)**

**Exchange rates, restrictions and controls.** Any re-measurement of Russian rouble amounts to US dollars or any other currency should not be construed as a representation that such Russian rouble amounts have been, could be, or will in the future be converted into other currencies at these exchange rates.

**Comparative figures adjustment.** The following adjustment has been made to the comparative figures to reflect the final fair value assessment of the identifiable assets and liabilities of OAO Sibneftegas, the Group's joint venture, after its acquisition in December 2010. At the acquisition date, the Group recorded the preliminary fair values for oil and gas properties and equipment, which were used as the basis for depreciation through the nine months of 2011. In December 2011, the Group completed an independent valuation of the fair values of Sibneftegas' identifiable net assets. Revisions made to the preliminary assessment were reflected as of the acquisition date and accordingly, the Group's share of profit (loss) of joint ventures, net of income tax, and as a result, profit attributable to shareholders of OAO NOVATEK for the three and nine months ended 30 September 2011 was decreased by RR 84 million and RR 253 million, respectively, to reflect the revised depreciation of Sibneftegas' assets.

**Reclassifications.** Certain reclassifications have been made to the comparative figures to conform to the current period presentation with no effect on profit for the period or equity.

## **3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies and methods of computation followed by the Group are consistent with those disclosed in the audited consolidated financial statements for the year ended 31 December 2011 except as described below.

Income tax expense is recognized based on management's estimate of the expected annual income tax rate for the full financial year.

**Derivative instruments.** Derivative financial instruments are contracts: (i) whose value changes in response to the change in one or more observable variables; (ii) that do not require any material initial net investment; and (iii) that are settled at a future date. Accordingly, contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the Group's expected purchase, sale or usage requirements, are accounted for as financial instruments. Gains or losses arising from changes in the fair value of derivatives are recognized in the income statement within other operating profit (loss).

Derivative instruments are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivative assets or liabilities expected to be recovered, or with the legal right to be settled more than twelve months after the reporting date are classified as non-current, with the exception of derivative financial instruments held for the purpose of being traded. The amounts of assets and liabilities associated with derivatives are presented without netting assets and liabilities with the same counterparty except where the right of offset and intent to net exist.

The estimated fair values of derivative financial instruments are determined with reference to various market information and other valuation methodologies as considered appropriate, however considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts that the Group could realize in a current market situation.

## OAO NOVATEK

### Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)

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

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

Derivatives embedded in other non-derivative financial instruments or in non-financial host contracts are recognized as separate derivatives when their risks and economic characteristics are not closely related to those of the host contracts, and the host contracts are not carried at fair value. Where there is an active market for a commodity or other non-financial item subject of a purchase or sale contract, a pricing formula will, for instance, be considered to be closely related to the host purchase or sales contract if the price formula is based on the active market in question. A price formula with indexation to other markets or products will however result in the recognition of a separate derivative. Where there is no active market for the commodity or other non-financial item in question, the Group assesses the characteristics of such a price related embedded derivative to be closely related to the host contract if the price formula is based on relevant indexations commonly used by other market participants. This applies to the Group's liquid hydrocarbons and domestic natural gas sales and purchases agreements. Contracts are assessed for embedded derivatives when the Group becomes a party to them, including at the date of a business combination. Such embedded derivatives are measured at fair value at each period end, and the changes in fair value are recognized in profit or loss for the period.

#### 4 ACQUISITIONS

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

In September 2011, the Group exercised two call options, acquired in 2009 and 2011, and, as a result, increased its equity stake in Yamal LNG to 100 percent through a purchase of additional 49 percent shares of the company for the total consideration of RR 31,670 million (USD 986 million), of which RR 15,101 million (USD 482 million) was paid through the end of 2011 and RR 16,290 million (USD 504 million) was paid in the six months ended 30 June 2012. As a result of these transactions, the Group reduced non-controlling interest by RR 19,920 million and recorded a difference of RR 11,750 million directly to retained earnings.

#### 5 PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment, for the nine months ended 30 September 2012 and 2011 are as follows:

<i>For the nine months ended 30 September 2011</i>	Operating assets	Assets under construction and advances for construction	Total
Cost	197,647	16,022	213,669
Accumulated depreciation, depletion and amortization	(28,096)	-	(28,096)
<b>Net book value at 1 January 2011</b>	<b>169,551</b>	<b>16,022</b>	<b>185,573</b>
Additions	8,594	19,774	28,368
Transfers	12,566	(12,566)	-
Depreciation, depletion and amortization	(6,424)	-	(6,424)
Impairment	(511)	(107)	(618)
Disposals, net	(634)	(463)	(1,097)
Cost	217,482	22,660	240,142
Accumulated depreciation, depletion and amortization	(34,340)	-	(34,340)
<b>Net book value at 30 September 2011</b>	<b>183,142</b>	<b>22,660</b>	<b>205,802</b>

**OAO NOVATEK****Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)**

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

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

<i>For the nine months ended 30 September 2012</i>	Operating assets	Assets under construction and advances for construction	Total
Cost	186,391	17,647	204,038
Accumulated depreciation, depletion and amortization	(37,254)	-	(37,254)
<b>Net book value at 1 January 2012</b>	<b>149,137</b>	<b>17,647</b>	<b>166,784</b>
Additions	2,307	28,962	31,269
Transfers	5,540	(5,540)	-
Depreciation, depletion and amortization	(7,727)	-	(7,727)
Disposals, net	(84)	(210)	(294)
Cost	193,980	40,859	234,839
Accumulated depreciation, depletion and amortization	(44,807)	-	(44,807)
<b>Net book value at 30 September 2012</b>	<b>149,173</b>	<b>40,859</b>	<b>190,032</b>

Included in additions to property, plant and equipment for the nine months ended 30 September 2012 and 2011 are capitalized interest and foreign exchange differences of RR 1,989 million and RR 3,113 million, respectively.

Included within the operating assets balance at 30 September 2012 and 31 December 2011 are proved properties of RR 21,312 million and RR 22,355 million, net of accumulated depletion of RR 11,409 million and RR 10,300 million, respectively.

Included within the operating assets balance at 30 September 2012 and 31 December 2011 are unproved properties of RR 14,690 million and RR 14,061 million, respectively. Management believes these costs are recoverable and has plans to explore and develop the respective unproved properties.

In October 2011, the Group ceased control of OAO Yamal LNG and has recorded a disposal aggregating RR 45,867 million in property, plant and equipment. The Group retained 80 percent of Yamal LNG and has recorded its proportional share in investments in joint ventures (see Note 6).

**6 INVESTMENTS IN JOINT VENTURES**

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
<i>Joint ventures:</i>		
OAO Yamal LNG	94,552	89,549
OOO Yamal Development (consolidated)	24,365	8,100
OAO Sibneftegas	23,916	24,187
ZAO Terneftegas	1,193	1,193
<b>Total investments in joint ventures</b>	<b>144,026</b>	<b>123,029</b>

In April 2012, in accordance with the Shareholders' agreement the equity of Yamal LNG was increased through disproportional contribution by its participants totalling RR 17,046 million, of which RR 6,462 million was attributable to NOVATEK (see Note 7). As a result of disproportional contributions, the Group's shareholding did not change notably.

In February 2012, the charter capital of Yamal Development was increased by converting RR 32,697 million of loans provided to the company by its participants, of which RR 16,348 million was attributable to NOVATEK (see Note 7). In June 2011, the charter capital of Yamal Development was increased by RR 20 billion through the conversion of loans, provided to the company by its participants, of which RR 10 billion was attributable to NOVATEK. As a result of each transaction, the participants' pro-rata share in the joint venture increased.

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

The table below summarizes the movement in the carrying amounts of the Group's joint ventures.

	Nine months ended 30 September:	
	2012	2011
<b>At 1 January</b>	<b>123,029</b>	<b>27,026</b>
Share of profit (loss) of joint ventures before income tax	(2,032)	(3,156)
Share of income tax (expense) benefit	219	635
<b>Share of profit (loss) of joint ventures, net of income tax</b>	<b>(1,813)</b>	<b>(2,521)</b>
Contribution to equity	22,810	10,000
Losses (reversals) recognized in excess of investments in joint ventures, reclassified to long-term loans receivable for these companies	-	(238)
<b>At 30 September</b>	<b>144,026</b>	<b>34,267</b>

**7 LONG-TERM LOANS AND RECEIVABLES**

	At 30 September 2012	At 31 December 2011
Russian rouble denominated loans	8,563	9,737
US dollar denominated loans	667	220
<b>Total</b>	<b>9,230</b>	<b>9,957</b>
Less: current portion of long-term loans	(186)	(634)
<b>Total long-term loans</b>	<b>9,044</b>	<b>9,323</b>
Long-term receivables	3,058	22,027
Long-term interest receivable	1,354	780
<b>Total long-term loans and receivables</b>	<b>13,456</b>	<b>32,130</b>

*Russian rouble denominated loans.* At 30 September 2012 and 31 December 2011, the Russian rouble denominated loans included loans to OAO Sibneftegas, the Group's joint venture, in the amount of RR 8,563 million and RR 9,737 million, respectively (see Note 22). The loans had interest rates ranging from 9.5 percent to 10 percent per annum (weighted average interest rate of 9.9 percent at 30 September 2012) and are repayable until November 2014.

*Long-term receivables.* In March 2012, the shareholders of OAO Yamal LNG, the Group's joint venture, made a decision to increase its equity through the disproportional subscription to the entity's additional shares emissions in the aggregated amount of RR 6,765 million, which were fully paid in July 2012. The legal procedures to register the new charter were not completed by 30 September 2012 and, accordingly, the Group's share of RR 2,706 million was recognized as long-term receivable at 30 September 2012 (see Note 22). Subsequent to the balance sheet date, in October 2012, the new charter was formally registered. The Group's shareholding did not change notably after the share emission.

In November 2011, the shareholders of OAO Yamal LNG made a decision to increase its equity through a disproportional subscription to the entity's additional shares emissions in the aggregated amount of RR 17,046 million. The legal procedures to register the new charter were not completed at 31 December 2011 and, accordingly, the Group's share of RR 3,955 million paid in 2011 was recognized as long-term receivables. In January 2012, the Group paid the remaining RR 2,507 million. In April 2012, the new charter was formally registered (see Note 6).

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**7 LONG-TERM LOANS AND RECEIVABLES (CONTINUED)**

In November 2011, the participants of OOO Yamal Development, the Group's joint venture, made a decision to pro-rata increase its equity by converting the part of the loan provided to the company in the amount of RR 32,697 million to equity. The legal procedures to register the new charter were not completed at 31 December 2011 and, accordingly, the Group's share of RR 16,348 million was recognized as long-term receivables. In February 2012, the new charter was formally registered (see Note 6).

No provisions for impairment of long-term loans and receivables were recognized in the consolidated interim condensed statement of financial position at 30 September 2012 and 31 December 2011.

**8 PREPAYMENTS AND OTHER CURRENT ASSETS**

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
<i>Financial assets</i>		
Russian rouble denominated loans	186	6,859
Short-term bank deposits	-	17
Commodity derivatives	345	-
<i>Non-financial assets</i>		
Deferred export duties for stable gas condensate and liquefied petroleum gas	1,017	922
Recoverable value-added tax	1,854	1,550
Deferred transportation expenses for natural gas	2,090	1,139
Prepayments and advances to suppliers (net of provision of RR 13 million and RR 12 million at 30 September 2012 and 31 December 2011, respectively)	5,465	3,322
Prepaid taxes other than income tax	1,567	668
Deferred transportation expenses for stable gas condensate and liquefied petroleum gas	545	413
Other current assets	33	60
<b>Total prepayments and other current assets</b>	<b>13,102</b>	<b>14,950</b>

At 31 December 2011, the Russian rouble denominated loans included a loan provided by NOVATEK proportionally with other participants to OOO SeverEnergiya, the Group's related party, in the amount of RR 6,225 million (see Note 22). The loan bore an annual interest rate of MosPrime plus three percent and was fully repaid in March 2012.

**9 LONG-TERM DEBT**

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
US dollar denominated bonds	38,431	39,982
Russian rouble denominated loans	24,821	24,966
US dollar denominated loans	11,421	20,559
Russian rouble denominated bonds	9,986	9,971
<b>Total</b>	<b>84,659</b>	<b>95,478</b>
Less: current portion of long-term debt	(18,938)	(20,298)
<b>Total long-term debt</b>	<b>65,721</b>	<b>75,180</b>

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

At 30 September 2012 and 31 December 2011 the Group's long-term debt by facility is as follows:

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
Sberbank	24,821	14,966
Eurobonds – Ten-Year Tenor	19,966	20,776
Eurobonds – Five-Year Tenor	18,465	19,206
Russian rouble denominated bonds	9,986	9,971
Nordea Bank	6,183	6,439
Sumitomo Mitsui Banking Corporation Europe Limited	4,620	7,685
UniCredit Bank	618	6,435
Gazprombank	-	10,000
<b>Total</b>	<b>84,659</b>	<b>95,478</b>

**Eurobonds.** In February 2011, the Group issued Eurobonds in an aggregate amount of USD 1,250 million. The Eurobonds were issued at par in two tranches, a five-year USD 600 million bond with a coupon rate of 5.326 percent and a ten-year USD 650 million bond with a coupon rate of 6.604 percent. The coupons are payable semi-annually. The bonds are repayable in February 2016 and February 2021, respectively.

**Sberbank.** In December 2010, the Group received a Russian rouble denominated loan from OAO Sberbank in the amount of RR 15 billion at an interest rate of 7.5 percent per annum. The loan is repayable in December 2013 and includes the maintenance of certain restrictive financial covenants.

In December 2011, the Group obtained a RR 40 billion credit line facility from OAO Sberbank available to withdraw until March 2012 which was subsequently extended until June 2012. In June 2012, the Group withdrew RR 10 billion under the facility at an interest rate of 8.9 percent per annum and repayable in December 2014, and extended the remaining proportion of the credit facility until December 2012. The facility includes the maintenance of certain restrictive financial covenants.

**Gazprombank.** In November 2009, the Group obtained a three-year Russian rouble denominated loan from OAO Gazprombank in the amount of RR 10 billion at an interest rate of eight percent per annum. The loan was fully repaid in January 2012 ahead of its maturity schedule.

**Sumitomo Mitsui Banking Corporation Europe Limited.** In April 2011, the Group obtained a US dollar denominated loan from Sumitomo Mitsui Banking Corporation Europe Limited in the amount of USD 300 million at an interest rate of LIBOR plus 1.45 percent per annum (1.81 percent and 2.03 percent at 30 September 2012 and 31 December 2011, respectively). The loan is payable until December 2013 and includes the maintenance of certain restrictive financial covenants.

**Nordea Bank.** In November 2010, the Group obtained a US dollar denominated loan from OAO Nordea Bank in the amount of USD 200 million at an interest rate of LIBOR plus 1.9 percent per annum (2.13 percent and 2.18 percent at 30 September 2012 and 31 December 2011, respectively). The loan is repayable until November 2013 and includes the maintenance of certain restrictive financial covenants.

**UniCredit Bank.** In October 2009, the Group obtained a US dollar denominated loan from ZAO UniCredit Bank in the amount of USD 200 million at an interest rate of LIBOR plus 3.25 percent per annum (3.48 percent and 3.52 percent at 30 September 2012 and 31 December 2011, respectively). Subsequent to the balance sheet date, in October 2012, the loan was fully repaid in accordance with its maturity schedule.

**Russian rouble denominated bonds.** In June 2010, the Group issued ten million three-year non-convertible Russian rouble denominated bonds, each with a nominal value RR 1,000 and a coupon rate of 7.5 percent per annum, payable semi-annually. The bonds are repayable in June 2013.

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

The fair values of long-term debt at 30 September 2012 and 31 December 2011 were as follows:

	At 30 September 2012	At 31 December 2011
Sberbank	24,754	14,539
Eurobonds – Ten-Year Tenor	23,506	21,150
Eurobonds – Five-Year Tenor	19,897	19,414
Russian rouble denominated bonds	10,014	10,000
Nordea Bank	6,138	6,256
Sumitomo Mitsui Banking Corporation Europe Limited	4,597	7,561
UniCredit Bank	619	6,439
Gazprombank	-	9,928
<b>Total</b>	<b>89,525</b>	<b>95,287</b>

Scheduled maturities of long-term debt at 30 September 2012 were as follows:

<i>Maturity period:</i>	RR million
1 October 2013 to 30 September 2014	17,449
1 October 2014 to 30 September 2015	9,841
1 October 2015 to 30 September 2016	18,465
1 October 2016 to 30 September 2017	-
After 30 September 2017	19,966
<b>Total long-term debt</b>	<b>65,721</b>

**10 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT**

*Short-term debt and current portion of long-term debt.* At 30 September 2012 and 31 December 2011, short-term debt and current portion of long-term debt consisted only of the current portion of long-term debt in the amount of RR 18,938 million and RR 20,298 million, respectively.

*Available credit facilities.* The Group's available credit facilities at 30 September 2012 were as follows:

	Par value	Expiring	
		Within one year	Between 1 and 3 years
BNP PARIBAS Bank <sup>(a)</sup>	USD 100 million	3,092	-
Credit Agricole Corporate and Investment Bank <sup>(a)</sup>	USD 100 million	3,092	-
UniCredit Bank <sup>(a)</sup>	USD 330 million	-	10,203
Sberbank <sup>(a)</sup>	RR 30 billion	30,000	-
<b>Total available credit facilities</b>		<b>36,184</b>	<b>10,203</b>

<sup>(a)</sup> – interest rates are predetermined or negotiated at time of each withdrawal.

The Group also maintained available funds under short-term credit lines in the form of bank overdrafts with various international banks for RR 7,409 million (USD 175 million and EUR 50 million) and RR 6,278 million (USD 195 million) at 30 September 2012 and 31 December 2011, respectively, on variable interest rates subject to the specific type of credit facility.



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**11 TRADE PAYABLES AND ACCRUED LIABILITIES**

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
<i>Financial liabilities</i>		
Trade payables	6,391	5,187
Interest payable	663	1,009
Other payables	114	16,615
<i>Non-financial liabilities</i>		
Advances from customers	1,325	743
Salary payables	192	52
Other liabilities	1,300	1,316
<b>Trade payables and accrued liabilities</b>	<b>9,985</b>	<b>24,922</b>

At 31 December 2011, other payables included RR 16,244 million, relating to the acquisition of a 49 percent equity stake in OAO Yamal LNG, which was fully repaid in June 2012.

**12 SHAREHOLDERS' EQUITY**

**Treasury shares.** In accordance with the *Share Buyback Program* authorized by the Board of Directors on 11 February 2008, the Group's wholly-owned subsidiary, Novatek Equity (Cyprus) Limited, during 2008 has purchased ordinary shares of OAO NOVATEK in the form of Global Depository Receipts (GDRs) on the London Stock Exchange through the use of independent brokers. At 30 September 2012 and 31 December 2011, the Group held 196,853 GDRs (1,969 thousand ordinary shares) at a total cost of RR 281 million. The Group has decided that these GDRs do not vote.

**Dividends.** Dividends (including tax on dividends) declared and paid were as follows:

	<u>Nine months ended 30 September:</u>	
	<u>2012</u>	<u>2011</u>
Dividends payable at 1 January	-	-
Dividends declared (*)	10,620	7,583
Dividends paid (*)	(10,620)	(7,583)
<b>Dividends payable at 30 September</b>	<b>-</b>	<b>-</b>
Dividends per share declared during the period (in Russian roubles)	3.50	2.50
Dividends per GDR declared during the period (in Russian roubles)	35.0	25.0

(\*) – excluding treasury shares.

On 27 April 2012, the Annual General Meeting of shareholders of OAO NOVATEK approved the final 2011 dividend totaling RR 10,627 million (including treasury shares), which is to be paid within 60 days to the shareholders of record at the close of business on 23 March 2012. The dividends were paid in May and June 2012.

Subsequent to the balance sheet date, on 16 October 2012, the Extraordinary General Meeting of Shareholders of OAO NOVATEK approved the interim dividend based on the financial results for the six months ended 30 June 2012 of RR 3.00 per share or RR 30 per GDR. The interim dividend payment totaling RR 9,109 million will be paid within 60 days to shareholders of record at the close of business on 10 September 2012.

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**13 SHARE-BASED COMPENSATION PROGRAM**

On 12 February 2010, NOVATEK’s Management Committee approved a share-based compensation program (the “Program”) for a limited number of the Group’s senior and key management, as well as high-potential managers, but excluding the members of the Management Committee, which aims to encourage participants to take an active interest in the future development of the Group and to provide material incentive to create shareholders value in OAO NOVATEK. The Program was established in accordance with the *Concept of the Long-Term Incentive of Senior Employees* approved by the Board of Directors on 25 September 2006 and the *Share Buyback Program*.

The amounts recognized by the Group in respect of the Program are as follows:

<i>Expenses included in</i>	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
General and administrative expenses	47	-	111	130
<i>Liabilities included in</i>				
		At 30 September 2012	At 31 December 2011	
Other non-current liabilities		-		226
Trade payables and accrued liabilities		227		244
<b>Total share-based compensation program liabilities</b>			<b>227</b>	<b>470</b>

**14 OIL AND GAS SALES**

	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Natural gas	34,322	25,735	100,899	78,390
Stable gas condensate	12,925	9,741	35,171	33,801
Liquefied petroleum gas	3,762	3,728	11,864	11,250
Crude oil	1,457	637	3,508	1,682
Oil and gas products	96	47	256	142
<b>Total oil and gas sales</b>	<b>52,562</b>	<b>39,888</b>	<b>151,698</b>	<b>125,265</b>

**15 TRANSPORTATION EXPENSES**

	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Natural gas transportation to customers	10,505	8,618	32,447	24,819
Liquid hydrocarbons transportation by rail	2,617	2,240	7,864	7,022
Liquid hydrocarbons transportation by tankers	940	788	2,873	2,660
Crude oil transportation to customers	147	74	367	194
Other	26	75	98	93
<b>Total transportation expenses</b>	<b>14,235</b>	<b>11,795</b>	<b>43,649</b>	<b>34,788</b>

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**16 TAXES OTHER THAN INCOME TAX**

The Group is subject to a number of taxes other than income tax, which are detailed as follows:

	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Unified natural resources production tax	3,402	3,656	10,903	10,546
Property tax	429	435	1,304	1,298
Excise and fuel taxes	217	276	714	754
Other taxes	72	76	187	211
<b>Total taxes other than income tax</b>	<b>4,120</b>	<b>4,443</b>	<b>13,108</b>	<b>12,809</b>

**17 PURCHASES OF NATURAL GAS AND LIQUID HYDROCARBONS**

	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Natural gas	4,017	903	10,280	2,729
Unstable gas condensate	736	-	1,129	-
Other liquid hydrocarbons	79	35	197	104
<b>Total purchases of natural gas and liquid hydrocarbons</b>	<b>4,832</b>	<b>938</b>	<b>11,606</b>	<b>2,833</b>

Natural gas purchases included volumes procured from OAO Sibneftegas, the Group's joint venture, pro-rata to its total production (see Note 22). From January 2012, the Group began purchasing natural gas from its related party OAO SIBUR Holding at prices based on the market prices in the region of purchases (see Note 22).

In April 2012, the Group began purchasing unstable gas condensate from OOO SeverEnergiya, a related party, at ex-field prices based on benchmark crude oil and oil products market quotes adjusted for quality and respective tariffs for transportation and processing (see Note 22).

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**18 FINANCE INCOME (EXPENSE)**

<i>Interest expense (including transaction costs)</i>	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
6.604% USD 650 million Eurobonds February 2021	348	321	1,016	826
7.5% RR 15 billion Sberbank December 2013	288	288	856	856
5.326% USD 600 million Eurobonds February 2016	263	243	767	624
7.5% RR 10 billion Bonds June 2013	194	194	578	577
8.9% RR 10 billion Sberbank December 2014	244	-	270	-
LIBOR+1.45% USD 300 million Sumitomo Mitsui Banking Corporation Europe Limited December 2013	35	51	121	98
LIBOR+1.9% USD 200 million Nordea Bank November 2013	35	31	100	91
LIBOR+3.25% USD 200 million UniCredit Bank October 2012 <sup>(1)</sup>	13	53	71	158
8% RR 10 billion Gazprombank November 2012 <sup>(1)</sup>	-	202	42	604
Other interest expenses <sup>(2)</sup>	4	4	5	170
<b>Subtotal</b>	<b>1,424</b>	<b>1,387</b>	<b>3,826</b>	<b>4,004</b>
Less: capitalized interest	(783)	(1,072)	(1,848)	(2,855)
<b>Interest expense (on historical cost basis)</b>	<b>641</b>	<b>315</b>	<b>1,978</b>	<b>1,149</b>
Effects of discounting of long-term financial liabilities	-	-	-	212
Provisions for asset retirement obligations: unwinding of the present value discount	56	61	172	173
<b>Total interest expense</b>	<b>697</b>	<b>376</b>	<b>2,150</b>	<b>1,534</b>

<sup>(1)</sup> – interest rates were reduced during the periods.

<sup>(2)</sup> – including credit facility with interest rates negotiated at time of each withdrawal.

<i>Interest income</i>	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Interest income on loans issued	215	657	837	2,114
Interest income on cash and cash equivalents	53	102	252	296
<b>Interest income (on historical cost basis)</b>	<b>268</b>	<b>759</b>	<b>1,089</b>	<b>2,410</b>
Effects of discounting of long-term financial liabilities	70	42	148	120
<b>Total interest income</b>	<b>338</b>	<b>801</b>	<b>1,237</b>	<b>2,530</b>

**19 INCOME TAX**

**Effective income tax rate.** The Group's Russian statutory income tax rate for 2012 and 2011 was 20 percent. For the nine months ended 30 September 2012 and 2011, the consolidated Group's effective income tax rate was 21.3 percent and 21.2 percent, respectively. For the three months ended 30 September 2012 and 2011, the consolidated Group's effective income tax rate was 20.9 percent and 21.7 percent respectively.

Effective 1 January 2012, Russian tax legislation introduced an option to submit a single consolidated income tax return, and, accordingly, in April 2012, the Group's management registered NOVATEK and its core Russian producing subsidiaries as a consolidated group of taxpayers for 2012 and thereafter. The application of a single consolidated taxpayer model did not have an effect on the Group's effective income tax rate.

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**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS**

The accounting policies for financial instruments have been applied to the line items below:

<i>Financial assets</i>	At 30 September 2012	At 31 December 2011
<i>Loans and receivables</i>		
<i>Current</i>		
Trade and other receivables	15,260	16,699
Russian rouble denominated loans	186	6,859
Short –term bank deposits	-	17
Cash and cash equivalents	17,472	23,831
<i>Non-current</i>		
Long-term loans receivable	9,044	9,323
Trade and other receivables	4,412	22,807
Long-term deposits	3	-
<i>At fair value through profit or loss</i>		
<i>Current</i>		
Commodity derivatives	345	-
<b>Total assets</b>	<b>46,722</b>	<b>79,536</b>
<i>Financial liabilities</i>		
<i>At amortized cost</i>		
<i>Current</i>		
Current portion of long-term debt	18,938	20,298
Trade and other payables	7,168	22,811
<i>Non-current</i>		
Long-term debt	65,721	75,180
<i>At fair value through profit or loss</i>		
<i>Non-current</i>		
Commodity derivatives	23	-
<b>Total liabilities</b>	<b>91,850</b>	<b>118,289</b>

**Derivative instruments.** Certain long-term natural gas purchase and sales contracts were entered into for trading purposes on active markets that do not meet the expected own-use requirements. These contracts include pricing terms that are based on a variety of commodities and indices and volume flexibility options that collectively qualify them under the scope of IAS 39, *Financial instruments: recognition and measurement*, although the activity surrounding these contracts involves the physical delivery of natural gas. Such contracts are recognized in the statement of financial position at fair value with movements in fair value recognized in the income statement.

The Group determines the fair values of these financial commodity derivative contracts using the mark-to-market and mark-to-model methods and as such, the Group evaluates the quality and reliability of the assumptions and data used to measure fair value in accordance with IFRS 7, *Financial instruments: Disclosures* in the three hierarchy levels as follows:

- i. quoted prices in active markets (Level 1);
- ii. inputs other than quoted prices included in Level 1 that are directly or indirectly observable in the market (externally verifiable inputs) (Level 2); and
- iii. inputs that are not based on observable market data (unobservable inputs). These inputs reflect the Group's own assumptions about the assumptions a market participant would use in pricing the asset or liability (Level 3).

**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The fair values of natural gas derivative contracts are estimated using internal models and other valuation techniques due to the absence of quoted prices or other observable, market-corroborated data, for the duration of the contracts. Valuations were derived from quoted market prices for the periods in which market quotes are available; thereafter, forward natural gas prices were developed by reference to equivalent oil and oil products prices on other analogous markets. For periods beyond observable market prices the fair values of the long-term contracts were calculated using the market yield curve at the reporting date. Due to the assumptions underlying their fair value, the gas contracts are categorized as Level 3 in the fair value hierarchy, described above.

At 30 September 2012, the Group recognized RR 345 million of assets and RR 23 million of liabilities related to long-term natural gas contracts in the consolidated statement of financial position. In the three months ended 30 September 2012, a gain of RR 322 million was included within other operating income representing non-cash mark-to-market net movements in fair values on these derivative instruments during the reporting period.

**Financial risk management objectives and policies.** In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on the degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial results. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position.

The Group's principal risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to these limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

**Market risk.** Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures, while optimizing the return on risk.

The Group is exposed to market price movements relating to changes in commodity prices such as crude oil, gas condensate, liquefied petroleum gas and natural gas (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities or expected future cash flows.

(a) *Foreign exchange risk*

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to the US dollar. Foreign exchange risk arises primarily from future commercial transactions, recognized assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. Foreign currency derivative instruments may be utilized to manage the risk exposures associated with fluctuations on certain firm commitments for sales and purchases, debt instruments and other transactions that are denominated in currencies other than the Russian rouble, and certain non-Russian rouble assets and liabilities.

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**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The carrying amounts of the Group's financial instruments are denominated in the following currencies:

<i>At 30 September 2012</i>	<b>Russian rouble</b>	<b>US dollar</b>	<b>Other</b>	<b>Total</b>
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	8,377	667	-	9,044
Trade and other receivables	4,359	31	22	4,412
Long-term deposits	-	-	3	3
<i>Current</i>				
Trade and other receivables	9,029	5,731	500	15,260
Russian rouble denominated loans	186	-	-	186
Commodity derivatives	-	-	345	345
Cash and cash equivalents	7,913	9,442	117	17,472
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(24,835)	(40,886)	-	(65,721)
Commodity derivatives	-	-	(23)	(23)
<i>Current</i>				
Current portion of long-term debt	(9,972)	(8,966)	-	(18,938)
Trade and other payables	(6,559)	(567)	(42)	(7,168)
<b>Net exposure at 30 September 2012</b>	<b>(11,502)</b>	<b>(34,548)</b>	<b>922</b>	<b>(45,128)</b>
<i>At 31 December 2011</i>				
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	9,103	220	-	9,323
Trade and other receivables	22,761	14	32	22,807
<i>Current</i>				
Trade and other receivables	8,692	7,618	389	16,699
Russian rouble denominated loans	6,859	-	-	6,859
Short-term bank deposits	-	-	17	17
Cash and cash equivalents	10,774	12,113	944	23,831
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(24,937)	(50,243)	-	(75,180)
<i>Current</i>				
Current portion of long-term debt	(10,000)	(10,298)	-	(20,298)
Trade and other payables	(4,949)	(17,799)	(63)	(22,811)
<b>Net exposure at 31 December 2011</b>	<b>18,303</b>	<b>(58,375)</b>	<b>1,319</b>	<b>(38,753)</b>

**(b) Commodity price risk**

The Group's overall commercial trading strategy in natural gas and liquid hydrocarbons is centrally managed. Changes in commodity prices could negatively or positively affect the Group's results of operations. The Group manages the exposure to commodity price risk by optimizing its core activities to achieve stable price margins.

**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

**Natural gas supplies on the Russian domestic market.** As an independent natural gas producer, the Group is not subject to the government's regulation of natural gas prices, except for those volumes sold to residential customers. Nevertheless, the Group's prices for natural gas sold are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011.

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date to implement full liberalization of the domestic natural gas market is planned on 1 January 2015; however, the Government reserves the right to amend or change the proposed timetable. As part of the plan, in June 2012, the FTS approved an increase of 15 percent in the regulated prices effective 1 July 2012. According to the Government's program, the regulation of the domestic natural gas price after 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets.

Management believes it has limited downside commodity price risk for natural gas and does not use commodity derivative instruments for trading purposes. All of the Group's natural gas purchase and sales contracts in the domestic market are entered to meet supply requirements to fulfil contract obligations or for own consumption and are not within the scope of IAS 39, *Financial instruments: recognition and measurement*. However, to effectively manage the margins achieved through its natural gas trading activities, management has established targets for volumes sold to wholesale traders, end-customers and eventually to the natural gas exchange when trading commences.

**Natural gas foreign trading activities.** The Group purchases and sells natural gas on the European market under long-term supply contracts based on formulas with reference to benchmark natural gas prices quoted for the North-Western European natural gas hubs, crude oil and oil products prices and/or a combination thereof. As a result, the Group's results from natural gas trading are subject to commodity price volatility based on fluctuations or changes in the respective benchmark reference prices.

Natural gas foreign trading activities are exercised by Novatek Gas & Power, the Group's wholly owned subsidiary, and are managed within the Group's integrated trading function.

**Liquid hydrocarbons.** The Group sells all its crude oil and gas condensate under spot contracts. Gas condensate volumes sold to the US, European, South American and Asian-Pacific Region (hereinafter referred to as "APR") markets are based on benchmark reference crude oil prices of WTI, Brent IPE and Dubai (or a combination thereof) or Naphtha Japan and Naphtha CIF NWE, respectively, plus a margin or discount, depending on current market situation. Crude oil sold internationally is based on benchmark reference crude oil prices of Brent dated, plus a discount and on a transaction-by-transaction basis for volumes sold domestically. As a result, the Group's revenues from the sales of liquid hydrocarbons are subject to commodity price volatility based on fluctuations or changes in the crude oil benchmark reference prices. All of the Group's liquid hydrocarbon purchase and sales contracts are entered to meet supply requirements to fulfil contract obligations or for own consumption and are not within the scope of IAS 39, *Financial instruments: recognition and measurement*.

(c) *Cash flow and fair value interest rate risk*

The Group is subject to interest rate risk on financial liabilities with variable interest rates. To mitigate this risk, the Group's treasury function performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favorable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favorable over the expected period until maturity.



**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The interest rate profiles of the Group's interest-bearing financial instruments were as follows:

	<u>At 30 September 2012</u>	<u>At 31 December 2011</u>
At variable rate	11,422	20,559
At fixed rate	73,237	74,919
<b>Total debt</b>	<b>84,659</b>	<b>95,478</b>

The Group centralizes the cash requirements and surpluses of controlled subsidiaries and the majority of their external financing requirements, and applies, on its consolidated net debt position, a funding policy to optimize its financing costs and manage the impact of interest rate changes on its financial results in line with market conditions. In this way, the Group is able to ensure that the balance between the floating rate portion of its debt and its cash surpluses has a low level of exposure to any change in interest rates over the short term. This policy makes it possible to significantly limit the Group's sensitivity to interest rate volatility.

**Credit risk.** Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations.

Credit risk is managed on a Group level and arises from cash and cash equivalents, including short-term deposits with banks, as well as credit exposures to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to minimal risk of default.

The Group's trade and other receivables consist of a large number of customers, spread across diverse industries and geographical areas. Most of the Group's international liquid hydrocarbons sales are made to customers with independent external ratings; however, if the customer has a credit rating below BBB, the Group requires the collateral for the trade receivable to be in the form of letters of credit from banks with an investment grade rating. All domestic sales of liquid hydrocarbons are made on a 100 percent prepayment basis. The Group also requires 100 percent prepayments from small customers for natural gas deliveries and partial advances from others. Although the Group generally does not require collateral in respect of trade and other receivables, it has developed standard credit payment terms and constantly monitors the status of trade receivables and the creditworthiness of the customers.

As a result of recent acquisitions of Russian regional natural gas trading companies, the Group's exposure to small and medium-size industrial users and individuals has increased. The Group monitors the recoverability of these debtors by analyzing ageing of receivables by type of customers and their respective prior payment history to mitigate credit risk.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the consolidated interim condensed statement of financial position.

**Liquidity risk.** Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing its liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows and matches the maturity profiles of financial assets and liabilities.

The Group prepares various financial plans (monthly, quarterly and annually) which ensures that the Group has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. The Group has entered into a number of short-term credit facilities. Such credit lines and overdraft facilities can be drawn down to meet short-term financing needs. To fund cash requirements of a more permanent nature, the Group will normally raise long-term debt in available international and domestic markets.

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**20 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The following tables summarize the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

<i>At 30 September 2012</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
<i>Principal</i> <sup>(*)</sup>	10,000	15,000	28,550	20,096	73,646
<i>Interest</i>	4,508	3,405	5,619	4,645	18,177
Debt at variable rate					
<i>Principal</i> <sup>(*)</sup>	8,966	2,473	-	-	11,439
<i>Interest</i>	165	8	-	-	173
Trade and other payables	7,168	-	-	-	7,168
<b>Total financial liabilities</b>	<b>30,807</b>	<b>20,886</b>	<b>34,169</b>	<b>24,741</b>	<b>110,603</b>

Derivative commodity contracts are included in the maturity analysis only if both criteria are met: the contract is a financial liability (has negative fair value) at the reporting date and will result in future cash outflows.

<i>At 31 December 2011</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
<i>Principal</i> <sup>(*)</sup>	10,000	25,000	19,318	20,927	75,245
<i>Interest</i>	4,748	3,825	6,298	5,655	20,526
Debt at variable rate					
<i>Principal</i> <sup>(*)</sup>	10,303	10,302	-	-	20,605
<i>Interest</i>	366	135	-	-	501
Trade and other payables	22,811	-	-	-	22,811
<b>Total financial liabilities</b>	<b>48,228</b>	<b>39,262</b>	<b>25,616</b>	<b>26,582</b>	<b>139,688</b>

<sup>(\*)</sup> – differs from long-term debt for transaction costs (see Note 9).

**Capital management.** The primary objectives of the Group's capital management policy are to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain investor, market and creditor confidence to support its business activities.

At the reporting date, the Group had investment grade credit ratings of Baa3 (stable outlook) by Moody's Investors Service, BBB- (stable outlook) by Fitch Ratings, and BBB- (stable outlook) by Standard & Poor's. To maintain its credit ratings, the Group has established certain financial targets and coverage ratios that it monitors on a quarterly and annual basis.

The Group manages its liquidity on a corporate-wide basis to ensure adequate funding to sufficiently meet the Group's operational requirements. All external debts are centralized at the Parent level, and all financing to Group entities is facilitated through inter-company loan arrangements or additional contributions to share capital.

The Group has a stated dividend policy that distributes at least 30 percent of its Parent company's non-consolidated statutory net profit determined according to Russian accounting standards. However, the dividend for a specific year is determined after taking into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the NOVATEK's shareholders.

The Group defines the term "capital" as equity attributable to OAO NOVATEK shareholders plus net debt (total debt less cash and cash equivalents). There were no changes to the Group's approach to capital management during the nine months ended 30 September 2012.

## 21 CONTINGENCIES AND COMMITMENTS

**Operating environment.** The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is in practice not convertible in most countries outside of the Russian Federation, and relatively high inflation. The tax, currency and customs legislation is subject to varying interpretations, frequent changes and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments.

The Group's business operations are primarily located in the Russian Federation and are thus exposed to the economic and financial market risks of this country.

**Commitments.** At 30 September 2012, the Group had contractual capital expenditures commitments aggregating approximately RR 16,964 million (at 31 December 2011: RR 17,805 million) mainly for ongoing development activities at the Yurkharovskoye field (through 2014), new field development at the North-Russkoye field (through 2014), both the Salmanovskoye (within the Utrenniy license area) and the Geofizicheskoye fields (through 2016), the Yarudeyskoye field (through 2013), phase three construction of the Purovsky Gas Condensate Plant (through 2013), construction of the terminal for the transshipment and fractionation of stable gas condensate (through 2013) and ongoing field development at the East-Tarkosalinskoye and Khancheyskoye fields (through 2013) all in accordance with duly signed agreements.

**Taxation.** Russian tax, currency and customs legislation is subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such taxation legislation as applied to the Group's transactions and activities may be periodically challenged by the relevant regional and federal authorities. Furthermore, events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued in the consolidated interim condensed financial information.

**Mineral licenses.** The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its mineral licenses. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitation, suspension or revocation. The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any material adverse effect on the Group's financial position, results of operations or cash flows.

The Group's oil and gas fields and license areas are situated on land located in the Yamal-Nenets Autonomous Region. Licenses are issued by the Federal Agency for the Use of Natural Resources, and the Group pays unified natural resources production tax to produce crude oil, natural gas and unstable condensate from these fields and contributions for exploration of license areas.

**Environmental liabilities.** The Group and its predecessor entities have operated in the oil and gas industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations and, as obligations are determined, they are recognized as an expense immediately if no future benefit is discernible. Potential liabilities arising as a result of a change in interpretation of existing regulations, civil litigation or changes in legislation cannot be estimated. Under existing legislation, management believes that there are no probable liabilities, which will have a material adverse effect on the Group's financial position, results of operations or cash flows.

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**21 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

**Legal contingencies.** The Group is subject of, or party to a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in the consolidated interim condensed financial information.

**22 RELATED PARTY TRANSACTIONS**

Transactions between NOVATEK and its subsidiaries, which are related parties of NOVATEK, have been eliminated on consolidation and are not disclosed in this Note.

For the purposes of this consolidated interim condensed financial information, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. Management has used reasonable judgments in considering each possible related party relationship with attention directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be affected on the same terms, conditions and amounts as transactions between unrelated parties.

<i>Related parties – joint ventures</i>	<b>Three months ended 30 September:</b>		<b>Nine months ended 30 September:</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Transactions</b>				
<b><i>OAO Sibneftegas:</i></b>				
Interest income on loans issued	221	253	687	774
Oil and gas products sales	10	10	32	31
Purchases of natural gas	(1,631)	(903)	(3,666)	(2,729)
<b><i>OOO Yamal Development:</i></b>				
Interest income on loans issued	-	306	-	1,162
<b><i>OOO SeverEnergiya:</i></b>				
Purchases of unstable gas condensate	(736)	-	(1,129)	-
Interest income on loans issued	-	79	145	124
<b><i>OAO Yamal LNG:</i></b>				
Other revenues (operator services sales)	16	-	68	-

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**22 RELATED PARTY TRANSACTIONS (CONTINUED)**

*Related parties – joint ventures*

At 30 September 2012 At 31 December 2011

**Balances**

**OAO Sibneftegas:**

Long-term loans receivable	8,377	9,103
Interest on long-term loans receivable	1,330	775
Short-term loans receivable	186	634
Trade payables and accrued liabilities	1,001	387

**OOO Yamal Development:**

Long-term loans and receivables	-	16,348
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**OOO SeverEnergiya:**

Short-term loans receivable	-	6,225
Interest on short-term loans receivable	-	94
Trade payables and accrued liabilities	338	-

**ZAO Terneftegas:**

Long-term loans receivable	667	220
Interest on long-term loans receivable	24	5

**OAO Yamal LNG:**

Long-term receivables	2,706	3,955
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In September 2011, the Chairman of the Management Committee of NOVATEK acquired a controlling stake in OAO SIBUR Holding. As a result, the Group's balances and transactions with this company and its subsidiaries following 1 October 2011 were disclosed as related parties – parties under control of key management personnel.

<i>Related parties – parties under control of key management personnel</i>	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011

**Transactions**

**OAO SIBUR Holding and its subsidiaries  
(from 1 October 2011):**

Natural gas sales	497	-	1,438	-
Purchases of natural gas	(2,386)	-	(6,614)	-
Purchases of liquid hydrocarbons	(10)	-	(34)	-

*Related parties – parties under control of key management personnel*

At 30 September 2012 At 31 December 2011

**Balances**

**OAO Pervobank:**

Cash and cash equivalents	1,906	4,066
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**OAO SIBUR Holding and its subsidiaries:**

Long-term receivable	-	1,424
Trade payables and accrued liabilities	616	-
Trade and other receivables	1,636	248
Prepayments and other current assets	1,690	-

**Key management compensation.** The Group paid to key management personnel (members of the Board of Directors and the Management Committee) short-term compensation, including salary, bonuses, and excluding dividends the following amounts.

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**22 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – members of key management personnel</i>	Three months ended 30 September:		Nine months ended 30 September:	
	2012	2011	2012	2011
Board of Directors	19	19	86	85
Management Committee	254	414	1,172	1,123
<b>Total compensation</b>	<b>273</b>	<b>433</b>	<b>1,258</b>	<b>1,208</b>

Such amounts include personal income tax and are net of payments to non-budget funds made by the employer. Some members of key management personnel have direct and/or indirect interests in the Group and receive dividends under general conditions based on their respective shareholdings. The Board of Directors consists of nine members. The Management Committee consisted of 15 members until 24 March 2011 and was subsequently reduced to eight members.

**23 SEGMENT INFORMATION**

The Group's activities were considered by the chief operating decision maker (hereinafter referred to as "CODM", represented by the Management Committee of NOVATEK) to comprise one operating segment: exploration, production and marketing of natural gas and liquid hydrocarbons until 30 June 2012. With the entering into long-term natural gas supply contracts in the third quarter 2012 (see Note 1), the Group established a new operating segment defined as "natural gas foreign trading activities". For the three months ended 30 September 2012, this segment's information, as reported to CODM, did not include any results as there were no actual operations in that period. Movements in fair values of the respective derivative contracts were disclosed within reconciling items for the presentation in accordance with IFRS.

Segment information is provided to the CODM in accordance with Regulations on Accounting and Reporting of the Russian Federation ("RAR") with reconciling items largely representing adjustments and reclassifications recorded in the consolidated interim condensed financial information for the fair presentation in accordance with IFRS.

The CODM assesses reporting segment performance based on income before income taxes, since income taxes are not allocated. No business segment assets or liabilities (except for capital expenditures for the period) are provided to the CODM for decision-making.

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**23 SEGMENT INFORMATION (CONTINUED)**

Segment information for the three months ended 30 September 2012 is as follows:

<i>For the three months ended 30 September 2012</i>	References	Exploration, production and marketing	Natural gas foreign trading activities	Segment information as reported to CODM	Reconciling items	Total per consolidated interim condensed financial information
External revenues		52,694	-	52,694	37	52,731
Operating expenses	<i>a, b, c, d</i>	(31,618)	-	(31,618)	1,773	(29,845)
Other operating income (loss)	<i>b</i>	(34)	-	(34)	373	339
Interest expense	<i>e</i>	(1,180)	-	(1,180)	483	(697)
Interest income		286	-	286	52	338
Foreign exchange gain (loss)	<i>e</i>	2,650	-	2,650	54	2,704
<b>Segment result</b>		<b>22,798</b>	<b>-</b>	<b>22,798</b>	<b>2,772</b>	<b>25,570</b>
Share of profit (loss) of joint ventures, net of income tax						(301)
<b>Profit before income tax</b>						<b>25,269</b>
Depreciation, depletion and amortization	<i>a, b</i>	3,757	-	3,757	(1,099)	2,658
Capital expenditures	<i>e</i>	11,416	-	11,416	64	11,480

Reconciling items mainly related to:

- a. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 1,178 million in operating expenses under IFRS;
- b. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 57 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- c. different methodology in recognizing expenses relating to natural gas storage services and payroll (including share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 207 million and the reversal in payroll expenses of RR 81 million recorded in operating expenses under IFRS;
- d. different methodology in recognizing of exploration expenses, which resulted in the reversal of operating expenses of RR 623 million charged under IFRS; and
- e. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest and foreign exchange differences capitalized in the amount of RR 567 million and the reversal of capital expenditures of RR 503 million under IFRS.

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**23 SEGMENT INFORMATION (CONTINUED)**

Segment information for the three months ended 30 September 2011 is as follows:

<i>For the three months ended 30 September 2011</i>	References	Exploration, production and marketing	Segment information as reported to CODM	Reconciling items	Total per consolidated interim condensed financial information
External revenues		39,981	39,981	52	40,033
Operating expenses	<i>a, b</i>	(24,539)	(24,539)	1,618	(22,921)
Other operating income (loss)		35	35	(17)	18
Interest expense	<i>c</i>	(1,284)	(1,284)	908	(376)
Interest income		742	742	59	801
Foreign exchange gain (loss)	<i>c</i>	(6,549)	(6,549)	234	(6,315)
<b>Segment result</b>		<b>8,386</b>	<b>8,386</b>	<b>2,854</b>	<b>11,240</b>
Share of profit (loss) of joint ventures, net of income tax					(835)
<b>Profit before income tax</b>					<b>10,405</b>
Depreciation, depletion and amortization	<i>a</i>	3,337	3,337	(985)	2,352
Capital expenditures	<i>c</i>	12,683	12,683	1,732	14,415

Reconciling items mainly related to:

- a. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 1,015 million in operating expenses under IFRS;
- b. different methodology in recognizing expenses relating to natural gas storage services and payroll (including share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in the additional transportation expenses of RR 195 million and reversal in payroll expenses of RR 799 million recorded in operating expenses under IFRS; and
- c. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest and foreign exchange differences capitalized in the amount of RR 1,276 million and additional capital expenditures of RR 456 million under IFRS.



**OAO NOVATEK**

**Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)**

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

**23 SEGMENT INFORMATION (CONTINUED)**

Segment information for the nine months ended 30 September 2012 is as follows:

<i>For the nine months ended 30 September 2012</i>	References	Exploration, production and marketing	Natural gas foreign trading activities	Segment information as reported to CODM	Reconciling items	Total per consolidated interim condensed financial information
External revenues		152,257	-	152,257	(8)	152,249
Operating expenses	<i>a, b, c, d</i>	(93,779)	-	(93,779)	5,303	(88,476)
Other operating income (loss)	<i>b</i>	(55)	-	(55)	399	344
Interest expense	<i>e</i>	(3,461)	-	(3,461)	1,311	(2,150)
Interest income		1,097	-	1,097	140	1,237
Foreign exchange gain (loss)	<i>e</i>	3,103	-	3,103	182	3,285
<b>Segment result</b>		<b>59,162</b>	<b>-</b>	<b>59,162</b>	<b>7,327</b>	<b>66,489</b>
Share of profit (loss) of joint ventures, net of income tax						(1,813)
<b>Profit before income tax</b>						<b>64,676</b>
Depreciation, depletion and amortization	<i>a, b</i>	11,113	-	11,113	(3,280)	7,833
Capital expenditures	<i>e</i>	26,445	-	26,445	4,824	31,269

Reconciling items mainly related to:

- a. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 3,426 million in operating expenses under IFRS;
- b. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 144 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- c. different methodology in recognizing expenses relating to natural gas storage services and payroll (including share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 60 million and additional payroll expenses of RR 454 million recorded in operating expenses under IFRS;
- d. different methodology in recognizing of exploration expenses, which resulted in the reversal of operating expenses of RR 2,515 million charged under IFRS; and
- e. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest and foreign exchange differences capitalized in the amount of RR 1,571 million and additional capital expenditures of RR 3,253 million under IFRS.

**OAO NOVATEK**

**Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)**

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

**23 SEGMENT INFORMATION (CONTINUED)**

Segment information for the nine months ended 30 September 2011 is as follows:

<i>For the nine months ended 30 September 2011</i>	References	Exploration, production and marketing	Segment information as reported to CODM	Reconciling items	Total per consolidated interim condensed financial information
External revenues		125,590	125,590	(37)	125,553
Operating expenses	<i>a, b, c, d</i>	(72,763)	(72,763)	3,925	(68,838)
Other operating income (loss)	<i>b</i>	(298)	(298)	289	(9)
Interest expense	<i>e</i>	(3,977)	(3,977)	2,443	(1,534)
Interest income		2,360	2,360	170	2,530
Foreign exchange gain (loss)	<i>e</i>	(3,299)	(3,299)	224	(3,075)
<b>Segment result</b>		<b>47,613</b>	<b>47,613</b>	<b>7,014</b>	<b>54,627</b>
Share of profit (loss) of joint ventures, net of income tax					(2,521)
<b>Profit before income tax</b>					<b>52,106</b>
Depreciation, depletion and amortization	<i>a, b</i>	9,171	9,171	(2,735)	6,436
Capital expenditures	<i>e</i>	24,373	24,373	3,995	28,368

Reconciling items mainly related to:

- a. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 2,986 million in operating expenses under IFRS;
- b. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 139 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- c. different methodology in recognizing expenses relating to natural gas storage services and payroll (including share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in the reversal in transportation expenses of RR 33 million and reversal payroll expenses of RR 160 million recorded in operating expenses under IFRS;
- d. different methodology in the recognition of impairment expenses between IFRS and management accounting, which resulted in net reversal of RR 714 million recorded in operating expenses under IFRS; and
- e. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest and foreign exchange differences capitalized in the amount of RR 2,935 million and additional capital expenditures of RR 1,060 million under IFRS.

**ОАО NOVATEK**
**Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)**

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

**23 SEGMENT INFORMATION (CONTINUED)**

**Geographical information.** The Group operates in the following geographical segments:

- *Russian Federation* – exploration, development, and production of hydrocarbons, and sales of natural gas, gas condensate, crude oil and related products;
- *USA* – sales of stable gas condensate;
- *Europe* – sales of stable gas condensate, liquefied petroleum gas and crude oil; and
- *Asian-Pacific Region (“APR”)* – sales of stable gas condensate.

Geographical information for the three months ended 30 September 2012 and 2011 is as follows:

<i>For the three months ended 30 September 2012</i>	<b>Russian Federation</b>	<b>Outside Russian Federation</b>					<b>Subtotal</b>	<b>Total</b>
		<b>Europe</b>	<b>USA</b>	<b>APR</b>	<b>Other</b>	<b>Export duty</b>		
Natural gas	34,322	-	-	-	-	-	-	34,322
Stable gas condensate	172	1,802	1,673	15,841	1,849	(8,412)	12,753	12,925
Liquefied petroleum gas	1,281	2,900	-	-	-	(419)	2,481	3,762
Crude oil	895	1,071	-	-	-	(509)	562	1,457
Oil and gas products	96	-	-	-	-	-	-	96
<b>Oil and gas sales</b>	<b>36,766</b>	<b>5,773</b>	<b>1,673</b>	<b>15,841</b>	<b>1,849</b>	<b>(9,340)</b>	<b>15,796</b>	<b>52,562</b>
Other revenues	139	30	-	-	-	-	30	169
<b>Total external revenues</b>	<b>36,905</b>	<b>5,803</b>	<b>1,673</b>	<b>15,841</b>	<b>1,849</b>	<b>(9,340)</b>	<b>15,826</b>	<b>52,731</b>

<i>For the three months ended 30 September 2011</i>	<b>Russian Federation</b>	<b>Outside Russian Federation</b>					<b>Subtotal</b>	<b>Total</b>
		<b>Europe</b>	<b>USA</b>	<b>APR</b>	<b>Other</b>	<b>Export duty</b>		
Natural gas	25,735	-	-	-	-	-	-	25,735
Stable gas condensate	-	3,345	4,813	9,907	-	(8,324)	9,741	9,741
Liquefied petroleum gas	1,352	3,013	-	-	-	(637)	2,376	3,728
Crude oil	393	530	-	-	-	(286)	244	637
Oil and gas products	47	-	-	-	-	-	-	47
<b>Oil and gas sales</b>	<b>27,527</b>	<b>6,888</b>	<b>4,813</b>	<b>9,907</b>	<b>-</b>	<b>(9,247)</b>	<b>12,361</b>	<b>39,888</b>
Other revenues	71	74	-	-	-	-	74	145
<b>Total external revenues</b>	<b>27,598</b>	<b>6,962</b>	<b>4,813</b>	<b>9,907</b>	<b>-</b>	<b>(9,247)</b>	<b>12,435</b>	<b>40,033</b>

Geographical information for the nine months ended 30 September 2012 and 2011 is as follows:

<i>For the nine months ended 30 September 2012</i>	<b>Russian Federation</b>	<b>Outside Russian Federation</b>					<b>Subtotal</b>	<b>Total</b>
		<b>Europe</b>	<b>USA</b>	<b>APR</b>	<b>Other</b>	<b>Export duty</b>		
Natural gas	100,899	-	-	-	-	-	-	100,899
Stable gas condensate	299	17,681	8,614	33,243	1,849	(26,515)	34,872	35,171
Liquefied petroleum gas	4,253	9,433	-	-	-	(1,822)	7,611	11,864
Crude oil	2,210	2,637	-	-	-	(1,339)	1,298	3,508
Oil and gas products	256	-	-	-	-	-	-	256
<b>Oil and gas sales</b>	<b>107,917</b>	<b>29,751</b>	<b>8,614</b>	<b>33,243</b>	<b>1,849</b>	<b>(29,676)</b>	<b>43,781</b>	<b>151,698</b>
Other revenues	476	75	-	-	-	-	75	551
<b>Total external revenues</b>	<b>108,393</b>	<b>29,826</b>	<b>8,614</b>	<b>33,243</b>	<b>1,849</b>	<b>(29,676)</b>	<b>43,856</b>	<b>152,249</b>

**OAO NOVATEK****Selected Notes to the Consolidated Interim Condensed Financial Information (unaudited)**

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

**23 SEGMENT INFORMATION (CONTINUED)**

<i>For the nine months ended 30 September 2011</i>	<b>Russian Federation</b>	<b>Outside Russian Federation</b>					<b>Subtotal</b>	<b>Total</b>
		<b>Europe</b>	<b>USA</b>	<b>APR</b>	<b>Other</b>	<b>Export duty</b>		
Natural gas	78,390	-	-	-	-	-	-	78,390
Stable gas condensate	46	19,880	12,669	25,317	-	(24,111)	33,755	33,801
Liquefied petroleum gas	3,989	8,793	-	-	10	(1,542)	7,261	11,250
Crude oil	963	1,512	-	-	-	(793)	719	1,682
Oil and gas products	142	-	-	-	-	-	-	142
<b>Oil and gas sales</b>	<b>83,530</b>	<b>30,185</b>	<b>12,669</b>	<b>25,317</b>	<b>10</b>	<b>(26,446)</b>	<b>41,735</b>	<b>125,265</b>
Other revenues	209	79	-	-	-	-	79	288
<b>Total external revenues</b>	<b>83,739</b>	<b>30,264</b>	<b>12,669</b>	<b>25,317</b>	<b>10</b>	<b>(26,446)</b>	<b>41,814</b>	<b>125,553</b>

Revenues are based on the geographical location of customers even though all revenues are generated from assets located in the Russian Federation. Substantially all of the Group's operating assets are located in the Russian Federation.

**Major customers.** For the three months ended 30 September 2012 and 2011, the Group had two major customers to whom individual revenues represented 33 percent and 32 percent of total external revenues, respectively.

For the nine months ended 30 September 2012 and 2011, the Group had two major customers to whom individual revenues represented 28 percent and 31 percent of total external revenues, respectively.

**24 SUBSEQUENT EVENTS**

On 15 October 2012, the Group issued three-year non-convertible Russian rouble denominated bonds in the amount of RR 20 billion with a coupon rate of 8.35 percent per annum.

On 6 November 2012, the Group signed an agreement with a third party to acquire 49 percent equity shares of ZAO Nortgas, subject to certain conditions to be met by both parties for the total consideration of USD 1,375 million payable upon the title transfer, which is expected to be completed by the year end. Nortgas is a Russian oil and gas production company and holds the production license for the North-Urengoykoye field, located in the YNAO (license expires in 2018), with estimated proved reserves appraised under the PRMS reserve methodology amounting to 225 billion cubic meters of natural gas and 26 million tons of gas condensate at 31 December 2011.

**25 NEW ACCOUNTING PRONOUNCEMENTS**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012, and which the Group has not early adopted.

*IFRS 9, Financial Instruments: Classification and Measurement.* IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortized cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealized and realized fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

*IFRS 10, Consolidated Financial Statements* (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27, *Consolidated and separate financial statements*, and SIC-12, *Consolidation - special purpose entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the new standard on its consolidated interim condensed financial information.

*IFRS 11, Joint Arrangements*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-Monetary Contributions by Ventures*. Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The Group is currently assessing the impact of the new standard on its consolidated interim condensed financial information.

**25 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

IFRS 12, *Disclosure of Interest in Other Entities*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28, *Investments in associates*. IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgments and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarized financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the new standard on its consolidated interim condensed financial information.

IFRS 13, *Fair value measurement*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its consolidated interim condensed financial information.

IAS 27, *Separate Financial Statements*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, *Consolidated Financial Statements*. The Group is currently assessing the impact of the amended standard on its consolidated interim condensed financial information.

IAS 28, *Investments in Associates and Joint Ventures*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the International Accounting Standards Board's ("Board") project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged. The Group is currently assessing the impact of the amended standard on its consolidated interim condensed financial information.

Amendments to IFRS 7, *Disclosures—Transfers of Financial Assets* – (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognized, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Group is currently assessing the impact of the amended standard on disclosures in its consolidated interim condensed financial information.

Amendments to IAS 1, *Presentation of Financial Statements* (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its consolidated interim condensed financial information, but have no impact on measurement of transactions and balances.

Amended IAS 19, *Employee Benefits* (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Group is currently assessing the impact of the amended standard on its consolidated interim condensed financial information.

**25 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

Amendments to IFRS 7, *Disclosures—Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity’s financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Amendments to IAS 32, *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of ‘currently has a legally enforceable right of set-off’ and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment, the impact on the Group and the timing of its adoption by the Group.

*Improvements to International Financial Reporting Standards* (issued in May 2012 and effective for annual periods beginning on or after 1 January 2013). The improvements consist of changes to five standards. IFRS 1 was amended to (i) clarify that an entity that resumes preparing its IFRS financial statements may either repeatedly apply IFRS 1 or apply all IFRSs retrospectively as if it had never stopped applying them, and (ii) to add an exemption from applying IAS 23, *Borrowing costs*, retrospectively by first-time adopters. IAS 1 was amended to clarify that explanatory notes are not required to support the third balance sheet presented at the beginning of the preceding period when it is provided because it was materially impacted by a retrospective restatement, changes in accounting policies or reclassifications for presentation purposes, while explanatory notes will be required when an entity voluntarily decides to provide additional comparative statements. IAS 16 was amended to clarify that servicing equipment that is used for more than one period is classified as property, plant and equipment rather than inventory. IAS 32 was amended to clarify that certain tax consequences of distributions to owners should be accounted for in the income statement as was always required by IAS 12. IAS 34 was amended to bring its requirements in line with IFRS 8. IAS 34 will require disclosure of a measure of total assets and liabilities for an operating segment only if such information is regularly provided to chief operating decision maker and there has been a material change in those measures since the last annual consolidated financial statements. The Group is currently assessing the impact of the amended standard on its consolidated interim condensed financial information.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued in June 2012 and effective for annual periods beginning on or after 1 January 2013). The amendments clarify the transition guidance in IFRS 10, *Consolidated Financial Statements*. Entities adopting IFRS 10 should assess control at the first day of the annual period in which IFRS 10 is adopted, and if the consolidation conclusion under IFRS 10 differs from IAS 27 and SIC 12, the immediately preceding comparative period (that is, year 2012 for a calendar year-end entity that adopts IFRS 10 in 2013) is restated, unless impracticable. The amendments also provide additional transition relief in IFRS 10, IFRS 11, *Joint Arrangements* and IFRS 12, *Disclosure of Interests in Other Entities*, by limiting the requirement to provide adjusted comparative information only for the immediately preceding comparative period. Further, the amendments will remove the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied. The Group is currently assessing the impact of the amended standard on its consolidated interim condensed financial information.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group’s consolidated interim condensed financial information.

**OAO NOVATEK**  
**Contact Information**

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OAO NOVATEK was incorporated as a joint stock company in accordance with the Russian law and is domiciled in the Russian Federation.

The Group's registered office is:

Ulitsa Pobedy 22a  
629850 Tarko-Sale  
Yamal-Nenets Autonomous Region  
Russian Federation

The Group's office in Moscow is:

Ulitsa Udaltsova 2  
119415 Moscow  
Russian Federation

Telephone: 7 (495) 730-60-00  
Fax: 7 (495) 721-22-53

[www.novatek.ru](http://www.novatek.ru)



**OAO NOVATEK**  
**IFRS CONSOLIDATED FINANCIAL STATEMENTS**  
**AND INDEPENDENT AUDITOR'S REPORT**  
**FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010**

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## *Independent Auditor's Report*

To the shareholders and Board of Directors of OAO NOVATEK

- 1 We have audited the accompanying consolidated financial statements of OAO NOVATEK and its subsidiaries (the "Group") set out on pages 4 to 72, which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of cash flows and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory information.

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

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

### **Auditor's Responsibility**

- 3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

- 4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

- 5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

- 6 In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OAO NOVATEK and its subsidiaries as at 31 December 2011, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
5 March 2012

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*ZAO PricewaterhouseCoopers Audit, White Square Office Center, 10 Butyrsky Val, Moscow, Russia, 125047  
T: +7 (495) 967 6000, F: +7 (495) 967 6001, www.pwc.ru*

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

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

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

Approved for issue and signed on behalf of the Board of Directors on 5 March 2012:



L. Mikhelson  
General Director



M. Gyetvay  
Financial Director

**OAO NOVATEK**
**Consolidated Statement of Income**

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

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

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

**OA0 NOVATEK**  
**Consolidated Statement of Comprehensive Income**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2011	2010
<b>Other comprehensive income (loss) after income tax:</b>			
Currency translation differences		313	(8)
<b>Other comprehensive income (loss)</b>		<b>313</b>	<b>(8)</b>
<b>Profit (loss)</b>		<b>119,291</b>	<b>40,278</b>
<b>Total comprehensive income (loss)</b>		<b>119,604</b>	<b>40,270</b>
Total comprehensive income (loss) attributable to:			
Non-controlling interest		(364)	(255)
<b>Shareholders of OA0 NOVATEK</b>		<b>119,968</b>	<b>40,525</b>

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

**OAO NOVATEK**  
**Consolidated Statement of Cash Flows**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2011	2010
<b>Profit before income tax</b>		<b>135,025</b>	<b>51,082</b>
<b>Adjustments to profit before income tax:</b>			
Depreciation, depletion and amortization		9,475	6,757
Net impairment expenses		782	541
Net foreign exchange loss (gain)		3,945	(1,036)
Net loss (gain) on disposal of assets		(62,811)	(1,253)
Interest expense		2,150	437
Interest income		(3,392)	(598)
Share of loss (profit) in equity investments, net of income tax		3,880	346
Net change in other non-current assets and long-term receivables		1,132	1,063
Share-based compensation	17	-	68
Other adjustments		202	241
<b>Working capital changes</b>			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(6,103)	(2,675)
Decrease (increase) in inventories		(132)	(479)
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends payable		567	(1,821)
Increase (decrease) in other taxes payable		1,120	765
<b>Total effect of working capital changes</b>		<b>(4,548)</b>	<b>(4,210)</b>
Income taxes paid		(13,933)	(8,575)
<b>Net cash provided by operating activities</b>		<b>71,907</b>	<b>44,863</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(25,317)	(21,360)
Acquisition of mineral licenses		(6,888)	(76)
Purchases of inventories intended for construction		(773)	(1,200)
Acquisition of subsidiaries net of cash acquired		(4,188)	(1,718)
Acquisition of and capital contribution to equity investments		(25,131)	(4,660)
Proceeds from disposals of subsidiaries net of cash disposed		11,796	1,173
Interest paid and capitalized		(3,508)	(2,002)
Loans provided		(6,729)	(39,402)
Repayments of loans provided		13,166	219
Interest received		929	184
<b>Net cash (used for) provided by investing activities</b>		<b>(46,643)</b>	<b>(68,842)</b>
<b>Cash flows from financing activities</b>			
Proceeds from long-term debt		44,885	35,018
Proceeds from short-term debt		3,700	20,331
Repayments of long-term debt		(8,552)	(18,718)
Repayments of short-term debt		(21,321)	(2,729)
Interest paid		(818)	(301)
Dividends paid	17	(15,166)	(9,868)
Acquisition of non-controlling interest	5	(14,817)	(629)
Additional capital contribution into subsidiaries	5	-	337
Proceeds from sale of treasury shares	17	354	341
<b>Net cash (used for) provided by financing activities</b>		<b>(11,735)</b>	<b>23,782</b>
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		64	(45)
<b>Net increase (decrease) in cash, cash equivalents and bank overdrafts</b>		<b>13,593</b>	<b>(242)</b>
Cash and cash equivalents at beginning of the period		10,238	10,532
Net decrease (increase) in cash and cash equivalents reclassified to assets classified as held for sale		-	(52)
<b>Cash, cash equivalents and bank overdrafts at end of the period</b>		<b>23,831</b>	<b>10,238</b>

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

**ОАО NOVATEK**

**Consolidated Statement of Changes in Equity**

(in millions of Russian roubles, except for number of shares)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Asset revaluation surplus on acquisitions	Currency translation differences	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b><i>For the year ended 31 December 2010</i></b>										
<b>1 January 2010</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>5,617</b>	<b>(112)</b>	<b>78,393</b>	<b>114,301</b>	<b>19,139</b>	<b>133,440</b>
Currency translation differences	-	-	-	-	-	(8)	-	(8)	-	(8)
Profit (loss)	-	-	-	-	-	-	40,533	40,533	(255)	40,278
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>40,533</b>	<b>40,525</b>	<b>(255)</b>	<b>40,270</b>
Dividends (Note 17)	-	-	-	-	-	-	(9,855)	(9,855)	-	(9,855)
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	-	-	-	2,414	2,414
Impact of additional shares subscription in subsidiaries on non-controlling interest (Note 5)	-	-	-	-	-	-	-	-	1,818	1,818
Acquisition of non-controlling interest (Note 5)	-	-	-	-	-	-	1,739	1,739	(2,368)	(629)
Disposal of subsidiaries	-	-	-	-	-	-	-	-	(81)	(81)
Share-based compensation funded by shareholders	-	-	-	68	-	-	-	68	-	68
Sales of treasury shares (Note 17)	1,070	-	153	188	-	-	-	341	-	341
<b>31 December 2010</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>5,617</b>	<b>(120)</b>	<b>110,810</b>	<b>147,119</b>	<b>20,667</b>	<b>167,786</b>

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



**OAO NOVATEK**

**Consolidated Statement of Changes in Equity**

(in millions of Russian roubles, except for number of shares)

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

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

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

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## 1 ORGANISATION AND PRINCIPAL ACTIVITIES

ОАО NOVATEK (hereinafter referred to as “NOVATEK”) and its subsidiaries (hereinafter jointly referred to as the “Group”) is an independent oil and gas company engaged in the acquisition, exploration, development, production and processing of hydrocarbons with its core oil and gas operations located and incorporated in the Yamal-Nenets Autonomous Region (“YNAO”) of the Russian Federation.

The Group sells its natural gas on the Russian domestic market at unregulated market prices; however, the majority of natural gas sold on the domestic market is sold at prices regulated by the Federal Tariff Service, a governmental agency. The Group’s stable gas condensate and crude oil sales volumes are sold on both the Russian domestic and international markets, and are subject to fluctuations in benchmark crude oil prices. Additionally, the Group’s natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in the winter months of December and January and troughing in the summer months of July and August. The Group’s liquids sales volumes comprising stable gas condensate, crude oil and oil and gas products remain relatively stable from period to period.

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

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

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

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

In November 2010, ООО Yamal Development, the Group’s joint venture, acquired a 51 percent participation interest in ООО SeverEnergia. SeverEnergia through its three wholly owned subsidiaries holds four exploration and production licenses for the fields located in the YNAO (see Note 5).

In September 2010, the Group disposed of its 100 percent participation interest in ООО NOVATEK-Polymer, its non-core subsidiary, to ЗАО SIBUR Holding (see Note 5).

In August 2010, the Group acquired Intergaz-System Sp.z o.o., domiciled in Poland, to support and extend the wholesale and retail trading of liquefied petroleum gas in Polish market (see Note 5). In December 2010, Intergaz-System was merged into Novatek Polska, the Group’s wholly owned subsidiary.

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

In May 2010, the Group established ООО NOVATEK-Perm, a wholly owned subsidiary, to support the Group’s current natural gas deliveries to the Perm region, one of the largest industrial centers in the Russian Federation, as well as to expand potential sales opportunities in the territory. Furthermore, in April 2011, the Group acquired ООО Yamalenergogaz, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Perm Region for RR 75 million. In January 2012, Yamalenergogaz was merged into NOVATEK-Perm.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

## 2 BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention. In the absence of specific IFRS guidance for oil and gas producing companies, the Group has developed accounting policies in accordance with other generally accepted accounting principles for oil and gas producing companies, mainly US GAAP, insofar as they do not conflict with IFRS principles. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Most of the Group entities prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation (“RAR”). The Group’s consolidated financial statements are based on the statutory records with adjustments and reclassifications recorded in the consolidated financial statements for the fair presentation in accordance with IFRS. The principal adjustments primarily relate to (1) depreciation, depletion and amortization, and valuation of property, plant and equipment, (2) consolidation of subsidiaries, (3) business combinations, (4) accounting for income taxes, and (5) valuation of unrecoverable assets, expense recognition and other provisions.

**Functional and presentation currency.** The consolidated financial statements are presented in Russian roubles, the Group’s reporting (presentation) currency and the functional currency for the majority of Group’s entities. The assets and liabilities (both monetary and non-monetary) of the Group entities whose functional currency is not the Russian rouble are translated into Russian roubles at the closing exchange rate at each balance sheet date. All items included in the shareholders’ equity, other than profit or loss, are translated at historical exchange rates. The financial results of these entities are translated into Russian roubles using average exchange rates for each reporting period. Exchange adjustments arising on the opening net assets and the profits for the reporting period are taken to a separate component of equity until the disposal of the foreign operation and reported as currency translation differences in the consolidated statement of changes in equity and the consolidated statement of comprehensive income.

Exchange rates used in preparation of this consolidated financial statements for the entities whose functional currency is not the Russian rouble were as follows:

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

**Exchange rates, restrictions and controls.** Any re-measurement of Russian rouble amounts to US dollars or any other currency should not be construed as a representation that such Russian rouble amounts have been, could be, or will in the future be converted into other currencies at these exchange rates.

### 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

**Principles of consolidation.** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Group measures non-controlling interest on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed and reviews appropriateness of their measurement. Acquisition-related costs are recognised as expenses rather than included in goodwill.

The consideration transferred for the acquiree is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed, including fair value of assets or liabilities from contingent consideration arrangements but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity. Changes in the Group's ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions.

**Disposals of subsidiaries, associates or joint ventures.** When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are recycled to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

**Acquisition of non-controlling interests.** The difference between the purchase consideration and the carrying amount of non-controlling interests acquired is recognized within equity to account for acquisitions of non-controlling minority stakes.

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

**Investments in associates and joint ventures.** Associated companies and joint ventures are entities over which the Group has significant influence or joint control, respectively, but which it does not control. Generally, significant influence exists when the Group has between 20 and 50 percent of voting rights. Associated companies and joint ventures are accounted for using the equity method and are initially recognized at cost. The difference between the cost of an acquisition and the share of the fair value of the associate's identifiable net assets represents goodwill upon acquiring the associated company. Dividends received from associates and joint ventures reduce the carrying value of the investment in associates and joint ventures. The carrying amount of associates and joint ventures includes goodwill identified on acquisition less accumulated impairment losses, if any. Other post-acquisition changes in the Group's share of net assets of an associate or joint venture are recognised as follows: (i) the Group's share of profits or losses is recorded in the consolidated profit or loss for the year as share of result of associates or joint ventures; (ii) the Group's share of other comprehensive income is recognised in other comprehensive income and presented separately; and (iii) all other changes in the Group's share of the carrying value of net assets of associates or joint ventures are recognised in profit or loss within the share of result of associates or joint ventures. When the Group's share of losses in an associate or joint ventures equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Accounting policies of associates and joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

**Non-current assets held for sale.** Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less selling costs. Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment are not depreciated once classified as held for sale.

**Property, plant and equipment.** Property, plant and equipment are carried at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion, amortization and impairment.

The Group follows the successful efforts method of accounting for its oil and gas properties and equipment whereby property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overheads and all exploration costs other than exploratory drilling and license acquisition costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

The Group's principal oil and gas reserves have been independently estimated by internationally recognized petroleum engineers whereas other oil and gas reserves of the Group have been determined based on estimates of mineral reserves prepared by management in accordance with internationally recognized definitions. The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, subject to depletion using the unit-of-production method.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components that extend the life of property, plant and equipment items are capitalized and depreciated over the estimated remaining life of the major part or component. All components that are replaced are written off.

The cost of self-constructed assets includes the cost of direct materials, direct employee related costs, a pro-rata portion of depreciation of assets used for construction and an allocation of the Group's overhead costs.

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

At each reporting date management assesses whether there is any indication of impairment in respect of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less selling costs and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in the consolidated statement of income. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

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

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

**Depreciation.** Depreciation, depletion and amortization of oil and gas properties and equipment (except for processing facilities) is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for costs associated with acquisitions of proved properties. A portion of the reserves used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation and past results (or experience) to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the current license expiry dates.

Property, plant and equipment, other than oil and gas properties and equipment, are depreciated on a straight-line basis over their estimated useful lives. Land and assets under construction are not depreciated.

The estimated useful lives of the Group's property, plant and equipment, other than oil and gas properties and equipment, are as follows:

	<u>Years</u>
Machinery and equipment	5-15
Processing facilities	20-30
Buildings	25-50

**Derivative instruments.** Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value except for derivatives that are linked to and must be settled by delivery of investments in equity instruments that do not have a quoted, market price in an active market and whose fair value cannot be reliably determined. Derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year.

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

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

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

**Effective interest method.** The effective interest method is a method of calculating the carrying value of a financial asset or a financial liability held at amortized costs and of allocating the interest income or interest expense over the relevant period.

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

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

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

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

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivative instruments are also categorized as held for trading unless they are designated as hedges. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the consolidated statement of income. Gains or losses arising from changes in the fair value of the “financial assets at fair value through profit or loss” category are presented in the consolidated statement of income within other operating income (loss) in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the consolidated statement of income as part of other operating income (loss) when the Group’s right to receive payments is established.

Financial assets at fair value through profit or loss are classified as current assets. There were no financial assets designated at fair value through profit or loss held by the Group at the reporting dates.

(b) *Held-to-maturity investments*

Held-to-maturity investments include quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. After initial measurement, the held-to-maturity investments are measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the investments are derecognized or impaired, as well as through the amortization process.

Held-to-maturity investments are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. There were no such investments held by the Group at the reporting dates.

(c) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Financial assets classified as loans and receivables are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets.

(d) *Available-for-sale financial assets*

Financial assets classified as available-for-sale are non-derivatives financial assets that are either designated in this category or are not classified in any of the other categories. After initial recognition, financial assets classified as available-for-sale are measured at fair value, with gains and losses recognized in other comprehensive income and accumulated in revaluation reserve in equity until the investment is derecognized or determined to be impaired, at which time the cumulative gain or loss previously recorded in equity is recognized in consolidated statement of income as a reclassification adjustment from other comprehensive income.

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

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale financial assets are analyzed between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognized in consolidated statement of income, while translation differences on non-monetary securities are recognized in other comprehensive income. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in other comprehensive income. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the consolidated statement of income as a reclassification adjustment from other comprehensive income.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in consolidated statement of income) is recognized in the consolidated statement of income as a reclassification adjustment from other comprehensive income. Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed. There were no available-for-sale investments held by the Group at the reporting dates.

**Financial liabilities.** Financial liabilities are classified at initial recognition as either financial liabilities at fair value through profit or loss, derivative instruments designated as hedging instruments in an effective hedge or as financial liabilities measured at amortized cost. There were no derivative instruments designated as hedging instruments by the Group at the reporting dates. The measurement of financial liabilities depends on their classification, as follows:

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

Derivative instruments, other than those designated as effective hedging instruments, are classified as held for trading and are included in this category. These financial liabilities are carried on the consolidated statement of financial position at fair value with gains or losses recognized in the consolidated statement of income. There were no financial liabilities designated at fair value through profit or loss held by the Group at the reporting dates.

(b) *Financial liabilities measured at amortized cost*

All other financial liabilities are included in this category and initially recognized at fair value. For interest-bearing debt, the fair value of the liability is the fair value of the proceeds received net of associated issue costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method. This category of financial liabilities includes trade and other payables and debt in the consolidated statement of financial position.

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

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

Income taxes have been provided for in the consolidated financial statements in accordance with Russian legislation enacted or substantively enacted as of end of the reporting period. The income tax charge or benefit comprises current tax and deferred tax and is recognized in the consolidated statement of income unless it relates to transactions that are recognized, in the same or a different period, in other comprehensive income or directly in equity. Current tax is the amount expected to be paid to or recovered from the tax authorities in respect of taxable profits or losses for the current and prior periods.



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

Deferred tax assets and liabilities are recognized in full for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or when the tax loss carry forwards will be utilized. Deferred tax assets and liabilities are netted only with respect to individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilized.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries or joint ventures, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future. Any resultant deferred income tax is measured at the expected tax rate.

**Inventories.** Natural gas, gas condensate, crude oil and related products inventories are valued at the lower of cost or net realizable value. The cost of inventories includes applicable purchase costs of raw materials, direct operating costs, and related production overhead expenses and is recorded on a first-in-first-out (FIFO) basis. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Materials and supplies inventories are carried at amounts which do not exceed their respective recoverable amounts in the normal course of business.

**Trade and other receivables.** Trade receivables are represented by amounts due from regular customers in the ordinary course of business (production and marketing of natural gas, gas condensate, crude oil and related products; production and marketing of polymer and insulation tape products). Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method and include value-added taxes. Trade receivables are analyzed for impairment on a debtor by debtor basis. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognized in the consolidated statement of income within operating expenses. Subsequent recoveries of amounts previously written off are credited against the amount of the provision in the consolidated statement of income.

**Cash and cash equivalents.** Cash and cash equivalents comprises cash on hand, cash deposits held with banks, investments which are readily convertible to known amounts of cash and which are not subject to significant risk of change in value and have an original maturity of three months or less. For purposes of the presentation of the statement of cash flows, bank overdrafts are deducted from cash and cash equivalents. Bank overdrafts are shown within short-term debt in current liabilities on the consolidated statement of financial position.

**Treasury shares.** Where any Group company purchases NOVATEK's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to OAO NOVATEK shareholders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to OAO NOVATEK shareholders. Treasury shares are recorded at weighted average cost. Gains or losses resulting from subsequent sales of shares are recorded in the consolidated statement of changes in equity, net of associated costs including taxation.

**Dividends.** Dividends are recognized as a liability and deducted from shareholders' equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the consolidated financial statements are authorized for issue.

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

**Value added tax (VAT).** Output VAT related to sales is payable to the tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT related to purchases is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which is not settled or recovered at the balance sheet date (VAT payable and VAT recoverable) is recognized on a gross basis and disclosed separately within current assets and current liabilities. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

**Borrowings.** Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statement of income over the period of the borrowings using the effective interest method.

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

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

**Provisions for liabilities and charges.** Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events; when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be low.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Provisions are reassessed at each reporting date and changes in the provisions resulting from the passage of time are recognized in the consolidated statement of income as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

**Asset retirement obligations.** An asset retirement obligation is recognized when the Group has a present legal or constructive obligation to dismantle, remove and restore items of property, plant and equipment whose construction is substantially completed. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation, determined using discount rates reflecting adjustments for risks specific to the obligation. Changes in the obligation resulting from the passage of time are recognized in the consolidated statement of income as interest expense. Changes in the obligation, reassessed at each balance sheet date, related to a change in the expected pattern of settlement of the obligation, or in the estimated amount of the obligation or in the discount rates, are treated as a change in an accounting estimate in the period. Such changes are reflected as adjustments to the carrying value of property, plant and equipment and the corresponding liability.

The Group's exploration, development and production activities involve the use of wells, related equipment and operating sites, oil and gas gathering and treatment facilities and in-field pipelines. Generally, licenses and other regulatory acts require that such assets be decommissioned upon the completion of production, i.e. the Group is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Group's estimates of these obligations are based on current regulatory or license requirements, as well as actual dismantling and related costs.

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

The Group's management believes that due to the limited history of gas condensate processing and polymer production plants activities, the useful lives of these assets are indeterminable (while certain of the operating components and equipment have definite useful lives). Because of these reasons, and the lack of clear legal requirements as to the recognition of obligations, the fair value of an asset retirement obligation for such processing facilities cannot be reasonably estimated and, therefore, legal or contractual asset retirement obligations related to these assets are not recognized.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

**Foreign currency transactions.** Transactions denominated in foreign currencies are converted into the functional currency of each entity of the Group at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency remeasurement into the functional currencies are included in the determination of profit (loss) for the reporting period.

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

**Revenue recognition.** Revenues represent the fair value of consideration received or receivable for the sale of goods and services in the normal course of business, net of discounts, value-added tax and export duties.

Revenues from oil and gas sales and sales of polymer and insulation tape are recognized when such products are shipped or delivered to customers in accordance with the contract terms, the price is fixed or determinable, and the title has transferred. Services are recognized in the period in which the services are rendered.

Interest income is recognized as the interest accrues as related to the net carrying amount of the financial asset.

**General and administrative expenses.** General and administrative expenses represent overall corporate management and other expenses related to the general management and administration of the business unit as a whole. They include management and administrative compensation, legal and other advisory expenses, insurance of properties, social expenses and compensatory payments of general nature not directly linked to the Group's oil and gas activities, charity and other expenses necessary for the administration of the Group.

**Employee benefits.** Wages and salaries, bonuses, voluntary medical insurance, paid annual and sick leaves are accrued in the period in which the associated services are rendered by the employees of the Group. Compensation at dismissals, vocational support payments, and other allowances are expensed when incurred.

The Group contributes to the Russian Federation State social insurance fund and State pension plan on behalf of its employees based on gross salary payments. Mandatory contributions to the State social insurance fund and the State pension plan, which is a defined contribution plan, are expensed when incurred and are included in payroll expenses in the consolidated statement of income.

The Group also incurs employee costs related to the provision of benefits such as health and social infrastructure and services, employees meals, transportation, and other services. These amounts principally represent an implicit cost of employing production workers and, accordingly, are charged to payroll expenses in the consolidated statement of income.

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

**Share based compensation.** The Group accounts for share-based compensation in accordance with IFRS 2, *Share-based Payment*. The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted measured at the grant date. For share-based compensation made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

**Pension obligations.** The Group operates a non-contributory post-employment defined benefit plan based on employees' years of service and average salary (Note 14).

The liability recognized in the consolidated statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligations at the balance sheet date, together with adjustments for unrecognized past service costs. The present value of the pension obligations are determined by discounting the estimated future cash outflows and then attributing such present value to years of service of the respective employees. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The discount rate was determined by reference to Russian rouble denominated bonds issued by the Government of the Russian Federation chosen to match the duration of the post-employment benefit obligations.

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

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

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

**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

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

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

Judgments and estimates that have the most significant effect on the amounts reported in these consolidated financial statements and have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are described below.

**Useful lives of property, plant and equipment.** Management assesses the useful life of an asset by considering the expected usage, estimated technical obsolescence, residual value, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future depreciation rates and expenses for the period.

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

***Fair values of financial assets and liabilities.*** The fair value of financial assets and liabilities, other than financial instruments that are traded in an active market, is determined by applying various valuation methodologies. Management uses its judgment to make assumptions based on market conditions existing at each balance sheet date. Discounted cash flow analysis is used for various loans and receivables as well as debt instruments that are not traded in active markets. The effective interest rate is determined by reference to the interest rates of instruments available to the Group in active markets. In the absence of such instruments, the effective interest rate is determined by reference to the interest rates of active market instruments available adjusted for the Group's specific risk premium estimated by management.

***Deferred income tax asset recognition.*** Management assesses deferred income tax assets at each balance sheet date and determines the amount recorded to the extent that realization of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments and applies estimations based on prior years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

***Estimation of oil and gas reserves.*** Engineering estimates of oil and gas reserves are inherently uncertain and are subject to future revisions. The Group estimates its oil and gas reserves in accordance with rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves. Accounting measures such as depreciation, depletion and amortization charges, impairment assessments and asset retirement obligations that are based on the estimates of proved reserves are subject to change based on future changes to estimates of oil and gas reserves.

Proved reserves are estimated by reference to available reservoir and well information, including production and pressure trends for producing reservoirs. Furthermore, estimates of proved reserves only include volumes for which access to market is assured with reasonable certainty. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans.

Proved reserves are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are substantially developed and depleted. As those fields are further developed, new information may lead to further revisions in reserve estimates.

Oil and gas reserves have a direct impact on certain amounts reported in the consolidated financial statements, most notably depreciation, depletion and amortization as well as impairment expenses. Depreciation rates on oil and gas assets using the units-of-production method for each field are based on proved developed reserves for development costs, and total proved reserves for costs associated with the acquisition of proved properties. Assuming all variables are held constant, an increase in proved developed reserves for each field decreases depreciation, depletion and amortization expenses. Conversely, a decrease in the estimated proved developed reserves increases depreciation, depletion and amortization expenses. Moreover, estimated proved reserves are used to calculate future cash flows from oil and gas properties, which serve as an indicator in determining whether or not property impairment is present.

Although the possibility exists for changes or revisions in estimated reserves to have a critical effect on depreciation, depletion and amortization charges and, therefore, reported net profit for the year, it is expected that in the normal course of business the diversity of the Group's asset portfolio will mitigate the likelihood of this occurring.

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

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

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

**Impairment provision for trade receivables.** The impairment provision for trade receivables is based on management's assessment of the probability of collection of individual customer accounts receivable. Significant financial difficulties of the customer, probability that the customer will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

When there is no expectation of recovering additional cash for an amount receivable, the expected amount receivable is written off against the associated provision.

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

**Pension obligations.** The cost of defined benefit pension plans and related current service costs are determined using actuarial valuations. The actuarial valuations involve making demographic assumptions (mortality rates, age of retirement, employee turnover and disability) as well as financial assumptions (discount rates, expected rates of return on assets, inflation forecasts, future salary and pension increases). Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

**Asset retirement obligations.** Management makes provision for the future costs of decommissioning oil and gas production facilities, pipelines and related support equipment based on the best estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future.

Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The Group also assesses its liabilities for site restoration at each consolidated statement of financial position period in accordance with the guidelines of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the balance sheet date based on current legislation where the Group's respective operating assets are located, and is also subject to change because of modifications, revisions and changes in laws and regulations and their interpretation thereof. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of incurring such costs.

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

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS

### *Acquisition of OOO Gazprom mezhregiongas Chelyabinsk*

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

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

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

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

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

In May 2009, the Group signed a call option agreement, which provided the Group with the right, but not the obligation, to purchase an additional 23.9 percent equity stake in Yamal LNG for USD 450 million until 4 June 2012. To enter into this call option agreement, the Group paid RR 325 million (USD 10 million) in July 2009, which was recorded as a decrease in retained earnings in the consolidated statement of changes in equity.

In February 2011, the Group reassigned the call option to purchase a 23.9 percent equity stake in Yamal LNG from its foreign subsidiary to its Russian subsidiary. As a result of a change in the functional currency from US dollars to Russian roubles, the call option was no longer considered an equity instrument and was reclassified to a financial asset with a value of RR 284 million (USD 10 million).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



## OAQ NOVATEK

### Notes to the Consolidated Financial Statements

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

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

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

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

Based on the Shareholders' agreement and the provisions of the Sales contract, the Group recorded the disposal of a 20 percent interest in Yamal LNG for total consideration of RR 36,893 million realizing a gain of RR 62,831 million, net of associated income tax of RR 117 million.

The following table summarizes the consideration details and shows the components of the gain from the sale of the ownership interest in Yamal LNG:

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

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

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

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

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

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

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

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

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

The following table reconciles the carrying value of Yamal LNG prior to disposal and the carrying value of the retained investment in the entity recorded under the equity method of accounting in these consolidated financial statements:

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

Prior to the disposal, the Group included balances and results of the operations of the disposed subsidiary within “exploration, production and marketing” in the Group’s segment.

***Acquisition of OOO Yamalgazresurs-Chelyabinsk***

In December 2010, the Group acquired a 100 percent participation interest in OOO Yamalgazresurs-Chelyabinsk, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Chelyabinsk Region of the Russian Federation for RR 410 million. Management has assessed the fair value of identifiable assets and liabilities and calculated that goodwill in the amount of RR 82 million arose on the acquisition. The financial and operational activities of Yamalgazresurs-Chelyabinsk would not have had a material impact on the Group’s revenues and results if the acquisition had occurred in January 2010.

***Acquisition of Intergaz-System Sp.z o.o.***

In August 2010, the Group acquired a 100 percent ownership in Intergaz-System Sp.z o.o., domiciled in Poland, for RR 159 million (USD 5 million). Intergaz-System holds a discharging and transshipment facility and was purchased to support and extend the wholesale and retail trading of liquefied petroleum gas in the Polish market. Management has assessed the fair value of identifiable assets and liabilities and calculated that negative goodwill RR 10 million arose on the acquisition which was recognized as other operating profit in the consolidated statement of income. The financial and operational activities of Intergaz-System would not have had a material impact on the Group’s revenues and results if the acquisition had occurred in January 2010.

In December 2010, the Group merged Intergaz-System into its wholly owned subsidiary Novatek Polska. The aforementioned merger did not affect the Group’s consolidated financial and operational results.

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

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

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)***Acquisition of OAO Sibneftegas*

On 17 December 2010, the Group acquired 51 percent of the outstanding ordinary shares of OAO Sibneftegas, an oil and gas company located in the YNAO, for total cash consideration of RR 25,826 million, of which RR 4,650 million was paid in December 2010 and the remaining RR 21,176 was paid in the first quarter of 2011. Sibneftegas holds production licenses in four fields, of which two, the Beregovoye and Pyreinoye gas condensate fields expire in 2023 and in 2021, respectively, are currently producing. Estimated aggregated proved reserves on these two fields as well as the Khadyryahinskoye (which expires in 2031) field appraised by DeGolyer and MacNaughton at 31 December 2010 under the PRMS and SEC reserve methodologies totaled approximately 282 billion and 200 billion cubic meters of natural gas and 2 million and 0.7 million tons of hydrocarbon liquids, respectively.

As part of the acquisition, the Group granted a loan in the amount of RR 11,038 million to Sibneftegas, which was used to fully repay its outstanding debt to Gazprombank ahead of its maturity schedule. Subsequent to the acquisition, the Group also entered into a purchase contract to buy natural gas from Sibneftegas in proportion to its ownership interest in the company's total production at pre-determined prices.

As described above, the Group acquired 51 percent of the outstanding ordinary shares of Sibneftegas; however, the Charter agreement stipulates that key financial and operational decisions regarding its business activities are subject to approval by nine out of the eleven members of the Board of Directors, representing unanimous approval by both shareholders and, consequently, the voting mechanism effectively establishes joint control over Sibneftegas. The Group accounts for it under the equity method.

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

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

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

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

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

In July 2010, NOVATEK and OAO Gazprom Neft, a subsidiary of OAO Gazprom, established a joint venture OOO Yamal Development. The Group owns a 50 percent participation interest in this entity and accounts for its share of the joint venture using the equity method.

On 30 November 2010, Yamal Development acquired a 51 percent participation interest in OOO SeverEnergiya for total cash consideration of RR 48,715 million paid upon acquisition. The acquisition was financed proportionally by its founders through the provision of loans in the total amount of RR 56,247 million (see Note 8). NOVATEK financed its part of the loan to Yamal Development through the use of a bridge loan facility (see Note 13).

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

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

Estimated aggregated proved reserves on these fields appraised by DeGolyer and MacNaughton under the PRMS and SEC reserve methodologies at 31 December 2010 totaled approximately 245 billion and 224 billion cubic meters of natural gas and 42 million and 39 million tons of hydrocarbon liquids, respectively.

As part of the acquisition, Yamal Development also provided a loan in the amount of RR 7,532 million to SeverEnergiya, which was used to fully repay the outstanding debt of the company to its previous shareholder ahead of its maturity schedule.

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

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

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

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

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

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

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

***Disposal of ownership interest in ZAO Terneftegas***

On 24 June 2009, NOVATEK and TOTAL E&P ACTIVITIES PETROLIERES ("TOTAL") signed a Heads of Agreement (the "Agreement") establishing the framework for joint cooperation in exploring and developing the Group's Termokarstovoye gas condensate field located in the YNAO.

The Agreement provides for the establishment of a joint venture through the acquisition by TOTAL of a 49 percent ownership interest in ZAO Terneftegas (formerly a limited liability company, OOO Terneftegas), a wholly owned subsidiary of the Group and holder of the license for exploration and production of natural gas and gas condensate at the Termokarstovoye field. Under the terms and conditions of the Agreement, the joint venture had two years to complete exploration works and prepare a field development plan, with a final investment decision to proceed further to be taken in 2011. In December 2011, a final investment decision was made and the respective field development plan was approved.

In December 2009, the Group signed a Sales and Purchase contract with Total Termokarstovoye B.V., an affiliate of TOTAL, for:

- the sale of a 28 percent interest in Terneftegas for total consideration of USD 24.1 million, of which USD 16 million was paid at the date of title transfer and the remaining USD 8.1 million (deferred payment) was to be paid upon approval by TOTAL of the final investment decision (payment received in December 2011); and
- a further increase of TOTAL's equity share in Terneftegas to 49 percent through a subscription to the entity's additional shares emission for total consideration of USD 18 million.

The Group transferred legal ownership of a 28 percent interest in Terneftegas to Total Termokarstovoye B.V. in February 2010 upon the execution of the first arrangement. In January 2010, Terneftegas registered with the Federal Service for Financial Markets (FSFM) for an additional shares emission, the acquisition of which was completed by TOTAL in June 2010. In September 2010, the legal implementation of the second arrangement of the transaction was completed and the subscription for the issuance of the additional shares was registered with the FSFM by Total Termokarstovoye B.V.

Based on the Agreement and the provisions of the Sales and Purchase contract, these two arrangements were accounted as a single transaction and, in February 2010, the Group recorded a disposal of a 49 percent ownership interest in Terneftegas for total consideration of RR 982 million realizing a gain of RR 1,466 million, net of associated income tax of RR 117 million.

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

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

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

The following table summarizes the consideration details and shows the components of the gain from the sale of the ownership interest in Terneftegas:

	<b>RR million</b>
Cash	483
Receivable in respect of the deferred payment (USD 8.1 million at exchange rate of RR 30.11 to USD 1.00 discounted at 5.1 percent per annum)	222
The Group's proportion in an additional shares emission proceeds (51 percent of USD 18 million at exchange rate of RR 30.11 to USD 1.00)	277
<b>Total consideration</b>	<b>982</b>
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment in joint venture	807
<b>Gain on the sale of ownership interest</b>	<b>1,583</b>

As described above, the Group retained a 51 percent interest in Terneftegas; however, the Agreement stipulates that key financial and operational decisions shall be subject to unanimous approval by both shareholders and none of the participants have a preferential voting right. In February 2010, all operating bodies of the joint venture were established and the Group's effective control over Terneftegas ceased. As a result of these changes, the Group has determined that Terneftegas is a joint venture and is accounted for using the equity method.

In accordance with IAS 27 "Consolidated and Separate Financial Statements", the Group remeasured its retained investment in Terneftegas at fair value at the date of ceasing control, with the change in value of RR 807 million recognized as a part of the gain from disposal.

The following table reconciles the carrying value of Terneftegas prior to disposal and the carrying value of the retained investment in the entity recorded under the equity method of accounting in these consolidated financial statements:

<i>ZAO Terneftegas</i>	<b>RR million</b>
Carrying value of the net assets at disposal	420
The Group's proportion in an additional shares emission proceeds	277
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment	807
<b>The carrying value of investment in joint venture</b>	<b>1,298</b>

Prior to the disposal, the Group included balances and results of the operations of the disposed subsidiary within "Exploration, production and marketing" in the Group's segment information.

**Acquisition of controlling interests in associates**

On 15 February 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksnftegas, entities recorded as associates to 51 percent through the acquisition of an additional 26 percent participation interests in each company for the total cash consideration of RR 1,297 million. These entities are all exploration stage oil and gas companies and hold exploration licenses for the Middle-Chaselskiy, North-Russkiy, West-Tazovski, Anomalniy and North-Yamsoveskiy license areas. These licenses expire between 2012 and 2014. The Group intends to receive production licenses for these fields based on the exploration activities performed to date. Following the acquisition, in February 2010, Oiltechproduct-Invest obtained the production license for the West-Chaselskoe field, which expires in 2030.

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

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

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

All three entities had no notable operating activities up to and as at the purchase date and are all considered to be in their early exploration stage; consequently, this acquisition is outside the definition of “business” as defined in IFRS 3, *Business Combinations*. The acquisition cost has been allocated based on the relative fair values of the assets acquired (largely comprised of their respective mineral licenses), and liabilities assumed.

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Property, plant and equipment	547	370	959	1,876
Other non-financial assets	531	199	314	1,044
Financial assets	190	9	18	217
Short-term debt	(769)	(519)	(862)	(2,150)
Other financial liabilities	(149)	(108)	(203)	(460)
Non-financial liabilities	(146)	(39)	(102)	(287)
<b>Total identifiable net assets (liabilities)</b>	<b>204</b>	<b>(88)</b>	<b>124</b>	<b>240</b>

The following table shows the total cost of the acquired mineral rights:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Carrying value of the 25 percent participation interest	438	369	407	1,214
Purchase consideration for the 26 percent participation interest	502	380	415	1,297
Gross up for total value of the assets acquired	903	720	791	2,414
Less: identifiable net assets (liabilities)	(204)	88	(124)	(240)
<b>Cost of the acquired mineral rights</b>	<b>1,639</b>	<b>1,557</b>	<b>1,489</b>	<b>4,685</b>

The aforementioned property, plant and equipment in the amount of RR 1,876 million combined with the cost of mineral rights in the amount of RR 4,685 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6.

The financial and operational activities of Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas were not material to the Group’s revenues and results of operations for the year ended 31 December 2010.

***Acquisition of additional participation interest in subsidiaries***

In April 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas to 82.4 percent, 92.6 percent and 94.2 percent, respectively, through an additional capital contribution to the ordinary share capital of these entities. Furthermore, in May 2010, the Group brought its participation interest in the share capital of each of the above mentioned companies to 100 percent through the acquisition of the remaining ordinary share capital from non-controlling interests. As a consequence of these two transactions the Group paid cash of RR 629 million, reduced non-controlling interests by RR 2,368 million and recorded a difference of RR 1,739 million directly to retained earnings.

In December 2010, the Group merged its wholly owned subsidiary, Oiltechproduct-Invest into its wholly owned subsidiary OOO NOVATEK-Tarkosaleneftegas. In November 2011, the Group merged its wholly owned subsidiary, Tailiksneftegas into its wholly owned subsidiary OOO NOVATEK-Yurkharovneftegas. The aforementioned mergers did not affect the Group’s consolidated financial and operational results.

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

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**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)*****Disposal of OOO NOVATEK-Polymer***

In September 2010, the Group disposed of its 100 percent participation interest in OOO NOVATEK-Polymer, its non-core subsidiary, to ZAO SIBUR Holding for RR 2,400 million (undiscounted) payable throughout September 2013. The Group recognized a loss on the sale of RR 279 million, net of associated income tax of RR 25 million. The Group has 100 percent participation interest in NOVATEK-Polymer as collateral for the receivable until full settlement.

Below is a breakdown of major classes of assets and liabilities disposed:

<i>OOO NOVATEK-Polymer</i>	<b>RR million</b>
Property, plant and equipment	1,617
Deferred tax assets	189
Inventories	440
Financial assets	340
Other non-financial assets	160
Deferred tax liability	(294)
Short-term debt	(113)
Other financial liabilities	(66)
<b>Total net assets</b>	<b>2,273</b>

The following table summarizes the consideration details from the sale of NOVATEK-Polymer:

	<b>RR million</b>
Cash	287
Receivable in respect of the deferred payments (RR 2,113 million discounted at 8 percent per annum)	1,732
Total consideration	2,019
Less: carrying amount of net assets disposed	(2,273)
<b>Loss on disposal</b>	<b>(254)</b>

NOVATEK-Polymer constituted the Group's "polymer products production and marketing" segment (see Note 31).

***Acquisition of OAO Tambeyneftegas***

On 1 July 2010, the Group acquired 100 percent of the outstanding ordinary shares of OAO Tambeyneftegas, an exploration stage oil and gas company located in the southern portion of the Yamal peninsula (YNAO) for total cash consideration of RR 312 million (USD 10 million), of which 75 percent was acquired from related parties for RR 234 million (USD 7 million) (see Note 30). Tambeyneftegas holds the license for exploration and development of the Malo-Yamalskoye field (expires in 2019) with estimated natural gas and gas condensate reserves in accordance with the Russian reserve classification (categories C1 + C2) amounting to 161 billion cubic meters and 14.4 million tons, respectively.

Tambeyneftegas had no notable operating activities up to and as at the purchase date, and is considered an entity in the early exploration stage; consequently, this acquisition is outside the definition of "business" as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the mineral license), and liabilities of the company acquired.



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

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

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>OAO Tambeyneftegas</i>	<b>RR million</b>
Property, plant and equipment	303
Deferred tax assets	176
Other non-financial assets	23
Financial assets	12
Short-term debt	(641)
Interest on short-term debt	(229)
Assets retirement obligations	(165)
Other non-financial liabilities	(4)
<b>Total identifiable net liabilities</b>	<b>(525)</b>

The following table shows the total cost of the acquired mineral rights:

	<b>RR million</b>
Total purchase consideration	312
Add: identifiable net liabilities	525
<b>Cost of the acquired mineral rights</b>	<b>837</b>

The property, plant and equipment in the amount of RR 303 million combined with the cost of the mineral rights in the amount of RR 837 million are included in the line "acquisition of subsidiaries" as disclosed in Note 6. Short-term debt in the amount of RR 641 million and interest on short-term debt in the amount of RR 229 million represent balances with the Group companies, which are to be settled in the normal course of business.

The financial and operational activities of Tambeyneftegas were not material to the Group's revenues and results of operations for the year ended 31 December 2010.

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**6 PROPERTY, PLANT AND EQUIPMENT**

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

	Oil and gas properties and equipment	Assets under construction and advances for construction	Other	Total
Cost	157,955	19,885	5,319	183,159
Accumulated depreciation, depletion and amortization	(20,436)	-	(1,275)	(21,711)
<b>Net book value at 1 January 2010</b>	<b>137,519</b>	<b>19,885</b>	<b>4,044</b>	<b>161,448</b>
Acquisition of subsidiaries	5,960	1,875	70	7,905
Additions	3,265	22,828	13	26,106
Transfers	27,018	(27,722)	704	-
Depreciation, depletion and amortization	(6,461)	-	(367)	(6,828)
Disposal of subsidiaries, net	-	(319)	(1,298)	(1,617)
Impairment	(321)	-	-	(321)
Disposals, net	(495)	(525)	(100)	(1,120)
Cost	193,411	16,022	4,236	213,669
Accumulated depreciation, depletion and amortization	(26,926)	-	(1,170)	(28,096)
<b>Net book value at 31 December 2010</b>	<b>166,485</b>	<b>16,022</b>	<b>3,066</b>	<b>185,573</b>
Acquisition of subsidiaries	108	183	30	321
Additions	10,140	27,869	22	38,031
Transfers	15,455	(20,216)	4,761	-
Depreciation, depletion and amortization	(9,026)	-	(424)	(9,450)
Disposal of subsidiaries, net	(40,136)	(5,665)	(66)	(45,867)
Impairment	(513)	(107)	-	(620)
Disposals, net	(549)	(439)	(216)	(1,204)
Cost	177,788	17,647	8,603	204,038
Accumulated depreciation, depletion and amortization	(35,824)	-	(1,430)	(37,254)
<b>Net book value at 31 December 2011</b>	<b>141,964</b>	<b>17,647</b>	<b>7,173</b>	<b>166,784</b>

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

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

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

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

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

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

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

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

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

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

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

Capital commitments are disclosed in Note 28.

**Asset retirement obligations.** Estimated costs of dismantling oil and gas production facilities, pipelines and related processing facilities, including abandonment and site restoration costs, amounting to RR 1,615 million and RR 1,115 million at 31 December 2011 and 2010, respectively, are included in the cost of oil and gas properties and equipment. The Group has estimated its liability based on current legislation using estimated costs and timing of when the expenses are expected to be incurred between the end of the reporting period and 2051. Governmental authorities are continually reviewing regulations and their enforcement. Consequently, the Group’s ultimate liabilities may differ from the recorded amounts.

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**7 INVESTMENTS IN JOINT VENTURES**

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

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

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

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

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

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

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

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

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

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

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

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**8 LONG-TERM LOANS AND RECEIVABLES**

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

*Russian rouble denominated loans.* On 15 December 2010, the Group provided two loans to OAO Sibneftegas, the Group's joint venture, for RR 7,429 million and RR 3,609 million. The first loan was issued at an annual interest rate of 10 percent and is repayable in November 2014. The second loan was issued at an annual interest rate of 9.5 percent and is repayable quarterly in equal parts starting from March 2011 until November 2014. At 31 December 2011 and 2010, the loans provided to Sibneftegas amounted to RR 9,737 million and RR 11,038 million, respectively (see Note 30).

On 29 November 2010, the Group provided a loan to OOO Yamal Development, the Group's joint venture, in the amount of RR 28,123 million. The loan was issued at an annual interest rate of 8 percent and is repayable in November 2011; however, for the purpose of these financial statements, the loan was treated as part of the Group's net investment in its joint venture and classified as long-term. At 31 December 2010, the loan was recorded in the amount of RR 28,123 million, net of accumulated losses recognized by Yamal Development in excess of the Group's investment in the joint venture in the amount of RR 238 million (see Note 7). In June 2011, NOVATEK converted RR 9,775 million, excluding accrued interest, of this loan to equity (see Note 7).

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

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

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

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**9 INVENTORIES**

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

The Group recorded an impairment expense of nil and RR 8 million during the years ended 31 December 2011 and 2010, respectively, to write-down the carrying value of inventory due to obsolescence. No inventories were pledged as security for the Group's borrowings or payables at both dates.

**10 TRADE AND OTHER RECEIVABLES**

	At 31 December:	
	2011	2010
Trade receivables (net of provision of RR 133 million and RR nil million at 31 December 2011 and 2010, respectively)	14,900	7,031
Other receivables	1,703	1,445
Interest on loans receivable	96	194
<b>Total trade and other receivables</b>	<b>16,699</b>	<b>8,670</b>

The carrying values of trade and other receivables approximate their respective fair values. The related exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above.

The Group holds letters of credit in banks with investment grade rating as security for trade receivables in amount RR 1,706 million and RR 1,667 million at 31 December 2011 and 2010, respectively. Also the Group holds as a collateral 100 percent participation interest in OOO NOVATEK-Polymer for other receivables from ZAO SIBUR Holding (see Note 5). The Group does not hold any other collateral as security for trade and other receivables (see Note 27 for credit risk disclosures).

Trade and other receivables that are less than three months past due are generally not considered for impairment unless other indicators of impairment exist. Trade and other receivables of RR 478 million and RR 8 million at 31 December 2011 and 2010, respectively, were past due but not impaired.

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

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

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

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

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

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

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

**11 PREPAYMENTS AND OTHER CURRENT ASSETS**

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

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



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**12 CASH AND CASH EQUIVALENTS**

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

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

**13 LONG-TERM DEBT**

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

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

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

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

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

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

**Gazprombank.** On 3 November 2009, the Group signed a loan agreement with OAO Gazprombank, which provided the Group with a loan facility of RR 10 billion until November 2012. By the end of 2010, the Group withdrew the full amount of the loan facility. Throughout 2010 and the first three months of 2011, the Group gradually reduced the stated interest rate from the initial 13 percent to 8 percent per annum. At 31 December 2011, the outstanding amount was RR 10 billion. In January 2012, the loan was fully repaid ahead of its maturity schedule.

**Russian rouble denominated bonds.** In June 2010, the Group issued ten million three-year non-convertible Russian rouble denominated bonds, each with a nominal value RR 1,000 and an annual coupon rate of 7.5 percent, payable semi-annually. At 31 December 2011, the outstanding amount was RR 9,971 million, net of unamortized transaction costs of RR 29 million.

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

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

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

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

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

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

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

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

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

**14 PENSION OBLIGATIONS**

In February 2007, the Group announced the implementation of a post-employment benefit program for its retired employees. Under the pension program, employees who are employed by the Group for more than three years (extended to five years effective 1 February 2011) and retire from the Group on or after the statutory retirement age will receive monthly payments from NOVATEK for life unless they are actively employed. The amount of payments to be disbursed depends on the average salary, duration and location of employment. The program is effective from 1 January 2007 and applies to employees who retire after that date.

The program represents an unfunded defined benefit plan and is accounted for as such under provisions of IAS 19, *Employee Benefits*. The impact of the program on the consolidated financial statements is disclosed below.

The amounts recognized in the consolidated statement of financial position and included in other non-current liabilities are determined as follows:

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

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

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

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**14 PENSION OBLIGATIONS (CONTINUED)**

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

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

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

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

	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Weighted average discount rate	7.4%	7.6%
Projected annual increase in employee compensation	5.8%	10%
Expected increases to pension benefits	5.8%	5%

The assumed average salary and pension payment increases for Group employees have been calculated on the basis of inflation forecasts, analysis of increases of past salaries and the general salary policy of the Group. Inflation forecasts have been estimated to reduce from 5.9 percent for 2012 to 4.7 percent in 2016 and on average equal to 4.4 percent thereafter.

Mortality assumptions are based on the Russian mortality tables published by the State Statistics Committee from the years 1986 to 1987, which management believes are the most conservative and prudent Russian whole-population mortality tables available.

Management has assessed that reasonable changes in the most significant actuarial assumptions will not have a significant impact on the consolidated statement of income or the liability recognized in the consolidated statement of financial position.

**15 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT**

	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
US dollar denominated loans	-	18,200
Total	-	18,200
Add: current portion of long-term debt	20,298	6,952
<b>Total short-term debt and current portion of long-term debt</b>	<b>20,298</b>	<b>25,152</b>

**15 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT (CONTINUED)**

**Bridge loan facility.** At 31 December 2010, the US dollar denominated loans included the RR 18,200 million (USD 597 million), net of unamortized part of transaction costs of RR 85 million, bridge loan facility obtained for financing of the acquisition by the Group's joint venture ООО Yamal Development of a 51 percent participation interest in ООО SeverEnergia. The bridge loan facility had a one-year tenure with a bullet repayment to be made by 15 November 2011. The interest rate under the bridge facility was LIBOR plus one percent per annum. In February 2011, the bridge loan was fully repaid ahead of its maturity schedule.

**Available credit facilities.** The Group's available credit facilities at 31 December 2011 were as follows:

	Par value	Expiring	
		Within one year	Between 1 and 2 years
Credit Agricole Corporate and Investment Bank <sup>(a)</sup>	USD 100 million	3,220	-
BNP PARIBAS Bank <sup>(a)</sup>	USD 100 million	3,220	-
UniCredit Bank <sup>(a)</sup>	USD 150 million	4,829	-
Sberbank <sup>(b)</sup>	RR 40 billion	40,000	-
<b>Total available credit facilities</b>		<b>51,269</b>	<b>-</b>

<sup>(a)</sup> – interest rates are predetermined or negotiated at time of each withdrawal.

<sup>(b)</sup> – interest rate set to 9.2 percent per annum and the facility is repayable by December 2014.

The Group also maintained available funds under short-term credit lines in the form of bank overdrafts with various international banks for RR 6,278 million (USD 195 million) and RR 5,943 million (USD 195 million) at 31 December 2011 and 2010, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

**16 TRADE PAYABLES AND ACCRUED LIABILITIES**

	At 31 December:	
	2011	2010
<b>Financial liabilities</b>		
Trade payables	5,187	2,194
Other payables	16,615	24,760
Interest payable	1,009	53
<b>Non-financial liabilities</b>		
Advances from customers	743	412
Salary payables	1,124	897
Other liabilities	244	163
<b>Trade payables and accrued liabilities</b>	<b>24,922</b>	<b>28,479</b>

At 31 December 2011, other payables included RR 16,244 million (USD 505 million) relating to the acquisition of a 49 percent equity stake in ОАО Yamal LNG.

At 31 December 2010, other payables included RR 21,176 million relating to the acquisition of 51 percent ownership in Sibneftegas, which was fully paid in March 2011.

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**17 SHAREHOLDERS' EQUITY**

**Ordinary share capital.** Share capital issued and paid in consisted of 3,036,306,000 ordinary shares at 31 December 2011 and 2010 with a par value of RR 0.1 each. The total authorized number of ordinary shares was 10,593,682,000 shares at both dates.

**Treasury shares.** In accordance with the *Share Buyback Program* authorized by the Board of Directors on 11 February 2008, the Group's wholly-owned subsidiary, Novatek Equity (Cyprus) Limited, during 2008 has purchased ordinary shares of OAO NOVATEK in the form of Global Depository Receipts (GDRs) on the London Stock Exchange through the use of independent brokers. At 31 December 2011 and 2010, the Group held 196,853 GDRs (1,969 thousand ordinary shares) and 312,277 GDRs (3,123 thousand ordinary shares) at a total cost of RR 281 million and RR 446 million, respectively. The Group has decided that these GDRs do not vote.

During the years ended 31 December 2011 and 2010, the Group sold 115,424 GDRs (1,154 thousand ordinary shares) and 106,956 GDRs (1,070 thousand ordinary shares) for RR 536 million and RR 341 million, recognizing gains of RR 355 million and RR 188 million, respectively, which were recorded within additional paid-in capital in the consolidated statement of changes in equity.

**Dividends.** Dividends (including tax on dividends) declared and paid were as follows:

	Year ended 31 December:	
	2011	2010
Dividends payable at 1 January	-	13
Dividends declared <sup>(*)</sup>	15,166	9,855
Dividends paid <sup>(*)</sup>	(15,166)	(9,868)
<b>Dividends payable at 31 December</b>	<b>-</b>	<b>-</b>
Dividends per share declared during the year (in Russian roubles)	5.00	3.25
Dividends per GDR declared during the year (in Russian roubles)	50.0	32.5

<sup>(\*)</sup> – excluding treasury shares.

The Group declares and pays dividends in Russian roubles. Dividends declared in 2011 and 2010 were as follows:

Final for 2010: RR 2.50 per share or RR 25.0 per GDR declared in April 2011	7,591
Interim for 2011: RR 2.50 per share or RR 25.0 per GDR declared in October 2011	7,591
<b>Total dividends declared in 2011</b>	<b>15,182</b>
Final for 2009: RR 1.75 per share or RR 17.5 per GDR declared in April 2010	5,314
Interim for 2010: RR 1.50 per share or RR 15.0 per GDR declared in October 2010	4,554
<b>Total dividends declared in 2010</b>	<b>9,868</b>

**Distributable retained earnings.** In accordance with Russian legislation, NOVATEK distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. Russian legislation identifies the net profit as basis of distribution. For 2011 and 2010, the net statutory profits of NOVATEK as reported in the published annual statutory reporting forms were RR 39,714 million and RR 21,323 million, respectively. The closing balances of the accumulated profit including the respective years net statutory profit totalled RR 120,889 million and RR 81,176 million at 31 December 2011 and 2010, respectively.

Accumulated profits legally distributable are based on the amounts available for distribution in accordance with the applicable legislation and as reflected in the statutory financial statements of the individual entities of the Group. These amounts may differ significantly from the amounts calculated on the basis of IFRS.

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**18 SHARE-BASED COMPENSATION PROGRAM**

On 12 February 2010, NOVATEK's Management Committee approved a share-based compensation program (the "Program") for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee, which aims to encourage participants to take an active interest in the future development of the Group and to provide material incentive to create shareholders value in OAO NOVATEK. The Program was established in accordance with the *Concept of the Long-Term Incentive of Senior Employees* approved by the Board of Directors on 25 September 2006 and the *Share Buyback Program*.

The Program is established as a cash-settled payment program and references the Group's GDRs, which are publicly traded on the London Stock Exchange ("LSE") under the ticker symbol "NVTK". At 31 December 2011 and 2010, the Program covered 146 and 164 employees, respectively. Each participant is assigned a pre-determined number of GDRs in accordance with their respective job classification grade and the entitlement for the cash-settled share-based payment cannot be transferred to another person. The cash-settled payments will only be awarded if the participant is employed with the Group at the date of payment.

	<i>Number of GDRs</i>	<i>Weighted average or closing price (LSE), USD per GDR</i>
<b>Total amount of GDRs granted at 12 February 2010</b>	<b>407,766</b>	<b>68.1</b>
Granted	5,352	94.1
Exercised	-	-
Forfeited	(30,750)	-
<b>Total amount of GDRs granted at 31 December 2010</b>	<b>382,368</b>	<b>119.5</b>
Granted	-	-
Exercised	(104,728)	105.0
Forfeited	(36,984)	-
<b>Total amount of GDRs granted at 31 December 2011</b>	<b>240,656</b>	<b>125.2</b>

The Program has three one-year vesting periods ending 31 January 2011, 2012, and 2013. Each participant is granted share appreciation rights, as part of their remuneration package, and may elect to get paid in cash at the end of each vesting period or to defer payment to the subsequent vesting periods during the Program life. Each payment is based on the sale of the allocated GDRs and is calculated as the difference between the GDRs market price at time of sale and the Program's pre-defined price set at USD 48.62 relating to the one-third of the total number of GDRs assigned to each participant during the vesting period, including any deferrals from prior vesting periods. The grant date is defined as 31 March 2010 and represents the date when all participants agreed to a share-based payment arrangement.

In accordance with IFRS 2 "*Share-based payment*", the Group re-measures the employees' services rendered and the liability incurred at the fair value of the liability. Until the liability is settled, the Group re-measures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model based on Monte-Carlo simulations, and to the extent to which the employees have rendered service to date.

The fair value of the Program is determined based on the following assumptions:

	<b>2011</b>	<b>2012</b>
Expected volatility	49.84%	49.84%
Risk-free interest rate	-	0.67%
Expected option life (years)	0.09	1.09
Exercise price per GDR (USD)	48.62	48.62

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**18 SHARE-BASED COMPENSATION PROGRAM (CONTINUED)**

Expected volatility is calculated based on the historical volatility of the price per GDR for the historical period equal to the expected life of the Program (1.1 years). Risk-free interest rate is based on a benchmark USD curve including Deposit Rates (DEPO), Forward Rate Agreements (FRA) and Interest Rate Swaps (IRS).

The fair value of the share-based payments is recognized as a payable to the employees over the vesting period and any changes in the fair value of the liability recognized in the consolidated statement of income.

The amounts recognized by the Group in respect of the Program are as follows:

<i>Expenses included in</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
General and administrative expenses	235	400
<hr/>		
<i>Liabilities included in</i>	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Other non-current liabilities	226	236
Trade payables and accrued liabilities	244	164
<hr/>		
<b>Total share-based compensation program liabilities</b>	<b>470</b>	<b>400</b>

**19 OIL AND GAS SALES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Natural gas	110,932	71,060
Stable gas condensate	46,778	29,754
Liquefied petroleum gas	15,227	12,747
Crude oil	2,479	1,458
Oil and gas products	186	143
<hr/>		
<b>Total oil and gas sales</b>	<b>175,602</b>	<b>115,162</b>

**20 TRANSPORTATION EXPENSES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Natural gas transportation to customers	34,441	26,569
Liquids transportation by rail	9,638	7,350
Liquids transportation by tankers	3,647	2,771
Crude oil transportation to customers	281	190
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	-	307
Other	169	13
<hr/>		
<b>Total transportation expenses</b>	<b>48,176</b>	<b>37,200</b>



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**21 TAXES OTHER THAN INCOME TAX**

The Group is subject to a number of taxes other than income tax, which are detailed as follows:

	Year ended 31 December:	
	2011	2010
Unified natural resources production tax	14,523	7,861
Property tax	1,742	1,482
Excise and fuel taxes	998	454
Other taxes	294	280
<b>Total taxes other than income tax</b>	<b>17,557</b>	<b>10,077</b>

The unified natural resources production tax for natural gas production was set at a rate of RR 237 and RR 147 per thousand cubic meters for 2011 and 2010.

The unified natural resources production tax rate for gas condensate was set at 17.5 percent of gas condensate revenues recognized by the producing entities.

Under the Tax Code of the Russian Federation, the tax rate for the unified natural resources production tax for crude oil is calculated by reference to an average price for Urals blend and an average exchange rate over the relevant tax period.

**22 GENERAL AND ADMINISTRATIVE EXPENSES**

	Year ended 31 December:	
	2011	2010
Employee compensation	4,650	3,874
Social expenses and compensatory payments	1,212	774
Legal, audit, and consulting services	774	504
Business trips expense	218	265
Depreciation – administrative buildings	198	141
Fire safety and security expenses	178	149
Rent expense	140	270
Board remuneration	103	93
Concession management services	63	125
Bank charges	58	59
Other	624	479
<b>Total general and administrative expenses</b>	<b>8,218</b>	<b>6,733</b>

**Auditors' fees and services.** ZAO PricewaterhouseCoopers Audit has served as the Group's independent external auditors for each of the reported financial years. The independent external auditor is subject to re-appointment at the Annual General Meeting of shareholders based on the recommendations from the Board of Directors. The following table presents the aggregate fees for professional services and other services rendered by ZAO PricewaterhouseCoopers Audit to the Group included within legal, audit, and consulting services:

	Year ended 31 December:	
	2011	2010
Audit services fee (audit of the Group's consolidated financial statements and the statutory audit of the parent company)	39	36
Non-audit services	1	4
<b>Total auditors' fees and services</b>	<b>40</b>	<b>40</b>

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**23 MATERIALS, SERVICES AND OTHER**

	Year ended 31 December:	
	2011	2010
Employee compensation	2,953	2,572
Repair and maintenance services	1,435	640
Electricity and fuel	405	388
Materials and supplies	309	1,386
Security expenses	237	179
Transportation expenses	184	106
Processing fees	99	566
Rent expenses	43	27
Other	282	208
<b>Total materials, services and other</b>	<b>5,947</b>	<b>6,072</b>

**24 PURCHASES OF NATURAL GAS AND LIQUID HYDROCARBONS**

	Year ended 31 December:	
	2011	2010
Natural gas	5,854	-
Liquid hydrocarbons	140	154
<b>Total purchases of natural gas and liquid hydrocarbons</b>	<b>5,994</b>	<b>154</b>

Natural gas purchases included volumes procured from Sibneftegas, the Group's joint venture, acquired in December 2010 (see Note 5), pro-rata to its total production in the amount of RR 3,661 million (see Note 30) and volumes procured from one of Gazprom's subsidiaries by the Group's regional gas trader, Gazprom mezhtregiongas Chelyabinsk, post its acquisition by the Group in November 2011 (see Note 5) in the amount of RR 1,929 million.

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**25 FINANCE INCOME (EXPENSE)**

<i>Interest expense (including transaction costs)</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
6.604% USD 650 million Eurobonds February 2021	1,165	-
7.5% RR 15 billion Sberbank December 2013	1,144	46
5.326% USD 600 million Eurobonds February 2016	879	-
8% RR 10 billion Gazprombank November 2012 <sup>(1)</sup>	805	700
7.5% RR 10 billion Bonds June 2013	772	392
LIBOR+3.25% USD 200 million UniCredit Bank October 2012 <sup>(1)</sup>	215	325
LIBOR+1.45% USD 300 million Sumitomo Mitsui Banking Corporation Europe Limited December 2013	148	-
LIBOR+1.9% USD 200 million Nordea Bank November 2013	125	-
LIBOR+1.5% USD 800 million Syndicated term loan facility April 2011	37	318
8.5% RR 5 billion Sberbank February 2011 <sup>(1)</sup>	-	341
Other interest expenses <sup>(2)</sup>	132	70
<b>Subtotal</b>	<b>5,422</b>	<b>2,192</b>
Less: capitalised interest	(3,709)	(2,166)
<b>Interest expense (on historical cost basis)</b>	<b>1,713</b>	<b>26</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	212	198
Provisions for asset retirement obligations: unwinding of the present value discount	225	213
<b>Total interest expense</b>	<b>2,150</b>	<b>437</b>

<sup>(1)</sup> – interest rates were reduced during the periods (see Note 13).  
<sup>(2)</sup> – including credit facility with interest rates negotiated at time of each withdrawal (see Note 15).

<i>Interest income</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Interest income on cash and cash equivalents	355	170
Interest income on loans issued	2,828	328
<b>Interest income (on historical cost basis)</b>	<b>3,183</b>	<b>498</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	209	100
<b>Total interest income</b>	<b>3,392</b>	<b>598</b>

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**26 INCOME TAX**

**Reconciliation of income tax.** The table below reconciles actual income tax expense and theoretical income tax, determined by applying the statutory tax rate to profit before income tax.

	Year ended 31 December:	
	2011	2010
Profit before income tax	135,025	51,082
Theoretical income tax expense at statutory rate of 20 percent	27,005	10,216
Increase (decrease) due to:		
Non-temporary differences in respect of share of losses of equity investments	776	-
Non-deductible expenses	686	538
Russian entities' taxation at lower income tax rate	(118)	-
Foreign entities' taxation at lower income tax rate	(226)	(112)
Deferred taxes write-off	342	31
Disposal of 20% interest in Yamal LNG	(12,473)	-
Other non-temporary differences	(258)	131
<b>Total income tax expense</b>	<b>15,734</b>	<b>10,804</b>

Domestic and foreign components of current income tax expense were:

	Year ended 31 December:	
	2011	2010
Russian Federation income tax	12,364	9,289
Foreign income tax	103	116
<b>Total current income tax expense</b>	<b>12,467</b>	<b>9,405</b>

**Effective income tax rate.** The Group's Russian statutory income tax rate for 2011 and 2010 was 20 percent. For the years ended 31 December 2011 and 2010, the Group's effective income tax rate was 11.7 percent and 21.2 percent, respectively. Excluding the effect of 20% disposal of Yamal LNG, the Group's effective income tax rate for the year ended 31 December 2011 was 21.7 percent.

The Group did not file a consolidated tax return for 2010 and will not file one for 2011. Instead, each legal entity filed (and will file for 2011) separate tax returns with various tax authorities, primarily in the Russian Federation. As Russian tax legislation provided an option to submit a single consolidated income tax return starting from 1 January 2012, the Group's management assessed such opportunity and is going to register NOVATEK and its core Russian producing subsidiaries as a consolidated group of taxpayers for 2012 and thereafter.

The Group has recorded a deferred tax liability in respect of the temporary difference associated with the investment in Yamal LNG at a zero tax rate as management expects that the carrying value of the investment in Yamal LNG would be recovered primarily through dividends taxable at zero tax rate and also potentially partially through a sale of an additional equity stake in the entity. The Group did not recognize deferred taxes related to a future sale as the tax base in respect of potential interest in Yamal LNG to be sold is assessed to be equal to its carrying amount.

**Deferred income tax.** Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes.

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**26 INCOME TAX (CONTINUED)**

Deferred income tax balances are presented in the consolidated statement of financial position as follows:

	At 31 December:	
	2011	2010
Long-term deferred income tax asset (other non-current assets)	660	1,392
Long-term deferred income tax liability	(12,805)	(9,473)
<b>Net deferred income tax liability</b>	<b>(12,145)</b>	<b>(8,081)</b>

Deferred income tax assets expected to be realized within twelve months of 31 December 2011 and 2010 were RR 462 million and RR 747 million, respectively. Deferred tax liabilities expected to be reversed within twelve months of 31 December 2011 and 2010 were RR 199 million and RR 258 million, respectively.

Movements in deferred income tax assets and liabilities during the years ended 31 December 2011 and 2010 are as follows:

	At 31 December 2011	Statement of Income effect	Acquisitions	Disposals	At 31 December 2010
Property, plant and equipment	(14,388)	(3,426)	-	138	(11,100)
Intangible assets	(324)	23	(265)	-	(82)
Other	(180)	(20)	(13)	-	(147)
<b>Total deferred income tax liabilities</b>	<b>(14,892)</b>	<b>(3,423)</b>	<b>(278)</b>	<b>138</b>	<b>(11,329)</b>
Inventories	654	(167)	-	(83)	904
Tax losses carried forward	1,375	603	16	(519)	1,275
Asset retirement obligation	547	131	-	(80)	496
Other	171	(411)	11	(2)	573
<b>Total deferred income tax assets</b>	<b>2,747</b>	<b>156</b>	<b>27</b>	<b>(684)</b>	<b>3,248</b>
<b>Net deferred income tax liabilities</b>	<b>(12,145)</b>	<b>(3,267)</b>	<b>(251)</b>	<b>(546)</b>	<b>(8,081)</b>

	At 31 December 2010	Statement of Income effect	Acquisitions	Disposals	At 31 December 2009
Property, plant and equipment	(11,100)	(2,050)	(70)	282	(9,262)
Intangible assets	(82)	-	(82)	-	-
Other	(147)	(67)	-	11	(91)
<b>Total deferred income tax liabilities</b>	<b>(11,329)</b>	<b>(2,117)</b>	<b>(152)</b>	<b>293</b>	<b>(9,353)</b>
Inventories	904	(14)	299	102	517
Tax losses carried forward	1,275	487	38	(181)	931
Asset retirement obligation	496	12	38	-	446
Other	573	233	(49)	(109)	498
<b>Total deferred income tax assets</b>	<b>3,248</b>	<b>718</b>	<b>326</b>	<b>(188)</b>	<b>2,392</b>
<b>Net deferred income tax liabilities</b>	<b>(8,081)</b>	<b>(1,399)</b>	<b>174</b>	<b>105</b>	<b>(6,961)</b>

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**26 INCOME TAX (CONTINUED)**

At 31 December 2011, the Group had recognized deferred income tax assets of RR 1,375 million (31 December 2010: RR 1,275 million) in respect of unused tax loss carry forwards of RR 6,875 million (31 December 2010: RR 6,375 million). Tax losses can be carried forward for relief against taxable profits for 10 years after they are incurred, subject to certain limitations. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments including expectations regarding the Group's ability to generate sufficient future taxable income and the projected time period over which deferred tax benefits will be realized.

**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS**

The accounting policies for financial instruments have been applied to the line items below:

<i>Financial assets</i>	<i>Loans and receivables</i>	
	At 31 December:	
	2011	2010
<i>Non-current</i>		
Long-term loans receivable	9,323	38,057
Trade and other receivables	22,807	2,094
<i>Current</i>		
Trade and other receivables	16,699	8,670
Prepayments and other current assets	6,876	969
Cash and cash equivalents	23,831	10,238
<b>Total carrying amount</b>	<b>79,536</b>	<b>60,028</b>

<i>Financial liabilities</i>	<i>Measured at amortized cost</i>	
	At 31 December:	
	2011	2010
<i>Non-current</i>		
Long-term debt	75,180	47,074
Other non-current liabilities	-	110
<i>Current</i>		
Current portion of long-term debt	20,298	6,952
Short-term debt	-	18,200
Trade and other payables	22,811	27,007
<b>Total carrying amount</b>	<b>118,289</b>	<b>99,343</b>

**Financial risk management objectives and policies.** In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on the degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial results. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position.

The Group's principal risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to these limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

**Market risk.** Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures, while optimizing the return on risk.

The Group is exposed to market price movements relating to changes in commodity prices such as crude oil, gas condensate, liquefied petroleum products and natural gas (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities or expected future cash flows.

(a) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to the US dollar. Foreign exchange risk arises primarily from future commercial transactions, recognized assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. Foreign currency derivative instruments may be utilized to manage the risk exposures associated with fluctuations on certain firm commitments for sales and purchases, debt instruments and other transactions that are denominated in currencies other than the Russian rouble, and certain non-Russian rouble assets and liabilities.

The carrying amounts of the Group's financial instruments are denominated in the following currencies:

<i>At 31 December 2011</i>	<b>Russian rouble</b>	<b>US dollar</b>	<b>Other</b>	<b>Total</b>
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	9,103	220	-	9,323
Trade and other receivables	22,761	14	32	22,807
<i>Current</i>				
Trade and other receivables	8,692	7,618	389	16,699
Prepayments and other current assets	6,859	-	17	6,876
Cash and cash equivalents	10,774	12,113	944	23,831
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(24,937)	(50,243)	-	(75,180)
<i>Current</i>				
Current portion of long-term debt	(10,000)	(10,298)	-	(20,298)
Trade and other payables	(4,949)	(17,799)	(63)	(22,811)
<b>Net exposure at 31 December 2011</b>	<b>18,303</b>	<b>(58,375)</b>	<b>1,319</b>	<b>(38,753)</b>

**OAO NOVATEK**

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

**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

<i>At 31 December 2010</i>	Russian rouble	US dollar	Other	Total
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	37,955	102	-	38,057
Trade and other receivables	2,072	-	22	2,094
<i>Current</i>				
Trade and other receivables	4,759	3,582	329	8,670
Prepayments and other current assets	969	-	-	969
Cash and cash equivalents	6,085	3,169	984	10,238
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(34,897)	(12,177)	-	(47,074)
Other non-current liabilities	-	(110)	-	(110)
<i>Current</i>				
Current portion of long-term debt	-	(6,952)	-	(6,952)
Short-term debt	-	(18,200)	-	(18,200)
Trade and other payables	(23,589)	(3,350)	(68)	(27,007)
<b>Net exposure at 31 December 2010</b>	<b>(6,646)</b>	<b>(33,936)</b>	<b>1,267</b>	<b>(39,315)</b>

The Group has chosen to provide information about market risk and potential exposure to hypothetical loss from its use of financial instruments through sensitivity analysis disclosures in accordance with IFRS requirements.

The sensitivity analysis depicted in the table below reflects the hypothetical loss that would occur assuming a 10 percent change in exchange rates and no changes in the portfolio of instruments and other variables at 31 December 2011 and 2010, respectively:

<i>Effect on pre-tax profit</i>	Increase in exchange rate	Year ended 31 December:	
		2011	2010
RUR / USD	10%	(5,838)	(3,394)

The effect of a corresponding 10 percent decrease in exchange rate is approximately equal and opposite.

*(b) Commodity price risk*

The Group's overall commercial trading strategy in natural gas, stable gas condensate and crude oil and related products is centrally managed. Changes in commodity prices could negatively or positively affect the Group's results of operations. The Group manages the exposure to commodity price risk by optimizing its core activities to achieve stable price margins.

**Natural gas.** As an independent natural gas producer, the Group is not subject to the government's regulation of natural gas prices. Nevertheless, the Group's prices for natural gas sold are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011. As part of the plan, in December 2010, the FTS approved an increase of 15 percent in the regulated prices effective 1 January 2011 for the year 2011.



27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015. According to the Government’s program, the regulation of the domestic natural gas price after 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets.

Management believes it has limited downside commodity price risk for natural gas and does not use commodity derivative instruments for trading purposes. However, to effectively manage the margins achieved through its natural gas trading activities, management has established targets for volumes sold to wholesale traders, end-customers and the natural gas exchange.

**Liquid hydrocarbons.** The Group sells all its crude oil and gas condensate under spot contracts. Gas condensate volumes sold to the US, European and Asian-Pacific Region (hereinafter referred to as “APR”) markets are based on benchmark reference crude oil prices of WTI, Brent IPE and Dubai or Naphtha Japan and Naphtha CIF NWE, respectively, plus a margin or discount, depending on current market situation. Crude oil sold internationally is based on benchmark reference crude oil prices of Brent dated, plus a discount and on a transaction-by-transaction basis for volumes sold domestically. As a result, the Group’s revenues from the sales of liquid hydrocarbons are subject to commodity price volatility based on fluctuations or changes in the crude oil benchmark reference prices.

(c) *Cash flow and fair value interest rate risk*

The Group is subject to interest rate risk on financial liabilities with variable interest rates. To mitigate this risk, the Group’s treasury function performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favorable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group’s exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favorable over the expected period until maturity.

The interest rate profiles of the Group’s interest-bearing financial instruments at the reporting dates were as follows:

	At 31 December:	
	2011	2010
At variable rate	20,559	37,327
At fixed rate	74,919	34,899
<b>Total debt</b>	<b>95,478</b>	<b>72,226</b>

The Group centralizes the cash requirements and surpluses of controlled subsidiaries and the majority of their external financing requirements, and applies, on its consolidated net debt position, a funding policy to optimize its financing costs and manage the impact of interest rate changes on its financial results in line with market conditions. In this way, the Group is able to ensure that the balance between the floating rate portion of its debt and its cash surpluses has a low level of exposure to any change in interest rates over the short term. This policy makes it possible to significantly limit the Group's sensitivity to interest rate volatility.

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The Group's financial results are sensitive to changes in interest rates on the floating rate portion of the Group's debt portfolio. If the interest rates applicable to floating rate debt were to increase by 100 basis points at the reporting dates, assuming all other variables remain constant, it is estimated that the Group's profit before taxation would decrease by the amounts shown below:

<i>Effect on pre-tax profit</i>	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Increase by 100 basis points	206	373

The effect of a corresponding 100 basis points decrease in interest rate is approximately equal and opposite.

The Group is examining various ways to manage its cash flow interest rate risk by using a combination of floating and fixed interest rates. No swaps or other similar instruments were in place as of 31 December 2011 and 2010, or during 2011 and 2010.

**Credit risk.** Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations.

Credit risk is managed on a Group level and arises from cash and cash equivalents, including short-term deposits with banks, as well as credit exposures to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to minimal risk of default.

The Group's trade and other receivables consist of a large number of customers, spread across diverse industries and geographical areas. Most of the Group's international liquid sales are made to customers with independent external ratings; however, if the customer has a credit rating below BBB, the Group requires the collateral for the trade receivable to be in the form of letters of credit from banks with an investment grade rating. All domestic sales of liquid hydrocarbons are made on a 100 percent prepayment basis. The Group also requires 100 percent prepayments from small customers for natural gas deliveries and partial advances from others. Although the Group generally does not require collateral in respect of trade and other receivables, it has developed standard credit payment terms and constantly monitors the status of trade receivables and the creditworthiness of the customers.

As a result of recent acquisitions of Russian regional natural gas trading companies, the Group's exposure to small and medium-size industrial users and individuals has increased. The Group monitors the recoverability of these debtors by analyzing ageing of receivables by type of customers and their respective prior payment history.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the consolidated statement of financial position.

The table below highlights the Group's trade and other receivables to published credit ratings of its counterparties.

<b>Moody's and/or Fitch</b>	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Investment grade rating	9,059	4,489
Non-investment grade rating	1,581	1,338
No external rating	6,059	2,843
<b>Total trade and other receivables</b>	<b>16,699</b>	<b>8,670</b>

**OAO NOVATEK**

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

The table below highlights the Group's cash and cash equivalents balances to published credit ratings of its banks and/or their parent companies.

Moody's and/or Fitch	At 31 December:	
	2011	2010
Investment grade rating	19,381	8,008
Non-investment grade rating	4,358	1,781
No external rating	92	449
<b>Total cash and cash equivalents</b>	<b>23,831</b>	<b>10,238</b>

Investment grade ratings classification referred to as Aaa to Baa3 for Moody's Investors Service and as AAA to BBB- for Fitch Rating, respectively.

**Liquidity risk.** Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing its liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows and matches the maturity profiles of financial assets and liabilities.

The Group prepares various financial plans (monthly, quarterly and annually) which ensures that the Group has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. The Group has entered into a number of short-term credit facilities. Such credit lines and overdraft facilities can be drawn down to meet short-term financing needs. To fund cash requirements of a more permanent nature, the Group will normally raise long-term debt in available international and domestic markets.

All of the Group's financial liabilities represent non-derivative financial instruments. The following tables summarize the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

<i>At 31 December 2011</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
Principal <sup>(*)</sup>	10,000	25,000	19,318	20,927	75,245
Interest	4,748	3,825	6,298	5,655	20,526
Debt at variable rate					
Principal <sup>(*)</sup>	10,303	10,302	-	-	20,605
Interest	366	135	-	-	501
Trade and other payables	22,811	-	-	-	22,811
<b>Total financial liabilities</b>	<b>48,228</b>	<b>39,262</b>	<b>25,616</b>	<b>26,582</b>	<b>139,688</b>

<i>At 31 December 2010</i>	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
Debt at fixed rate					
Principal <sup>(*)</sup>	-	10,000	25,000	-	35,000
Interest	2,725	2,372	1,411	-	6,508
Debt at variable rate					
Principal <sup>(*)</sup>	25,252	6,095	6,095	-	37,442
Interest	656	413	78	-	1,147
Trade and other payables	27,007	-	-	-	27,007
<b>Total financial liabilities</b>	<b>55,640</b>	<b>18,880</b>	<b>32,584</b>	<b>-</b>	<b>107,104</b>

<sup>(\*)</sup> – differs from long-term debt (Note 13) for transaction costs.

**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

**Capital management.** The primary objectives of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain investor, market and creditor confidence to support its business activities.

At the reporting date, the Group had investment grade credit ratings of Baa3 (stable outlook) by Moody's Investors Service and BBB- (stable outlook) by Fitch Ratings, as well as a credit rating of BBB- (stable outlook) by Standard & Poor's. To maintain its credit ratings, the Group has established certain financial targets and coverage ratios that it monitors on a quarterly and annual basis.

The Group manages its liquidity on a corporate-wide basis to ensure adequate funding to sufficiently meet group operational requirements. All external debts are centralized at the Parent level, and all financing to Group entities is facilitated through inter-company loan arrangements or additional contributions to share capital.

The Group has a stated dividend policy that distributes at least 30 percent of its Parent company's non-consolidated statutory net profit determined according to Russian accounting standards. However, the dividend for a specific year is determined after taking into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the NOVATEK's shareholders.

The Group defines the term "capital" as equity attributable to OAO NOVATEK shareholders minus net debt (total debt less cash and cash equivalents). There were no changes to the Group's approach to capital management during the year ended 31 December 2011.

**28 CONTINGENCIES AND COMMITMENTS**

**Operating environment.** The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is in practice not convertible in most countries outside of the Russian Federation, and relatively high inflation. The tax, currency and customs legislation is subject to varying interpretations, frequent changes and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

The Group's business operations are primarily located in the Russian Federation and are thus exposed to the economic and financial markets of the country.

**Commitments.** At 31 December 2011, the Group had contractual capital expenditures commitments aggregating approximately RR 17,805 million (at 31 December 2010: RR 9,834 million) mainly for ongoing development activities at the Yurkharovskoye field (through 2013), development of the North-Russkoe field (through 2013) and Urengoiyskoye field (within the Olimpiyskiy license area, through 2013), phase three construction of the Purovsky Gas Condensate Plant (through 2013), construction of the terminal for the transshipment and fractionation of stable gas condensate (through 2012) and development of the East-Tarkosalinskoye and Khancheyskoye fields (through 2012) all in accordance with duly signed agreements. Furthermore, the Group's share in capital commitments for its interests in joint ventures aggregates approximately RR 5,850 million for development of the South-Tambeyskoye (through 2013), Urengoiyskoye (within the Samburgskiy license area, through 2012) and Termokarstovoye (through 2013) fields (at 31 December 2010: RR 2,661 million).

**Taxation.** Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such taxation legislation as applied to the Group's transactions and activities may be periodically challenged by the relevant regional and federal authorities. Furthermore, events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

As at 31 December 2011, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued.

**Mineral licenses.** The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its mineral licenses. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitation, suspension or revocation. The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any material adverse effect on the Group's financial position, results of operations or cash flows.

The Group's oil and gas fields and license areas are situated on land located in the Yamal-Nenets Autonomous Region. Licenses are issued by the Federal Agency for the Use of Natural Resources under the Ministry of Natural Resources of the Russian Federation and the Group pays unified natural resources production tax to produce crude oil, natural gas and unstable condensate from these fields and contributions for exploration of license areas. The principal licenses of the Group and its joint ventures and their expiry dates are:

Field	License holder	License expiry date
<b>Subsidiaries:</b>		
Yurkharovskoye	ООО NOVATEK-Yurkharovneftegas	2034
Salmanovskoye (Utrenneye)	ООО NOVATEK-Yurkharovneftegas	2031
Geofizicheskoye	ООО NOVATEK-Yurkharovneftegas	2031
East-Tarkosalinskoye	ООО NOVATEK-Tarkosaleneftegas	2043
Urengoiszkoye (within the Olimpiyskiy license area)	ООО NOVATEK-Tarkosaleneftegas	2026
Khancheyzkoye	ООО NOVATEK-Tarkosaleneftegas	2044
North-Russkoe	ООО NOVATEK-Tarkosaleneftegas	2031
Malo-Yamalsky	ОАО Тамбейнефтегаз	2019
<b>Joint ventures:</b>		
South-Tambeyskoye	ОАО Yamal LNG	2045
Termokarstovoye	ЗАО Тернефтегаз	2021
Yaro-Yakhinskoye	ЗАО Urengoil Inc.	2018
Urengoiszkoye (within the Samburgskiy and Yevo-Yakhinskiy license areas)	ОАО Арктическая газовая компания	2018
Beregovoe	ОАО Sibneftegas	2023
Pyreinoye	ОАО Sibneftegas	2021
North-Chaselskoye	ОАО Нефтегастехнология	Life of field

Management believes the Group has the right to extend its licenses beyond the initial expiration date under the existing legislation and intends to exercise this right on all of its fields.

**Environmental liabilities.** The Group and its predecessor entities have operated in the oil and gas industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations and, as obligations are determined, they are recognized as an expense immediately if no future benefit is discernible. Potential liabilities arising as a result of a change in interpretation of existing regulations, civil litigation or changes in legislation cannot be estimated. Under existing legislation, management believes that there are no probable liabilities, which will have a material adverse effect on the Group's financial position, results of operations or cash flows.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

**Legal contingencies.** The Group is subject of, or party to a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in the consolidated financial statements.

**29 PRINCIPAL SUBSIDIARIES AND JOINT VENTURES**

The principal subsidiaries and joint ventures of the Group and respective ownership in the ordinary share capital at 31 December 2011 and 2010 are set out below:

	Ownership percent at 31 December:		Country of incorporation	Principal activities
	2011	2010		
<i>Subsidiaries</i>				
ООО NOVATEK-Yurkharovneftegas	100	100	Russia	Exploration and production
ООО NOVATEK-Tarkosaleneftegas	100	100	Russia	Exploration and production
ООО NOVATEK-Purovsky ZPK	100	100	Russia	Gas Condensate Plant
ООО NOVATEK-Transervice	100	100	Russia	Transportation services
ООО NOVATEK-AZK	100	100	Russia	Wholesale and retail trading
ООО NOVATEK Severo-Zapad	100	100	Russia	Trading and marketing
ООО NOVATEK-Ust-Luga	100	100	Russia	Construction of sea terminal
ОАО Tambeyneftegaz	100	100	Russia	Exploration and production
ООО Gazprom mezhregiongas Chelyabinsk	100	-	Russia	Trading and marketing
ООО NOVATEK-Chelyabinsk (formerly ООО Yamalgazresurs-Chelyabinsk)	100	100	Russia	Trading and marketing
ООО Yamalenergogaz	100	-	Russia	Trading and marketing
Novatek Gas & Power GmbH (formerly Runitek GmbH)	100	100	Switzerland	Trading and marketing
Novatek Polska	100	100	Poland	Trading and marketing
<i>Joint ventures</i>				
ООО Yamal Development	50	50	Russia	Holding company
ООО SeverEnergiya (through ООО Yamal Development)	25.5	25.5	Russia	Exploration and production
ОАО Sibneftegas	51	51	Russia	Exploration and production
ОАО Yamal LNG (subsidiary until October 2011)	80	51	Russia	Exploration and production

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**30 RELATED PARTY TRANSACTIONS**

Transactions between the NOVATEK and its subsidiaries, which are related parties of the NOVATEK, have been eliminated on consolidation and are not disclosed in this Note.

For the purposes of these consolidated financial statements, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. Management has used reasonable judgments in considering each possible related party relationship with attention directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be affected on the same terms, conditions and amounts as transactions between unrelated parties. The Group enters into transactions with related parties based on market or regulated prices.

All natural gas producers and wholesalers operating in Russia transport their natural gas volumes through the Unified Gas Supply System (UGSS), which is owned and operated by OAO Gazprom, a State monopoly. As an independent natural gas producer, the Group utilizes the UGSS to transport natural gas to end-consumers at the tariff established by the Federal Tariff Service.

Transactions with OAO Gazprom, a shareholder of significant influence, from October 2006 until 20 December 2010, and its subsidiaries are presented below.

*Related parties – OAO Gazprom and its subsidiaries  
(until December 2010)*

	Year ended 31 December:	
	2011	2010
<b>Transactions</b>		
<i>OAO Gazprom:</i>		
Natural gas sales	-	12,935
Natural gas transportation to customers	-	(26,550)
<i>OOO Gazprom mezhregiongaz (formerly OOO Mezhregiongaz):</i>		
Natural gas sales	-	1,055
<i>Other Gazprom subsidiaries:</i>		
Processing fees	-	(458)
Unstable gas condensate transportation	-	(307)

On 20 December 2010, OAO Gazprom sold 9.4 percent of its NOVATEK shares to a third party and consequently ceased to be a related party of the Group from that date.

	As at and for the year ended 31 December:	
	2011	2010
<i>Related parties – equity investments</i>		
<b>Transactions</b>		
<i>OAO Sibneftegas (from December 2010):</i>		
Interest income on loans issued	1,023	45
Oil and gas products sales	39	-
Purchases of natural gas	(3,661)	-
<i>OOO Yamal Development (from November 2010):</i>		
Interest income on loans issued	1,325	191
<i>OOO SeverEnergiya (from November 2010):</i>		
Interest income on loans issued	247	-
<i>OAO Yamal LNG (from October 2011):</i>		
Interest income on loans issued	167	-

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**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – equity investments</i>	As at and for the year ended 31 December:	
	2011	2010
<b>Balances</b>		
<i>OAO Sibneftegas (from December 2010):</i>		
Long-term loans receivable	9,103	10,070
Interest on long-term loans receivable	775	33
Short-term loans receivable	634	967
Trade payables and accrued liabilities	387	-
<i>OOO Yamal Development (from November 2010):</i>		
Long-term loans and receivables	16,348	27,886
Interest on long-term loans receivable	-	191
<i>OOO SeverEnergiya (from November 2010):</i>		
Short-term loans receivable	6,225	-
Interest on short-term loans receivable	94	-
<i>ZAO Terneftegas (from February 2010):</i>		
Long-term loans receivable	220	102

As discussed in Note 5, in October 2011, the Group's effective control over OAO Yamal LNG ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity are disclosed as related parties – equity investments.

As discussed in Note 5, in February 2010, the Group's effective control over ZAO Terneftegas ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity are disclosed as related parties – equity investments.

In September 2011, the Chairman of the Management Committee of NOVATEK acquired a controlling stake in ZAO SIBUR Holding. As a result, the Group's balances with this company and its subsidiaries at 31 December 2011 were disclosed as related parties – parties under control of key management personnel.

<i>Related parties – parties under control of key management personnel</i>	As at and for the year ended 31 December:	
	2011	2010
<b>Balances</b>		
<i>OAO Pervobank:</i>		
Cash and cash equivalents	4,066	1,760
<i>ZAO SIBUR Holding and its subsidiaries (from September 2011):</i>		
Long-term receivable	1,424	-
Trade and other receivables	248	-

Effective 1 January 2011, the Group adopted the revised standard IAS 24, *Related Party Disclosures*, which adjusted the definition of the related party. In accordance with the revised standard, parties under significant influence of key management personnel are not related parties of the Group. Thus OOO Nova, Aldi trading Limited, Orsel consultant Limited and Innecto ventures Limited are no longer considered to be related parties.

The comparative figures in the disclosure with respect to balances at 31 December 2010 and transactions for the year ended 31 December 2010 have been adjusted to reflect the change in definitions of a related party following the adoption of the revised standard IAS 24, *Related Party Disclosures*.

**Key management compensation.** The Group paid to key management personnel (members of the Board of Directors and the Management Committee, some of whom have also direct and indirect interests in the Group) short-term compensation, including salary, bonuses, and excluding dividends the following amounts.



## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

#### 30 RELATED PARTY TRANSACTIONS (CONTINUED)

<i>Related parties – members of the key management personnel</i>	Year ended 31 December:	
	2011	2010
Board of Directors	103	93
Management Committee	1,242	1,049
<b>Total compensation</b>	<b>1,345</b>	<b>1,142</b>

Such amounts include personal income tax and are net of unified social tax. The Board of Directors consists of nine members. The Management Committee consisted of 15 members until 24 March 2011 and was subsequently reduced to eight members.

The remuneration for serving on the Board of Directors is subject to approval by the General Meeting of Shareholders. Members of the Management Committee also receive certain short-term benefits related to healthcare.

In addition, RR 68 million was recognized during the year ended 31 December 2010 as part of the share-based compensation scheme and included in general and administrative expenses. In May 2010, share-based compensation to the key members of the Group's management team was fully recognized.

#### 31 SEGMENT INFORMATION

The Group's activities are considered by the chief operating decision maker (hereinafter referred to as "CODM", represented by the Management Committee of NOVATEK) to comprise the following operating segments:

- Exploration, production and marketing – acquisitions, exploration, development, production, processing, marketing and transportation of natural gas, gas condensate and related products; and
- Polymer products production and marketing – production and marketing of polymer insulation tape and other polymer products (disposed in September 2010).

Segment information is provided to the CODM in accordance with Regulations on Accounting and Reporting of the Russian Federation ("RAR") with reconciling items largely representing adjustments and reclassifications recorded in the consolidated financial statements for the fair presentation in accordance with IFRS.

The CODM assesses reporting segments performance based on income before income taxes, since income taxes are not allocated. No business segment assets or liabilities (except for capital expenditures for the period) are provided to the CODM for decision-making.

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**31 SEGMENT INFORMATION (CONTINUED)**

Segment information for the year ended 31 December 2011 is as follows:

<i>For the year ended 31 December 2011</i>	References	Exploration, production and marketing	Segment information as reported to CODM	Reconciling items	Total per consolidated financial statements
External revenues	<i>a</i>	176,340	176,340	(276)	176,064
Operating expenses	<i>b, c, d, e</i>	(101,659)	(101,659)	3,994	(97,665)
Other operating income (loss)	<i>c, f</i>	12,950	12,950	50,259	63,209
Interest expense	<i>g</i>	(5,392)	(5,392)	3,242	(2,150)
Interest income		3,137	3,137	255	3,392
Foreign exchange gain (loss)	<i>g</i>	(4,368)	(4,368)	423	(3,945)
<b>Segment result</b>		<b>81,008</b>	<b>81,008</b>	<b>57,897</b>	<b>138,905</b>
Share of loss of equity investments, net of income tax					(3,880)
<b>Profit before income tax</b>					<b>135,025</b>
Depreciation, depletion and amortization	<i>b, c</i>	12,925	12,925	(3,450)	9,475
Capital expenditures	<i>g</i>	30,510	30,510	7,521	38,031

Reconciling items mainly related to:

- a. different methodology of liquefied petroleum gas sales recognition under IFRS and the RAR which requires reversal of external revenues for RR 207 million under IFRS;
- b. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 3,892 million in operating expenses under IFRS;
- c. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 280 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- d. different methodology in recognizing expenses relating to natural gas storage services and payroll (including share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 37 million and additional payroll expenses of RR 233 million recorded in operating expenses under IFRS;
- e. different methodology in the recognition of impairment expenses between IFRS and management accounting, which resulted in net reversal of RR 755 million recorded in operating expenses under IFRS;
- f. different methodology in recognizing the gain on disposal of ownership interest in OAO Yamal LNG between IFRS and management accounting, which resulted in additional gain of RR 49,589 million recorded in other operating income (loss) under IFRS; and
- g. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized and additional capitalization of foreign exchange differences of RR 3,942 million and additional capital expenditures of RR 3,579 million under IFRS.

**OAO NOVATEK**

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

**31 SEGMENT INFORMATION (CONTINUED)**

Segment information for the year ended 31 December 2010 is as follows:

<i>For the year ended 31 December 2010</i>	<b>References</b>	<b>Exploration, production and marketing</b>	<b>Polymer products production and marketing</b>	<b>Segment information as reported to CODM</b>	<b>Reconciling items</b>	<b>Total per consolidated financial statements</b>
External revenues		115,590	1,739	117,329	(305)	117,024
Operating expenses	<i>a, b, c, d</i>	(67,879)	(1,545)	(69,424)	906	(68,518)
Other operating income (loss)	<i>b, e</i>	767	15	782	943	1,725
Interest expense	<i>f, h</i>	(2,010)	-	(2,010)	1,573	(437)
Interest income		414	2	416	182	598
Foreign exchange gain (loss)	<i>g</i>	580	-	580	456	1,036
<b>Segment result</b>		<b>47,462</b>	<b>211</b>	<b>47,673</b>	<b>3,755</b>	<b>51,428</b>
Share of loss of equity investments, net of income tax						(346)
<b>Profit before income tax</b>						<b>51,082</b>
Depreciation, depletion and amortization	<i>a, b</i>	9,031	50	9,081	(2,324)	6,757
Capital expenditures	<i>g, h</i>	22,259	57	22,316	3,790	26,106

Reconciling items mainly related to:

- a. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 3,049 million in operating expenses under IFRS;
- b. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 464 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- c. different methodology in recognizing expenses relating to natural gas storage services and payroll (incl. share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 149 million and additional payroll expenses of RR 708 million recorded in operating expenses under IFRS;
- d. different methodology in recognizing of impairment expenses in respect of different categories of assets between IFRS and management accounting, which resulted in additional operating expense of RR 541 million charged under IFRS;
- e. different methodology in recognizing the gain on disposal of ownership interest in ZAO Terneftegas and OOO NOVATEK-Polymer between IFRS and management accounting, which resulted in additional gain of RR 185 million recorded in other operating income (loss) under IFRS;
- f. different methodology in valuating long-term payables and asset retirement obligations between IFRS and management accounting, which resulted in additional interest expense of RR 411 million charged under IFRS;
- g. different methodology in capitalization policy between IFRS and management accounting which resulted in additional capitalization of foreign exchange loss of RR 455 million under IFRS; and
- h. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized of RR 2,349 million and additional capital expenditures of RR 1,441 million under IFRS.

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

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

**31 SEGMENT INFORMATION (CONTINUED)**

**Geographical information.** The Group's two segments operate in four major geographical areas of the world. In the Russian Federation, its home country, the Group is mainly engaged in the exploration, development, production and sales of natural gas, crude oil, gas condensate and related products and sales of polymer and insulation tape. Activities outside the Russian Federation are conducted in the United States (sales of stable gas condensate), in Europe (sales of stable gas condensate, liquefied petroleum gas and crude oil), in Asian-Pacific region (hereinafter referred to as "APR") (sales of stable gas condensate) and other areas (sales of liquefied petroleum gas and sales of polymer and insulation tape).

Geographical information for the years ended 31 December 2011 and 2010 is as follows:

<i>For the year ended 31 December 2011</i>	Russian Federation	Outside Russian Federation					Subtotal	Total
		Europe	USA	APR	Other	Export duty		
Natural gas	110,932	-	-	-	-	-	-	110,932
Stable gas condensate	46	28,265	17,920	35,642	-	(35,095)	46,732	46,778
Liquefied petroleum gas	5,520	12,023	-	-	10	(2,326)	9,707	15,227
Crude oil	1,458	2,143	-	-	-	(1,122)	1,021	2,479
Oil and gas products	186	-	-	-	-	-	-	186
<b>Oil and gas sales</b>	<b>118,142</b>	<b>42,431</b>	<b>17,920</b>	<b>35,642</b>	<b>10</b>	<b>(38,543)</b>	<b>57,460</b>	<b>175,602</b>
Other revenues	323	139	-	-	-	-	139	462
<b>Total external revenues</b>	<b>118,465</b>	<b>42,570</b>	<b>17,920</b>	<b>35,642</b>	<b>10</b>	<b>(38,543)</b>	<b>57,599</b>	<b>176,064</b>

<i>For the year ended 31 December 2010</i>	Russian Federation	Outside Russian Federation					Subtotal	Total
		Europe	USA	APR	Other	Export duty		
Natural gas	71,060	-	-	-	-	-	-	71,060
Stable gas condensate	34	6,598	25,976	12,660	3,653	(19,167)	29,720	29,754
Liquefied petroleum gas	4,686	8,855	-	-	9	(803)	8,061	12,747
Crude oil	855	1,191	-	-	-	(588)	603	1,458
Oil and gas products	143	-	-	-	-	-	-	143
<b>Oil and gas sales</b>	<b>76,778</b>	<b>16,644</b>	<b>25,976</b>	<b>12,660</b>	<b>3,662</b>	<b>(20,558)</b>	<b>38,384</b>	<b>115,162</b>
Polymer products sales (until September 2010)	1,390	-	-	-	309	-	309	1,699
Other revenues	157	6	-	-	-	-	6	163
<b>Total external revenues</b>	<b>78,325</b>	<b>16,650</b>	<b>25,976</b>	<b>12,660</b>	<b>3,971</b>	<b>(20,558)</b>	<b>38,699</b>	<b>117,024</b>

Revenues from external customers are based on the geographical location of customers even though all revenues are generated from assets located in the Russian Federation. Substantially all of the Group's assets are located in the Russian Federation.

**Major customers.** For the years ended 31 December 2011 and 2010, the Group has two and three major customer to whom individual revenues represent 30 percent and 42 percent of total external revenues, respectively.

Sales to major customers are included in the results of the Exploration, production and marketing segment.

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

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

**32 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES**

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Net book value of assets value at 1 January</b>	<b>6,372</b>	<b>2,535</b>
Additions	13,500	1,394
Acquisition of subsidiaries	-	7,894
Disposals	(1,921)	(821)
Reclassification in proved properties	(1,700)	(4,630)
<b>Net book value of assets at 31 December</b>	<b>16,251</b>	<b>6,372</b>
Liabilities	650	3,026
Cash flows used for operating activities	1,469	1,151
Cash flows used for investing activities	10,093	2,112

**33 NEW ACCOUNTING PRONOUNCEMENTS**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012 or later, and which the Group has not early adopted.

IFRS 9, *Financial Instruments: Classification and Measurement*. IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 10, *Consolidated Financial Statements* (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27, *Consolidated and separate financial statements*, and SIC-12, *Consolidation - special purpose entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

IFRS 11, *Joint Arrangements*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-Monetary Contributions by Ventures*. Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

### 33 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

IFRS 12, *Disclosure of Interest in Other Entities*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28, *Investments in associates*. IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgments and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

IFRS 13, *Fair value measurement*, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its consolidated financial statements.

IAS 27, *Separate Financial Statements*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, *Consolidated Financial Statements*. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IAS 28, *Investments in Associates and Joint Ventures*, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Amendments to IFRS 7, *Disclosures—Transfers of Financial Assets* – (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Group is currently assessing the impact of the amended standard on disclosures in its consolidated financial statements.

Amendments to IAS 1, *Presentation of Financial Statements* (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its consolidated financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, *Employee Benefits* (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

**33 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

Amendments to IFRS 7, *Disclosures—Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Amendments to IAS 32, *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment, the impact on the Group and the timing of its adoption by the Group.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's consolidated financial statements.



**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES**

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). In the absence of specific IFRS guidance, the Group has reverted to other relevant disclosure standards, mainly US GAAP, that are consistent with norms established for the oil and gas industry. While not required under IFRS, this section provides unaudited supplemental information on oil and gas exploration and production activities but excludes disclosures regarding the standardized measures of discounted cash flows related to oil and gas activities.

The Group’s exploration and production activities are mainly within the Russian Federation; therefore, all of the information provided in this section pertains to this country. The Group operates through various oil and gas production subsidiaries, and also has an interest in oil and gas companies that are accounted for under the equity method.

**Oil and Gas Exploration and Development Costs**

The following tables set forth information regarding oil and gas acquisition, exploration and development activities. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the years ended 31 December 2011 and 2010 (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Costs incurred in exploration and development activities</b>		
Acquisition cost	-	7,694
Acquisition of unproved properties	7,448	76
Exploration costs	2,447	2,042
Development costs	23,098	22,047
<b>Total costs incurred in exploration and development activities</b>	<b>32,993</b>	<b>31,859</b>
The share of the Group in its equity investees	2,051	78,300

	<b>At 31 December:</b>	
	<b>2011</b>	<b>2010</b>
<b>Capitalized costs relating to oil and gas producing activities</b>		
Wells and related equipment and facilities	145,063	163,130
Support equipment and facilities	30,717	29,222
Uncompleted wells, equipment and facilities	12,862	10,277
<b>Total capitalized costs relating to oil and gas producing activities</b>	<b>188,642</b>	<b>202,629</b>
Less: accumulated depreciation, depletion and amortization	(35,540)	(26,698)
<b>Net capitalized costs relating to oil and gas producing activities</b>	<b>153,102</b>	<b>175,931</b>
The share of the Group in its equity investees	150,449	78,220

The Group has reclassified capitalized costs relating to oil and gas producing activities of Yamal LNG due to cessation of control on 6 October 2011 and the subsequent accounting of its activities under the equity method (see Note 5).

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

**Results of Operations for Oil and Gas Producing Activities**

The Group's results of operations for oil and gas producing activities are shown below. The results of operations for oil and gas producing activities do not include general corporate overhead or its associated tax effects. Income tax is based on statutory rates. In the following table, revenues from oil and gas sales are comprised of the sale of the Group's hydrocarbons and include processing costs, related to the Group's processing facilities as well as transportation expenses to the customer (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2011</b>	<b>2010</b>
Revenues from oil and gas sales	163,765	115,008
Lifting costs	(5,236)	(4,854)
Transportation expenses	(46,064)	(37,187)
Taxes other than income tax	(17,287)	(9,831)
Depreciation, depletion and amortization	(8,878)	(6,384)
Exploration expenses	(1,819)	(1,595)
<b>Total production costs</b>	<b>(79,284)</b>	<b>(59,851)</b>
Results of operations for oil and gas producing activities before income tax	84,481	55,157
Less: related income tax expense	(16,896)	(11,031)
<b>Results of operations for oil and gas producing activities</b>	<b>67,585</b>	<b>44,126</b>

**Proved Oil and Gas Reserves**

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

The Group estimates its oil and gas reserves in accordance with rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves.

The oil and gas reserve estimates reported below are determined by the Group's independent petroleum reservoir engineers, DeGolyer and MacNaughton ("D&M"). The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for the reserve determination. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of this process, senior management reviews and approves the final reserve estimates issued by D&M.

The following reserve estimates were prepared using standard geological and engineering methods generally accepted by the petroleum industry. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history.

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2011 and 2010.

Extensions of production licenses are assumed to be at the discretion of the Group. Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. The Group's licenses expire between 2018 and 2045, with the most significant licenses for Yurkharovskoye and East-Tarkosalinskoye fields, expiring in 2034 and 2043, respectively. Legislation of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Management intends to extend its licenses for properties expected to produce beyond the license expiry dates.

Proved reserves are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

Proved developed reserves are those reserves which are expected to be recovered through existing wells with existing equipment and operating methods. Undeveloped reserves are those reserves which are expected to be recovered as a result of future investments to drill new wells, to re-complete existing wells and/or install facilities to collect and deliver the production.

Net reserves exclude quantities due to others when produced.

The reserve quantities below include 100 percent of the net proved reserve quantities attributable to the Group's consolidated subsidiaries and the Group's ownership percentage of the net proved reserves quantities of the joint ventures. A portion of the Group's total proved reserves are classified as either developed non-producing or undeveloped. Of the non-producing reserves, a portion represents existing wells which are to be returned to production at a future date.

For convenience, reserves estimates are provided both in English and Metric units.

**OAO NOVATEK**  
**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of natural gas are presented below.

	Net proved reserves		Group's share in equity companies		Total net proved reserves	
	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters
<b>Reserves at 31 December 2009</b>	<b>40,726</b>	<b>1,153</b>	-	-	<b>40,726</b>	<b>1,153</b>
Changes attributable to:						
Revisions of previous estimates	(54)	(1)	-	-	(54)	(1)
Extension and discoveries	3,097	88	-	-	3,097	88
Acquisitions	-	-	5,613	158	5,613	158
Disposals	(426)	(12)	-	-	(426)	(12)
Reclassifications	(444)	(13)	444	13	-	-
Production	(1,314)	(37)	-	-	(1,314)	(37)
<b>Reserves at 31 December 2010</b>	<b>41,585</b>	<b>1,178</b>	<b>6,057</b>	<b>171</b>	<b>47,642</b>	<b>1,349</b>
Changes attributable to:						
Revisions of previous estimates	(106)	(3)	370	11	264	8
Extension and discoveries	3,398	97	676	19	4,074	116
Disposals	(3,331)	(95)	-	-	(3,331)	(95)
Reclassifications	(13,323)	(377)	13,323	377	-	-
Production	(1,676)	(48)	(190)	(5)	(1,866)	(53)
<b>Reserves at 31 December 2011</b>	<b>26,547</b>	<b>752</b>	<b>20,236</b>	<b>573</b>	<b>46,783</b>	<b>1,325</b>
<b>Net proved developed reserves (included above)</b>						
At 31 December 2009	20,612	584	-	-	20,612	584
At 31 December 2010	22,515	638	2,536	71	25,051	709
At 31 December 2011	20,763	588	2,348	66	23,111	654
<b>Net proved undeveloped reserves (included above)</b>						
At 31 December 2009	20,114	569	-	-	20,114	569
At 31 December 2010	19,070	540	3,521	100	22,591	640
At 31 December 2011	5,784	164	17,888	507	23,672	671

The net proved reserves reported in the table above included reserves of natural gas attributable to non-controlling interest of 120 billion of cubic feet and 4 billion of cubic meters and 7,227 billion of cubic feet and 205 billion of cubic meters at 31 December 2011 and 2010, respectively.

**OAO NOVATEK**  
**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of crude oil, gas condensate and natural gas liquids are presented below.

	Net proved reserves		Group's share in equity companies		Total net proved reserves	
	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons
<b>Reserves at 31 December 2009</b>	<b>589</b>	<b>70</b>	-	-	<b>589</b>	<b>70</b>
Changes attributable to:						
Revisions of previous estimates	(12)	(1)	-	-	(12)	(1)
Extension and discoveries	60	8	-	-	60	8
Acquisitions	-	-	83	10	83	10
Disposals	(20)	(2)	-	-	(20)	(2)
Reclassifications	(20)	(3)	20	3	-	-
Production	(31)	(4)	-	-	(31)	(4)
<b>Reserves at 31 December 2010</b>	<b>566</b>	<b>68</b>	<b>103</b>	<b>13</b>	<b>669</b>	<b>81</b>
Changes attributable to:						
Revisions of previous estimates	10	1	4	1	14	2
Extension and discoveries	116	14	38	4	154	18
Disposals	(34)	(4)	-	-	(34)	(4)
Reclassifications	(138)	(16)	138	16	-	-
Production	(35)	(4)	-	-	(35)	(4)
<b>Reserves at 31 December 2011</b>	<b>485</b>	<b>59</b>	<b>283</b>	<b>34</b>	<b>768</b>	<b>93</b>
<b>Net proved developed reserves (included above)</b>						
At 31 December 2009	272	33	-	-	272	33
At 31 December 2010	304	36	-	-	304	36
At 31 December 2011	282	33	-	-	282	33
<b>Net proved undeveloped reserves (included above)</b>						
At 31 December 2009	317	37	-	-	317	37
At 31 December 2010	262	32	103	13	365	45
At 31 December 2011	203	26	283	34	486	60

The net proved reserves reported in the table above included reserves of crude oil, gas condensate and natural gas liquids attributable to non-controlling interest of 16 million of barrels and 2 million of metric tons and 65 million of barrels and 8 million of metric tons at 31 December 2011 and 2010, respectively.

In October 2011, the Group's effective control over OAO Yamal LNG, the holder of the South-Tambeyskoye field, ceased. As a result, the Group's interest in Yamal LNG is accounted for using the equity method.

During 2010, the Group acquired 51 percent of the outstanding ordinary shares of OAO Sibneftegas, which holds licenses on Beregovoye, Pyreinoeye and Khadyryahinskoye fields (see Note 5). During 2010, the Group's joint venture OOO Yamal Development acquired a 51 percent of the participation interest in OOO SeverEnergiya. SeverEnergiya and its subsidiaries hold licenses on Samburgskiy, Yevo-Yakhinskiy, Yaro-Yakhinskiy and North-Chaselskiy license areas (see Note 5).

In February 2010, the Group's effective control over ZAO Terneftegas, the holder of the Termokarstovoye field, ceased. As a result, the Group's interest in Terneftegas is accounted for using the equity method.

**OAO NOVATEK**  
**Contact Information**

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OAO NOVATEK was incorporated as a joint stock company in accordance with the Russian law and is domiciled in the Russian Federation.

The Group's registered office is:

Ulitsa Pobedy 22a  
629850 Tarko-Sale  
Yamal-Nenets Autonomous Region  
Russian Federation

The Group's office in Moscow is:

Ulitsa Udaltsova 2  
119415 Moscow  
Russian Federation

Telephone: 7 (495) 730-60-00  
Fax: 7 (495) 721-22-53

[www.novatek.ru](http://www.novatek.ru)

**OAO NOVATEK**  
**IFRS CONSOLIDATED FINANCIAL STATEMENTS**  
**AND INDEPENDENT AUDITOR'S REPORT**  
**FOR THE YEARS ENDED 31 DECEMBER 2010 AND 2009**

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## *Independent Auditor's Report*

To the shareholders and Board of Directors of OAO NOVATEK

- 1 We have audited the accompanying consolidated financial statements of OAO NOVATEK and its subsidiaries (the "Group") set out on pages 4 to 70 which comprise the consolidated statement of financial position as at 31 December 2010 and the consolidated statement of income, consolidated statement of cash flows, consolidated statement of comprehensive income and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory notes.

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

- 2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **Auditor's Responsibility**

- 3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

- 4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

- 5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

- 6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
11 March 2011

ZAO PricewaterhouseCoopers Audit, White Square Office Center, 10 Butyrsky Val, Moscow, Russia, 125047  
T: +7 (495) 967 6000, F: +7 (495) 967 6001, www.pwc.ru


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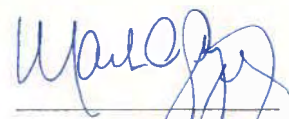
**OAD NOVATEK**  
**Consolidated Statement of Financial Position**  
(in millions of Russian roubles)

	Notes	At 31 December:	
		2010	2009
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	6	185,573	161,448
Investments in associates and joint ventures	7	27,026	1,214
Long-term loans and receivables	8	40,151	933
Other non-current assets	9	2,858	2,669
<b>Total non-current assets</b>		<b>255,608</b>	<b>166,264</b>
<b>Current assets</b>			
Inventories	10	1,868	1,790
Current income tax prepayments		285	241
Trade and other receivables	11	8,670	8,504
Prepayments and other current assets	12	8,504	5,800
Cash and cash equivalents	13	10,238	10,532
<b>Total current assets</b>		<b>29,565</b>	<b>26,867</b>
<b>Assets held for sale</b>		<b>-</b>	<b>508</b>
<b>Total assets</b>		<b>285,173</b>	<b>193,639</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Non-current liabilities</b>			
Long-term debt	14	47,074	23,876
Deferred income tax liabilities	26	9,473	7,460
Other non-current liabilities		917	3,034
Asset retirement obligations		2,482	2,232
<b>Total non-current liabilities</b>		<b>59,946</b>	<b>36,602</b>
<b>Current liabilities</b>			
Short-term debt and current portion of long-term debt	16	25,152	13,827
Trade payables and accrued liabilities	17	28,479	7,335
Current income tax payable		1,212	386
Other taxes payable		2,598	2,045
<b>Total current liabilities</b>		<b>57,441</b>	<b>23,593</b>
<b>Liabilities associated with assets held for sale</b>		<b>-</b>	<b>4</b>
<b>Total liabilities</b>		<b>117,387</b>	<b>60,199</b>
<b>Equity attributable to OAO NOVATEK shareholders</b>			
Ordinary share capital		393	393
Treasury shares		(446)	(599)
Additional paid-in capital		30,865	30,609
Currency translation differences		(120)	(112)
Asset revaluation surplus on acquisitions		5,617	5,617
Retained earnings		110,810	78,393
<b>Total equity attributable to OAO NOVATEK shareholders</b>	18	<b>147,119</b>	<b>114,301</b>
<b>Non-controlling interest</b>		<b>20,667</b>	<b>19,139</b>
<b>Total equity</b>		<b>167,786</b>	<b>133,440</b>
<b>Total liabilities and equity</b>		<b>285,173</b>	<b>193,639</b>

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

Approved for issue and signed on behalf of the Board of Directors on 10 March 2011:

  
L. Mikhelson  
General Director

  
M. Gyetvay  
Financial Director

**OAQ NOVATEK**
**Consolidated Statement of Income**

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

	Notes	Year ended 31 December:	
		2010	2009
<b>Revenues</b>			
Oil and gas sales	20	115,162	86,903
Sales of polymer and insulation tape		1,699	1,873
Other revenues		163	1,178
<b>Total revenues</b>		<b>117,024</b>	<b>89,954</b>
<b>Operating expenses</b>			
Transportation expenses	21	(37,200)	(29,026)
Taxes other than income tax	22	(10,077)	(8,042)
General and administrative expenses	23	(6,733)	(5,126)
Depreciation, depletion and amortization	6	(6,616)	(5,588)
Materials, services and other	24	(6,072)	(6,259)
Exploration expenses		(1,595)	(566)
Net impairment expense		(541)	(125)
Purchases of natural gas and liquid hydrocarbons		(154)	(1,143)
Change in natural gas, liquid hydrocarbons, and polymer products and work-in-progress		470	(255)
<b>Total operating expenses</b>		<b>(68,518)</b>	<b>(56,130)</b>
Net gain on disposal of interest in subsidiaries		1,329	52
Other operating income (loss)		396	(343)
<b>Profit from operations</b>		<b>50,231</b>	<b>33,533</b>
<b>Finance income (expense)</b>			
Interest expense	25	(437)	(819)
Interest income	25	598	527
Foreign exchange gain (loss)		1,036	(539)
<b>Total finance income (expense)</b>		<b>1,197</b>	<b>(831)</b>
Share of profit (loss) of associates and joint ventures, net of income tax		(346)	(202)
<b>Profit before income tax</b>		<b>51,082</b>	<b>32,500</b>
<b>Income tax expense</b>			
Current income tax expense		(9,405)	(5,896)
Net deferred income tax (expense) benefit		(1,399)	(882)
<b>Total income tax expense</b>	26	<b>(10,804)</b>	<b>(6,778)</b>
<b>Profit (loss)</b>		<b>40,278</b>	<b>25,722</b>
Profit (loss) attributable to:			
Non-controlling interest		(255)	(321)
<b>Shareholders of OAO NOVATEK</b>		<b>40,533</b>	<b>26,043</b>
Basic and diluted earnings per share (in Russian roubles)		13.37	8.59
<i>Weighted average number of shares outstanding (in thousands)</i>		<i>3,032,218</i>	<i>3,032,114</i>

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

**OAO NOVATEK**  
**Consolidated Statement of Cash Flows**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2010	2009
<b>Profit before income tax</b>		<b>51,082</b>	<b>32,500</b>
<b>Adjustments to profit before income tax:</b>			
Depreciation, depletion and amortization		6,757	5,738
Net impairment expense		541	125
Net foreign exchange loss (gain)		(1,036)	539
Net loss (gain) on disposal of assets		(1,253)	233
Interest expense		437	819
Interest income		(598)	(527)
Share of loss (profit) in associates, net of income tax		346	202
Net change in other non-current assets and long-term receivables		1,063	399
Share-based compensation	18	68	176
Other adjustments		241	(238)
<b>Working capital changes</b>			
Decrease (increase) in trade and other receivables, prepayments and other current assets		(2,675)	(1,298)
Decrease (increase) in inventories		(479)	334
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends		(1,821)	(615)
Increase (decrease) in other taxes payable		765	724
<b>Total effect of working capital changes</b>		<b>(4,210)</b>	<b>(855)</b>
Income taxes paid		(8,575)	(4,264)
<b>Net cash provided by operating activities</b>		<b>44,863</b>	<b>34,847</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(21,436)	(16,218)
Purchases of inventories intended for construction		(1,200)	(20)
Acquisition of subsidiaries net of cash acquired		(1,718)	(19,034)
Investments in associates and joint ventures		(4,660)	-
Proceeds from disposals of subsidiaries net of cash disposed		1,173	419
Interest paid and capitalized		(2,002)	(1,280)
Loans provided		(39,402)	(427)
Repayments of loans provided		219	80
Interest received		184	295
<b>Net cash (used for) provided by investing activities</b>		<b>(68,842)</b>	<b>(36,185)</b>
<b>Cash flows from financing activities</b>			
Proceeds from long-term debt		35,018	16,926
Proceeds from short-term debt		20,331	5,385
Repayments of long-term debt		(18,718)	(6,758)
Repayments of short-term debt		(2,729)	(8,348)
Interest paid		(301)	(583)
Dividends paid	18	(9,868)	(7,628)
Acquisition of non-controlling interest	5	(629)	-
Additional capital contribution into subsidiaries	5	337	1,767
Proceeds from sale of treasury shares	18	341	-
<b>Net cash (used for) provided by financing activities</b>		<b>23,782</b>	<b>761</b>

**ОАО NOVATEK**  
**Consolidated Statement of Cash Flows**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2010	2009
Net effect of exchange rate changes on cash, cash equivalents and bank overdrafts		(45)	141
<b>Net increase (decrease) in cash, cash equivalents and bank overdrafts</b>		<b>(242)</b>	<b>(436)</b>
Cash and cash equivalents at beginning of the year		10,532	10,991
Cash and cash equivalents reclassified as assets classified as held for sale		-	(52)
Net decrease (increase) in cash and cash equivalents reclassified to assets classified as held for sale		(52)	(23)
<b>Cash, cash equivalents and bank overdrafts at end of the year</b>		<b>10,238</b>	<b>10,532</b>

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

**ОАО NOVATEK**  
**Consolidated Statement of Comprehensive Income**  
(in millions of Russian roubles)

	Notes	Year ended 31 December:	
		2010	2009
<b>Other comprehensive income (loss) after income tax:</b>			
Currency translation differences		(8)	(21)
<b>Other comprehensive income (loss)</b>		<b>(8)</b>	<b>(21)</b>
<b>Profit (loss)</b>		<b>40,278</b>	<b>25,722</b>
<b>Total comprehensive income</b>		<b>40,270</b>	<b>25,701</b>
Total comprehensive income (loss) attributable to:			
Non-controlling interest		(255)	(321)
<b>Shareholders of ОАО NOVATEK</b>		<b>40,525</b>	<b>26,022</b>

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

**OAO NOVATEK**

**Consolidated Statement of Changes in Equity**

(in millions of Russian roubles, except for number of shares)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Currency translation differences	Asset revaluation surplus on acquisitions	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b>31 December 2008</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,433</b>	<b>(91)</b>	<b>5,617</b>	<b>60,316</b>	<b>96,069</b>	<b>571</b>	<b>96,640</b>
Currency translation differences	-	-	-	-	(21)	-	-	(21)	-	(21)
Profit (loss)	-	-	-	-	-	-	26,043	26,043	(321)	25,722
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(21)</b>	<b>-</b>	<b>26,043</b>	<b>26,022</b>	<b>(321)</b>	<b>25,701</b>
Dividends (Note 18)	-	-	-	-	-	-	(7,641)	(7,641)	-	(7,641)
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	160	160
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	-	-	-	18,729	18,729
Equity call option consideration (Note 5)	-	-	-	-	-	-	(325)	(325)	-	(325)
Share-based compensation funded by shareholders	-	-	-	176	-	-	-	176	-	176
<b>31 December 2009</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>(112)</b>	<b>5,617</b>	<b>78,393</b>	<b>114,301</b>	<b>19,139</b>	<b>133,440</b>

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

**OAO NOVATEK**

**Consolidated Statement of Changes in Equity**

(in millions of Russian roubles, except for number of shares)

	<i>Number of ordinary shares (in thousands)</i>	Ordinary share capital	Treasury shares	Additional paid-in capital	Currency translation differences	Asset revaluation surplus on acquisitions	Retained earnings	Equity attributable to OAO NOVATEK shareholders	Non- controlling interest	Total equity
<b>31 December 2009</b>	<b>3,032,114</b>	<b>393</b>	<b>(599)</b>	<b>30,609</b>	<b>(112)</b>	<b>5,617</b>	<b>78,393</b>	<b>114,301</b>	<b>19,139</b>	<b>133,440</b>
Currency translation differences	-	-	-	-	(8)	-	-	(8)	-	(8)
Profit (loss)	-	-	-	-	-	-	40,533	40,533	(255)	40,278
<b>Total comprehensive income (loss)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>-</b>	<b>40,533</b>	<b>40,525</b>	<b>(255)</b>	<b>40,270</b>
Dividends (Note 18)	-	-	-	-	-	-	(9,855)	(9,855)	-	(9,855)
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	-	-	-	2,414	2,414
Impact of additional shares subscription in subsidiaries on non-controlling interest	-	-	-	-	-	-	-	-	1,818	1,818
Acquisition of non-controlling interest (Note 5)	-	-	-	-	-	-	1,739	1,739	(2,368)	(629)
Disposal of subsidiaries	-	-	-	-	-	-	-	-	(81)	(81)
Share-based compensation funded by shareholders	-	-	-	68	-	-	-	68	-	68
Sales of treasury shares (Note 18)	<i>1,070</i>	-	153	188	-	-	-	341	-	341
<b>31 December 2010</b>	<b>3,033,184</b>	<b>393</b>	<b>(446)</b>	<b>30,865</b>	<b>(120)</b>	<b>5,617</b>	<b>110,810</b>	<b>147,119</b>	<b>20,667</b>	<b>167,786</b>

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



## **ОАО NOVATEK**

### **Notes to the Consolidated Financial Statements**

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

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## **1 ORGANISATION AND PRINCIPAL ACTIVITIES**

ОАО NOVATEK (hereinafter referred to as “NOVATEK”) and its subsidiaries (hereinafter jointly referred to as the “Group”) is an independent oil and gas company engaged in the acquisition, exploration, development, production and processing of hydrocarbons with its core oil and gas operations located and incorporated in the Yamal-Nenets Autonomous Region (“YNAO”) of the Russian Federation.

The Group sells its natural gas on the Russian domestic market at unregulated market prices; however, the majority of natural gas sold on the domestic market is sold at prices regulated by the Federal Tariff Service, a governmental agency. The Group’s stable gas condensate and crude oil sales volumes are sold on both the Russian domestic and international markets, and are subject to fluctuations in benchmark crude oil prices. Additionally, the Group’s natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in the winter months of December and January and troughing in the summer months of July and August. The Group’s liquids sales volumes comprising stable gas condensate, crude oil and oil products remain relatively stable from period to period.

In December 2010, the Group acquired 100 percent participation interest in ООО Yamalgazresurs-Chelyabinsk, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Chelyabinsk Region in Russian Federation (see Note 5).

In December 2010, the Group acquired 51 percent ownership in ОАО Sibneftegas, an oil and gas production company, which owns four licenses for the fields located in YNAO, with total production in 2010 of 9.8 billion cubic meters (see Note 5).

In November 2010, ООО Yamal Development, the Group’s joint venture, acquired a 51 percent participation interest in ООО SeverEnergiya. SeverEnergiya through its three wholly owned subsidiaries holds four exploration and production licenses for the fields located in the YNAO (see Note 5).

In September 2010, the Group disposed of its 100 percent participation interest in ООО NOVATEK-Polymer, its non-core subsidiary to ОАО SIBUR Holding (see Note 5).

In August 2010, the Group acquired 100 percent ownership in Intergaz-System Sp.z o.o., domiciled in Poland, to support and extend the wholesale and retail trading of liquefied petroleum gas in Polish market (see Note 5).

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

In May 2010, the Group established ООО NOVATEK Perm, a wholly-owned subsidiary, to support the Group’s current natural gas deliveries to the Perm region, one of the largest industrial centers in the Russian Federation, as well as to expand potential sales opportunities in the territory.

In November 2009, the Group established Novatek Polska, a wholly-owned subsidiary, domiciled in Poland to manage the administration, marketing and trading of liquefied petroleum gas to European markets. Beginning in January 2010, the Group commenced export sales through this subsidiary.

## **2 BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention. In the absence of specific IFRS guidance for oil and gas producing companies, the Group has developed accounting policies in accordance with other generally accepted accounting principles for oil and gas producing companies, mainly US GAAP, insofar as they do not conflict with IFRS principles. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

## 2 BASIS OF PRESENTATION (CONTINUED)

Most of the Group entities prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation (“RAR”). The Group’s consolidated financial statements are based on the statutory records with adjustments and reclassifications recorded in the consolidated financial statements for the fair presentation in accordance with IFRS. The principal adjustments primarily relate to (1) depreciation, depletion and amortization, and valuation of property, plant and equipment, (2) consolidation of subsidiaries, (3) business combinations, (4) accounting for income taxes, and (5) valuation of unrecoverable assets, expense recognition and other provisions.

**Functional and presentation currency.** The consolidated financial statements are presented in Russian roubles, the Group’s reporting (presentation) currency and the functional currency for the majority of entities. The assets and liabilities (both monetary and non-monetary) of the Group entities whose functional currency is not the Russian rouble are translated into Russian roubles at the closing exchange rate at each balance sheet date. All items included in the shareholders’ equity, other than profit or loss, are translated at historical exchange rates. The financial results of these entities are translated into Russian roubles using average exchange rates for each reporting period. Exchange adjustments arising on the opening net assets and the profits for the reporting period are taken to a separate component of equity until the disposal of the foreign operation and reported as currency translation differences in the consolidated statement of changes in equity and the consolidated statement of comprehensive income.

Exchange rates used in preparation of this consolidated financial statement for the entities whose functional currency is not the Russian rouble were as follows:

<i>For one currency unit to one Russian rouble</i>	<b>At 31 December:</b>		<b>Average annual rate</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
US dollar (“USD”)	30.48	30.24	30.37	31.72
Polish Zloty (“PLN”)	10.17	10.32	10.09	10.64

**Exchange rates, restrictions and controls.** Any re-measurement of Russian rouble amounts to US dollars or any other currency should not be construed as a representation that such Russian rouble amounts have been, could be, or will in the future be converted into other currencies at these exchange rates.

## 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Adoption of IFRS 3.** Effective 1 January 2010, the Group adopted IFRS 3, *Business Combinations* (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquirer’s identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognized as expenses rather than included in goodwill. An acquirer will have to recognize at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognized in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone;

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

**Adoption of IAS 27.** Effective 1 January 2010, the Group adopted IAS 27, *Consolidated and Separate Financial Statements* (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously “minority interests”) even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group has changed its accounting policy for the accounting for loss of control or significant influence from 1 January 2010. Previously, when the Group ceased to have control or significant influence over an entity, the carrying amount of the investment at the date control or significant influence became its cost for the purposes of subsequently accounting for the retained interests as associates, jointly controlled entity or financial assets. The Group has applied the new accounting policies prospectively to transactions occurring on or after 1 January 2010.

**Adoption of IAS 1.** Effective 1 January 2009, the Group adopted IAS 1, *Presentation of Financial Statements* (revised September 2007) (“IAS 1”). Following the adoption, the Group introduced the statement of financial position instead of the balance sheet, and replaced the income statement by two statements: a separate income statement and a statement of comprehensive income. Also, non-controlling shares in the Group’s subsidiaries’ net assets and financial results are presented as non-controlling interests (previously “minority interests”). The adoption of IAS 1 affects the formal presentation of the Group’s financial statements but has no impact on the recognition or measurement of specific transactions and balances.

**Adoption of IFRS 8.** Effective 1 January 2009, the Group adopted IFRS 8, *Operating Segments* (“IFRS 8”), which replaces IAS 14, *Segment Reporting*. IFRS 8 introduces new requirements and guidelines regarding the disclosures of operating segments. For periods prior to 1 January 2010, a measure of total segment assets was required to be disclosed for all segments regardless of whether those measures were reviewed by the chief operating decision maker. In December 2007, however, the IASB concluded that IFRS 8 should be changed to state that a measure of segment assets should only be disclosed when such information is provided to the chief operating decision maker. This change was included as part of the IASB’s 2009 annual improvement project issued in April 2009 which has been adopted by Group as of 1 January 2009.

Operating segments are defined as components of the Group where separate financial information is available and reported regularly to the chief operating decision maker (hereinafter referred to as “CODM”, represented by the Management Committee of NOVATEK), which decides how to allocate resources and assesses operational and financial performance using the information provided.

The Group conducts its normal course of business through its principal business segment “exploration, production and marketing”. Substantially all of the Group’s business activities are related to the natural gas and gas condensate exploration, production and marketing segment, and includes all headquarter-related costs. To a significantly lesser extent, the Group was engaged in polymer production and marketing activities, which was considered a separately reportable operating segment until its disposal in September 2010.

The CODM assesses reporting segments performance based on income before income taxes, since income taxes are not allocated. No business segment assets or liabilities (except for capital expenditures for the period) are provided to the CODM for decision-making.

**Principles of consolidation.** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

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

The Group measures non-controlling interest on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed and reviews appropriateness of their measurement.

The consideration transferred for the acquiree is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed, including fair value of assets or liabilities from contingent consideration arrangements but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity.

**Disposals of subsidiaries, associates or joint ventures.** When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are recycled to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

**Acquisition of non-controlling interests.** The difference between the purchase consideration and the carrying amount of non-controlling interests acquired is recognized within equity to account for acquisitions of non-controlling minority stakes.

**Investments in associates and joint ventures.** Associated companies and joint ventures are entities over which the Group has significant influence, but which it does not control. Generally, significant influence exists when the Group has between 20 and 50 percent of voting rights. Associated companies and joint ventures are accounted for using the equity method and are initially recognized at cost. The difference between the cost of an acquisition and the share of the fair value of the associate's identifiable net assets represents goodwill upon acquiring the associated company. Dividends received from associates and joint ventures reduce the carrying value of the investment in associates. The carrying amount of associates and joint ventures includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the associates' post-acquisition profits or losses is recorded in the consolidated statement of income, and its share of post-acquisition movements in reserves is recognized in the consolidated statement of changes in equity. When the Group's share of losses in an associate or joint ventures equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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

Accounting policies of associates and joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

**Non-current assets held for sale.** Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less selling costs. Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment are not depreciated once classified as held for sale.

**Property, plant and equipment.** Property, plant and equipment are carried at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion, amortization and impairment.

The Group follows the successful efforts method of accounting for its oil and gas properties and equipment whereby property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overheads and all exploration costs other than exploratory drilling and license acquisition costs are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

The Group's principal oil and gas reserves have been independently estimated by internationally recognized petroleum engineers whereas other oil and gas reserves of the Group have been determined based on estimates of mineral reserves prepared by management in accordance with internationally recognized definitions. The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, subject to depletion using the unit-of-production method.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components that extend the life of property, plant and equipment items are capitalized and depreciated over the estimated remaining life of the major part or component. All components that are replaced are written off.

The cost of self-constructed assets includes the cost of direct materials, direct employee related costs, a pro-rata portion of depreciation of assets used for construction and an allocation of the Group's overhead costs.

At each reporting date management assesses whether there is any indication of impairment in respect of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less selling costs and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in the consolidated statement of income. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. Gains and losses are recognized in the consolidated statement of income.

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

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

**Depreciation.** Depreciation, depletion and amortization of oil and gas properties and equipment (except for processing facilities) is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for costs associated with acquisitions of proved properties. A portion of the reserves used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation and past results (or experience) to extend mineral licenses at the initiative of the Group and, as such, intends to extend its licenses for properties expected to produce beyond the current license expiry dates.

Property, plant and equipment, other than oil and gas properties and equipment, are depreciated on a straight-line basis over their estimated useful lives. Land and assets under construction are not depreciated.

The estimated useful lives of the Group's property, plant and equipment, other than oil and gas properties and equipment, are as follows:

	<u>Years</u>
Machinery and equipment	5-15
Processing facilities	20-30
Buildings	25-50

**Derivative instruments.** Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- (i) hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedge); or
- (ii) hedges of a particular risk associated with a recognized asset or liability or a highly probable forecast transaction (cash flow hedge).

At inception, the Group documents the relationship between the hedging instruments and the items hedged, as well as the Group's risk management objectives and strategy for undertaking various hedging activities. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Group enters into commodity derivative instruments with the primary objective of reducing the Group's exposure to fluctuating of oil and gas prices. The Group has not entered into commodity derivative instruments for trading purposes.

During the year ended 31 December 2009, the Group entered into commodity price swap contracts for total notional volume of three million barrels of stable gas condensate. The contractual notional volumes are not physically exchanged, rather they are cash settled on a net basis. None of the contracts executed during this period qualified for hedge treatment under IAS 39, *Financial Instruments: Recognition and Measurement*. All contracts were settled realizing net losses of RR 190 million. The results of the commodity price swap contracts were recorded within other operating income (loss) in the consolidated statement of income.

(a) *Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of income, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The Group only applies fair value hedge accounting for hedging fixed interest risk on borrowings. The gain or loss relating to the effective portion of interest rate swaps hedging fixed rate borrowings is recognized in the consolidated statement of income within finance income (expenses). The gain or loss relating to the ineffective portion is recognized in the consolidated statement of income within other operating income (loss). Changes in the fair value of the hedge fixed rate borrowings attributable to interest rate risk are recognized in the consolidated statement of income within finance income (expenses).

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

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to profit or loss over the period to maturity. There were no fair value hedges used throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

(b) *Cash flow hedge*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in consolidated statement of changes in equity. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income within other operating income (loss).

Amounts accumulated in equity are recycled in the consolidated statement of income in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognized in the consolidated statement of income within finance income (expenses). The gain or loss relating to the ineffective portion is recognized in the consolidated statement of income within other operating income (loss). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory or fixed assets), the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset. The deferred amounts are ultimately recognized in cost of goods sold in case of inventory or in depreciation in the case of fixed assets.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in the consolidated statement of income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated statement of income within other operating income (loss). No cash flow hedges were used throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

(c) *Derivatives at fair value through profit or loss and accounted for at fair value through profit or loss*

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any these derivative instruments are recognized immediately in the consolidated statement of income within other operating income (loss). No net derivative instruments were recorded at fair value through profit or loss throughout 2009 or 2010, or in place at 31 December 2010 and 2009.

**Effective interest method.** The effective interest method is a method of calculating the carrying value of a financial asset or a financial liability held at amortized costs and of allocating the interest income or interest expense over the relevant period.

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

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

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)***(a) Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivative instruments are also categorized as held for trading unless they are designated as hedges. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the consolidated statement of income. Gains or losses arising from changes in the fair value of the “financial assets at fair value through profit or loss” category are presented in the consolidated statement of income within other operating income (loss) in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the consolidated statement of income as part of other operating income (loss) when the Group’s right to receive payments is established.

Financial assets at fair value through profit or loss are classified as current assets. There were no financial assets designated at fair value through profit or loss held by the Group at the reporting dates.

*(b) Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and are classified as held-to-maturity when the Group has the positive intention and ability to hold these investments to maturity. After initial measurement, the held-to-maturity investments are measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the investments are derecognized or impaired, as well as through the amortization process.

Held-to-maturity investments are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. There were no such investments held by the Group at the reporting dates.

*(c) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Financial assets classified as loans and receivables are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets.

*(d) Available-for-sale financial assets*

Financial assets classified as available-for-sale are non-derivatives financial assets that are either specially designated in this category or are not classified in any of the other categories. After initial recognition, financial assets classified as available-for-sale are measured at fair value, with gains and losses recognized directly in the consolidated statement of changes in equity until the investment is derecognized or determined to be impaired, at which time the cumulative gain or loss previously recorded in equity is recognized in consolidated statement of income as profit or loss.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale financial assets are analyzed between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognized in consolidated statement of income, while translation differences on non-monetary securities are recognized in consolidated statement of changes in equity. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in consolidated statement of changes in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the consolidated statement of income as profit or loss on sales of available-for-sale investments.



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

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in consolidated statement of income) is removed from equity and recognized in the consolidated statement of income. Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed. There were no available-for-sale investments held by the Group at the reporting dates.

**Financial liabilities.** Financial liabilities are classified at initial recognition as either financial liabilities at fair value through profit or loss, derivative instruments designated as hedging instruments in an effective hedge or as financial liabilities measured at amortized cost. There were no derivative instruments designated as hedging instruments by the Group at the reporting dates. The measurement of financial liabilities depends on their classification, as follows:

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

Derivative instruments, other than those designated as effective hedging instruments, are classified as held for trading and are included in this category. These financial liabilities are carried on the consolidated statement of financial position at fair value with gains or losses recognized in the consolidated statement of income. There were no financial liabilities designated at fair value through profit or loss held by the Group at the reporting dates.

(b) *Financial liabilities measured at amortized cost*

All other financial liabilities are included in this category and initially recognized at fair value. For interest-bearing debt, the fair value of the liability is the fair value of the proceeds received net of associated issue costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method. This category of financial liabilities includes trade and other payables and debt in the consolidated statement of financial position.

**Income taxes.** Russian legislation does not contain the concept of a “consolidated tax payer” and, accordingly, the Group is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. Current tax is the amount expected to be paid to or recovered from the tax authorities in respect of taxable profits or losses for the current and prior periods.

Income taxes have been provided for in the consolidated financial statements in accordance with Russian legislation enacted or substantively enacted as of end of the reporting period. The income tax charge or benefit comprises current tax and deferred tax and is recognized in the consolidated statement of income unless it relates to transactions that are recognized, in the same or a different period, directly in equity.

Deferred tax assets and liabilities are recognized in full for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or when the tax loss carry forwards will be utilized. Deferred tax assets and liabilities are netted only with respect to individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilized.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary’s dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

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

**Inventories.** Natural gas, gas condensate, crude oil and related products inventories are valued at the lower of cost or net realizable value. The cost of inventories includes applicable purchase costs of raw materials, direct operating costs, and related production overhead expenses and is recorded on a first-in-first-out (FIFO) basis. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Materials and supplies inventories are carried at amounts which do not exceed their respective recoverable amounts in the normal course of business.

**Trade and other receivables.** Trade receivables are represented by amounts due from regular customers in the ordinary course of business (production and marketing of natural gas, gas condensate, crude oil and related products; production and marketing of polymer and insulation tape products). Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method and include value-added taxes. Trade receivables are analyzed for impairment on a debtor by debtor basis. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognized in the consolidated statement of income within operating expenses. Subsequent recoveries of amounts previously written off are credited against the amount of the provision in the consolidated statement of income.

**Cash and cash equivalents.** Cash and cash equivalents comprises cash on hand, cash deposits held with banks, investments which are readily convertible to known amounts of cash and which are not subject to significant risk of change in value and have an original maturity of three months or less. For purposes of the presentation of the statement of cash flows, bank overdrafts are deducted from cash and cash equivalents. Bank overdrafts are shown within short-term debt in current liabilities on the consolidated statement of financial position.

**Treasury shares.** Where any Group company purchases NOVATEK's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to OAO NOVATEK shareholders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to OAO NOVATEK shareholders. Treasury shares are recorded at weighted average cost. Gains or losses resulting from subsequent sales of shares are recorded in the consolidated statement of changes in equity, net of associated costs including taxation.

**Dividends.** Dividends are recognized as a liability and deducted from shareholders' equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the consolidated financial statements are authorized for issue.

**Value added tax (VAT).** Output VAT related to sales is payable to the tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT related to purchases is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which is not settled or recovered at the balance sheet date (VAT payable and VAT recoverable) is recognized on a gross basis and disclosed separately within current assets and current liabilities. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

**Borrowings.** Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statement of income over the period of the borrowings using the effective interest method.

Interest costs and foreign exchange losses on borrowings to finance the construction of property, plant and equipment are capitalized during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

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

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

**Provisions for liabilities and charges.** Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events; when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be low.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Provisions are reassessed at each reporting date and changes in the provisions resulting from the passage of time are recognized in the consolidated statement of income as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

**Asset retirement obligations.** An asset retirement obligation is recognized when the Group has a present legal or constructive obligation to dismantle, remove and restore items of property, plant and equipment. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation, determined using discount rates reflecting adjustments for risks specific to the obligation. Changes in the obligation resulting from the passage of time are recognized in the consolidated statement of income as interest expense. Changes in the obligation, reassessed at each balance sheet date, related to a change in the expected pattern of settlement of the obligation, or in the estimated amount of the obligation or in the discount rates, are treated as a change in an accounting estimate in the period. Such changes are reflected as adjustments to the carrying value of property, plant and equipment and the corresponding liability.

The Group's exploration, development and production activities involve the use of wells, related equipment and operating sites, oil and gas gathering and treatment facilities and in-field pipelines. Generally, licenses and other regulatory acts require that such assets be decommissioned upon the completion of production, i.e. the Group is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Group's estimates of these obligations are based on current regulatory or license requirements, as well as actual dismantling and related costs.

The Group's management believes that due to the limited history of gas condensate processing and polymer production plants activities, the useful lives of these assets are indeterminable (while certain of the operating components and equipment have definite useful lives). Because of these reasons, and the lack of clear legal requirements as to the recognition of obligations, the fair value of an asset retirement obligation for such processing facilities cannot be reasonably estimated and, therefore, legal or contractual asset retirement obligations related to these assets are not recognized.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

**Foreign currency transactions.** Transactions denominated in foreign currencies are converted into the functional currency of each entity of the Group at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency remeasurement into the functional currencies are included in the determination of profit for the reporting period.

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

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

**Revenue recognition.** Revenues represent the fair value of consideration received or receivable for the sale of goods and services in the normal course of business, net of discounts, value-added tax and export duties.

Revenues from oil and gas sales and sales of polymer and insulation tape are recognized when such products are shipped or delivered to customers in accordance with the contract terms, the price is fixed or determinable, and the title has transferred. Services are recognized in the period in which the services are rendered.

Interest income is recognized as the interest accrues as related to the net carrying amount of the financial asset.

**General and administrative expenses.** General and administrative expenses represent overall corporate management and other expenses related to the general management and administration of the business unit as a whole. They include management and administrative compensation, certain legal and other advisory expenses, insurance of properties, social expenses and other expenses necessary for the administration of the Group.

**Employee benefits.** Wages and salaries, bonuses, voluntary medical insurance, paid annual and sick leaves are accrued in the period in which the associated services are rendered by the employees of the Group. Compensation at dismissals, vocational support payments, and other allowances are expensed when incurred.

The Group contributes to the Russian Federation State social insurance fund and State pension plan on behalf of its employees based on gross salary payments. Mandatory contributions to the State social insurance fund and the State pension plan, which is a defined contribution plan, are expensed when incurred and are included in payroll expenses in the consolidated statement of income.

The Group also incurs employee costs related to the provision of benefits such as health and social infrastructure and services, employees meals, transportation, and other services. These amounts principally represent an implicit cost of employing production workers and, accordingly, are charged to payroll expenses in the consolidated statement of income.

**Share based compensation.** The Group accounts for share-based compensation in accordance with IFRS 2, *Share-based Payment* ("IFRS 2"). The fair value of the employee services received in exchange for the grant of the equity instruments is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted measured at the grant date. For share-based compensation made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

**Pension obligations.** The Group operates a non-contributory post-employment defined benefit plan based on employees' years of service and average salary (Note 15).

The liability recognized in the consolidated statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligations at the balance sheet date, together with adjustments for unrecognized past service costs. The present value of the pension obligations are determined by discounting the estimated future cash outflows. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The discount rate was determined by reference to Russian rouble denominated bonds issued by the Government of the Russian Federation chosen to match the duration of the post-employment benefit obligations.

**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

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

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

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

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

Judgments and estimates that have the most significant effect on the amounts reported in these consolidated financial statements and have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are described below.

**Useful lives of property, plant and equipment.** Management assesses the useful life of an asset by considering the expected usage, estimated technical obsolescence, residual value, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future depreciation rates and expenses for the period.

**Fair values of financial assets and liabilities.** The fair value of financial assets and liabilities, other than financial instruments that are traded in an active market, is determined by applying various valuation methodologies. Management uses its judgment to make assumptions based on market conditions existing at each balance sheet date. Discounted cash flow analysis is used for various loans and receivables as well as debt instruments that are not traded in active markets. The effective interest rate is determined by reference to the interest rates of instruments available to the Group in active markets. In the absence of such instruments, the effective interest rate is determined by reference to the interest rates of active market instruments available adjusted for the Group's specific risk premium estimated by management.

**Deferred income tax asset recognition.** Management assesses deferred income tax assets at each balance sheet date and determines the amount recorded to the extent that realization of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments and applies estimations based on prior years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

**Estimation of oil and gas reserves.** Engineering estimates of oil and gas reserves are inherently uncertain and are subject to future revisions. The Group estimates its oil and gas reserves in accordance with rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves. Accounting measures such as depreciation, depletion and amortization charges, impairment assessments and asset retirement obligations that are based on the estimates of proved reserves are subject to change based on future changes to estimates of oil and gas reserves.

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

Proved reserves are estimated by reference to available reservoir and well information, including production and pressure trends for producing reservoirs. Furthermore, estimates of proved reserves only include volumes for which access to market is assured with reasonable certainty. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans.

Proved reserves are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are substantially developed and depleted. As those fields are further developed, new information may lead to further revisions in reserve estimates.

Oil and gas reserves have a direct impact on certain amounts reported in the consolidated financial statements, most notably depreciation, depletion and amortization as well as impairment expenses. Depreciation rates on oil and gas assets using the units-of-production method for each field are based on proved developed reserves for development costs, and total proved reserves for costs associated with the acquisition of proved properties. Assuming all variables are held constant, an increase in proved developed reserves for each field decreases depreciation, depletion and amortization expenses. Conversely, a decrease in the estimated proved developed reserves increases depreciation, depletion and amortization expenses. Moreover, estimated proved reserves are used to calculate future cash flows from oil and gas properties, which serve as an indicator in determining whether or not property impairment is present.

Although the possibility exists for changes or revisions in estimated reserves to have a critical effect on depreciation, depletion and amortization charges and, therefore, reported net profit for the year, it is expected that in the normal course of business the diversity of the Group's asset portfolio will mitigate the likelihood of this occurring.

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

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

**Impairment provision for trade receivables.** The impairment provision for trade receivables is based on management's assessment of the probability of collection of individual customer accounts receivable. Significant financial difficulties of the customer, probability that the customer will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

When there is no expectation of recovering additional cash for an amount receivable, the expected amount receivable is written off against the associated provision.

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

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

**Pension obligations.** The cost of defined benefit pension plans and related current service costs are determined using actuarial valuations. The actuarial valuations involve making demographic assumptions (mortality rates, age of retirement, employee turnover and disability) as well as financial assumptions (discount rates, expected rates of return on assets, inflation forecasts, future salary and pension increases). Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

**Asset retirement obligations.** Management makes provision for the future costs of decommissioning oil and gas production facilities, pipelines and related support equipment based on the best estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future.

Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The Group also assesses its liabilities for site restoration at each consolidated statement of financial position period in accordance with the guidelines of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the balance sheet date based on current legislation where the Group's respective operating assets are located, and is also subject to change because of modifications, revisions and changes in laws and regulations and their interpretation thereof. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of incurring such costs.

#### 5 MERGERS, ACQUISITIONS AND DISPOSALS

##### *Acquisition of OOO Yamalgazresurs-Chelyabinsk*

In December 2010, the Group acquired a 100 percent participation interest in OOO Yamalgazresurs-Chelyabinsk, a Russian regional natural gas trader, to support and expand natural gas sales opportunities in the Chelyabinsk Region of the Russian Federation for RR 410 million. Management has assessed the fair value of identifiable assets and liabilities and calculated that goodwill RR 82 million arose on the acquisition. The financial and operational activities of Yamalgazresurs-Chelyabinsk would not have had a material impact on the Group's revenues and results if the acquisition occurred in January 2010.

##### *Acquisition of Intergaz-System Sp.z o.o.*

In August 2010, the Group acquired a 100 percent ownership in Intergaz-System Sp.z o.o., domiciled in Poland, for RR 159 million (USD 5 million). Intergaz-System holds a discharging and transshipment facility and was purchased to support and extend the wholesale and retail trading of liquefied petroleum gas in the Polish market. Management has assessed the fair value of identifiable assets and liabilities and calculated that negative goodwill RR 10 million arose on the acquisition which was recognized as other operating profit in the consolidated statement of income. The financial and operational activities of Intergaz-System would not have had a material impact on the Group's revenues and results if the acquisition occurred in January 2010.

In December 2010, the Group merged Intergaz-System into its wholly-owned subsidiary Novatek Polska. The aforementioned merger did not affect the Group's consolidated financial and operational results.

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### Acquisition of OAO Sibneftegas

On 17 December 2010, the Group acquired 51 percent of the outstanding ordinary shares of OAO Sibneftegas, an oil and gas company located in the YNAO, for total cash consideration of RR 25,826, of which RR 4,650 million was paid in December 2010 and the remaining RR 21,176 million is payable in February and March 2011. Sibneftegas holds two production licenses: the Beregovoye and Pyreinoye gas condensate fields, which expire in 2023 and in 2021, respectively. Estimated aggregated proved reserves on these two fields as well as the Khadyryahinskoye (expires in 2031) field appraised by DeGolyer and MacNaughton at 31 December 2010 under the PRMS and SEC reserve methodologies totaled approximately 282 and 200 billion cubic meters of natural gas and 2 and 0.7 million tons of hydrocarbon liquids, respectively.

As part of the acquisition, the Group granted a loan in the amount of RR 11,038 million to Sibneftegas, which was used to fully repay its outstanding debt to Gazprombank ahead of its maturity schedule. Subsequent to the acquisition the Group also entered into the purchase contract to buy natural gas from Sibneftegas in proportion to its ownership interest in the company's total production at pre-determined prices.

As described above, the Group acquired 51 percent of the outstanding ordinary shares of Sibneftegas; however, the Charter agreement stipulates that key financial and operational decisions regarding its business activities are subject to approval by nine out of the eleven members of the Board of Directors. As a result, the Group has determined that it has significant influence over the business activities of Sibneftegas and will account for the investment under the equity method.

In accordance with IAS 28 "Investments in Associates", the Group assessed preliminary fair values of the identified assets and liabilities of Sibneftegas. In the consolidated financial statements for the year ended 31 December 2010, the fair value of purchase consideration and the fair value of the identifiable acquired assets and liabilities are preliminary as the Group is in the process of finalizing the fair value estimates for certain assets and liabilities, primarily for property, plant and equipment. Management is required to finalize the fair value determination within 12 months of the date of acquisition. Any revisions to the provisional values will be reflected as of the acquisition date.

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

<i>Sibneftegas</i>	<b>Preliminary fair values at the acquisition date</b>
Non-current assets	66,930
Current assets	1,072
Non-current liabilities	(28,199)
Current liabilities	(2,222)
<b>Total identifiable net assets</b>	<b>37,581</b>
Purchase consideration	25,826
Preliminary fair value of the Group's interest in net assets (RR 37,581 million at 51% ownership)	(19,166)
<b>Preliminary goodwill</b>	<b>6,660</b>

In accordance with Russian legislation, the Group issued (via AKB "Bank of Moscow") a bank guarantee for RR 25.8 billion in January 2011 in favor of the minority holders of the ordinary shares of Sibneftegas. The guarantee is provided as financial support in case the minority shareholders tender to sell their stakes to the Group at a pre-determined fixed price. This bank guarantee expires in April 2011. Management does not believe that any of the minority shareholders will tender their shares as a result of this offer.



## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### Acquisition of OOO SeverEnergia

On July 2010, NOVATEK and OAO Gazprom Neft, a subsidiary of OAO Gazprom, established a joint venture OOO Yamal Development. The Group owns a 50 percent participation interest in the new entity and accounts for its share of the joint venture using the equity method.

On 30 November 2010, Yamal Development acquired a 51 percent participation interest in OOO SeverEnergia for total cash consideration of RR 48,715 million paid upon acquisition. The acquisition was financed proportionally by its founders through the provision of loans in the total amount of RR 56,247 million (see Note 8). As part of the acquisition, Yamal Development also provided a loan in the amount of RR 7,532 million to SeverEnergia, which was used to fully repay the outstanding debt of the company to its previous shareholder ahead of its maturity schedule. NOVATEK financed its part of the loan to Yamal Development through the use of a bridge loan facility (see Note 16).

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

Subsidiary of SeverEnergia	Field	Expiring date
OAO Arkticheskaya gazovaya kompaniya	Samburgskoye, Yevo-Yakhinskoye	2018
ZAO Urengoil Inc.	Yaro-Yakhinskoye	2018
OAO Neftegastehnologiya	North-Chaselskoye	upon full production

Estimated aggregated proved reserves on these fields appraised by DeGolyer and MacNaughton under the PRMS and SEC reserve methodologies at 31 December 2010 totaled approximately 245 and 224 billion cubic meters of natural gas and 42 and 39 million tons of hydrocarbon liquids, respectively.

The transaction provides the Group with an effective interest ownership of 25.5 percent in SeverEnergia. Since this company is a subsidiary of Yamal Development, the Group's joint venture, the assets and liabilities of SeverEnergia and its financial results are included in the assets, liabilities and financial results of Yamal Development and its subsidiaries in the disclosure of summarized financial information about the Group's investments in associates and joint ventures (see Note 7).

In accordance with IAS 28 "Investments in Associates", the Group assessed preliminary fair values of the identified assets and liabilities of SeverEnergia. In the consolidated financial statements for the year ended 31 December 2010, the fair value of purchase consideration and the fair value of the identifiable acquired assets and liabilities are preliminary as the Group is in the process of finalizing the fair value estimates for certain assets and liabilities, primarily for property, plant and equipment. Management is required to finalize the fair value determination within 12 months of the date of acquisition. Any revisions to the provisional values will be reflected as of the acquisition date.

The following table represents the preliminary fair values comprising 100 percent of the assets and liabilities of the SeverEnergia and its subsidiaries.

<i>SeverEnergia and its subsidiaries</i>	<b>Preliminary fair values at the acquisition date</b>
Non-current assets	137,228
Current assets	3,810
Non-current liabilities	(22,950)
Current liabilities	(22,568)
<b>Total identifiable net assets</b>	<b>95,520</b>

As a result of the preliminary assessment of fair value of identifiable assets and liabilities management calculated that no goodwill arose on the acquisition.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### *Disposal of OOO NOVATEK-Polymer*

In September 2010, the Group disposed of its 100 percent participation interest in OOO NOVATEK-Polymer, its non-core subsidiary, to OAO SIBUR Holding for RR 2,400 million (undiscounted) payable throughout September 2013. The Group recognized a loss on the sale of RR 279 million, net of associated income tax of RR 25 million. The Group has 100 percent participation interest in OOO NOVATEK-Polymer as collateral for the receivable until full settlement.

Below is a breakdown of major classes of assets and liabilities disposed:

<i>OOO NOVATEK-Polymer</i>	<b>RR million</b>
Property, plant and equipment	1,617
Deferred tax assets	189
Inventories	440
Financial assets	340
Other non-financial assets	160
Deferred tax liability	(294)
Short-term debt	(113)
Other financial liabilities	(66)
<b>Total net assets</b>	<b>2,273</b>

The following table summarizes the consideration details from the sale of OOO NOVATEK-Polymer:

	<b>RR million</b>
Cash	287
Receivable in respect of the deferred payments (RR 2,113 million discounted at 8 percent per annum)	1,732
<b>Total consideration</b>	<b>2,019</b>
Less: carrying amount of net assets disposed	(2,273)
<b>Loss on disposal</b>	<b>(254)</b>

OOO NOVATEK-Polymer constituted the Group's "polymer products production and marketing" segment (see Note 31).

### *Acquisition of OAO Tambeyneftegas*

On 1 July 2010, the Group acquired 100 percent of the outstanding ordinary shares of OAO Tambeyneftegas, an exploration stage oil and gas company located in the southern portion of the Yamal peninsula (YNAO) for total cash consideration of RR 312 million (USD 10 million), of which 75 percent was acquired from related parties for RR 234 million (USD 7 million) (see Note 30). Tambeyneftegas holds the license for exploration and development of the Malo-Yamalskoye field (expires in 2019) with estimated natural gas and gas condensate reserves in accordance with the Russian reserve classification (categories C1 + C2) amounting to 161 bcm and 14.4 mmt, respectively.

Tambeyneftegas had no notable operating activities up to and as at the purchase date, and is considered an entity in the early exploration stage; consequently, this acquisition is outside the definition of business as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the mineral license), and liabilities of the company acquired.

## ОАО NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>ОАО Тамбейнефтегаз</i>	<b>RR million</b>
Property, plant and equipment	303
Deferred tax assets	176
Other non-financial assets	23
Financial assets	12
Short-term debt	(641)
Interest on short-term debt	(229)
Assets retirement obligations	(165)
Other non-financial liabilities	(4)
<b>Total identifiable net liabilities</b>	<b>(525)</b>

The following table shows the total cost of the acquired mineral rights:

	<b>RR million</b>
Total purchase consideration	312
Add: identifiable net liabilities	525
<b>Cost of the acquired mineral rights</b>	<b>837</b>

The property, plant and equipment in the amount of RR 303 million combined with the cost of the mineral rights in the amount of RR 837 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6. Short-term debt in the amount of RR 641 million and interest on short-term debt in the amount of RR 229 million represent balances with the Group companies, which are to be settled in the normal course of business.

The financial and operational activities of Тамбейнефтегаз were not material to the Group’s revenues and results of operations for the year ended 31 December 2010.

### *Disposal of ownership interest in ZAO Terneftegas*

On 24 June 2009, NOVATEK and TOTAL E&P ACTIVITIES PETROLIERES (“TOTAL”) signed a Heads of Agreement (the “Agreement”) establishing the framework for joint cooperation in exploring and developing the Group’s Термocarстovoye gas condensate field located in the YNAO.

The Agreement provides for the establishment of a joint venture through the acquisition, by TOTAL of a 49 percent ownership interest in ZAO Terneftegas (formerly a limited liability company, ООО Terneftegas), a wholly-owned subsidiary of the Group and holder of the license for exploration and production of natural gas and gas condensate at the Термocarстovoye field. Under the terms and conditions of the Agreement, the joint venture has two years to complete exploration works and prepare a field development plan, with a final investment decision to proceed further to be taken in 2011.

In December 2009, the Group signed a Sales and Purchase contract with Total Термocarстovoye B.V., an affiliate of TOTAL, for:

- the sale of a 28 percent interest in ZAO Terneftegas for total consideration of USD 24.1 million, of which USD 16 million was paid at the date of title transfer and the remaining USD 8.1 million (deferred payment) to be paid upon approval by TOTAL of the final investment decision; and
- a further increase of TOTAL’s equity share in ZAO Terneftegas to 49 percent through a subscription to the entity’s additional shares emission for total consideration of USD 18 million.

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

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

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

The Group transferred legal ownership of a 28 percent interest in ZAO Terneftegas to Total Termokarstovoye B.V. in February 2010 upon the execution of the first arrangement. In January 2010, ZAO Terneftegas registered with the Federal Service for Financial Markets (FSFM) for an additional shares emission, the acquisition of which was completed by TOTAL in June 2010. In September 2010, the legal implementation of the second arrangement of the transaction was finished and the subscription for the additional shares issued was registered by Total Termokarstovoye B.V. with the FSFM.

Based on the Agreement and the provisions of the Sales and Purchase contract, these two arrangements were accounted as a single transaction and, in February 2010, the Group recorded a disposal of a 49 percent ownership interest in ZAO Terneftegas for total consideration of RR 982 million realizing a gain of RR 1,466 million, net of associated income tax of RR 117 million.

The following table summarizes the consideration details and shows the components of the gain from the sale of the ownership interest in ZAO Terneftegas:

	<b>RR million</b>
Cash	483
Receivable in respect of the deferred payment (USD 8.1 million at exchange rate of RR 30.11 to USD 1.00 discounted at 5.1 percent per annum)	222
The Group's proportion in an additional shares emission proceeds (51 percent of USD 18 million at exchange rate of RR 30.11 to USD 1.00)	277
<b>Total consideration</b>	<b>982</b>
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment in joint venture	807
<b>Gain on the sale of ownership interest</b>	<b>1,583</b>

As described above, the Group retained a 51 percent interest in ZAO Terneftegas; however, the Agreement stipulates that key financial and operational decisions regarding its business shall be subject to unanimous approval by both shareholders and none of the participants have a preferential voting right. In February 2010, all operating bodies of the joint venture were established and the Group's effective control over ZAO Terneftegas ceased. As a result of these changes, the Group's interest in ZAO Terneftegas is accounted for using the equity method.

In accordance with IAS 27 "Consolidated and Separate Financial Statements", the Group remeasured its retained investment in ZAO Terneftegas at fair value at the date of ceasing control, with the change in value of RR 807 million recognized as a part of the gain from disposal.

The following table reconciles the carrying value of ZAO Terneftegas prior to disposal and the carrying value of the retained investment in the entity recorded under the equity method of accounting in these consolidated financial statements:

<i>ZAO Terneftegas</i>	<b>RR million</b>
Carrying value of the net assets at disposal	420
The Group's proportion in an additional shares emission proceeds	277
Less: carrying amount of the Group's interest in net assets	(206)
Revaluation of the retained investment	807
<b>The carrying value of investment in joint venture</b>	<b>1,298</b>

Prior to the disposal, the Group included balances and results of the operations of the disposed subsidiary within "exploration, production and marketing" in the Group's segment information.

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

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

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)***Acquisition of controlling interests in the associates*

On 15 February 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas, entities recorded as associates to 51 percent through the acquisition of an additional 26 percent participation interests in each company for the total cash consideration of RR 1,297 million. These entities are all exploration stage oil and gas companies and hold exploration licenses for the Middle-Chaselskiy, North-Russkiy, West-Tazovski, Anomalniy and North-Yamsoveskiy license areas. These licenses expire between 2012 and 2014. The Group intends to receive production licenses for these fields based on the exploration activities performed to date. Following the acquisition, in February 2010, OOO Oiltechproduct-Invest obtained the production license for the West-Chaselskoe field, which expires in 2030.

All three entities had no notable operating activities up to and as at the purchase date and are all considered to be in their early exploration stage; consequently, this acquisition is outside the definition of “business” as defined in IFRS 3, “*Business Combinations*”. The acquisition cost has been allocated based on the relative fair values of the assets acquired (largely comprised of their respective mineral licenses), and liabilities assumed.

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Property, plant and equipment	547	370	959	1,876
Other non-financial assets	531	199	314	1,044
Financial assets	190	9	18	217
Short-term debt	(769)	(519)	(862)	(2,150)
Other financial liabilities	(149)	(108)	(203)	(460)
Non-financial liabilities	(146)	(39)	(102)	(287)
<b>Total identifiable net assets (liabilities)</b>	<b>204</b>	<b>(88)</b>	<b>124</b>	<b>240</b>

The following table shows the total cost of the acquired mineral rights:

<i>RR million</i>	OOO Oiltechproduct- Invest	OOO Petra Invest-M	OOO Tailiksneftegas	Total
Carrying value of the 25 percent participation interest	438	369	407	1,214
Purchase consideration for the 26 percent participation interest	502	380	415	1,297
Gross up for total value of the assets acquired	903	720	791	2,414
Less: identifiable net assets (liabilities)	(204)	88	(124)	(240)
<b>Cost of the acquired mineral rights</b>	<b>1,639</b>	<b>1,557</b>	<b>1,489</b>	<b>4,685</b>

The aforementioned property, plant and equipment in the amount of RR 1,876 million combined with the cost of mineral rights in the amount of RR 4,685 million are included in the line “acquisition of subsidiaries” as disclosed in Note 6.

The financial and operational activities of Oiltechproduct-Invest, Petra Invest-M and Tailiksneftegas were not material to the Group’s revenues and results of operations for the year ended 31 December 2010.

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

## 5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)

### *Acquisition of additional participation interest in subsidiaries*

In April 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas to 82.4 percent, 92.6 percent and 94.2 percent, respectively, through an additional capital contribution to the ordinary share capital of these entities. Furthermore, in May 2010, the Group brought its participation interest in the share capital of each of the above mentioned companies to 100 percent through the acquisition of the remaining ordinary share capital from non-controlling interests. As a consequence of these two transactions the Group paid cash of RR 629 million, reduced non-controlling interests by RR 2,368 million and recorded a difference of RR 1,739 million directly to retained earnings.

In December 2010, the Group merged its wholly-owned subsidiary, OOO Oiltechproduct-Invest, which holds exploration licenses for the Middle-Chaselskiy, West-Chaselskiy and North-Russkiy license areas into its wholly-owned subsidiary OOO NOVATEK-Tarkosaleneftegas. The aforementioned merger did not affect the Group's consolidated financial and operational results.

### *Acquisition of OAO Yamal LNG*

On 26 May 2009, the Group entered into the contract to acquire 51 percent of the outstanding ordinary shares of OAO Yamal LNG, an exploration stage oil and gas company located in the north-eastern part of the Yamal peninsula, YNAO. This company holds the license for exploration and development of the South-Tambeyskoye field (initial license term expired in 2020 but was extended to 2045 in December 2009). The acquisition of the South-Tambeyskoye field significantly increases the Group's resource base ensuring future natural gas and gas condensate production growth.

OAO Yamal LNG had no notable operating activities up to and as at the purchase date, and is considered an entity in the early exploration stage; consequently, this acquisition is outside the definition of "business" as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the mineral license), and liabilities of the company acquired.

The following table summarizes the total purchase consideration for the acquisition of Yamal LNG.

	<u>USD million</u>	<u>Exchange rate</u>	<u>RR million</u>
Cash	250	30.51	7,628
Promissory notes of NOVATEK	300	30.73	9,219
Deferred cash payment	100	30.51	2,546 <sup>(*)</sup>
<b>Total purchase consideration</b>	<b>650</b>		<b>19,393</b>

<sup>(\*)</sup> – discounted at 7.5 percent per annum.

The contingent consideration arrangement (referred to as the deferred cash payment) requires the Group to pay the former owners of Yamal LNG USD 100 million (undiscounted) upon the conclusion of an agreement between Yamal LNG and OAO Gazprom, defining the main sales terms of the LNG produced from the South-Tambeyskoye field. On 18 September 2010, such Cooperation Agreement, setting out the key parameters for cooperation between Gazprom and NOVATEK in implementing the pilot LNG project including the development and subsequent utilization of related infrastructure facilities on the Yamal peninsula, was signed and in February 2011 the payment was made.

Acquisition-related costs (legal and evaluation services) directly associated with the transaction in the amount of RR 100 million were included in the cost of the asset acquired.

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

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

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

Recognized amounts of identifiable assets acquired and liabilities assumed are presented below.

<i>OAQ Yamal LNG</i>	<b>RR million</b>
Financial assets	886
Property, plant and equipment	818
Other non-financial assets	807
Long-term debt	(2,833)
Other financial liabilities	(271)
Asset retirement obligations	(587)
Other non-financial liabilities	(150)
<b>Total identifiable net liabilities</b>	<b>(1,330)</b>

In November 2009, the Group fully repaid the outstanding long-term debt of Yamal LNG ahead of its maturity schedule.

The following table shows the total cost of the acquired mineral rights:

	<b>RR million</b>
Total purchase consideration	19,393
Gross up for total value of the asset acquired	18,704
Legal and evaluation services	100
Add: identifiable net liabilities	1,330
<b>Cost of the acquired mineral rights</b>	<b>39,527</b>

The aforementioned property, plant and equipment in the amount of RR 818 million combined with the cost of mineral rights in the amount of RR 39,527 million are included in the line "acquisition of subsidiaries" as disclosed in Note 6.

In May 2009, the Group signed a call option agreement with one of the sellers, which provides the Group with the right, but not the obligation, to purchase an additional 23.9 percent of OAO Yamal LNG for USD 450 million within three years following the controlling acquisition. To enter into this call option agreement, the Group paid RR 325 million (USD 10 million) in July 2009, which was recorded as a decrease in retained earnings in the consolidated statement of changes in equity.

In accordance with the Russian legislation, in November 2009, the Group issued (via AKB "Bank of Moscow") a bank guarantee for RR 19.4 billion in favor of the minority holders of the ordinary shares of OAO Yamal LNG. The guarantee was provided as financial support in the case the minority shareholders tender to sell their stakes to the Group at the pre-determined fixed price. The guarantee expired in August 2010 and no payment was made.

In March 2010, the existing shareholders of Yamal LNG made cash contributions to the company's ordinary share capital proportionally to their respective ownership interests in the total amount of RR 3,607 million. The resulting increase of RR 1,767 million in non-controlling interest was recorded within consolidated statement of changes in equity.

The financial and operational activities of Yamal LNG were not material to the Group's revenues and results of operations for the year ended 31 December 2009.

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

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

**5 MERGERS, ACQUISITIONS AND DISPOSALS (CONTINUED)***Acquisition of OOO EkropromStroy*

On 19 June 2009, the Group acquired 100 percent of the participation interest in OOO EkropromStroy from several members of key management personnel of the Group for total cash consideration of RR 1,999 million, all paid in 2009. The Group obtained an independent appraisal supporting the purchase price and considers that the amount paid is substantially consistent with the terms that would be agreed in an arm's length transaction. The company manages the construction of the Group's new office building located in Moscow and has no activities other than the management of construction activities and ownership of the constructed building. Accordingly, the purchase is outside the definition of business as defined in IFRS 3, "Business Combinations". The cost of the acquisition has been allocated based on the relative fair values of the assets (largely comprised of the office building), and liabilities of the company acquired. The property, plant and equipment in the amount of RR 2,263 million was included in the line "acquisition of subsidiaries" as disclosed in Note 6.

The financial and operational activities of EkropromStroy were not material to the Group's revenues and results of operations for the year ended 31 December 2009.

**6 PROPERTY, PLANT AND EQUIPMENT**

Movements in property, plant and equipment, for the years ended 31 December 2010 and 2009 are as follows:

	Oil and gas properties and equipment	Assets under construction and advances for construction	Other	Total
Cost	95,242	24,771	4,787	124,800
Accumulated depreciation, depletion and amortization	(15,166)	-	(920)	(16,086)
<b>Net book value at 1 January 2009</b>	<b>80,076</b>	<b>24,771</b>	<b>3,867</b>	<b>108,714</b>
Acquisition of subsidiaries	40,141	2,463	4	42,608
Additions	943	16,927	2	17,872
Transfers	21,650	(23,431)	1,781	-
Depreciation, depletion and amortization	(5,221)	-	(578)	(5,799)
Reclassified as assets held for sale	(65)	(323)	(2)	(390)
Disposals, net	(5)	(522)	(1,030)	(1,557)
Cost	157,955	19,885	5,319	183,159
Accumulated depreciation, depletion and amortization	(20,436)	-	(1,275)	(21,711)
<b>Net book value at 31 December 2009</b>	<b>137,519</b>	<b>19,885</b>	<b>4,044</b>	<b>161,448</b>
Acquisition of subsidiaries	5,960	1,875	70	7,905
Additions	3,265	22,828	13	26,106
Transfers	27,018	(27,722)	704	-
Depreciation, depletion and amortization	(6,461)	-	(367)	(6,828)
Disposal of subsidiaries, net	-	(319)	(1,298)	(1,617)
Impairment	(321)	-	-	(321)
Disposals, net	(495)	(525)	(100)	(1,120)
Cost	193,411	16,022	4,236	213,669
Accumulated depreciation, depletion and amortization	(26,926)	-	(1,170)	(28,096)
<b>Net book value at 31 December 2010</b>	<b>166,485</b>	<b>16,022</b>	<b>3,066</b>	<b>185,573</b>



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

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

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

Included within the oil and gas properties and equipment balance at 31 December 2010 and 2009 are proved properties of RR 62,509 million and RR 65,086 million, net of accumulated depreciation, depletion and amortization of RR 8,915 million and RR 7,730 million, respectively.

Oil and gas properties and equipment balance at 31 December 2010 and 2009 include costs to acquire unproved properties in the amount of RR 4,352 million and RR 99 million, respectively. The Group's management believes these costs are recoverable and has plans to explore and develop the respective properties.

Included within assets under construction are advances to suppliers of equipment of RR 2,676 million and RR 1,217 million at 31 December 2010 and 2009, respectively.

Included in additions to property, plant and equipment for the years ending 31 December 2010 and 2009 are capitalized interest and foreign exchange loss of RR 2,621 million and RR 1,481 million, respectively. The interest capitalization rates for 2010 and 2009 used for additions were 5.4 percent and 6.0 percent, respectively.

During 2010, the transfers and additions to oil and gas property include the completion of the second phase of the Purovsky Gas Condensate Plant for RR 1,718 million, completion of the second and third stages of the second phase development at the Yurkharovskoye field in the amount of RR 22,784 million and the completion of the second phase development at the Khancheyevskoye field in the amount of the RR 180 million.

During 2009, the transfers and additions to oil and gas property include the completion of the second phase of the Purovsky Gas Condensate Plant for RR 5,268 million, completion of the second stage of the second phase development at the Yurkharovskoye field in the amount of RR 8,390 million and the completion of the second phase development at the Khancheyevskoye field in the amount of the RR 2,412 million.

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

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
DD&A included in operating expenses	6,616	5,588
DD&A included in general and administrative expenses (see Note 23)	141	150
DD&A capitalized in the in the course of intra-group construction services	71	61
<b>Total depreciation, depletion and amortization</b>	<b>6,828</b>	<b>5,799</b>

At 31 December 2010 and 2009, no property, plant and equipment were pledged as security for the Group's borrowings. Impairment of RR 321 million and nil was recognized in respect of oil and gas properties and equipment for the years ended 31 December 2010 and 2009, respectively.

Capital commitments are disclosed in Note 28.

**Asset retirement obligations.** Estimated costs of dismantling oil and gas production facilities, pipelines and related processing facilities, including abandonment and site restoration costs, amounting to RR 1,115 million and RR 1,235 million at 31 December 2010 and 2009, respectively, are included in the cost of oil and gas properties and equipment. The Group has estimated its liability based on current legislation using estimated costs and timing of when the expenses are expected to be incurred between the end of the reporting period and 2051. Governmental authorities are continually reviewing regulations and their enforcement. Consequently, the Group's ultimate liabilities may differ from the recorded amounts.

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

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

**7 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES**

	At 31 December:	
	2010	2009
<i>Associates:</i>		
OAQ Sibneftegas	25,758	-
OOO Oiltechproduct-Invest	-	438
OOO Tailiksneftegas	-	407
OOO Petra Invest-M	-	369
<i>Joint ventures:</i>		
ZAO Terneftegaz	1,268	-
<b>Total investments in associates and joint ventures</b>	<b>27,026</b>	<b>1,214</b>

The Group's investment in OOO Yamal Development at 31 December 2010 is valued at nil due to the Group's proportionate share of accumulated losses exceeding the Group's cost of investment. The excess of the accumulated losses over the Group's cost of investment in Yamal Development were allocated to decrease of long-term loans provided by the Group to the joint venture (see Note 8).

The table below summarizes the movement in the carrying amounts of the Group's investments in associates and joint ventures.

	Year ended 31 December:	
	2010	2009
<b>At 1 January</b>	<b>1,214</b>	<b>1,416</b>
Share of profit (loss) of associates and joint ventures before income tax	(412)	(216)
Share of income tax (expense) benefit	66	14
<b>Share of profit (loss) of associates and joint ventures, net of income tax</b>	<b>(346)</b>	<b>(202)</b>
Acquisition of associates and joint ventures	19,176	-
Preliminary goodwill recognized on acquisition of associates	6,660	-
Disposals of subsidiaries resulting in recognition of associates and joint ventures	1,298	-
Acquisition of controlling stake resulting in derecognition of associates	(1,214)	-
Losses recognized in excess of investment in joint ventures, reclassified to long-term loans receivable	238	-
<b>At 31 December</b>	<b>27,026</b>	<b>1,214</b>

At 31 December 2010, the Group's interests in its principal associates and joint ventures and their summarized financial information, including total assets, liabilities, revenues and profit or loss relating to the Group's interest, were as follows:

<i>Associate or joint venture</i>	<i>Total non-current assets</i>	<i>Total current assets</i>	<i>Total non-current liabilities</i>	<i>Total current liabilities</i>	<i>Non-controlling interest</i>	<i>Revenues</i>	<i>Profit (loss)</i>	<i>% interest held</i>
OOO Yamal Development and its subsidiaries	68,567	1,931	39,599	7,782	23,355	-	(248)	50%
OAQ Sibneftegas	34,053	703	14,381	1,277	-	157	(68)	51%
ZAO Terneftegaz	1,543	170	442	3	-	2	(30)	51%
<b>Total</b>	<b>104,163</b>	<b>2,804</b>	<b>54,422</b>	<b>9,062</b>	<b>23,355</b>	<b>159</b>	<b>(346)</b>	

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

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

**8 LONG-TERM LOANS AND RECEIVABLES**

	At 31 December:	
	2010	2009
Russian rouble denominated loans	38,057	-
Long-term receivables	2,063	932
Interest receivable (non-current)	31	1
<b>Total long-term loans and receivables</b>	<b>40,151</b>	<b>933</b>

On 15 December 2010, the Group provided two loans to OAO Sibneftegas, the Group's associate, for RR 7,429 million and RR 3,609 million. The first loan was issued at an annual interest rate of 10 percent and is repayable in November 2014, whereas the second loan was issued at an annual interest rate of 9.5 percent and is repayable by equal parts starting from March 2011 until November 2014. Included in the Russian rouble denominated loans is the long-term parts of the loans in the total amount of RR 10,069 million.

On 29 November 2010, the Group provided a loan to OOO Yamal Development, the Group's joint venture, in the amount of RR 28,123 million. The loan was issued at an annual interest rate of 8 percent and, in accordance with the signed terms and conditions is repayable by 29 November 2011. For the purpose of these financial statements, the loan was treated as part of the Group's net investment in its joint venture and classified as long-term. At 31 December 2010, the loan was recorded net of losses accumulated recognized by Yamal Development in excess of the Group's investment in the joint venture in the amount of RR 238 million (see Note 7).

No provisions for impairment of long-term loans and receivables were recognized in the consolidated statement of financial position at 31 December 2010 and 2009.

**9 OTHER NON-CURRENT ASSETS**

	At 31 December:	
	2010	2009
Deferred tax assets	1,392	499
Materials for construction	953	2,115
Other	513	55
<b>Total other non-current assets</b>	<b>2,858</b>	<b>2,669</b>

**10 INVENTORIES**

	At 31 December:	
	2010	2009
Natural gas and hydrocarbon liquids at cost	1,090	705
Materials and supplies at cost	575	614
Materials and supplies at net realizable value (net of provisions of RR 33 million and RR 29 million at 31 December 2010 and 2009, respectively)	192	236
Polymer and insulation tape products (net of provisions of RR nil million at 31 December 2009)	-	174
Other inventories	11	61
<b>Total inventories</b>	<b>1,868</b>	<b>1,790</b>

The Group recorded an impairment expense of RR 8 million and RR 46 million during the years ended 31 December 2010 and 2009, respectively, to write-down the carrying value of inventory due to obsolescence. No inventories were pledged as security for the Group's borrowings or payables at both dates.

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

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

**11 TRADE AND OTHER RECEIVABLES**

	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Trade receivables (net of provision of RR nil million and RR 7 million at 31 December 2010 and 2009, respectively)	7,031	6,440
Other receivables	1,445	1,772
Interest on loans receivable	194	292
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

The carrying values of trade and other receivables approximate their respective fair values. The related exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above.

The Group holds letter of credit in banks with investment grade rating as security for trade receivables in amount RR 1,667 million and RR 2,627 million at 31 December 2010 and 2009, respectively. Also the Group holds as a collateral 100 percent participation interest in OOO NOVATEK-Polymer for other receivables from OAO SIBUR Holding (see Note 5). The Group does not hold any other collateral as security for trade and other receivables (see Note 27 for credit risk disclosures).

Trade and other receivables that are less than three months past due are generally not considered for impairment unless other indicators of impairment exist. Trade and other receivables of RR 8 million and RR 188 million at 31 December 2010 and 2009, respectively were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these past due but not impaired trade and other receivables are as follows:

	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Up to 90 days past-due	-	77
91 to 360 days past-due	-	103
Over 360 days past-due	8	8
<b>Total past due but not impaired</b>	<b>8</b>	<b>188</b>
Not past due and not impaired	8,662	8,316
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

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

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>At 1 January</b>	<b>7</b>	<b>34</b>
Additional provision recorded	184	51
Receivables written off as uncollectible	(191)	(72)
Provision amount reversed into income	-	(6)
<b>At 31 December</b>	<b>-</b>	<b>7</b>

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

**OAO NOVATEK**

**Notes to the Consolidated Financial Statements**

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

**12 PREPAYMENTS AND OTHER CURRENT ASSETS**

	At 31 December:	
	2010	2009
<i>Financial assets</i>		
Russian rouble denominated loans	969	1,477
Short-term bank deposits	-	111
<i>Non-financial assets</i>		
Recoverable value-added tax	1,340	955
Prepayments and advances to suppliers (net of provision of RR 89 million and RR 77 million at 31 December 2010 and 2009)	2,388	1,814
Deferred export duties for stable gas condensate	1,151	-
Prepaid taxes other than income tax	912	660
Deferred transportation expense for natural gas	824	581
Deferred transportation expense for stable gas condensate	514	78
Other current assets	406	124
<b>Total prepayments and other current assets</b>	<b>8,504</b>	<b>5,800</b>

**13 CASH AND CASH EQUIVALENTS**

	At 31 December:	
	2010	2009
Cash at current bank accounts	4,509	2,944
Russian rouble denominated deposits (average interest rate 2.4% p.a. and 1.8% p.a. for 2010 and 2009, respectively)	4,105	5,479
US dollar denominated deposits (average interest rate 0.3% p.a. and 0.4% p.a. for 2010 and 2009, respectively)	1,584	2,107
Other currencies denominated deposits	40	2
<b>Total cash and cash equivalents</b>	<b>10,238</b>	<b>10,532</b>

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

**14 LONG-TERM DEBT**

	At 31 December:	
	2010	2009
Russian rouble denominated loans	24,948	11,030
US dollar denominated loans	19,129	26,673
Russian rouble denominated bonds	9,949	-
<b>Total</b>	<b>54,026</b>	<b>37,703</b>
Less: current portion of long-term debt	(6,952)	(13,827)
<b>Total long-term debt</b>	<b>47,074</b>	<b>23,876</b>

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

At 31 December 2010 and 2009, the Group's long-term debt by facility is as follows:

	At 31 December:	
	2010	2009
Sberbank	14,948	4,924
Gazprombank	10,000	6,106
Russian rouble denominated bonds	9,949	-
Syndicated term loan facility	6,952	20,646
Nordea Bank	6,095	-
UniCredit Bank	6,082	6,027
<b>Total</b>	<b>54,026</b>	<b>37,703</b>

**Sberbank.** On 28 August 2009, the Group obtained a RR 5 billion loan from OAO Sberbank repayable in January and February 2011. Throughout 2010, the Group gradually reduced the stated interest rate from the initial 12.37 percent to 8.5 percent per annum. In July 2010, the loan was fully repaid ahead of its maturity schedule.

On 6 December 2010, the Group obtained a RR 15 billion loan from Sberbank for general corporate purposes including financing capital expenditures. The loan bears an interest rate of 7.5 percent per annum and is repayable in December 2013. At 31 December 2010, the outstanding loan amount was RR 14,948 million, net of unamortized part of the transaction cost of RR 52 million.

**Gazprombank.** On 3 November 2009, the Group signed a loan agreement with OAO Gazprombank, which provided the Group with a loan facility of RR 10 billion until November 2012. At 31 December 2010, the full amount had been drawn down under this loan agreement. Throughout 2010, the Group gradually reduced the stated interest rate from the initial 13 percent to 8.5 percent per annum. Subsequent to the balance sheet date, in February 2011, the Group was able to further reduce the interest rate to 8 percent per annum.

**Russian rouble denominated bonds.** In June 2010, the Group issued ten million three-year non-convertible Russian rouble denominated bonds, each with a nominal value RR 1,000 and an annual coupon rate of 7.5 percent, payable semi-annually. At 31 December 2010, the outstanding amount was RR 9,949 million, net of unamortized part of the transaction costs of RR 51 million.

**Syndicated term loan facility.** On 21 April 2008, the Group obtained a USD 800 million unsecured syndicated term loan facility for general corporate purposes including funding capital expenditures. The facility has a three-year tenure with payments to begin 18 months after 21 April 2008 and is to be repaid in quarterly installments thereafter. The facility paid an initial interest of LIBOR plus 1.25 percent per annum for the first 18 months and subsequently increased to LIBOR plus 1.5 percent per annum thereafter (1.79 percent and 1.78 percent at 31 December 2010 and 2009, respectively). The loan facility includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the remaining amount of the loan facility was RR 6,952 million (USD 228 million), net of unamortized part of the transaction costs of RR 15 million.

**Nordea Bank.** On 16 November 2010, the Group entered into a USD 200 million credit line facility with OAO Nordea Bank. The facility has a three-year tenure with repayments to begin in the first quarter 2013 and is to be repaid in quarterly installments thereafter until November 2013. The facility has an initial interest rate of LIBOR plus 1.9 percent per annum (2.16 percent at 31 December 2010) and includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the full amount of RR 6,095 million (USD 200 million) had been drawn under this agreement.

**UniCredit Bank.** On 5 October 2009, the Group obtained a USD 200 million loan until October 2012 under credit line facilities with UniCredit Bank at an initial interest rate of LIBOR plus 6.5 percent, which was subsequently reduced to LIBOR plus 4.65 percent effective from 25 February 2010 (4.92 percent and 6.73 percent at 31 December 2010 and 2009, respectively). The loan includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the amount of RR 6,082 million (USD 200 million), net of unamortized part of the transaction costs of RR 13 million, had been drawn under this agreement. Subsequent to the balance sheet date, in January 2011, the Group was able to further reduce the interest rate to LIBOR plus 3.25 percent per annum.

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

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

	<u>At 31 December 2010</u>
Sberbank	15,000
Gazprombank	10,122
Russian rouble denominated bonds	10,061
Syndicated term loan facility	6,885
UniCredit Bank	6,139
Nordea Bank	5,814
<b>Total</b>	<b>54,021</b>

Scheduled maturities of long-term debt at 31 December 2010 were as follows:

<u>Maturity period:</u>	<u>RR million</u>
1 January 2012 to 31 December 2012	16,082
1 January 2013 to 31 December 2013	30,992
<b>Total long-term debt</b>	<b>47,074</b>

**15 PENSION OBLIGATIONS**

In February 2007, the Group announced the implementation of a post-employment benefit program for its retired employees. Under the pension program, employees who are employed by the Group for more than three years and retire from the Group on or after the statutory retirement age will receive monthly payments from NOVATEK for life unless they are actively employed. The amount of payments to be disbursed depends on the average salary, duration and location of employment. The program is effective from 1 January 2007 and applies to employees who retire after that date.

The program represents an unfunded defined benefit plan and is accounted for as such under provisions of IAS 19, *Employee Benefits*. The impact of the program on the consolidated financial statements is disclosed below.

The amounts recognized in the consolidated statement of financial position and included in other non-current liabilities are determined as follows:

	<u>At 31 December:</u>	
	<u>2010</u>	<u>2009</u>
Present value of the defined benefit obligations	758	620
Unrecognized past service cost	(200)	(228)
<b>Defined benefit plan liability recognized in the consolidated statement of financial position</b>	<b>558</b>	<b>392</b>

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**15 PENSION OBLIGATION (CONTINUED)**

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

	Year ended 31 December:	
	2010	2009
<b>At 1 January</b>	<b>620</b>	<b>468</b>
Interest cost	31	30
Benefits paid	(8)	(5)
Current service cost	66	60
Past services cost	51	-
Disposal of obligation due to disposal of subsidiary	(75)	-
Actuarial (gain) loss	73	67
<b>At 31 December</b>	<b>758</b>	<b>620</b>

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

	Year ended 31 December:	
	2010	2009
Current service cost	66	60
Interest cost	31	30
Disposal of obligation due to disposal of subsidiary	(75)	-
Actuarial (gain) loss	73	67
Amortization of past service cost	79	28
<b>Defined benefit plan (benefits) costs recognized in operating expenses</b>	<b>174</b>	<b>185</b>
<i>of which the following amounts were included as employee compensation in:</i>		
Materials, services and other	73	85
General and administrative expenses	101	100

The Group recognized a gain of RR 5 million and RR 2 million as a result of experience adjustments on plan liabilities during the years ended 31 December 2010 and 2009, respectively, included in actuarial (gain) loss.

The principal actuarial assumptions used at 31 December 2010 and 2009 are as follows:

	At 31 December:	
	2010	2009
Weighted average discount rate	7.6%	7.8%
Projected annual increase in employee compensation	10%	10%
Expected increases to pension benefits	5%	5%

The assumed average salary and pension payment increases for Group employees have been calculated on the basis of inflation forecasts, analysis of increases of past salaries and the general salary policy of the Group. Inflation forecasts have been estimated to reduce from 7.9 percent for 2010 to 5.8 percent in 2015 and on average equal to 5.6 percent thereafter.

Mortality assumptions are based on the Russian mortality tables published by the State Statistics Committee from the years 1986 to 1987, which management believes are the most conservative and prudent Russian whole-population mortality tables available.

Management has assessed that reasonable changes in the most significant actuarial assumptions will not have a significant impact on the consolidated statement of income or the liability recognized in the consolidated statement of financial position.



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**16 SHORT-TERM DEBT AND CURRENT PORTION OF LONG-TERM DEBT**

	At 31 December:	
	2010	2009
US dollar denominated loans	18,200	-
Total	18,200	-
Add: current portion of long-term debt	6,952	13,827
<b>Total short-term debt and current portion of long-term debt</b>	<b>25,152</b>	<b>13,827</b>

**Bridge loan facility.** On 29 November 2010, the Group obtained a USD 600 million bridge loan facility for financing of the acquisition by its joint venture OOO Yamal Development of a 51 percent participation interest in OOO SeverEnergiya (see Note 5). The bridge loan facility has a one year tenure with a bullet repayment to be made by 15 November 2011. The interest rate under the bridge facility is LIBOR plus 1 percent per annum for the first six months from 16 November 2010, LIBOR plus 1.25 percent from May 2011 and LIBOR plus 1.5 percent from August 2011 and includes the maintenance of certain restrictive financial covenants. At 31 December 2010, the outstanding amount of the loan facility was RR 18,200 million (USD 597 million), net of unamortized part of the transaction costs of RR 85 million. In February 2011, the bridge loan was fully repaid ahead of its maturity schedule (see Note 33).

**Available credit facilities.** Available credit facilities at 31 December 2010 were as follows:

<i>in millions of Russian roubles</i>	Par value in	Expiring	
		Within one year	Between 1 and 2 years
Credit Agricole Corporate and Investment Bank <sup>(a)</sup>	USD	3,048	-
BNP PARIBAS Bank <sup>(a)</sup>	USD	-	3,048
UniCredit Bank <sup>(a)</sup>	USD	-	3,048
Sumitomo Mitsui Banking Corporation Europe Limited <sup>(b)</sup>	USD	6,096	-
<b>Total available credit facilities</b>		<b>9,144</b>	<b>6,096</b>

<sup>(a)</sup> – interest rates negotiated at time of each withdrawal

<sup>(b)</sup> – interest rate LIBOR plus 1.45 percent

The Group also maintained available funds under short-term credit lines in the form of bank overdrafts with various international banks for RR 5,943 million (USD 195 million) and RR 6,048 million (USD 200 million) at 31 December 2010 and 2009, respectively, on either fixed or variable interest rates subject to the specific type of credit facility.

**17 TRADE PAYABLES AND ACCRUED LIABILITIES**

	At 31 December:	
	2010	2009
<b>Financial liabilities</b>		
Trade payables	2,194	2,483
Other payables	24,760	1,979
Interest payable	53	100
<b>Non-financial liabilities</b>		
Advances from customers	412	2,041
Salary payables	897	719
Other payables	163	13
<b>Trade payables and accrued liabilities</b>	<b>28,479</b>	<b>7,335</b>

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**17 TRADE PAYABLES AND ACCRUED LIABILITIES (CONTINUED)**

At 31 December 2010, other payable included RR 21,176 million relating to the acquisition of 51 percent ownership in Sibneftegas (see Note 5).

**18 SHAREHOLDERS' EQUITY**

**Ordinary share capital.** Share capital issued and paid in consisted of 3,036,306,000 ordinary shares at 31 December 2010 and 2009 with a par value of RR 0.1 each. The total authorized number of ordinary shares was 10,593,682,000 shares at both dates.

**Treasury shares.** In accordance with the share buyback program authorized by the Board of Directors on 11 February 2008, the Group's wholly-owned subsidiary, Novatek Equity (Cyprus) Limited, has periodically purchased ordinary shares of OAO NOVATEK in the form of Global Depository Receipts (GDRs) on the London Stock Exchange through the use of independent brokers. At 31 December 2010 and 2009, the Group held 312,277 GDRs (3,123 thousand ordinary shares) and 419,233 GDRs (4,192 thousand ordinary shares) at total cost of RR 446 million and RR 599 million, respectively. The Group has decided that these shares do not vote.

During the year ended 31 December 2010, the Group sold 106,956 GDRs (1,070 thousand ordinary shares) for RR 341 million recognizing a gain of RR 188 million which was recorded within additional paid-in capital in the consolidated statement of changes in equity.

**Dividends.** Dividends (including tax on dividends) declared and paid were as follows:

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Dividends payable at 1 January	13	-
Total dividends declared <sup>(*)</sup>	9,855	7,641
Dividends paid <sup>(*)</sup>	(9,868)	(7,628)
<b>Dividends payable at 31 December</b>	<b>-</b>	<b>13</b>
Dividends per share declared during the year (in Russian roubles)	3.25	2.52
Dividends per GDR declared during the year (in Russian roubles)	32.5	25.2

<sup>(\*)</sup> – excluding treasury shares

The Group declares and pays dividends in Russian roubles. Dividends declared in 2010 and 2009 were as follows:

Final for 2009: RR 1.75 per share or RR 17.5 per GDR declared in April 2010	5,314
Interim for 2010: RR 1.50 per share or RR 15.0 per GDR declared in October 2010	4,554
<b>Total dividends declared in 2010</b>	<b>9,868</b>
Final for 2008: RR 1.52 per share or RR 15.2 per GDR declared in May 2009	4,615
Interim for 2009: RR 1.00 per share or RR 10.0 per GDR declared in October 2009	3,036
<b>Total dividends declared in 2009</b>	<b>7,651</b>

**Share-based compensation.** In 2005, certain shareholders provided share-based compensation to key members of the Group's management team. The fair value of the awards of RR 879 million is being recognized as compensation expense evenly over their five year vesting period beginning the second quarter of 2005. A corresponding increase is recorded to additional paid in capital as expense is recognized to reflect the shareholders contribution in providing the award. The fair value of the awards was determined by reference to the fair value of the limited liability company's net assets estimated by its owners.

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#### 18 SHAREHOLDERS' EQUITY (CONTINUED)

**Distributable retained earnings.** In accordance with Russian legislation, NOVATEK distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. Russian legislation identifies the net profit as basis of distribution. Russian legislation identifies the net profit as basis of distribution. As of the date of preparation of these consolidated financial statements the statutory net profit of NOVATEK for 2010 as determined under Russian Accounting Rules has not been finalized. For 2009, the net statutory profit of NOVATEK as reported in the published annual statutory reporting forms was RR 11,835 million and the closing balance of the accumulated profit including the current year net statutory profit totaled RR 59,853 million.

Accumulated profits legally distributable are based on the amounts available for distribution in accordance with the applicable legislation and as reflected in the statutory financial statements of the individual entities of the Group. These amounts may differ significantly from the amounts calculated on the basis of IFRS.

#### 19 SHARE-BASED COMPENSATION PROGRAM

On 12 February 2010, NOVATEK's Management Committee approved a share-based compensation program (the "Program") for a limited number of the Group's senior and key management, as well as high-potential managers, but excluding the members of the Management Committee, which aims to encourage participants to take an active interest in the future development of the Group and to provide material incentive to create shareholders value in OAO NOVATEK. The Program was established in accordance with the *Concept of the Long-Term Incentive of Senior Employees* approved by the Board of Directors on 25 September 2006 and the *Share Buyback Program*.

The Program is established as a cash-settled payment program and references the Group's GDRs, which are publicly traded on the London Stock Exchange under the ticker symbol "NVTK". At 31 December 2010, the Program covered 164 employees amongst which 382,368 GDRs were allocated. Each participant is assigned a pre-determined number of GDRs in accordance with their respective job classification grade and the entitlement for the cash-settled share-based payment cannot be transferred to another person. The cash-settled payments will only be awarded if the participant is employed with the Group at the date of payment.

	<i>Number of GDRs</i>
Total amount of GDRs granted at 12 February 2010	407,766
Granted	-
Exercised	-
Forfeited	(25,398)
Total amount of GDRs granted at 31 December 2010	382,368

The Program has three one-year vesting periods ending 31 January 2011, 2012, and 2013. Each participant is granted share appreciation rights, as part of their remuneration package, and may elect to get paid in cash at the end of each vesting period or to defer payment to the subsequent vesting periods during the Program life. Each payment is based on the sale of the allocated GDRs and is calculated as the difference between the GDRs market price at time of sale and the Program's pre-defined price set at USD 48.62 relating to the one-third of the total number of GDRs assigned to each participant during the vesting period, including any deferrals from prior vesting periods. The grant date is defined as 31 March 2010 and represents the date when all participants agreed to a share-based payment arrangement. The closing prices per GDR on the LSE at 31 December 2010 and 2009 were USD 119.50 and USD 66.00, respectively.

In accordance with IFRS 2 "*Share-based payment*", the Group re-measures the employees' services rendered and the liability incurred at the fair value of the liability. Until the liability is settled, the Group re-measures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model based on Monte-Carlo simulations, and to the extent to which the employees have rendered service to date.

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**19 SHARE-BASED COMPENSATION PROGRAM (CONTINUED)**

The fair value of the Program is determined based on the following assumptions:

	2010	2011	2012
Expected volatility	57.7%	57.7%	57.7%
Risk-free interest rate	-	0.32%	0.69%
Expected option life (years)	0.08	0.96	1.96
Exercise price per GDR (USD)	48.62	48.62	48.62

Expected volatility is calculated based on the historical volatility of the price per GDR for the historical period equal to the expected life of the Program (2.1 years). Risk-free interest rate is based on a benchmark USD curve including DEPO, FRA and IRS rates.

The fair value of the share-based payments is recognized as a payable to the employees over the vesting period and any changes in the fair value of the liability recognized in the consolidated statement of income.

During the year ended 31 December 2010, the Group recorded RR 400 million, as expenses under this Program, which is included in general and administrative expenses, and RR 164 million and RR 236 million was recognized as trade payables and accrued liabilities and other non-current liabilities at 31 December 2010, respectively.

**20 OIL AND GAS SALES**

	Year ended 31 December:	
	2010	2009
Natural gas	71,060	53,623
Stable gas condensate	29,754	23,599
Liquefied petroleum gas	12,747	8,253
Crude oil	1,458	1,335
Oil products	143	93
<b>Total oil and gas sales</b>	<b>115,162</b>	<b>86,903</b>

**21 TRANSPORTATION EXPENSES**

	Year ended 31 December:	
	2010	2009
Natural gas transportation to customers	26,569	20,019
Liquids transportation by rail	7,350	5,820
Liquids transportation by tankers	2,771	2,675
Unstable gas condensate transportation from the fields to the processing facilities through third party pipelines	307	340
Crude oil transportation to customers	190	160
Other	13	12
<b>Total transportation expenses</b>	<b>37,200</b>	<b>29,026</b>

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**22 TAXES OTHER THAN INCOME TAX**

The Group is subject to a number of taxes other than income tax, which are detailed as follows:

	Year ended 31 December:	
	2010	2009
Unified natural resources production tax	7,861	6,699
Property tax	1,482	1,155
Excise and fuel taxes	454	-
Other taxes	280	188
<b>Total taxes other than income tax</b>	<b>10,077</b>	<b>8,042</b>

In 2010 and 2009, the unified natural resources production tax for natural gas production was fixed at a rate of RR 147 per thousand cubic meters.

The unified natural resources production tax rate for gas condensate is set at 17.5 percent of gas condensate revenues recognized by the producing entities.

Under the Tax Code of the Russian Federation, the tax rate for the unified natural resources production tax for crude oil is calculated by reference to an average price for Urals blend and an average exchange rate over the relevant tax period.

**23 GENERAL AND ADMINISTRATIVE EXPENSES**

	Year ended 31 December:	
	2010	2009
Employee compensation	3,874	2,840
Charitable contributions	774	533
Legal, audit, and consulting services	504	301
Rent expense	270	245
Business trips expense	265	207
Fire safety and security expenses	149	143
Depreciation – administrative buildings	141	150
Concession management services	125	225
Insurance expense	73	90
Other	558	392
<b>Total general and administrative expenses</b>	<b>6,733</b>	<b>5,126</b>

**Auditors' fees and services.** ZAO PricewaterhouseCoopers Audit has served as the Group's independent external auditors for each of the reported financial years. The independent external auditor is subject to re-appointment at the Annual General Meeting of shareholders based on the recommendations from the Board of Directors. The following table presents the aggregate fees for professional services and other services rendered by ZAO PricewaterhouseCoopers Audit to the Group included within legal, audit, and consulting services:

	Year ended 31 December:	
	2010	2009
Audit services fee (audit of the Group's consolidated financial statements and the statutory audit of the parent company)	36	37
Non-audit services	4	1
<b>Total auditors' fees and services</b>	<b>40</b>	<b>38</b>

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**24 MATERIALS, SERVICES AND OTHER**

	Year ended 31 December:	
	2010	2009
Employee compensation	2,572	2,457
Materials and supplies	1,386	1,455
Repair and maintenance services	640	396
Processing fees	566	556
Electricity and fuel	388	331
Fire safety and security expense	179	186
Third party services (under operator contracts)	3	624
Other	338	254
<b>Total materials, services and other</b>	<b>6,072</b>	<b>6,259</b>

**25 FINANCE INCOME (EXPENSE)**

<i>Interest income</i>	Year ended 31 December:	
	2010	2009
Interest income on cash and cash equivalents	170	294
Interest income on loans issued	328	168
<b>Interest income (on historical cost basis)</b>	<b>498</b>	<b>462</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	100	65
<b>Total interest income</b>	<b>598</b>	<b>527</b>

<i>Interest expense</i>	Year ended 31 December:	
	2010	2009
8.5% RR 10 billion Gazprombank November 2012 <sup>(a)</sup>	700	298
7.5% RR 10 billion Bonds June 2013	392	-
8.5% RR 5 billion Sberbank February 2011 <sup>(a)</sup>	341	231
LIBOR+4.65% USD 200 million UniCredit Bank October 2012 <sup>(a)</sup>	325	86
LIBOR+1.5% USD 800 million BNP PARIBAS April 2011	318	828
7.5% RR 15 billion Sberbank December 2013	46	-
Interest expense on short-term debt <sup>(b)</sup>	64	288
Other interest expense	6	59
<b>Subtotal</b>	<b>2,192</b>	<b>1,790</b>
Less: capitalised interest	(2,166)	(1,280)
<b>Interest expense (on historical cost basis)</b>	<b>26</b>	<b>510</b>
IAS 32 and IAS 39 “ <i>Financial Instruments</i> ” – fair value remeasurement	198	126
Provisions for asset retirement obligations: unwinding of the present value discount	213	183
<b>Total interest expense</b>	<b>437</b>	<b>819</b>

<sup>(a)</sup> – interest rates were changed during the periods (see Note 14)

<sup>(b)</sup> – including credit facility with interest rates negotiated at time of each withdrawal (see Note 16)

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**26 INCOME TAX**

**Reconciliation of income tax.** The table below reconciles actual income tax expense and theoretical income tax, determined by applying the statutory tax rate to profit before income tax and share of income in associates.

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Profit before income tax (excluding share of profit (loss) of associates, net of income tax)	51,428	32,702
Theoretical income tax expense at statutory rate of 20 percent	10,286	6,541
Increase (decrease) due to:		
Non-deductible expenses	538	493
Foreign entities' taxation at lower income tax rate	(112)	(161)
Other non-temporary differences	92	(95)
<b>Total income tax expense</b>	<b>10,804</b>	<b>6,778</b>

Domestic and foreign components of current income tax expense were:

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Russian Federation income tax	9,289	5,806
Foreign income tax	116	90
<b>Total current income tax expense</b>	<b>9,405</b>	<b>5,896</b>

**Effective income tax rate.** The Group's Russian statutory income tax rate for 2010 and 2009 was 20 percent. For the years ended 31 December 2010 and 2009, the Group's effective income tax rate was 21.0 percent and 20.7 percent, respectively.

The Group does not file a consolidated tax return according to Russian legislation. Instead, each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

**Deferred income tax.** Differences between IFRS and Russian statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes.

Deferred income tax balances are presented in the consolidated statement of financial position as follows:

	<b>At 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Long-term deferred income tax asset (other non-current assets)	1,392	499
Long-term deferred income tax liability	(9,473)	(7,460)
<b>Net deferred income tax liability</b>	<b>(8,081)</b>	<b>(6,961)</b>

Deferred income tax assets expected to be realized within twelve months of 31 December 2010 and 2009 were RR 747 million and RR 26 million, respectively. Deferred tax liabilities expected to be reversed within twelve months of 31 December 2010 and 2009 were RR 258 million and RR 82 million, respectively.

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**26 INCOME TAX (CONTINUED)**

Movements in deferred income tax assets and liabilities during the years ended 31 December 2010 and 2009 are as follows:

	At 31 December 2010	Statement of Income effect	Acquisitions	Disposals	At 31 December 2009	
<b>Liabilities</b>						
Property, plant and equipment	(11,100)	(2,050)	(70)	282	(9,262)	
Inventories	(75)	2	-	14	(91)	
Other current assets	(63)	(61)	-	(2)	-	
Trade payables and accrued liabilities	(91)	(8)	(82)	(1)	-	
<b>Total deferred income tax liabilities</b>	<b>(11,329)</b>	<b>(2,117)</b>	<b>(152)</b>	<b>293</b>	<b>(9,353)</b>	
<b>Assets</b>						
Inventories	1,344	426	299	102	517	
Trade and other receivables	116	(14)	-	1	129	
Trade payables and accrued liabilities	948	331	(11)	(106)	734	
Tax losses carried forward	835	47	38	(181)	931	
Other	5	(72)	-	(4)	81	
<b>Total deferred income tax assets</b>	<b>3,248</b>	<b>718</b>	<b>326</b>	<b>(188)</b>	<b>2,392</b>	
<b>Net deferred income tax liabilities</b>	<b>(8,081)</b>	<b>(1,399)</b>	<b>174</b>	<b>105</b>	<b>(6,961)</b>	
	At 31 December 2009	Reclassification to the (assets) liabilities classified as held for sale	Statement of Income effect	Acquisitions	Disposals	At 31 December 2008
<b>Liabilities</b>						
Property, plant and equipment	(9,262)	(26)	(1,672)	(126)	35	(7,473)
Inventories	(91)	-	(43)	-	8	(56)
Other current assets	-	-	-	-	10	(10)
Trade payables and accrued liabilities	-	-	25	-	-	(25)
<b>Total deferred income tax liabilities</b>	<b>(9,353)</b>	<b>(26)</b>	<b>(1,690)</b>	<b>(126)</b>	<b>53</b>	<b>(7,564)</b>
<b>Assets</b>						
Inventories	517	30	(191)	318	(70)	430
Trade and other receivables	129	-	84	-	-	45
Trade payables and accrued liabilities	734	-	228	117	-	389
Tax losses carried forward	931	29	694	40	(58)	226
Other	81	1	(7)	5	-	82
<b>Total deferred income tax assets</b>	<b>2,392</b>	<b>60</b>	<b>808</b>	<b>480</b>	<b>(128)</b>	<b>1,172</b>
<b>Net deferred income tax liabilities</b>	<b>(6,961)</b>	<b>34</b>	<b>(882)</b>	<b>354</b>	<b>(75)</b>	<b>(6,392)</b>



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**26 INCOME TAX (CONTINUED)**

At 31 December 2010, the Group had recognized deferred income tax assets of RR 835 million (31 December 2009: RR 931 million) in respect of unused tax loss carry forwards of RR 4,175 million (31 December 2009: RR 4,655 million). Tax losses can be carried forward for relief against taxable profits for 10 years after they are incurred, subject to certain limitations. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments including expectations regarding the Group's ability to generate sufficient future taxable income and the projected time period over which deferred tax benefits will be realized.

**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS**

The accounting policies for financial instruments have been applied to the line items below:

<i>Financial assets</i>	<i>Loans and receivables</i>	
	At 31 December:	
	2010	2009
<i>Non-current</i>		
Long-term loans receivable	38,057	-
Trade and other receivables	2,094	933
Long-term bank deposits	-	20
<i>Current</i>		
Short-term loans receivable	969	1,477
Trade and other receivables	8,670	8,504
Short-term bank deposits	-	111
Cash and cash equivalents	10,238	10,532
<b>Total carrying amount</b>	<b>60,028</b>	<b>21,577</b>
<i>Financial liabilities</i>		
	<i>Measured at amortized cost</i>	
	At 31 December:	
	2010	2009
<i>Non-current</i>		
Long-term debt	47,074	23,876
Other non-current liabilities	110	2,636
<i>Current</i>		
Current portion of long-term debt	6,952	13,827
Short-term debt	18,200	-
Trade and other payables	27,007	4,562
<b>Total carrying amount</b>	<b>99,343</b>	<b>44,901</b>

**Financial risk management objectives and policies.** In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on the degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial results. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position.

The Group's principal risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to these limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

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

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

**Market risk.** Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures, while optimizing the return on risk.

The Group is exposed to market price movements relating to changes in commodity prices such as crude oil, gas condensate, liquefied petroleum products and natural gas (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities or expected future cash flows.

*(a) Foreign exchange risk*

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to the US dollar. Foreign exchange risk arises primarily from future commercial transactions, recognized assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. Foreign currency derivative instruments may be utilized to manage the risk exposures associated with fluctuations on certain firm commitments for sales and purchases, debt instruments and other transactions that are denominated in currencies other than the Russian rouble, and certain non-Russian rouble assets and liabilities.

The carrying amounts of the Group's financial instruments are denominated in the following currencies:

At 31 December 2010	Russian rouble	US dollar	Other	Total
<i>Financial assets</i>				
<i>Non-current</i>				
Long-term loans receivable	37,955	102	-	38,057
Trade and other receivables	2,072	-	22	2,094
<i>Current</i>				
Short-term loans receivable	969	-	-	969
Trade and other receivables	4,759	3,582	329	8,670
Cash and cash equivalents	6,085	3,169	984	10,238
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(34,897)	(12,177)	-	(47,074)
Other non-current liabilities	-	(110)	-	(110)
<i>Current</i>				
Current portion of long-term debt	-	(6,952)	-	(6,952)
Short-term debt	-	(18,200)	-	(18,200)
Trade and other payables	(23,589)	(3,350)	(68)	(27,007)
<b>Net exposure at 31 December 2010</b>	<b>(6,646)</b>	<b>(33,936)</b>	<b>1,267</b>	<b>(39,315)</b>

**OAO NOVATEK**

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

At 31 December 2009	Russian rouble	US dollar	Other	Total
<i>Financial assets</i>				
<i>Non-current</i>				
Trade and other receivables	933	-	-	933
Long-term deposits	20	-	-	20
<i>Current</i>				
Short-term loans receivable	1,477	-	-	1,477
Trade and other receivables	4,461	4,021	22	8,504
Short-term bank deposits	43	-	68	111
Cash and cash equivalents	7,390	3,128	14	10,532
<i>Financial liabilities</i>				
<i>Non-current</i>				
Long-term debt	(11,030)	(12,846)	-	(23,876)
Other non-current liabilities	-	(2,636)	-	(2,636)
<i>Current</i>				
Current portion of long-term debt	-	(13,827)	-	(13,827)
Short-term debt				
Trade and other payables	(4,312)	(222)	(28)	(4,562)
<b>Net exposure at 31 December 2009</b>	<b>(1,018)</b>	<b>(22,382)</b>	<b>76</b>	<b>(23,324)</b>

The Group has chosen to provide information about market risk and potential exposure to hypothetical loss from its use of financial instruments through sensitivity analysis disclosures in accordance with IFRS requirements.

The sensitivity analysis depicted in the table below reflects the hypothetical loss that would occur assuming a 10 percent change in exchange rates and no changes in the portfolio of instruments and other variables at 31 December 2010 and 2009, respectively.

<i>Effect on pre-tax profit</i>	Increase in exchange rate	At 31 December:	
		2010	2009
RUR / USD	10%	(3,394)	(2,239)

The effect of a corresponding 10 percent decrease in exchange rate is approximately equal and opposite.

*(b) Commodity price risk*

The Group's overall commercial trading strategy in natural gas, stable gas condensate and crude oil and related products is centrally managed. Changes in commodity prices could negatively or positively affect the Group's results of operations. The Group manages the exposure to commodity price risk by optimizing its core activities to achieve stable price margins.

**Natural gas.** As an independent natural gas producer, the Group is not subject to the government's regulation of natural gas prices. Nevertheless, the Group's prices for natural gas sold are strongly influenced by the prices regulated by the Federal Tariffs Service (FTS), a governmental agency. In November 2006, the FTS approved and published a plan to liberalize the price of natural gas sold on the Russian domestic market by the year 2011.

As part of the plan, the FTS increased the regulated price by 5 percent, 7 percent, 7 percent and 6.2 percent effective 1 January 2009, 1 April 2009, 1 July 2009 and 1 October 2009, respectively. In December 2009, the FTS approved an increase of 15 percent in the regulated price effective 1 January 2010 for the year 2010. In December 2010, the FTS approved a further increase of 15 percent in the regulated price effective 1 January 2011 for the year 2011.

27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

In February 2011, the Government of the Russian Federation announced certain revisions to the domestic natural gas market liberalization plan. According to the revised plan, the target date for full liberalization of the domestic natural gas market is 1 January 2015. The regulation of the domestic natural gas price prior to 2015 will be based on the net-back parity of natural gas prices on the domestic and export markets while taking into account the cost of alternative fuels.

Management believes it has limited downside commodity price risk for natural gas and does not use commodity derivative instruments for trading purposes. However, to effectively manage the margins achieved through its natural gas trading activities, management has established targets for volumes sold to wholesale traders, end-customers and the natural gas exchange.

**Liquid hydrocarbons.** The Group sells all its crude oil and related products and gas condensate under spot contracts. Gas condensate volumes sold to the US, European and Asian-Pacific Region (hereinafter referred to as “APR”) markets are based on benchmark reference crude oil prices of WTI, Brent IPE and Dubai or Naphtha Japan, respectively, plus a margin or discount, depending on current market situation. Crude oil sold internationally is based on benchmark reference crude oil prices of Brent dated, plus a discount and on a transaction-by-transaction basis for volumes sold domestically. As a result, the Group’s revenues from the sales of liquid hydrocarbons are subject to commodity price volatility based on fluctuations or changes in the crude oil benchmark reference prices.

(c) *Cash flow and fair value interest rate risk*

The Group is subject to interest rate risk on financial liabilities with variable interest rates. To mitigate this risk, the Group’s treasury function performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favorable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group’s exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favorable over the expected period until maturity.

The interest rate profiles of the Group’s interest-bearing financial instruments at the reporting dates were as follows:

	At 31 December:	
	2010	2009
At variable rate	37,327	26,673
At fixed rate	34,899	11,030
<b>Total debt</b>	<b>72,226</b>	<b>37,703</b>

The Group centralizes the cash requirements and surpluses of controlled subsidiaries and the majority of their external financing requirements, and applies, on its consolidated net debt position, a funding policy to optimize its financing costs and manage the impact of interest rate changes on its financial results in line with market conditions. In this way, the Group is able to ensure that the balance between the floating rate portion of its debt and its cash surpluses has a low level of exposure to any change in interest rates over the short term. This policy makes it possible to significantly limit the Group’s sensitivity to interest rate volatility.

The Group’s financial results are sensitive to changes in interest rates on the floating rate portion of the Group’s debt portfolio. If the interest rates applicable to floating rate debt were to increase by 100 basis points at the reporting dates, assuming all other variables remain constant, it is estimated that the Group’s profit before taxation for 2010 would decrease by the amounts shown below.

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**27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)**

<i>Effect on pre-tax profit</i>	At 31 December:	
	2010	2009
Increase by 100 basis points	373	267

The effect of a corresponding 100 basis points decrease in interest rate is approximately equal and opposite.

The Group is examining various ways to manage its cash flow interest rate risk by using a combination of floating and fixed interest rates. No swaps or other similar instruments were in place as of 31 December 2010 and 2009, or during 2010 and 2009.

**Credit risk.** Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations.

Credit risk is managed on a Group level and arises from cash and cash equivalents, including short-term deposits with banks, as well as credit exposures to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to minimal risk of default.

The Group's trade and other receivables consist of a large number of customers, spread across diverse industries and geographical areas. Most of the Group's international liquid sales are made to customers with independent external ratings; however, if the customer has a credit rating below BBB-, the Group requires the collateral for the trade receivable to be in the form of letters of credit from banks with an investment grade rating. All domestic sales of liquid hydrocarbons are made on a 100 percent prepayment basis. The Group also requires 100 percent prepayments from small customers for natural gas deliveries and partial advances from others. Although the Group generally does not require collateral in respect of trade and other receivables, it has developed standard credit payment terms and constantly monitors the status of trade receivables and the creditworthiness of the customers.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the consolidated statement of financial position.

The table below highlights the Group's trade and other receivables to published credit ratings of its counterparties.

Moody's and/or Fitch	At 31 December:	
	2010	2009
Investment grade rating	4,489	5,176
Non-investment grade rating	1,338	2,939
No external rating	2,843	389
<b>Total trade and other receivables</b>	<b>8,670</b>	<b>8,504</b>

The table below highlights the Group's cash and cash equivalents balances to published credit ratings of its banks.

Moody's and/or Fitch	At 31 December:	
	2010	2009
Investment grade rating	8,008	9,614
Non-investment grade rating	1,781	846
No external rating	449	72
<b>Total cash and cash equivalents</b>	<b>10,238</b>	<b>10,532</b>

Investment grade ratings classification referred to as Aaa to Baa3 for Moody's Investment Services and as AAA to BBB- for Fitch Rating, respectively.

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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#### 27 FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (CONTINUED)

**Liquidity risk.** Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing its liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows and matches the maturity profiles of financial assets and liabilities.

The Group prepares various financial plans (monthly, quarterly and annually) which ensures that the Group has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. The Group has entered into a number of short-term credit facilities. Such credit lines and overdraft facilities can be drawn down to meet short-term financing needs. To fund cash requirements of a more permanent nature, the Group will normally raise long-term debt in available international and domestic markets.

All of the Group's financial liabilities represent non-derivative financial instruments. The following tables summarize the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

At 31 December 2010	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
<i>Principal</i> <sup>(*)</sup>	-	10,000	25,000	35,000
<i>Interest</i>	2,725	2,372	1,411	6,508
Debt at variable rate				
<i>Principal</i> <sup>(*)</sup>	25,252	6,095	6,095	37,442
<i>Interest</i>	656	413	78	1,147
Trade and other payables	27,007	-	-	27,007
<b>Total financial liabilities</b>	<b>55,640</b>	<b>18,880</b>	<b>32,584</b>	<b>107,104</b>
At 31 December 2009	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Total
Debt at fixed rate				
<i>Principal</i> <sup>(*)</sup>	-	4,924	6,106	11,030
<i>Interest</i>	619	77	-	696
Debt at variable rate				
<i>Principal</i> <sup>(*)</sup>	13,827	6,819	6,027	26,673
<i>Interest</i>	570	385	209	1,164
Trade and other payables	4,562	2,636	-	7,198
<b>Total financial liabilities</b>	<b>19,578</b>	<b>14,841</b>	<b>12,342</b>	<b>46,761</b>

<sup>(\*)</sup> – differs from long-term debt (Note 14) for transaction costs

**Capital management.** The primary objectives of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain investor, market and creditor confidence to support its business activities.

At the reporting date, the Group had investment grade credit ratings of Baa3 (stable outlook) by Moody's Investor Services, BBB- (negative outlook) by Fitch Ratings, and a credit rating of BBB- (negative outlook) by Standard & Poor's. To maintain its credit ratings, the Group has established certain financial targets and coverage ratios that it monitors on a quarterly and annual basis.

The Group manages its liquidity on a corporate-wide basis to ensure adequate funding to sufficiently meet group operational requirements. All external debts are centralized at the parent level, and all financing to Group entities is facilitated through inter-company loan arrangements.

**28 CONTINGENCIES AND COMMITMENTS**

The Group has a stated dividend policy that distributes at least 30 percent of its parent company's non-consolidated statutory net profit determined according to Russian accounting standards. However, the dividend for a specific year is determined after taking into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the NOVATEK's shareholders.

The Group defines the term "capital" as equity attributable to OAO NOVATEK shareholders minus net debt (total debt less cash and cash equivalents). There were no changes to the Group's approach to capital management during the year.

**Operating environment.** The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is in practice not convertible in most countries outside of the Russian Federation, and relatively high inflation. The tax, currency and customs legislation is subject to varying interpretations, frequent changes and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

The Group's business operations are primarily located in the Russian Federation and are thus exposed to the economic and financial markets of the country.

**Commitments.** At 31 December 2010, the Group had contractual capital expenditures commitments aggregating approximately RR 9,834 million (at 31 December 2009: RR 10,974 million) mainly for phase two development of the Yurkharovskoye field (through 2012), development of the East-Tarkosalinskoye and Khancheyskoye fields (through 2011), for continuation of phase two construction of the Purovsky Gas Condensate Plant (through 2011) and development of the South-Tambeyskoye field (through 2012) all in accordance with duly signed agreements. In addition, at 31 December 2010, the Group has capital commitments for exploration activities under the El Arish Concession Agreement aggregating USD nil million (at 31 December 2009: USD 13 million). Furthermore the Group's share of capital commitments for investments in joint ventures aggregates approximately RR 4,581 million development of the Samburgskoye field through 2012 (at 31 December 2009: nil).

**Taxation.** Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activities of the Group may be challenged by the relevant regional and federal authorities. Furthermore, events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2010, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued.

**Mineral licenses.** The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its mineral licenses. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitation, suspension or revocation. The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any material adverse effect on the Group's financial position, statement of income or of cash flows.

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**28 CONTINGENCIES AND COMMITMENTS (CONTINUED)**

The Group's oil and gas fields and license areas are situated on land located in the Yamal-Nenets Autonomous Region. Licenses are issued by the Federal Agency for the Use of Natural Resources under the Ministry of Natural Resources and the Group pays unified natural resources production tax to produce oil and gas from these fields and contributions for exploration of license areas. The principal licenses of the Group and its associates and joint ventures and their expiry dates are:

Field	License holder	License expiry date
Yurkharovskoye	ООО NOVATEK-Yurkharovneftegas	2034
East-Tarkosalinskoye	ООО NOVATEK-Tarkosaleneftegas	2043
Khancheyevskoye	ООО NOVATEK-Tarkosaleneftegas	2044
Sterkhovoye (within the Olimpiyskiy license area)	ООО NOVATEK-Tarkosaleneftegas	2026
South-Tambeyskoye	ОАО Yamal LNG	2045
Termokarstovoye	ЗАО Тернефтегаз (joint venture)	2021
Beregovoe	ОАО Sibneftegas (associate)	2023
Pyreinoye	ОАО Sibneftegas (associate)	2021
Samburgskoye	ОАО Арктическая газовая компания (under control of joint venture Yamal Development)	2018
Yevo-Yakhinskoye	ОАО Арктическая газовая компания (under control of joint venture Yamal Development)	2018
Yaro-Yakhinskoye	ЗАО Urengoil Inc. (under control of joint venture Yamal Development)	2018
North-Chaselskoye	ОАО Нефтегастехнология (under control of joint venture Yamal Development)	upon full production

Management believes the Group has the right to extend its licenses beyond the initial expiration date under the existing legislation and intends to exercise this right on all of its fields.

**Environmental liabilities.** The Group and its predecessor entities have operated in the oil and gas industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations and, as obligations are determined, they are recognized as an expense immediately if no future benefit is discernible. Potential liabilities which might arise as a result of a change in interpretation of existing regulations, civil litigation or changes in legislation cannot be estimated. Under existing legislation, management believes that there are no probable liabilities which will have a material adverse effect on the Group's financial position, statement of income or of cash flows.

**Legal contingencies.** The Group is subject of, or party to a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in the consolidated financial statements.



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**29 PRINCIPAL SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES**

The principal subsidiaries and associates of the Group and respective ownership in the ordinary share capital at 31 December 2010 and 2009 are set out below.

	<b>Ownership percent at 31 December:</b>		<b>Country of incorporation</b>	<b>Principal activities</b>
	<b>2010</b>	<b>2009</b>		
<i>Subsidiaries</i>				
OOO NOVATEK-Yurkharovneftegas	100	100	Russia	Exploration and production
OOO NOVATEK-Tarkosaleneftegas	100	100	Russia	Exploration and production
OOO NOVATEK-Purovsky ZPK	100	100	Russia	Gas Condensate Plant
OOO NOVATEK-Transervice	100	100	Russia	Transportation services
OOO NOVATEK-AZK	100	100	Russia	Wholesale and retail trading
OOO NOVATEK Severo-Zapad	100	100	Russia	Trading and marketing
OOO NOVATEK-Polymer	-	100	Russia	Production of polymer and insulation tape
OOO NOVATEK-Ust-Luga	100	100	Russia	Construction of sea terminal
OOO Yargeo	51	51	Russia	Exploration activities
OAO Yamal LNG	51	51	Russia	Exploration activities
OOO Oiltechproduct-Invest (merged into OOO NOVATEK-Tarkosaleneftegas in December 2010)	-	25	Russia	Exploration activities
OOO Petra Invest-M	100	25	Russia	Exploration activities
OOO Tailiksneftegas	100	25	Russia	Exploration activities
OOO Tambeyneftegaz	100	-	Russia	Exploration activities
OOO NOVATEK-Perm	100	-	Russia	Trading and marketing
OOO Yamalgazresurs-Chelyabinsk	100	-	Russia	Trading and marketing
OOO EkropromStroy	100	100	Russia	Construction of office building
Novatek Overseas AG	100	100	Switzerland	Holding company
Runitek GmbH	100	100	Switzerland	Trading and marketing
Novatek Overseas Exploration & Production GmbH	100	100	Switzerland (branch in Egypt)	Exploration activities
Novatek Equity (Cyprus) Limited	100	100	Cyprus	Purchase and sale of the Group's shares
Novatek Polska	100	100	Poland	Trading and marketing
<i>Joint ventures</i>				
ZAO Terneftegas (until September 2009 OOO Terneftegas)	51	100	Russia	Exploration and production
OOO Yamal Developmet	50	-	Russia	Holding company
OOO SeverEnergia (through OOO Yamal Developmet)	25.5	-	Russia	Exploration and production
<i>Associates</i>				
OAO Sibneftegas	51	-	Russia	Exploration and production

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**30 RELATED PARTY TRANSACTIONS**

Transactions between NOVATEK and its subsidiaries, which are related parties of NOVATEK, have been eliminated on consolidation and are not disclosed in this Note.

For the purposes of these consolidated financial statements, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. Management has used reasonable judgments in considering each possible related party relationship with attention directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be affected on the same terms, conditions and amounts as transactions between unrelated parties. The Group enters into transactions with related parties based on market or regulated prices.

All natural gas producers and wholesalers operating in Russia transport their natural gas volumes through the Unified Gas Supply System (UGSS), which is owned and operated by OAO Gazprom, a State monopoly. As an independent natural gas producer, the Group utilizes the UGSS to transport natural gas to end-consumers at the tariff established by the Federal Tariff Service.

Transactions with OAO Gazprom, a shareholder of significant influence, from October 2006 until 20 December 2010, and its subsidiaries are presented below.

<i>Related parties – OAO Gazprom and its subsidiaries</i>	<b>As at and for the year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Transactions</b>		
<b><i>OAO Gazprom:</i></b>		
Natural gas sales	12,935	-
Natural gas transportation to customers	(26,550)	(19,930)
Other expenses	(25)	(3)
<b><i>OOO Gazprom mezhhregiongaz (formerly OOO Mezhhregiongaz):</i></b>		
Natural gas sales	1,055	15,791
<b><i>Other Gazprom subsidiaries:</i></b>		
Sales of polymer and insulation tape	22	37
Unstable gas condensate transportation	(307)	(340)
Processing fees	(458)	(532)
Natural gas transportation	(4)	(3)
Other operating income (loss)	9	-
Other expenses	(34)	(33)
<b>Balances</b>		
<b><i>OAO Gazprom:</i></b>		
Trade payables and accrued liabilities	-	530
<b><i>OOO Gazprom mezhhregiongaz (formerly OOO Mezhhregiongaz):</i></b>		
Trade and other receivables	-	784
<b><i>Other Gazprom subsidiaries:</i></b>		
Trade and other receivables	-	16
Trade payables and accrued liabilities	-	157

On 20 December 2010, OAO Gazprom sold 9.4 percent of its NOVATEK shares to a third party and consequently ceased to be a related party of the Group from that date.

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

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

**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – associates and joint ventures</i>	As at and for the year ended 31 December:	
	2010	2009
<b>Transactions</b>		
<i>OAO Sibneftegas (from December 2010):</i>		
Interest income on loans issued	45	-
<i>OOO Yamal Development and its subsidiaries (from November 2010):</i>		
Interest income on loans issued	191	-
<i>OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas (until February 2010):</i>		
Other revenues	-	773
Interest income on loans issued	-	76
<b>Balances</b>		
<i>OAO Sibneftegas (from December 2010):</i>		
Long-term loans receivable	10,070	-
Interest on long-term loans receivable	33	-
Short-term loans receivable	967	-
<i>OOO Yamal Development and its subsidiaries (from November 2010):</i>		
Long-term loans receivable	27,886	-
Interest on long-term loans receivable	191	-
<i>ZAO Terneftegas (from February 2010):</i>		
Long-term loans receivable	102	-
<i>OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas (until February 2010):</i>		
Long-term loans and receivable	-	108
Trade and other receivables	-	80
Short-term loans receivable	-	837

As discussed in Note 5, in February 2010, the Group's effective control over ZAO Terneftegas ceased; therefore, subsequent to that event, the Group's balances and transactions with this entity were disclosed as related parties – joint ventures.

As discussed in Note 5, in February 2010, the Group increased its participation interests in OOO Oiltechproduct-Invest, OOO Petra Invest-M and OOO Tailiksneftegas to 51 percent. These companies ceased to be associates subsequent to the date that the Group effectively acquired a controlling stake in these companies and, from that date forwards, are fully consolidated and are no longer accounted for as related parties.

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

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

**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

<i>Related parties – parties under significant influence of key management personnel</i>	As at and for the year ended 31 December:	
	2010	2009
<b>Transactions</b>		
<b>OOO Nova (formerly SNP NOVA):</b>		
Purchases of construction services (capitalized within property, plant and equipment)	3,825	2,245
Oil products sales	17	28
Other revenues	7	20
Other expenses	(9)	(5)
Other operating income (loss)	17	-
<b>OAO Tambeyneftegas (until July 2010):</b>		
Other operating income (loss)	(11)	-
Other expenses	(15)	(16)
Interest income on loans issued	44	79
<b>Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited:</b>		
Finance income (expense)	(221)	(41)
<b>Balances</b>		
<b>OOO Nova (formerly SNP NOVA):</b>		
Trade and other receivables	20	11
Advances for construction	278	137
Trade payables and accrued liabilities	312	188
<b>OAO Tambeyneftegas (until July 2010):</b>		
Trade and other receivables	-	184
Short-term loans receivable	-	636
<b>OAO SIBUR Holding (from December 2010):</b>		
Trade and other receivables	218	-
Long-term receivable	1,548	-
Trade payables and accrued liabilities	11	-
<b>Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited:</b>		
Other non-current liabilities	-	2,636
Trade payables and accrued liabilities	2,836	-

In December 2010, Chairman of the Management Board of NOVATEK acquired an effective 25 percent stake in OAO SIBUR Holding. As a result, the Group's balances and transactions with this company and its subsidiaries are disclosed from that date as related parties – parties under significant influence of key management personnel.

As discussed in Note 5, in July 2010, the Group acquired a 75 percent ownership interest in OAO Tambeyneftegas from parties under significant influence of a member of the Group's Board of Directors for RR 234 million (USD 7 million) and, as a result, this entity is fully consolidated and is no longer accounted for as a related party.

As discussed in Note 5, in May 2009, the Group purchased a 51 percent stake in OAO Yamal LNG. Following the acquisition (but not as of the acquisition date), an individual who significantly influences the sellers of the stake became a member of the Group's Board of Directors. Consequently, the sellers are considered a related party at 31 December 2009 and thereafter. The Group included outstanding liabilities to these related parties (Aldi trading Limited, Orsel consultant Limited, Innecto ventures Limited) in trade payables and accrued liabilities and other non-current liabilities at 31 December 2010 and 2009, respectively.

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

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**30 RELATED PARTY TRANSACTIONS (CONTINUED)**

In addition, in June 2010, the Group paid RR 30 million in transaction fees to Investment Company Troika Dialog, the party under significant influence of a member of the Group's Board of Directors, for services related to the issuance of Russian rouble denominated bonds. This transaction cost was capitalized within long-term debt and will be amortized over the bonds life time.

<i>Related parties – party under control of key management personnel</i>	<b>As at and for the year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Transactions</b>		
<i>OAO Pervobank:</i>		
Finance income (expense)	18	30
Other expenses	(12)	-
<b>Balances</b>		
<i>OAO Pervobank:</i>		
Cash and cash equivalents	1,760	845

As discussed in Note 5, in June 2009, the Group purchased 100 percent participation interest of OOO EkropromStroy from several members of the Group's key management personnel. As part of this acquisition, the Group consolidated a US dollar denominated long-term debt of RR 468 million (USD 15 million) of OOO EkropromStroy to SWGI Growth Fund (Cyprus) Limited, a party under control of key management personnel. The loan bore annual interest of 5.2 percent and was fully repaid in July 2009 ahead of its maturity schedule.

**Key management compensation.** The Group paid to key management personnel (members of the Board of Directors and the Management Committee, some of whom have also direct and indirect interests in the Group) short-term compensation, including salary, bonuses, and excluding dividends the following amounts.

<i>Related parties – members of the key management personnel</i>	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Board of Directors	93	38
Management Committee	1,049	624
<b>Total compensation</b>	<b>1,142</b>	<b>662</b>

Such amounts include personal income tax and are net of unified social tax. The Board of Directors consists of nine members. The Management Committee consisted of 11 members until 4 December 2009 and was subsequently increased to 15 members.

The remuneration for serving on the Board of Directors is subject to approval by the General Meeting of Shareholders. Members of the Management Committee also receive certain short-term benefits related to healthcare.

In addition, RR 68 million and RR 176 million was recognized during the years ended 31 December 2010 and 2009, respectively, as part of the share-based compensation scheme and included in general and administrative expenses. At 30 June 2010, share-based compensation to the key members of the Group's management team provided in 2005 (see Note 18) was fully recognized in the consolidated statement of changes in equity.

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

#### 31 SEGMENT INFORMATION

The Group's activities are considered by the chief operating decision maker (hereinafter referred to as "CODM", represented by the Management Committee of NOVATEK) to comprise the following operating segments:

- Exploration, production and marketing – acquisitions, exploration, development, production, processing, marketing and transportation of natural gas, gas condensate and related products; and
- Polymer products production and marketing – production and marketing of polymer insulation tape and other polymer products (disposed in September 2010, see Note 5).

Segment information is provided to the CODM in accordance with management accounting based on Regulations on Accounting and Reporting of the Russian Federation ("RAR") with reconciling items largely representing adjustments and reclassifications recorded in the consolidated financial statements for the fair presentation in accordance with IFRS.

Segment information for the year ended 31 December 2010 is as follows:

<i>For the year ended 31 December 2010</i>	<i>References</i>	<b>Exploration, production and marketing</b>	<b>Polymer products production and marketing</b>	<b>Segment information as reported to CODM</b>	<b>Reconciling items</b>	<b>Total per consolidated financial statements</b>
External revenues		115,590	1,739	117,329	(305)	117,024
Operating expenses	<i>a, b, c, d</i>	(67,879)	(1,545)	(69,424)	906	(68,518)
Other operating income (loss)	<i>e, b</i>	767	15	782	943	1,725
Interest expense	<i>f, h</i>	(2,010)	-	(2,010)	1,573	(437)
Interest income		414	2	416	182	598
Foreign exchange gain (loss)	<i>g</i>	580	-	580	456	1,036
<b>Segment result</b>		<b>47,462</b>	<b>211</b>	<b>47,673</b>	<b>3,755</b>	<b>51,428</b>
Share of loss of associates, net of income tax						(346)
<b>Profit before income tax</b>						<b>51,082</b>
Depreciation, depletion and amortization	<i>a, b</i>	9,031	50	9,081	(2,324)	6,757
Capital expenditures	<i>g, h</i>	22,259	57	22,316	3,790	26,106

Reconciling items mainly related to:

- different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 3,049 million in operating expenses under IFRS;
- different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 464 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- different methodology in recognizing expenses relating to natural gas storage services and payroll (incl. share-based payments, pension obligation, discounting loans to employee and bonus accruals) between IFRS and management accounting, which resulted in additional transportation expenses of RR 149 million and additional payroll expenses of RR 708 million recorded in operating expenses under IFRS;
- different methodology in recognizing of impairment expenses in respect of different categories of assets between IFRS and management accounting, which resulted in additional operating expense of RR 541 million charged under IFRS;

## OAO NOVATEK

### Notes to the Consolidated Financial Statements

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

#### 31 SEGMENT INFORMATION (CONTINUED)

- e. different methodology in recognizing the gain on disposal of ownership interest in ZAO Terneftegas and OOO NOVATEK-Polymer between IFRS and management accounting, which resulted in additional gain of RR 185 million recorded in other operating income (loss) under IFRS;
- f. different methodology in valuating long-term payables and asset retirement obligations between IFRS and management accounting, which resulted in additional interest expense of RR 411 million charged under IFRS;
- g. different methodology in capitalization policy between IFRS and management accounting which resulted in additional capitalization of foreign exchange loss of RR 455 million under IFRS; and
- h. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized and additional capitalization of foreign exchange loss of RR 2,349 million and additional capital expenditures of RR 1,441 million under IFRS.

Segment information for the year ended 31 December 2009 is as follows:

<i>For the year ended 31 December 2009</i>	<i>References</i>	<b>Exploration, production and marketing</b>	<b>Polymer products production and marketing</b>	<b>Segment information as reported to CODM</b>	<b>Reconciling items</b>	<b>Total per consolidated financial statements</b>
External revenues	<i>a</i>	87,588	1,925	89,513	441	89,954
Operating expenses	<i>b, c</i>	(54,088)	(1,824)	(55,912)	(218)	(56,130)
Other operating income (loss)	<i>c</i>	(1,133)	3	(1,130)	839	(291)
Interest expense	<i>d, e</i>	(1,212)	-	(1,212)	393	(819)
Interest income		347	1	348	179	527
Foreign exchange gain (loss)		(736)	(1)	(737)	198	(539)
<b>Segment result</b>		<b>30,766</b>	<b>104</b>	<b>30,870</b>	<b>1,832</b>	<b>32,702</b>
Share of loss of associates, net of income tax						(202)
<b>Profit before income tax</b>						<b>32,500</b>
Depreciation, depletion and amortization		5,825	36	5,861	(123)	5,738
Capital expenditures	<i>d</i>	19,557	32	19,589	(1,717)	17,872

Reconciling items mainly related to:

- a. different methodology in recognizing deferred natural gas revenue of RR 381 million recorded under IFRS in external revenues as a result of acquisitions of Tarkosaleneftegaz and Khancheyneftegas in 2004;
- b. different methodology in calculating depreciation, depletion and amortization for oil and gas properties between IFRS (units of production method) and management accounting (straight-line method), which resulted in reversal of RR 951 million in operating expenses under IFRS;
- c. different methodology in the classification of depreciation, depletion and amortization for operating assets, which have not completed their statutory registration, between IFRS and management accounting, which resulted in the reclassification of RR 966 million from other operating income (loss) to depreciation, depletion and amortization in operating expenses under IFRS;
- d. different methodology in interest capitalization policy and certain recognition policy differences in capital expenditures between IFRS and management accounting, which resulted in additional interest capitalized of RR 1,084 million and reversal of capital expenditures of RR 2,801 million under IFRS; and
- e. different methodology in valuating long-term payables and asset retirement obligations between IFRS and management accounting, which resulted in additional interest expense of RR 294 million charged under IFRS.

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

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**31 SEGMENT INFORMATION (CONTINUED)**

**Geographical information.** The Group's two segments operate in four major geographical areas of the world. In the Russian Federation (considered the Group's home country), the Group is mainly engaged in the exploration, development, production and sales of natural gas, crude oil, gas condensate and related products and sales of polymer and insulation tape (until September 2010). Activities outside the Russian Federation are conducted in the United States (sales of stable gas condensate), in Europe (sales of stable gas condensate, liquefied petroleum gas and crude oil), in Asian-Pacific region (sales of stable gas condensate) and other areas (sales of liquefied petroleum gas and sales of polymer and insulation tape).

Geographical information for the year ended 31 December 2010 and 2009 is as follows:

<i>For the year ended 31 December 2010</i>	Russian Federation	Outside Russian Federation						Total
		Europe	USA	APR	Other	Export duty	Subtotal	
Natural gas	71,060	-	-	-	-	-	-	71,060
Stable gas condensate	34	6,598	25,976	12,660	3,653	(19,167)	29,720	29,754
Liquefied petroleum gas	4,686	8,855	-	-	9	(803)	8,061	12,747
Crude oil	855	1,191	-	-	-	(588)	603	1,458
Oil products	143	-	-	-	-	-	-	143
<b>Oil and gas sales</b>	<b>76,778</b>	<b>16,644</b>	<b>25,976</b>	<b>12,660</b>	<b>3,662</b>	<b>(20,558)</b>	<b>38,384</b>	<b>115,162</b>
Polymer products sales	1,390	-	-	-	309	-	309	1,699
Other revenues	157	6	-	-	-	-	6	163
<b>Total external revenues</b>	<b>78,325</b>	<b>16,650</b>	<b>25,976</b>	<b>12,660</b>	<b>3,971</b>	<b>(20,558)</b>	<b>38,699</b>	<b>117,024</b>

<i>For the year ended 31 December 2009</i>	Russian Federation	Outside Russian Federation						Total
		Europe	USA	APR	Other	Export duty	Subtotal	
Natural gas	53,623	-	-	-	-	-	-	53,623
Stable gas condensate	354	3,303	21,415	10,324	-	(11,797)	23,245	23,599
Liquefied petroleum gas	2,724	5,533	-	-	100	(104)	5,529	8,253
Crude oil	781	945	-	-	-	(391)	554	1,335
Oil products	83	14	-	-	-	(4)	10	93
<b>Oil and gas sales</b>	<b>57,565</b>	<b>9,795</b>	<b>21,415</b>	<b>10,324</b>	<b>100</b>	<b>(12,296)</b>	<b>29,338</b>	<b>86,903</b>
Polymer products sales	1,534	-	-	-	339	-	339	1,873
Other revenues	1,178	-	-	-	-	-	-	1,178
<b>Total external revenues</b>	<b>60,277</b>	<b>9,795</b>	<b>21,415</b>	<b>10,324</b>	<b>439</b>	<b>(12,296)</b>	<b>29,677</b>	<b>89,954</b>

Revenues from external customers are based on the geographical location of customers even though all revenues are generated from assets located in the Russian Federation. Substantially all of the Group's assets are located in the Russian Federation.

**Major customers.** For the years ended 31 December 2010 and 2009, the Group has three and one major customer to whom individual revenues represent 42 percent and 18 percent of total external revenues, respectively.

Sales to major customers are included in the results of the Exploration, production and marketing segment.



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

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

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**32 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES**

The amounts included within the consolidated financial statements associated with the exploration for and evaluation of mineral resources for the years ended 31 December 2010 and 2009 is as follows:

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Net book value of assets value at 1 January</b>	<b>2,535</b>	<b>2,462</b>
Additions	1,394	249
Acquisition of subsidiaries	7,894	39,527
Disposals	(821)	(176)
Reclassification in proved properties	(4,630)	(39,527)
<b>Net book value of assets at 31 December</b>	<b>6,372</b>	<b>2,535</b>
Liabilities	3,026	2,653
Cash flows used for operating activities	1,151	350
Cash flows used for investing activities	2,112	16,786

**33 SUBSEQUENT EVENTS**

On 3 February 2011, the Group issued two tranches of Eurobonds, in the amount of USD 600 million with a coupon rate of 5.326 percent per annum due in five years and USD 650 million with a coupon rate of 6.604 percent per annum due in ten years. The proceeds from Eurobonds issues were used for repayment of a bridge loan.

As discussed in Note 16, in February 2011, the Group fully repaid a RR 18,285 (USD 600 million) bridge facility ahead of its maturity schedule.

**34 NEW ACCOUNTING PRONOUNCEMENTS**

Beginning 1 January 2010, in addition to that which is disclosed in Note 3, the Group has adopted the following new standards and interpretations:

- Amendments to IFRS 2, *Share-based Payment. Group Cash-settled Share-based Payment Transactions*. (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard;
- Amendment to IAS 39, *Financial Instruments: Recognition and Measurement. Eligible Hedged Items*. (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations;
- IFRIC 17, *Distribution of Non-Cash Assets to Owners* (effective for annual periods beginning on or after 1 July 2009). IFRIC 17 clarifies when and how distribution of non-cash assets as dividends to the owners should be recognized. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognized in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners;
- Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognized asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; and amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. In addition, the amendments clarifying classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary published as part of the *Annual Improvements to International Financial Reporting Standards*, which were issued in May 2008, are effective for annual periods beginning on or after 1 July 2009; and
- IFRIC 18, *Transfers of Assets from Customers* (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

### 34 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

The adoption of these new standards and interpretations, in case of such operations, had an insignificant effect on the Group's consolidated financial statement.

Recently, the International Accounting Standards Board published the following new standards and interpretations which have not been early adopted by the Group.

- IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments* (effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity settles its debt by issuing its own equity instruments. A gain or loss is recognised in profit or loss based on the fair value of the equity instruments compared to the carrying amount of the debt;
- Amendment to IAS 32 (effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives;
- Amendment to IAS 24, *Related Party Disclosures* (effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities;
- Amendment to IFRIC 14, IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Prepayments of a Minimum Funding Requirement* (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement;
- Improvements to International Financial Reporting Standards (issued in May 2010 and effective for the Group from 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits;

**34 NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

- IFRS 9, *Financial Instruments Part 1: Classification and Measurement* (effective for annual periods beginning on or after 1 January 2013). IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities. Key features of the standard are as follows:
  - Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument;
  - An instrument is subsequently measured at amortized cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss;
  - All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealized and realized fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment; and
  - Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's consolidated financial statement.

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES**

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). In the absence of specific IFRS guidance, the Group has reverted to other relevant disclosure standards, mainly US GAAP, that are consistent with norms established for the oil and gas industry. While not required under IFRS, this section provides unaudited supplemental information on oil and gas exploration and production activities but excludes disclosures regarding the standardized measures of discounted cash flows related to oil and gas activities.

The Group’s exploration and production activities are mainly within the Russian Federation; therefore, all of the information provided in this section pertains to this country. The Group operates through various oil and gas production subsidiaries, and also has an interest in oil and gas companies that are accounted for under the equity method.

**Oil and Gas Exploration and Development Costs**

The following tables set forth information regarding oil and gas acquisition, exploration and development activities. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the years ended 31 December 2010 and 2009 (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
<b>Costs incurred in exploration and development activities</b>		
Acquisition cost	7,694	39,897
Exploration costs	2,042	770
Development costs	22,123	15,977
<b>Total costs incurred in exploration and development activities</b>	<b>31,859</b>	<b>56,644</b>
The share of the Group in its equity investees	69,286	178
<b>Capitalized costs relating to oil and gas producing activities</b>		
Wells and related equipment and facilities	163,130	134,538
Support equipment and facilities	29,222	22,509
Uncompleted wells, equipment and facilities	10,277	15,839
<b>Total capitalized costs relating to oil and gas producing activities</b>	<b>202,629</b>	<b>172,886</b>
Less: accumulated depreciation, depletion and amortization	(26,698)	(20,211)
<b>Net capitalized costs relating to oil and gas producing activities</b>	<b>175,931</b>	<b>152,675</b>
The share of the Group in its equity investees	69,413	1,896

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

**Results of Operations for Oil and Gas Producing Activities**

The Group's results of operations for oil and gas producing activities are shown below. The results of operations for oil and gas producing activities do not include general corporate overhead or its associated tax effects. Income tax is based on statutory rates. In the following table both transportation and processing costs are included in revenues from oil and gas sales (amounts in millions of Russian roubles).

	<b>Year ended 31 December:</b>	
	<b>2010</b>	<b>2009</b>
Revenues from oil and gas sales	115,162	86,903
Lifting costs	(4,786)	(3,646)
Transportation expenses	(37,187)	(28,482)
Taxes other than income tax	(9,363)	(7,840)
Depreciation, depletion and amortization	(6,384)	(5,139)
Exploration expenses	(1,595)	(566)
<b>Total production costs</b>	<b>(59,315)</b>	<b>(45,673)</b>
Purchases of natural gas, gas condensate and crude oil	(154)	(1,143)
Transportation expenses related to purchases of natural gas, gas condensate and crude oil	-	(533)
Results of operations for oil and gas producing activities before income tax	55,693	39,554
Less: related income tax expense	(11,139)	(7,911)
<b>Results of operations for oil and gas producing activities</b>	<b>44,554</b>	<b>31,643</b>

**Proved Oil and Gas Reserves**

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

The Group estimates its oil and gas reserves in accordance with rules promulgated by the Securities and Exchange Commission (SEC) for proved reserves.

The oil and gas reserve estimates reported below are determined by the Group's independent petroleum reservoir engineers, DeGolyer and MacNaughton ("D&M"), for the Group's fields – Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye, Sterkhovoye, Termokarstovoye (until February 2010), Urengoyskoe, South-Tambeyskoye, West-Yurkharovskoye, Yarudeiskoye, North-Khancheyskoye and North-Russkoye fields. The Group provides D&M annually with engineering, geological and geophysical data, actual production histories and other information necessary for the reserve determination. The Group's and D&M's technical staffs meet to review and discuss the information provided, and upon completion of this process, senior management reviews and approves the final reserve estimates issued by D&M.

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

The following reserve estimates were prepared using standard geological and engineering methods generally accepted by the petroleum industry. The method or combination of methods used in the analysis of each reservoir is tempered by experience with similar reservoirs, stages of development, quality and completeness of basic data, and production history.

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2010 and 2009.

Extensions of production licenses are assumed to be at the discretion of the Group. Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. The Group's licenses expire between 2014 and 2045, with the most significant license, Yurkharovskoye and East-Tarkosalinskoye fields, expiring in 2034 and 2043, respectively. Legislation of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Management intends to extend its licenses for properties expected to produce beyond the license expiry dates.

The Group has disclosed information on proved oil and gas reserve quantities for periods up to and past the license expiry dates separately.

Proved reserves are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

Proved developed reserves are those reserves which are expected to be recovered through existing wells with existing equipment and operating methods. Undeveloped reserves are those reserves which are expected to be recovered as a result of future investments to drill new wells, to re-complete existing wells and/or install facilities to collect and deliver the production.

Net reserves exclude quantities due to others when produced.

The reserve quantities below include 100 percent of the net proved reserve quantities attributable to the Group's consolidated subsidiaries. A portion of the Group's total proved reserves are classified as either developed non-producing or undeveloped. Of the non-producing reserves, a portion represents existing wells which are to be returned to production at a future date.

For convenience, reserves estimates are provided both in English and Metric units.

**OAO NOVATEK**  
**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of natural gas are presented below.

	Year ended			
	31 December 2010:		31 December 2009:	
	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>	<i>Billions of cubic feet</i>	<i>Billions of cubic meters</i>
<i>Consolidated entities:</i>				
<b>Net proved reserves at 1 January</b>	<b>40,726</b>	<b>1,153</b>	<b>24,357</b>	<b>690</b>
Revisions of previous estimates	(54)	(1)	(187)	(6)
Extension and discoveries	3,097	88	4,278	121
Acquisitions	-	-	13,420	380
Disposals	(870)	(25)	-	-
Production	(1,314)	(37)	(1,142)	(32)
<b>Net proved reserves at 31 December<sup>(*)</sup></b>	<b>41,585</b>	<b>1,178</b>	<b>40,726</b>	<b>1,153</b>
Net proved developed reserves (included above)	22,515	638	20,612	584
Net proved undeveloped reserves (included above)	19,070	540	20,114	569
<i>Equity-accounted entities (based on the Group's proportional interest):</i>				
<b>Net proved reserves at 31 December</b>	<b>6,057</b>	<b>171</b>	-	-
Net proved developed reserves (included above)	2,536	71	-	-
Net proved undeveloped reserves (included above)	3,521	100	-	-

<sup>(\*)</sup> – The net proved reserves reported in the table above included reserves of natural gas attributable to non-controlling interest of 7,227 billions of cubic feet and 205 billion of cubic meters and 6,576 billions of cubic feet and 186 billions of cubic meters at 31 December 2010 and 2009, respectively.



**OAO NOVATEK**  
**Unaudited Supplemental Oil and Gas Disclosures**

**UNAUDITED SUPPLEMENTAL OIL AND GAS DISCLOSURES (CONTINUED)**

Net proved reserves of crude oil, gas condensate and natural gas liquids are presented below.

	Year ended			
	31 December 2010:		31 December 2009:	
	<i>Millions of barrels</i>	<i>Millions of metric tons</i>	<i>Millions of barrels</i>	<i>Millions of metric tons</i>
<i>Consolidated entities:</i>				
<b>Net proved reserves at 1 January</b>	<b>589</b>	<b>70</b>	<b>452</b>	<b>55</b>
Revisions of previous estimates	(12)	(1)	(23)	(4)
Extension and discoveries	60	8	67	8
Acquisitions	-	-	118	14
Disposals	(40)	(5)	-	-
Production	(31)	(4)	(25)	(3)
<b>Net proved reserves at 31 December<sup>(*)</sup></b>	<b>566</b>	<b>68</b>	<b>589</b>	<b>70</b>
Net proved developed reserves (included above)	304	36	272	33
Net proved undeveloped reserves (included above)	262	32	317	37
<i>Equity-accounted entities (based on the Group's proportional interest):</i>				
<b>Net proved reserves at 31 December</b>	<b>103</b>	<b>13</b>	<b>-</b>	<b>-</b>
Net proved developed reserves (included above)	-	-	-	-
Net proved undeveloped reserves (included above)	103	13	-	-

<sup>(\*)</sup> – The net proved reserves reported in the table above included reserves of crude oil, gas condensate and natural gas liquids attributable to non-controlling interest of 65 millions of barrels and eight million of metric tons and 58 million of barrels and seven million of metric tons at 31 December 2010 and 2009, respectively.

During 2010, the Group acquired a 51 percent of the outstanding ordinary shares of OAO Sibneftegas, which holds licenses on Beregovoye, Pyreinoye and Khadyryahinskoye fields (see Note 5). During 2010, the Group's joint venture OOO Yamal Development acquired a 51 percent of the participation interest in OOO SeverEnergia. OOO SeverEnergia and its subsidiaries hold licenses on Samburgskoye, Yevo-Yakhinskoye, Yaro-Yakhinskoye and North-Chaselskoye fields (see Note 5).

During 2010, the Group disposed a 49 percent ownership in ZAO Terneftegas (see Note 5), the holder of the Termokarstovoye field. As a result, the Group's interest in ZAO Terneftegas is accounted for using the equity method.

During 2009, the Group acquired a 51 percent equity stake in OAO Yamal LNG (see Note 5), the holder of the South Tambeyskoye license area. Included in the reserves estimates noted above are reserves attributable to 100 percent of the equity in the acquired company as required by US GAAP SFAS 69, *Disclosures about Oil and Gas Producing Activities*. The reserves estimates for proved reserves attributable to the non-controlling interest are shown separately for natural gas and crude oil, gas condensate and natural gas liquids.

**ОАО NOVATEK**  
**Contact Information**

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ОАО NOVATEK was incorporated as a joint stock company in accordance with the Russian law and is domiciled in the Russian Federation.

The Group's registered office is:

Ulitsa Pobedy 22a  
629850 Tarko-Sale  
Yamal-Nenets Autonomous Region  
Russian Federation

Telephone: 7 (495) 730-60-00

Fax: 7 (495) 721-22-53

[www.novatek.ru](http://www.novatek.ru)

## APPENDIX A – SUMMARY RESERVES REPORTS

DEGOLYER AND MACNAUGHTON  
500 I SPRING VALLEY ROAD  
SUITE 800 EAST  
DALLAS, TEXAS 75 2 44

This is a digital representation of a DeGolyer and MacNaughton report.

This file is intended to be a manifestation of certain data in the subject report and as such are subject to the same conditions thereof. The information and data contained in this file may be subject to misinterpretation; therefore, the signed and bound copy of this report should be considered the only authoritative source of such information.



DEGOLYER AND MACNAUGHTON

5001 SPRING VALLEY ROAD

SUITE 800 EAST

DALLAS, TEXAS 75244

November 26, 2012

OAO Novatek  
Ul. Udaltsova, d. 2  
119415, Moscow  
Russia

Re: Estimated Reserves and Values, as of December 31, 2011, SEC Case

Gentlemen:

At the request of OAO NOVATEK (NOVATEK), we have prepared estimates, as of December 31, 2011, of the extent and value of the proved natural gas, condensate, and crude oil reserves of certain fields in Russia owned by NOVATEK through its subsidiaries, which hold the licenses for these fields, and through certain joint venture interests. The fields evaluated are located in western Siberia, Russia, and are listed in the attached table.

Estimates of reserves presented in this report have been prepared in compliance with the regulations promulgated by the United States Securities and Exchange Commission (SEC). These reserves definitions are discussed in detail in this letter report.

NOVATEK has represented that the Russian Law on Subsoil provides for the extension of production licenses at the request of the license holder if there exists economic reserves upon the expiration of the primary term, provided the license holder is in material compliance with the terms of the existing license. We understand that the principal requirements for license extension are that the license holder complies with the material terms of the license and that mineral extraction has not been completed. As in the past, NOVATEK is required to submit to the appropriate government agency for approval, prior to production, individual field development plans based on the economic life of the field and not based on the term

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of the associated license. NOVATEK has represented that upon completion of the primary term of its current licenses they intend to continue to extend these licenses until the end of the economic life of the associated fields, and that they intend to proceed accordingly with development and operations of these fields. Based on these representations we have included as proved reserves those volumes that are estimated to be economically producible from the fields evaluated after the expiration of the primary term of their licenses.

Reserves estimated in this report are expressed as gross reserves and reserves owned by NOVATEK (NOVATEK net reserves). Gross reserves are defined as the total estimated petroleum to be produced after December 31, 2011. NOVATEK net reserves are that portion of the total estimated petroleum to be produced after December 31, 2011, attributable to NOVATEK after deducting interest owned by others. NOVATEK's interests in each subsidiary, joint venture, and field are listed in the attached table.

Estimates of gas, condensate, and oil reserves and future net revenue should be regarded only as estimates that may change as further production history and additional information become available. Not only are such reserves and revenue estimates based on that information which is currently available, but such estimates are also subject to the uncertainties inherent in the application of judgmental factors in interpreting such information.

Information used in the preparation of this report was obtained from NOVATEK. In the preparation of this report we have relied, without independent verification, upon information furnished by NOVATEK with respect to ownership, production, current costs of operation and development, current prices for production, agreements relating to current and future operations and sale of production, and various other information and data that were accepted as represented. Field examinations have been conducted in the East Tarkosalinsk, Khancheiskoye, and Yurkharovskoye fields.

The report was signed November 20, 2012; therefore, certain events that may have occurred before the preparation of this report but after the "as-of" date of December 31, 2011, which might have affected the reserves, prices, costs, and values used in the estimates presented herein, were not taken into account.

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Sales gas is defined as the deliverable quantity of gas available for sales after deduction for various losses and fuel usage. In addition, sales-gas quantities shown herein include ethane quantities that are liberated from the field condensate stream during processing and reintroduced into the gas stream for processing and sales. Gas quantities estimated herein are expressed at a temperature base of 20 °C and a pressure base of 1 atmosphere.

Condensate reserves estimated include both stable condensate and what is referred to in Russia as “shflu” or wide-range light hydrocarbons (WRLH). These WRLH consist of unstable condensate, propane, and butanes. After field condensate removal by normal separation, additional liquids are recovered as WRLH through additional separation at reduced temperatures. Gas recovered during the de-ethanization process is reintroduced into the sales gas stream. Oil reserves estimated are recovered by normal separation in the field. Estimates of condensate and oil reserves are expressed in thousands of barrels ( $10^3$ bbl) and thousands of metric tons ( $10^3$ mt). In these estimates, 1 barrel equals 42 United States gallons.

DEGOLYER AND MACNAUGHTON

The estimated NOVATEK net proved sales gas reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in millions of cubic feet ( $10^6\text{ft}^3$ ) and millions of cubic meters ( $10^6\text{m}^3$ ), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Sales Gas Reserves		
	English Units		Total Proved ( $10^6\text{ft}^3$ )
	Proved Developed ( $10^6\text{ft}^3$ )	Proved Undeveloped ( $10^6\text{ft}^3$ )	
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	6,851,243	636,396	7,487,639
Khancheiskoye	980,441	210,229	1,190,670
North Khancheiskoye	0	69,181	69,181
North Russkoye	0	794,315	794,315
Sterkhaovoye	22,990	25,815	48,805
Urengoi Field (South Area)	0	744,363	744,363
Dobrovolskoye	0	175,973	175,973
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	0	443,922	443,922
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	12,908,183	2,827,328	15,735,511
WestYurkharovskoye	0	55,868	55,868
<b>OAO YAMAL LNG</b>			
South Tambayskoye	0	13,323,490	13,323,490
<b>OOOYARGEO</b>			
Yarudeiskoye	0	124,777	124,777
<b>OOO SeverEnergia</b>			
North Chaselskoye	0	418,726	418,726
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiskoye	0	0	0
Samburgskoye	0	865,313	865,313
Urengoiskoye	0	874,526	874,526
Yaro-Yakhinskoye	0	900,812	900,812
Yevo-Yakhinskoye	0	0	0
<b>OAO Sibneftegaz</b>			
Beregovoye, S. Geologicheskoye	2,269,069	611,654	2,880,723
Khadyryakhinskoye	0	231,359	231,359
Pyreynoye	78,839	218,276	297,115
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>23,110,765</b>	<b>23,552,323</b>	<b>46,663,088</b>

DEGOLYER AND MACNAUGHTON

Subsidiary or Joint Venture Field	NOVATEK Net Sales Gas Reserves		
	Metric Units		
	Proved Developed (10 <sup>6</sup> m <sup>3</sup> )	Proved Undeveloped (10 <sup>6</sup> m <sup>3</sup> )	Total Proved (10 <sup>6</sup> m <sup>3</sup> )
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	194,006	18,020	212,026
Khancheiskoye	27,763	5,953	33,716
North Khancheiskoye	0	1,959	1,959
North Russkoye	0	22,492	22,492
Sterkhaovoye	651	731	1,382
Urengoi Field (South Area)	0	21,078	21,078
Dobrovolskoye	0	4,983	4,983
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	0	12,571	12,571
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	365,519	80,061	445,580
WestYurkharovskoye	0	1,582	1,582
<b>OAO YAMAL LNG</b>			
South Tambeyskoye	0	377,279	377,279
<b>OOOYARGEO</b>			
Yarudeiskoye	0	3,533	3,533
<b>OOO SeverEnergia</b>			
North Chaselskoye	0	11,857	11,857
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiskoye	0	0	0
Samburgskoye	0	24,503	24,503
Urengoiskoye	0	24,764	24,764
Yaro-Yakhinskoye	0	25,508	25,508
Yevo-Yakhinskoye	0	0	0
<b>OAO Sibneftegaz</b>			
Beregovoye, S. Geologicheskoye	64,253	17,320	81,573
Khadyryakhinskoye	0	6,551	6,551
Pyreynoye	2,232	6,181	8,413
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>654,424</b>	<b>666,926</b>	<b>1,321,350</b>



DEGOLYER AND MACNAUGHTON

The estimated NOVATEK net proved total liquid (oil and condensate) reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in thousands of barrels (10<sup>3</sup>bbl) and thousands of metric tons (10<sup>3</sup>mt), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Total Liquids Reserves		
	English Units		
	Proved Developed (10 <sup>3</sup> bbl)	Proved Undeveloped (10 <sup>3</sup> bbl)	Total Proved (10 <sup>3</sup> bbl)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	74,208	99,029	173,237
Khancheiskoye	30,229	1,894	32,123
North Khancheiskoye	0	0	0
North Russkoye	0	15,588	15,588
Sterkhaovoye	1,443	1,753	3,196
Urengoi Field (South Area)	0	7,142	7,142
Dobrovolskoye	0	10,542	10,542
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	0	20,194	20,194
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	176,047	32,186	208,233
WestYurkharovskoye	0	2,115	2,115
<b>OAO YAMAL LNG</b>			
South Tambeyskoye	0	137,618	137,618
<b>OOOYARGEO</b>			
Yarudeiskoye	0	16,703	16,703
<b>OOO SeverEnergia</b>			
North Chaselskoye	0	4,705	4,705
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiszkoye	0	0	0
Samburgskoye	0	45,872	45,872
Urengoiszkoye	0	42,027	42,027
Yaro-Yakhinskoye	0	29,574	29,574
Yevo-Yakhinskoye	0	0	0
<b>OAO Sibneftegaz</b>			
Beregovoye, S. Geologicheskoye	0	2,954	2,954
Khadyryakhinskoye	0	0	0
Pyreynoye	0	0	0
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>281,927</b>	<b>469,896</b>	<b>751,823</b>

Note: Total liquids are oil and condensate.

DEGOLYER AND MACNAUGHTON

Subsidiary or Joint Venture Field	NOVATEK Net Total Liquids Reserves		
	Metric Units		
	Proved Developed (10 <sup>9</sup> mt)	Proved Undeveloped (10 <sup>9</sup> mt)	Total Proved (10 <sup>9</sup> mt)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	9,171	12,889	22,060
Khancheiskoye	3,715	237	3,952
North Khancheiskoye	0	0	0
North Russkoye	0	1,943	1,943
Sterkhaovoye	177	215	392
Urengoi Field (South Area)	0	876	876
Dobrovolskoye	0	1,293	1,293
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	0	2,360	2,360
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	20,473	3,743	24,216
WestYurkharovskoye	0	246	246
<b>OAD YAMAL LNG</b>			
South Tambeyskoye	0	16,004	16,004
<b>OOOYARGE O</b>			
Yarudeiskoye	0	2,151	2,151
<b>OOO SeverEnergia</b>			
North Chaselskoye	0	582	582
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiskoye	0	0	0
Samburgskoye	0	5,620	5,620
Urengoiskoye	0	5,114	5,114
Yaro-Yakhinskoye	0	3,642	3,642
Yevo-Yakhinskoye	0	0	0
<b>OAD Sibneftegaz</b>			
Beregovoye, S. Geologicheskoye	0	356	356
Khadyryakhinskoye	0	0	0
Pyreynoye	0	0	0
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>33,536</b>	<b>57,271</b>	<b>90,807</b>

Note: Total liquids are oil and condensate.

DEGOLYER AND MACNAUGHTON

The estimated total NOVATEK net proved reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in thousands of barrels of oil equivalent (10<sup>3</sup>boe), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Barrels of Oil Equivalent		
	Proved Developed (10 <sup>3</sup> boe)	Proved Undeveloped (10 <sup>3</sup> boe)	Total Proved (10 <sup>3</sup> boe)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	1,343,007	216,880	1,559,887
Khancheiskoye	211,799	40,827	252,626
North Khancheiskoye	0	12,812	12,812
North Russkoye	0	162,686	162,686
Sterkhaovoye	5,701	6,534	12,235
Urengoi Field (South Area)	0	144,992	144,992
Dobrovolskoye	0	43,131	43,131
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	0	102,408	102,408
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	2,566,541	555,785	3,122,326
West Yurkharovskoye	0	12,461	12,461
<b>OAO YAMAL LNG</b>			
South Tambeyskoye	0	2,605,023	2,605,023
<b>OOO YARGEO</b>			
Yarudeiskoye	0	39,809	39,809
<b>OOO SeverEnergiya</b>			
North Chaselskoye	0	82,250	82,250
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiszkoye	0	0	0
0	0	206,122	206,122
Urengoiszkoye	0	203,984	203,984
Yaro-Yakhinskoye	0	196,396	196,396
Yevo-Yakhinskoye	0	0	0
<b>OAO Sibneftegaz</b>			
Beregovoye, S. Geologicheskoye	420,215	116,227	536,442
Khadyryakhinskoye	0	42,844	42,844
Pyreynoye	14,597	40,424	55,021
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>4,561,860</b>	<b>4,831,595</b>	<b>9,393,455</b>

Note: In converting gas to oil equivalent, 1,000 cubic meters of gas equals 6.54 barrels of oil equivalent.

Petroleum reserves included in this report are classified as proved. Only proved reserves have been evaluated for this report. Reserves classifications used in this report are in accordance with the reserves definitions of Rules 4–10(a) (1)–(32) of Regulation S–X of the SEC. Reserves are judged to be economically producible in future years from known reservoirs under existing economic and operating conditions and assuming continuation of current regulatory practices using conventional production methods and equipment. In the analyses of production-decline curves, reserves were estimated only to the limit of economic rates of production under existing economic and operating conditions using prices and costs consistent with the effective date of this report, including consideration of changes in existing prices provided only by contractual arrangements but not including escalations based upon future conditions. The petroleum reserves are classified as follows:

*Proved oil and gas reserves* – Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

(i) The area of the reservoir considered as proved includes:

(A) The area identified by drilling and limited by fluid contacts, if any, and (B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.

(ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.

(iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.

(iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:

(A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and (B) The project has been approved for development by all necessary parties and entities, including governmental entities.

(v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

*Probable reserves* – Probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered.

(i) When deterministic methods are used, it is as likely as not that actual remaining quantities recovered will exceed the sum of estimated proved plus probable reserves. When probabilistic methods are used, there should be at least a 50% probability

that the actual quantities recovered will equal or exceed the proved plus probable reserves estimates.

(ii) Probable reserves may be assigned to areas of a reservoir adjacent to proved reserves where data control or interpretations of available data are less certain, even if the interpreted reservoir continuity of structure or productivity does not meet the reasonable certainty criterion. Probable reserves may be assigned to areas that are structurally higher than the proved area if these areas are in communication with the proved reservoir.

(iii) Probable reserves estimates also include potential incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than assumed for proved reserves.

(iv) See also guidelines in paragraphs (iv) and (vi) of the definition of possible reserves.

*Possible reserves* – Possible reserves are those additional reserves that are less certain to be recovered than probable reserves.

(i) When deterministic methods are used, the total quantities ultimately recovered from a project have a low probability of exceeding proved plus probable plus possible reserves. When probabilistic methods are used, there should be at least a 10% probability that the total quantities ultimately recovered will equal or exceed the proved plus probable plus possible reserves estimates.

(ii) Possible reserves may be assigned to areas of a reservoir adjacent to probable reserves where data control and interpretations of available data are progressively less certain. Frequently, this will be in areas where geoscience and engineering data are unable to define clearly the area and vertical limits of commercial production from the reservoir by a defined project.

(iii) Possible reserves also include incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than the recovery quantities assumed for probable reserves.

(iv) The proved plus probable and proved plus probable plus possible reserves estimates must be based on reasonable alternative technical and commercial interpretations within the reservoir or subject project that are clearly documented, including comparisons to results in successful similar projects.

(v) Possible reserves may be assigned where geoscience and engineering data identify directly adjacent portions of a reservoir within the same accumulation that may be separated from proved areas by faults with displacement less than formation thickness or other geological discontinuities and that have not been penetrated by a wellbore, and the registrant believes that such adjacent portions are in communication with the known (proved) reservoir. Possible reserves may be assigned to areas that are structurally higher or lower than the proved area if these areas are in communication with the proved reservoir.

(vi) Pursuant to paragraph (iii) of the proved oil and gas reserves definition, where direct observation has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves should be assigned in the structurally higher portions of the reservoir above the HKO only if the higher contact can be established with reasonable certainty through reliable technology. Portions of the reservoir that do not meet this reasonable certainty criterion may be assigned as probable and possible oil or gas based on reservoir fluid properties and pressure gradient interpretations.

*Developed oil and gas reserves* – Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

(i) Through existing wells with existing equipment and operating methods or in which the cost of the required

equipment is relatively minor compared to the cost of a new well; and

(ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

*Undeveloped oil and gas reserves* – Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

(i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.

(ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time.

(iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined in [section 210.4-10 (a) Definitions], or by other evidence using reliable technology establishing reasonable certainty.

The extent to which probable and possible reserves ultimately may be reclassified as proved reserves is dependent upon future drilling, testing, and well performance. The degree of risk to be applied in evaluating probable and possible reserves is influenced by economic and technological factors as well as the time element. No probable or possible reserves have been evaluated for this report.



In this report, values of the proved reserves are expressed in terms of estimated future gross revenue, future net revenue, and present worth. Future gross revenue is that revenue which will accrue to the appraised interests from the production and sale of the estimated gross reserves. Future net revenue is calculated by deducting estimates of operating expenses, capital and abandonment costs, production and other taxes, and profit tax from the future gross revenue. Operating expenses include field operating costs, compression charges, the estimated expenses of direct supervision, and minor general administrative costs. Future profit tax expenses at the field level only are taken into account in the preparation of these estimates. Present worth is defined as future net revenue discounted at a specified discount rate compounded monthly over the expected period of realization. In this report, present worth values are shown using discount rate of 10 percent.

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Estimates of future net revenue and present worth derived from anticipated production and sales profile as of December 31, 2011, of the NOVATEK net proved reserves in the fields evaluated, reported at NOVATEK's represented ownership interest, as of December 31, 2011, are summarized as follows, expressed in thousands of United States dollars (10<sup>3</sup>U.S.\$). Values were estimated in United States dollars (U.S.\$) using an exchange rate of 29.2923 Russian Rubles per U.S.\$1.00.

Subsidiary or Joint Venture Field	NOVATEK Net Present Worth at 10 Percent		
	Proved Developed	Proved Undeveloped	Total Proved
	(10 <sup>3</sup> U.S.\$)	(10 <sup>3</sup> U.S.\$)	(10 <sup>3</sup> U.S.\$)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>			
East Tarkosalinsk	3,660,734	1,326,277	4,987,011
Khancheiskoye	1,099,333	76,412	1,175,745
North Khancheiskoye	(193)	4,410	4,217
North Russkoye	(868)	208,627	207,759
Sterkhaovoye	43,140	19,557	62,697
Urengoi Field (South Area)	0	223,898	223,898
Dobrovolskoye	0	145,140	145,140
<b>ZAO TERNEFTEGAZ</b>			
Termokarstovoye	(1,549)	62,797	61,248
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>			
Urengoi	0	0	0
Yurkharovskoye	7,875,032	1,088,021	8,963,053
WestYurkharovskoye	0	31,919	31,919
<b>OAO YAMAL LNG</b>			
South Tambeykoye	(31,222)	1,506,706	1,475,484
<b>OOOYARGEO</b>			
Yarudeiskoye	(1,596)	132,811	131,215
<b>OOO SeverEnergia</b>			
North Chaselskoye	(64)	46,328	46,264
North Purovskoye	0	0	0
N. Esetinskoye + E. Urengoiskoye	(531)	0	(531)
Samburgskoye	(1,392)	874,018	872,626
Urengoiskoye	(56)	702,860	702,804
Yaro-Yakhinskoye	(535)	509,717	509,182
Yevo-Yakhinskoye	(24)	0	(24)
<b>OAO Sibneftegaz</b>			
Berëgovoye, S. Geologicheskoye	888771	84009	972780
Khadyryakhinskoye	0	16295	16295
Pyreynoye	37153	40481	77634
West Zapolyarnoye	0	0	0
<b>Grand Total</b>	<b>13,566,133</b>	<b>7,100,283</b>	<b>20,666,416</b>

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Revenue values of the proved reserves were developed using methods generally accepted by the petroleum industry. A production forecast of the proved reserves was prepared using the development plan provided by NOVATEK for each field as of December 31, 2011.

Oil, condensate, and gas prices were provided by NOVATEK. The prices used in the evaluation, listed by subsidiary or joint venture, are as follows:

	Export Oil \$U.S./mt	Domestic Oil \$U.S./mt	Domestic Oil Within Oil-Gas/Condensate Mixture \$U.S./mt	Condensate \$U.S./mt	Domestic Sales Gas \$U.S./10 <sup>3</sup> m <sup>3</sup>
OOO NOVATEK-TARKOSALENEFTEGAS	331.66	307.21		380.88	48.79
ZAO TERNEFTEGAZ				380.88	48.79
OOO NOVATEK-YURKHAROVNEFTEGAS				380.88	48.79
OAO YAMAL LNG				517.39	48.79
OOO YARGEО	350.21			350.21	48.79
OAO Sibneftegaz				299.30	46.09
OOO SeverEnergiа		334.22	264.02	299.30	57.32

Unescalated cost data for the proved reserves were provided by NOVATEK. Cost data were held constant through the life of the fields. The capital investment and operating expense forecasts were reviewed in detail and modified in accordance with the production forecast. Abandonment costs were included in the analysis when applicable. The tax provisions were assumed to remain unchanged from legislation in place on December 31, 2011.

Corporate overhead costs have not been considered in the valuation of the proved reserves. For the purposes of this report, all regulatory practices and taxes approved or in place as of December 31, 2011, were maintained.

In our opinion, the information relating to estimated proved reserves, estimated future net revenue from proved reserves, and present worth of estimated future net revenue from proved reserves of oil, condensate, natural gas liquids, and gas contained in this report has been prepared in accordance with Paragraphs 932-235-50-4, 932-235-50-6 through 932-235-50-9, 932-235-50-30, and 932-235-50-31(a), (b) and (e) of the Accounting Standards Update 932-235-50, *Extractive Industries – Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures* (January 2010) of the Financial Accounting Standards Board and Rules 4-10(a) (1)-(32) of Regulation S-X and Rules 302(b), 1201, 1202(a) (1), (2), (3), (4), (8)(i), (ii), and (v)-(x), and 1203(a) of Regulation S-K of the Securities and Exchange Commission;

DEGOLYER AND MACNAUGHTON

provided, however, that (i) certain proved undeveloped reserves are scheduled for development more than 5 years in the future and (ii) certain economically producible quantities of reserves beyond the primary term of the current production licenses have been classified as proved reserves in this report based on NOVATEK's representation that each of the subsidiary enterprises discussed herein has the ability to and intends to extend the applicable current production licenses to the end of the economic life of the associated fields and that NOVATEK believes with reasonable certainty that the inclusion of the reserves and revenue under extended license terms is consistent with SEC regulations.

NOVATEK has represented to us that the Russian Law on Subsoil requires that an operator develop a field according to a development plan that has been submitted to and approved by the appropriate government authority. Once approved, failure to follow the development plan is a violation of the Russian Law on Subsoil and may result in the cancellation of the operator's production license for the field. Since the implementation of the approved development plan, including that portion that may occur more than 5 years in the future, is a requirement for maintaining the production license, we have included in certain of our estimates of SEC proved reserves those quantities associated with development activities that are part of the approved development plan and scheduled more than 5 years in the future. We believe that since they must be developed to prevent the loss of licenses that there is reasonable certainty that the reserves will be developed. NOVATEK has represented to us that the development plans provided to us are in accordance with the approved development plans. We cannot render an opinion regarding the actual possibility that a license will be terminated for failure to follow approved development plans nor an opinion on how many companies have lost their licenses for not following approved development plans.

We are not in a position to offer an opinion on the duration of the subsidiary enterprises' production licenses under the Russian Law on Subsoil, but, in light of the above, believe NOVATEK's view on the probability of license extensions to be reasonable although such view may not be confirmed by the SEC.

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DeGolyer and MacNaughton is a Delaware corporation with offices at 5001 Spring Valley Road Suite 800 East, Dallas, Texas 75244, U.S.A. The firm has been providing petroleum consulting services throughout the world for more than 74 years. The firm's professional engineers, geologists, geophysicists, petrophysicists, and economists are engaged in the independent appraisal of oil and gas properties, evaluation of hydrocarbon and other mineral prospects, basin evaluations, comprehensive field studies, equity studies, and studies of supply and economics related to the energy industry. Except for the provision of professional services on a fee basis, DeGolyer and MacNaughton has no commercial arrangement with any other person or company involved in the interests which are the subject of this report.

The evaluation has been supervised by Mr. Gary L. McKenzie. Mr. McKenzie is a Senior Vice President with DeGolyer and MacNaughton, a Division Manager within the company, a Registered Professional Engineer in the State of Texas, and a member of the Society of Petroleum Engineers. He has 30 years of oil and gas industry experience.

Very truly yours,

*DeGolyer and MacNaughton*

DeGOLYER and MacNAUGHTON  
Texas Registered Engineering Firm F-716

Attachment



*Gary L. McKenzie, P.E.*

Gary L. McKenzie, P.E.  
Senior Vice President  
DeGolyer and MacNaughton



**ATTACHMENT  
FIELDS EVALUATED  
as of  
DECEMBER 31, 2011  
for  
OAO NOVATEK  
in  
WESTERN SIBERIA, RUSSIA**

Field	License	Subsidiary	Novatek's Ownership Interest (%)
East Tarkosalinsk	East Tarkosalinsky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Khancheiskoye	Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Khancheiskoye	Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Khancheiskoye	North Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Russkoye	North Russky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Sterkhovoye	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Urengoi	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Dobrovolskoye	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Termokarstovoye	Termokarstovy	ZAO TERNEFTEGAZ	51.0
Urengoi	West Urengoi	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
Yurkharovskoye	Yurkharovsky	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
West Yurkharovskoye	West Yurkharovsky	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
West Yurkharovskoye	Yurkharovskoye	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
South Tambeykoye	South Tambeysky	OAO YAMAL LNG	80.0
Yarudeiskoye	Yarudeisky	OOO YARGEO	51.0
Beregovoye	Beregovoy	OAO Sibneftegaz	51.0
Khadyryakhinskoye	Khadyryakhinsky	OAO Sibneftegaz	51.0
Pyreynoye	Pyreyny	OAO Sibneftegaz	51.0
South Geologicheskoye	Beregovoy	OAO Sibneftegaz	51.0
West Zapolyarnoye	West Zapolyarny	OAO Sibneftegaz	51.0
North Chaselskoye	North Chaselsky	OOO SeverEnergia	25.5
North Purovskoye	Samburgsky	OOO SeverEnergia	25.5
North Esetinskoye + East Urengoiskoye	Samburgsky	OOO SeverEnergia	25.5
North Esetinskoye + East Urengoiskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5
Samburgskoye	Samburgsky	OOO SeverEnergia	25.5
Urengoiskoye	Samburgsky	OOO SeverEnergia	25.5
Urengoiskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5
Yaro-Yakhinskoye	Yaro-Yakhinsky	OOO SeverEnergia	25.5
Yevo-Yakhinskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5

These data accompany the report of DeGolyer and MacNaughton and are subject to its specific conditions.

**DEGOLYER AND MACNAUGHTON**  
5001 SPRING VALLEY ROAD  
SUITE 800 EAST  
DALLAS, TEXAS 75244

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DEGOLYER AND MACNAUGHTON

5001 SPRING VALLEY ROAD

SUITE 800 EAST

DALLAS, TEXAS 75244

November 26, 2012

OAO Novatek  
Ul. Udaltsova, d. 2  
119415, Moscow  
Russia

Re: Estimates of Reserves and Values, as of December 31, 2011, PRMS Case

Gentlemen:

At the request of OAO NOVATEK (NOVATEK), we have prepared estimates, as of December 31, 2011, of the extent and value of the proved and proved-plus-probable natural gas, condensate, and crude oil reserves of certain fields in Russia owned by NOVATEK through its subsidiaries, which hold the licenses for these fields, and through certain joint venture interests. The fields evaluated are located in western Siberia, Russia, and are listed in the attached table.

The proved and probable reserves presented in this report have been prepared in accordance with the Petroleum Resources Management System (PRMS) approved in March 2007 by the Society of Petroleum Engineers, the World Petroleum Council, the American Association of Petroleum Geologists, and the Society of Petroleum Evaluation Engineers. These reserves definitions are discussed in detail in this letter report.

NOVATEK has represented that the Russian Law on Subsoil provides for the extension of production licenses at the request of the license holder if there exists economic reserves upon the expiration of the primary term, provided the license holder is in material compliance with the terms of the existing license. We understand that the principal requirements for license extension are that the license holder complies with the material terms of the license and that mineral extraction has not been completed. As in the past, NOVATEK is required to submit to the



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appropriate government agency for approval, prior to production, individual field development plans based on the economic life of the field and not based on the term of the associated license. NOVATEK has represented that upon completion of the primary term of its current licenses they intend to continue to extend these licenses until the end of the economic life of the associated fields, and that they intend to proceed accordingly with development and operations of these fields. Based on these representations we have included as proved reserves those volumes that are estimated to be economically producible from the fields evaluated after the expiration of the primary term of their licenses.

Reserves estimated in this report are expressed as gross reserves and reserves owned by NOVATEK (NOVATEK net reserves). Gross reserves are defined as the total estimated petroleum to be produced after December 31, 2011. NOVATEK net reserves are that portion of the total estimated petroleum to be produced after December 31, 2011, attributable to NOVATEK after deducting interest owned by others. NOVATEK's interests in each subsidiary, joint venture, and field are listed in the attached table.

Estimates of gas, condensate, and oil reserves and future net revenue should be regarded only as estimates that may change as further production history and additional information become available. Not only are such reserves and revenue estimates based on that information which is currently available, but such estimates are also subject to the uncertainties inherent in the application of judgmental factors in interpreting such information.

Information used in the preparation of this report was obtained from NOVATEK. In the preparation of this report we have relied, without independent verification, upon information furnished by NOVATEK with respect to ownership, production, current costs of operation and development, current prices for production, agreements relating to current and future operations and sale of production, and various other information and data that were accepted as represented. Field examinations have been conducted in the East Tarkosalinsk, Khancheiskoye, and Yurkharovskoye fields.

The report was signed November 20, 2012; therefore, certain events that may have occurred before the preparation of this report but after the "as-of" date of December 31, 2011, which might have affected the reserves, prices, costs, and values used in the estimates presented herein, were not taken into account.

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Sales gas is defined as the deliverable quantity of gas available for sales after deduction for various losses and fuel usage. In addition, sales-gas quantities shown herein include ethane quantities that are liberated from the field condensate stream during processing and reintroduced into the gas stream for processing and sales. Gas quantities estimated herein are expressed at a temperature base of 20 °C and a pressure base of 1 atmosphere.

Condensate reserves estimated include both stable condensate and what is referred to in Russia as “shflu” or wide-range light hydrocarbons (WRLH). These WRLH consist of unstable condensate, propane, and butanes. After field condensate removal by normal separation, additional liquids are recovered as WRLH through additional separation at reduced temperatures. Gas recovered during the de-ethanization process is reintroduced into the sales gas stream. Oil reserves estimated are recovered by normal separation in the field. Estimates of condensate and oil reserves are expressed in thousands of barrels ( $10^3$ bbl) and thousands of metric tons ( $10^3$ mt). In these estimates, 1 barrel equals 42 United States gallons.

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The estimated NOVATEK net proved and probable sales gas reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in millions of cubic feet (10<sup>6</sup>ft<sup>3</sup>) and millions of cubic meters (10<sup>6</sup>m<sup>3</sup>), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Sales Gas Reserves				
	English Units				
	Proved Developed (10 <sup>6</sup> ft <sup>3</sup> )	Proved Undeveloped (10 <sup>6</sup> ft <sup>3</sup> )	Total Proved (10 <sup>6</sup> ft <sup>3</sup> )	Probable (10 <sup>6</sup> ft <sup>3</sup> )	Proved Plus Probable (10 <sup>6</sup> ft <sup>3</sup> )
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>					
East Tarkosalinsk	6,851,243	696,862	7,548,105	614,376	8,162,481
Khancheiskoye	980,441	210,229	1,190,670	783,279	1,973,949
North Khancheiskoye	0	150,264	150,264	86,238	236,502
North Russkoye	0	1,590,835	1,590,835	474,560	2,065,395
Sterkhaovoye	22,990	25,815	48,805	7,910	56,715
Urengoi Field (South Area)	0	744,363	744,363	140,481	884,844
Dobrovolskoye	0	175,973	175,973	120,988	296,961
<b>ZAO TERNEFTEGAZ</b>					
Termokarstovoye	0	443,922	443,922	144,012	587,934
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>					
Urengoi	0	0	0	39,588	39,588
Yurkharovskoye	12,908,183	2,827,328	15,735,511	6,428,188	22,163,699
WestYurkharovskoye	0	55,868	55,868	196,985	252,853
<b>AO YAMAL LNG</b>					
South Tambeyskoye	0	19,364,164	19,364,164	5,469,140	24,833,304
<b>OOOYARGEO</b>					
Yarudeiskoye	0	176,791	176,791	51,312	228,103
<b>OOO SeverEnergiya</b>					
North Chaselskoye	0	502,961	502,961	377,212	880,173
North Purovskoye	0	0	0	0	0
N. Esetinskoye + E. Urengoiszkoye	0	0	0	848,366	848,366
Samburgskoye	0	1,021,843	1,021,843	424,993	1,446,836
Urengoiszkoye	0	1,280,266	1,280,266	1,012,657	2,292,923
Yaro-Yakhinskoye	0	1,059,656	1,059,656	217,477	1,277,133
Yevo-Yakhinskoye	0	0	0	51,825	51,825
<b>AO Sibneftegaz</b>					
Beregovoye, S. Geologicheskoye	2,269,069	1,698,659	3,967,728	346,287	4,314,015
Khadyryakhinskoye	0	595,510	595,510	355,509	951,019
Pyreynoye	78,839	246,925	325,764	215,638	541,402
West Zapolyarnoye	0	0	0	64,287	64,287
<b>Grand Total</b>	<b>23,110,765</b>	<b>32,868,234</b>	<b>55,978,999</b>	<b>18,471,308</b>	<b>74,450,307</b>

Note: Probable reserves have not been adjusted for risk to make them comparable to proved reserves.

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Subsidiary or Joint Venture Field	NOVATEK Net Sales Gas Reserves				
	Metric Units				
	Proved Developed (10 <sup>6</sup> m <sup>3</sup> )	Proved Undeveloped (10 <sup>6</sup> m <sup>3</sup> )	Total Proved (10 <sup>6</sup> m <sup>3</sup> )	Probable (10 <sup>6</sup> m <sup>3</sup> )	Proved Plus Probable (10 <sup>6</sup> m <sup>3</sup> )
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>					
East Tarkosalinsk	194,006	19,732	213,738	17,397	231,135
Khancheiskoye	27,763	5,953	33,716	22,180	55,896
North Khancheiskoye	0	4,255	4,255	2,442	6,697
North Russkoye	0	45,047	45,047	13,438	58,485
Sterkhaovoye	651	731	1,382	224	1,606
Urengoi Field (South Area)	0	21,078	21,078	3,978	25,056
Dobrovolskoye	0	4,983	4,983	3,426	8,409
<b>ZAO TERNEFTEGAZ</b>					
Termokarstovoye	0	12,571	12,571	4,078	16,649
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>					
Urengoi	0	0	0	1,121	1,121
Yurkharovskoye	365,519	80,061	445,580	182,026	627,606
West Yurkharovskoye	0	1,582	1,582	5,578	7,160
<b>OAO YAMAL LNG</b>					
South Tambeyskoye	0	548,332	548,332	154,869	703,201
<b>OOO YARGEO</b>					
Yarudeiskoye	0	5,006	5,006	1,453	6,459
<b>OOO SeverEnergia</b>					
North Chaselskoye	0	14,242	14,242	10,681	24,923
North Purovskoye	0	0	0	0	0
N. Esetinskoye + E. Urengoiskoye	0	0	0	24,023	24,023
Samburgskoye	0	28,935	28,935	12,034	40,969
Urengoiskoye	0	36,253	36,253	28,675	64,928
Yaro-Yakhinskoye	0	30,006	30,006	6,158	36,164
Yevo-Yakhinskoye	0	0	0	1,468	1,468
<b>OAO Sibneftegaz</b>					
Beregovoye, S. Geologicheskoye	64,253	48,101	112,354	9,806	122,160
Khadyryakhinskoye	0	16,863	16,863	10,067	26,930
Pyreynoye	2,232	6,992	9,224	6,106	15,330
West Zapolyarnoye	0	0	0	1,820	1,820
<b>Grand Total</b>	<b>654,424</b>	<b>930,723</b>	<b>1,585,147</b>	<b>523,048</b>	<b>2,108,195</b>

Note: Probable reserves have not been adjusted for risk to make them comparable to proved reserves.

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The estimated NOVATEK net proved and probable total liquid (oil and condensate) reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in thousands of barrels (10<sup>3</sup>bbl) and thousands of metric tons (10<sup>3</sup>mt), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Total Liquids Reserves				
	English Units				
	Proved Developed (10 <sup>3</sup> bbl)	Proved Undeveloped (10 <sup>3</sup> bbl)	Total Proved (10 <sup>3</sup> bbl)	Probable (10 <sup>3</sup> bbl)	Proved Plus Probable (10 <sup>3</sup> bbl)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>					
East Tarkosalinsk	74,208	143,625	217,833	98,198	316,031
Khancheiskoye	30,229	2,526	32,755	31,853	64,608
North Khancheiskoye	0	0	0	0	0
North Russkoye	0	36,181	36,181	10,518	46,699
Sterkhaovoye	1,443	1,753	3,196	546	3,742
Urengoi Field (South Area)	0	7,142	7,142	8,087	15,229
Dobrovolskoye	0	10,542	10,542	6,587	17,129
<b>ZAO TERNEFTEGAZ</b>					
Termokarstovoye	0	20,194	20,194	16,000	36,194
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>					
Urengoi	0	0	0	1,935	1,935
Yurkharovskoye	176,047	32,186	208,233	94,865	303,098
WestYurkharovskoye	0	2,115	2,115	7,232	9,347
<b>OAO YAMAL LNG</b>					
South Tambeyskoye	0	204,216	204,216	85,701	289,917
<b>OOOYARGEO</b>					
Yarudeiskoye	0	53,032	53,032	105,465	158,497
<b>OOO SeverEnergia</b>					
North Chaselskoye	0	5,319	5,319	21,540	26,859
North Purovskoye	0	0	0	0	0
N. Esetinskoye + E. Urengoisikoye	0	0	0	30,022	30,022
Samburgskoye	0	51,292	51,292	56,195	107,487
Urengoisikoye	0	60,895	60,895	39,735	100,630
Yaro-Yakhinskoye	0	48,465	48,465	28,294	76,759
Yevo-Yakhinskoye	0	0	0	1,545	1,545
<b>OAO Sibneftegaz</b>					
Beregovoye, S. Geologicheskoye	0	8,520	8,520	1,648	1,648
Khadyryakhinskoye	0	0	0	0	0
Pyreynoye	0	0	0	5,696	5,696
West Zapolyarnoye	0	0	0	0	0
<b>Grand Total</b>	<b>281,927</b>	<b>688,003</b>	<b>969,930</b>	<b>651,662</b>	<b>1,621,592</b>

Notes:

1. Total liquids are oil and condensate.
2. Probable reserves have not been adjusted for risk to make them comparable to proved reserves.

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Subsidiary or Joint Venture Field	NOVATEK Net Total Liquids Reserves				
	Metric Units				
	Proved Developed (10 <sup>3</sup> mt)	Proved Undeveloped (10 <sup>3</sup> mt)	Total Proved (10 <sup>3</sup> mt)	Probable (10 <sup>3</sup> mt)	Proved Plus Probable (10 <sup>3</sup> mt)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>					
East Tarkosalinsk	9,171	18,745	27,916	12,736	40,652
Khancheiskoye	3,715	320	4,035	4,072	8,107
North Khancheiskoye	0	0	0	0	0
North Russkoye	0	4,510	4,510	1,311	5,821
Sterkhaovoye	177	215	392	67	459
Urengoi Field (South Area)	0	876	876	992	1,868
Dobrovolskoye	0	1,293	1,293	808	2,101
<b>ZAO TERNEFTEGAZ</b>					
Termokarstovoye	0	2,360	2,360	1,869	4,229
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>					
Urengoi	0	0	0	240	240
Yurkharovskoye	20,473	3,743	24,216	11,032	35,248
WestYurkharovskoye	0	246	246	841	1,087
<b>OOO YAMAL LNG</b>					
South Tambayskoye	0	23,749	23,749	9,966	33,715
<b>OOO YARGEO</b>					
Yarudeiskoye	0	6,858	6,858	13,663	20,521
<b>OOO SeverEnergia</b>					
North Chaselskoye	0	658	658	2,951	3,609
North Purovskoye	0	0	0	0	0
N. Esetinskoye + E. Urengoiskoye	0	0	0	3,653	3,653
Samburgskoye	0	6,274	6,274	7,184	13,458
Urengoiskoye	0	7,409	7,409	4,864	12,273
Yaro-Yakhinskoye	0	6,108	6,108	3,767	9,875
Yevo-Yakhinskoye	0	0	0	188	188
<b>OOO Sibneftegaz</b>					
Beregovoye, S. Geologicheskoye	0	1,028	1,028	199	1,227
Khadyryakhinskoye	0	0	0	0	0
Pyreynoye	0	0	0	690	690
West Zapolyarnoye	0	0	0	0	0
<b>Grand Total</b>	<b>33,536</b>	<b>84,392</b>	<b>117,928</b>	<b>81,093</b>	<b>199,021</b>

Notes:

1. Total liquids are oil and condensate.
2. Probable reserves have not been adjusted for risk to make them comparable to proved reserves.

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The estimated total NOVATEK net proved and probable reserves, as of December 31, 2011, in the fields evaluated, reported at NOVATEK's represented ownership interest and expressed in thousands of barrels of oil equivalent (10<sup>3</sup>boe), are summarized as follows:

Subsidiary or Joint Venture Field	NOVATEK Net Barrels of Oil Equivalent				
	Proved	Proved	Total	Probable	Proved Plus
	Developed (10 <sup>3</sup> boe)	Undeveloped (10 <sup>3</sup> boe)	Proved (10 <sup>3</sup> boe)	Probable (10 <sup>3</sup> boe)	Probable (10 <sup>3</sup> boe)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>					
East Tarkosalinsk	1,343,007	272,672	1,615,679	211,974	1,827,653
Khancheiskoye	211,799	41,459	253,258	176,910	430,168
North Khancheiskoye	0	27,828	27,828	15,971	43,799
North Russkoye	0	330,788	330,788	98,403	429,191
Sterkhaovoye	5,701	6,534	12,235	2,011	14,246
Urengoi Field (South Area)	0	144,992	144,992	34,103	179,095
Dobrovolskoye	0	43,131	43,131	28,993	72,124
<b>ZAO TERNEFTEGAZ</b>					
Termokarstovoye	0	102,408	102,408	42,670	145,078
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>					
Urengoi	0	0	0	9,266	9,266
Yurkharovskoye	2,566,541	555,785	3,122,326	1,285,315	4,407,641
WestYurkharovskoye	0	12,461	12,461	43,712	56,173
<b>AO YAMAL LNG</b>					
South Tambeyskoye	0	3,790,307	3,790,307	1,098,544	4,888,851
<b>OOOYARGEO</b>					
Yarudeiskoye	0	85,771	85,771	114,968	200,739
<b>OOO SeverEnergia</b>					
North Chaselskoye	0	98,462	98,462	91,394	189,856
North Purovskoye	0	0	0	0	0
N. Esetinskoye + E. Urengoiszkoye	0	0	0	187,132	187,132
Samburgskoye	0	240,527	240,527	134,897	375,424
Urengoiszkoye	0	297,990	297,990	227,270	525,260
Yaro-Yakhinskoye	0	244,704	244,704	68,567	313,271
Yevo-Yakhinskoye	0	0	0	11,146	11,146
<b>AO Sibneftegaz</b>					
Beregovoye, S. Geologicheskoye	420,215	323,101	743,316	65,779	809,095
Khadyryakhinskoye	0	110,284	110,284	65,838	176,122
Pyreynoye	14,597	45,728	60,325	45,629	105,954
West Zapolyarnoye	0	0	0	11,903	11,903
<b>Grand Total</b>	<b>4,561,860</b>	<b>6,774,932</b>	<b>11,336,792</b>	<b>4,072,395</b>	<b>15,409,187</b>

Notes:

1. In converting gas to oil equivalent, 1,000 cubic meters of gas equals 6.54 barrels of oil equivalent.
2. Probable reserves have not been adjusted for risk to make them comparable to proved reserves.

Reserves are those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions. Reserves must further satisfy four criteria: they must be discovered, recoverable, commercial, and remaining (as of the evaluation date) based on the development project(s) applied. Reserves are further categorized in accordance with the level of certainty associated with the estimates and may be sub-classified based on project maturity and/or characterized by development and production status.

*Proved Reserves* – Proved Reserves are those quantities of petroleum which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under defined economic conditions, operating methods, and government regulations. If deterministic methods are used, the term reasonable certainty is intended to express a high degree of confidence that the quantities will be recovered. If probabilistic methods are used, there should be at least a 90-percent probability that the quantities actually recovered will equal or exceed the estimate.

*Unproved Reserves* – Unproved Reserves are based on geoscience and/or engineering data similar to that used in estimates of Proved Reserves, but technical or other uncertainties preclude such reserves being classified as Proved. Unproved Reserves may be further categorized as Probable Reserves and Possible Reserves.

*Probable Reserves* – Probable Reserves are those additional Reserves which analysis of geoscience and engineering data indicate are less likely to be recovered than Proved Reserves but more certain to be recovered than Possible Reserves. It is equally likely that actual remaining quantities recovered will be greater than or less than the sum of the estimated Proved plus Probable Reserves (2P). In this context, when probabilistic methods are used, there should be at least a 50-percent probability that the actual quantities recovered will equal or exceed the 2P estimate.

*Reserves Status Categories* – Reserves status categories define the development and producing status of wells and reservoirs.



*Developed Reserves* – Developed Reserves are expected quantities to be recovered from existing wells and facilities. Reserves are considered developed only after the necessary equipment has been installed, or when the costs to do so are relatively minor compared to the cost of a well. Where required facilities become unavailable, it may be necessary to reclassify Developed Reserves as Undeveloped. Developed Reserves may be further sub-classified as Producing or Non-Producing.

*Developed Producing Reserves* – Developed Producing Reserves are expected to be recovered from completion intervals that are open and producing at the time of the estimate. Improved recovery reserves are considered producing only after the improved recovery project is in operation.

*Developed Non-Producing Reserves* – Developed Non-Producing Reserves include shut-in and behind-pipe Reserves. Shut-in Reserves are expected to be recovered from (1) completion intervals which are open at the time of the estimate but which have not yet started producing, (2) wells which were shut-in for market conditions or pipeline connections, or (3) wells not capable of production for mechanical reasons. Behind-pipe Reserves are expected to be recovered from zones in existing wells which will require additional completion work or future recompletion prior to the start of production. In all cases, production can be initiated or restored with relatively low expenditure compared to the cost of drilling a new well.

*Undeveloped Reserves* – Undeveloped Reserves are quantities expected to be recovered through future investments: (1) from new wells on undrilled acreage in known accumulations, (2) from deepening existing wells to a different (but known) reservoir, (3) from infill wells that will increase recovery, or (4) where a relatively large expenditure (e.g. when compared to the cost of drilling a new well) is required to (a) recomplete an existing well or (b) install production or transportation facilities for primary or improved recovery projects.

The extent to which probable reserves ultimately may be reclassified as proved reserves is dependent upon future drilling, testing, and well performance. The degree of risk to be applied in evaluating probable reserves is influenced by

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economic and technological factors as well as the time element. Probable reserves in this report have not been adjusted in consideration of these additional risks to make them comparable to proved reserves.

In this report, values of the proved and proved-plus-probable reserves are expressed in terms of estimated future net revenue and present worth. Future gross revenue is that revenue which will accrue to the appraised interests from the production and sale of the estimated gross reserves. Future net revenue is calculated by deducting estimates of operating expenses, capital and abandonment costs, and production and other taxes, and profit tax from the future gross revenue. Operating expenses include field operating costs, compression charges, the estimated expenses of direct supervision, and minor general administrative costs. Future profit tax expenses at the field level only are taken into account in the preparation of these estimates. Present worth is defined as future net revenue discounted at a specified discount rate compounded monthly over the expected period of realization. In this report, present worth values are shown using discount rate of 10 percent.

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Estimates of future net revenue and present worth derived from anticipated production and sales profile as of December 31, 2011, of the NOVATEK net proved and proved-plus-probable reserves in the fields evaluated, reported at NOVATEK's represented ownership interest, as of December 31, 2011, are summarized as follows, expressed in thousands of United States dollars (10<sup>3</sup>U.S.\$). Values were estimated in United States dollars (U.S.\$) using an exchange rate of 29.2923 Russian Rubles per U.S.\$1.00.

Subsidiary or Joint Venture Field	NOVATEK Net Present Worth at 10 Percent			
	Proved Developed (10 <sup>3</sup> U.S.\$)	Proved Undeveloped (10 <sup>3</sup> U.S.\$)	Total Proved (10 <sup>3</sup> U.S.\$)	Proved plus Probable (10 <sup>3</sup> U.S.\$)
<b>OOO NOVATEK-TARKOSALENEFTEGAS</b>				
East Tarkosalinsk	3,660,734	1,736,967	5,397,701	6,216,522
Khancheiskoye	1,099,333	89,376	1,188,709	1,632,343
North Khancheiskoye	(193)	7,965	7,772	32,170
North Russkoye	(868)	594,235	593,367	818,784
Sterkhaovoye	43,140	19,557	62,697	68,275
Urengoi Field (South Area)	0	223,898	223,898	332,576
Dobrovolskoye	0	145,140	145,140	164,364
<b>ZAO TERNEFTEGAZ</b>				
Termokarstovoye	(1,549)	62,797	61,248	119,761
<b>OOO NOVATEK-YURKHAROVNEFTEGAS</b>				
Urengoi	0	0	0	32,292
Yurkharovskoye	7,875,032	1,088,021	8,963,053	11,555,959
WestYurkharovskoye	0	31,919	31,919	140,417
<b>OAD YAMAL LNG</b>				
South Tambeyskoye	(31,222)	2,030,207	1,998,985	2,503,211
<b>OOOYARGEO</b>				
Yarudeiskoye	(1,596)	642,181	640,585	1,387,069
<b>OOO SeverEnergia</b>				
North Chaselskoye	(64)	51,400	51,336	207,671
North Purovskoye	0	0	0	0
N. Esetinskoye + E. Urengoisikoye	(531)	0	(531)	263,011
Samburgskoye	(1,392)	850,705	849,313	1,117,064
Urengoisikoye	(56)	926,473	926,417	1,238,306
Yaro-Yakhinskoye	(535)	695,473	694,938	909,028
Yevo-Yakhinskoye	(24)	0	(24)	3,294
<b>OAD Sibneftegaz</b>				
Beregovoye, S. Geologicheskoye	888,771	171,029	1,059,800	1,070,045
Khadyryakhinskoye	0	14,023	14,023	27,443
Pyreynoye	37,153	43,442	80,595	89,466
West Zapolyarnoye	0	0	0	6,526
<b>Grand Total</b>	<b>13,566,133</b>	<b>9,424,808</b>	<b>22,990,941</b>	<b>29,935,597</b>

Note: Values for probable reserves have not been adjusted for risk to make them comparable to values for proved reserves.

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Values for proved and proved-plus-probable reserves are based on projections of estimated future production and revenue prepared for these properties with no risk adjustment applied to the probable reserves. Probable reserves involve substantially higher risks than proved reserves. Revenue values for proved-plus-probable reserves have not been adjusted to account for such risks; this adjustment would be necessary in order to make proved-plus-probable reserves values comparable with values for proved reserves.

Revenue values of the proved and proved-plus-probable reserves were developed using methods generally accepted by the petroleum industry. A production forecast of the proved and proved-plus-probable reserves was prepared using the development plan provided by NOVATEK for each field as of December 31, 2011.

Oil, condensate, and gas prices were provided by NOVATEK. The prices used in the evaluation, listed by subsidiary or joint venture, are as follows:

	Export Oil (\$U.S./mt)	Domestic Oil (\$U.S./mt)	Domestic Oil within Oil-Gas/Condensate Mixture (\$U.S./mt)	Condensate (\$U.S./mt)	Domestic Sales Gas (\$U.S./10 <sup>3</sup> m <sup>3</sup> )
OOO NOVATEK-TARKOSALENEFTEGAS	331.66	307.21		380.88	48.79
ZAO TERNEFTEGAZ				380.88	48.79
OOO NOVATEK-YURKHAROVNEFTEGAS				380.88	48.79
OAO YAMAL LNG				517.39	48.79
OOO YARGEO	350.21			350.21	48.79
OAO Sibneftegaz				299.30	46.09
OOO SeverEnergia		334.22	264.02	299.30	57.32

Unescalated cost data for the proved and proved-plus-probable reserves were provided by NOVATEK. Cost data were held constant through the life of the fields. The capital investment and operating expense forecasts were reviewed in detail and modified in accordance with the production forecast. Abandonment costs were included in the analysis when applicable. The tax provisions were assumed to remain unchanged from legislation in place on December 31, 2011.

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Corporate overhead costs have not been considered in the valuation of the proved and proved-plus-probable reserves. For the purposes of this report, all regulatory practices and taxes approved or in place as of December 31, 2011, were maintained.

DeGolyer and MacNaughton is a Delaware corporation with offices at 5001 Spring Valley Road, Suite 800 East, Dallas, Texas 75244, U.S.A. The firm has been providing petroleum consulting services throughout the world for more than 75 years. The firm's professional engineers, geologists, geophysicists, petrophysicists, and economists are engaged in the independent appraisal of oil and gas properties, evaluation of hydrocarbon and other mineral prospects, basin evaluations, comprehensive field studies, equity studies, and studies of supply and economics related to the energy industry. Except for the provision of professional services on a fee basis, DeGolyer and MacNaughton has no commercial arrangement with any other person or company involved in the interests which are the subject of this report.

The evaluation has been supervised by Mr. Gary L. McKenzie. Mr. McKenzie is a Senior Vice President with DeGolyer and MacNaughton, a Division Manager within the company, a Registered Professional Engineer in the State of Texas, and a member of the Society of Petroleum Engineers. He has 30 years of oil and gas industry experience.

Very truly yours,

*DeGolyer and MacNaughton*

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Texas Registered Engineering Firm F-716

Attachment



*Gary L. McKenzie, P.E.*  
 Gary L. McKenzie, P.E.  
 Senior Vice President  
 DeGolyer and MacNaughton



**ATTACHMENT  
FIELDS EVALUATED  
as of  
DECEMBER 31, 2011  
for  
OAO NOVATEK  
in  
WESTERN SIBERIA, RUSSIA**

Field	License	Subsidiary	Novatek's Ownership Interest (%)
East Tarkosalinsk	East Tarkosalinsky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Khancheiskoye	Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Khancheiskoye	Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Khancheiskoye	North Khancheisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
North Russkoye	North Russky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Sterkhovoye	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Urengoi	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Dobrovolskoye	Olimpisky	OOO NOVATEK-TARKOSALENEFTEGAS	100.0
Termokarstovoye	Termokarstovy	ZAO TERNEFTEGAZ	51.0
Urengoi	West Urengoi	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
Yurkharovskoye	Yurkharovsky	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
West Yurkharovskoye	West Yurkharovsky	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
West Yurkharovskoye	Yurkharovskoye	OOO NOVATEK-YURKHAROVNEFTEGAS	100.0
South Tambeyskoye	South Tambeysky	OAO YAMAL LNG	80.0
Yarudeiskoye	Yarudeisky	OOO YARGEO	51.0
Beregovoye	Beregovoy	OAO Sibneftegaz	51.0
Khadyryakhinskoye	Khadyryakhinsky	OAO Sibneftegaz	51.0
Pyreynoye	Pyreyny	OAO Sibneftegaz	51.0
South Geologicheskoye	Beregovoy	OAO Sibneftegaz	51.0
West Zapolyarnoye	West Zapolyarny	OAO Sibneftegaz	51.0
North Chaselskoye	North Chaselsky	OOO SeverEnergia	25.5
North Purovskoye	Samburgsky	OOO SeverEnergia	25.5
North Esetinskoye + East Urengoiskoye	Samburgsky	OOO SeverEnergia	25.5
North Esetinskoye + East Urengoiskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5
Samburgskoye	Samburgsky	OOO SeverEnergia	25.5
Urengoiskoye	Samburgsky	OOO SeverEnergia	25.5
Urengoiskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5
Yaro-Yakhinskoye	Yaro-Yakhinsky	OOO SeverEnergia	25.5
Yevo-Yakhinskoye	Yevo-Yakhinsky	OOO SeverEnergia	25.5

These data accompany the report of DeGolyer and MacNaughton and are subject to its specific conditions.

**BORROWER**

**OAQ NOVATEK**  
 22 "A" Pobedy Street  
 Tarko-Sale, Purovsky Region  
 Yamal-Nenets Autonomous Region  
 629850  
 Russian Federation

**ISSUER**

**Novatek Finance Limited**  
 12 Merrion Square  
 Dublin 2  
 Ireland

**JOINT LEAD MANAGERS**

**Barclays Bank PLC**  
 5 The North Colonnade  
 Canary Wharf, London E14 4BB  
 United Kingdom

**GPB-Financial Services Ltd.**  
 Interlink Hermes Plaza  
 1<sup>st</sup> Floor 46 Ayios Athanasios Av.  
 4102 Limassol, Cyprus

**Goldman Sachs International**  
 Peterborough Court  
 133 Fleet Street  
 London, EC4A 2BB  
 United Kingdom

**SIB (Cyprus) Limited**  
 57 Digeni Akrita Avenue  
 Zachariades Building  
 Office 301 CY-1070 Nicosia  
 Cyprus

**LEGAL ADVISERS TO THE ISSUER AND THE BORROWER**

*as to English law*  
**Cleary Gottlieb Steen & Hamilton LLP**  
 City Place House  
 55 Basinghall Street  
 London EC2V 5EH  
 United Kingdom

*as to Russian and U.S. law*  
**Cleary Gottlieb Steen & Hamilton LLC**  
 Paveletskaya Square 2/3  
 115054 Moscow  
 Russian Federation

**LEGAL ADVISERS TO THE JOINT LEAD MANAGERS AND TRUSTEE**

*as to English and U.S. law*  
**Linklaters LLP**  
 One Silk Street  
 London EC2Y 8HQ  
 United Kingdom

*as to Russian law*  
**Linklaters CIS**  
 Paveletskaya Square 2/2  
 115054 Moscow  
 Russian Federation

**LEGAL ADVISERS TO THE ISSUER**

*As to Irish law*  
**Arthur Cox**  
 Earlsfort Centre  
 Earlsfort Terrace  
 Dublin 2  
 Ireland

**AUDITORS TO THE BORROWER**

**ZAO PricewaterhouseCoopers Audit**  
 10 Butyrsky Val  
 125047 Moscow  
 Russian Federation

**GAS AND OIL CONSULTANTS**

**DeGolyer and MacNaughton**  
 5001 Spring Valley Road  
 Suite 800  
 East Dallas, Texas 75244  
 United States

**TAX ADVISER TO THE BORROWER**

**ZAO KPMG**  
 Naberezhnaya Tower Complex, Block C  
 10 Presnenskaya Naberezhnaya  
 123317 Moscow  
 Russian Federation

**TRUSTEE**

**Citicorp Trustee Company Limited**  
 Citigroup Centre  
 Canada Square  
 Canary Wharf  
 London E14 5LB

**PRINCIPAL PAYING AGENT AND TRANSFER AGENT**

**Citibank, N.A, London Branch**  
 Citigroup Center  
 Canada Square  
 Canary Wharf  
 London E14 5LB

**REGISTRAR**

**Citigroup Global Markets  
 Deutschland AG**  
 Reuterweg 16  
 Frankfurt am Main 60323  
 Germany

**LISTING AGENT**

**Arthur Cox Listing Services Limited**  
 Earlsfort Centre  
 Earlsfort Terrace  
 Dublin 2  
 Ireland