



524,453 Ordinary Shares

Offering of Ordinary Shares and Global Depositary Receipts at an offer price of \$1,675 per Ordinary Share and \$16.75 per Global Depositary Receipt

We are OAO NOVATEK, the largest independent natural gas producer in the Russian Federation and the second-largest producer of natural gas in Russia after OAO Gazprom.

SWG Growth Fund (Cyprus) Limited, one of our principal shareholders (hereinafter, the Selling Shareholder or SWGI) is offering 524,453 ordinary shares, with a nominal value of 100 roubles per share, of NOVATEK in an international simultaneous offering of shares and global depositary receipts, or GDRs, with 100 GDRs representing one share. The GDRs are being offered in the United States to qualified institutional buyers, or QIBs, as defined in, and in reliance on, Rule 144A under the US Securities Act of 1933 (hereinafter, the Securities Act), and outside the United States and the Russian Federation to certain persons in offshore transactions in reliance on Regulation S under the Securities Act, or Regulation S. The shares are being offered only in the Russian Federation.

The Selling Shareholder has granted the underwriters, as named in "Plan of Distribution," an option, exercisable within 30 days after the announcement of the offer price to purchase up to 52,445 additional shares in the form of GDRs at the offer price, solely to cover over-allotments, if any, in the offering.

Our shares trade primarily on the RTS Stock Exchange. Prices for shares traded on the RTS Stock Exchange may not reflect the underlying value of the GDRs. Prior to the offering described herein, there has been no market for the GDRs.

This document comprises a prospectus relating to NOVATEK prepared in accordance with the Prospectus Rules of the UK Listing Authority made under section 73A of the Financial Services and Markets Act 2000 (hereinafter, the FSMA). Application has been made (i) to the UK Financial Services Authority (hereinafter, the UK Listing Authority) in its capacity as competent authority under the FSMA for a listing of up to 121,452,200 GDRs, consisting of up to 52,445,300 GDRs to be issued on the closing date, up to 5,244,500 additional GDRs to be issued pursuant to the over-allotment option, as described herein, and up to 63,762,400 additional GDRs to be issued from time to time against the deposit of shares with Deutsche Bank Trust Company Americas, as depositary, to be admitted to the official list of the UK Listing Authority (hereinafter, the Official List) and (ii) to the London Stock Exchange plc (hereinafter, the London Stock Exchange) for such GDRs to be admitted to trading on the London Stock Exchange's regulated market for listed securities. Admission to the Official List together with admission to trading on the London Stock Exchange's regulated market for listed securities constitute admission to official listing on a stock exchange. Application has also been made to have the Rule 144A GDRs (as defined herein) designated eligible for trading in The PORTAL Market of the NASDAQ Stock Market, Inc. (hereinafter, PORTAL).

For a discussion of certain risk factors that should be considered in connection with an investment in the shares and GDRs, see "Risk Factors" beginning on page 10. The GDRs are of a specialist nature and should only be bought and traded by investors who are particularly knowledgeable in investment matters.

The shares and GDRs have not been and will not be registered under the Securities Act and may not be offered or sold within the United States, except to QIBs in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A under the Securities Act, or Rule 144A, or outside the United States to certain persons in offshore transactions in reliance on Regulation S. Prospective purchasers are hereby notified that sellers of shares and GDRs may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a discussion of certain restrictions on transfers of the shares and GDRs, see "Description of the Global Depositary Receipts."

The shares and GDRs are offered by the underwriters when, as and if delivered to and accepted by the underwriters and subject to their right to reject orders in whole or in part. The GDRs will be issued in global form and will be evidenced by a Master Rule 144A GDR registered in the name of Cede & Co., as nominee for The Depository Trust Company (hereinafter, DTC), and a Master Regulation S GDR (together with the Master Rule 144A GDR, the Master GDRs) registered in the name of BT Globenet Nominees Limited, as nominee for Deutsche Bank AG London, as common depositary for Euroclear Bank S.A./N.V., as operator of the Euroclear System (hereinafter, Euroclear) and Clearstream Banking, société anonyme (hereinafter, Clearstream). It is expected that delivery of the GDRs will be made against payment therefor in US dollars in same day funds through the facilities of DTC, Euroclear and Clearstream on or about 26 July 2005. See "Settlement and Delivery."

Joint Global Coordinators

Morgan Stanley

UBS Investment Bank

Joint Lead Managers and Joint Bookrunners

Morgan Stanley

UBS Investment Bank

Credit Suisse First Boston

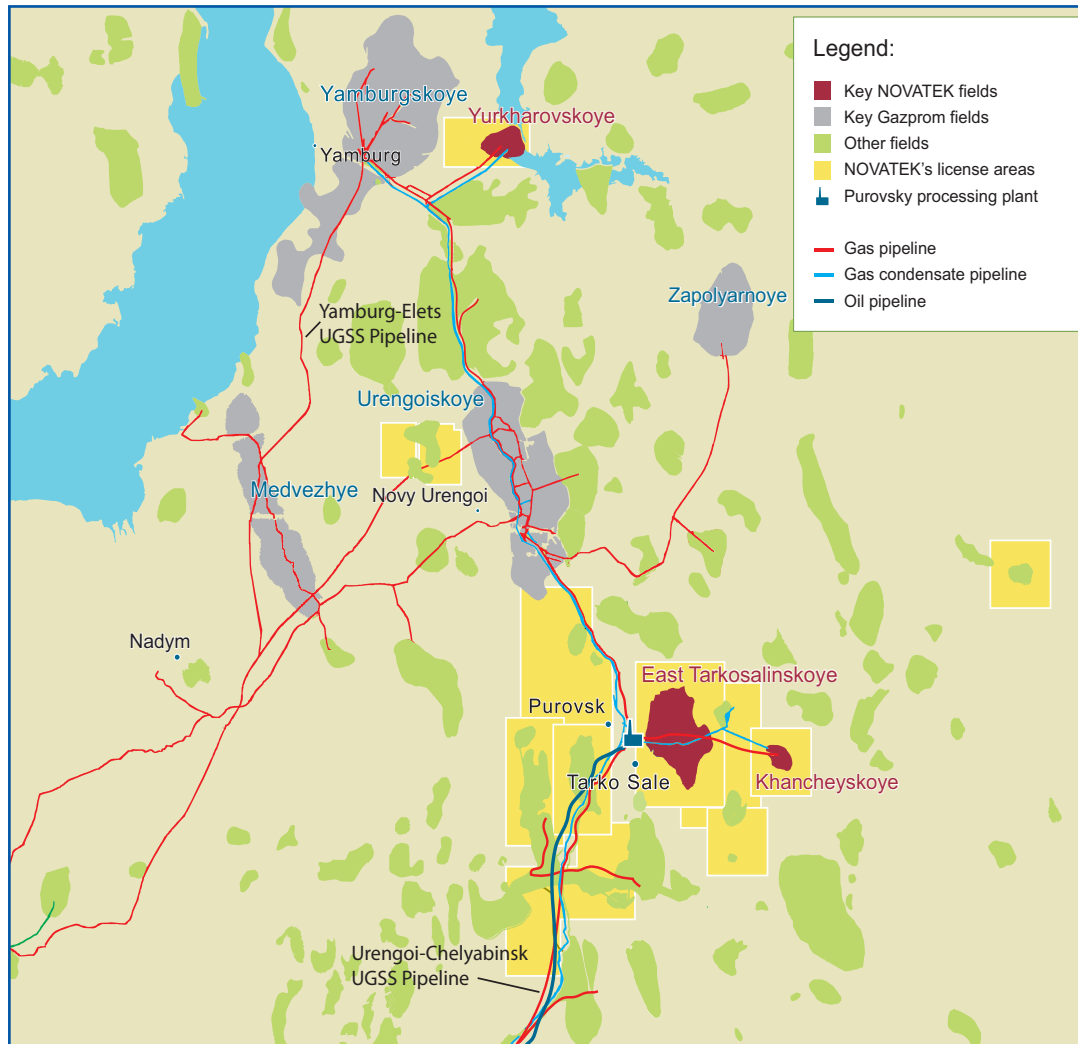
Co-Lead Manager

Troika Dialog

Co-Managers

Alfa Capital Markets

Vnesheconombank



IMPORTANT INFORMATION ABOUT THIS PROSPECTUS

This prospectus is being furnished by NOVATEK and the Selling Shareholder solely for the purpose of enabling a prospective investor to consider the purchase of the shares or the GDRs. No representation or warranty, express or implied, is made by any underwriter or any of their affiliates or advisors as to the accuracy or completeness of any information contained in this prospectus, and nothing contained in this prospectus is, or shall be relied upon as, a promise or representation by any underwriter as to the past or the future. Any reproduction or distribution of this prospectus, in whole or in part, any disclosure of its contents or use of any information herein for any purpose other than considering an investment in the shares or the GDRs is prohibited, except to the extent that such information is otherwise publicly available. Neither the delivery of this prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs since the date hereof or that the information contained herein is correct at any time subsequent to its date. Each prospective investor, by accepting delivery of this prospectus, agrees to the foregoing.

None of the underwriters makes any representation, express or implied, or accepts any responsibility, with respect to the accuracy or completeness of any of the information in this prospectus. This prospectus is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of NOVATEK, the Selling Shareholder or the underwriters that any recipient of this prospectus should subscribe for or purchase the shares or GDRs. Each potential subscriber or purchaser of shares or GDRs should determine for itself the relevance of the information contained in this prospectus and its subscription or purchase of shares or GDRs should be based upon such investigation as it deems necessary.

This prospectus, including the financial information and the appendix included herein, is in compliance with the prospectus rules made by the UK Listing Authority for the purpose of giving information with regard to NOVATEK and its subsidiaries, the shares and GDRs.

We accept responsibility for the information contained in this prospectus, and having taken all reasonable care to ensure that such is the case, the information contained in this prospectus is, to the best of our knowledge, in accordance with the facts and contains no omissions likely to affect its import.

In making an investment decision regarding the shares and GDRs offered hereby, you must rely on your own examination of our company and the terms of the offering, including the merits and risks involved. You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operations and the information set forth in this prospectus may have changed since that date.

You should not consider any information in this prospectus to be investment, legal or tax advice. You should consult your own counsel, accountant and other advisors for legal, tax, business, financial and related advice regarding purchasing the shares and GDRs. We are not, and the underwriters are not, making any representation to any offeree or purchaser of the shares and GDRs regarding the legality of an investment in the shares and GDRs by such offeree or purchaser under appropriate investment or similar laws.

Morgan Stanley & Co. International Limited, UBS Limited and Credit Suisse First Boston (Europe) Limited are acting exclusively for us and the Selling Shareholder and no one else in connection with the offering and will not be responsible to any other person for providing the protections afforded to their respective clients or for providing advice in relation to the offering.

Industry data in “Summary—Strategy” (on page 3), “Business—Strategy” (on page 104) and “Russian Gas Industry” (on pages 97 to 102) attributed to BP therein has been sourced from BP’s *Statistical Review of World Energy* (June 2005) and attributed to Wood Mackenzie therein has been sourced from Wood Mackenzie’s *Time to Step on the Gas* (December 2004). We confirm that this information has been accurately reproduced and that as far as we are aware and able to ascertain from information published by these third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading.

The contents of our websites do not form any part of this prospectus.

We may withdraw the offering at any time, and we and the underwriters reserve the right to reject any offer to purchase the shares and GDRs in whole or in part and to sell to any prospective investor less than the full amount of the shares and GDRs sought by such investor. The underwriters and certain related entities may acquire a portion of the shares and GDRs for their own accounts.

The distribution of this prospectus and the offer and sale of the shares and GDRs may be restricted by law in certain jurisdictions. You must inform yourself about, and observe, any such restrictions. See “Description of the Global Depositary Receipts” and “Plan of Distribution” elsewhere in this prospectus. You must comply with all applicable laws and regulations in force in any jurisdiction in which you purchase, offer or sell the shares and GDRs or possess or distribute this prospectus and must obtain any consent, approval or permission required for your purchase, offer or sale of the shares and GDRs under the laws and regulations in force in any jurisdiction to which you are subject or in which you make such purchases, offers or sales. We are not, and the underwriters are not, making an offer to sell the shares and GDRs or a solicitation of an offer to buy any of the shares and GDRs to any person in any jurisdiction except where such an offer or solicitation is permitted.

THE SHARES AND GDRS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE US SECURITIES AND EXCHANGE COMMISSION (HEREINAFTER, THE SEC), ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER US REGULATORY AUTHORITY, NOR HAVE ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF THE SHARES AND GDRS OR THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

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 OF NEW HAMPSHIRE 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.

NOTICE TO CANADIAN INVESTORS

The Shares and GDRs have not been nor will be qualified by prospectus for sale to the public in Canada under applicable Canadian securities laws and, accordingly, any offer or sale of the GDRs in Canada will be made pursuant to an exemption from the applicable prospectus filing requirements, and otherwise in compliance with applicable Canadian laws. Investors in Canada should refer to “Plan of Distribution—Information for Canadian Investors” and Ontario purchasers in particular should refer to the subsection entitled “Statutory Rights of Action (Ontario Purchasers)”.

NOTICE TO RUSSIAN INVESTORS

The GDRs have not been registered under the law of the Russian Federation “On the Securities Market” dated 22 April 1996, as amended, and are not being offered, sold or delivered directly in the Russian Federation or to any Russian residents.

STABILIZATION

IN CONNECTION WITH THE OFFERING, MORGAN STANLEY & CO. INTERNATIONAL LIMITED (OR ANY AGENT OR OTHER PERSON ACTING FOR MORGAN STANLEY & CO. INTERNATIONAL LIMITED), AS STABILIZING MANAGER, MAY OVER-ALLOT OR EFFECT TRANSACTIONS INTENDED TO ENABLE IT TO SATISFY ANY OVER-ALLOCATIONS OR WHICH STABILIZE, MAINTAIN, SUPPORT OR OTHERWISE AFFECT THE MARKET PRICE OF THE GDRS AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A PERIOD OF

30 DAYS AFTER THE ANNOUNCEMENT OF THE OFFER PRICE. HOWEVER, THERE MAY BE NO OBLIGATION ON MORGAN STANLEY & CO. INTERNATIONAL LIMITED, OR ANY AGENT OF MORGAN STANLEY & CO. INTERNATIONAL LIMITED, TO DO THIS. SUCH TRANSACTIONS MAY BE EFFECTED ON THE LONDON STOCK EXCHANGE AND ANY OTHER SECURITIES MARKET, OVER THE COUNTER MARKET, STOCK EXCHANGE OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, AND MUST BE BROUGHT TO AN END 30 DAYS AFTER THE ANNOUNCEMENT OF THE OFFER PRICE. SAVE AS REQUIRED BY LAW, MORGAN STANLEY & CO. INTERNATIONAL LIMITED DOES NOT INTEND TO DISCLOSE THE EXTENT OF ANY OVER-ALLOTMENTS AND/OR STABILIZATION TRANSACTIONS UNDER THE OFFERING.

AVAILABLE INFORMATION

For so long as any Rule 144A GDRs (or the shares represented thereby) are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, we will, during any period in which we are neither subject to Section 13 or Section 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted Rule 144A GDRs or to any prospective purchaser of such restricted Rule 144A GDRs designated by such holder or beneficial owner upon the request of such holder, beneficial owner or prospective purchaser, the information required to be delivered to such persons pursuant to Rule 144A(d)(4) under the Securities Act.

CAUTIONARY NOTE REGARDING 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 US Securities Exchange Act of 1934 (hereinafter, the Exchange Act). Forward-looking statements appear in various locations, including, without limitation, under the headings “Prospectus Summary,” “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 shareholders and in other communications. Forward-looking statements include statements concerning our plans, expectations, projections, objectives, targets, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, our competitive strengths and weaknesses, plans or goals relating to forecasted production, reserves, financial position and future operations and development, our business strategy and the trends we anticipate in the industries and the political and legal environment in which we operate and other information that is not historical information. They include, for example, statements about our production targets, development and exploratory drilling plans and costs, plans to build additional gas and gas condensate processing and transportation capacity and the cost thereof, future prices for our products and our ability to secure transportation capacity on the UGSS from Gazprom.

Words such as “believe,” “anticipate,” “estimate,” “target,” “potential,” “expect,” “intend,” “predict,” “project,” “could,” “should,” “may,” “will,” “plan,” “aim,” “seek” and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

The forward-looking statements contained in this prospectus are largely based on our expectations, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors, some of which are discussed below. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management’s assumptions about future events may prove to be inaccurate. We caution all readers that the forward-looking statements contained in this prospectus are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or the forward-looking events and circumstances will occur.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, many of which are beyond our control and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. These risks, uncertainties and other factors include, among other things, those listed under “Risk Factors,” as well as those included elsewhere in this prospectus. You should be aware that a number of important factors could cause actual results to

differ materially from the plans, objectives, expectations, estimates (including production targets) and intentions expressed in such forward-looking statements. These factors include:

- changes in the balance of oil and gas supply and demand in Russia and Europe;
- the effects of domestic and international oil and gas price volatility and changes in regulatory conditions, including prices and taxes;
- the effects of competition in the domestic and export oil and gas markets;
- our ability to successfully implement any of our business strategies;
- the impact of our expansion on our revenue potential, cost basis and margins;
- our ability to meet production volume targets in the face of, among other things, restrictions on our access to transportation infrastructure;
- the effects of changes to our capital expenditure projections on the growth of our production;
- potentially lower production levels in the future than currently estimated by our management and/or independent petroleum reservoir engineers;
- inherent uncertainties in interpreting geophysical data;
- commercial negotiations regarding oil and gas sales contracts;
- changes to project schedules and estimated completion dates;
- our ability to service our existing indebtedness;
- our ability to fund our future operations and capital needs through borrowing or otherwise;
- our success in identifying and managing risks to our businesses;
- our ability to obtain necessary regulatory approvals for our businesses;
- the effects of changes in the Russian legal framework or in interpretations by Russian regulators relating to currently held and any newly acquired oil and gas production licenses;
- changes in political, social, legal or economic conditions in Russia and the CIS;
- the effects of, and changes in, the policies of the government of the Russian Federation, including the President and his administration, the Prime Minister, the Cabinet and the Prosecutor General and his office;
- the effects of international political events;
- the effects of technological changes;
- the effects of changes in accounting standards or practices; and
- inflation, interest rate and exchange rate fluctuations.

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. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, 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. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

CURRENCIES AND EXCHANGE RATES

In this prospectus, references to “US dollars,” “USD” or “\$” are to the currency of the United States, references to “roubles” or “RR” are to the currency of the Russian Federation and references to “euro” or “€” are to the currency of the member states of the European Union participating in the European Monetary Union.

The following tables show, for the periods indicated, certain information regarding the exchange rate between the rouble and the US dollar, based on the official exchange rate quoted by the Central Bank of Russia. These rates may differ from the actual rates used in the preparation of our financial statements and other financial information appearing in this prospectus.

Years ended 31 December	Roubles per US dollar			
	High	Low	Average ⁽¹⁾	Period end
2004	29.45	27.75	28.73	27.75
2003	31.89	29.25	30.61	29.45
2002	31.86	30.14	31.39	31.78
2001	30.30	28.16	29.22	30.14
2000	28.87	26.90	28.13	28.16

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

Months	Roubles per US dollar	
	High	Low
June 2005	28.68	28.19
May 2005	28.09	27.78
April 2005	27.94	27.70
March 2005	27.83	27.46
February 2005	28.19	27.75
January 2005	28.16	27.75

The exchange rate between the rouble and the US dollar on 20 July 2005 was 28.73 roubles per \$1.00.

No representation is made that the rouble or US dollar amounts in this prospectus could have been converted into US dollars or roubles, as the case may be, at any particular rate or at all. 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.

PRESENTATION OF RESERVES AND PRODUCTION INFORMATION

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

mcm	thousand cubic meters, as measured under one atmosphere of pressure at 20°C.
mmcm	million cubic meters, as measured under one atmosphere of pressure at 20°C.
bcm	billion cubic meters, as measured under one atmosphere of pressure at 20°C.
tcn	trillion cubic meters, as measured under one atmosphere of pressure at 20°C.
mmcf	million cubic feet, as measured under one atmosphere of pressure at 20°C.
tcf	trillion cubic feet, as measured under one atmosphere of pressure at 20°C.
tonne	metric tonne.
mt	thousand metric tonnes.
mmt	million metric tonnes.
barrel	one stock tank barrel, or 42 US gallons of liquid volume.
mbbls	thousand barrels.
mmbbls	million barrels.
boe	barrels of oil equivalent. For natural gas, we use the conversion factor of one mcm equals 6.54 barrels.
	For gas condensate, we use the conversion factors of one tonne equals:
	<ul style="list-style-type: none"> ● 8.87 barrels for our Yurkharovskoye field; ● 8.12 barrels for our East Tarkosalinskoye field; ● 8.51 barrels for our Khancheynskoye field; and ● 8.50 for all other fields.
	For crude oil, we use the conversion factors of one tonne equals:
	<ul style="list-style-type: none"> ● 7.62 barrels for our Yurkharovskoye, East Tarkosalinskoye and Khancheynskoye fields; and ● 7.30 barrels for all other fields.
	These conversion factors differ due to the differing quality of the hydrocarbons at the fields, including differences in calorific content.
mboe	thousand boe.
mmboe	million boe.

Except as described below, we present the reserves and production of our subsidiaries and equity investments in proportion to our shareholding. In December 2004, we completed the acquisitions of the remaining shareholdings in Tarkosaleneftegas and Khancheyneftegas that we did not own, thus increasing our equity interest to 100% in each of these companies. Prior to the acquisitions, we accounted for our less than majority interests in these companies under the equity method of accounting in our consolidated financial statements. Tarkosaleneftegas and Khancheyneftegas held the licenses to the East Tarkosalinskoye and Khancheynskoye fields, respectively, two of our three core fields. Except in our consolidated financial statements, the unaudited oil and gas disclosures supplemental thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” to provide more relevant comparative information we present reserves and production information for these two fields as if we had owned a 100% equity interest in Tarkosaleneftegas and Khancheyneftegas in all periods prior to the December 2004 acquisitions. In addition, reserves and production information excludes reserves and production of OOO Geoilbent, an equity investment we disposed of in June 2005, OAO Selkupneftegas, an equity investment we agreed to dispose of in June 2005, and OAO Tambeyneftegas, an equity investment we disposed of in July 2005.

All estimates of proved and probable reserves presented herein are from the report of DeGolyer and MacNaughton (D&M), an independent petroleum engineering consulting firm, included in this prospectus in Appendix A. Your attention is directed, in particular, to the basis on which the report was prepared, the representations made by us to D&M in the preparation of the report, and the definitions, assumptions, explanations and qualifications relating to D&M’s estimates set out therein. D&M has estimated our “proved reserves” in accordance with the rules and regulations of the SEC (SEC standards), provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. D&M has estimated our “proved-plus-probable” reserves in accordance with reserves definitions consistent with those approved in March 1997 by the Society of Petroleum Engineers (SPE) and approved by the World Petroleum Congresses (SPE standards). We also present estimates of our reserves under the Russian reserves system, which are based on data approved by the relevant Russian governmental authorities. See “Business—Exploration and Development—Reserves.”

Information relating to our estimated proved natural gas, gas condensate and crude oil reserves is not necessarily indicative of information that would be reported under SEC standards in an offering document registered with the SEC. In addition, SEC standards do not permit the presentation of reserves other than proved reserves.

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TABLE OF CONTENTS

	<u>Page</u>
Summary	1
The Offering	6
Risk Factors	10
Use of Proceeds	37
Dividend Policy	38
Market Information	39
Capitalization	40
Selected Consolidated Historical Financial Data	41
Unaudited Condensed Pro Forma Financial Information	44
Management’s Discussion and Analysis of Financial Condition and Results of Operations	46
Summary of Certain Differences between IFRS and US GAAP	90
Russian Gas Industry	97
Business	103
Classification of Reserves	135
Regulation	139
Management	148
Transactions with Affiliates	154
Principal Shareholders and Selling Shareholder	159
Description of Share Capital and Certain Requirements of Russian Legislation	161
Description of the Global Depositary Receipts	174
Taxation	193
Plan of Distribution	201
Settlement and Delivery	208
Information Relating to the Depositary	211
Limitation on Service of Process and Enforcement of Civil Liabilities	211
Legal Matters	212
Independent Auditors	212
Oil and Gas Consultants	212
General Information	213
Glossary	218
Index to Consolidated Financial Statements	F-1
Appendix A: Report of DeGolyer and MacNaughton	A-1

OAO 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, Ulitsa Pobedy, Tarko-Sale, Purovsk district, Yamal-Nenets Autonomous District, Russian Federation, and our principal executive offices are located at 8, 2nd Brestskaya Street, Moscow 125047, Russian Federation. Our telephone number is +7 (095) 730 6000. Our Internet address is www.novatek.ru. Information posted on our website does not constitute a part of this prospectus.

Unless the context otherwise requires, references to “NOVATEK,” “we,” “us” and “our” refer to OAO NOVATEK and its subsidiaries collectively. Prior to March 2003, OAO NOVATEK was known as OAO FIK Novafininvest. Certain oil- and gas-related terms used in this prospectus are defined in “Glossary” included at the end of this prospectus. Unless the context otherwise requires, references to “shares” refer to the ordinary shares of NOVATEK.

Certain amounts that appear in this prospectus have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

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SUMMARY

Following the implementation of the relevant provisions of the Prospectus Directive (Directive 2003/71/EC) in each member state of the European Economic Area no civil liability will attach to our directors in any such member state solely on the basis of this summary, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this prospectus. Where a claim relating to the information contained in this prospectus is brought before a court in a member state of the European Economic Area, the claimant may, under the national legislation of that member state, be required to bear the costs of translating this prospectus before legal proceedings are initiated.

The following summary information does not purport to be complete and should be read as an introduction to the more detailed information appearing elsewhere in this prospectus, including our consolidated financial statements and the accompanying notes beginning on page F-1. Any decision by a prospective investor to invest in shares or GDRs should be based on consideration of the prospectus as a whole, including the information discussed in “Cautionary Note Regarding Forward-Looking Statements” and “Risk Factors,” and not solely on this summarized information.

In December 2004, we completed the acquisitions of the remaining shareholdings in Tarkosalenftegas and Khancheynftegas that we did not own, thus increasing our equity interest to 100% in each of these companies. Prior to the acquisitions, we accounted for our less than majority interests in these companies under the equity method of accounting in our consolidated financial statements. Tarkosalenftegas and Khancheynftegas held the licenses to the East Tarkosalinskoye and Khancheynskoye fields, respectively, two of our three core fields. Except in our consolidated financial statements, the unaudited oil and gas disclosures supplemental thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” to provide more relevant comparative information, we present reserves and production information for these two fields as if we had owned a 100% equity interest in Tarkosalenftegas and Khancheynftegas in all periods prior to the December 2004 acquisitions. In addition, reserves and production information excludes reserves and production of Geoilbent, an equity investment we disposed of in June 2005, Sellkupnftegas, an equity investment we agreed to dispose of in June 2005, and Tambeynftegas, an equity investment we disposed of in July 2005.

Overview

We are Russia’s largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom. In terms of proved natural gas reserves, we are the third largest oil and gas company in Russia after Gazprom and LUKOIL. Our three core fields, together with all our other fields and license areas, are located in the gas-rich Yamal-Nenets Autonomous District (Yamal-Nenets) of the Russian Federation in Western Siberia. Yamal-Nenets is the world’s largest natural gas producing region, accounting for over 90% of Russia’s and approximately 20% of the world’s natural gas production.

DeGolyer and MacNaughton, an independent petroleum engineering consulting firm, has appraised the reserves at our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheynskoye—and estimates that as of 31 December 2004 these fields had proved reserves of 4,108.3 mmboe, consisting of 583.1 bcm of natural gas, 27.9 mmt of gas condensate and 7.6 mmt of crude oil.

In the first quarter of 2005, our three core fields produced 47.4 mmboe (approximately 526,000 boe per day), consisting of 6.6 bcm of natural gas, 459.8 mt of gas condensate and 33.5 mt of crude oil, representing over 99% of our total hydrocarbon production. In 2004, these fields produced 150.2 mmboe (approximately 410,000 boe per day), consisting of 20.4 bcm of natural gas, 1.8 mmt of gas condensate and 123.1 mt of crude oil, an 18.2% increase over production from these fields in 2003.

Our three core fields are described below.

Yurkharovskoye. The Yurkharovskoye field is our largest field in terms of proved-plus-probable reserves and we expect it to be the primary source of our production growth over the medium term. D&M estimates that as of 31 December 2004, the field had proved reserves of 1,608.8 mmboe, consisting of 232.0 bcm of natural gas and 10.3 mmt of gas condensate. In the first quarter of 2005, the field produced 16.1 mmboe, consisting of 2.2 bcm of natural gas and 168.5 mt of gas condensate. In 2004, it produced 49.9 mmboe, consisting of 6.7 bcm of natural gas and 700.1 mt of gas condensate. Commercial production of natural gas and gas condensate began in 2003.

East Tarkosalinskoye. The East Tarkosalinskoye field is currently our largest producer of hydrocarbons. D&M estimates that as of 31 December 2004, the field had proved reserves of 2,155.3 mmboe, consisting of 306.9 bcm of natural gas, 11.1 mmt of gas condensate and 7.6 mmt of crude

oil. In the first quarter of 2005, the field produced 25.6 mmboe, consisting of 3.7 bcm of natural gas, 148.2 mt of gas condensate and 33.5 mt of crude oil. In 2004, it produced 80.2 mmboe, consisting of 11.4 bcm of natural gas, 567.2 mt of gas condensate and 123.1 mt of crude oil. Commercial production began as follows: crude oil in 1994; natural gas in 1998; and gas condensate in 2001.

Khancheykskoye. D&M estimated that as of 31 December 2004, the field had proved reserves of 344.2 mmboe, consisting of 44.2 bcm of natural gas and 6.5 mmt of gas condensate. In the first quarter of 2005, the field produced 5.6 mmboe, consisting of 0.7 bcm of natural gas and 143.2 mt of gas condensate. In 2004, it produced 20.2 mmboe, consisting of 2.3 bcm of natural gas and 576.4 mt of gas condensate. Commercial production of gas condensate and natural gas began in 2002 and 2003, respectively.

We sell 100% of our natural gas to customers in the Russian Federation, including wholesale gas traders, regional gas distributors and end-users such as power utilities and metal producers. We are not subject to the government's regulation of natural gas prices, and historically we have sold most of our natural gas at prices higher than the prices set by the government for Gazprom's domestic gas sales. All our natural gas production is piped through our pipelines into Russia's Unified Gas Supply System (UGSS), which transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. Transportation tariffs for the use of the UGSS are set by the government.

Prior to the launch of our Purovsky gas condensate stabilization and processing plant, all of our gas condensate was processed by Gazprom and the stabilized gas condensate and liquefied petroleum gas (LPG) received after such processing were sold mostly in the domestic market. Most of our stabilized gas condensate was sold through the Russian trunk pipeline network operated by Transneft where it was mixed with the crude oil and liquid products of other companies for sale as a blend commonly known as Urals blend. With the commissioning of our Purovsky processing plant in June 2005, we are migrating the processing of substantially all of our gas condensate to that plant. We expect this migration to be completed at the end of the third quarter of 2005, by which time we expect to be able to export substantially all of our stabilized gas condensate directly to international markets where the price for gas condensate has historically exceeded the Urals blend price. Depending on market conditions, we may also export a significant part of our LPG production.

Competitive Strengths

We believe our main competitive strengths are the following:

- **Prolific, concentrated resource base.** Our three core fields have estimated proved reserves of 4,108.3 mmboe, consisting of 583.1 bcm of natural gas, 27.9 mmt of gas condensate and 7.6 mmt of crude oil as of 31 December 2004, as appraised by D&M. Based on 2004 production and estimated proved reserves as of 31 December 2004, our proved reserves to production (R/P) ratio for these fields at the beginning of 2005 was 27 years. Our other fields, which have not been appraised by D&M, have total ABC1 reserves of 444.9 mmboe. Our three core fields, together with other fields we expect to be the focus of our future exploration and development efforts, are all located in the Nadym-Pur-Taz region of Yamal-Nenets, the traditional center of Russian gas production well served by the UGSS. Moreover, our fields are located in the same region as a number of mature Gazprom fields and have therefore historically benefited from gradually increasing available pipeline capacity in the Central and Southern Corridors of the UGSS. We expect this geographic concentration and favorable location of our resource base to facilitate production increases and reserve additions in a cost-effective manner.
- **Low operating costs and disciplined approach to capital expenditures.** We believe we are one of the lowest cost producers of hydrocarbons in the oil and gas industry. In 2004, our total production cost was \$3.43 per boe, of which \$1.03 per boe was transportation cost, our finding and development cost was \$0.99 per boe and our reserves replacement cost was \$0.68 per boe. 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 prolific nature of our fields, will allow us to maintain our low production, finding and development and reserves replacement costs.
- **Leadership among independent gas producers.** We sell natural gas to a wide range of end-users, including utilities, and wholesale gas traders. We believe we have built a strong reputation with these customers, and in the Russian gas market generally, by acting as a reliable alternative source of natural gas and consistently meeting our delivery obligations. We have an active

marketing organization, and we believe we are well positioned to penetrate new markets and diversify and grow our customer base.

- ***Experienced management team.*** Our core management team has extensive experience in all aspects of our business, and has successfully transformed the company from its establishment in 1994 into the largest independent gas producer in Russia. Mr. Leonid V. Mikhelson has been our chief executive officer since 1994, when he founded the company, and has been an executive in the oil and gas industry since 1987. Most other members of our core management team have extensive gas industry experience with some starting their careers in the Ministry of the Gas Industry prior to the creation of Gazprom.

Strategy

Our strategic objective is to leverage our competitive strengths to increase our hydrocarbon production on a sustainable and profitable basis. Specifically, we intend to:

- ***Substantially increase our production of hydrocarbons, particularly natural gas.*** Wood Mackenzie, an independent expert, estimates that in 2010 demand for natural gas in Russia may reach 448 bcm, a substantial portion of which will not be supplied by Gazprom. We believe we are well positioned to capture a significant share of this shortfall by increasing production and using transportation capacity in the UGSS which we believe will become available due to declining production at mature fields in the Nadym-Pur-Taz region. Our three core fields produced 20.4 bcm of natural gas and 2.0 mmt of gas condensate and crude oil in 2004. Our target is to increase our natural gas production at these fields to approximately 45.0 bcm and our gas condensate and crude oil production to approximately 4.6 mmt in 2010. See “Business—Exploration and Development—Production Targets” for further information.
- ***Maintain our low cost structure.*** We intend to maintain our low cost structure through the continued use of modern technology and production techniques across our prolific hydrocarbon resource base. In 2004, our production, finding and development and reserves replacement costs were among the lowest in the industry. We believe that the geographic concentration of our resource base and the resulting economies of scale will continue to be a major factor in helping us maintain our low cost structure. Moreover, we intend to continue to tightly control overhead costs.
- ***Maximize risk-adjusted margins on sales of natural gas and liquids.*** Our marketing and sales team continues to optimize gas sales between end-users and wholesale traders and liquid sales 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. In addition, we intend to take advantage of our recently commissioned Purovsky processing plant and our storage and loading facilities at the Port of Vitino to enable us to export substantially all of our stabilized gas condensate production, which we believe should result in improved margins.
- ***Develop our resource base.*** We intend to continue to prove up our reserves as we expand the development of our fields. We believe the concentration of our resource base in gas-rich Yamal-Nenets, along with the proximity of our fields to the gas transportation infrastructure in the Nadym-Pur-Taz region, will facilitate cost-effective reserve growth.
- ***Further simplify our corporate structure to improve transparency and management efficiency.*** In December 2004, we completed the acquisition of the remaining shareholdings in Tarkosalenftegas and Khancheyneftegas that we did not own, thus obtaining a 100% interest in our East Tarkosalinskoye and Khancheyskoye fields. In addition, we have recently disposed of non-core businesses, including our oil and gas construction services, banking and telecommunication businesses. In June 2005, we disposed of our stake in Geoilbent and agreed to dispose of our stake in Selkupneftegas. In July 2005, we disposed of our stake in Tambeyneftegas.

Risk Factors

Prior to investing in the shares or GDRs prospective investors should consider, together with the other information contained in this prospectus, the factors and risks set out in “Cautionary Note Regarding Forward-Looking Statements” and “Risk Factors.”

Summary Reserves Information

The reserves in our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye—have been appraised by D&M. According to D&M, as of 31 December 2004 we had estimated natural gas, gas condensate and crude oil reserves attributable to these fields as follows:

Reserves		Proved Developed ⁽¹⁾	Proved Undeveloped ⁽¹⁾	Total Proved ⁽¹⁾	SPE ⁽³⁾ Proved-plus- Probable
Natural gas	bcm	389	194	583	920
	tcf	14	7	21	33
Gas condensate	mmt	16	12	28	49
	mmbbls	131	105	237	421
Crude oil	mmt	1	7	8	30
	mmbbls	6	52	58	225
Total	mmboe⁽²⁾	2,683	1,425	4,108	6,666

(1) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034, the end of the expected economic life of the field. Excluding the reserves estimated to be producible at the East Tarkosalinskoye and Khancheyskoye fields beyond the primary terms of our licenses, as of 31 December 2004 we calculate we would have had estimated total proved reserves of 3,272 mmboe, consisting of 464 bcm of natural gas and 18 mmt of gas condensate and crude oil. See “Business—Exploration and Production—Reserves.”

(2) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

(3) Society of Petroleum Engineers.

Summary Production Information

The following table sets forth the production from our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye—of natural gas, gas condensate and crude oil for the three months ended 31 March 2005 and 2004 and the years ended 31 December 2004, 2003 and 2002:

Production		Three months ended 31 March		Year ended 31 December		
		2005	2004 ⁽¹⁾	2004 ⁽¹⁾	2003 ⁽¹⁾	2002 ⁽¹⁾
Natural gas						
Yurkharovskoye field	mmcm	2,238	1,313	6,674	3,066	—
East Tarkosalinskoye field	mmcm	3,690	3,068	11,409	14,033	11,646
Khancheyskoye field	mmcm	677	449	2,341	687	404
Total natural gas	mmcm	6,605	4,831	20,423	17,787	12,050
Gas condensate						
Yurkharovskoye field	mt	169	153	700	333	—
East Tarkosalinskoye field	mt	148	131	567	462	305
Khancheyskoye field	mt	143	119	576	370	210
Total gas condensate	mt	460	403	1,844	1,165	515
Crude oil						
Yurkharovskoye field	mt	—	—	—	—	—
East Tarkosalinskoye field	mt	34	30	123	122	139
Khancheyskoye field	mt	—	—	—	—	—
Total crude oil	mt	34	30	123	122	139
Total for core fields	mboe⁽²⁾	47,367	35,260	150,228	127,111	84,132

(1) Production figures for our East Tarkosalinskoye and Khancheyskoye fields are presented on a 100% ownership basis, although prior to December 2004 we did not hold a 100% interest in these fields. See “Presentation of Reserves and Production Information.”

(2) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

Summary Historical Financial Information

The following table sets forth certain historical consolidated financial information as of and for the three months ended 31 March 2005 and 2004, and as of and for the twelve months ended 31 December 2004, 2003 and 2002, all of which has been extracted from our audited annual consolidated financial statements and unaudited consolidated interim condensed financial information included elsewhere in this prospectus. Our financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and are presented in roubles. The summary financial information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the accompanying notes included elsewhere in this prospectus.

	Three months ended 31 March			Year ended 31 December			
	2005		2004	2004		2003	2002
	RR	USD	RR	RR	USD	RR	RR
	(in millions)						
Total revenues and other income ⁽¹⁾	9,000	324	6,626	25,198	877	17,256	5,679
Operating expenses, excluding depreciation, depletion and amortization	(4,938)	(178)	(4,958)	(16,903)	(588)	(12,659)	(4,991)
Depreciation, depletion and amortization . .	(814)	(29)	(149)	(681)	(24)	(425)	(151)
Income from operations	3,248	117	1,519	7,614	265	4,172	537
Total finance income (expense), net	(241)	(9)	11	(292)	(10)	(156)	67
Share of income from associates	77	3	374	721	25	524	737
Total income tax expense	(776)	(28)	(479)	(2,075)	(72)	(1,331)	(749)
Minority interest	7	—	9	(274)	(10)	72	52
Net income ⁽²⁾	2,315	83	1,434	5,694	198	3,281	644

	As of 31 March 2005		As of 31 December			
	RR	USD	2004		2003	2002
	RR	USD	RR	USD	RR	RR
	(in millions)					
Total assets	83,085	2,986	82,450	2,971	26,386	15,855
Total shareholders' equity	48,002	1,726	44,936	1,619	12,013	6,225
Net debt ⁽³⁾	18,125	651	20,997	757	6,203	4,690

(1) Includes total revenues and other income attributable to our oil and gas construction services business sold in June 2004 of RR 2,186 million, RR 3,227 million and RR 1,084 million for the years ended 31 December 2004, 2003 and 2002, respectively, and nil and RR 1,102 million for the three months ended 31 March 2005 and 2004, respectively.

(2) Includes net losses attributable to our oil and gas construction services business sold in June 2004 of RR 335 million, RR 122 million and RR 23 million for the years ended 31 December 2004, 2003 and 2002, respectively, and nil and RR 94 million for the three months ended 31 March 2005 and 2004, respectively.

(3) Net debt is defined as total debt less cash and cash equivalents.

Summary of the Offering

SWG, one of our principal shareholders, is offering 524,453 shares of NOVATEK in a simultaneous international offering of shares and GDRs, with 100 GDRs representing one share. The Selling Shareholder intends to raise gross proceeds of \$878.5 million (assuming no exercise of the over-allotment option). We are not offering any shares. The Selling Shareholder and ZAO Levit (Levit), another principal shareholder and an affiliate of the Selling Shareholder, have confirmed in writing that the reason for the offering is to, and that they will, use a portion of the proceeds of the offering to repay (i) loans with an aggregate principal balance of approximately \$260 million that the Selling Shareholder received from commercial banks and (ii) the loan we extended to Levit. These loans were made in connection with our acquisitions of the remaining interests in Tarkosaleftegas and Khancheyftegas in December 2004. As of the date of this prospectus, the outstanding principal amount of the loan we extended to Levit is \$270 million, plus accrued interest of \$15.7 million. We expect to use the funds we receive from the repayment of our loan to Levit for general corporate purposes, including repayment of indebtedness. The GDRs are being offered in the United States to QIBs in reliance on Rule 144A under the Securities Act and outside the United States and the Russian Federation to certain persons in offshore transactions in reliance on Regulation S under the Securities Act. The shares are being offered only in the Russian Federation.

THE OFFERING

The Company	OAo NOVATEK.
The Selling Shareholder	SWGI Growth Fund (Cyprus) Limited.
The Offering	The Selling Shareholder is offering 524,453 shares in a simultaneous international offering of shares and GDRs, with 100 GDRs representing one share. The GDRs are being offered in the United States to QIBs in reliance on Rule 144A and outside the United States and the Russian Federation to certain persons in offshore transactions in reliance on Regulation S. The GDRs will be issued by Deutsche Bank Trust Company Americas, as depositary (hereinafter, the Depositary). The shares are being offered only in the Russian Federation.
The Shares	Our share capital consists of 3,036,306 ordinary shares, each with a nominal value of 100 roubles, which are fully paid, issued and outstanding. In addition, we are authorized by our charter to issue an additional 7,557,376 ordinary shares. Our shares have the rights described under “Description of Share Capital and Certain Requirements of Russian Legislation.”
The GDRs	<p>100 GDRs will represent one share on deposit with the Custodian (as defined below). The GDRs will be issued by the Depositary pursuant to two separate deposit agreements, one relating to the Rule 144A GDRs (hereinafter, the Rule 144A Deposit Agreement) and another relating to the Regulation S GDRs (hereinafter, the Regulation S Deposit Agreement), among us, the Depositary and holders and beneficial owners from time to time of the relevant GDRs. The Rule 144A Deposit Agreement and the Regulation S Deposit Agreement are herein collectively referred to as the Deposit Agreements. The Regulation S GDRs will be evidenced initially by a Master Regulation S GDR and the Rule 144A GDRs will be evidenced initially by a Master Rule 144A GDR, each to be issued by the Depositary pursuant to the relevant Deposit Agreement. The Master Regulation S GDR and the Master Rule 144A GDR are herein collectively referred to as the Master GDRs. Pursuant to the Deposit Agreements, the shares represented by the GDRs will be held in Russia by Deutsche Bank Ltd., as Custodian, for the benefit of the Depositary and for the further benefit of the holders and beneficial owners of GDRs.</p> <p>Except in the limited circumstances described herein, definitive GDR certificates will not be issued to holders in exchange for interests in the GDRs represented by the Master GDRs. Subject to the terms of the Deposit Agreements, interests in the Master Regulation S GDR may be exchanged for interests in the corresponding number of GDRs represented by the Master Rule 144A GDR, and vice versa.</p>
Offer Price	\$1,675 per share. \$16.75 per GDR.
Closing Date	26 July 2005.
Over-Allotment Option	The Selling Shareholder has granted to the underwriters an option, exercisable within 30 days after the announcement of the offer price, to purchase up to 52,445 additional shares in the form of GDRs, solely to cover over-allotments, if any, in the offering.

Lock-up	We, the Selling Shareholder and certain other shareholders have agreed, subject to certain exceptions, as part of the Underwriting Agreement, not to issue, offer, sell, contract to sell, pledge, charge, grant options over or otherwise dispose of, directly or indirectly, any shares in us or securities convertible or exchangeable into or exercisable for any shares in us or warrants or other rights to purchase such shares or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying securities, including equity swaps, forward sales and options or GDRs representing the right to receive any such securities or publicly announce any intention to do any of the foregoing, for a period of 180 days from the closing date, without the prior written consent of the underwriters. See “Plan of Distribution.”
Transfer Restrictions	The shares and GDRs will be subject to certain restrictions on transfer as described under “Description of Share Capital and Certain Requirements of Russian Legislation” and “Description of the Global Depositary Receipts,” respectively.
Dividend Policy	See “Dividend Policy.”
Listing and Market for the Shares and GDRs	<p>Application has been made to (i) the UK Listing Authority for a listing of up to 121,452,200 GDRs, consisting of up to 52,445,300 GDRs to be issued on the closing date, up to 5,244,500 additional GDRs issued pursuant to the over-allotment option, as described herein, and up to 63,762,400 additional GDRs to be issued from time to time against the deposit of shares with the Depositary, to be admitted to the Official List and (ii) the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange’s regulated market for listed securities. Application has also been made to have the Rule 144A GDRs designated eligible for trading in PORTAL. Our existing shares are listed on the RTS Stock Exchange and the MICEX Stock Exchange. Prior to the offering, there has been no market for the GDRs. Trading in the GDRs on the London Stock Exchange is expected to commence on a when and if issued basis on 21 July 2005. Closing and settlement are expected to take place on 26 July 2005, and admission to the Official List of the UK Listing Authority and to trading on the London Stock Exchange’s regulated market for listed securities are expected to take place on 27 July 2005.</p> <p>Shares may be deposited, subject to the provisions set forth under “Description of the Global Depositary Receipts” and in the Deposit Agreements, with the Custodian against which the Depositary shall issue GDRs representing such shares up to the maximum aggregate number of 121,452,200 GDRs. See also “Risk Factors—Risks Relating to the GDRs, the Shares and the Trading Market—You may not be able to deposit shares in the GDR program in order to receive GDRs” and “—We may not be able to prepare a prospectus that may be required in connection with the deposit of additional shares into the GDR program.”</p>

Settlement Procedures	<p>Payment for the GDRs is expected to be made in US dollars in same-day funds through the facilities of DTC, Euroclear and Clearstream. The Depositary has applied to DTC to have the Rule 144A GDRs accepted into DTC's book-entry settlement system. Upon acceptance by DTC, a single Master Rule 144A GDR will be held in book-entry form and will be issued to DTC and registered in the name of Cede & Co., as nominee for DTC. The Master Regulation S GDR will be registered in the name of BT Globenet Nominees Limited, as nominee for Deutsche Bank AG London, as common depositary for Euroclear and Clearstream. Euroclear and Clearstream are expected to accept the Regulation S GDRs for settlement in their respective book-entry settlement systems. Except in limited circumstances described herein, investors may hold beneficial interests in the GDRs evidenced by the corresponding Master GDR only through DTC, Euroclear or Clearstream, as applicable.</p> <p>Transfers within DTC, Euroclear and Clearstream will be in accordance with the usual rules and operating procedures of the relevant system. See "Settlement and Delivery."</p> <p>Each purchaser of the shares in the offering is required to pay for any shares in same-day funds and the shares will be delivered to such purchasers on or about 26 July 2005 or a later date. In order to take delivery of the shares, potential purchasers may be required to have a depo account at one or more depositaries designated by us. Upon taking delivery of the shares, purchasers may choose to hold the shares through a direct account with our share registrar; however, directly-held shares are ineligible for trading on the MICEX Stock Exchange or the RTS. In addition, in order to trade your shares on the MICEX Stock Exchange or the RTS, you may have to further transfer your shares to an account at a different depositary.</p>
Voting	<p>The Deposit Agreements do not allow for the voting of fractional entitlements. Thus, you will need 100 GDRs to be entitled to one vote. If you hold shares, you are generally entitled to one vote per share at a shareholders' meeting. See "Description of Share Capital and Certain Requirements of Russian Legislation—General Meetings of Shareholders."</p>
Use of Proceeds	<p>We are not selling any shares in this offering and will not receive any of the proceeds of this offering. The Selling Shareholder and Levit, one of our principal shareholders and an affiliate of the Selling Shareholder, have confirmed in writing that the reason for the offering is to, and that they will, use a portion of the proceeds of the offering to repay (i) loans with an aggregate principal balance of \$260 million the Selling Shareholder received from commercial banks and (ii) the loan we extended to Levit. These loans were made in connection with our acquisitions of the remaining interests in Tarkosalenftegas and Khancheyneftegas in December 2004. As of the date of this prospectus, the outstanding principal amount of the loan we extended to Levit is \$270 million, plus accrued interest of \$15.7 million. See "Business—Recent Developments."</p> <p>We expect to use the funds we receive from the repayment of our loan to Levit for general corporate purposes, including repayment of indebtedness.</p>

General Information Shares:

ISIN: RU000A0DKVS5

RTS Stock Exchange trading symbols:

NVTK (in US dollars)

NVTKG (in roubles)

MICEX Stock Exchange trading symbol:

FIKO (in roubles)

Regulation S GDRs:

CUSIP: 669888 10 9

ISIN: US6698881090

Common Code: 020623926

Rule 144A GDRs:

CUSIP: 669888 20 8

ISIN: US6698882080

Common Code: 022011472

London Stock Exchange GDR trading symbol: NVTK

PORTAL Rule 144A GDR trading symbol: NVTKYP

RISK FACTORS

An investment in the shares or GDRs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained elsewhere in this prospectus, before you decide to buy the shares or GDRs. Each of these risks could have a material adverse effect on our business, prospects, financial condition or results of operations, or on the trading price of the shares and GDRs 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

The Russian government, directly and through its influence over Gazprom, our largest competitor and the owner of the UGSS, effectively controls our industry and may determine that independent gas producers such as ourselves should not have a significant role in the Russian gas industry.

As described in more detail elsewhere in this prospectus, all material aspects of the Russian natural gas industry are subject to or materially affected by government regulation. See “Russian Gas Industry” and “Regulation.” Moreover, through its share ownership, representation on the board of directors and role as regulator, the government has strong influence over Gazprom, our principal competitor and the dominant participant in our industry. As a result, the Russian government effectively controls our industry. The significant participation in the Russian natural gas industry of independent gas producers such as ourselves is a relatively recent development. Moreover, we have recently begun processing substantial quantities of our unstable gas condensate at our Purovsky processing plant. Prior to the launch of our Purovsky processing plant, all of our unstable gas condensate was processed at Gazprom’s facilities.

If the government was to determine, through legislation, administrative action or otherwise, that independent gas producers such as ourselves should have a less significant role in the Russian gas industry than envisioned in what we understand to be the Russian government’s current energy strategy, as published in “Energy Strategy for Russia until 2020” approved by the Russian government in August 2003 (Russian Federation Energy Strategy 2020), it could take actions (including through Gazprom) that would have a material adverse effect on our business, results of operations or prospects, possibly even threatening our ability to continue as a going concern. See also “Risks Relating to the Russian Federation.”

Government regulation keeps natural gas prices in Russia lower than international natural gas prices and we have limited ability to charge prices higher than those set by the Russian government.

Gazprom sells over 75% of all natural gas sold in Russia and the prices it charges for natural gas in Russia are subject to control by the Russian government under the Gas Supply Law (see “Regulation”). The prices the government has set for the sale of Gazprom’s natural gas in Russia are significantly lower than prices Gazprom charges off-takers in Western Europe. We sell all of our natural gas in Russia and, although the sales prices for most of our natural gas are not regulated, almost all of our customers are eligible to purchase natural gas from Gazprom at the regulated prices. Thus, the prices we can achieve for our natural gas are strongly influenced by the regulated prices. There can be no assurance that natural gas prices in Russia will increase even if energy prices elsewhere in the world do, or that the regulation of natural gas prices in Russia will be relaxed. Accordingly, we have and may continue to have limited pricing flexibility with respect to our sales of natural gas. These limitations could have a material adverse effect on our business, results of operations and prospects, particularly if the regulated prices are decreased or we experience a significant increase in our operating costs.

In accordance with the Gas Supply Law, consumers in Russia 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 a number of government resolutions. The government has, however, issued a number of resolutions regulating the restriction or suspension of supplies to certain customers. These consumers include, among others, medical institutions, military units, nuclear plants, communication organizations and certain vital utilities. Currently, none of our customers are consumers benefiting from these regulations.

A decline in the prices we receive for our natural gas and liquid hydrocarbons, as a result of declines in world prices, deregulation of the Russian energy market or otherwise, would have a negative effect on our results of operations and could result in a reduction in our reserves.

Our revenue, profitability and cash flow depend upon the prices we receive for our natural gas and liquid hydrocarbons. The prices we charge for our natural gas are strongly influenced by the prices the Russian government sets for the sale of natural gas by Gazprom, and there can be no assurance that these regulated prices will not decline. If world prices for natural gas decline to levels below those established by the Russian government, the government could come under pressure to reduce natural gas prices in Russia. Moreover, the prices we charge for our liquid hydrocarbons are determined by prices established on the world market. Thus, declines in the prices for natural gas and liquid hydrocarbons on world markets would decrease our revenue and could have a material adverse effect on our business, results of operations and prospects.

World markets for natural gas and liquid hydrocarbons are very volatile. Prices may fluctuate widely in response to relatively minor changes in supply and demand, market uncertainty and a variety of other factors beyond our control. These factors include: domestic and global economic conditions; political and economic conditions in oil and gas producing countries; the ability of the Organization of Petroleum Exporting Countries (OPEC) to agree to and maintain oil production controls; weather conditions; domestic and foreign government regulation; and the price and availability of alternative fuels. The Russian economy is heavily dependent on its oil and gas exports, and a steep or sustained decline in the price of these products could negatively affect the Russian economy, potentially resulting in a rouble devaluation. In any such situation, we may not be able to raise our prices and our business, results of operations and prospects could be materially adversely affected.

The prices we charge for our natural gas could also be adversely affected by deregulation of the Russian natural gas industry. If government regulation of natural gas prices were abandoned, there can be no assurance that free market prices would be higher than those previously set by the government.

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 our having to make substantial 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, accounting rules may require us to write down, as a non-cash charge to earnings, the carrying value of our oil and gas properties for impairments.

Increases in government-established natural gas transportation tariffs could have a material adverse effect on our business.

In Russia, the Federal Tariff Service (FTS) regulates natural gas transportation tariffs. In 2003 and 2004, our average natural gas transportation expenses represented approximately 38.8% and 34.6%, respectively, of the average price per one mcm sold to end customers, net of VAT. Regulated natural gas transportation tariffs have risen in recent years and we expect them to continue to rise. If natural gas transportation tariffs continue to rise and we are 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, our business, results of operations and prospects could be materially adversely affected.

We are dependent on Gazprom, our largest competitor, for the transportation of our natural gas and a part of our unstable condensate.

We transport substantially all of our natural gas through the UGSS. The UGSS is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia and 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 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 this legislation will remain in place or that Gazprom will continue to provide us with access to the UGSS or that the terms of access offered will be commercially reasonable. A change in the existing legislation, or a failure by Gazprom to comply with the legislation, such that Gazprom no longer provides access to the UGSS on a non-discriminatory or commercially reasonable basis or other action by Gazprom to decrease our access to transportation capacity would likely result in a decrease in our production and sales.

We have entered into agreements with Gazprom for the transportation of natural gas. We are also dependent on Gazprom for the transportation of a part of our unstable gas condensate. Gazprom is under no statutory obligation to transport this condensate, and does so pursuant to a bilateral agreement with us that expires in 2006. There can be no assurance, however, that Gazprom will accept our deliveries in accordance with these agreements or that we will be able to enter into extensions of or replacements to these agreements on commercially reasonable terms. In addition, future agreements with Gazprom may be on terms unfavorable to us or inconsistent with our business strategies. We currently plan to build our own pipeline to transport this condensate when needed. However, if we are unable to build this pipeline or extend the agreement with Gazprom or extend it on commercially reasonable terms, our business, results of operations, financial condition and prospects may be materially adversely affected.

In July 2004, an independent gas producer filed a complaint with the Russian Federal Anti-Monopoly Service against Gazprom and two of its subsidiaries, naming us and other independent gas producers as affected entities, although we were not a party to this complaint. The complaint alleged a breach of the Anti-Monopoly Law by the Gazprom parties in connection with actions allegedly taken by them to restrict access to the UGSS. In October 2004, the Russian Federal Anti-Monopoly Service found Gazprom and its subsidiaries guilty of restricting access to the UGSS for independent gas producers and ordered that the restrictions be lifted. Gazprom challenged this order in the Moscow Arbitration Court but withdrew its appeal in June 2005.

Our ability to transport natural gas may be limited by capacity constraints on 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 ten years old with certain parts being over thirty years old. A significant part of the pipelines is protected by chemical processes of limited duration and large segments of the network are located in regions with harsh climates where construction, maintenance and refurbishment are difficult and costly. 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. A major disruption in the UGSS would have a material adverse effect on our business and results of operations. Moreover, the capacity constraints of the UGSS may prevent us from increasing natural gas production in the future, which would have a material adverse effect on our prospects.

Since we share capacity on the UGSS with Gazprom, LUKOIL and other producers, a substantial increase in production by any of them in areas in which we currently have access to available capacity could limit our access to the transportation capacity we need to market our natural gas. Such a development would likely result in a decrease in our production and sale of natural gas and have a material adverse effect on our business, results of operations and prospects. Both Gazprom and LUKOIL have stated that they plan to develop significant fields in Yamal-Nenets, production from which would compete with our production for transportation capacity on the UGSS, in some cases as early as 2007. We expect any production from these fields to be insufficient to offset the declines in production from other fields in the area, but there can be no assurance that this will be the case.

Finally, a substantial increase in prices for natural gas in Russia or a substantial decrease in the prices Gazprom realizes on its sales in Western Europe could lead Gazprom and other producers to accelerate development plans and increase production in Russia that would compete with our production for transportation capacity and increase competition on sales to end customers and traders. Gazprom has stated that the European Commission has expressed a desire to see a move from long-term contracts in favor of short-term contracts. Such a move may lead to a decrease in the prices Gazprom realizes on its sales in Western Europe.

We are dependent on OAO AK Transneft, a government-owned monopoly, for the transportation of our crude oil and on OAO Russian Railways, also a government-owned monopoly, for the transportation of our liquid hydrocarbons.

We transport our crude oil through a network of trunk pipelines in Russia operated by the government-owned monopoly, OAO AK Transneft. Access to Transneft's pipeline network is regulated by the Russian government with transportation capacity generally allocated in proportion to the production and supply schedules of all network users. The limited transportation capacity of the pipeline system

constrains the ability of producers to transport crude oil and thus adversely effects our ability to optimize, our crude oil production.

Regulated crude oil transportation tariffs have risen in recent years and may continue to rise. The continued increase of transportation tariffs could have a material adverse effect on our business, results of operations and prospects since we are generally unable to pass on these additional costs to our customers.

Much of the Transneft-operated pipeline system is over ten years old with certain parts having been 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 system 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 transporting crude oil. A major disruption in the Transneft-operated system could have a material adverse effect on our business and results of operations.

We are dependent on OAO Russian Railways, or RZD, the government-owned entity that controls the transportation by rail of liquid products from our Purovsky processing plant to our storage and loading facilities in the Port of Vitino, where we load our liquid products onto ocean-going tankers for export. Our ability to transport these liquid products by rail depends on the availability of railway tank cars, which are typically provided by RZD or private companies. Although we have reduced our dependence on these third parties by leasing our own tank cars for the transportation of LPG through our subsidiary, OOO NovaTrans, there can be no assurance that we will be able to obtain access to a sufficient number of tank cars in the future. An inability to obtain a sufficient number of tank cars could adversely affect our ability to transport our liquid products for export sale.

RZD is a government-owned monopoly whose transportation tariffs (other than transit tariffs) are set by the FTS. There have been recent increases in the transportation tariffs we pay RZD to transport our liquid products and there can be no assurance that there will not be further increases. Increases in these tariffs may reduce the net price we realize for liquid products we intend to export since we are generally unable to pass these additional costs on to our customers. Further increases in these transportation tariffs could have a material adverse effect on our business, results of operations and prospects.

Competition in the gas industry is intense and we face competition from other independent gas producers.

In addition to competing with Gazprom, we face competition from other independent gas producers. Our exploration and production business faces competition from other independent oil and gas companies in each of the following areas:

- seeking to obtain desirable licenses for future exploration and production;
- marketing our natural gas production;
- obtaining capacity to transport our natural gas; and
- hiring of personnel, purchasing equipment and expertise necessary to develop and operate our properties.

Our ability to obtain additional desirable licenses will be dependent upon our ability to evaluate and select suitable license areas and to gain necessary government approvals in a highly competitive environment. In addition, our ability to market and transport our natural gas will depend upon our ability to successfully negotiate contracts with customers and to successfully arrange with Gazprom for sufficient transportation capacity on the UGSS in this highly competitive environment.

We sell a substantial amount of our products to a limited number of customers.

In the three months ended 31 March 2005, we sold over 58% of our natural gas to five customers, including over 33% to the Itera group of companies, a wholesale gas trader (the Itera Group). Although we plan to diversify our customer base, we expect the concentration of customers to continue for the foreseeable future and have contracted to sell a significant amount of our natural gas production to the Itera Group for each of the next five years. In 2005, we expect to sell most of our exported liquid products to Kerden Trading Ltd., a company indirectly owned by one of our principal shareholders. This concentration of customers affects our overall credit risk in that these entities may be similarly affected by changes in industry specific 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 diversify our customer base could have a material adverse effect on our business, results of operations and financial condition.

An exploration and production license held by one of our subsidiaries may be subject to challenge by Russian authorities or minority shareholders of the transferring entity because of irregularities in the manner in which it was transferred.

The exploration and production license to the East Tarkosalinskoye field held by our subsidiary Tarkosaleneftegas was transferred from OAO Purneftegasgeologiya in reliance on an interpretation issued by the Ministry of Natural Resources (formerly known as the Committee of the Russian Federation on Geology and Use of Subsoil) that was ultimately determined by a Russian court to be incorrect and was withdrawn by the Ministry in April 1999. This field accounted for over 50% of our proved reserves at 31 December 2004 and over 53% of our production for the three months ended 31 March 2005. Many licenses were re-issued in reliance on the withdrawn interpretation and a few have been challenged and found to have been transferred in violation of the Subsoil Law. To date, none of the subsoil licenses held by our subsidiaries have been challenged on this basis, but there can be no assurance that there will not be such challenges in future. The termination or suspension of the East Tarkosalinskoye license would have a material adverse effect on our reserves, business, results of operations and prospects.

Our exploration and production licenses may be suspended, amended or terminated prior to the end of their terms, and we may not be able to obtain or maintain various permits and authorizations.

The licensing regime in Russia for the exploration and production of natural gas, gas condensates and crude oil is governed primarily by the Subsoil Law and numerous regulations issued thereunder. We currently conduct our operations under multiple exploration and production licenses principally held by our subsidiaries. Our production licenses for our core fields currently have terms extending through the period between 2018 and 2034. Most of our licenses also provide that they may be terminated if, among other things, we fail to comply with license requirements, do not make timely payments of levies and taxes for the use of the subsoil, systematically fail to provide information, become bankrupt or fail to fulfill any capital expenditure and/or production obligations set forth in our development plans and license agreements with the Ministry of Natural Resources.

One requirement with respect to each of our exploration and production licenses is that we produce a certain volume of hydrocarbons over the life of the license. There can be no assurance that these production requirements can be met. In some cases, required production volumes may exceed the amount of estimated proved-plus-probable reserves with respect to the field to which the license relates. Producing more than 110% of the government approved volumes with respect to a particular field would also be a violation of the related license.

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 the license areas in a manner that violates Russian law, government regulators may impose fines on us or suspend or terminate our licenses. Any suspension, amendment or termination of our licenses could have a material adverse effect on our reserves, business, results of operations, financial condition, prospects or the value of our assets.

In addition, we are required to obtain and maintain other licenses, permits, authorizations, land use rights and approvals to develop our fields, retain our licenses, operate the Purovsky processing plant and transport our natural gas, gas condensate and oil. If we fail to obtain or maintain these other licenses, permits, authorizations, land use rights and approvals, our investment program could be delayed or terminated, our licenses could be terminated, our ability to operate the Purovsky processing plant could be restricted or our access to transportation capacity could be impaired. Any of these events may reduce our cash flows and materially adversely affect our business.

Challenges to the privatization of two of our subsidiaries may threaten our interest in those subsidiaries and in licenses previously held by those subsidiaries.

Two of our subsidiaries, Purneftegasgeologiya and OAO Novatek-Polimer (formerly Truboizolyatsia), were formed through the privatization of state owned enterprises. These subsidiaries held none of our proved reserves at 31 December 2004, however, the licenses to the East Tarkosalinskoye and Khancheykskoye fields were at one time owned by Purneftegasgeologiya. Those two fields accounted for over 60% of our proved reserves at 31 December 2004 and over 65.4% of our production for the three

months ended 31 March 2005. Since Russian privatization laws in effect at the time of the privatization of these two subsidiaries were often vague, inconsistent and in conflict with other laws, including conflicts between federal and regional privatization laws, privatizations effected under these laws may be vulnerable to challenge. Although the statute of limitations currently in effect for substantive challenges to most privatization transactions is ten years and will have run for all such transactions by the end of 2005, the Russian government or any other interested party with standing may challenge a privatization at any time on the grounds of technical violations. Any such challenges, if successful, could pose a significant risk to our interest in these two subsidiaries or our right to continue to operate under the exploration and production licenses for the East Tarkosalinskoye and Khancheykskoye fields, and materially adversely affect our reserves, production capacity, market share and results of operations and prospects.

Proposed changes in law could adversely affect our ability to participate in certain future auctions for exploration and production licenses and could subject us to a statutory requirement to sell our natural gas to the government.

Pursuant to the latest proposed draft restatement of the Subsoil Law supported by the Russian government only Russian persons will be entitled to participate in auctions for subsoil use rights. Under the draft restatement, Russian legal entities directly or indirectly controlled by, or under common control with, foreign citizens and/or foreign legal entities may not be permitted to participate in certain auctions (as may be determined by federal laws or on a case-by case basis by authorities conducting such auctions). The sale of shares and GDRs in this offering will likely result in a substantial increase in the number of foreign citizens and/or foreign legal entities that beneficially own our shares. If the draft restatement becomes effective, there can be no assurance how it may be interpreted or applied and thus whether or not we and our subsidiaries might be determined to be directly or indirectly controlled by, or under common control with, foreign citizens and/or foreign legal entities. As a result, we could be prevented from obtaining further subsoil use rights.

In addition, if pursuant to the proposed draft restatement of the Subsoil Law, another federal law requiring producers of strategic natural resources to sell all or a portion of their production to the government is adopted and if natural gas continues to be classified by the government as a strategic natural resource or if the government classifies as a strategic natural resource our other hydrocarbons, we may be required to sell all or a portion of our natural gas or other hydrocarbons production to the government.

Our Purovsky processing plant has a limited operating history and we may not have all the permits and other authorizations we need to fully operate the plant on a permanent basis.

Our Purovsky processing plant was commissioned in June 2005 and thus has a limited operating history. There can be no assurance that the plant will be able to reliably process the volumes that we currently expect at the stage of full scale operation. If the plant is unable to process these volumes, we would be required to use Gazprom's Surgutsky refinery to process the gas condensate we are unable to process at the Purovsky processing plant. This would reduce the margins we expect to realize by processing our gas condensate at the Purovsky processing plant and could have a material adverse effect on our business, results of operations and prospects.

We may not have obtained all the permits and other authorizations required for the full operation of the Purovsky processing plant. If we are not able to obtain all the required permits and other authorizations, then we could be required to cease the operations of the Purovsky processing plant, which would have a material adverse effect on our business, results of operations and prospects.

We have been and will continue to be controlled by a group of majority shareholders comprising substantially all of our senior management team, whose interests could conflict with those of the holders of the shares and GDRs.

Following the offering, 70.99% of our outstanding shares (or 69.26% if the over-allotment option is exercised in full) will be owned by Mr. Mikhelson directly and by companies effectively controlled by members of our Board of Directors, our Management Committee and employees, including Mr. Mikhelson. See "Principal Shareholders and Selling Shareholder." We believe that the involvement of such shareholders in our operations has been, and will continue to be, important in the pursuit and implementation of our strategy. However, there can be no assurance that they will remain controlling shareholders in the future. Our business could suffer if such shareholders ceased to participate actively in our operations. 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, such shareholders will have the power to control the outcome of most matters to be decided by vote at a shareholders' meeting and, as long as they hold, directly or indirectly, the majority of our ordinary shares, will control appointment and removal of directors. These shareholders will also be able to control or significantly influence the outcome of any vote on, among other things, any proposed amendment to our charter, merger proposal, proposed substantial sale of assets or other major corporate transactions. Our controlling shareholders have interests in other companies, some of which conduct significant amounts of business with us. Moreover, substantially all of our senior management team holds or owns interests in, and/or receives compensation from, companies with which we enter into significant transactions. Thus, the interests of our controlling shareholders and members of senior management could conflict with those of the other holders of shares and with the holders of GDRs, which could adversely affect a prospective investor's investment in our securities. Any such conflict could have a material adverse effect on our business, financial condition, results of operations or prospects and the market price of the shares and GDRs.

Corruption, investigations thereof and negative publicity associated therewith could disrupt our ability to conduct our business and materially adversely affect our business, financial condition, results of operations or prospects and the market price of the shares and GDRs.

The local and international press have reported significant criminal activity, including organized crime, in Russia. In addition, the local and international press have reported high levels of corruption, including the bribing of officials and the press by competitors and others for the purpose of interfering with normal business activities. Press reports have also described instances in which governmental agencies have engaged in selective investigations and prosecutions. Additionally, published reports indicate that a part of the Russian print media regularly publishes disparaging articles in return for payment.

We have been and may continue to be the subject of press speculation and other accusations relating to, among other things, our shareholders, directors and management. For instance, certain members of our Board of Directors and senior managers and a former senior manager of one of our subsidiaries currently serve as government officials in regions where we operate. A member of our Board of Directors, who is also a former chief executive officer of one of our key subsidiaries, is a member of the Management Board of the Yamal Regional Fund for Development (Yamal Fund) and a former Vice-Governor of Yamal-Nenets. Another member of our Board of Directors, who is also the chief executive officer of one of our key subsidiaries, is a deputy in the Yamal-Nenets parliament. Some current and former shareholders who hold or have held significant stakes in our company are related to the government officials serving on our Board of Directors and as our senior managers. In addition, one of our shareholders is a member of the Duma. There has been and may be further press speculation or other accusations that we may have benefited improperly from these or other relationships and past decisions by government authorities may be challenged as a result. Any further speculation concerning these or other relationships or any investigations and challenges relating thereto could have a material adverse effect on our business, results of operations and prospects and on the market price of the shares and GDRs. See "Management" and "Principal Shareholders and Selling Shareholder."

In June 2005, the Prosecutor's Office of the Yamal-Nenets Autonomous District issued a search warrant to us for certain documents it wanted to review in connection with a criminal investigation relating to an alleged abuse of position by the President of the Yamal Fund in connection with, among other things, a contribution to us by the Yamal Fund of certain assets in exchange for our newly issued shares. See "Business—Litigation." The Yamal Fund was formerly a shareholder of NOVATEK, and, in addition to the exchange mentioned above, we have engaged in other transactions involving the Yamal Fund as described elsewhere in this prospectus. We have been informed that we are not a target of this investigation; however, prosecutors in Russia have broad discretion to expand the scope of investigations. If we or any of our directors or managers are made a target of the investigation or the negative publicity relating thereto continues or increases there could be a material adverse effect on our business, results of operations and prospects or on the market price of the shares and GDRs.

If past and future interested party transactions in which we were involved are successfully challenged, their invalidation could have a material adverse effect on our business, financial condition, results of operations or prospects or the market price of the shares and GDRs.

We own less than 100.0% of equity interests in some of our current subsidiaries. In addition, certain of our wholly owned subsidiaries have had other shareholders in the past. We and our subsidiaries in the past

have carried out, and continue to carry out, transactions with us and others which may be considered to be “interested party transactions” under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders depending on the nature of the transaction and parties involved. See “Business—History” and “Description of Share Capital and Certain Requirements of Russian Legislation—Interested Party Transactions.” The provisions of Russian law defining which transactions must be approved as “interested party transactions” are subject to different interpretations. We cannot assure you that our and our subsidiaries’ applications of these concepts will not be subject to challenge by former and current shareholders. Any such challenges, if successful, could result in the invalidation of transactions, which could have a material adverse effect on our business, financial condition, results of operations or prospects of the market price of the shares and GDRs.

A recent position taken by the Russian tax authorities regarding the natural resources production tax due on production of gas condensate could require us to pay a material amount of back tax and materially increase our tax liability.

In 2004, the Russian tax authorities took a position on how to calculate the natural resources production tax due on gas condensate that differed from how the industry has generally calculated this tax. The new position taken would require that the tax be assessed on the value of the stabilized gas condensate delivered from a processing facility, rather than on the value of unstable gas condensate delivered to the processing facility. To date, we have been paying tax on the value of the unstable gas condensate.

We understand that the tax payer against whom this position was asserted has challenged the tax authorities’ interpretation. Should the authorities prevail in their interpretation, although we have recorded a provision in our consolidated financial statements in respect of this issue, we could be required to pay a significant amount of additional tax related to prior periods, including perhaps amounts in excess of the provision, and our future tax liability on gas condensate would materially increase.

We may have a tax liability related to the payment of the taxes on production from the West Tarkosalinskoye field.

Russian tax law provides that the license holder is responsible for all taxes payable on production from the relevant licensed field. Until January 2004, while our subsidiary Purneftegasgeologiya held the license to the West Tarkosalinskoye field, Gazprom was operating the field pursuant to an operating agreement under which Gazprom was to keep 90% of the production from the Cenomanian formation and pay a proportionate share of taxes on behalf of Purneftegasgeologiya. We believe that Gazprom paid its proportionate share of the relevant taxes, which taxes should have been paid by Purneftegasgeologiya as it was the holder of the license. In January 2004, Purneftegasgeologiya transferred the license to a subsidiary and in October 2004 sold this subsidiary to a subsidiary of Gazprom, however, there can be no assurance that the government will not require Purneftegasgeologiya to pay the taxes on Gazprom’s proportionate 90% of the production through January 2004 even though we believe Gazprom has already paid such amount.

Vaguely drafted Russian transfer pricing rules and lack of reliable pricing information may allow tax authorities to challenge some of our transactions.

Russian transfer pricing rules effective since 1999, give Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between unrelated parties, such as foreign trade transactions or transactions with significant price fluctuations if the transaction price deviates by more than 20.0% from the market price. Special transfer pricing rules apply to operations with securities and derivative instruments. The Russian transfer pricing rules are vaguely drafted, and are subject of interpretation by Russian tax authorities and courts. We believe that the prices we use are in compliance with the provisions of the Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian courts and become effective, our results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of underpaid prior tax and related interest and penalties, which would have a material adverse effect on our financial condition and results of operations. It is also possible that Russian transfer pricing rules may change in the future, in particular, for transactions involving securities.

Our current 2010 target production levels of natural gas and oil differ from those estimated by D&M on 31 December 2004 as a result of, among other things, the subsequent development of our management plans incorporating revised assumptions from those indicated to D&M at the time of compiling their report.

We have made certain forward-looking statements in this prospectus relating to our target natural gas and oil production levels at our core fields for the year 2010. Our estimate of such target production levels is higher than that estimated by D&M in their report as of 31 December 2004 as a result of, among other things, three principal changes in our management development plan: (i) a faster drilling rate; (ii) an increased percentage of wells drilled being horizontal wells; and (iii) higher well flow rates. The higher flow rate assumptions in the revised management development plan results, in part, from recent indications of increased flow rates from certain of the wells at our Yurkharovskoye field. We cannot assure you that we will actually achieve higher flow rates at other wells at our Yurkharovskoye or other core fields or that we will be able to sustain the faster drilling rate or the percentage of horizontal wells being drilled underlying our revised management development plan. If our average flow rates, drilling rates or percentage of horizontal wells being drilled are materially lower than we currently expect, we may have to drill additional wells and incur additional capital expenditures to realize our current production forecasts for the year 2010.

Failure to develop our fields as planned may lead to a failure to meet our production targets and a decline in our production levels.

The development of oil and gas fields is subject to many risks. There can be no assurance that we will be able to develop our fields as planned due to the possibility of unforeseeable and unpredictable cost overruns, lower natural gas prices, unexpected drilling conditions, abnormal 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 reserve base. However, we cannot assure you that our exploration programs will be successful. Except to the extent we complete successful exploration and development projects or acquire properties containing proven reserves, or both, our reserves will decline as our natural gas and liquid hydrocarbons are produced and our reserves are depleted. Our future production is highly dependent upon our ability to develop our existing reserve base and, in the longer term, finding or acquiring additional reserves. If we are unsuccessful in developing our current reserve base, we may not be able to meet our production targets, and, in the longer term, if we fail to add new reserves through exploration or acquisitions, our total proved reserves and production will decline, which would adversely affect our business, results of operations and prospects.

We must make significant capital expenditures to maintain our current production levels and replace our reserves. The inability to finance these and other expenditures could have a material adverse effect on our financial condition and results of operations.

Our business requires significant capital expenditures for exploration and development, production, transport, refining and environmental compliance. In 2003 and 2004, we spent RR 5,002 million and RR 7,412 million, respectively, on capital expenditures. Our plans require substantial capital expenditures for the foreseeable future. Our financing strategy involves funding our capital expenditures with short and long-term debt financing, including both rouble and US dollar denominated indebtedness. We may also consider working with joint venture partners to develop some of our assets. Our ability to secure debt or equity financing in amounts sufficient to meet our financial needs or to attract partners could be materially adversely affected by many factors beyond our control, including but not limited to, economic conditions in Russia and the health of the Russian banking sector. If we are unable to raise the necessary financing or attract appropriate partners, we will have to reduce the amount of our planned capital expenditures. Any such reduction could adversely affect our ability to expand our business and meet our production targets, and if the reductions are severe enough, they could adversely affect our ability to maintain our production at current levels.

The natural gas, gas condensate and oil 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.

The natural gas, gas condensate and oil reserves data included elsewhere in this prospectus represent only estimates. Reserves valuation is a subjective process of estimating underground accumulations of natural gas, gas condensate and crude oil that cannot be measured in an exact manner. The accuracy of any reserve estimate depends on the quality and reliability of available data, engineering and geological interpretation and subjective judgment. Additionally, these estimates are based on many assumptions that may turn out to be inaccurate and changes in these assumptions, as well as subsequent results of drilling, testing and production, may result in material revisions to the estimates of our hydrocarbon reserves. Moreover, reserve estimates may differ materially from the quantities of natural gas, gas condensate and crude oil ultimately recoverable.

Some of our reserves have been booked and reported in this prospectus on the basis that 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 in this prospectus, on the basis 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. If we had booked reserves on the basis that the licenses in question would not be extended, our proved reserves at 31 December 2004, would have been approximately 14% less than what we are reporting in this prospectus. There can be no assurance that such extensions will be granted. A failure to receive such extensions would have a material adverse effect on our reserves, business, results of operations and prospects. See “Classification of Reserves—SEC Standards.”

Some of our reserve information is presented using the Russian reserve system, which differs significantly from SPE Standards and the standards applied by the SEC.

Some of the information relating to natural gas, gas condensate and oil reserves contained in this prospectus has been prepared on the basis of the Russian reserves system which differs significantly from SPE Standards and the standards applied by the SEC, 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.”

How, where and when we develop our reserves and explore for new reserves is subject to the approval of the Russian government.

The Russian government must approve all of our exploration and development plans. The government does not always agree with the initial plans we submit, and therefore, our plans are sometimes modified to meet the government’s requirements, even if we do not believe that these requirements represent the best use of our capital. Thus, we may be required to make capital expenditures on projects that we believe to be less attractive than those that we would otherwise choose to undertake. For example, the government has required us to alter our proposed development plans to make additional capital expenditures to explore C2 reserves.

Our accounting systems may not be as sophisticated or robust as those of companies organized in jurisdictions with a longer history of compliance with international accounting standards.

Russian companies are not required to adopt international accounting standards. The recent introduction of international accounting standards by some Russian companies coupled with the historical significance of tax reporting in Russia have resulted in Russian companies, including us, not having implemented accounting systems that are commonplace in countries with a longer history of compliance with international accounting standards. Not having implemented these systems makes our financial information less reliable than that of companies using these systems and could jeopardize the quality of decision making by our senior management.

The recent introduction of international accounting standards in Russia also means that Russian companies are not as experienced with or knowledgeable about international accounting standards as

companies in countries that have a longer history of complying with international accounting standards. As a result, Russian companies, including us:

- may lack a sufficient number of financial personnel with experience in the application and interpretation of international accounting standards;
- have limited experience in exercising the judgment required by international accounting standards;
- have not fully developed and implemented the required methodologies for the preparation of international financial statements, including the internal control frameworks, development methodologies or risk assessment activities on which they depend; and
- have limited familiarity with the information technology and business process automation systems that facilitate the methodologies for the preparation of international financial statements.

Historically, the financial information provided by our subsidiaries has not been uniform and has required the reclassification of certain entries in order for our accounting personnel to process and consolidate the information for the purposes of producing our financial statements. As we develop and implement accounting systems, we may identify further deficiencies with the financial information provided by our subsidiaries that may impact our historical financial statements. We may also experience similar issues with the financial information to be provided by Tarkosaleneftgas and Khancheyneftgas, which entities we now consolidate following our acquisition in December 2004 of the shareholding in those entities that we did not own. Prior to the consolidation of those entities, we accounted for them using the equity method of accounting, which method did not require us to assess the financial information provided by those entities.

We may incur material costs to comply with health, safety and environmental laws and regulations.

We incur, and expect to continue to incur, significant capital and operating costs in order to comply with increasingly complex laws and regulations covering the protection of the environment and human health and safety, including abandonment and site restoration costs relating to our oil and gas properties. Moreover, 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, in the event of environmental contamination, we must provide for remediation. This regulatory burden may increase our costs by requiring us to make significant capital expenditures to modify operations, install pollution control equipment, perform site clean-ups, curtail or cease certain operations, pay fees or fines or make other payments for discharges or other breaches of environmental standards. Costs of compliance and potential liabilities due to environmental damage may be material and could materially adversely effect our business, results of operations and prospects.

Exploratory drilling involves numerous risks, including the risk that we will encounter no commercially productive reserves.

We are exploring in Western Siberia, in an area located far from population centers, which has challenging environmental conditions and where the cost of drilling, completing and operating wells can be uncertain. As a result, we may incur cost overruns or may be required to curtail, delay or cancel drilling operations because of a variety of factors, including unexpected drilling conditions, abnormal 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. Our overall drilling activity or drilling activity in particular project areas may be unsuccessful in that we may not find commercially productive reservoirs.

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

The insurance industry is not yet well developed in Russia 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. We can provide no assurance that our insurance will be adequate to cover all of our losses or liabilities. We also

can provide no assurance that insurance will continue to be available to us on commercially reasonable terms. We do not have full coverage for all of our facilities, and we do not have any coverage for business interruption, third-party liability in respect of property or environmental damage arising from accidents on our property or relating to our operations. Until we are able to obtain adequate insurance coverage, there is a risk that losses and liabilities arising from events that are typically insurable in more developed markets could significantly increase our costs and have a material adverse effect on our operations, financial condition and prospects.

Restrictive covenants may affect our flexibility to operate.

In order to operate effectively, we incur debt. In order to obtain loans, we occasionally pledge some of our significant assets as security. Currently, assets pledged to secure our debt include an approximately 31% participation interest in Tarkosalenftegas, the holder of the exploration and productions licenses to two of our three core fields, and certain materials and supplies inventories. Moreover, restrictive covenants in loan facilities may limit our flexibility to operate and pay dividends. Our ability to comply with these covenants may be affected by events beyond our control. A violation of the terms of a loan agreement could result in the loss of assets pledged to secure the loan evidenced thereby and thus could have a material adverse effect on our business, results of operations, financial condition and prospects. A violation could also result in restrictions on our ability to pay dividends on the shares, which could have a material adverse effect on the market price of the shares and GDRs.

We depend on our senior managers and other key personnel.

Our growth and future success depends on our senior management, particularly Mr. Mikhelson, who is the Chairman of our Management Committee and one of our key founders, as well as on our ability to attract employees with relevant expertise. The loss of some or all of our key management or our inability to attract new qualified employees could have a material adverse effect on our business, financial condition and results of operations.

We may be classified as a passive foreign investment company, which could result in adverse United States federal income tax consequences to US holders.

A non-US corporation will be considered a passive foreign investment company, or a PFIC, for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) at least 50% of the value of its assets is attributable to assets that produce or are held for the production of passive income. Based on our current and projected activities and operations, we do not expect to be considered a PFIC for United States federal income tax purposes for our current taxable year ending 31 December 2005. However, we must make a separate determination each year as to whether we are a PFIC (after the close of each taxable year) and we cannot assure you that we will not be a PFIC for our current taxable year or any future taxable year. In addition, the market value of our assets may be determined in large part by the market price of our GDRs and shares, which is likely to fluctuate, and thus could impact the asset test described above. If we were treated as a PFIC for any taxable year during which a US holder held a GDR, certain adverse United States federal income tax consequences could apply to the US holder. See “Taxation—United States Federal Income Tax Considerations.”

Risks Relating to the Russian Federation

Emerging markets such as the Russian Federation are subject to greater risks than more developed markets, including significant legal, economic and political risks.

Investors in emerging markets such as the Russian Federation should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. 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 is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in the shares and GDRs.

Economic Risks

Economic instability in Russia could adversely affect our business.

Since the dissolution of the Soviet Union, the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to domestic enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and grey market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

The Russian economy has been subject to abrupt downturns. In particular, on 17 August 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its rouble-denominated securities, the Central Bank of Russia stopped its support of the rouble and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the rouble and a sharp increase in the rate of inflation, a dramatic decline in the prices of Russian debt and equity securities and an inability of Russian issuers to raise funds in the international capital markets.

These problems were aggravated by a major banking crisis in the Russian banking sector after the events of 17 August 1998, as evidenced by the termination of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies and resulted in the losses of bank deposits in some cases.

Recently, the Russian economy has experienced positive trends, such as an increase in the gross domestic product, a relatively stable national currency, strong domestic demand, rising real wages and a reduced rate of inflation; however, these trends may not continue or may be abruptly reversed.

The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.

Russia's banking and other financial systems are not well developed or regulated, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent applications. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans at that time. Although the Central Bank of Russia has the mandate and authority to suspend banking licenses of insolvent banks, many insolvent banks still operate. Most Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still lags far behind internationally accepted norms. Aided by inadequate supervision by the regulators, many banks do not follow existing Central Bank of Russia regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure.

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of Russian corporate rouble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. The

serious deficiencies in the Russian banking sector, combined with the deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. In addition, the Central Bank of Russia has recently revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

There is currently a limited number of creditworthy Russian banks, most of which are located in Moscow. We have tried to reduce our risk by receiving and holding funds in a number of Russian banks, including subsidiaries of foreign banks. Nonetheless, we hold the bulk of our excess rouble and foreign currency cash in Russian banks, including subsidiaries of foreign banks, in part, because we are required to do so by Central Bank of Russia regulations and because the rouble is not transferable or convertible outside of Russia. There are few, if any, safe rouble-denominated instruments in which we may invest our excess rouble cash. Another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial conditions and results of operations.

The infrastructure in Russia is inadequate, which could disrupt normal business activity.

The infrastructure in Russia largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission systems, communication systems and building stock. In May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major outage in a large section of Moscow and some surrounding regions, which resulted in a suspension of half of the Moscow metro lines leaving thousands of people blocked underground for a long time. The blackout also hit the ground electric transport, led to road traffic accidents and massive traffic congestion, disrupted electricity and water supply in office and residential buildings and affected mobile communications. The trading on exchanges and the operation of many banks, stores and markets were also halted. Road conditions throughout Russia are poor. The Russian government is actively considering plans to reorganize the nation's rail, electricity and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The deterioration of infrastructure in Russia harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia and can interrupt business operations. These difficulties can impact us directly. Further deterioration in the physical infrastructure could have a material adverse effect on our business and thereby the price of the shares and GDRs.

Fluctuations in the global economy may materially adversely affect the Russian economy and our business, financial condition, results of operations or prospects.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. 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 Russian businesses could face severe liquidity constraints, further materially adversely affecting their economies. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy or undermine the value of the rouble against foreign currencies. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks to the Russian economy. Russia is also a major producer and exporter of metal products and its economy is vulnerable to fluctuations in world commodity prices and the imposition of tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

Political and Social Risks

Political and governmental instability could materially adversely affect our business, financial condition, results of operations or prospects or the value of the shares and GDRs.

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market economy. As a result of the sweeping nature of the reforms, and

the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to demands for autonomy from particular regional and ethnic groups. Moreover, the composition of the Russian government, the prime minister and the other heads of federal ministries has, at times, been highly unstable. For example, six different prime ministers led the governments between March 1998 and May 2000. On 31 December 1999, President Yeltsin unexpectedly resigned. Vladimir Putin was subsequently elected president on 26 March 2000 and re-elected for a second term on 14 March 2004. Throughout most of his first term in office, President Putin maintained governmental stability and accelerated the reform process. In February 2004, President Putin dismissed his entire cabinet, including the prime minister. This was followed on 12 March 2004 by President Putin's announcement of a far-reaching restructuring of the Russian government, with the stated aim of making the government more transparent and efficient. The changes included, for example, reducing the number of ministries from 30 to 14 and dividing the government into three levels: ministries; services; and agencies. In addition to the restructuring of the Russian Federal government, the Russian parliament adopted legislation whereby the executives of sub-federal political units will no longer be directly elected by the population and will instead be nominated by the President of the Russian Federation and confirmed by the legislature of the sub-federal political unit. Further, President Putin has proposed to eliminate individual races in State Duma elections, so that voters would only cast ballots for political parties.

Future changes in government, major policy shifts or lack of consensus between various branches of the government and powerful economic groups could also disrupt or reverse economic and regulatory reforms. Any disruption or reversal of the reform policies, recurrence of political or governmental instability or occurrence of conflicts with powerful economic groups could have a material adverse effect on our business, financial condition, results of operations or prospects and the value of investments in Russia, and the price of the shares and GDRs could decline as a result.

Conflict between central and regional authorities and other conflicts could create an uncertain operating environment hindering our long-term planning ability and could materially adversely affect the value of investments in Russia, including the value of the shares and GDRs.

The Russian Federation is a federation of 89 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area. Violence and attacks relating to this conflict have spread to other parts of Russia, and several terrorist attacks have allegedly been carried out by Chechen terrorists in other parts of Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from Russia, and could materially adversely affect our business and the value of investments in Russia, including the price of the shares and GDRs.

Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our business, financial condition, results of operations or prospects.

The failure 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 have led in the past, and could lead in the future, to labor and social unrest. Labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized

authority, increased nationalism, including restrictions on foreign involvement in the economy of Russia, and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of revenue, materially adversely affecting our business, financial condition, results of operations or prospects.

Legal Risks and Uncertainties

Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity, which could have a material adverse effect on our business, financial condition, results of operations or prospects or the price of the shares and GDRs.

Russia is still developing the legal framework required to support a market economy. The following risk factors relating to the Russian legal system create uncertainties with respect to the legal and business decisions that we make, many of which uncertainties do not exist in countries with more developed market economies:

- inconsistencies between and among laws, the Constitution, Presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting legislation;
- the relative inexperience of judges and courts in interpreting legislation;
- the lack of an independent judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as suspension or termination of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

Furthermore, several fundamental laws have only recently become effective. The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our licenses and under our contracts, or to defend ourselves against claims by others. We cannot assure you that regulators, judicial authorities or third parties will not challenge our internal procedures and by-laws or our compliance with applicable laws, decrees and regulations.

Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions or court judgments which could materially adversely affect our business, financial condition, results of operations and prospects.

Our operations and properties are subject to regulation by various government entities and agencies in connection with obtaining and renewing various licenses, permits, approvals and authorizations, as well as with ongoing compliance with existing laws, regulations and standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licenses, permits, approvals and authorizations and in monitoring licensees' compliance with the terms thereof. Russian authorities have the right to, and frequently do, conduct periodic inspections of our operations and properties throughout the year. Any such future inspections may conclude that we or our subsidiaries have violated laws, decrees or regulations, and we may be unable to refute such conclusions or remedy the violations.

Our failure to comply with existing laws and regulations or the findings of government inspections may result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or termination of our licenses and permits, or in requirements that we cease certain of our business activities, or in criminal and administrative penalties applicable to our officers. Moreover, an agreement made or transaction executed in violation of a law may be invalidated and unwound by a court decision. Any such decisions, requirements or sanctions, or any increase in governmental regulation of our

operations, could increase our costs and materially adversely affect our business, financial condition, results of operations and prospects.

One or more of our subsidiaries may be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations or prospects.

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation, reorganization or during its operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for liquidation of a legal entity. For example, in Russian corporate law, negative net assets calculated on the basis of Russian accounting standards, or RAS, as at the end of the second or any subsequent year of a company's operation, can serve as a basis for a court to order the liquidation of the company, upon a claim by governmental authorities. Many Russian companies have negative net assets due to very low historical asset values reflected on their RAS balance sheets; however, their solvency, *i.e.*, their ability to pay debts as they come due, is not otherwise adversely affected by such negative net assets. Some Russian courts in deciding whether or not to order the liquidation of a company have looked beyond the fact that the company failed to fully comply with all applicable legal requirements and have taken into account other factors, such as the financial standing of the company and its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation.

This judicial approach is supported by a recent decision of the Constitutional Court of the Russian Federation that held that even repeated violations of law may not serve as a basis for an involuntary liquidation of a company, and instead consideration should be given to whether the liquidation would be an adequate sanction for such violations. We currently do not have any subsidiaries with negative net assets. Although some of our subsidiaries might have failed from time to time to fully comply with all the applicable legal requirements, we believe that neither we, nor any of our subsidiaries, should be subject to liquidation on such grounds and none of the possible violations has caused any damage to anyone or has had any other negative consequences. However, weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions of a Russian court or a governmental authority difficult, if not impossible, to predict. If involuntary liquidation were to occur, then we may be forced to reorganize the operations we currently conduct through the affected subsidiaries. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations or prospects.

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

After the Soviet Union ceased to exist, land reform commenced in Russia and real estate legislation changed continuously over the following years; more than one hundred federal laws, presidential decrees and governmental resolutions were issued. Almost all Russian regions passed their own real estate legislation. Until recently, the land legislation in Russia was unsystematic and contradictory. In many instances, there was no certainty regarding which municipal, regional or federal government body, had power to sell, lease or otherwise dispose of land. In 2001, the Russian Civil Code was amended and the new Russian Land Code, as well as a number of other federal laws regulating land use and ownership were enacted. Nevertheless, 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.

Non-compliance with governmental and administrative real estate regulations in Russia could materially affect our business, financial condition, results of operations or prospects.

In order to use and develop land or other real property in Russia, approvals and consents of various federal, regional or local governmental authorities, such as the various environmental, sanitation and epidemiological control authorities, are required. The approval and consent requirements vary from

locality to locality; they are numerous, sometimes contradictory and are subject to change without public notice and are occasionally applied retroactively. The enforcement of such requirements is inconsistent and is often arbitrary and selective. Failure to obtain the required approvals and consents may lead to severe consequences to landowners and leaseholders or other property holders. No assurance can be given that we will at all times be in full compliance with all governmental and administrative real estate regulations in Russia. If any of our existing or prospective sites is found not to be in compliance with all applicable regulations, we may be subject to fines or penalties or our rights to such properties may be affected which could have a material adverse effect on our business, financial condition, results of operations or prospects.

The judiciary's lack of independence, overall inexperience, occasional abuse of discretion, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, materially adversely affecting our business, financial condition, results of operations or prospects and the price of the shares and GDRs.

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. The court system in Russia is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow or unjustifiably swift. Enforcement of court orders can, in practice, be very difficult in Russia. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies, and the government may attempt to invalidate court decisions by backdating or retroactively applying relevant legislative changes.

These uncertainties also extend to property rights. During Russia's transformation from a centrally planned economy to a market economy, legislation has been enacted to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and due to potential political changes, these protections would not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of our entities, their assets or portions thereof, potentially without adequate compensation, would have a material adverse effect on our business, financial condition, results of operations or prospects.

The judiciary's corruption and occasional abuse of discretion can lead to unjustified and abusive court decisions. For example, it is not uncommon for excessive injunctive remedies to be sought by claimants and granted by courts in commercial disputes. 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 the Federal Anti-Monopoly Service 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.

Selective or arbitrary government action may have a material adverse effect on our business, financial condition, results of operations or prospects and on the value of the GDRs.

We operate in an uncertain regulatory environment. Governmental authorities in Russia have a high degree of discretion and, at times, act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is inconsistent with legislation or influenced by political or commercial considerations. Selective or arbitrary governmental actions have reportedly included the denial or withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used ordinary defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations or to void transactions, often for political purposes. Moreover, the government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Standard & Poor's, a provider of independent credit ratings, has expressed concerns that "Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups." In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, in 2003 and 2004, the Ministry for Taxes and Levies aggressively brought tax evasion claims on certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. Selective or arbitrary government action, if directed at us, could have a material adverse effect on our business, financial condition, results of operations or prospects and on the price of the shares and GDRs.

The ongoing government investigation of Yukos could have a negative effect on the Russian economy and on our business, financial condition, results of operations or prospects.

Since June 2003, representatives of the Russian government have been conducting investigations into Yukos and its subsidiaries, one of the largest oil companies in the Russian Federation, which resulted in the filing of charges of tax evasion against the company, the arrest on criminal charges and subsequent trial and sentence of some of the company's key shareholders (including Yukos' Chief Executive Officer, Mikhail Khodorkovsky). In December 2004, OAO Rosneft, a Russian state-owned oil company, bought 76.79% of shares in OAO Yuganskneftegaz, Yukos' core oil production unit, by way of an auction conducted by the Russian government which resulted in the effective nationalization of Yukos' main assets. In addition, Yukos filed a petition seeking bankruptcy protection in the United States in December 2004, which has subsequently been denied. In May 2005, Yukos filed a lawsuit in a Russian court against various governmental agencies, Rosneft and other participants in the auction where Yuganskneftegas shares were sold, seeking the annulment of the auction and damages in excess of \$11.5 billion. There has been considerable volatility in the Russian stock market as a consequence of these events. There can be no assurance that any impact of the Yukos affair on the Russian economy will not have an adverse effect on our business, financial condition, results of operations or prospects.

According to some commentators, these events have called into question the security of property and contractual rights and the independence of the judiciary in the Russian Federation, and raise concerns about the revision of tax legislation, the re-examination of past privatizations in the Russian Federation and the re-distribution of the assets involved. There can be no assurance that representatives of the Russian government will not seek to renationalize some, or all, of our assets in the future.

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 considerably less developed in Russia than in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted, whereas laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities, which are often in competition with each other. These include:

- the Federal Service for the Financial Markets;
- the Ministry of Finance;
- the Federal Anti-Monopoly Service;
- the Central Bank of the Russian Federation; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory.

In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. 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 our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

Because there is little minority shareholder protection in Russia, your ability to bring, or recover in, an action against us will be limited.

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate actions, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of actions. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. See “Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital” for a more detailed description of some of these protections. While these protections are similar to the types of protections available to minority shareholders in US corporations, in practice, corporate governance standards for many Russian companies have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholder meetings have been irregularly conducted, and shareholder resolutions have not always been respected by management. Shareholders of some companies also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

The supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders’ meeting. Thus, controlling shareholders owning slightly less than 75% of outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of the voting power at a shareholders’ meeting, they are in a position to approve amendments to the charter of the company or significant transactions including asset transfers, which could be prejudicial to the interests of minority shareholders. It is possible that our majority shareholders and our management in the future may not run us and our subsidiaries for the benefit of minority shareholders, and this could materially and adversely affect the price of the shares and GDRs.

Disclosure and reporting requirements, as well as anti-fraud legislation, have only recently been enacted in Russia. Most Russian companies and managers are not accustomed to restrictions on their activities arising from these requirements. The concept of fiduciary duties of management or directors to their companies and shareholders is also relatively new and is not well developed. Violations of disclosure and reporting requirements or breaches of fiduciary duties to us and our subsidiaries or to our shareholders could materially adversely affect the price of the shares and GDRs.

While the Joint Stock Companies Law provides that shareholders owning not less than 1% of the company’s stock may bring an action for damages on behalf of the company, Russian courts to date do not have much experience with such lawsuits. Russian law does not contemplate class action litigation. Accordingly, your ability to pursue legal redress against us may be limited, reducing the protections available to you as a holder of the shares and GDRs.

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

The Civil Code and the Federal Law on Joint Stock Companies, or the Joint Stock Companies Law, generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an “effective parent.” The person whose decisions are capable of being so determined is deemed an “effective subsidiary.” Under the Joint Stock Companies Law, an effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary’s debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent’s ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary’s losses from the effective parent which caused the effective subsidiary to take action or fail to

take action knowing that such action or failure to take action would result in losses. 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 and financial condition.

Shareholder rights provisions under Russian law may impose additional costs on us, which could materially adversely affect our financial condition and results of operations.

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to sell their shares to the company at market value in accordance with Russian law. The decisions that trigger this right to sell shares 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 our assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of our charter in a manner that limits shareholder rights.

Our (or, as the case may be, our subsidiaries’) obligation to purchase shares in these circumstances, which is limited to 10% of the company’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 and prospects.

The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares, including the shares underlying the GDRs.

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company’s shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Further, the Depositary, under the terms of the Deposit Agreements, will not be liable for the unavailability of shares or for the failure to make any distribution of cash or property with respect thereto due to the unavailability of the shares. See “Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital—Registration and Transfer of Shares” and “Description of the Global Depositary Receipts—Russian Share Register” for a further discussion of the share registration system and registrars in the Russian Federation.

Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and an investment in the shares and GDRs.

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- value-added tax, or VAT;
- mineral resources extraction tax and export duties;
- unified social tax; and
- property tax.

The tax environment in Russia historically has been complicated by the fact that various authorities have often issued contradictory pieces of tax legislation. This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our licenses.

Because of the political changes, which have occurred in Russia over the past several years, there have recently been significant changes to the Russian taxation system. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, or the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate income tax, VAT and property tax with new chapters of the Tax Code.

In practice, the Russian tax authorities generally interpret the tax laws in ways that rarely favor taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretations of the legislation and assessments. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, in an audit taxpayers are subject to inspection with respect to the three calendar years which immediately preceded the year in which the audit is carried out. Previous audits do not completely exclude subsequent claims relating to the audited period because Russian tax law authorizes upper-level tax inspectorates to review the results of tax audits conducted by subordinate tax inspectorates. In addition, on 14 July 2005 the Russian Constitutional Court issued a decision that allows the statute of limitations for tax liabilities to be extended beyond the three-year term set forth in the tax laws if a court determines that a taxpayer has obstructed or hindered a tax inspection. Because none of the relevant terms are defined, tax authorities may have broad discretion to argue that a taxpayer has “obstructed” or “hindered” an inspection and ultimately seek penalties beyond the three-year term. In some instances, new tax regulations have been given retroactive effect.

Moreover, financial results of Russian companies cannot be consolidated for tax purposes. Therefore, each of our Russian subsidiaries pays its own Russian taxes and may not offset its profit or loss against the loss or profit of any of our other subsidiaries. In addition, intercompany dividends are subject to a withholding tax of 9%, if being distributed to Russian residents, and 15%, if being distributed to foreign residents. If the receiving company itself pays a dividend, it may offset the withholding against its own withholding liability of the onward dividend although not against any withholding made on a distribution to a foreign resident. These tax requirements impose additional burdens and costs on our operations, including management resources.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could materially adversely affect our business and the price of the shares and GDRs. See also “—Risks Relating to the Russian Federation—Legal Risks and Uncertainties—Unlawful or arbitrary government action may have a material adverse effect on our business, financial condition, results of operations or prospects and on the price of the shares and GDRs.”

Russian currency control regulations could hinder our ability to conduct our business.

Over the past several years, the rouble has fluctuated dramatically against the US dollar. The Central Bank of Russia has from time to time imposed various currency control regulations in attempts to support the rouble, and may take further actions in the future. For example, Central Bank regulations currently require us to convert into roubles 10% of our export proceeds. Furthermore, the government and the Central Bank may impose additional requirements on cash inflows and outflows into and out of Russia or on the use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A new framework law on exchange controls took effect in June 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters,

including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank, envisaging instead the implementation of generally applicable restrictions on currency operations. As the evolving regulatory regime is very recent and untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced. See “Description of Share Capital and Certain Requirements of Russian Legislation—Exchange Controls” for a further description of Russia’s currency control regulations.

Foreign judgments may not be recognized in the Russian Federation.

Judgments rendered by a court in any jurisdiction outside the Russian Federation are likely to be 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 in which the judgment is rendered, and
- a federal law of the Russian Federation provides for the recognition and enforcement of foreign court judgments.

No such federal law has been passed and no such treaty exists between the United States or the United Kingdom and the Russian Federation for the reciprocal enforcement of foreign court judgments. Thus, enforcement of foreign court judgments against us in the Russian Federation may be impossible. Also, the underwriting agreement provides that controversies, claims and causes of action brought by any party thereto against us may be settled by arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the lack of experience of Russian courts in international commercial transactions and their limited experience in the enforcement of foreign arbitral awards. The possible need to re-litigate in the Russian Federation a judgment obtained in a foreign court on the merits may significantly delay the enforcement of such judgment. Under Russian law, certain amounts may be payable by the claimant upon the initiation of any action or proceeding in any Russian court. These amounts in many instances depend on the amount of the relevant claim. See “Limitation on Service of Process and Enforcement of Civil Liabilities.”

Risks Relating to the GDRs, the Shares and the Trading Market

Because the Depositary may be considered the beneficial holder of the shares underlying the GDRs, these shares may be arrested or seized in legal proceedings in Russia against the Depositary.

Because Russian law may not recognize GDR holders as beneficial owners of the underlying shares, it is possible that you could lose all your rights to those shares if the Depositary’s assets in Russia are seized or arrested. In that case, you would lose all the money you invested.

Russian law may treat the Depositary as the beneficial owner of the shares underlying the GDRs. This is different from the way other jurisdictions treat GDRs. In the United States, although shares may be held in the Depositary’s name or to its order, making it a “legal” owner of the shares, the GDR holders are the “beneficial,” or real owners. In US courts, an action against the Depositary, the legal owner of the shares, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and it may only recognize the rights of the Depositary in whose name the shares are held, not the rights of GDR holders, to the underlying shares. Thus, in proceedings brought against a depositary, whether or not related to shares underlying GDRs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. In the past, a lawsuit was filed against a depositary bank other than Deutsche Bank Trust Company Americas seeking the seizure of various Russian companies’ shares represented by GDRs issued by that depositary. In the event that this type of suit were to be successful in the future against the Depositary, and the shares underlying our GDRs were to be seized or arrested, the GDR holders involved would lose their rights to such underlying shares.

Your voting rights with respect to the shares represented by the GDRs are limited by the terms of the Deposit Agreements for the GDRs and relevant requirements of Russian law.

As a GDR holder, you will have no direct voting rights with respect to the shares represented by the GDRs. You will be able to exercise voting rights with respect to the shares represented by GDRs only in accordance with the provisions of the Deposit Agreements relating to the GDRs and relevant requirements of Russian law. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, the Joint Stock Companies Law and our charter require us to notify shareholders no less than 30 days prior to the date of any meeting and at least 50 days prior to the date of an extraordinary meeting to elect our Board of Directors. Our ordinary shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

As a GDR holder, you, by comparison, will not receive notice directly from us. Rather, in accordance with the Deposit Agreements, we will provide the notice to the Depositary. The Depositary has undertaken, in turn, as soon as reasonably practicable thereafter, if requested by us in writing in a timely manner and at our expense, and provided there are no US, English or Russian legal prohibitions (including, without limitation, the rules of the London Stock Exchange or the rules of any Russian stock exchange on which the shares are listed or admitted to trading), to mail to you notice of such meeting, copies of voting materials (if and as received by the Depositary from us) and a statement as to the manner in which instructions may be given by holders. To exercise your voting rights, you must then instruct the Depositary how to vote the shares represented by the GDRs you hold. Because of this additional procedural step involving the Depositary, the process for exercising voting rights may take longer for you than for holders of the shares and we cannot assure you that you will receive voting materials in time to enable you to return voting instructions to the Depositary in a timely manner. GDRs for which the Depositary does not receive timely voting instructions will not be voted.

In addition, although Russian securities regulations expressly permit the Depositary to split the votes with respect to the shares underlying the GDRs in accordance with instructions from GDR holders, such regulations remain untested, and the Depositary may choose to refrain from voting at all unless it receives instructions from all GDR holders to vote the shares in the same manner. You may thus have significant difficulty in exercising voting rights with respect to the shares underlying the GDRs. There can be no assurance that holders and beneficial owners of GDRs will (i) receive notice of shareholder meetings to enable the timely return of voting instructions to the Depositary, (ii) receive notice to enable the timely cancellation of GDRs in respect of shareholder actions or (iii) be given the benefit of dissenting or minority shareholders' rights in respect of an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions. See "Description of the Global Depositary Receipts—Voting Rights" for a description of the voting rights of holders of GDRs.

Holders of GDRs will not be able to instruct the Depositary to (i) vote the shares represented by their GDRs on a cumulative basis, (ii) introduce proposals for the agenda of shareholders' meetings or request that a shareholders meeting be called or (iii) nominate candidates for our Board of Directors or our review commission. If you wish to take such actions, you must timely request that your GDRs be cancelled and take delivery of the shares and thus become the owner of the shares on our share register.

Because there has been no prior market for the GDRs, the offering may fail to result in an active or liquid market for the GDRs, and the price of the GDRs may be highly volatile.

Before the offering, there has been no prior market for the GDRs. Although application has been made to the UK Listing Authority for the GDRs to be admitted to the Official List and to the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange's regulated market for listed securities, an active public market may not develop or be sustained after the offering. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. If a liquid trading market for the GDRs does not develop, the price of the GDRs may become more volatile and it may be more difficult to complete a buy or sell order for such GDRs.

The liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. GDR holders are entitled to withdraw the shares underlying the GDRs from the Depositary, but there is limited trading of our shares on the RTS Stock Exchange and the MICEX Stock Exchange, where they are currently listed. We cannot assure you that this offering will result in active trading in our shares or GDRs.

The trading prices of the GDRs may be subject to wide fluctuations in response to a number of factors, including:

- variations in our operating results and those of other Russian companies;
- variations in national and industry growth rates;
- actual or anticipated announcements of technical innovations or new products or services by us or our competitors;
- changes in governmental legislation or regulation;
- general economic conditions within our business sector or in Russia; or
- extreme price and volume fluctuations on the Russian or other emerging market stock exchanges.

In addition, the Russian stock market has experienced extreme price and volume fluctuations. These market fluctuations could adversely affect the value of the GDRs. Moreover, the market price of the GDRs may decline below the offering price, which will be determined by negotiation between us and representatives of the underwriters.

You may be unable to repatriate distributions made on the shares.

We intend to pay dividends on shares in roubles and Russian legislation currently permits such rouble funds to be converted into US dollars by the Depositary without restriction. The ability to convert roubles into US dollars is subject to the availability of US dollars in Russia's currency markets. Although there is an existing market within Russia for the conversion of roubles into US dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of roubles into foreign currencies outside of Russia and no viable market in which to hedge rouble- and rouble-denominated investments.

Future sales of shares or GDRs may affect the market price of the shares and GDRs.

Sales, or the possibility of sales, of substantial numbers of the shares or the GDRs in the public markets, including the Russian stock market, following the offering could have an adverse effect on the market trading prices of the shares or GDRs. Our subsequent equity offerings may reduce the percentage ownership of our shareholders. Moreover, newly issued preferred shares may have rights, preferences or privileges senior to those of the shares.

You may not be able to benefit from double tax treaties.

In accordance with Russian legislation, dividends paid to a non-resident holder generally will be subject to Russian withholding at a rate of 15% for legal entities and organizations and at a rate of 30% for individuals. This tax may be reduced to 5% or 10% for legal entities and organizations and to 10% for individuals under the United States-Russia double tax treaty for US holders and to 10% under the United Kingdom-Russia double tax treaty for UK holders. However, the Russian tax rules applicable to GDR holders are characterized by significant uncertainties and, until recently, by an absence of interpretive guidance. In 2005 the Ministry of Finance expressed an opinion that GDR holders should be treated as the beneficial owners of the underlying shares for the purposes of the double tax treaty provisions applicable to taxation of dividend income from the underlying shares, provided that tax residencies of the GDR holders are duly confirmed. However, in the absence of any specific provisions in the Russian tax legislation with respect to the concept of beneficial ownership and taxation of income of beneficial owners, it is unclear how the Russian tax authorities will ultimately treat the GDR holders in this regard. Thus, we may be obliged to withhold tax at higher rates when paying out dividends to US and UK holders, and US and UK holders may be unable to benefit from these treaties. See "Taxation—Certain Russian Tax Law Considerations" for further details.

Capital gains from the sale of shares or GDRs may be subject to Russian income tax.

Under Russian tax legislation, gains realized by non-resident legal entities or organizations from the disposition of Russian shares and securities, such as the shares, as well as financial instruments derived from such shares, such as the GDRs, may be subject to Russian profits tax or withholding income tax if immovable property located in Russia constitutes more than 50% of our assets. However, no procedural

mechanism currently exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered presence in Russia. Gains arising from the disposition of the foregoing types of securities listed on foreign stock exchanges by foreign holders who are legal entities or organizations are not subject to taxation in Russia.

Gains arising from the disposition of the foregoing types of securities and derivatives outside of Russia by US or UK holders who are individuals not resident in Russia for tax purposes will not be considered Russian source income and will not be taxable in Russia. Gains arising from disposition of the foregoing types of securities and derivatives in Russia by US or UK holders who are individuals not resident in Russia for tax purposes may be subject to tax either at the source in Russia or based on an annual tax return, which they may be required to submit with the Russian tax authorities. See “Taxation—Certain Russian Tax Law Considerations.”

You may not be able to deposit shares in the GDR program in order to receive GDRs.

Russian securities regulations provide that no more than 40% of a Russian company’s shares may be circulated abroad through sponsored depositary receipt programs and we currently have approval for only 29.99% of our shares to be circulated abroad in this manner. Upon completion of the offering and assuming exercise of the over-allotment option in full, our GDR program would have a remaining capacity of only 10.99% of our outstanding shares if all the shares offered in the offering are ultimately held in the form of GDRs. We also expect that the International Finance Corporation (the IFC), which holds 1% of our outstanding shares, will convert its shares into GDRs after the offering. Any remaining capacity may be used by our other existing shareholders, and we cannot guarantee that you will be able to deposit shares into our GDR program in order to receive GDRs.

We may not be able to prepare a prospectus that may be required in connection with the deposit of additional shares into the GDR program.

In order for you to receive GDRs if you deposit shares into our GDR program, we may be required by the UK Listing Authority to produce a further prospectus. We may not be able to produce such a further prospectus. Accordingly, notwithstanding the terms of the Deposit Agreements, we cannot assure you that we will be in a position to make an application (i) to the UK Listing Authority for a listing of the GDRs to be issued from time to time against the deposit of such shares with the Depositary and (ii) to the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange’s regulated market for listed securities. Under such circumstances, you will be unable to deposit shares into, and no further issuances of GDRs will be made under, our GDR program unless and until a further prospectus is prepared in accordance with the Prospectus Rules of the UK Listing Authority.

You may have limited recourse against us and our directors and executive officers because we generally conduct our operations outside the United States and the United Kingdom and all of our directors and executive officers reside outside the United States and the United Kingdom.

Our presence outside the United States and the United Kingdom may limit your legal recourse against us. We are incorporated under the laws of the Russian Federation. All of our directors and executive officers reside outside the United States and the United Kingdom, principally in the Russian Federation. All or a substantial portion of our assets and the assets of our directors and executive officers are located outside the United States and the United Kingdom, principally in the Russian Federation. As a result, you may not be able to effect service of process within the United States or the United Kingdom upon us or our directors and executive officers or to enforce US or UK court judgments obtained against us or our directors and executive officers in jurisdictions outside the United States and the United Kingdom, including actions under the civil liability provisions of US securities laws. In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions outside the United States and the United Kingdom, liabilities predicated upon US or UK securities laws.

There is no treaty between the United States and the Russian Federation or the United Kingdom and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the GDRs. The Deposit Agreements provide for actions brought by any party thereto against us to be settled by arbitration in accordance with the rules of the London Court of International Arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to

enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts' inability to enforce such orders and corruption.

Other Risks

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

We have sourced certain information contained in this prospectus from third parties, including private companies and Russian government agencies, 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 of Western countries. 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 the Russian government may be questionable. In the summer of 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and charged in connection with their misuse of economic data.

USE OF PROCEEDS

We are not selling any shares in this offering and will not receive any of the proceeds of this offering. The Selling Shareholder and Levit, one of our principal shareholders and an affiliate of the Selling Shareholder, have confirmed in writing that the reason for the offering is to, and that they will, use a portion of the proceeds of the offering to repay (i) loans with an aggregate principal balance of \$260 million the Selling Shareholder received from commercial banks and (ii) the loan we extended to Levit. These loans were made in connection with our acquisitions of the remaining interests in Tarkosalenftegas and Khancheyneftegas in December 2004. As of the date of this prospectus, the outstanding principal amount of the loan we extended to Levit is \$270 million, plus accrued interest of \$15.7 million. See “Business—Recent Developments.”

We expect to use the funds we receive from the repayment of our loan to Levit for general corporate purposes, including repayment of indebtedness.

DIVIDEND POLICY

With respect to the results of our fiscal years ended 31 December 2002, 2003 and 2004, we declared annual dividends of RR 35 million (or RR 22 per share), RR 565 million (or RR 251 per share) and RR 777 million (or RR 256 per share), respectively, which represented 6.7%, 18.6% and 15%, respectively, of our annual net income calculated in accordance with Russian accounting standards and 5.4%, 17.2% and 13.6%, respectively, of our IFRS net income for those years. In addition, in 2004 we declared a special dividend of RR 1,445 million (or RR 643 per share).

For subsequent years, as we reduce our ratio of debt to equity, we expect to increase the ratio of annual dividends to net income from at least 15% of our annual net income calculated in accordance with Russian accounting standards for 2005 to 2007, to at least 30% of our annual net income calculated in accordance with Russian accounting standards for 2008 and thereafter. We will seek to adopt a dividend pay-out policy to ensure that the company does not retain excessive net cash balances. In any one year, however, the aggregate dividends paid to shareholders may be lower or higher than 15% in respect of each of 2005, 2006 and 2007 and lower or higher than 30% in respect of 2008 and thereafter, 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.

Pursuant to a recent agreement with the IFC, SWGI and Levit have agreed to use their votes to procure that we pay dividends in amounts equal to at least (i) 15% of our distributable profits for 2005 to 2007 and (ii) 30% of our distributable profits for 2008 and thereafter, in each case, such distributable profits calculated in accordance with Russian accounting standards. See “Business—Recent Developments—Sale of shares to International Finance Corporation.”

Dividend payments, if any, must be recommended by our Board of Directors and approved by our shareholders. In particular, dividends may be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- our charter capital has been paid in full;
- the value of our net assets, calculated under Russian accounting standards, is not less, and would not, as a result of the proposed dividend payment, become less than the sum of our charter capital, our reserve fund and the difference between the liquidation value and the par value of our issued and outstanding preferred shares;
- we have repurchased all shares from shareholders having the right to demand repurchase;
- we are not, and would not become as the result of the proposed dividend payment, insolvent; and
- our reserve fund in an amount equal to 5% of our charter capital has been funded.

Dividends, if declared, are payable to our shareholders within 60 days of the declaration unless a shorter time period is set forth by the shareholders’ decision declaring the dividends. Dividends not claimed within three years of the date of payment lapse and accrue to us. See “Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital—Dividends.”

We anticipate that any dividends we may pay in the future in respect of the shares represented by the GDRs will be declared and paid to the Depositary in roubles and will be converted into US dollars by the Depositary and distributed to holders of the GDRs, net of the Depositary’s fees and expenses. Accordingly, the value of dividends received by holders of the GDRs will be subject to fluctuations in the exchange rate between the rouble and the US dollar. In addition, dividends that we may distribute to the Depositary will be subject to applicable Russian withholding taxes. See “Taxation—Certain Russian Tax Law Considerations—Taxation of Dividends” and “Risk Factors—Risks Relating to the GDRs and the Trading Market—You may not be able to benefit from double tax treaties.”

MARKET INFORMATION

Our shares have been listed on the RTS Stock Exchange in US dollars (symbol: NVTK) since December 2004. Our shares have also been listed in roubles on the MICEX Stock Exchange (symbol: FIKO) since October 2004 and on the RTS Stock Exchange (symbol: NVTKG) since April 2005.

The following table sets forth the monthly high and low market prices per share and total monthly trading volume of our shares traded in US dollars (symbol: NVTK) on the RTS Stock Exchange for each of the most recent six months and the quarterly high and low market prices per share and the total quarterly trading volume for each quarter since trading of our shares in US dollars commenced on the RTS Stock Exchange.

	<u>High</u>	<u>Low</u>	<u>Number of Shares Traded in Period</u>
June 2005	\$1,635	\$1,290	4,460
May 2005	1,330	1,295	250
April 2005	1,348	1,310	1,516
March 2005	1,320	1,220	1,470
February 2005	1,265	1,115	980
January 2005	1,095	1,095	50
Second Quarter 2005	1,635	1,290	6,226
First Quarter 2005	1,320	1,095	2,500

Trading activity in our shares in roubles on the MICEX Stock Exchange and the RTS Stock Exchange is not significant.

CAPITALIZATION

The following table sets forth our cash and cash equivalents, short-term borrowings and capitalization as of 31 March 2005, and as adjusted to reflect the expected repayment of the loan we extended to Levit, one of our principal shareholders and an affiliate of the Selling Shareholder, in connection with the acquisitions of the remaining interests in Tarkosalenftegas and Khancheyneftegas in December 2004 from the proceeds of this offering. See “Use of Proceeds.” Prospective investors should read this information in conjunction with “Selected Consolidated Historical Financial Data,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the accompanying notes appearing elsewhere in this prospectus.

	As of 31 March 2005			
	Actual		As Adjusted ⁽²⁾	
	RR	USD	RR	USD
	(in millions)			
Cash and cash equivalents	1,725	62	9,446	339
Short-term borrowings	6,952	250	6,952	250
Long-term borrowings	12,898	463	12,898	463
Equity attributable to our shareholders:				
Ordinary share capital ⁽¹⁾	393	14	393	14
Additional paid-in-capital	29,797	1,071	29,797	1,071
Asset revaluation surplus	5,345	193	5,345	193
Retained earnings	12,029	432	12,029	432
Total equity attributable to our shareholders	47,564	1,710	47,564	1,710
Minority interest	438	16	438	16
Total equity	48,002	1,726	48,002	1,726
Total capitalization	60,900	2,189	60,900	2,189

(1) Our share capital consists of 3,036,306 ordinary shares, fully paid, issued and outstanding, with a nominal value of 100 roubles each. In addition, we are authorized by our charter to issue an additional 7,557,376 ordinary shares.

(2) At 31 March 2005, the amount due to us from Levit totaled RR 7,721 million (\$277 million), including RR 208 million (\$7 million) of accrued interest.

The US dollar amounts in this section were calculated based on the exchange rate of RR 27.83 per \$1.00, the official exchange rate as reported by the Central Bank of Russia for 31 March 2005.

SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA

The selected consolidated financial information set forth below as of and for the three months ended 31 March 2005 and 2004, and as of and for the twelve months ended 31 December 2004, 2003 and 2002 has been extracted from our audited annual consolidated financial statements and unaudited consolidated interim condensed financial information included elsewhere in this prospectus. Our annual consolidated financial statements and our unaudited consolidated interim condensed financial information have been prepared in accordance with IFRS, including International Accounting Standards (IAS) and Interpretations issued by the International Accounting Standards Board. IFRS differs in certain respects from US GAAP. For a summary of certain differences between IFRS and US GAAP that are relevant to us, see “Summary of Certain Differences between IFRS and US GAAP.”

Our results of operations for the periods presented are significantly affected by acquisitions. Results of operations of these acquired businesses are included in our consolidated financial statements for the periods after their respective dates of acquisition. The financial data below should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements, unaudited consolidated interim condensed financial information and the accompanying notes included elsewhere in this prospectus and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

As a result of our acquisitions during 2004, we have consolidated the operations of Tarkosalenftegas and Khancheyneftegas from December 2004. For periods prior to December 2004, Tarkosalenftegas and Khancheyneftegas were considered associates and our interests in their operating results were included in our statement of income under the caption “Share of income from associates.” See “Business—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance” and “Unaudited Condensed Pro Forma Financial Information.”

Except for the three months ended 31 March 2005, the selected consolidated historical financial data below includes the activities of our oil and gas construction services business, which we sold in June 2004 to focus on our core activities of oil and gas exploration and production. Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation. Total revenues and other income attributable to our oil and gas construction services business were RR 2,186 million, RR 3,227 million and RR 1,084 million for the years ended 31 December 2004, 2003 and 2002, respectively, and RR nil and RR 1,102 million for the three month periods ended 31 March 2005 and 2004, respectively. Net losses attributable to our oil and gas construction services business were RR 335 million, RR 122 million and RR 23 million for the years ended 31 December 2004, 2003 and 2002, respectively, and RR nil and RR 94 million for the three month periods ended 31 March 2005 and 2004, respectively.

Total assets attributable to our oil and gas construction services business were RR 3,580 million and RR 1,951 million at 31 December 2003 and 2002, respectively. Total liabilities attributable to our oil and gas construction services business were RR 2,464 million and RR 944 million at 31 December 2003 and 2002, respectively.

All rouble amounts related to financial information for periods prior to 1 January 2003 are expressed in constant rouble as of 31 December 2002 purchasing power, in accordance with IAS No. 29, *Financial Reporting in Hyperinflationary Economies* (“IAS 29”). As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003, we no longer apply the provisions of IAS 29. Accordingly, no adjustment for the effects of changes in general purchasing power have been made for periods after 1 January 2003. See our consolidated financial statements and the accompanying notes included elsewhere in this prospectus.

Solely for the convenience of the reader, certain information derived from the consolidated financial statements included herein has been converted into US dollars based on the exchange rate of RR 27.83 per \$1.00, the official exchange rate as reported by the Central Bank of Russia for 31 March 2005.

The amounts translated in US dollars should not be construed as representations that the rouble amounts have been or could be converted to US dollars at that or any other rate or as being representative of the US dollar amounts that would have resulted if we reported in US dollars.

Selected Income Data

	Three months ended 31 March			Year ended 31 December			
	2005		2004	2004		2003	2002
	RR	USD	RR	RR	USD	RR	RR
	(in millions, except as indicated)						
Revenues:							
Oil and gas sales	8,693	312	5,238	21,489	748	12,024	2,302
Oil and gas construction services	—	—	1,067	2,053	72	3,258	2,212
Other revenues	311	12	362	1,073	37	776	771
Total revenues	9,004	324	6,667	24,615	857	16,058	5,285
Other income (loss)	(4)	—	(41)	583	20	1,198	394
Total revenues and other income	9,000	324	6,626	25,198	877	17,256	5,679
Operating expenses:							
Materials, services and other	(867)	(31)	(1,710)	(4,175)	(145)	(4,982)	(2,844)
Purchases of oil, gas condensate and natural gas	(611)	(22)	(1,485)	(5,708)	(199)	(3,310)	(607)
Transportation expenses	(1,740)	(63)	(1,040)	(4,234)	(147)	(2,390)	(321)
Taxes other than income tax	(1,301)	(47)	(392)	(1,569)	(55)	(847)	(296)
Depreciation, depletion and amortization	(814)	(29)	(149)	(681)	(24)	(425)	(151)
Other expenses	(419)	(15)	(331)	(1,217)	(42)	(1,130)	(923)
Income from operations	3,248	117	1,519	7,614	265	4,172	537
Total finance income (expense)	(241)	(9)	11	(292)	(10)	(156)	67
Share of income from associates	77	3	374	721	25	524	737
Total income tax expense	(776)	(28)	(479)	(2,075)	(72)	(1,331)	(749)
Minority interest	7	—	9	(274)	(10)	72	52
Net income	2,315	83	1,434	5,694	198	3,281	644
Basic and diluted earnings per share ⁽¹⁾ (in RR and USD)	762	27	638	2,510	87	1,895	565
Weighted average shares outstanding (actual)	3,036,306	3,036,306	2,247,030	2,268,654	2,268,654	1,731,512	1,139,636

(1) Included within basic and diluted earnings per share are losses per share of RR nil and RR 42 for the three months ended 31 March 2005 and 2004, respectively, and RR 148, RR 70 and RR 20 for the years ended 31 December 2004, 2003 and 2002, respectively, related to our oil and gas construction business sold in June 2004.

Selected Balance Sheet Data

	As of 31 March		As of 31 December			
	2005		2004		2003	2002
	RR	USD	RR	USD	RR	RR
	(in millions)					
Assets:						
Property, plant and equipment, net	63,181	2,270	62,449	2,251	10,057	5,626
Other non-current assets	11,486	413	10,867	391	8,564	4,583
Cash and cash equivalents	1,725	62	3,003	108	1,618	306
Other current assets	6,693	241	6,131	221	6,147	5,340
Total assets	83,085	2,986	82,450	2,971	26,386	15,855
Liabilities and Equity:						
Long-term debt	12,898	463	13,232	477	5,752	3,279
Other non-current liabilities	10,226	368	10,043	362	1,793	1,304
Short-term debt	6,952	250	10,768	388	2,069	1,717
Other current liabilities	5,007	179	3,471	125	4,759	3,330
Total liabilities	35,083	1,260	37,514	1,352	14,373	9,630
Minority interest	438	16	449	16	468	781
Total equity attributable to shareholders	47,564	1,710	44,487	1,603	11,545	5,444
Total equity	48,002	1,726	44,936	1,619	12,013	6,225
Total liabilities and equity	83,085	2,986	82,450	2,971	26,386	15,855

Selected Cash Flow Data

	Three months ended 31 March			Year ended 31 December			
	2005		2004	2004		2003	2002
	RR	USD	RR	RR	USD	RR	RR
	(in millions)						
Net cash provided by (used in) operating activities	4,681	168	1,215	4,799	168	3,812	(787)
Net cash used in investing activities	(1,342)	(48)	(1,574)	(12,874)	(449)	(5,311)	(2,796)
Net cash provided by (used in) financing activities	(4,610)	(166)	173	9,433	328	2,865	3,083

Certain Items and Ratios

	As of and for the three months ended 31 March			As of and for the year ended 31 December			
	2005		2004	2004		2003	2002
	RR	USD	RR	RR	USD	RR	RR
	(in millions, except as indicated)						
EBITDA ⁽¹⁾	4,146	149	2,051	8,742	304	5,193	1,477
EBITDA margin ⁽²⁾	46%	46%	31%	35%	35%	30%	26%
Capital expenditures ⁽³⁾	1,577	57	N/A	7,412	267	5,002	3,451
Net debt ⁽⁴⁾	18,125	651	N/A	20,997	757	6,203	4,690
Debt to equity	0.4x	0.4x	N/A	0.5x	0.5x	0.7x	0.8x

(1) EBITDA represents net income before finance income (expense), income taxes and depreciation, depletion and amortization. We present EBITDA because we consider it an important supplemental measure of our operating performance and believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our operating results as reported under IFRS. Some of these limitations are as follows:

- EBITDA does not reflect the impact of financing costs, which are significant and could further increase if we incur more debt, on our operating performance.
- EBITDA does not reflect the impact of income taxes on our operating performance.
- EBITDA does not reflect the impact of depreciation and amortization on our operating performance. The assets of our business which are being depreciated and/or amortized will have to be replaced in the future and such depreciation and amortization expense may approximate the cost to replace these assets in the future. By excluding this expense from EBITDA, EBITDA does not reflect our future cash requirements for these replacements.
- Other companies in our industry may calculate EBITDA 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 only supplementally. See our consolidated statements of income and consolidated statements of cash flows included elsewhere in this prospectus.

EBITDA is a measure of our operating performance that is not required by, or presented in accordance with, IFRS.

EBITDA is not a measurement of our operating performance under IFRS and should not be considered as an alternative to net income, operating income 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, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Reconciliation of EBITDA to net income is as follows for the periods indicated:

	As of and for the three months ended 31 March			As of and for the year ended 31 December			
	2005		2004	2004		2003	2002
	RR	USD	RR	RR	USD	RR	RR
	(in millions)						
Net income	2,315	83	1,434	5,694	198	3,281	644
Add:							
Depreciation, depletion and amortization	814	29	149	681	24	425	151
Total finance income (expense)	241	9	(11)	292	10	156	(67)
Total income tax expense	776	28	479	2,075	72	1,331	749
EBITDA	4,146	149	2,051	8,742	304	5,193	1,477

(2) Calculated as EBITDA divided by total revenues and other income, net.

(3) Represents additions to property, plant and equipment.

(4) Calculated as total debt less cash and cash equivalents.

UNAUDITED CONDENSED PRO FORMA FINANCIAL INFORMATION

Pro Forma Information for the Year Ended 31 December 2004

The following table sets forth summary unaudited condensed pro forma financial information for the year ended 31 December 2004 which is presented to give effect to the acquisitions of all remaining equity interests in Tarkosaleneftegaz and Khancheyneftegas as if they had occurred on 1 January 2004. As a result of the acquisitions, we have consolidated the operations of Tarkosaleneftegaz and Khancheyneftegas from December 2004. For periods prior to December 2004, Tarkosaleneftegaz and Khancheyneftegas were considered associates and our interests in their operating results were included in our statement of income under the caption “Share of income from associates.” See “Business—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance.”

Our consolidated financial information for the year ended 31 December 2004 includes the activities of our oil and gas construction services business through its sale in June 2004. For the year ended 31 December 2004, total revenues and other income and net loss attributable to our oil and gas construction services business, were RR 2,186 million and RR 335 million, respectively.

All unaudited condensed pro forma financial information is based on estimates and assumptions deemed appropriate by us. The unaudited condensed pro forma financial information is presented for illustrative purposes only. If the acquisitions had occurred on 1 January 2004, our operating results might have been different from those presented in the following table. The unaudited condensed pro forma financial information should not be relied upon as an indication of the operating results that we would have achieved if the acquisitions had occurred on 1 January 2004, nor should it be used as an indication of the results that we will achieve following the acquisitions.

The unaudited condensed pro forma financial information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” our audited consolidated financial statements, our unaudited consolidated interim condensed financial information for the three months ended 31 March 2005, and the audited consolidated financial statements of Tarkosaleneftegaz, together with the accompanying notes included elsewhere in this prospectus.

	NOVATEK Consolidated (A)	Tarkosaleneftegaz (B)	Khancheyneftegas (C)	Pro forma adjustments (D)	Notes	Pro Forma
		(in millions of RR, except per share information)				
Total revenues	24,615	4,457	2,749	(3,928)	E,F	27,893
Gain on disposal of subsidiaries, net	198	—	—	—		198
Other income (expense)	385	223	(85)	—		523
Total revenues and other income	25,198	4,680	2,664	(3,928)		28,614
Total operating expenses	(17,584)	(3,530)	(2,060)	3,807	E,G	(19,367)
Income from operations	7,614	1,150	604	(121)		9,247
Total finance income (expense)	(292)	(1,117)	(103)	538	E,F,H	(974)
Share of income from associates	721	—	—	(299)	I	422
Income before income tax and minority interest	8,043	33	501	118		8,695
Total income tax expense	(2,075)	(137)	(80)	182	I,J	(2,110)
Income before minority interest	5,968	(104)	421	300		6,585
Minority interest	(274)	—	—	—		(274)
Net income	5,694	(104)	421	300		6,311
Basic and diluted earnings per share (in RR)	2,510					2,078
Shares used in calculating basic and diluted earnings per share	2,268,654			767,652		3,036,306

Notes

(A) NOVATEK Historical Financial Data

NOVATEK historical financial data is derived from our audited consolidated financial statements for the year ended 31 December 2004, presented elsewhere in this prospectus. Following the acquisitions described above, we consolidated Tarkosaleneftegaz and Khancheyneftegas as of 31 December 2004. The financial position and results of operations and cash flows of Tarkosaleneftegaz and Khancheyneftegas were fully consolidated in our unaudited consolidated interim condensed financial information as of and for the three months ended 31 March 2005, presented elsewhere in this prospectus.

(B) Tarkosaleneftegas Historical Financial Data

In December 2004, we acquired 67.7% of Tarkosaleneftegas, bringing our ownership to 100%. Tarkosaleneftegas historical financial data is derived from its audited consolidated financial statements for the year ended 31 December 2004, presented elsewhere in this prospectus.

(C) Khancheyneftegas Historical Financial Data (Unaudited)

In December 2004, we acquired 57% of Khancheyneftegas, bringing our ownership to 100%. Khancheyneftegas historical financial data is derived from Khancheyneftegas historical accounting records and prepared in accordance with IFRS.

(D) Pro Forma Adjustments (Unaudited)

The unaudited pro forma adjustments reflect the effect of the acquisition of Tarkosaleneftegas and Khancheyneftegas. The acquisitions were accounted for in accordance with IFRS 3, *Business Combinations*. The acquisition adjustments reflect the allocation of estimated fair values to the acquired entities as of acquisition. Consideration provided for the acquisitions included NOVATEK shares, early repayment of debt and a long term gas sales contract with the Itera Group. See “Business—History—Relationship with the Itera Group” and “Business—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance.” We believe that the assumptions underlying the unaudited pro forma financial information are reasonable.

(E) Intercompany Eliminations

Intercompany revenues of RR 5,224 million and the corresponding purchases of RR 5,224 recorded within operating expenses in our consolidated financial statements, between Tarkosaleneftegas, Khancheyneftegas and us during the year ended 31 December 2004 were eliminated.

(F) Five Year Gas Sales Contract

This adjustment increases revenues by RR 1,297 million to reflect the amortization of the unfavorable sales contract and the difference between actual sales prices from Tarkosaleneftegas to the Itera Group recognized during 2004 and the price designated for sales under the five year gas supply contract provided as part of the consideration for the acquisition of Tarkosaleneftegas and Khancheyneftegas.

Total net finance expense was increased by RR 79 million to reflect the accretion of the discount associated with the value of the long-term gas supply contract that was recorded at its net present value in our balance sheet. The difference between the contract value and its present value is considered interest expense under IFRS. See “Business—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance.”

(G) Purchase Accounting Adjustments

Operating expenses were increased by RR 1,417 million to reflect higher depreciation, depletion and amortization expense as a result of estimated fair value adjustments recorded to oil and gas properties within property, plant and equipment.

(H) Early Repayment of Debt

Total net finance expense was decreased by RR 38 million as repayment of our debt to the Itera Group was assumed to have occurred on 1 January 2004. Additionally, the loss on early extinguishment of debt in the amount of RR 578 million recognized in Tarkosaleneftegas’ financial statements as a result of the our acquisition of Tarkosaleneftegas was reversed as such loss was treated as part of our cost of acquisition.

(I) Share of Income and Income Taxes from Associates

Our share of the income from Tarkosaleneftegas and Khancheyneftegas of RR 299 million and our share of the income taxes of Tarkosaleneftegas and Khancheyneftegas of RR 118 million that were recorded in our consolidated financial statements were eliminated as the activities of Tarkosaleneftegas and Khancheyneftegas were consolidated from the beginning of the year in the unaudited pro forma information.

(J) Income Taxes

An additional adjustment of RR 64 million to income taxes reflects the tax effect of the other adjustments recorded above, as applicable, recorded at the enacted tax rate of 24%.

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

You should read the following discussion and analysis of our financial condition and results of operations as of 31 March 2005 and 2004 and as of 31 December 2004, 2003 and 2002 and the periods then ended in conjunction with our consolidated financial statements as of and for the three months ended 31 March 2005 and 2004, and as of and for the years ended 31 December 2004, 2003 and 2002. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS). In accordance with International Accounting Standards (IAS) No. 29, *Financial Reporting in Hyperinflationary Economies*, all rouble amounts related to financial information for periods prior to 1 January 2003 are expressed in constant roubles as of 31 December 2002 purchasing power, unless otherwise noted. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003, we no longer apply the provisions of IAS 29 and, accordingly, all rouble amounts have been stated at their nominal value for periods beginning on and after that date.

The financial and operating information contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" comprises information of OAO NOVATEK, its consolidated subsidiaries and its share of the results of associates. Accordingly, production volumes in the following discussion and analysis exclude volumes of Tarkosaleneftegaz and Khancheyneftegas prior to their being consolidated in December 2004. Prior to that date, sales volumes and revenues include the volumes of Tarkosaleneftegaz and Khancheyneftegas only to the extent OAO NOVATEK purchased such production from Tarkosaleneftegaz and Khancheyneftegas. We have, however, been responsible for managing the development and the operations of these associates for the periods discussed.

In June 2004, we sold to our shareholders our oil and gas construction services business to focus on our core activities of oil and gas exploration and production. Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation.

Overview

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

Our exploration, development, production, processing and marketing of natural gas, gas condensate, crude oil and related oil products have been conducted primarily within the Russian Federation and, historically, most of our revenues were derived from sales within the Russian Federation. However, with the commissioning of the Purovsky processing plant in June 2005, we plan to export the majority of our gas condensate directly to international markets, significantly increasing the share of our revenues derived from international sales.

Our business has benefited from success in expanding our production volumes, and the production volumes of our associates, as well as from increases in market prices of natural gas, gas condensate, crude oil and related oil products. Our continued efforts in funding exploration and development activities have allowed us to expand our sales volumes annually since our inception. Our sales volumes of natural gas increased from 3,583 mmcm in 2002 to 13,161 mmcm, in 2003, or 267.3%, and to 17,277 mmcm in 2004, or a further 31.3%. Our combined sales volumes of crude oil and gas condensate and oil products increased from 411,000 tonnes in 2002 to 1,235,000 tonnes in 2003, or 200.5%, and to 2,112,000 tonnes in 2004, or a further 71%. We expect to continue to increase our sales volumes, but at a more measured pace, due to continued production growth and the consolidation of production from some of our associates due to the acquisitions described below.

We also benefited from strong international and domestic prices, particularly the continued rise in the domestic natural gas tariffs regulated by the FTS. Unlike Gazprom, we are not required to sell our gas at the regulated tariff. We do, however, sell to customers eligible to purchase natural gas from Gazprom at regulated prices. Thus, the prices we can achieve for our natural gas are strongly influenced by regulated prices. The average realized prices of our natural gas sold to end-customers and natural gas sold at the entry point to the natural gas transportation system (referred to as "ex-field") were higher by 36.6% and 56.2%, respectively, in 2003 than in 2002, and were higher by 10.2% and 16.6%, respectively, in 2004 than

in 2003. If regulated prices continue to rise, as forecast in the Russian Federation Energy Strategy 2020, we expect our average realized prices for natural gas to continue to increase.

Recent developments

Significant events occurring between 31 March 2005 and the date of this prospectus are as follows:

- commissioning of the Purovsky processing plant in June 2005;
- commissioning of the Vitino port facilities in June 2005;
- disposal of Geoilbent to LUKOIL and one of its subsidiaries in June 2005;
- sale of Tambeyneftegas to OOO GazpromBank-Invest in July 2005;
- agreement to sell Selkupneftegas to Rosneft executed in June 2005;
- commissioning of the BOPP film wrap plant in June 2005;
- merger of Khancheyneftegas into Tarkosaleneftegas in May 2005; and
- disposal of our stake in NOVA Bank to Levit in May 2005.

Certain Factors Affecting our Results of Operations

Consolidation of our operations

Since 2002, we have pursued a strategy of increasing our holdings in, and focusing on, our core oil and gas assets and made a number of acquisitions and disposals to further this strategy. Our three core fields are held in our subsidiaries Tarkosaleneftegas and Yurkharovneftegas. With the completion of the December 2004 acquisitions discussed below, we acquired 100% of these producing subsidiaries. As a result of these acquisitions and our other consolidation and restructuring initiatives over the past three years, we have simplified our holding structure, allowing us to directly manage our core assets and improving the overall transparency of our financial reporting.

Acquisitions

In December 2004, we undertook a series of transactions whereby we acquired a 67.7% interest in Tarkosaleneftegas and a 57.0% interest in Khancheyneftegas in exchange for the issuance of 789,276 new ordinary shares of NOVATEK, resulting in these companies becoming fully consolidated subsidiaries as at 31 December 2004. In May 2005, Khancheyneftegas was merged into Tarkosaleneftegas. See “Business—Recent Developments—Buyout of the Itera Group; Consolidation and New Share Issuance”.

Prior to our acquisitions of additional interests in Tarkosaleneftegas and Khancheyneftegas in December 2004, we purchased approximately 56% of Tarkosaleneftegas’ hydrocarbon production and 100% of Khancheyneftegas’ hydrocarbon production and then resold the production to third parties. Subsequent to the acquisitions, Tarkosaleneftegas’ and Khancheyneftegas’ activities were consolidated into our financial position and results of operations. Accordingly, all purchases from, sales to and balances with Tarkosaleneftegas and Khancheyneftegas have been eliminated in our consolidated balance sheets at 31 March 2005 and 31 December 2004 and in our consolidated statement of income for the three months ended 31 March 2005, and each line item within our total operating expenses for the three months ended 31 March 2005 includes the corresponding results of Tarkosaleneftegas and Khancheyneftegas for the period. At all other balance sheet dates and in all other reporting periods, we accounted for Tarkosaleneftegas and Khancheyneftegas under the equity method of accounting as investments in associates, and thus the operating costs of the two acquired entities were effectively included (pro rata to the percentage of volumes purchased) within purchases of oil, gas condensate and natural gas in our consolidated statements of income.

From 31 December 2004 onward, we expect changes in the composition of our consolidated financial statements arising from, among other things, the consolidation of Tarkosaleneftegas and Khancheyneftegas, including a significant increase in operating expenses and a corresponding decrease in purchases of oil, gas condensate and natural gas. See “Pro Forma Information for the Year Ended 31 December 2004.”

Divestitures

Historically, our business has included various non-core business activities, including oil and gas construction services, banking and telecommunications. In June 2004, we sold to our shareholders our oil and gas construction services business to focus on our core activities of oil and gas exploration and production. Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation.

In 2004, we sold to Gazprom a subsidiary of Purneftegasegeologiya, which held the mineral license in the West Tarkosalinskoye field, in return for an 8.34% interest in Purneftegasegeologiya. In connection with this transaction, we retained a right to 10% of the natural gas extracted from the Cenomanian horizon and 100% of the hydrocarbons extracted from the Valanginian horizon at the West Tarkosalinskoye field for the duration of the license (which expires in 2018).

In 2004, other disposals included the sale of our telecommunication business as well as other non-core businesses. In May 2005, we disposed of our equity interest in NOVA Bank to Levit. We plan to continue our efforts to divest our remaining non-core businesses as opportunities arise.

In June 2005, we disposed of our 66% participation interest in Geoilbent to LUKOIL and one of its subsidiaries for approximately RR 5.1 billion. The disposal was in line with our strategy to divest assets that do not fit our core strategy of developing our upstream natural gas and gas condensate assets. We accounted for our interest in Geoilbent under the equity method as all significant operating and financing decisions required the consent of the other shareholder, and thus we were not able to control Geoilbent.

In June 2005, we also agreed to sell our interest in our associated company Selkupneftegas and in July 2005, we disposed of our interest in our associated company Tambeyneftegas.

Growth in production and prices

Growth in production

We have significantly increased our production volumes of natural gas, gas condensate and crude oil during the three years ended 31 December 2004. Our growth in production was achieved through the efficient exploitation of our existing producing asset base, together with increases in our holdings of core assets such that we could consolidate the production from these assets rather than show it as purchases. As discussed in the section on “Acquisitions” above, in December 2004, we began consolidating the production volumes from the fields licensed to Tarkosaleneftegas and Khancheyneftegas into our results.

We expect our total production volumes to continue growing, primarily as a result of the development activities at our existing producing fields and by exploring and developing other oil and gas fields in our asset portfolio.

Natural gas prices

As an independent natural gas producer, we are not subject to the government’s regulation of natural gas prices. Historically, we have sold most of our natural gas at prices higher than the regulated prices set by the government for Gazprom’s domestic gas sales, although the prices we can achieve are strongly influenced by the regulated prices. The terms for delivery of natural gas affect our average realized prices. Natural gas sold “ex-field” is sold primarily to wholesale gas traders, in which case the buyer is responsible for the payment of gas transportation tariffs. We generally realize higher prices and net margins for natural gas volumes sold directly to the end-customer, as the gas transportation tariff is included in the contract price and no retail margin is lost to wholesale gas traders.

The following table shows our average natural gas sales prices for the three months ended 31 March 2005 and 2004 and for the years ended 31 December 2004, 2003 and 2002:

Natural Gas Prices⁽¹⁾	Three months ended 31 March		Year ended 31 December		
	2005	2004	2004	2003	2002
Average natural gas price to end-customers ⁽²⁾	1,055	931	958	869	636
Gas transportation expense for sales to end-customers	379	296	331	337	391
Average natural gas netback on end-customer sales	676	635	627	532	245
Average natural gas price ex-field	654	469	528	453	290

(1) Net of VAT, excise tax and export duties. Average RR realized per mcm.

(2) Includes cost of transportation.

See additional detail on regulated prices in “Russian Gas Industry.”

Crude oil and gas condensate and oil products prices

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

The following table shows our average crude oil and gas condensate and oil products sales prices for the periods indicated:

Sales Prices⁽¹⁾⁽²⁾	Three months ended 31 March		Year ended 31 December		
	2005	2004	2004	2003	2002
Average oil and gas condensate export price	5,579	4,750	4,743	4,474	5,111
Average oil and gas condensate domestic price	3,930	3,566	3,685	2,362	2,426
Average oil products export price	—	4,900	4,900	3,472	—
Average oil products domestic price	4,918	2,319	4,097	5,186	5,167

(1) Net of VAT, excise tax and export duties. Average RR realized price per tonne.

(2) Includes cost of transportation.

Prior to the commissioning of our Purovsky processing plant in June 2005, all of our gas condensate volumes were sent to a Gazprom controlled gas condensate processing facility in Surgut (Surgutsky refinery) via Gazprom controlled gas condensate trunk pipelines. The stabilized gas condensate we received from the Surgutsky refinery was sold as Urals blend crude oil transported through the Transneft pipeline network and subject to the applicable quotas on export. In addition, our oil products (including diesel fuel, light distillate and naptha) were transported by rail for sale either domestically or on the export market. With the commissioning of our Purovsky processing plant in June 2005, we are migrating the processing of substantially all of our unstable gas condensate to that plant. We expect this migration to be complete at the end of the third quarter of 2005, by which time we expect to be able to export the majority of our stabilized gas condensate to international markets. We expect our gas condensate revenues and margins to increase since prices for stabilized gas condensate in international markets have historically exceeded prices for Urals blend crude oil.

Transportation tariffs

Transportation tariffs established by the FTS from 1 October 2004 for the transport of natural gas produced in Russia are set at RR 19.37 (excluding VAT) per mcm per 100 km 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, Russia and Tajikistan). This represents an increase from the tariffs of RR 16.56 (excluding VAT) per mcm per 100 km from 1 August 2003 to 30 September 2004 and RR 13.80 (excluding VAT) per mcm per 100 km prior to 1 August 2003. The increases in regulated transportation tariffs are passed on to end-customers pursuant to our contracts with them. There is no set timetable for reviews or changes in transportation tariffs set by the FTS, and thus changes in transportation tariffs occur on an irregular basis. For a further discussion of transportation tariffs, see “Business—Transportation—Access to the UGSS.”

The following table shows our average gas transportation expense per mcm for the three months ended 31 March 2005 and 2004 and for the years ended 31 December 2004, 2003 and 2002:

	Three months ended 31 March		Year ended 31 December		
	2005	2004	2004	2003	2002
Gas transportation expense (average realized RR per mcm sold to end-customers)	379	296	331	337	391 ⁽¹⁾
Gas transportation expense as a % of end-customer sales	35.9%	31.8%	34.6%	38.8%	61.5%

(1) Prior to 1 January 2003, our financial statements included restatement of balances and transactions for the changes in the general purchasing power of the Russian rouble in accordance with IAS No. 29, *Financial Reporting in Hyperinflationary Economies* (IAS 29).

Our gas transportation expense is a function of the volume of natural gas transported to end-customers, the average distance to end-customers and the transportation tariff per mcm per 100 km. As a percentage of end-customer sales, our gas transportation expense has decreased from 2002 to 2004 due to the price of natural gas increasing at a rate faster than the average transportation tariff and a decrease in the average delivery distance to our end-customers. For the three months ended 31 March 2005, our gas transportation expense increased by 2.8% compared to the corresponding period in 2004 as a result of the tariff increase effective from 1 October 2004.

Our unstable gas condensate has historically been transported through our own pipeline network and pipelines owned by Gazprom to the Surgutsky refinery, where it is processed into stabilized gas condensate and oil products (including diesel fuel, light distillate and naptha). With the commissioning of our Purovsky processing plant in June 2005, we plan to begin transporting substantially all of our unstable gas condensate production volumes from our East Tarkosalinskoye and Khancheyskoye fields through our own pipeline network directly to the Purovsky processing plant. We have an agreement with Gazprom to access its gas condensate pipeline network to deliver the unstable gas condensate produced at our Yurkharovskoye field to the Purovsky processing plant through 2006, after which we will consider constructing our own pipeline if needed. See “Risk Factors—Risks Relating to Our Business—We are dependent on Gazprom, our largest competitor, for the transportation of our natural gas and a part of our unstable condensate.” The stabilized gas condensate and oil products mix that we receive from the Surgutsky refinery has historically been transported to market using a combination of the Transneft crude oil pipeline network and the Russian Railways system. With the commissioning of our Purovsky processing plant in June 2005, we plan to change our distribution channel for delivery of stabilized gas condensate to the market and export the majority of our stabilized gas condensate to international markets using our recently commissioned storage and loading facilities at the Port of Vitino.

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

Oil and gas production costs

Our oil and gas production costs are derived from our results of operations for oil and gas producing activities as reported in the unaudited supplemental oil and gas disclosures for the periods ended 31 December 2004 and 2003. Oil and gas production costs do not include general corporate overheads or its associated tax effects. The following tables set forth certain operating information with respect to our oil and gas production costs during the periods presented in roubles and in US dollars per boe:

	Year ended 31 December	
	2004	2003
	(RR million)	
Production costs:		
Operating expenses	711	436
Purchases	5,708	3,310
Taxes other than on income	1,393	641
Transportation costs	3,833	1,829
Total production costs before DD&A	11,645	6,216
Depreciation, depletion and amortization (DD&A)	584	287
Total production costs	12,229	6,503

	Year ended 31 December	
	2004	2003
	(\$/boe)	
Production costs:		
Operating expenses	0.38	0.43
Purchases	3.07	1.72
Taxes other than on income	0.74	0.63
Transportation costs	1.03	0.62
Total production costs before DD&A	3.12	2.11
Depreciation, depletion and amortization (DD&A)	0.31	0.28
Total production costs	3.43	2.39

Production costs consist of amounts directly related to the operation and maintenance of our producing oil and gas wells, related equipment and facilities, purchases of natural gas and crude oil and gas condensate from our affiliates and other third parties, and transportation cost to end-customers. The average production costs per boe reflect the crude oil equivalent of natural gas and gas condensate at our respective producing fields converted based on the relative energy content of each field's hydrocarbons. For further information on our conversion factors, see "—Conversion Factors" in the introductory section of this prospectus.

Beginning December 2004, we expect our operating expenses and our operating expenses per boe to significantly increase and our purchases to significantly decrease as a result of the consolidation of Tarkosalenftegas and Khancheyneftegas.

Transactions with related parties

Historically, we have had significant transactions with our shareholders, companies related to our shareholders, our associated companies and other related parties. Such transactions have included the purchase and sale of natural gas, gas condensate, crude oil, construction and other related services, the holding of equity securities, and the provision of and receipt of loans, guarantees and other non-cash settlements. Our reported statements of income, balance sheets and statements of cash flows would be different had such transactions been conducted amongst unrelated parties. The production volumes of natural gas, gas condensate and crude oil purchased from Tarkosalenftegas prior to December 2004 represented a combination of our direct equity interest in the field's production volumes and volumes attributable to the equity interest held by our principal shareholders in an aggregate volume of approximately 56% of total Tarkosalenftegas production. We have purchased 100% of the natural gas production volumes from Khancheyneftegas since it commenced commercial production in 2003. In 2004, we began purchasing volumes attributable to our equity interest in Geoilbent. Prior to that period, Geoilbent marketed its volumes independently.

With the consolidation of our key producing assets, as discussed in the “Acquisitions” section above, and the disposal of Geoilbent, as discussed in the “Divestitures” section above, we estimate that the volume of related party transactions that we will conduct in the future will be significantly reduced. For further discussion, see “Transactions with Affiliates.”

Our tax burden

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax, significant taxes to which we are subject include VAT, mineral extraction tax, export duties, property tax, social taxes and contributions, and prior to 1 January 2004, excise tax. See “Regulation—Taxation.”

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

We have not employed any tax minimization schemes using offshore or domestic tax zones in the Russian Federation as of and for the periods ended 31 March 2005 and 2004 and 31 December 2004, 2003, and 2002.

Critical accounting policies

Our financial statements reflect the selection and application of accounting policies that require management to make significant estimates and assumptions. We believe that the following are some of the most critical accounting policies that currently affect our financial position and results of operations.

Oil and gas exploration and production activities

We follow the successful efforts method of accounting for oil and gas properties which we believe is the most prudent and conservative accounting treatment for our oil and gas operations. Under the successful efforts method 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, overhead and all exploration costs other than exploratory drilling are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

We calculate our depreciation, depletion and amortization of capitalized costs of oil and gas properties using the unit-of-production method for each field based upon proved developed reserves for exploration and development costs, and total proved reserves for acquisitions of proved properties. For this purpose, the oil and gas reserves of our fields have been determined based on estimates of mineral reserves prepared by us, and for our three core fields reserves have been determined in accordance with internationally recognized definitions and were independently appraised by internationally recognized petroleum engineers. 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, and therefore are subject to amortization thereon using the unit-of-production method.

Revenue recognition

We recognize revenues from the production and sale of natural gas, crude oil and gas condensate when such products are delivered to customers and title has transferred. Our revenues are stated net of VAT, excise tax and export duties. Revenues from construction contracts are recognized in accordance with contract terms after provision of the contractual goods and services and acceptance by customers. A majority of the payments for the sale of natural gas, crude oil and gas condensate are pre-payments.

Related party transactions

The following are considered to be our related parties:

- our associates are entities we do not control but over which we exercise significant influence and therefore we account for them in accordance with IAS standard No. 28, *Investments in Associates*;
- our major shareholders and their immediate relatives;
- our directors and officers and their immediate relatives;
- enterprises in which principal shareholders, officers and directors and their immediate relatives have control or significant influence; and
- other parties with which we deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

In considering each possible related party relationship, attention is directed to the nature and substance of the relationship, and not merely to its legal form. Our reported statements of income, balance sheets and statements of cash flows would be different had such transactions been carried out amongst unrelated parties. Related parties may enter into transactions that unrelated parties might not, and transactions between related parties may not be executed on the same terms, conditions and amounts as transactions between unrelated parties. For more information on our related party transactions, see “Transactions with Affiliates.”

Business combinations

On 31 March 2004, the International Accounting Standards Board (IASB) issued IFRS No. 3, *Business Combinations* (IFRS 3), on accounting for business combinations and revised Standard IAS No. 36, *Impairment of Assets* (IAS 36) and IAS No. 38, *Intangible Assets* (IAS 38). The main features of the new and revised standards are that all business combinations within the scope of IFRS 3 must be accounted for using the purchase method. The previously permitted pooling-of-interest method is prohibited. Identifiable assets acquired, liabilities, and contingent liabilities incurred or assumed must be initially measured at fair value. Intangible items acquired in a business combination must be recognized as assets separately from goodwill if they meet the definition of an asset, are either separable or arise from contractual or other legal rights, and their fair value can be measured reliably. Identifiable assets acquired, liabilities, and contingent liabilities incurred or assumed, must be initially measured at fair value. Amortization of goodwill and intangible assets with indefinite useful lives is prohibited. Instead, they must be tested for impairment annually or more frequently if events or changes in circumstances indicate a possible impairment. IFRS 3 allows for the use of provisional values in the initial accounting for a business combination if the fair values of assets and liabilities purchased or the cost of the combination can only be determined provisionally. Adjustments to the provisional values are expected to be finalized within 12 months of the acquisition date. These standards apply to business combinations commencing on or after 31 March 2004. We have accounted for our December 2004 acquisitions of the remaining equity interests in Tarkosalenftegas and Khancheyneftegas that we did not previously own in accordance with provisions promulgated in IFRS 3, IAS 36 and IAS 38.

We applied the transitional rules of IFRS 3, *Business Combinations*, in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. Consequently, beginning 1 January 2005, previously recognized goodwill was no longer amortized and will be tested for impairment in accordance with IAS 36, *Impairment of Assets*, and on 1 January 2005, previously recognized negative goodwill of RR 762 million was reversed with a corresponding adjustment to the opening balance of retained earnings.

Accounting for the effects of inflation

Prior to 1 January 2003, our financial statements included restatement of balances and transactions for the changes in the general purchasing power of the Russian rouble in accordance with IAS No. 29, *Financial Reporting in Hyperinflationary Economies* (IAS 29). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003, we no longer apply the provisions of

IAS 29. Accordingly, no adjustments for the effects of changes in general purchasing power have been made for any periods after 31 December 2002.

New accounting developments

We prepare our financial statements in accordance with IFRS. As discussed within the Business Combinations section above, we were required to adopt the provisions of IFRS 3, *Business Combinations*, for all business combinations within the scope of IFRS 3 from 31 March 2004.

In December 2003, the International Accounting Standards Board issued amendments to 15 existing IFRS standards that became effective 1 January 2005. The application of these 15 revised IFRS standards has not had a material effect on our financial position, statements of income or cash flows.

In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004. Significant changes relevant to us are discussed below.

The revisions to IAS 1, *Presentation of Financial Statements*, clarify certain presentation requirements. Most significantly, the revised standard requires that minority interest be presented within equity. We have retroactively reflected the revised presentation standard for equity in the consolidated interim condensed financial information.

IAS 24, *Related Party Disclosures*, as revised, requires the disclosure of compensation of key management personnel and clarifies that such personnel include non-executive directors.

Other revised and amended standards effective on 1 January 2005 are as follows: IAS 2, *Inventories*; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 10, *Events after the Balance Sheet Date*; IAS 16, *Property, Plant and Equipment*; IAS 17, *Leases*; IAS 19, *Employee Benefits*; IAS 21, *The Effects of Changes in Foreign Exchange Rates*; IAS 27, *Consolidated and Separate Financial Statements*; IAS 28, *Investments in Associates*; IAS 31, *Investments in Joint Ventures*; IAS 32, *Financial Instruments: Disclosure and Presentation*; IAS 33, *Earnings per Share*; IAS 36, *Impairment of Assets*; IAS 38, *Intangible Assets*; and IAS 39, *Financial Instruments: Recognition and Measurement*. The adoption of these revised and amended standards has not had a material effect on our financial position, statements of income or of cash flows.

Other new standards and interpretations that we early adopted on 1 January 2005 are as follows: IAS 19 (amended), *Employee Benefits*, IFRS 4, *Insurance Contracts*; IFRIC 3, *Emission Rights*; IFRIC 4, *Determining whether an Arrangement contains a Lease*; IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12. The adoption of these standards did not have a material impact on our financial position, statements of income or of cash flows.

Accounting policies significant to us that were adopted or modified on 1 January 2005 are discussed below.

Share based payments. We account for share-based payments 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. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised. For transactions with parties other than employees, we account for the transaction based upon the fair value of goods or services provided, unless the fair values are not reliably estimable. The adoption of IFRS 2 did not have a material effect on us as we had no outstanding share-based awards at 1 January 2005.

For share-based payments made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

Business combinations. See “Critical accounting policies” above. We account for business combinations in accordance with the provisions of IFRS 3, *Business Combinations* (IFRS 3).

Non-current assets held for sale and discontinued operations. We account for non-current assets held for sale and discontinued operations in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 replaced IAS 35, *Discontinuing Operations*. Assets or disposal groups that

are classified as held for sale are presented separately on the balance sheet and are carried at the lower of the carrying amount and fair value less costs to sell. Additionally, the results of discontinued operations are shown separately on the face of the income statement. The adoption of IFRS 5 did not have a material effect on us.

On 1 January 2005, we early adopted IFRS 6, *Exploration for and Evaluation of Mineral Resources*. This standard provides guidance on accounting for costs incurred in the exploration for and evaluation of mineral resources. Adoption of the standard did not have a material effect on us and did not result in changes to our accounting policies.

Results of Operations

For the three months ended 31 March 2005 compared to the three months ended 31 March 2004

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2005 and 2004. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March			
	2005		2004	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Total Revenues⁽¹⁾	9,004	100%	6,667	100%
Other income (loss)	(4)	0%	(41)	1%
Total revenues and other income	9,000	100%	6,626	99%
Operating expenses	(5,752)	64%	(5,107)	77%
Income from operations	3,248	36%	1,519	23%
Finance income (expense)	(241)	3%	11	0%
Share of income from associates	77	1%	374	6%
Income before income tax and minority interest	3,084	34%	1,904	29%
Total income tax expense	(776)	9%	(479)	7%
Income before minority interest	2,308	26%	1,425	21%
Minority interest	7	0%	9	0%
Net income	2,315	26%	1,434	22%

(1) Net of VAT, excise tax and export duties.

Revenues

Our total revenues comprise oil and gas sales, sales from our oil and gas construction services, sales of polymer and insulation tape and other revenues. Total revenues increased by RR 2,337 million, or 35.1%, to RR 9,004 million for the three months ended 31 March 2005 compared to RR 6,667 million for the corresponding period in 2004. Total revenues attributable to our oil and gas construction services business were RR nil and RR 1,067 million for the three month periods ended 31 March 2005 and 2004,

respectively. The following table sets forth our net sales, volumes and average realized prices for the three months ended 31 March 2005 and 2004:

	Three months ended 31 March	
	2005	2004
Sales of natural gas		
Net sales ⁽¹⁾	5,938	3,476
Volumes in mmcm	7,010	5,055
Average price, \$ per mcm ⁽²⁾	30.4	24
Average price, RR per mcm	847	688
Sales of crude oil and gas condensate		
Net sales ⁽¹⁾	1,560	1,497
Volumes in thousands of tonnes	360	372
Average price, \$ per tonne ⁽²⁾	155.6	140.5
Average price, RR per tonne	4,333	4,024
Sales of oil products		
Net sales ⁽¹⁾	1,195	265
Volumes in thousands of tonnes	243	92
Average price, \$ per tonne ⁽²⁾	176.6	100.6
Average price, RR per tonne	4,918	2,880
Total oil and gas sales	8,693	5,238
Oil and gas construction services revenues ⁽¹⁾	—	1,067
Sales of polymer and insulation tape ⁽¹⁾	212	159
Other revenues ⁽¹⁾	99	203
Total revenues	9,004	6,667
Net loss on disposals	—	(43)
Other income (expense)	(4)	2
Total revenues and other income	9,000	6,626

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

Excluding revenues from our oil and gas construction services business, which we sold in June 2004, revenues from our core oil and gas business increased by RR 3,455 million, or 66%, for the three months ended 31 March 2005 compared to the corresponding period in 2004, primarily due to the increase in sales volumes of natural gas, crude oil and gas condensate and oil products and higher average realized prices for all three products during the 2005 period. Our natural gas and liquids (crude oil and gas condensate and oil products) sales volumes increased for the three months ended 31 March 2005 by 38.7% and 30%, respectively, compared to the corresponding period in 2004. These increases were the result of an increase in production attributable to our increased interest in Tarkosalenftegas and to a lesser extent general increases in production at our three core fields (partially offset by decreases in production at our other fields).

Oil and gas sales

The following table shows the sources of our production and purchases of natural gas in the three months ended 31 March 2005 compared to the corresponding period in 2004:

	Three months ended 31 March	
	2005	2004
	(mmcm)	
Production from:		
Yurkharovneftegas	2,228	1,303
Tarkosaleneftegas ⁽¹⁾	3,672	—
Khancheyneftegas ⁽¹⁾	660	—
Other	15	1,158
Total natural gas production	6,575	2,461
Purchases from:		
Khancheyneftegas ⁽¹⁾	—	425
Tarkosaleneftegas ⁽¹⁾	—	1,702
Other	554	361
Total natural gas purchases	554	2,488
Changes in inventory	(119)	106
Total natural gas sales volumes	7,010	5,055

(1) These companies were not consolidated in the three months ended 31 March 2004.

In the three months ended 31 March 2005, our three core fields, East Tarkosalinskoye, Yurkharovskoye and Khancheynskoye, produced approximately 6.6 bcm of natural gas, representing over 93.8% of our total natural gas sales volumes. In the three months ended 31 March 2004, we purchased approximately 56% of Tarkosaleneftegas' production and 100% of Khancheyneftegas' production.

Our revenues from the sale of natural gas for the three months ended 31 March 2005 increased by RR 2,462 million, or 70.8%, compared to the corresponding period in 2004. Revenues from the sale of natural gas accounted for 65.9% and 52.1% of our total revenues for the three months ended 31 March 2005 and 2004, respectively. The increase in natural gas revenues was attributable to an increase in sales volumes and an increase in tariffs for the three months ended 31 March 2005 compared to the corresponding period in 2004. We sell our entire natural gas volumes in the Russian domestic market. For the three months ended 31 March 2005, our average realized price per mcm increased by RR 159 per mcm, or 23.1%, compared to the corresponding period in 2004, due to an overall increase in natural gas prices and an increase in sales to end-customers. The decrease in production from "Other" was primarily attributable to the sale of our subsidiary holding the license to the West Tarkosalinskoye field to Gazprom. After the sale, we began purchasing the production from the West Tarkosalinskoye field.

The following table shows the breakdown of natural gas sales volumes between ex-field and end-customer market segments for the three months ended 31 March 2005 and 2004:

	Three months ended 31 March	
	2005	2004
	(mmcm)	
Sales ex-field	3,630	2,664
End-customer sales	3,380	2,391
Total gas sales	7,010	5,055

As part of the December 2004 acquisitions of the remaining interests in Tarkosaleneftegas and Khancheyneftegas, we have committed to sell to the Itera Group ex-field 37.5 bcm of natural gas over a five year period starting in January 2005. As our largest sales contract, this contract will have an effect on the relative proportion of ex-field sales and end-customer sales for that period.

Total sales volumes of crude oil and gas condensate decreased for the three months ended 31 March 2005 by 12,000 tonnes, or 3.2%, compared to the corresponding period in 2004, whereas sales volumes of oil products (diesel fuel, light distillate, naptha and others) increased for the 2005 period by 151,000 tonnes, or 164.1%, compared to the 2004 period, due to a significantly lower yield of stabilized gas condensate from the Surgutsky refinery in the 2005 period.

The following table shows the sources of our production and purchases of crude oil and gas condensate for the three months ended 31 March 2005 and 2004:

	Three months ended 31 March	
	2005	2004
	(mt)	
Production from:		
Yurkharovneftegas	154	122
Tarkosaleneftgas	173	—
Khancheyneftgas	129	—
Other	33	50
Total production	489	172
Purchases from:		
Tarkosaleneftgas	—	77
Khancheyneftgas	—	107
Geoilbent	109	98
From third parties	37	15
Total purchases	146	297
Total production and purchases	635	469
Changes in inventory and other losses	(32)	(5)
Total liquids sales	603	464
Oil and gas condensate sales	360	372
Oil products sales	243	92

In the three months ended 31 March 2005, our three core fields, East Tarkosalinskoye, Yurkharovskoye and Khancheynskoye, produced 456,000 tonnes of oil and gas condensate, accounting for 93.3% of our total crude oil and gas condensate production volumes. For the three months ended 31 March 2005, crude oil and gas condensate production increased by 317,000 tonnes, or 184.3%, over production for the corresponding period in 2004. The increase was largely attributable to the continued development of the Yurkharovskoye, Khancheynskoye and East Tarkosalinskoye fields (partially offset by decreases in production at our other fields), and to a lesser extent an increase in production attributable to Tarkosaleneftgas resulting from its consolidation in December 2004. Purchases for the three months ended 31 March 2005 decreased by 151,000 tonnes, or 50.8%, compared to the corresponding period in 2004, primarily due to the consolidation of Tarkosaleneftgas and Khancheyneftgas in December 2004.

The table below shows the net sales, volumes and average realized prices we received for our crude oil and gas condensate in the three months ended 31 March 2005 and 2004.

	Three months ended 31 March	
	2005	2004
Sales of crude oil and gas condensate—exported		
Net sales⁽¹⁾	491	684
<i>Volumes in thousands of tonnes</i>	88	144
<i>Average price, \$ per tonne⁽²⁾</i>	200.3	165.8
<i>Average price, RR per tonne</i>	5,579	4,750
Sales of crude oil and gas condensate—domestic		
Net sales⁽¹⁾	1,069	813
<i>Volumes in thousands of tonnes</i>	272	228
<i>Average price, \$ per tonne⁽²⁾</i>	141.1	124.5
<i>Average price, RR per tonne</i>	3,930	3,566

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

Our revenues from the sales of crude oil and gas condensate increased marginally by RR 63 million, or 4.2%, for the three months ended 31 March 2005 compared to the corresponding period in 2004, primarily as a result of higher prices for both domestic and export sales volumes (partially offset by a reduction in the overall volumes of crude oil and gas condensate sold during the period.) The negative revenue impact of the reduction in export sales volumes was offset by a higher sales price realized on both the domestic and international markets and an increase in domestic sales volumes. Our revenue from the sales of oil products depends on the product mix we receive from the Surgutsky refinery over which we have limited control. The product mix is a result of the level of refining available whereby more complex refining yields higher margin products like diesel fuel and light distillate while less complex refining yields lower margin products like stabilized condensate and butane fractions. The decrease in sales volumes of crude oil and gas condensate for the three months ended 31 March 2005 compared to the corresponding period in 2004, was primarily the result of a lower yield of stabilized gas condensate from the Surgutsky refinery in the 2005 period. In the three months ended 31 March 2005 stabilized gas condensate output comprised 42.8% of the total yield from the refinery compared with 65.4% for the corresponding period in 2004.

Following our disposal of Geoilbent in June 2005, we ceased purchasing its crude oil volumes which amounted to 109,000 tonnes and 98,000 tonnes in the three months ended 31 March 2005 and 2004, respectively.

Our average realized sales price translated into US dollars for crude oil and gas condensate exported to Europe and the CIS countries increased by USD 34.5 per tonne, or 20.8%, in the three months ended 31 March 2005 compared to the corresponding period in 2004, primarily due to the higher pricing environment in the international crude oil markets during the 2005 period. Our average realized crude oil and gas condensate domestic sales price increased by RR 364 per tonne, or 10.2%, in the three months ended 31 March 2005 compared to the corresponding period in 2004, due to the strengthening of domestic crude oil prices compared to the corresponding period in 2005.

Our crude oil and gas condensate sold for export is generally sold free on board (FOB) or delivery at frontier (DAF) at the border of the Russian Federation. Historically, the majority of our sales volumes sold for export are transported by pipeline to Germany or through the shipping ports at Butinge, Lithuania and Novorossiysk, Russia. Under such agreements, the buyer takes ownership and responsibility for further transportation of the crude oil and gas condensate to its final destination. Our affiliated companies, Kerden Trading Ltd and TNG Energy, act as trading agents for a majority of our export sales of crude oil and gas condensate. See “Transactions with Affiliates.”

The following table sets out the net sales, volumes and average realized prices we received for our oil products in the three months ended 31 March 2005 and 2004:

	Three months ended 31 March	
	2005	2004
Sales of oil products—export		
Net sales⁽¹⁾	—	98
<i>Volumes in thousands of tonnes</i>	—	20
<i>Average price, \$ per tonne⁽²⁾</i>	—	171.1
<i>Average price, RR per tonne</i>	—	4,900
Sales of oil products—domestic		
Net sales⁽¹⁾	1,195	167
<i>Volumes in thousands of tonnes</i>	243	72
<i>Average price, \$ per tonne⁽²⁾</i>	176.6	90.0
<i>Average price, RR per tonne</i>	4,918	2,319

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

For the three months ended 31 March 2005, our revenues from the sales of oil products increased by RR 930 million, or 350.9%, compared to the corresponding period in 2004. The increase was attributable roughly equally to increased throughput at the refinery and an increase in the average oil products price in the 2005 period compared to the 2004 period. The main oil products sold were diesel fuel, light distillate and naptha. We did not supply oil products to the export market in the three months ended 31 March 2005, because we were able to realize better margins for light distillate and diesel fuel, the main products sold for export, on the domestic market. For the three months ended 31 March 2005, domestic sales of oil products increased by RR 1,028 million, or 615.6%, compared to the corresponding period in 2004, due to a generally stronger domestic pricing environment and increased volumes in the 2005 period. The domestic market for oil products in the three months ended 31 March 2004 was characterized by generally lower prices across all oil products categories and we received a lower proportion of higher margin processed volumes from the Surgutsky refinery compared to the 2005 period.

Oil and gas construction services

We had no revenues from our oil and gas construction services in the three months ended 31 March 2005 compared to RR 1,067 million for the corresponding period in 2004 due to the divestiture of this business in June 2004. For more information on this divestiture, see “Restructuring activities and discontinued operations” below.

Sales of polymer and insulation tape and other income

Our sales of polymer and insulation tape increased to RR 212 million in the three months ended 31 March 2005 compared to RR 159 million in the corresponding period in 2004 due to higher volumes and prices for the sale of film wrap for the 2005 period.

Other income

Other income includes gains and losses recognized on the disposals of our investments in oil and gas producing subsidiaries and associates.

Operating expenses

Operating expenses for the three months ended 31 March 2005 increased by RR 645 million, or 12.6%, to RR 5,752 million compared to RR 5,107 million for the corresponding period in 2004. Operating expenses decreased as a percentage of revenues from 76.6% for the three months ended 31 March 2004 to 63.9% for the corresponding period in 2005. The decrease was largely attributable to lower materials, services and other expenses due to the divestiture of the oil and gas construction services business in June 2004. Total operating expenses attributable to our oil and gas construction services business were

RR nil and RR 1,153 million for the three month periods ended 31 March 2005 and 2004, respectively. The table below presents a breakdown of operating expenses in each period:

	Three months ended 31 March			
	2005		2004	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Materials, services and other expense	867	10%	1,710	26%
Purchases of oil, gas condensate and natural gas	611	7%	1,485	22%
Transportation expenses	1,740	19%	1,040	16%
Taxes other than income tax	1,301	14%	392	6%
General and administrative expenses	228	3%	235	4%
Depreciation, depletion and amortization	814	9%	149	2%
Net impairment expense	42	0%	33	0%
Exploration expenses	149	2%	63	1%
Total operating expenses	5,752	64%	5,107	77%

Materials, services and other expense

Our materials, services and other expense in the three months ended 31 March 2005 decreased by RR 843 million, or 49.3%, compared to the corresponding period in 2004. The decrease related to the sale of our oil and gas construction services business in June 2004 and was partially offset by increases due to the consolidation of Tarkosalenftegas and Khancheyneftegas at 31 December 2004. See note on the “Restructuring activities and discontinued operations” below.

Purchases of natural gas, gas condensate and crude oil

For the three months ended 31 March 2005 and 2004, we purchased natural gas, gas condensate and crude oil as shown in the following table:

	Three months ended 31 March			
	2005		2004	
	(Quantity)	(RR million)	(Quantity)	(RR million)
Purchases from related parties				
Purchases of natural gas from (mmcm):				
Tarkosalenftegas ⁽¹⁾	—	—	1,702	509
Khancheyneftegas ⁽¹⁾	—	—	425	177
Total purchases of natural gas from related parties	—	—	2,127	686
Purchases of natural gas from third parties	554	231	361	203
Purchases of crude oil and gas condensate from (mt):				
Tarkosalenftegas	—	—	77	124
Khancheyneftegas	—	—	107	171
Geoilbent	109	288	98	266
Purchases of crude oil and gas condensate from related parties	109	288	282	561
Purchases of crude oil and gas condensate from third parties	37	92	15	35
Total purchases of natural gas and crude oil and gas condensate		611		1,485
Total purchases from related parties		288		1,247
Total purchases from third parties		323		238

(1) These companies were not consolidated in the three months ended 31 March 2004.

In the three months ended 31 March 2005, our purchases of hydrocarbons decreased significantly due to the consolidation of hydrocarbon production from Tarkosalenftegas and Khancheyneftegas. In the three months ended 31 March 2005, our purchases of natural gas included production from the West Tarkosalinskoye field in the amount of 219 mmcm of natural gas. This field was previously owned by us (See “Divestures” above) and our net production of natural gas from this field in the three months ended 31 March 2004 was 232 mmcm.

Transportation expense

Our transportation expense for the three months ended 31 March 2005 increased by RR 700 million, or 67.3%, compared to the corresponding period in 2004. Transportation expense for natural gas for the three months ended 31 March 2005, increased by RR 572 million, or 80.7%, to RR 1,281 million compared to the corresponding period in 2004 due to a 41.4% increase in our sales volumes of natural gas sold to end-customers, for whom the cost of transportation is included in the sales prices, and a 16.9% increase in our average natural gas transportation tariff. These two factors contributed roughly equally to the increase in natural gas transportation expense.

Our expenses for transportation of crude oil and gas condensate shipped via the Transneft pipeline network increased by RR 14 million, or 9.4%, for the three months ended 31 March 2005 compared to the corresponding period in 2004, primarily due to an increase in transportation tariffs partially offset by a decrease in volumes shipped.

Our expenses for oil products transported by railroad increased for the three months ended 31 March 2005 due to higher volumes, as compared to the corresponding period in 2004.

Taxes other than income tax

Taxes other than income tax include mineral extraction tax (also referred to as the “unified natural resources production tax”), property tax, excise tax, social taxes and other taxes. For the three months ended 31 March 2005, taxes other than income taxes increased by RR 909 million, or 231.9%, compared to the corresponding period in 2004. This increase in taxes other than income tax resulted primarily from a RR 801 million, or 228.9%, increase in our mineral extraction tax due to increased volumes produced in the three months ended 31 March 2005 compared to the corresponding period in 2004, and the tax impact from the consolidation of Tarkosalenftegas and Khancheyneftegas. Prior to the consolidation, mineral extraction tax from these companies was not included as part of our expenses due to the fact that, as associates, these companies were accounted for under the equity method.

Effective 1 January 2005, the base rate for unified natural resources production taxes relating to crude oil increased from RR 347 per metric tonne to RR 419 per metric tonne. A new rate will be applicable from 1 January 2007, after which the rate will be 16.5% of our crude oil revenues, net of VAT. Production tax for natural gas in the three months ended 31 March 2004 was RR 107 per mcm and for the corresponding period in 2005 it was increased to RR 135 per mcm.

Other operating expenses

We saw a general increase in other operating expenses for the three months ended 31 March 2005 compared to the corresponding period in 2004, due to the continued development of our oil and gas fields and a corresponding growth in sales volumes resulting from the full consolidation of Tarkosalenftegas and Khancheyneftegas. However, certain expenses were discontinued following the sale of our oil and gas construction services business in June 2004. See note on the “Restructuring activities and discontinued operations” below.

Notwithstanding the discontinued operations:

- Depreciation, depletion and amortization expense, calculated on a units of production basis for our oil and gas properties, increased by RR 665 million for the three months ended 31 March 2005, or 446.3%, compared to the corresponding period in 2004, largely due to the growth in production volumes and additions of property, plant and equipment at the Yurkharovskoye field and from the consolidation of Tarkosalenftegas and Khancheyneftegas in December 2004; and
- Employee compensation expense and general and administrative expenses, excluding the effects of the discontinued operations, were generally higher during the three months ended

31 March 2005 compared to the corresponding period in 2004 due to the consolidation of Tarkosaleneftegas and Khancheyneftegas which increased the average number of employees from 2,400 as at 31 March 2004 to 3,800 as at 31 March 2005.

Income from operations

As a result of the factors discussed above, our income from operations increased by RR 1,729 million to RR 3,248 million, or 113.8%, for the three months ended 31 March 2005 from RR 1,519 million for the corresponding period in 2004. Our income from operations as a percentage of our total revenues increased to 36.1% for the three months ended 31 March 2005 compared to 22.8% for the corresponding period in 2004.

Finance income and expense

Finance income and expense decreased from a net gain of RR 11 million in the three months ended 31 March 2004 to a net expense of RR 241 million in the corresponding period in 2005. The decrease was due to higher interest expense resulting from the consolidation of debt and related interest expense of Tarkosaleneftegas and Khancheyneftegas in 2005 (see note on “—Debt obligations”). In addition, the decrease resulted from foreign exchange losses of RR 127 million largely associated with debt, in the three months ended 31 March 2005 compared to a net gain of RR 44 million in the corresponding period in 2004. The increase in finance expense in the three months ended 31 March 2005 was offset by an increase in interest income of RR 134 million for the corresponding period in 2004. Interest income for the three months ended 31 March 2005 increased compared to the corresponding period in 2004 due to the provision of additional loans to our associated companies and other related parties.

Share of income of associated companies

For the three months ended 31 March 2005, our share of the net income of Tarkosaleneftegas and Khancheyneftegas was nil, compared to RR 115 million for the corresponding period in 2004, as we now consolidate these entities and no longer account for them on an equity basis due to the acquisition of the additional interests in these entities in December 2004.

Our share of the net income of other associated companies decreased by RR 297 million to RR 77 million for the three months ended 31 March 2005 compared to RR 374 million for the corresponding period in 2004. The decrease was due to lower income from operations recorded by our associated company, Geoilbent (which was sold in June 2005), and the consolidation of Tarkosaleneftegas and Khancheyneftegas. During the first quarter of 2004, Geoilbent received a beneficial tax ruling reducing its income taxes by RR 341 million, RR 225 million of which was attributable to our 66% participation interest.

Income tax expense

Our overall effective income tax rates (total tax expense calculated as a percentage of our reported IFRS income before income tax, share of net income from associates and minority interest) were 25.8% and 31.3% for the three months ended 31 March 2005 and 2004, respectively. Our share of the taxation expenses of our associated companies is included within our income tax expense.

The table below shows the income tax expense for the three months ended 31 March 2005 and 2004.

	Three months ended 31 March	
	2005	2004
	(RR million)	
Current income tax expense	(866)	(435)
Deferred income tax expense	90	(44)
Total income tax expense	<u>(776)</u>	<u>(479)</u>

Our effective income tax rate of 25.8% for the three months ended 31 March 2005 correlates closely to our statutory income tax rate of 24%. The difference was primarily due to a reduction in non-deductible expenses for statutory income tax purposes.

Net income and earnings per share

As a result of the factors discussed above, our net income increased by RR 881 million, or 61.4%, to RR 2,315 million for the three months ended 31 March 2005 from RR 1,434 million for the corresponding period in 2004. Net losses attributable to our oil and gas construction services business were RR nil and RR 94 million for the three months ended 31 March 2005 and 2004, respectively.

Our weighted average basic and diluted earnings per share increased to RR 762 per share for the three months ended 31 March 2005 from RR 638 per share for the corresponding period in 2004. The weighted average number of ordinary shares outstanding for the three months ended 31 March 2005 and 2004 were 3,036,306 and 2,247,030, respectively. The weighted average number of shares was higher in the 2005 period due to the issuance of 789,276 new ordinary shares in connection with the acquisitions in December 2004 of the remaining interests in Tarkosaleneftegaz and Khancheyneftegaz.

The year ended 31 December 2004 compared to the year ended 31 December 2003

The following table and discussion is a summary of our consolidated statements of income for the years ended 31 December 2004 and 2003. The following table includes the activities of our oil and gas construction services business through its sale in June 2004. Total revenues attributable to our oil and gas construction services business were RR 2,053 million and RR 3,258 million for the years ended 31 December 2004 and 2003, respectively. Total operating expenses attributable to our oil and gas construction services business were RR 2,194 million and RR 3,341 million for the years ended 31 December 2004 and 2003, respectively. Net losses, including the loss attributable to the sale of our oil and gas construction services business were RR 335 million and RR 122 million for the years ended 31 December 2004 and 2003, respectively. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December			
	2004		2003	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Total revenues⁽¹⁾	24,615	100%	16,058	100%
Other income	583	2%	1,198	7%
Total revenues and other income	25,198	102%	17,256	107%
Operating expenses	(17,584)	(71)%	(13,084)	(81)%
Income from operations	7,614	31%	4,172	26%
Finance income (expense)	(292)	(1)%	(156)	(1)%
Share of income from associates	721	3%	524	3%
Income before income tax and minority interest	8,043	33%	4,540	28%
Total income tax expense	(2,075)	(9)%	(1,331)	(8)%
Income before minority interest	5,968	24%	3,209	20%
Minority interest	(274)	(1)%	72	0%
Net income	5,694	23%	3,281	20%

(1) Net of VAT, excise tax and export duties.

Revenues

The following table sets forth our sales volumes and our average realized prices for the year ended 31 December 2004 and 2003:

	Year ended 31 December	
	2004	2003
Sales of natural gas		
Net sales ⁽¹⁾	12,943	7,612
<i>Volumes in mmcm</i>	17,277	13,161
<i>Average price, \$ per mcm</i> ⁽²⁾	26.1	18.9
<i>Average price, RR per mcm</i>	749	578
Sales of crude oil and gas condensate		
Net sales ⁽¹⁾	6,387	2,268
<i>Volumes in thousands of tonnes</i>	1,589	734
<i>Average price, \$ per tonne</i> ⁽²⁾	139.9	100.7
<i>Average price, RR per tonne</i>	4,020	3,090
Sales of oil products		
Net sales ⁽¹⁾	2,159	2,144
<i>Volumes in thousands of tonnes</i>	523	501
<i>Average price, \$ per tonne</i> ⁽²⁾	143.7	139.5
<i>Average price, RR per tonne</i>	4,128	4,279
Total oil and gas sales	21,489	12,024
Oil and gas construction services revenues ⁽¹⁾	2,053	3,258
Sales of polymer and insulation tape ⁽¹⁾	617	286
Other revenues ⁽¹⁾	456	490
Total revenues	24,615	16,058
Net gain (loss) on disposals ⁽¹⁾	198	1,011
Net other income (expense) ⁽¹⁾	385	187
Total revenues and other income	25,198	17,256

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

The increase in total revenues and other income of RR 7,942 million, or 46%, in 2004 compared to 2003 was primarily due to increased sales volumes of natural gas, crude oil and gas condensate and oil products. The increase in sales volumes was due to higher production from our wholly owned subsidiary, Yurkharovneftegas, and an increase in purchases from Tarkosaleneftgas and Khancheyneftgas reflecting the production growth at both the East Tarkosalinskoye and Khancheyskoye fields. The increase in volumes was combined with higher average realized prices for all three products during 2004. In June 2004, we sold our interests in our oil and gas construction services business which resulted in a decrease in revenue from this business for the full year ended 31 December 2004 compared to the corresponding period in 2003 but contributed to higher overall profit margin as a percentage of revenues. Our total revenues include revenues from our oil and gas construction services business up until the point of sale.

Oil and gas sales

Total sales volumes of natural gas increased by 4,116 mmcm, or 31.3%, for 2004 compared to 2003, as shown in the following table of sources of production and purchases of natural gas for 2004 and 2003:

	Year ended 31 December	
	2004	2003
	(mmcm)	
Production from:		
Yurkharovneftegas	6,673	3,019
Other ⁽¹⁾	2,309	1,535
Total natural gas production	8,982	4,554
Purchases from:		
Khancheyneftegas	2,297	588
Tarkosaleneftegas	5,738	5,223
Pur-Land ⁽²⁾	—	2,873
Other including third parties	523	30
Total natural gas purchases	8,558	8,714
Changes in inventory	(263)	(107)
Total natural gas sales volumes	17,277	13,161

(1) Includes post-sale purchases from Purgasdobycha in 2004—see “Divestitures” above.

(2) In 2004 purchases from Pur-Land ceased due to direct purchases from our associated companies.

For 2004, our revenues from the sale of natural gas increased by RR 5,331 million, or 70%, compared to 2003 as a result of increased production and purchases as well as an increase in prices. Revenues from the sale of natural gas accounted for 52.6% and 47.4% of our total revenues in 2004 and 2003, respectively. During 2004 and 2003, we sold our entire natural gas volumes in the Russian domestic market. For 2004, our average realized price for natural gas increased by RR 171 per mcm, or 29.6%, compared to 2003 due to a larger proportion of our natural gas sales volumes being sold directly to end-customers, mainly to customers in the electricity generation industry. For 2004, end-customer sales volumes increased by 4,916 mmcm, or 123.7%, compared to 2003, more than offsetting a decline in ex-field sales between the same periods. In addition, the regulated natural gas price for 2004, which influenced our contract prices, increased by 21% compared to the regulated natural gas price for 2003. The increase in natural gas revenues in 2004 is attributable in roughly equal amounts to an increase in volumes and natural gas prices for 2004 compared to 2003.

The following table shows the breakdown of natural gas sales volumes between ex-field and end-customer market customer segments for the years ended 31 December 2004 and 2003:

	Year ended 31 December	
	2004	2003
	(mmcm)	
Ex-field sales	8,388	9,188
End-customer sales	8,889	3,973
Total gas sales	17,277	13,161

The following table shows the sources of our production and purchases of crude oil and gas condensate for 2004 and 2003:

	Year ended 31 December	
	2004	2003
	(mt)	
Production from:		
Yurkharovneftegas	554	275
Other	239	146
Total production	793	421
Purchases from:		
Tarkosaleneftegas	348	306
Khancheyneftegas	520	336
Geoilbent	358	—
Other including third parties	99	139
Total purchases	1,325	781
Total production and purchases	2,118	1,202
Changes in inventory and other losses	(6)	33
Total liquids sales	2,112	1,235
Oil and gas condensate sales	1,589	734
Oil products sales	523	501

Our production of crude oil and gas condensate increased in 2004 by 372,000 tonnes, or 88.4%, compared to 2003 mainly due to the continued development and extraction of gas condensate at the Yurkharovskoye field. For 2004, our purchases of crude oil and gas condensate increased by 544,000 tonnes, or 69.7%, compared to 2003, due to increased production volumes of gas condensate at Tarkosaleneftegas and Khancheyneftegas and the corresponding increase in our proportion of the production.

The following table sets out the net sales, volumes and average realized prices we received for our crude oil and gas condensate in 2004 and 2003.

	Year ended 31 December	
	2004	2003
Sales of crude oil and gas condensate—exported		
Net sales⁽¹⁾	2,381	1,132
<i>Volumes in thousands of tonnes</i>	502	253
<i>Average price, \$ per tonne⁽²⁾</i>	165.1	145.9
<i>Average price, RR per tonne</i>	4,743	4,474
Sales of crude oil and gas condensate—domestic		
Net sales⁽¹⁾	4,006	1,136
<i>Volumes in thousands of tonnes</i>	1,087	481
<i>Average price, \$ per tonne⁽²⁾</i>	128.3	77.1
<i>Average price, RR per tonne</i>	3,685	2,362

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

For 2004, total sales volumes of crude oil and gas condensate increased by 855,000 tonnes, or 116.5%, compared to 2003, while sales of oil products increased by 22,000 tonnes, or 4.4%, compared to 2003.

Our revenues from the sales of crude oil and gas condensate increased in 2004 by RR 4,119 million, or 181.6%, compared to 2003, as a result of increased sales volumes to the export and domestic markets, as well as an increase in the domestic sales price. For 2004, crude oil and gas condensate sold on the export and domestic markets increased by 249,000 tonnes and 606,000 tonnes, or 98.4% and 126%, respectively,

compared to 2003. Our average realized sales price translated into US dollars for crude oil and gas condensate exported to Europe and other CIS countries increased by USD 19 per tonne in 2004 from 2003 due to higher sales volumes sold outside the CIS countries, where prices are generally higher relative to prices received from the CIS countries. This figure was also positively affected by the appreciation of the rouble relative to the US dollar. Our average realized crude oil and gas condensate domestic sales price increased by RR 1,323 per tonne, or 56%, in 2004 compared to 2003 due to the strengthening of domestic crude oil prices. The increase in revenues from crude oil and gas condensate sales of 181.6% in 2004 compared to 2003 was attributable to increases in domestic and export sales volumes and price increases, with domestic sales volumes and prices contributing more to the increase than export sales volumes and prices.

For 2004, we increased our liquid volumes processed at the Surgutsky refinery thus slightly increasing our revenues from the sales of oil products by RR 15 million, or less than one percent, compared to 2003. The main oil products sold were diesel fuel, light distillate and butane gas.

The following table sets out the net sales, volumes and average realized prices we received for our oil products in 2004 and 2003:

	Year ended 31 December	
	2004	2003
Sales of oil products—exported		
Net sales⁽¹⁾	98	1,372
<i>Volumes in thousands of tonnes</i>	20	265
<i>Average price, \$ per tonne⁽²⁾</i>	170.6	168.7
<i>Average price, RR per tonne</i>	4,900	5,177
Sales of oil products—domestic		
Net sales⁽¹⁾	2,061	772
<i>Volumes in thousands of tonnes</i>	503	236
<i>Average price, \$ per tonne⁽²⁾</i>	142.6	106.7
<i>Average price, RR per tonne</i>	4,097	3,273

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

Our oil products export revenue decreased significantly in 2004 to RR 98 million from RR 1,372 in 2003 as we focused on supplying the domestic market due to better margins available domestically from strong diesel fuel prices during 2004. In 2004, domestic sales of oil products increased by RR 1,289 million, or 167%, compared to 2003 due to increased volumes of oil products sold and a generally stronger pricing environment. The increase in domestic revenues from oil products sales in 2004 compared to 2003 was largely attributable to an increase in volumes and to a lesser extent an increase in price for 2004 compared to 2003. Our revenue from the sales of oil products depends on the product mix we receive from the Surgutsky refinery and we have limited control over this product mix. The product mix is a result of the level of refining available whereby more complex refining yields higher margin products like diesel fuel and light distillate while less complex refining yields lower margin products like stable condensate and butane fractions. In 2004, our overall average price decreased by RR 151, or 3.5%, per tonne compared to 2003 because we received a higher proportion of lower margin products from the refinery during 2004.

Oil and gas construction services

For 2004, revenues from our oil and gas construction services decreased by RR 1,205 million, or 37%, compared to 2003 due to the sale of this business segment as of June 2004. For a further discussion, see “Restructuring activities and discontinued operations” below.

Sales of polymer and insulation tape

Our sales of polymer and insulation tape increased to RR 617 million in 2004 compared to RR 286 million in 2003 due to an increase in sales of film wrap for 2004.

Other income

Other income includes gains and losses recognized on the disposals of our investments in oil and gas producing subsidiaries and associates. In November 2003, we sold our 40% interests in both Nakhodkaneftegaz and Yamalneftegasdobycha to a subsidiary of LUKOIL and recognized gains of RR 1,015 million. In 2004, we recognized gains on disposal of assets of RR 198 million comprising the net effect of the sale of the oil and gas construction services business and of other subsidiaries to shareholders.

Operating expenses

For 2004, our operating expenses increased by RR 4,500 million, or 34.4%, compared to 2003 due to our substantial growth in operating activities in 2004. Total operating expenses attributable to our oil and gas construction services business sold in June 2004 were RR 2,194 million and RR 3,341 million for the years ended 31 December 2004 and 2003, respectively. As a percentage of total revenues, operating expenses decreased from 81.5% in 2003 to 71.4% in 2004, as shown in the table below:

	Year ended 31 December			
	2004		2003	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Materials, services and other	4,175	17%	4,982	31%
Purchases of oil, gas condensate and natural gas	5,708	23%	3,310	21%
Transportation expenses	4,234	17%	2,390	15%
Taxes other than income tax	1,569	6%	847	5%
General and administrative expenses	1,152	5%	700	4%
Depreciation, depletion and amortization	681	3%	425	3%
Net impairment expense (benefit)	(118)	0%	308	2%
Exploration expenses	183	0%	122	0%
Total operating expenses	17,584	71%	13,084	81%

Materials, services and other expense

The table below presents the main components of our materials, services and other expense.

	Year ended 31 December	
	2004	2003
	(RR million)	
Materials and supplies	1,606	1,932
Employee compensation	756	946
Construction services	415	679
Tolling fees	365	457
Other	1,033	968
Total materials, services and other expenses	4,175	4,982

For 2004, our materials and supplies, employee compensation and construction services expenses decreased by RR 326 million, or 16.9%, RR 190 million, or 20.1%, and RR 264 million, or 38.9%, respectively, compared to 2003. These decreases were primarily related to the sale of our oil and gas construction services business in June 2004. See note on the “Restructuring activities and discontinued operations” below.

Tolling fees include the fees we pay to the Surgutsky refinery for refining our unstable gas condensate. This expense decreased in 2004 by RR 92 million, or 20.1%, compared to 2003 due to the less complex refining of our unstable gas condensate in 2004 compared to 2003.

Other expenses comprise electricity and fuel, extraction services, rent expense and repair and maintenance services. For 2004, we saw a general increase in other expenses of RR 65 million, compared to 2003 due to increased field development and production at the Yurkharovskoye field. However, certain expenses were discontinued during the period with the disposal of the oil and gas construction services business in June 2004. See note on the “Restructuring activities and discontinued operations” below.

Purchases of natural gas, gas condensate and crude oil

In 2004 and 2003, we purchased natural gas and crude oil and gas condensate volumes as shown in the following table:

	Year ended 31 December			
	2004		2003	
	(Quantity)	(RR million)	(Quantity)	(RR million)
Purchases from related parties				
Purchases of natural gas from (mmcm):				
Tarkosalenftegas	5,738	1,727	5,223	1,050
Khancheynftegas	2,297	958	588	245
Pur-Land ⁽¹⁾	—	—	2,873	467
Total purchases of natural gas from related parties	8,035	2,685	8,684	1,762
Purchases of natural gas from third parties	523	288	30	15
Purchases of crude oil and gas condensate from (mt):				
Tarkosalenftegas	348	557	306	597
Khancheynftegas	520	832	336	674
Geoilbent	358	920	—	—
Purchases of crude oil and gas condensate from related parties	1,226	2,309	642	1,271
Purchases of crude oil and gas condensate from third parties	99	426	139	262
Total purchases of natural gas and crude oil and gas condensate		5,708		3,310
Total purchases from related parties		4,994		3,033
Total purchases from third parties		714		277

(1) After 2003 Pur-Land ceased to act as an agent for the sales of natural gas from our associates.

For 2004, our total purchases of natural gas and crude oil and gas condensate increased by RR 2,398, or 72.4%, compared to volumes purchased in 2003.

The growth in volumes purchased from Tarkosalenftegas and Khancheynftegas reflect production growth at both the East Tarkosalinskoye and Khancheynskoye fields. Our volumes purchased from Tarkosalenftegas represented the combined equity interest held directly by us and our principal shareholders in the field. The proportion of production purchased by us from Khancheynftegas in 2004 and 2003 represented 100% of the production volumes from the commencement of commercial production of natural gas in October 2003, as agreed by the other shareholder in the company. In December 2004, Tarkosalenftegas and Khancheynftegas became our wholly owned subsidiaries. See “—Certain Factors Affecting our results of Operations—Consolidation of our operations—Acquisitions.”

Transportation expense

Our transportation expense increased by RR 1,844 million, or 77.2%, for 2004 compared to 2003. Transportation expense for natural gas sold to our end-customers increased to RR 2,938 million in 2004 from RR 1,338 million in 2003, or 119.6%, due to the significant increase in our sales volumes of natural gas sold to end-customers for 2004 compared to 2003. For 2004, our volumes sold to end-customers increased by 4,916 mmcm, or 123.7%, compared to 2003. Transportation expenses as a percentage of end-customer sales revenue was lower for 2004 than for 2003.

For 2004, our transportation expense for crude oil and gas condensate shipped via the Transneft pipeline network increased by RR 306 million, or 122.9%, compared to 2003, due to the increase in crude oil and gas condensate volumes sold and an increase in the transportation tariffs.

Our expenses for transportation of oil products by railway increased by RR 49 million for 2004, compared to 2003. The increase was largely attributable to an increase in the volumes sold in the domestic market in 2004 compared to 2003.

Taxes other than on income tax

Taxes other than on income tax include mineral extraction tax, property tax, excise tax and other taxes. For 2004, taxes other than income taxes increased by RR 722 million, or 85.2%, compared to 2003. The increase in taxes other than income tax resulted primarily from a RR 755 million, or 140.3%, increase in our mineral extraction tax due to increased volumes produced in 2004 compared to 2003, plus generally higher average rates for unified natural resources production tax.

Other operating expenses

We saw a general increase in other operating expenses for 2004 compared to 2003 due to the continued development of our oil and gas fields. However, certain expenses were discontinued following the sale of the oil and gas construction services business in June 2004. See note on the “Restructuring activities and discontinued operations” below.

Notwithstanding the discontinued operations noted above:

- Depreciation, depletion and amortization expense, calculated on a units of production basis for our oil and gas properties, increased for 2004 by RR 256 million, or 60.2%, compared to 2003 largely due to the growth in production volumes and the addition of property, plant and equipment at the Yurkharovskoye field in 2004; and
- Employee compensation expense and general and administrative expenses, ignoring the discontinued operations, were generally higher for 2004 compared to 2003 due to a rise in salary levels during 2004. The average number of employees decreased from 6,800 in 2003 to 3,600 in 2004 as a result of the sale of the oil and gas construction services business.

Income from operations

As a result of the factors discussed above, our income from operations increased by RR 3,442 million, or 82.5%, to RR 7,614 million for 2004 from RR 4,172 million for 2003. Our income from operations as a percentage of our total revenues increased from 26% in 2003 to 30.9% in 2004.

Finance income and expense

We recognized net foreign exchange gains of RR 109 million in 2004 compared to RR 192 million in 2003. The change between periods reflects the rouble’s appreciation against the US dollar of 5.8% in 2004 and 7.3% in 2003 and its primary impact on foreign currency denominated borrowings during the respective periods.

For 2004, interest income increased by RR 287 million, or 164%, over 2003. The increase was due primarily to an increase in loans provided to our associates and other related parties.

For 2004, interest expense that we incurred increased by RR 340 million, or 65%, compared to 2003. The increase was due primarily to the increase in the amount of our short- and long-term indebtedness, much of which was passed on to our associates and related parties as indicated above.

Share of income of associated companies

Our share of income from associates (before income taxes) for 2004 increased by RR 197 million, or 37.6%, compared to 2003, due primarily to increased income from Geoilbent and Khancheyneftegas in 2004.

The following table provides certain financial information for our main oil and gas producing associates, Tarkosalenftegas (audited) and Khancheynftegas (unaudited), for the year ended 31 December 2004:

	Tarkosalenftegas	Khancheynftegas
	Year ended 31 December 2004 (audited)	Year ended 31 December 2004 (unaudited)
	(RR million)	
Total revenues and other income⁽¹⁾	4,680	2,664
Operating expenses	(3,530)	(2,060)
Income from operations	1,150	604
Finance and other income/(expense)	(1,117)	(103)
Income before income tax	33	501
Total income tax expense	(137)	(80)
Net income (loss)	(104)	421
Cash and equivalents	505	38
Short-term debt, including	3,940	1,488
Short-term debt to NOVATEK	615	957
Long-term debt, including	935	1,179
Long-term debt to NOVATEK	nil	1,110

(1) Net of VAT, excise tax and customs duties.

In 2004, Tarkosalenftegas and Khancheynftegas produced 690,000 tonnes and 576,000 tonnes of crude oil and gas condensate, and 11,409 mmcm and 2,341 mmcm of natural gas, respectively, compared to 584,000 tonnes and 370,000 tonnes of crude oil and gas condensate, and 14,033 mmcm and 687 mmcm of natural gas, respectively, in 2003.

Operating expenses at Tarkosalenftegas and Khancheynftegas increased in 2004 compared to 2003 reflecting increased production activities and higher material and supplies costs due to inflation.

Our share of the tax benefits and expenses of our associates is included within our income tax expense.

Income tax expense

Our overall effective income tax rates (total tax expense calculated as a percentage of our reported IFRS income before income tax and minority interest) were 25.8% and 29.3% for the years ended 31 December 2004 and 2003, respectively.

	Year ended 31 December	
	2004	2003
	(RR million)	
Current income tax expense	(1,906)	(1,434)
Deferred income tax benefit (expense)	(212)	191
Share of income tax of associates (benefit)	43	(88)
Total income tax expense	(2,075)	(1,331)

For 2004, total income tax expense increased by RR 744 million, or 55.9%, compared to 2003. In 2004, our effective income tax rate of 25.8% correlated closely to our statutory income tax rate of 24%. The difference was primarily due to a reduction in non-deductible expenses for statutory income tax purposes.

Net income and earnings per share

As a result of the factors discussed above, our net income for 2004 increased by RR 2,413 million, or 73.5%, to RR 5,694 million compared to RR 3,281 million for 2003. Included in our net income were net losses, including the loss on disposal, attributable to our oil and gas construction services business sold in June 2004 of RR 335 million and RR 122 million for the years ended 31 December 2004 and 2003, respectively.

In 2004, our weighted average basic and diluted earnings per share increased by RR 615 per share, or 32.5%, compared to 2003. In December 2004, we issued an additional 789,276 new ordinary shares to increase our total ordinary shares issued from 2,247,030 to 3,036,306 in connection with our acquisition of the remaining interests in Tarkosaleneftegas and Khancheyneftegas. The weighted average number of ordinary shares outstanding for 2004 and 2003 were 2,268,654 and 1,731,512, respectively.

Restructuring activities and discontinued operations

In June 2004, we sold our 99% investment in the share capital of OOO Novafininvest (NFI) to certain of our principal shareholders to focus our activities in the core areas of oil and gas exploration and production.

For 2004 and 2003, NFI acted as general contractor for construction activities at the Khancheyskoye and Yurkharovskoye fields. NFI was also the holding company for OAO SNP NOVA, which was the primary provider of oil and gas construction services to us. The disposal of NFI represented the discontinuance of our oil and gas construction services operations which represented substantially all of the activities of these operations in our consolidated financial statements. For the years ended 31 December 2004 and 2003, our discontinued operations relating to our oil and gas construction services earned total revenues of RR 2,186 million and RR 3,227 million, respectively, incurred expenses of RR 2,194 million and RR 3,341 million, respectively, incurred pre-tax operating losses of RR 8 million and RR 114 million, respectively, and had related income tax expenses of RR 31 million, and RR 8 million, respectively.

The year ended 31 December 2003 compared to the year ended 31 December 2002

The following table and discussion is a summary of our consolidated statements of income for the years ended 31 December 2003 and 2002. All rouble amounts related to financial information for periods prior to 1 January 2003 are expressed in constant roubles as of 31 December 2002 purchasing power, unless otherwise noted. No adjustments for the effects of changes in general purchasing power have been made for the period commencing from 1 January 2003. The following table includes the activities of our oil and gas construction services business through its disposal in June 2004. Total revenues attributable to our oil and gas construction services business were RR 3,258 million and RR 2,212 million for the years ended 31 December 2003 and 2002, respectively. Total operating expenses attributable to our oil and gas construction services business were RR 3,341 and RR 1,032 million for the years ended 31 December 2003 and 2002, respectively. Net losses attributable to our oil and gas construction services business were RR 122 million and RR 23 million for the years ended 31 December 2003 and 2002, respectively. Each line item is also shown as a percentage of our revenues.

	Year ended 31 December			
	2003		2002	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Total revenues⁽¹⁾	16,058	100%	5,285	100%
Other income	1,198	7%	394	7%
Total revenues and other income	17,256	107%	5,679	107%
Operating expenses	(13,084)	82%	(5,142)	97%
Income from operations	4,172	26%	537	10%
Finance income (expense)	(156)	1%	67	1%
Share of income from associates	524	3%	737	14%
Income before income tax and minority interest	4,540	28%	1,341	25%
Total income tax expense	(1,331)	8%	(749)	14%
Income before minority interest	3,209	20%	592	11%
Minority interest	72	0%	52	1%
Net income	3,281	20%	644	12%

(1) Net of VAT, excise tax and export duties.

Revenues

The following table sets forth our volumes and average realized prices for the years ended 31 December 2003 and 2002:

	Year ended 31 December	
	2003	2002
Sales of natural gas		
Net sales ⁽¹⁾	7,612	1,094
Volumes in mmcm	13,161	3,583
Average price, \$ per mcm ⁽²⁾	18.9	9.7
Average price, RR per mcm	578	305
Sales of crude oil and gas condensate		
Net sales ⁽¹⁾	2,268	1,084
Volumes in thousands of tonnes	734	387
Average price, \$ per tonne ⁽²⁾	100.7	89.2
Average price, RR per tonne	3,090	2,801
Sales of oil products		—
Net sales ⁽¹⁾	2,144	124
Volumes in thousands of tonnes	501	24
Average price, \$ per tonne ⁽²⁾	139.5	164.6
Average price, RR per tonne	4,279	5,167
Total oil and gas sales	12,024	2,302
Oil and gas construction services revenues ⁽¹⁾	3,258	2,212
Sales of polymer and insulation tape ⁽¹⁾	286	—
Other revenues ⁽¹⁾	490	771
Total revenues	16,058	5,285
Net gain on disposals ⁽¹⁾	1,011	79
Net other income ⁽¹⁾	187	315
Total revenues and other income	17,256	5,679

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

The increase in total revenues of RR 10,773 million, or 203.8%, for 2003 compared to 2002 is due to increased sales volumes of natural gas, crude oil and gas condensate, and related oil products, combined with higher average realized sales prices for natural gas and crude oil and gas condensate on the domestic market. Revenues were offset slightly by a decrease in average realized sales prices for crude oil and gas condensate on the export market.

Oil and gas sales

Total sales volumes of natural gas increased by 9,578 mmcm, or 267.3%, for 2003 compared to 2002, as shown in the following table of sources of production and purchases of natural gas for 2003 and 2002:

	Year ended 31 December	
	2003	2002
	(mmcm)	
Production from:		
Yurkharovneftegas	3,019	—
Other	1,535	1,735
Total natural gas production	4,554	1,735
Purchases from:		
Khancheyneftegas	588	—
Tarkosaleneftegas	5,223	1,978
Pur-Land	2,873	—
Other including third parties	30	—
Total natural gas purchases	8,714	1,978
Changes in inventory	(107)	(130)
Total natural gas sales volumes	13,161	3,583

In 2003, we commenced commercial natural gas production at both the Yurkharovskoye and Khancheyskoye fields, which significantly increased production volumes relative to 2002. In addition, we also increased our purchases of natural gas, excluding other adjustments, in 2003 by 6,736 mmcm, or 340.5%, over volumes purchased in 2002. Volumes of natural gas purchased from Tarkosaleneftegas increased by 3,245 mmcm, or 164.1%, to 5,223 mmcm in 2003 from 1,978 mmcm in 2002. We also purchased 2,873 mmcm of natural gas from Pur-Land, a related party owned by our shareholders, in 2003.

For 2003, our revenues from the sale of natural gas increased by RR 6,518 million, or 595.8%, compared to 2002 and accounted for 47.4% and 20.7% of total revenues in 2003 and 2002, respectively. For 2003, our average realized rouble price for natural gas increased by RR 273 per mcm, or 89.5%, compared to 2002 due to an increase in sales to end-customers, mainly from the electricity generation industry, and an increase in the regulated FTS gas price tariff. The average regulated FTS gas price tariff in 2003, which influenced our contract prices, increased by 20% compared to 2002.

Prior to 2003, almost all of our natural gas volumes were sold ex-field to wholesale gas traders who were responsible for securing access to the pipeline transportation network and related transportation expenses. For 2003, the proportion of natural gas sales to end-customers increased to 30.2% from 4.4% in 2002.

The following table shows the breakdown between ex-field and end-customer natural gas sales volumes for the years ended 31 December 2003 and 2002:

	Year ended 31 December	
	2003	2002
	(mmcm)	
Sales ex-field	9,188	3,424
End-customer sales	3,973	159
Total gas sales	13,161	3,583

The following table shows the sources of our production and purchases of crude oil and gas condensate for the 2003 and 2002:

	Year ended 31 December	
	2003	2002
	(mt)	
Production from:		
Yurkharovneftegas	275	—
Other	146	173
Total production	421	173
Purchases from:		
Khancheyneftegas	336	
Tarkosaleneftegas	306	117
Other including third parties	139	24
Total purchases	781	141
Total production and purchases	1,202	314
Changes in inventory and other losses	33	97
Total liquids sales	1,235	411
Oil and gas condensate sales	734	387
Oil products sales	501	24

The following table sets out the net sales, volumes and average realized prices we received for our crude oil and gas condensate in 2003 and 2002:

	Year ended 31 December	
	2003	2002
Sales of crude oil and gas condensate—exported		
Net sales⁽¹⁾	1,132	276
<i>Volumes in thousands of tonnes</i>	253	54
<i>Average price, \$ per tonne⁽²⁾</i>	145.9	162.8
<i>Average price, RR per tonne</i>	4,474	5,111
Sales of crude oil and gas condensate—domestic		
Net sales⁽¹⁾	1,136	808
<i>Volumes in thousands of tonnes</i>	481	333
<i>Average price, \$ per tonne⁽²⁾</i>	77.1	77.3
<i>Average price, RR per tonne</i>	2,362	2,426

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period. See “Currencies and Exchange Rates.”

For 2003, total sales volumes of crude oil and gas condensate increased by 347,000 tonnes, or 89.7%, compared to 2002, while sales of oil products increased significantly by 477,000 tonnes, or 21 fold, compared to 2002. Our average realized sales price translated into US dollars for crude oil and gas condensate exported to Europe and the CIS countries decreased by USD 17 per tonne in 2003 from 2002 due to a greater proportion of our export volumes shipped to CIS-based customers, where prices on average are lower relative to other export markets. Our average realized sales price decreased marginally in 2003 from 2002 for crude oil and gas condensate volumes sold on the domestic market.

The following table sets out our net sales, volumes and average realized prices we received for our oil products for 2003 and 2002:

	Year ended 31 December	
	2003	2002
Sales of oil products—export		
Net sales⁽¹⁾	920	—
Volumes in thousands of tonnes	265	—
Average price, \$ per tonne ⁽¹⁾	113.2	—
Average price, RR per tonne	3,471	—
Sales of oil products—domestic		
Net sales⁽¹⁾	1,224	124
Volumes in thousands of tonnes	236	24
Average price, \$ per tonne ⁽²⁾	169.1	164.6
Average price, RR per tonne	5,186	5,167

(1) Millions of RR, net of VAT, excise tax and export duties.

(2) Converted from the average realized RR price using average exchange rates for the period—see “Currencies and Exchange Rates.”

In 2002, we did not send any of our unstable gas condensate production to the Surgutsky refinery for processing, because gas condensate produced by our associated company, Tarkosalenftegas, was sold directly from the field as crude oil. Oil product volumes sold in 2002 were purchased from our subsidiary, Purneftegasgeologiya, which has a limited amount of processing capacity at the field. In 2003, we began transporting our unstable gas condensate volumes to the Surgutsky refinery for processing after the commencement of commercial production at the Yurkharovskoye and Khancheynskoye fields. Our revenues from sales of oil products increased in 2003 by RR 2,020 million, or 17 fold, over 2002. For 2003, the main oil products sold for export were light distillate and diesel fuel to our related party, Kerden Trading Ltd. We had no export sales of oil products in 2002. In 2003, we increased our volumes of oil products sold to the domestic market by 212,000 tonnes, or 883.3%, compared to our volumes sold in 2002.

Oil and gas construction services

Revenues from oil and gas construction services increased by RR 1,046, or 47.3%, for 2003 compared to 2002. Revenues earned from rendering construction services to associated companies increased by RR 530, or 57.8% to RR 1,447 million in 2003 from RR 917 million in 2002. Revenues from construction services rendered to third parties increased to RR 1,811 million in 2003 from RR 1,295 million in 2002. In 2003, our major projects for third parties included oil and gas construction services rendered to Artic Gas and Transneft, as well as services provided to construct the Surgut to Salekhard road.

Other revenues and other income

Other income includes gains and losses recognized on the disposals of our investments in oil and gas producing subsidiaries and associates. In November 2003, we sold our 40% interests in both Nakhodkaneftegas and Yamalneftegasdobysha to a subsidiary of LUKOIL, recognizing a total gain on the sale of RR 1,015 million in 2003.

Operating expenses

Our operating expenses increased by RR 7,942 million, or 154.5%, in 2003 compared to 2002 due to our substantial growth in operating activities, particularly with the commencement of natural gas production from Yurkharovneftegas and Khancheyneftegas. Total operating expenses attributable to our oil and gas construction services business were RR 3,341 and RR 1,032 million for the years ended

31 December 2003 and 2002, respectively. As a percentage of revenues, operating expenses decreased from 97.3% in 2002 to 81.5% in 2003, as shown in the table below:

	Year ended 31 December			
	2003		2002	
	(RR million)	(% of total revenues)	(RR million)	(% of total revenues)
Materials, services and other	4,982	31%	2,844	54%
Purchases of oil, gas condensate and natural gas	3,310	21%	607	11%
Transportation expenses	2,390	15%	321	6%
Taxes other than income tax	847	5%	296	6%
General and administrative expenses	700	4%	584	11%
Depreciation, depletion and amortization	425	3%	151	3%
Net impairment expense	308	2%	283	5%
Exploration expenses	122	0%	56	1%
Total operating expenses	13,084	81%	5,142	97%

Materials, services and other expense

The table below presents the main items of the materials, services and other expense.

	Year ended 31 December	
	2003	2002
	(RR million)	
Materials and supplies	1,932	1,040
Employee compensation	946	736
Construction services	679	462
Tolling fees	457	—
Other	968	606
Total materials, services and other expenses	4,982	2,844

Our materials and supplies, employee compensation and construction services expenses increased in 2003 by RR 892 million, or 85.8%, RR 210 million, or 28.5% and RR 217 million, or 47%, respectively, compared to 2002. These increases were primarily related to an increase in our production activities and higher prices for material purchases due to inflation. In January 2003, Yurkharovneftegas commenced production activities which are reflected in the higher materials and supplies and employee compensation expenses. While commencement of activities in Khancheyneftegas is reflected in higher purchases.

Tolling fees are the fees we pay to the Surgutsky refinery for refining our unstable gas condensate. This expense increased in 2003 by RR 457 million from RR nil in 2002. The increase in 2003 was due to the commencement of production of gas condensate at Yurkharovneftegas and Khancheyneftegas and, due to the increase in volumes, the overall usage of processing services of the Surgutsky refinery.

Other expenses comprised electricity and fuel, extraction services, rent expense and repair and maintenance services. We saw a general increase in other expenses of RR 362 million in 2003 compared to 2002 due to increased development and production at the Yurkharovskoye field.

Purchases of natural gas and crude oil and gas condensate

In 2003 and 2002, we purchased natural gas and crude oil and gas condensate as shown in the following table:

	Year ended 31 December			
	2003		2002	
	(Quantity)	(RR million)	(Quantity)	(RR million)
Purchases from related parties				
Purchases of natural gas from (mmcm):				
Tarkosalenftegas	5,223	1,050	1,978	222
Khancheynftegas	588	245	—	—
Pur-Land	2,873	467	—	—
Total purchases of natural gas from related parties	8,684	1,762	1,978	222
Purchases of natural gas from third parties	30	15	—	—
Purchases of crude oil and gas condensate from (mt):				
Tarkosalenftegas	306	597	117	258
Khancheynftegas	336	674	—	—
Purchases of crude oil and gas condensate from related parties	642	1,271	117	258
Purchases of crude oil and gas condensate from third parties	139	262	24	127
Total purchases of natural gas and crude oil and gas condensate		3,310		607
Total purchases from related parties		3,033		480
Total purchases from third parties		277		127

In 2003, our total purchases of natural gas and crude oil and gas condensate increased by RR 2,703 million, or by 445.3%, compared to 2002, due to an increase in volumes purchased in 2003 reflecting our proportion of the growth in production at our associated companies.

The growth in volumes purchased from Tarkosalenftegas and Khancheynftegas for 2003 reflects production growth at the East Tarkosalinskoye field and the commencement of production of natural gas at the Khancheynskoye field in October 2003. Our volumes purchased from Tarkosalenftegas represent our combined equity interest held directly by us and our principal shareholders of approximately 56%. The proportion of production purchased from Khancheynftegas represents 100% of the production volumes from the commencement of commercial production of natural gas in October 2003, as agreed by the other shareholder.

Transportation expense

Our transportation expense increased by RR 2,069 million, or 644.5%, in 2003 compared to 2002. Transportation expense for natural gas sold to our end-customers increased to RR 1,338 million for 2003 from RR 62 million in 2002, or 21 fold, due to the significant year-on-year increase of natural gas sold to end-customers, for whom the price includes the cost of transportation. For 2003, our volumes sold to end-customers increased by 3,814 mmcm, or approximately 25 fold, compared to volumes sold in 2002.

For 2003, our transportation expense for crude oil and gas condensate shipped via the Transneft pipeline network increased by RR 193 million, or 344.6%, compared to 2002 due to the increase in crude oil and gas condensate volumes sold. In addition, during 2003, we commenced transportation of oil products, mainly light distillate, by rail, which resulted in rail expenses of RR 82 million in 2003 compared with nil in 2002.

Taxes other than income tax

Taxes other than income tax include mineral extraction tax, property tax, excise tax, social taxes and other taxes. For 2003, taxes other than income taxes increased by RR 551 million, or 186.1%, compared to 2002. The increase in taxes other than income tax resulted primarily from a RR 384 million, or 249.4%, increase in our mineral extraction tax due to increased volumes produced in 2003 compared to 2002.

Other operating expenses

We saw a general increase in other operating expenses during the period 2002 through 2003 due to the development of our oil and gas fields, growth in sales volumes and the occupancy of a new head office in Moscow. In particular, depreciation, depletion and amortization expense, calculated on a units-of-production basis for our oil and gas properties, increased in 2003 by RR 274 million, or 181.5%, compared to 2002 due to the commencement of production at the Yurkharovskoye field in 2003.

Income from operations

As a result of the factors discussed above, our income from operations increased by RR 3,635 million, or 676.9%, to RR 4,172 million in 2003 compared to RR 537 million in 2002. Our income from operations as a percentage of our total revenues increased from 10.2% in 2002 to 26% in 2003.

Finance income and expense

We incurred a net foreign exchange gain of RR 192 million in 2003 and a net foreign exchange loss of RR 75 million in 2002. The change between the periods reflects the Russian rouble appreciation against the US dollar of 7.3% in 2003 compared to a depreciation of 5.4% in 2002, and its impact on foreign currency denominated borrowings during the respective periods.

For 2003, interest income that we received increased by RR 154 million, or 733.3%, compared to 2002. The increase was due primarily to an increase in loans provided to our associates and other related companies. during 2003.

For 2003, interest expense that we incurred increased by RR 348 million, or 198.9%, compared to 2002. The increase was due primarily to the increase in the amount of our short- and long-term indebtedness.

In 2002, we recorded a net monetary gain of RR 296 million resulting from the application of the inflationary accounting required under IAS 29.

Share of income of associated companies

Our primary associates accounted for as equity investments in 2003 and 2002 were Tarkosaleneftegas, Khancheyneftegas and Geoilbent.

Our share of income from associates (before income taxes) in 2003 decreased by RR 213 million, or 28.9%, compared to 2002. The decrease was primarily due to lower income from operations recorded by our associate, Geoilbent.

The following table provides key financial information for our main oil and gas producing associated companies, Tarkosaleneftegas (audited) and Khancheyneftegas (unaudited), for the year ended 31 December 2003, is as follows:

	Tarkosaleneftegas	Khancheyneftegas
	Year ended 31 December 2003 (audited)	Year ended 31 December 2003 (unaudited)
	(RR million)	
Total revenues and other income⁽¹⁾	3,669	881
Operating expenses	(2,610)	(676)
Income from operations	1,059	205
Finance and other income/(expense)	(288)	17
Income before income tax	771	222
Total income tax expense	(25)	(39)
Net income	746	183
Cash and equivalents	246	62
Short-term debt, including	1,424	914
Short-term debt to NOVATEK	—	—
Long-term debt, including	2,739	2,305
Long-term debt to NOVATEK	794	1,262

(1) Net of VAT, excise tax and customs duties.

In 2003, Tarkosaleneftegas and Khancheyneftegas produced 584 thousand tonnes and 370 thousand tonnes of crude oil and gas condensate, and 14,033 mmcm and 687 mmcm of natural gas, respectively. Our associate, Khancheyneftegas, commenced commercial production in October 2003 resulting in no corresponding production information for 2002.

Income tax expense

Our overall effective income tax rates (total tax expense calculated as a percentage of our reported IFRS income before income tax and minority interest) were 29.3% and 55.9% for the years ended 31 December 2003 and 2002, respectively. The effective income tax rate of 55.9% in 2002 was primarily due to a larger proportion of non-deductible expenses as a percentage of income before taxes and minority interest and the non-recognition of deductible temporary differences due to the cessation of the application of the provisions of IAS 29 effective 1 January 2003.

The enacted statutory income tax rate in the Russian Federation was 24% for both 2003 and 2002.

Net income and earnings per share

As a result of the factors discussed above, our net income increased by RR 2,637 million, or 409.5%, to RR 3,281 million in 2003 compared to RR 644 million in 2002. Included in our net income were net losses, including losses for both years attributable to our oil and gas construction services business sold in June 2004, of RR 122 million and RR 23 million for the years ended 31 December 2003 and 2002, respectively.

In 2003, our weighted average basic and diluted earnings per share increased by RR 1,330 per share, or 235.4%, compared to 2002. In October 2002, we issued an additional one million new ordinary shares for cash to increase our total issued ordinary shares from 593,682 to 1,593,682. In October 2003, we issued an additional 653,348 new ordinary shares to increase our total issued ordinary shares from 1,593,682 to 2,247,030. The new share issuance was made in connection with an exchange for additional stakes in Tambeyneftegas, Yamalneftegasdobysha and Minlay from the Yamal Fund, and the Group's shareholders contribution of their respective stakes in Minlay.

The weighted average number of ordinary shares outstanding as at 31 December 2003 and 2002 was 1,731,512 and 1,139,636, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are the cash provided from operating activities, debt financing, and access to capital markets. Our plan going forward is to finance our budgeted capital expenditures, interest and dividend mainly out of operating cash flows supplemented by additional borrowings and equity. In addition, we intend to improve our debt profile by retiring a portion of our short-term rouble denominated debt and by refinancing our debt portfolio with long-term borrowings in roubles and other currencies.

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2005 and 2004 and for each of the years ended 31 December 2004, 2003 and 2002:

	Three months ended 31 March		Year ended 31 December		
	2005	2004	2004	2003	2002
	(RR million)				
Net cash provided by (used in)					
operating activities	4,681	1,215	4,799	3,812	(787)
Net cash used in investing activities	(1,342)	(1,574)	(12,874)	(5,311)	(2,796)
Net cash provided by (used in) financing activities	(4,610)	173	9,433	2,865	3,083

Net cash provided by (used in) operating activities

Net cash provided by operating activities increased by RR 3,466 million, or 285.3%, to RR 4,681 million for the three months ended 31 March 2005 compared to RR 1,215 million for the corresponding period in 2004, mainly due to the trend noted above of higher operating income from our natural gas, crude oil and gas condensate sales as a result of continued growth in our sales volumes and higher sales prices realized for the three months ended 31 March 2005 compared to the corresponding period in 2004.

Net cash provided by operating activities increased to a cash inflow of RR 4,799 million and RR 3,812 million for 2004 and 2003, respectively, from a cash outflow of RR 787 million in 2002. The cash inflow was mainly attributable to significantly higher operating income from our sales of natural gas and crude oil and gas condensate as a result of increases in our sales volumes and realized prices for 2004 and 2003. The positive impact on our cash flows due to higher sales volumes and realized prices was partially offset by increasing income tax payments in each year.

Net cash used for investing activities

Net cash used in investing activities was RR 1,342 million for the three months ended 31 March 2005 and RR 1,574 million for the corresponding period in 2004, continuing the trend noted below of maintaining capital expenditure levels for development of our key subsidiaries.

Net cash used in investing activities increased to RR 12,874 million and RR 5,311 million in 2004 and 2003, respectively, from RR 2,796 million in 2002. The increase in cash used to finance our activities for 2004 and 2003 is due to significant expenditures we made to continue our oil and gas development activities, particularly funds spent on the Purovsky processing plant and short- and long-term loans provided to our associates, Tarkosalenftegas and Khancheyneftegas.

In December 2004, we loaned RR 8.1 billion (USD 290 million) to Levit, one of our principal shareholders, for the acquisition of shares in Tarkosalenftegas and Khancheyneftegas. As Tarkosalenftegas and Khancheyneftegas are consolidated subsidiaries from 31 December 2004, we expect that short- and long-term loans provided to these entities in the future will be reflected as capital expenditures in our consolidated statements of cash flows. In December 2004, USD 20 million of this loan was repaid.

Net cash provided by financing activities

Net cash used by financing activities increased to RR 4,610 million for the three months ended 31 March 2005 compared to net cash provided by financing activities of RR 173 million for the corresponding period in 2004. The increase in net cash used for financing activities was mainly attributable to the repayment of short- and long-term borrowings during the period, offset slightly by the receipt of additional long-term loans.

Net cash provided by financing activities increased to RR 9,433 million in 2004 compared to RR 2,865 million in 2003, and from RR 3,083 million in 2002. The increase was primarily due to an increase in our net borrowings of RR 8,319 million to finance our investing activities. See “Debt obligations” below. Dividends paid increased to RR 2,010 million in 2004 compared to RR 35 million in 2003.

Working capital

At 31 March 2005, our working capital deficit (current assets less current liabilities) was RR 3,541 million compared to RR 5,105 million at 31 December 2004. The deficit in working capital resulted mainly from the extension of the loan to Levit in December 2004.

Prior to extending the loan to Levit, we had a working capital surplus of RR 937 million as of 31 December 2003 and RR 599 million as of 31 December 2002.

The RR 6,042 million decrease in our net working capital position at the end of 2004 compared to 2003 is primarily due to the extension of the current portion of our long-term debt of RR 5,388 million. Additionally, we expect the loan we extended to Levit (currently classified as a long term loan receivable) to be repaid out of the proceeds of this offering.

We believe that we have sufficient working capital to meet our requirements for at least the next twelve months; however, we are dependent on the continued availability of capital and certain other factors. See “Risk Factors—Risks Relating to Our Business” and “—Risks Relating to the Russian Federation.”

Capital expenditures

Total capital expenditures on property, plant and equipment (excluding the effect of the acquisitions of our associates in December 2004) by segment for each of the years ended 31 December 2004, 2003 and 2002 amounted to the following:

	Year ended 31 December					
	2004		2003		2002	
	RR million	% of total	RR million	% of total	RR million	% of total
Exploration and production (includes processing)	7,212	97%	4,376	87%	3,194	93%
Oil and gas construction services . . .	—	—	474	10%	148	4%
Other ⁽¹⁾	200	3%	152	3%	109	3%
Total	7,412	100%	5,002	100%	3,451	100%

(1) Includes expenditures for other activities, including head office services, banking and telecommunications.

Exploration and production expenditures represent our investments in developing our oil and gas properties. During 2002 and 2003, capital expenditures in exploration and production were mainly attributable to the development of the Yurkharovskoye field, including the drilling of wells, the construction of pipelines, and installing gas processing and other support facilities on the property.

In 2004, our capital expenditures program relating to exploration and production activities consisted mainly of the construction of the Purovsky processing plant and the storage and loading facilities at the Port of Vitino as well as further development at our three core fields. During 2004, we spent and capitalized an aggregate of RR 7.9 billion on those activities.

Capitalized interest of RR 446 million, RR 322 million, and RR 265 million was included within capital expenditures for 2004, 2003 and 2002, respectively.

For the three months ended 31 March 2005, our capital expenditures amounted to RR 1,577 million, the majority of which was spent on our exploration and production activities, including the construction of the Purovsky processing plant (which was commissioned in June 2005).

We have budgeted total capital expenditures of approximately RR 5.0 billion for 2005, which included funds for completion of the Purovsky processing plant and the storage and loading facilities at the Port of Vitino, as well as funds targeted for further field development at our Yurkharovskoye and East Tarkosalinskoye fields and other miscellaneous capital projects.

Budgeted total capital expenditures on property, plant and equipment by segment for the year ended 31 December 2005 are as follows:

	2005	
	RR million	% of total
Exploration and production (includes processing)	4,765	97%
Other	142	3%
Total	4,907	100%

The actual amount and timing of our capital expenditures are subject to adjustment.

Debt obligations

Recent developments

In June 2005, we received a US dollar denominated loan from ZAO International Moscow Bank in the amount of USD 20 million at an interest rate of LIBOR plus 3.5% per annum. The loan is payable in 2006.

In June 2005, we received a Russian rouble denominated credit facility from Sberbank in the amount of up to RR 1,000 million at an interest rate of 8% per annum. The loan is payable in October 2005. Currently, we have borrowed RR 235 million under this loan.

In May 2005, we received a US dollar denominated loan from ZAO Standard Bank in the amount of USD 9 million at an interest rate of LIBOR plus 3.25% per annum. The loan is payable in 2006.

In April 2005, we received a five-year loan from the Yamal Fund, at the time one of our shareholders, in the amount of RR 500 million at an interest rate of 10% per annum. In June 2005, we repaid this loan.

Overview

Our total debt decreased by RR 4,150 million to RR 19,850 million at 31 March 2005 from 24,000 million at 31 December 2004. Our total debt increased by RR 16,179 million to RR 24,000 million at 31 December 2004, from RR 7,821 million at 31 December 2003. Our total debt was RR 4,996 million at 31 December 2002. Our borrowings have been used primarily for the financing of capital expenditures related to development of our three core oil and gas fields and investment in related assets such as the construction of the Purovsky processing plant.

Our debt position at 31 March 2005 and 2004 and at 31 December 2004, 2003 and 2002, was as follows:

	31 March 2005	31 December		
		2004	2003	2002
		(RR million)		
Short-term debt				
Russian rouble denominated loans	1,230	3,680	1,276	1,420
US dollar denominated loans	705	—	660	159
Loans from related parties ⁽¹⁾	—	425	—	127
Promissory notes issued	991	1,275	133	11
Current portion of long-term debt	4,026	5,388	—	—
Total short-term debt and current portion of long-term debt	6,952	10,768	2,069	1,717
Long-term debt				
Russian rouble denominated loans	3,300	4,537	1,628	4
US dollar denominated loans	11,469	11,586	2,946	2,066
Loans from related parties ⁽¹⁾	1,155	1,497	1,178	1,209
Rouble bonds issued	1,000	1,000	—	—
Less current portion of long-term debt	(4,026)	(5,388)	—	—
Total long-term debt	12,898	13,232	5,752	3,279
Total debt	19,850	24,000	7,821	4,996

(1) Some of the loans from related parties are denominated in US dollars.

Maturities

Scheduled maturities of long-term debt outstanding at 31 December 2004 are as follows:

Year ended 31 December:	Scheduled maturities as at 31 December		
	2004	2003	2002
	(RR millions)		
2004	—	—	4
2005	—	950	1,209
2006	7,920	2,160	1,271
2007	2,697	982	795
2008	2,093	1,660	—
2009	515	—	—
Thereafter	7	—	—
Total long-term debt	13,232	5,752	3,279

Available credit facilities

In December 2004, we obtained a USD 20 million (RR 559 million) line of credit from BNP Paribas, which was fully drawn in February 2005. The facility bears interest of LIBOR plus 3.5% per annum. In March 2005, we repaid USD 1.7 million (RR 46 million) of this loan.

Short-term debt

Russian rouble denominated loans

At 31 March 2005, our short-term Russian rouble denominated loans had a weighted average interest rate of 11.2% per annum. During the three months ended 31 March 2005, we repaid short-term loans from Sberbank in the aggregated amount of RR 2,450 million.

Our short-term Russian rouble denominated loans had a weighted average interest rate of 10.5% per annum (with interest rates ranging from 8.8% to 12.0% per annum), and 14.4% per annum (with interest rates ranging from 12% to 16% per annum) at 31 December 2004 and 2003, respectively. At 31 December

2002, our short-term Russian rouble denominated loans had a weighted average interest rate of 19% per annum (with interest rates ranging from 18% to 20% per annum).

US dollar denominated loans

At 31 March 2005, our short-term US dollar denominated loans included a loan from International Moscow Bank for USD 7 million at an interest rate of LIBOR plus 4.25% payable in 2006.

At 31 December 2004, we had no outstanding short-term indebtedness denominated in US dollars.

Loans from related parties

At 31 December 2004, our short-term loans from related parties consisted of US dollar denominated loans from the Yamal Fund, at the time one of our shareholders, in the amount of USD 15.3 million (RR 425 million). The loan was obtained by Khancheyneftegas and was consolidated with our debt after the acquisition of Khancheyneftegas in December 2004. The loan bore interest of 10% per annum and was repaid in February 2005.

In March 2003, we obtained a US dollar denominated loan from the Selling Shareholder in the amount of USD 2.2 million with an interest rate of 10% per annum, payable in six months from disbursement. We repaid this loan in 2003.

At 31 December 2002, our short-term loans from related parties consisted of US dollar denominated loans from the Selling Shareholder in the amount of RR 127 million (USD 4 million). The loans were unsecured and bore interest from nil to 10% per annum. During 2003, these loans were repaid.

Promissory notes

At 31 March 2005, short-term promissory notes of RR 991 million consisted of unsecured promissory notes issued by our subsidiary, Tarkosaleneftegas, repayable within one year of issuance. Subsequent to 31 March 2005, we have repaid these promissory notes.

Long-term debt

Russian rouble denominated loans

Sberbank

During the three months ended 31 March 2005, we repaid loans in the amount of RR 1,741 million and obtained additional loans in the amount of RR 547 million from Sberbank. The loans bear interest of 12% per annum and mature in 2009. RR 600 million of the repayments were made ahead of schedule, and as a result, we were released from a pledge of 2.5% of our participation interest in Tarkosaleneftegas.

During 2004, we received loans from Sberbank in the amounts of RR 900 million at an interest rate of 12% per annum repayable between 2008 and 2009, RR 495 million at interest rates between 12% and 13% per annum repayable in 2007, RR 499 million at an interest rate of 10.5% per annum repayable in 2005. The loans are collateralized by a pledge of part of our property, plant and equipment. The loans were obtained for the purpose of financing the construction of the Purovsky processing plant. During 2004, RR 459 million of these loans were repaid.

At 31 December 2004, Tarkosaleneftegas became a consolidated group subsidiary and its Sberbank loans were added to our debt in the amount of RR 1,460 million. The borrowings bear interest at rates ranging from 10.5% to 12% per annum and are repayable between 2005 and 2007.

Finance Department of the Yamal Administration

In August 2003, we received a loan from the Finance Department of the Yamal Administration in the amount of RR 1,130 million with an annual interest rate of 12.75% per annum (effective August 2004 the interest rate was reduced to 11.75% per annum) payable in July 2008. The borrowings were secured by a 4.7% participation interest in Tarkosaleneftegas as at 31 March 2005.

Other

At 31 December 2004, other Russian rouble denominated loans aggregating RR 424 million were free of interest and consisted mainly of a loan from Pur-Land, a related party, in the amount of RR 371 million. These loans were repaid in full during the first quarter of 2005.

US dollar denominated loans

C.R.R. B.V.

In December 2004, we received a loan in the amount of USD 200 million (RR 5,582 million) from C.R.R. B.V. backed by unsecured, 18-month credit-linked notes with an annual coupon of 7.75%, payable semi-annually. The loan is repayable in June 2006 and was guaranteed by Yurkharovneftegas for the full loan amount. Subsequent to 31 December 2004, an additional guarantee was provided by Tarkosaleneftogas. We used the proceeds of this loan to partially fund a USD 290 million loan from us to Levit which we made in December 2004 in connection with the acquisition of the remaining interests in Tarkosaleneftogas and Khancheyneftogas.

In April 2004, we received a loan in the amount of USD 100 million (RR 2,859 million) from ING Bank N.V. backed by unsecured 18-month credit-linked notes with an annual coupon rate of 9.125%, payable semi-annually. The proceeds of the loan were used for developing our oil and gas fields and the construction of the Purovsky processing plant. The loan is repayable in October 2005 and was guaranteed by Yurkharovneftogas and Tarkosaleneftogas for USD 100 million and USD 50 million, respectively. In April 2004, ING Bank N.V. transferred the loan to C.R.R. B.V.

Vneshtorgbank

In 2003, we obtained a USD 100 million (RR 3,157 million) loan from Vneshtorgbank. The loan is collateralized by 26.0% of the participation interest in Tarkosaleneftogas and is guaranteed by Yurkharovneftogas and Khancheyneftogas. Following the merger of Khancheyneftogas with and into Tarkosaleneftogas in May 2005, Tarkosaleneftogas assumed all obligations of Khancheyneftogas under these guarantees. The loan bears interest of 9.75% per annum. The loan is payable between 2005 and 2008.

Other US dollar denominated loans

At 31 March 2005 and 31 December 2004, other loans included US dollar denominated loans totaling USD 20 million (RR 552 million) and USD 17.6 million (RR 487 million), respectively. At 31 March 2005 and 31 December 2004, these US dollar denominated loans had weighted average interest rates of 8.8% and 8.3% per annum, respectively, and were payable between 2005 and 2010.

In 2003, Khancheyneftogas obtained a USD 5 million loan from Raiffeisenbank with an interest rate of 4.43% per annum and payable between 2003 and 2008. Following the merger of Khancheyneftogas into Tarkosaleneftogas in May 2005, Tarkosaleneftogas assumed the obligations of Khancheyneftogas under this loan.

At 31 December 2002, we had an outstanding US dollar denominated loan from LUKOIL Western Siberia totaling RR 795 million (USD 25 million) that was repaid in 2003.

Loans from related parties

In March 2005, we repaid the US dollar denominated loan to the Yamal Fund in the amount of USD 35 million (RR 1,053 million) with an interest rate of 10.0% per annum and obtained the release of the pledge of a 31% participation interest in Yurkharovneftogas.

In February 2005, we received an additional RR 1,000 million loan from the Yamal Fund, at the time one of our shareholders. The loan was unsecured, bore interest of 10% per annum and matured in five years. In June 2005, we repaid this loan.

In December 2001, we entered into a USD 40 million credit agreement with the Yamal Fund, at the time one of our shareholders. The borrowing was secured by a 31% participation interest in Yurkharovneftogas and bore interest of 10% per annum. The total balance repayable at 31 December 2004 was RR 1,126 million, which was repaid subsequent to 31 December 2004, securing the release of the pledge.

In 2003, we repaid in full our loans from the Selling Shareholder, in the amount of RR 1,209 million (USD 38 million). These loans were unsecured and carried interest rates of 12-15% per annum.

Rouble bonds issued

In December 2004, we issued one million non-convertible Russian rouble denominated bonds with a nominal value of RR 1,000 each, payable in 728 days with an annual coupon rate of 9.4%, payable semi-annually.

Contractual obligations and other commitments

We had guaranteed bank debt and interest obligations of related parties totaling RR 999 million and RR 682 million at 31 December 2004 and 2003, respectively.

As of 31 March 2005, we have pledged a part of our property, plant, equipment and inventory under various loan and pledge agreements. We have also pledged a total of 30.7% of our participation interest in Tarkosaleneftegas as a guarantee for long-term bank loans.

In 2003, we entered into a series of five-year lease agreements with Alfa-Leasing to finance purchases of equipment and rolling stock for hydrocarbon liquids in the total amounts of RR 1,716 million (Euros 46.6 million) and RR 627 million (USD 21.3 million). Lease payments are payable during the period beginning 2004 through 2009. As payments on these leases are denominated in US dollars and Euros, our actual expenses, as measured in Russian roubles, will be affected by the changes in the Russian rouble exchange rate against the US dollar and Euro.

As of 31 December 2004, we had entered into commitments to finance construction of the Purovsky processing plant in the amount of RR 2,682 million in 2005.

Our five-year contract with the Itera Group provides for the sale of 37.5 bcm of natural gas over the period from 2005 through 2009 at prices determined annually. The price is calculated as a percentage (which at no time during the term of the contract may be less than 95%) of the price set by the FTS for the Sverdlovsk region. The Itera Group sells this gas in the Sverdlovsk region.

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. We record liabilities for potential tax deficiencies. These liabilities are based on management's judgment of the risk of loss. If we were to determine that tax-related items would not be considered deficiencies or that items previously not considered to be potential deficiencies could be considered as potential tax deficiencies (as a result of an audit, tax ruling or other positions or authority) an adjustment to the liability would be recorded through income in the period such determination was made. See "Business—Litigation" for a description of certain tax-related contingencies.

Our oil and gas fields are situated on land belonging to the Russian Federation, Yamal-Nenets and municipalities. We pay unified natural resources production tax to the state budget to explore and produce oil and gas from these fields. We are subject to periodic reviews of our activities by governmental authorities with respect to the requirements of our oil and gas mineral licenses. We correspond 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. We expect any issues of non-compliance will be resolved through negotiations or corrective actions without any material adverse effect on our financial position or the operating results, but there can be no assurance that our expectation will prove to be correct.

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Our interpretation of such legislation as applied to our transactions and activities may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments. 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.

Qualitative and quantitative disclosures and market risks

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates, and interest rates. We are exposed to commodity price risk as our crude oil destined for export sales are linked to oil products prices. We are exposed to foreign exchange risk to the extent that our sales revenues, costs, receivables, loans and debt are denominated in currencies other than Russian roubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing.

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. At 31 December 2004, RR 12,547 million, or 67.4%, of our long-term debt, including the current portion of long-term debt, was denominated in US dollars (out of RR 22,725 million of our total borrowings, excluding promissory notes, at that date). Decreases in the value of the Russian rouble relative to the US dollar will increase our foreign currency denominated costs and expenses and our debt service obligations for foreign currency denominated borrowings in Russian rouble terms. A depreciation of the Russian rouble relative to the US dollar will also result in an increase in the value of our foreign currency borrowings in Russian rouble terms. Our foreign currency exposure is partially mitigated by the fact that a portion of our revenues, 13% in 2004, is denominated in US dollars. As of 31 December 2004, the Russian rouble had appreciated against the US dollar by approximately 5.8% since 1 January 2004.

A hypothetical, instantaneous and unfavorable 10% change in currency exchange rates as of 31 December 2004 and 2003 would have resulted in an estimated foreign exchange loss of approximately RR 1,160 million and RR 360 million on foreign currency denominated borrowings held as of 31 December 2004 and 2003, respectively. A hypothetical, instantaneous and unfavorable 10% change on 31 December 2004 and 2003 currency exchange rates would have resulted in additional interest expense of approximately RR 60 million and RR 40 million in 2004 and 2003, respectively, reflecting the hypothetical increased costs in rouble terms of servicing our foreign currency denominated borrowings held as of 31 December 2004 and 2003.

Commodity risk

Substantially all of our crude oil export sales to Europe are sold under spot contracts. Our export prices are linked to world crude oil prices. Worldwide political developments and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

We do not use derivative instruments to hedge our production in order to decrease our price risk exposure.

The weather is another factor affecting demand for and, therefore, the price of natural gas. Changes in weather conditions from year to year can influence demand for natural gas and to some extent gas condensate and oil products. We do not enter into any significant hedging arrangements to mitigate the price risk of our sales activities.

Ability to reinvest

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

Off balance sheet activities

As at 31 March 2005, and as at 31 December 2004, 2003 and 2002, 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.

SUMMARY OF CERTAIN DIFFERENCES BETWEEN IFRS AND US GAAP

The financial information included herein is prepared and presented in accordance with IFRS. Certain differences exist between IFRS and US GAAP, which might be material to the financial information herein.

The matters described below summaries certain differences between IFRS and US GAAP that may be material. The Company has not prepared a complete reconciliation of its consolidated financial statements and related footnote disclosures between IFRS and US GAAP and has not financially quantified such differences. Accordingly, no assurance is provided that the following summary of differences between IFRS and US GAAP is complete. Potential investors should consult their own professional advisors for an understanding of the differences between IFRS and US GAAP, and how those differences might affect the financial information herein.

IFRS is a relatively young, principles-based set of standards while US GAAP is more mature, rules-based and contains more specificity and implementation guidance. IFRS does not yet address many of today's technical issues, but does point users to the more developed bases of accounting, such as US GAAP, when an issue is not addressed by IFRS.

IFRS	US GAAP
Accounting framework	
Historical cost basis, adjusted for inflation by applying the consumer price index, for the periods when Russia was considered highly inflationary (through 31 December 2002). However, generally financial assets and liabilities are carried at amortized cost.	Similar to IFRS.
Property, plant and equipment	
Assets may be revalued to fair value, which is market value or depreciated replacement cost. Any surplus arising on the revaluation is taken directly to a revaluation reserve within equity except to the extent that the surplus reversed a previous revaluation deficit on the same asset charged to the statement of operations, in which case the credit to the extent is recognized in the statement of operations. Any deficit of revaluation is charged to the statement of operations except that it reverses a previous revaluation surplus on the same asset, in which case it is taken directly to the revaluation reserve. If an asset is revalued, then all property, plant and equipment of the same class must be revalued and these revaluations must be kept up to date. Depreciation on a revalued asset is based upon its revalued amount, as are gains and losses on disposal. The revaluation surplus may be transferred directly to retained earnings as the surplus is realized through depreciation and ultimate disposal.	Revaluation of historical cost is not permitted except in connection with purchase or sale of a business or a significant assets.

Depreciation of property, plant and equipment

The depreciable amount of an item of property, plant and equipment must be allocated on a systematic basis over its useful life, reflecting the pattern in which the asset's benefits are consumed by the entity. Any changes in the depreciation method used are treated as change in an accounting estimate reflected in the depreciation charge for the current and prospective periods.

Similar to IFRS, except that US GAAP classifies a change in the depreciation method as a change in accounting principle. The cumulative effect of the change is reflected in income in the period of the change. Changes in the estimated useful lives and salvage values are considered changes in estimates and accounted for prospectively.

US GAAP has specific accounting guidance for oil and gas producing companies that requires the application of the units-of-production method for depreciation, depletion and amortization of oil and gas producing assets. Additionally, for the purpose of calculating depreciation, depletion and amortization charges under the units-of-production method and complying with other specific oil and gas accounting standards prescribed by US GAAP, the definitions of proved reserves are the definitions adopted by the SEC for its reporting purposes that are in effect on the dates for which such calculations and other disclosures are required under US GAAP.

Impairment of assets

An entity must assess annually whether there are any indications that an asset may be impaired. If there is any such indication, the assets must be tested for impairment. An impairment loss must be recognized in the statement of operations when an asset's carrying amount exceeds its recoverable amount (see below).

A long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that the asset's carrying value is not recoverable. An impairment loss shall be recognized only if the carrying value of an asset is not recoverable and exceeds its fair value. The recoverability of the carrying amount of a long-lived asset is determined by reference to the sum of undiscounted cash flows expected to result from the use and eventual disposition of an asset.

The impairment loss is the difference between the asset's carrying amount and its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. Value in use is the future cash flows to be derived from the particular asset, discounted to present value using a pre-tax market determined rate that reflects the current assessment of the time value of money and the risks specific to the asset.

The impairment loss is based on the asset's fair value, being either market value (if an active market for the asset exists) or the sum of discounted future cash flows. The discount rate reflects the risk specific to that asset. For assets to be disposed of, the loss recognized is the excess of the asset's carrying amount over its fair value less cost to sell. Such assets are not depreciated or amortized during the selling period.

An impairment loss recognized for an asset should be reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized, in which case, the carrying amount of the asset should be increased to its recoverable amount.

Prohibits reversals of impairment losses for assets to be held and used. Subsequent revisions, both increases and decreases, to the carrying amount of an asset to be disposed, must be reported as adjustments to the carrying amount of the asset but limited by the carrying amount at the date the decision to dispose of the asset is made.

Revenue recognition

Based on several criteria, which require the recognition of revenue when risks and rewards have been transferred and the revenue and related costs can be reliably measured.

Revenue should be recognized only when all four of the following criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price is fixed and determinable; and collectibility is reasonably assured. Extensive detailed guidance exists for specific transactions.

Provisions

Provisions are recorded for present obligations arising from past events if an outflow of resources is probable and can be reliably estimated.

Similar to IFRS, with rules for specific situations (employee termination costs, environmental liabilities, loss contingencies, etc).

Comprehensive income

IFRS does not require disclosure of comprehensive income.

US GAAP requires disclosure of comprehensive income, which is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distribution to owners.

Business combinations

Business combinations initiated after 31 March 2004 are acquisitions and accounted for in accordance with one method—the purchase method. Before 31 March 2004, business combinations were accounted for as either an acquisition or a uniting of interests. Business combinations accounted for as acquisitions were the most common method of accounting for a business combination, as use of uniting of interests was severely restricted.

The date of acquisition is the date on which the acquirer obtains control over the acquired entity.

The purchase method records the assets and liabilities of the acquired entity at fair value. The cost of acquisition is the amount of cash or cash equivalents paid (or fair value of non-monetary assets exchanged). Where consideration comprises an exchange of shares, specific guidance applies under each of the two frameworks. Under IFRS, shares issued as consideration are recorded at their fair value as at the date of the exchange, being the date when the acquirer obtains control over the net assets and operations of the acquiree. When the acquisition occurs in stages, the fair value of the shares issued as purchase consideration is determined at each exchange date. In an active market the published price of a share at the date of exchange is the best evidence of fair value.

All business combinations initiated after June 30, 2001 are acquisitions and accounted for in accordance with one method—the purchase method. Before June 30, 2001, business combinations were accounted for using either the purchase method or the pooling-of-interests method.

The date of acquisition is the date on which assets are received or securities are issued.

Similar to IFRS.

Shares issued as consideration are measured at their market price over a reasonable period of time (interpreted to be a few days) before and after the parties reach an agreement on the purchase price and the proposed transaction is announced. The date for measuring the value of marketable securities must not be influenced by the need to obtain shareholder or regulatory approval.

IFRS	US GAAP
<p>Where an investor acquires less than 100% of a subsidiary, any minority interest should be stated at the minority's proportion of the net fair value of acquired assets, liabilities and contingent liabilities assumed.</p>	<p>Fair values are assigned only to the parent company's shares of the net assets acquired. The minority interest is valued at its historical book value.</p>
Definition of a subsidiary	
<p>Focuses on the concept of the power to control in determining whether a parent/subsidiary relationship exists. Control is the parent's ability to govern the financial and operating policies of a subsidiary to obtain benefits. Subsidiaries are consolidated from the date on which effective control is transferred and are no longer consolidated from the date control ceases. Generally companies own more than 50% of the voting interests in these subsidiaries.</p>	<p>Focuses on a controlling financial interest through ownership of a majority voting interest or by contract, coupled with control. Also variable interest entities (VIEs) in which a parent may not have voting control but absorbs the majority of expected losses or residual returns, must also be consolidated.</p>
Special purpose entities	
<p>Consolidate where the substance of the relationship indicates control.</p>	<p>Special purpose entities must be consolidated if consolidation requirements for VIEs are met. To avoid consolidation, the SPE must be a qualifying SPE.</p>
Goodwill	
<p>The amortization of goodwill was ceased from 1 January 2004, and for 2004 and onwards goodwill is tested annually for impairment as well as when there are indications of impairment.</p>	<p>For fiscal years beginning after 15 December 2001 goodwill should not be amortized but should be tested for impairment at least annually at the reporting unit level. For prior periods, goodwill was required to be capitalized and amortized over a useful life not to exceed 40 years. It was also required to be tested for impairment if factors indicated that impairment may exist.</p>
<p>For prior periods, goodwill was capitalized and amortized over its useful life. There was a rebuttable presumption that the useful life of goodwill did not exceed 20 years. In very rare cases goodwill might be demonstrated to have a useful life in excess of 20 years. If the useful life did exceed 20 years, amortization was still mandatory and the reasons for rebutting the presumption might be disclosed.</p>	

For all business combinations initiated after 1 January 2004, the acquirer must reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities. Any excess remaining after that reassessment (negative goodwill) is recognized in the statement of operations immediately. Before 1 January 2004, negative goodwill relating to expected future losses or expenses identified in the acquirer's plan for the acquisition was to be recognized in the statement of operations when those losses/expenses occur. Otherwise negative goodwill not exceeding the fair value of acquired identifiable, non-monetary assets was to be recognized in the statement of operations on a systematic basis over the useful lives of such assets. Where negative goodwill exceeded the fair value of non-monetary assets it was to be immediately recognized in the statement of operations.

Similar to IFRS. Excess of fair value of acquired net assets over cost is allocated as a pro-rata reduction to the assigned values of all assets, except financial assets other than investments accounted for by the equity method, any current assets and deferred tax assets. If any excess remains after reducing to zero the amounts of qualifying assets, the remaining excess is recognized in income as extraordinary gain.

Inventories

Carried at the lower of cost or net realizable value (being sale proceeds less all further costs to bring the inventories to completion). Reversal is required for a subsequent increase in value of inventory previously written down.

Broadly consistent with IFRS, in that the lower of cost and market value is used to value inventories. Market value is defined as being current replacement cost subject to an upper limit of net realizable value and a lower limit of net realizable value less a normal profit margin.

Reversal of a write down is prohibited.

Taxation

Current and deferred taxes are measured based on tax laws and rates that have been enacted or "substantively enacted" by the balance sheet date. In some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

Current and deferred taxes are measured using enacted tax laws and rates. For income tax purposes in the Russian Federation, the enactment date is the date that the tax acts are signed into law and published in designated official bulletins. Enactment of a new tax law is viewed as a discrete event of the period of enactment.

Segment reporting

Report primary and secondary (business and geographic) segments based on risks and returns.

Report based on internal reporting segments. Operating segments are those business activities for which discrete information is available, and whose operating results are regularly reviewed by the determining resource allocation and assessing performance.

Related parties

There is no specific requirement in IFRS to disclose the name of the related party (other than the ultimate parent entity) or the amounts involved in a transaction. Disclosure of “pricing policy” is required along with the elements of transactions necessary for an understanding of the financial statements.

Recent revisions to IFRS have eliminated previous exemptions for state controlled enterprises from disclosing transactions with other state controlled enterprises, government departments and agencies to the extent that such dealings are in the normal course of business. The provisions of the revised IFRS standard are effective for periods after 1 January 2005.

Transactions involving related parties cannot be presumed to be carried out on an arm’s-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Unlike IFRS, US GAAP does not require the disclosure of any changes in the method of establishing “terms” for related party transactions or the resulting effect on the financial statements. In addition, disclosure of the nature of the relationship, a description of the transaction, the amounts for each period, and the amounts due to or from related parties is required. US GAAP does not provide for any specific exemptions for disclosing transactions with other state controlled enterprises but requires disclosure of all material related party transactions.

Supplemental oil and gas disclosures

The IASB published IFRS 6 “Exploration for and Evaluation of Mineral Resources” (“IFRS 6”) in December 2004. We early adopted this standard on 1 January 2005. IFRS 6 requires an entity to disclose information that identifies and explains the amounts recognized in its financial statements arising from the exploration for and evaluation of mineral resources but its scope does not apply to, and thus require, any supplemental oil and gas reserve disclosures. No other specific oil and gas standards exist under IFRS and thus there is no requirement to publish supplemental oil and gas reserve disclosures.

Unaudited supplemental oil and gas disclosures as stipulated in SFAS 69 are required for public companies.

Guarantees

Guarantees are recognized as part of provisions and should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guarantee. The fair value of guarantees may be represented by the amount of premiums received, or by transactions for similar guarantees on a stand-alone basis or part of bundled transactions, or by the present value of future expected economic outflows. Subsequent to its initial recognition, the liability for a guarantee would typically not be adjusted for subsequent changes in fair value unless the guarantee is accounted for as a derivative. Depending on the nature of the guarantee, the guarantor's liability would typically be released to earnings as the guarantor is relieved from the associated risks by amortizing the liability into earnings through a systematic method over the term of the guarantee or releasing the liability to earnings at the expiration of the guarantee obligation. Most guarantees issued in transactions between related parties are exempt from fair value liability recognition requirements.

RUSSIAN GAS INDUSTRY

Introduction

The Russian natural gas industry developed during the Soviet era and expanded rapidly after the discovery in the 1960s of the exceptionally large reserves of natural gas in Yamal-Nenets in Western Siberia.

After the dissolution of the Soviet Union, the oil and coal industries were restructured into several regional enterprises (most of which have subsequently been privatized). The natural gas industry (including production, refining, transportation and sales), however, remains largely the business of Gazprom, a state-controlled monopoly. In 2004 demand for natural gas exceeded demand for each of oil, coal and nuclear energy and accounted for some 54% of overall demand for primary fuels in Russia according to the *BP Statistical Review of World Energy* (June 2005) (the BP Review). Russia, particularly west of the Urals mountains, has an extensive gas infrastructure, including the UGSS. The UGSS, which is owned and operated by Gazprom, collects, processes, transports, stores and delivers substantially all the natural gas sold in Russia. In addition, Russia exports natural gas both to other parts of the former Soviet Union (FSU) and to Western Europe, accounting for approximately 27% of the latter's 2004 consumption according to Wood Mackenzie.

Resources

According to the BP Review, Russia is the largest holder of proved natural gas reserves in the world controlling approximately 27% of known proved reserves at 1 June 2005.

Country	(tcm)	% of Total
Russia	48.0	26.7%
Iran	27.5	15.3%
Qatar	25.8	14.4%
Saudi Arabia	6.8	3.8%
United Arab Emirates	6.1	3.4%
United States	5.3	2.9%
Nigeria	5.0	2.8%
Algeria	4.5	2.5%
Venezuela	4.2	2.4%
Iraq	3.2	1.8%
Rest of the world	43.1	24%
Total worldwide	179.5	100%

Source: BP Review

Gazprom is the largest holder of proved natural gas reserves in Russia with reported proved reserves of 16.4 tcm at 31 December 2004. NOVATEK ranks third in Russia in terms of proved natural gas reserves with 583.1 bcm of proved reserves as of December 31, 2004, as appraised by D&M.

Yamal-Nenets, where our exploration and production fields are located, is Russia's main gas-producing region with over 90% of Russian natural gas production currently coming from this region. Eastern Siberia and the Arctic Ocean shelf have significant existing reserves appraised under Russian classification standards and additional exploration potential. However, the commercial viability of these reserves is not yet known.

Today Gazprom's historically largest fields in Western Siberia, which still account for the majority of its current gas production, are more than 50% depleted and produce at annual rates substantially below peak levels achieved between 10 and 20 years ago. According to Gazprom, aggregate production at its Yamburgskoye, Urengoiyskoye and Medvezhye fields decreased to 313 bcm in 2004 compared to 380 bcm in 2001. Wood Mackenzie have reported that the recent commissioning of Gazprom's large Zapolyarnoye field, which is expected to produce 100 bcm in 2005 is likely to be among the last of the giant low-cost natural gas developments in Yamal-Nenets from the Cenomanian horizons.

Producers

Producers of natural gas in Russia can be divided into the following segments:

- Gazprom;
- isolated gas producers;
- independent gas producers; and
- integrated oil companies.

Gazprom

As a result of the industry's historical development Gazprom is the principal supplier of natural gas throughout Russia. Gazprom currently owns and operates the UGSS. Ownership of the UGSS entails responsibility for the reliability of gas supply in Russia, maintenance and development of the pipeline network and ensuring Russia's compliance with international treaties on gas supply.

By virtue of its central position in the development and distribution of Russia's huge gas reserves, Gazprom is the world's largest natural gas company in terms of reserves, production and transportation volumes. According to Gazprom, it produced approximately 545 bcm of natural gas in 2004. According to Wood Mackenzie, Gazprom's natural gas production in 2004 accounted for approximately 85% of total Russian gas production.

Isolated Gas Producers

Certain producers operating in remote areas not connected to the UGSS supply natural gas directly to large end customers in their respective regions.

Independent Gas Producers

We are the largest independent natural gas producer in Russia, with production in 2004 of 20.4 bcm from our three core fields in Yamal-Nenets. Other large independent gas producers include the Itera Group and Northgas. Gazprom has reported that in 2004 independent suppliers accounted for 87.7 bcm of the natural gas transported through the UGSS.

Independent gas producers sell their gas in a number of ways:

- **Bilateral contracts with end consumers at unregulated prices.** Independent producers agree gas prices directly with their customers and then apply for access to Gazprom's pipeline network. The prices are usually set on a delivered basis.
- **Domestic supplies indexed to FTS prices.** Independent producers in some cases agree to service gas requirements of particular Russian regions at regulated prices.
- **Sales to Gazprom at the entry to its transportation pipeline at unregulated prices.** Gazprom buys natural gas directly from independent producers in order to cover temporary shortages in its domestic gas market supply commitments.
- **Sale to wholesale suppliers at unregulated prices.** A number of wholesale gas traders operate in the Russian market. They usually purchase gas at the entry to the UGSS and arrange their own transportation within Gazprom's infrastructure.

Oil Companies

Russia's large integrated oil companies (including LUKOIL, Surgutneftegas, Sibneft, Yukos and Rosneft) have substantial proved gas reserves and undeveloped gas resources. Recently, as domestic gas prices have increased and Gazprom's export obligations have grown, these integrated oil companies have accelerated development and production of their gas reserves. In 2004, total gas production for Russia's integrated oil companies was 45 bcm according to the Ministry of Industry and Energy, accounting for approximately half of non-Gazprom shipments through the UGSS.

Transportation Infrastructure: The Unified Gas Supply System

The Gas Supply Law (see "Regulation") defines the UGSS as a centrally managed, technologically and economically regulated system of gas production, transportation, storage and supply. Gazprom is

currently the owner and operator of the UGSS. Under the Gas Supply Law the owner of the UGSS has a number of responsibilities. To ensure reliable gas supply and compliance with international treaties of the Russian Federation and gas delivery contracts, Gazprom maintains and develops the UGSS network, monitors the function of its facilities, procures the use of equipment and processes for power-saving and environmental safety at its industrial sites, takes action to ensure industrial and ecological safety within the UGSS, and operates disaster management systems.

The UGSS includes the world's largest high-pressure trunk pipeline system, with over 152,800 km of pipelines (not including pipelines for the transportation of gas condensate) as of December 31, 2004. As of that date, its gas transportation was powered by 263 compressor stations with a total capacity of approximately 44,200 MW. To help handle seasonal and other peak demand, Gazprom maintains 24 underground natural gas storage facilities with an active storage capacity of approximately 62.0 bcm.

According to Gazprom, it transports natural gas an average distance of approximately 2,400 km for domestic consumption and 3,400 km for export. In 2004, Gazprom transported 687.4 bcm of natural gas and in 2003 674.1 bcm of natural gas. Transportation for third parties accounted for approximately 87.7 bcm and 82.9 bcm, or 12.8% and 12.3%, of the natural gas transported in 2004 and 2003, respectively.

The UGSS transports natural gas principally from large Western Siberian fields westward toward the more heavily populated regions of Russia, certain other FSU countries and Europe. Other parts of the pipeline system originate in the natural gas fields of the southern Russia-Volga region, including the Orenburgskoye and Astrakhanskoye fields. Several large pipeline systems enter Russia from Kazakhstan and connect with the UGSS, transporting natural gas from fields in Turkmenistan, Uzbekistan and Kazakhstan.

Under the Gas Supply Law, Gazprom as owner of the UGSS is obliged to provide third-party access to the network assuming that:

- there is spare transport capacity at the relevant time and place requested by the third party;
- the proposed natural gas shipments meet established quality and technical parameters;
- input and output connections and quality control stations are available; and
- there are supplies of natural gas and customer demand for the relevant time period.

In practice, Gazprom exercises considerable discretion over access to the UGSS as it is sole owner of information relating to capacity. Independent gas producers, such as our company, are required to negotiate with Gazprom the specific terms of access to the UGSS on the basis of field development plans and production volumes previously agreed with the Ministry of Natural Resources.

However, it was recently reported in the press that the head of the Russian Federal Anti-Monopoly Service, Igor Artemyev, indicated the service's intention to complete the drafting of a new set of rules regarding non-discriminatory access to the UGSS by the end of 2005. Although the specifics of this potential new regulation are not yet clear, Mr. Artemyev has stated that they will "make conditions tougher for Gazprom" in terms of monopolizing pipeline access and thus should be favorable to independent producers such as us. There can be no assurance that these new rules will come into effect or, even if they do, that they will be favorable to us.

The Russian and European Natural Gas Markets

Natural gas is gaining an increasing share of the world energy market, in part because it is generally perceived to be an effective and environmentally clean fuel. According to the BP Review, natural gas consumption, as a percentage of energy consumption in Western Europe, has increased in recent years and is expected to continue to increase. The BP Review states that this is primarily due to the growth in natural gas-fired power generating capacity, an increase in the use of natural gas for residential consumption (particularly in Central and Eastern Europe), a decline in the attractiveness of nuclear power, and environmental considerations which have reduced the attractiveness of fuels such as coal. According to the BP Review, in 2004 natural gas consumption accounted for approximately 24.1% of primary energy consumption in Western Europe, 24.2% in Central and Eastern Europe and 54.1% in Russia.

The following table sets forth primary energy and natural gas consumption in markets relevant to us for 1994, 1999 and 2004 as well as the percentage of natural gas consumed as a proportion of primary energy consumption in such markets for such years, all as reported in the BP Review:

Energy and natural gas consumption (million tonnes of oil equivalent, except percentages)	1994	1999	2004
Western Europe⁽¹⁾			
Primary Energy Consumption ⁽²⁾	1,463	1,586.4	1,671.2
Gas consumption	264	344.9	403.4
Gas consumption as percentage of primary energy consumption	18.0%	21.7%	24.1%
Central and Eastern Europe⁽³⁾			
Primary Energy Consumption ⁽²⁾	241.7	225.7	236.8
Gas consumption	52.3	50.9	57.4
Gas consumption as percentage of primary energy consumption	21.6%	22.6%	24.2%
FSU (except Russia)			
Primary Energy Consumption ⁽²⁾	350	302.5	335.7
Gas consumption	158.5	155.3	169.2
Gas consumption as percentage of primary energy consumption	45.3%	51.3%	50.4%
Russia			
Primary Energy Consumption ⁽²⁾	702.8	621.1	668.6
Gas consumption	351.8	327.3	361.8
Gas consumption as percentage of primary energy consumption	50.1%	52.7%	54.1%

Source: BP Review

(1) Defined for the purposes of this table to consist of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Luxembourg, Republic of Ireland, Italy, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey and the United Kingdom.

(2) Primary energy consumption comprises commercially traded fuels only.

(3) Defined for the purposes of this table to consist of Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia.

In the period from 1994 to 2004, natural gas consumption as a percentage of primary energy consumption in Western Europe rose from 18.0% to 24.1%.

Market conditions in Western Europe, Central and Eastern Europe and the FSU other than Russia are relevant to us as they influence Gazprom's export targets, which, in turn, partly determine actual and projected demand for gas in Russia from independent producers.

Exports from Russia

The UGSS connects Russia's gas fields with markets in the FSU, Europe and Turkey. Independent producers do not export gas beyond certain countries in the FSU such as the Ukraine and Belarus.

The demand for natural gas in Europe is expected to increase in the immediate future, driven by growth in gas-fired electricity generation. Over the same period, European natural gas production is expected to decline. These factors will result in an increase in the gap between demand and indigenous supply. Wood Mackenzie expects that Europe will require over 290 bcm per annum of imports by 2010 and up to 470 bcm per annum by 2020 to meet its needs. Gazprom's sales to Europe are expected to grow substantially both in absolute and relative terms by Wood Mackenzie, such that it supplies up to approximately 38% of the continent's natural gas, or 329 bcm, by 2020.

Sources and Uses of Natural Gas in Russia

One of Gazprom's obligations under the Gas Supply Law is to ensure an annual balance of supply and demand for natural gas in Russia.

The following table sets forth data on the natural gas balance of the UGSS for the periods indicated (including natural gas in transit from Central Asia):

Gas Balance Items	For the year ended 31 December			
	2004	2003	2002	2001
Total gas supplies (bcm), including	687.4	674.1	637.1	630.6
Gazprom's gas production and purchases by Gazprom's subsidiaries ⁽¹⁾⁽²⁾	529.1	524.9	510.6	499.0
Gas from independent suppliers, including purchases by Gazprom and gas in transit from Central Asia	105.2	95.5	79.6	77.4
Withdrawals from underground storage ⁽³⁾	41.1	42.8	40.4	48.3
Decrease in natural gas volume within the UGSS pipelines ⁽⁴⁾	11.4	10.2	5.9	5.2
Other	0.6	0.7	0.6	0.7
Total Deliveries (bcm), including	687.4	674.1	637.1	630.6
Additions to underground storage	45.5	56.3	45.7	46.8
Deliveries to customers in Russia	333.5	327.0	319.1	317.5
Deliveries to Europe	148.9	134.7	129.4	127.0
Deliveries to FSU countries other than Russia	97.1	94.2	88.8	88.0
Technological needs and transportation system issues ⁽⁵⁾	52.0	51.3	47.7	45.7
Increase in natural gas volume within the UGSS pipelines ⁽⁴⁾	10.4	10.6	6.4	5.6

Source: Gazprom

(1) Amounts are less than yearly total production because some of the natural gas produced is used for the operations of booster compressor stations and in northern cities near fields and thus does not enter the UGSS.

(2) Includes Gazprom's share of the production of Purgaz and deliveries to the UGSS by Vostokgazprom starting from the second half of 2002.

(3) Includes gas of independent suppliers.

(4) Represents changes in the volume of gas contained within the UGSS pipeline network.

(5) Includes own consumption required to run natural gas compressor stations plus technological losses, including gas lost during repair and diagnostic work.

Natural gas in Russia is used primarily for electricity generation and in the metallurgical, agro-chemical and construction industries, as well as by households. Among the principal domestic fuels, the Russian Government currently regulates only Gazprom's wholesale natural gas prices. The market determines prices of crude oil and coal and natural gas sold by independent producers, although, in the case of natural gas, such prices are heavily influenced by the regulated price. According to Gazprom, natural gas prices and the prices for alternative fuels are distorted as a result of its regulated prices being set below those economically viable.

Regulated prices are differentiated by type of consumer (household or industrial), and by price bands based on the relative distance from the gas production region to the consumer. From 1 January 2005, the number of price bands was increased to 11 from the previous seven. Regulated prices for natural gas supplied to industrial consumers in the Russian Federation are typically higher than those for natural gas supplied to household consumers. In addition, excise tax was levied on sales to industrial consumers prior to 1 January 2004, but not on sales to household consumers.

Today, the total price paid by industrial consumers includes the regulated wholesale price, a tariff for transportation through the gas distribution network and a marketing and sales services fee. The transportation tariffs, also established by the FTS, vary by region, volume and type of consumer. Such tariffs are paid to the gas distribution companies that transport the gas through their networks to consumers. The marketing and sales services fees, which are also set by the FTS, are paid to the regional gas sales companies.

The total price paid by household consumers for natural gas is established by the administrations of the Russian regions and includes the regulated wholesale price for household consumers, a tariff for transportation through the gas distribution network and a marketing and sales services fee.

The Russian Federation Energy Strategy 2020 (approved by Government Resolution of 28 August, 2003 No. 1234-p) provides for the long-term levels of wholesale regulated gas prices that should be

achieved to ensure the targeted levels of gas production. The Russian Federation Energy Strategy 2020 provides the following parameters for wholesale gas prices: US\$40-41 per mcm in 2006 and US\$59-64 per mcm in 2010. The Russian Federation Energy Strategy 2020 also provides for a gradual shift to the sale of gas at market prices to ensure self-financing by gas market participants and a more objective consumer valuation of natural gas.

The following table sets out the weighted average regulated gas prices over the years shown for industrial sales and household sales:

RR/mcm	1998	1999	2000	2001	2002	2003	2004	2005
Household	153	177	209	266	347	473	567	723
Industrial	260	260	330	402	525	684	820	1003

Source: Wood Mackenzie

Regulated natural gas prices remained relatively stable from late 1996 until late 1999. Since early 2000, however, they have risen annually and increased by 23% on 1 January 2005. Since 2002, gas prices in Russia have increased at a rate faster than inflation.

Transportation Tariffs

Pursuant to the decree of the FTS of 16 September 2004 “On Tariffs on Gas Transportation Services Through the System of Main Gas Pipelines of Gazprom,” from 1 October 2004, the transportation tariff is RR 19.37 per 1,000 cm per 100 km (excluding VAT) for the transportation of gas produced in the Russian Federation by independent producers through the UGSS for subsequent sale to Russian consumers at unregulated prices. Gas transportation tariffs have been increasing in recent years as is shown below.

Tariff per mcm per 100 km	For the period starting on					
	1 Jan 2000	1 Aug 2001	1 Mar 2002	1 Aug 2002	1 Aug 2003	1 Oct 2004
In roubles	9.00	10.00	12.00	13.80	16.56	19.37

Source: Federal Tariffs Service

BUSINESS

Overview

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia after Gazprom. In terms of proved natural gas reserves, we are the third largest oil and gas company in Russia after Gazprom and LUKOIL. Our three core fields, together with all our other fields and license areas, are located in the gas-rich Yamal-Nenets in Western Siberia. Yamal-Nenets is the world's largest natural gas producing region, accounting for over 90% of Russia's and approximately 20% of the world's natural gas production.

D&M, an independent petroleum engineering consulting firm, has appraised the reserves at our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye—and estimates that as of 31 December 2004 these fields had proved reserves of 4,108.3 mmboe, consisting of 583.1 bcm of natural gas, 27.9 mmt of gas condensate and 7.6 mmt of crude oil.

In the first quarter of 2005, our three core fields produced 47.4 mmboe (approximately 526,000 boe per day), consisting of 6.6 bcm of natural gas, 459.8 mt of gas condensate and 33.5 mt of crude oil, representing over 99% of our total hydrocarbon production. In 2004, these fields produced 150.2 mmboe (approximately 410,000 boe per day), consisting of 20.4 bcm of natural gas, 1.8 mmt of gas condensate and 123.1 mt of crude oil, an 18.2% increase over production from these fields in 2003.

Our three core fields are described below.

Yurkharovskoye. The Yurkharovskoye field is our largest field in terms of proved-plus-probable reserves and we expect it to be the primary source of our production growth over the medium term. D&M estimates that as of 31 December 2004, the field had proved reserves of 1,608.8 mmboe, consisting of 232.0 bcm of natural gas and 10.3 mmt of gas condensate. In the first quarter of 2005, the field produced 16.1 mmboe, consisting of 2.2 bcm of natural gas and 168.5 mt of gas condensate. In 2004, it produced 49.9 mmboe, consisting of 6.7 bcm of natural gas and 700.1 mt of gas condensate. Commercial production of natural gas and gas condensate began in 2003.

East Tarkosalinskoye. The East Tarkosalinskoye field is currently our largest producer of hydrocarbons. D&M estimates that as of 31 December 2004, the field had proved reserves of 2,155.3 mmboe, consisting of 306.9 bcm of natural gas, 11.1 mmt of gas condensate and 7.6 mmt of crude oil. In the first quarter of 2005, the field produced 25.6 mmboe, consisting of 3.7 bcm of natural gas, 148.2 mt of gas condensate and 33.5 mt of crude oil. In 2004, it produced 80.2 mmboe, consisting of 11.4 bcm of natural gas, 567.2 mt of gas condensate and 123.1 mt of crude oil. Commercial production began as follows: crude oil in 1994; natural gas in 1998; and gas condensate in 2001.

Khancheyskoye. D&M estimated that as of 31 December 2004, the field had proved reserves of 344.2 mmboe, consisting of 44.2 bcm of natural gas and 6.5 mmt of gas condensate. In the first quarter of 2005, the field produced 5.6 mmboe, consisting of 0.7 bcm of natural gas and 143.2 mt of gas condensate. In 2004, it produced 20.2 mmboe, consisting of 2.3 bcm of natural gas and 576.4 mt of gas condensate. Commercial production of gas condensate and natural gas began in 2002 and 2003, respectively.

We sell 100% of our natural gas to customers in the Russian Federation, including wholesale gas traders, regional gas distributors and end-users such as power utilities and metal producers. We are not subject to the government's regulation of natural gas prices, and historically we have sold most of our natural gas at prices higher than the prices set by the government for Gazprom's domestic gas sales. All our natural gas production is piped through our pipelines into UGSS, which transports substantially all of the natural gas sold in Russia and is owned and operated by Gazprom. Transportation tariffs for the use of the UGSS are set by the government.

Prior to the launch of our Purovsky gas condensate stabilization and processing plant, all of our gas condensate was processed by Gazprom and the stabilized gas condensate and LPG received after such processing were sold mostly in the domestic market. Most of our stabilized gas condensate was sold through the Russian trunk pipeline network operated by Transneft where it was mixed with the crude oil and liquid products of other companies for sale as a blend commonly known as Urals blend. With the commissioning of our Purovsky processing plant in June 2005, we are migrating the processing of substantially all of our gas condensate to that plant. We expect this migration to be completed at the end of the third quarter of 2005, by which time we expect to be able to export substantially all of our stabilized gas condensate directly to international markets where the price for gas condensate has historically exceeded

the Urals blend price. Depending on market conditions, we may also export a significant part of our LPG production.

Competitive Strengths

We believe our main competitive strengths are the following:

- ***Prolific, concentrated resource base.*** Our three core fields have estimated proved reserves of 4,108.3 mmboe, consisting of 583.1 bcm of natural gas, 27.9 mmt of gas condensate and 7.6 mmt of crude oil as of 31 December 2004, as appraised by D&M. Based on 2004 production and estimated proved reserves as of 31 December 2004, our proved reserves to production (R/P) ratio for these fields at the beginning of 2005 was 27 years. Our other fields, which have not been appraised by D&M, have total ABC1 reserves of 444.9 mmboe. Our three core fields, together with other fields, which we expect to be the focus of our future exploration and development efforts, are all located in the Nadym-Pur-Taz region of Yamal-Nenets, the traditional center of Russian gas production well served by the UGSS. Moreover, our fields are located in the same region as a number of mature Gazprom fields and have therefore historically benefited from gradually increasing available pipeline capacity in the Central and Southern Corridors of the UGSS. We expect this geographic concentration and favorable location of our resource base to facilitate production increases and reserve additions in a cost-effective manner.
- ***Low operating costs and disciplined approach to capital expenditures.*** We believe we are one of the lowest cost producers of hydrocarbons in the oil and gas industry. In 2004, our total production cost was \$3.43 per boe, of which \$1.03 per boe was transportation cost, our finding and development cost was \$0.99 per boe and our reserves replacement cost was \$0.68 per boe. 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 prolific nature of our fields, will allow us to maintain our low production, finding and development and reserves replacement costs.
- ***Leadership among independent gas producers.*** We sell natural gas to a wide range of end-users, including utilities and wholesale gas traders. We believe we have built a strong reputation with these customers, and in the Russian gas market generally, by acting as a reliable alternative source of natural gas and consistently meeting our delivery obligations. We have an active marketing organization, and we believe we are well positioned to penetrate new markets and diversify and grow our customer base.
- ***Experienced management team.*** Our core management team has extensive experience in all aspects of our business, and has successfully transformed the company from its establishment in 1994 into the largest independent gas producer in Russia. Mr. Leonid V. Mikhelson has been our chief executive officer since 1994, when he founded the company, and has been an executive in the oil and gas industry since 1987. Most other members of our core management team have extensive gas industry experience with some starting their careers in the Ministry of the Gas Industry prior to the creation of Gazprom.

Strategy

Our strategic objective is to leverage our competitive strengths to increase our hydrocarbon production on a sustainable and profitable basis. Specifically, we intend to:

- ***Substantially increase our production of hydrocarbons, particularly natural gas.*** Wood Mackenzie, an independent expert, estimates that in 2010 demand for natural gas in Russia may reach 448 bcm, a substantial portion of which will not be supplied by Gazprom. We believe we are well positioned to capture a significant share of this shortfall by increasing production and using transportation capacity in the UGSS which we believe will become available due to declining production at mature fields in the Nadym-Pur-Taz region. Our three core fields produced 20.4 bcm of natural gas and 2.0 mmt of gas condensate and crude oil in 2004. Our target is to increase our natural gas production at these fields to approximately 45.0 bcm and our gas condensate and crude oil production to approximately 4.6 mmt in 2010. See “Business—Exploration and Development—Production Targets” for further information.

- **Maintain our low cost structure.** We intend to maintain our low cost structure through the continued use of modern technology and production techniques across our prolific hydrocarbon resource base. In 2004, our production, finding and development and reserves replacement costs were among the lowest in the industry. We believe that the geographic concentration of our resource base and the resulting economies of scale will continue to be a major factor in helping us maintain our low cost structure. Moreover, we intend to continue to tightly control overhead costs.
- **Maximize risk-adjusted margins on sales of natural gas and liquids.** Our marketing and sales team continues to optimize gas sales between end-users and wholesale traders and liquid sales 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. In addition, we intend to take advantage of our recently commissioned Purovsky processing plant and our storage and loading facilities at the Port of Vitino to enable us to export substantially all of our stabilized gas condensate production, which we believe should result in improved margins.
- **Develop our resource base.** We intend to continue to prove up our reserves as we expand the development of our fields. We believe the concentration of our resource base in gas-rich Yamal-Nenets, along with the proximity of our fields to the gas transportation infrastructure in the Nadym-Pur-Taz region, will facilitate cost-effective reserve growth.
- **Further simplify our corporate structure to improve transparency and management efficiency.** In December 2004, we completed the acquisition of the remaining shareholdings in Tarkosalenftegas and Khancheyneftegas that we did not own, thus obtaining a 100% interest in our East Tarkosalinskoye and Khancheynskoye fields. In addition, we have recently disposed of non-core businesses, including our oil and gas construction services, banking and telecommunication businesses. In June 2005, we disposed of our stake in Geoilbent and agreed to dispose of our stake in Selkupneftegas. In July 2005, we disposed of our stake in Tambeyneftegas.

History

We were formed in August 1994 by a group of individuals, including Mr. Leonid V. Mikhelson, the Chairman of our Management Committee 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 formed to provide management and obtain financing for construction in the oil and gas industry and for exploration and production of oil and gas in Russia. We acquired our first operating business in January 1995, when we acquired a controlling equity interest in AOOT SNP NOVA from its shareholders.

NOVA was formed in August 1991 by the privatization of Kuybyshevtruboprovodstroy, one of the largest state-owned enterprises specializing in oil and gas pipeline construction in Russia, originally organized in 1979. At the time of the privatization, Mr. Mikhelson was, and had been since 1987, the Managing Director of Kuybyshevtruboprovodstroy. Following the privatization, Mr. Mikhelson continued as the Managing Director of NOVA.

Following our acquisition of a controlling interest in NOVA, under Mr. Mikhelson’s direction we began to expand and diversify our operations by acquiring interests in oil and gas companies which held exploration and production licenses in Yamal-Nenets. These licenses generally covered oil and gas fields in the early stages of development. The most important of these acquisitions were of interests in the following companies: Purneftegasgeologiya; Tarkosalenftegas; Khancheyneftegas; and Yurkharovneftegas. A brief history of each of these companies and Novatek-Polimer and of how we acquired our interests in each follows.

See “Risk Factors—Risks Relating to Our Business—If past and future interested party transactions in which we were involved are successfully challenged, their invalidation could have a material adverse effect on our business, financial condition, results of operations or prospects or the market price of the shares and GDRs.”

Purneftegasgeologiya. OAO Purneftegasgeologiya was formed in April 1994 by the privatization of the state-owned geological enterprise Purneftegasgeologiya, originally organized in 1965. At the time of the privatization, Mr. Iosif L. Levinzon, a member of our Board of Directors, was, and had been since 1987,

the Managing Director of Purneftegasgeologiya. Following the privatization, Mr. Levinzon continued as the Managing Director of Purneftegasgeologiya until 1995.

Purneftegasgeologiya holds licenses for the exploration and production of hydrocarbons in the Ust-Purpeyskiy and Olimpiski license areas, which licenses it was granted in March 1993 and April 2001, respectively. Purneftegasgeologiya held exploration and production licenses for the East Tarkosalinskoye and Khancheynskoye fields, which licenses it was granted in March 1993 and February 1994, respectively. These licenses were subsequently transferred to Tarkosaleneftegas and Khancheyneftegas, as described below. Purneftegasgeologiya also held an exploration and production license for the West Tarkosalinskoye field prior to its transfer to a subsidiary of Gazprom as described below.

After its privatization in 1994, Purneftegasgeologiya was not generating sufficient revenues to adequately develop its fields to meet production requirements under the terms of its subsoil licenses. In 1994, certain of our shareholders began to acquire shares of Purneftegasgeologiya from its shareholders and by 2001 had acquired enough shares so that, together with shares held by certain other Purneftegasgeologiya shareholders, they had sufficient voting power to authorize a share issuance to finance the needed development work. In September 2001, pursuant to the terms of a subscription agreement Purneftegasgeologiya issued and sold to us new shares of its capital stock, giving us an equity interest in Purneftegasgeologiya of 58.3%.

A Gazprom subsidiary, one of Purneftegasgeologiya's shareholders whose interest was diluted by the issuance, filed a claim against Purneftegasgeologiya alleging improper shareholder approval of the issuance. In November 2002, the Arbitration Court for the Yamal-Nenets Autonomous District upheld the issuance, concluding that it was valid and duly authorized by Purneftegasgeologiya's shareholders (including the Gazprom's subsidiary). The Appellate Division of the Arbitration Court for the Yamal-Nenets Autonomous District affirmed this ruling in January 2003.

Throughout this period, we continued to acquire additional shares in Purneftegasgeologiya from other Purneftegasgeologiya shareholders. We financed some of these purchases by issuances of our shares, including issuances to Levit, which resulted in it becoming one of our principal shareholders.

In 2004, Purneftegasgeologiya and Gazprom decided to restructure the rights to and operation of the West Tarkosalinskoye field, which by agreement were at the time divided between Purneftegasgeologiya and a subsidiary of Gazprom. In October 2004, pursuant to an agreement reached earlier that year we caused Purneftegasgeologiya to sell its wholly-owned subsidiary holding the exploration and production license for the West Tarkosalinskoye field to a subsidiary of Gazprom. Purneftegasgeologiya retained the rights to the production from the field it had under the previous agreement and the Gazprom subsidiary sold us its remaining 8.3% equity interest in Purneftegasgeologiya. In addition, Purneftegasgeologiya leased the gas production assets at the field to a Gazprom subsidiary.

We continue to purchase equity interests in Purneftegasgeologiya as they become available in the open market. We currently own an approximately 80.6% equity interest in Purneftegasgeologiya.

See "Risk Factors—Risks Relating to Our Business—Challenges to the privatization of two of our subsidiaries may threaten our interests in those subsidiaries and in licenses previously held by those subsidiaries" and "—We may have a tax liability related to the payment of the taxes on production from the West Tarkosalinskoye field."

Tarkosaleneftegas. OOO Tarkosaleneftegas was formed as an open joint stock company in March 1994 by NOVA, Purneftegasgeologiya and a subsidiary of Gazprom. Tarkosaleneftegas was converted to a limited liability company in March 2005. Tarkosaleneftegas holds an exploration and production license for the East Tarkosalinskoye field, which license was transferred from Purneftegasgeologiya to Tarkosaleneftegas in December 1995. In December 1996, NOVA sold all of its shares in Tarkosaleneftegas to us and Mr. Mikhelson became the Chairman of the Board of Directors of Tarkosaleneftegas, a position which he held until Tarkosaleneftegas was converted to a limited liability company in March 2005. In June 2005, the license for the East Tarkosalinskoye field was re-issued in the name of OOO Tarkosaleneftegas.

From 1997 to 2000, in order to finance further development of the East Tarkosalinskoye field, Tarkosaleneftegas carried out several issuances and sales of its capital stock. These additional shares were purchased by us, the Itera Group and TNG Energy AG (TNG), a joint venture formed by SWGI Growth Fund, a Cayman Islands company (SWGI (Cayman)), the owner of 100% of SWGI, and the Itera Group. See "—Ownership" and "—Relationship with the Itera Group" below.

In January 2003, Gazprom subsidiaries sold their remaining equity interests in Tarkosalenftegas to the Itera Group and immediately thereafter, the Itera Group sold a part (3.7%) of its interest to Levit. As part of the same transaction, TNG acquired a 10% interest in OAO Sibneftegas previously held by Gazprom and a TNG affiliate sold to Gazprom a 51% interest in OAO Severneftegazprom, a production company holding a license for the development of the Yuzhno Russkoye field.

In the first half of 2003, we acquired additional shares of Tarkosalenftegas from Purneftegasgeologiya and Levit and in August 2004 we acquired additional shares of Tarkosalenftegas from Mr. Mikhelson.

In the December 2004 consolidation described below under “—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance,” we acquired the remaining 67.7% equity interest in Tarkosalenftegas we did not own and thus, we now own a 100.0% equity interest in Tarkosalenftegas. In April 2005, the charter capital of Tarkosalenftegas was increased as a result of the contribution of our 100% interest in Khancheyneftegas.

See “Risk Factors—Risks Relating to Our Business—An exploration and production license held by one of our subsidiaries may be subject to challenge by Russian authorities or minority shareholders of the transferring entity because of irregularities in the manner in which it was transferred.”

Khancheyneftegas. OOO Khancheyneftegas was formed as an open joint stock company in February 1999 by Purneftegasgeologiya and OAO Nordpipes, a company formed in June 1998 by the Itera Group and certain of our shareholders and dissolved in 2002. At the time of the formation of Khancheyneftegas, Purneftegasgeologiya and Nordpipes held 51% and 49% of its equity interests, respectively. Khancheyneftegas was converted to a limited liability company in June 2002. Prior to its merger into Tarkosalenftegas, Khancheyneftegas held an exploration and production license for the Khancheynskoye field, which was transferred from Purneftegasgeologiya to Khancheyneftegas in November 2000. TNG purchased from Nordpipes a 49.0% equity interest in Khancheyneftegas in September 2000 and purchased from Purneftegasgeologiya an additional 2% equity interest in Khancheyneftegas in November 2000. In September 2002, Purneftegasgeologiya sold a 6% equity interest in Khancheyneftegas to unaffiliated third parties. From October 2002 to May 2003, the remaining equity interest in Khancheyneftegas held by Purneftegasgeologiya (43%) was transferred to NOVATEK in a series of transactions.

In the consolidation described below under “—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance,” we acquired the remaining 57% equity interest in Khancheyneftegas we did not own and thus, we now own a 100% equity interest in Khancheyneftegas. In May 2005, we merged Khancheyneftegas into Tarkosalenftegas. The license for the Khancheynskoye field was re-issued to Tarkosalenftegas in July 2005.

Yurkharovneftegas. OOO Yurkharovneftegas 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 privatized in April 1993. Yurkharovneftegas was converted to a limited liability company in January 2002. Yurkharovneftegas holds an exploration and production license for the Yurkharovskoye field, which was transferred from Zapolyarneftegasgeologiya to Yurkharovneftegas in February 1999. In March 2003, OAO Minlay, a company formed in April 2001 by White Bay Limited, an English limited liability company and a 100% subsidiary of SWGI (Cayman), Purneftegasgeologiya, OAO Rosneft-Purneftegas and OAO NGC Yamalneftegasdobycha, acquired a 100% equity interest in Yurkharovneftegas. In October 2003, we acquired the remaining 86% equity interest in Minlay we did not own from its shareholders (including the Yamal Fund) in exchange for issuances of our shares. In March 2004, Minlay was merged into us and as a result, we acquired 100% of Yurkharovneftegas. The Yamal Fund has since disposed of the shares it received in these transactions, including one share transferred to the Department for the Management of State Property of the Yamal-Nenets Autonomous District. See “—Litigation.”

Novatek-Polimer. OAO Novatek-Polimer (formerly OAO Truboizolyatsiya) was formed in January 1994 by the privatization of the state-owned enterprise Truboizolyatsiya, originally organized in 1961. Novatek-Polimer is Russia’s largest producer of anti-corrosive insulating materials used in the oil and gas industry for the insulation of underground pipelines of various diameters and pressure ratings.

From 1998 to 2004 we acquired a 97.93% equity interest in Novatek-Polimer by purchasing shares of capital stock from its shareholders (including from some of our shareholders) and through an auction held by the Russian Federal Property Fund.

See “Risk Factors—Risks Relating to Our Business—Challenges to the privatization of two of our subsidiaries may threaten our interests in those subsidiaries and in licenses previously held by those subsidiaries” and “—We may have a tax liability related to the payment of the taxes on production from the West Tarkosalinskoye field.”

Relationship with the Itera Group. The Itera Group is a producer and distributor of gas in Russia and other parts of the FSU. One of the Itera Group’s businesses is wholesale gas trading and in that capacity it is, and has been for the last 6 years, the largest purchaser of our natural gas. In 2005, we expect to sell over 33% of our natural gas to the Itera Group, primarily under the five year sales contract described under “—Sales and Marketing—Sales of Natural Gas.” From 1998 to 2002, the Itera Group acquired interests in some of the same oil and gas companies in which we and our shareholders were acquiring interests, mainly through TNG. See “—Tarkosalenftegas” and “—Khancheyneftegas” above and “—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance” below.

In May 2002, we formed another joint venture with the Itera Group with the name of OOO NGK Itera. The joint venture was capitalized with equal cash contributions by us and the Itera Group, and members of our management team took positions with NGK Itera. The intended purpose of NGK Itera was to combine our experience in exploration and production of natural gas with the Itera Group’s expertise in marketing natural gas in Russia and other parts of the FSU, and to possibly consolidate all of the oil and gas interests held directly or indirectly by us and the Itera Group and both group’s marketing businesses under one entity and to operate all of those assets under one management. Shortly after formation of NGK Itera and before any transfers of our assets to NGK Itera, it became apparent that the joint ownership and management plan was inconsistent with our long term strategy. Therefore, in August 2002, our management resigned from NGK Itera and in January 2003, we sold our interest in NGK Itera to the Itera Group.

In December 2004, we indirectly acquired from the Itera Group the interests in Tarkosalenftegas and Khancheyneftegas. See “—Recent Developments—Buyout of the Itera Group; Consolidation and new share issuance.” Our only existing relationship with the Itera Group is through their purchases of our natural gas, including under the five year sales contract described under “—Sales and Marketing—Sales of Natural Gas.”

Ownership. We have four principal direct shareholders, SWGI, Levit, a Russian closed joint stock company, OOO Kopitek, a Russian limited liability company, and Vnesheconombank, a Russian state-owned specialized bank. SWGI is a wholly-owned subsidiary of SWGI (Cayman). Levit and SWGI (Cayman) are owned directly and indirectly by a number of entities and individuals, including Mr. Mikhelson and other members of our management. Kopitek is owned by certain of our managers and employees. SWGI (Cayman), Levit and Kopitek have some ultimate beneficial owners in common, including certain of our managers and employees, as well as Mr. Mikhelson who has a substantial interest in Levit and, indirectly, in SWGI (Cayman), but does not have any beneficial ownership interest in Kopitek. See “Principal Shareholders and Selling Shareholder.” Certain of our managers and directors recently increased their interests in Levit and, indirectly, in SWGI (Cayman) and ultimately in our share capital.

Recent Developments

Buyout of the Itera Group; Consolidation and new share issuance. In August 2004, the Selling Shareholder and Levit sought and acquired the necessary consent of our other shareholders to increase our equity interest in Tarkosalenftegas and Khancheyneftegas to 100% through contributions of the remaining equity interests in Tarkosalenftegas and Khancheyneftegas not owned by us in return for newly issued NOVATEK shares. At that time, SWGI (Cayman) (through TNG) and Levit owned some but not all of such remaining interests.

In December 2004, SWGI (Cayman) purchased the Itera Group’s indirect ownership interests in Tarkosalenftegas and Khancheyneftegas through a purchase of all of the Itera Group’s interest in TNG and Levit purchased the remaining direct ownership interests in Tarkosalenftegas from the Itera Group and in Khancheyneftegas from others. Immediately thereafter, SWGI (Cayman) caused TNG to contribute and Levit contributed their respective direct interests in Tarkosalenftegas and Khancheyneftegas to us in return for newly issued NOVATEK shares. In February 2005, SWGI (Cayman) caused TNG to sell all of its shares in NOVATEK to SWGI.

The purchase by SWGI (Cayman) of the Itera Group's indirect ownership interest in Tarkosalenftegas and Khancheynftegas was funded principally by bank loans made to SWGI secured by pledges by Levit of some of its shares in us. The remaining funding was provided by the sale of our shares by SWGI to Levit and to third parties. The funding of the purchase by Levit of the remaining direct ownership interests in Tarkosalenftegas and Khancheynftegas and of our shares from SWGI was provided by a \$290 million unsecured loan from us to Levit, of which \$20 million has been repaid. See "Transactions with Affiliates" for a more detailed description of the loan by NOVATEK to Levit and the other transactions described in this paragraph. We expect that SWGI will use a portion of the proceeds from this offering to repay the loan we extended to Levit. See "Use of Proceeds."

As a result of these transactions, we increased our equity interest in Tarkosalenftegas and Khancheynftegas to 100%.

As part of the agreement to acquire the equity interests in Tarkosalenftegas and Khancheynftegas, we agreed to repay ahead of schedule long-term, zero coupon debt with original maturities extending through 2017 from Tarkosalenftegas to the Itera Group at their face values of RR 1,013 million. In addition, in connection with the acquisition of the Itera Group's equity interests in Tarkosalenftegas and Khancheynftegas in December 2004, we entered into a five year gas sales contract with the Itera Group providing for the sale of an estimated 37.5 bcm of natural gas. See "—Sales and Marketing—Sales of Natural Gas." As a result of the December 2004 consolidation, the Itera Group no longer holds any interest in any of our subsidiaries.

Proposed transaction with Total. During the summer and fall of 2004, representatives of SWGI (Cayman) and SWGI negotiated with Total S.A. for the sale of a 25% plus one share interest in NOVATEK by SWGI to a subsidiary of Total. This interest would represent a "blocking" interest since under Russian corporate law many significant transactions require a 75% majority shareholder vote. The proposed purchase and sale agreement contemplated that the proceeds from the sale of shares to the Total subsidiary would be used by SWGI (Cayman) and Levit to fund the previously planned consolidation of our ownership interests in Tarkosalenftegas and Khancheynftegas described above.

On 19 September 2004, SWGI, SWGI (Cayman) and the Total subsidiary signed a protocol agreement in which the parties agreed to use all reasonable endeavors to finalize and execute the proposed purchase and sale agreement and certain other documents related to the sale of our shares to the Total subsidiary. By its terms the protocol agreement ceased to have effect on the earliest to occur of the execution of such documents, receipt by the Total subsidiary of official notice from the Russian Federal Anti-Monopoly Service of its refusal to consent to the sale or 29 October 2004. In preparation for the possible receipt of such consent, the parties initialed but did not execute the proposed purchase and sale agreement and certain other transaction documents on 5 November 2004.

We have been informed by SWGI and SWGI (Cayman) that there was no agreement to extend the 29 October deadline and that therefore the protocol agreement ceased to have effect by its terms on 29 October 2004.

Sales of non-core businesses. Historically, our business also included non-core activities devoted to oil and gas construction services, banking and telecommunications. In June 2004, consistent with our strategy of divesting non-core businesses, we sold our 99% interest in NFI, to some of our shareholders. NFI was our principal construction subsidiary, which acted as the general contractor for the construction of the Khancheynskoye and Yurkharovskoye fields. Other less significant disposals included the 2004 sale of our telecom and other media businesses to third parties. In May 2005, we sold our interest in NOVA Bank to Levit.

Sale of shares to International Finance Corporation. In June 2005, SWGI completed the sale of approximately 1% of our shares to the IFC, an international organization established by Articles of Agreement among its member countries, including the Russian Federation. Pursuant to the Share Sale and Purchase Agreement by and among SWGI, Levit (with respect to certain provisions) and the IFC, SWGI and Levit are obligated to use their votes and other powers to procure that: (i) we distribute dividends in an amount equal to at least (a) 15% of our distributable profits for 2005-2007 and (b) 30% of our distributable profits for 2008 and thereafter; (ii) the IFC, so long as it is our shareholder, is entitled to appoint a representative to serve as an observer to our Board of Directors; (iii) we implement and comply with certain environmental, social and corporate governance provisions as required by the IFC; (iv) neither we nor any of our subsidiaries make any unlawful payments for the purpose of influencing any act or decision or omission of any official in order to obtain or retain business or secure any improper benefit or

advantage; and (v) we permit IFC representatives, not more frequently than once per year, to inspect sites owned and managed by us for purposes of monitoring compliance with these corporate and environmental policies. In addition, the IFC received put and tag along rights from SWGI in certain circumstances. SWGI also undertook to allow the IFC to participate in the admission of our shares to the Official List and the admission to trading on the London Stock Exchange on terms no less favorable than those offered to other participants. The IFC will be entitled to hold its shares in the form of GDRs, which will be admitted to the Official List and to trading on the London Stock Exchange.

Disposal of Geoilbent. In June 2005, we disposed of our 66% interest in Geoilbent, subject to the approval by the Federal Anti-Monopoly Service. Geoilbent is engaged in the exploration and production of crude oil. We contributed our interest in Geoilbent into the charter capital of OOO Oil Holding Company, our wholly-owned subsidiary, and sold Oil Holding Company, to LUKOIL and OOO LUKOIL West Siberia Company, a subsidiary of LUKOIL, for RR 5.1 billion.

In April 2005, Broadwood Trading and Investments Ltd., the holder of the other 34% in Geoilbent filed a claim against us in the Arbitration Court for the Yamal-Nenets Autonomous District, requesting the court to amend the charter of Geoilbent to require the written consent of all participants for transfers of interests to affiliated entities, and seeking recognition of its right of first refusal in connection with such transfers. The court hearing is scheduled for 10 August 2005. Moreover, Broadwood Trading and Investments Ltd. may attempt to challenge the contribution and subsequent disposition of our interest in Geoilbent, as described above, as a constructive sale. If either the existing or any future claims are successful, we may be required to unwind the sale to LUKOIL and its subsidiary and transfer our interest in Geoilbent to Broadwood Trading and Investments Ltd. at the same price we received for Oil Holding Company from LUKOIL and its subsidiary and we may incur substantial legal fees in connection with defending such actions.

In June 2005, there were three further attempts to prevent us from disposing of our interest in Geoilbent. On 9 June 2005, following a motion for injunctive relief by Broadwood Trading and Investments Ltd., Andropovsky Court of the Stavropol District enjoined us from disposing of our interest in Geoilbent, enjoined Transneft from accepting crude oil from Geoilbent and prohibited the Federal Anti-Monopoly Service from approving the transaction. On 22 June 2005 the Stavropol District Court reversed the ruling of the Andropovsky Court because it had been issued in violation of procedural requirements and dismissed the action by Broadwood Trading and Investments Ltd. Pursuant to another claim, filed on 23 June 2005 in the Staropromyslovsky Court of the city of Grozny, Chechen Republic, the court issued an injunction enjoining us from disposing of our interest in Geoilbent, enjoining Transneft from accepting crude oil from Geoilbent and us and prohibiting the Federal Anti-Monopoly Service from approving the transaction. The Higher Court of the Chechen Republic reversed this ruling and dismissed the claim on 28 June 2005. On 30 June 2005 the Arbitration Court of the Chechen Republic issued a similar injunction, which was reversed on 19 July 2005 by the Appellate Division of the Arbitration Court of the Republic of the Ingushetia because it had been issued in violation of law and instructions of the High Arbitration Court of the Russian Federation. See “Risk Factors—Risks relating to the Russian Federation—Legal Risks and Uncertainties—The judiciary’s lack of independence, overall inexperience, occasional abuse of discretion, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, materially adversely affecting our business, financial condition, results of operations or prospects and the price of the shares and GDRs.”

Sale of Tambeyneftegas. In July 2005, we sold our 25.1% minority interest in Tambeyneftegas to OOO Gazprombank-Invest, a subsidiary of Gazprom. Tambeyneftegas is engaged in exploration and production of gas condensate in the South Tambeyskoye field, which is located 600 km north of Salekhard on the eastern portion of the Yamal Peninsula. We were a minority shareholder in Tambeyneftegas and not actively involved in its exploration and development activities.

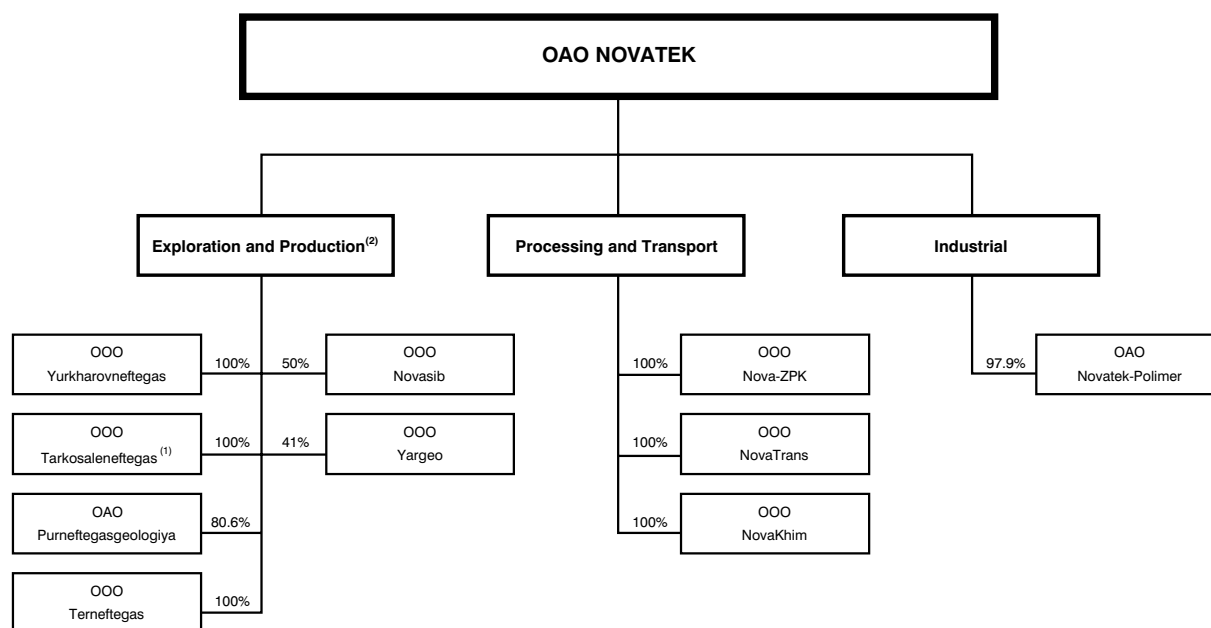
Sale of Selkupneftegas and cooperation with Rosneft. In June 2005, we agreed to sell our 34% minority interest in Selkupneftegas to Rosneft, the owner of the remaining 66% interest in the company. Selkupneftegas is engaged in the exploration of the Kiynsko Chaselskiy license area. The closing of this transaction is conditioned upon the obtaining of antimonopoly approval by Rosneft.

Within the framework of our cooperation with Rosneft, in June 2005, we also entered into an agreement with Rosneft making available to us Rosneft’s existing infrastructure, including gas condensate pipelines and processing facilities, located near our Termokarstovoye field. In particular, this agreement provides for the joint financing of the construction of a gas pipeline that would allow us to transport our gas produced at the Termokarstovoye field through the Kiynsko Chaselskiy license area to the UGSS.

Cooperation with Gazprom. In July 2005, we entered into a framework cooperation agreement with Gazprom contemplating the coordination of both companies' efforts in the development of the gas industry in Russia. In particular, the agreement would allow us to participate in the expansion of the UGSS on terms to be further agreed with Gazprom. We also agreed with Gazprom to jointly participate in the creation of infrastructure to transport gas condensate from the fields owned by the companies to potential customers. In addition, both companies confirmed their intention to cooperate in the construction of joint petrochemical facilities, including for the production of ethylene/polypropylene, methanol and liquefied gas, to promote the use of liquefied and compressed gas as fuel and to collaborate in the ecological enhancement of regions where the companies operate. Finally, we agreed to supply, in certain circumstances, gas to Gazprom at agreed prices and to certain customers at regulated prices.

Corporate Structure

A corporate structure chart showing our principal subsidiaries and equity investments and our respective ownership interests therein is set out below as of 30 June 2005.



(1) In May 2005, Khancheyneftegas was merged into Tarkosaleneftegas.

(2) In June 2005, we agreed to dispose of our minority interest in Selkupneftegas and in July 2005, we disposed of our minority interest in Tambeyneftegas.

Exploration and Production

Reserves

D&M has appraised the reserves at our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye. Proved reserves for these fields have been appraised in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034, the end of the expected economic life of the field. We intend to file for the extension of the terms of the licenses for our two other core fields—East Tarkosalinskoye and Khancheyskoye. While we believe that we have the ability to extend our licenses as they expire, the absence of an absolute legal right to extension and a significant demonstrated history of extension makes it uncertain whether extractable reserves we plan to recover only after the expiration of a current license periods may be considered proved reserves under SEC standards as of 31 December 2004. We understand that the SEC has not provided definitive guidance on whether in these circumstances such extractable reserves could be considered proved under SEC standards. See “Classification of Reserves—SEC Standards.”

Proved-plus-probable reserves for our three core fields have been appraised in accordance with the SPE standards. See “Classification of Reserves—SPE Standards.”

In appraising the reserves at our three core fields, D&M relied on pricing information supplied by us as set forth in Appendix A hereto.

Estimated natural gas reserves are presented in terms of sales gas, which is the deliverable quantity of gas available for sales after deduction for various losses and fuel usage. In addition, sales gas volumes include ethane volumes that are liberated from the field condensate stream during processing and reintroduced into the gas stream for processing and sales.

In addition, the tables below present estimates of our reserves under the Russian reserves system, which are based on data approved by the relevant Russian governmental authorities. In this prospectus, under the Russian reserves system we present only A, B and C1 categories of reserves which represent reserves classified as explored under the Russian reserves system. See “Classification of Reserves—Russian Reserves System.”

The following table sets forth estimates of the proved reserves, proved-plus-probable reserves and ABC1 reserves of natural gas, gas condensate and crude oil as of 31 December 2004 for our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheykoye.

Reserves		Proved Developed ⁽¹⁾	Proved Undeveloped ⁽¹⁾	Total Proved ⁽¹⁾	SPE Proved- plus- Probable	ABC1
Natural gas	bcm	389	194	583	920	763
	tcf	14	7	21	33	27
Gas condensate	mmt	16	12	28	49	38
	mmbbls	131	105	237	421	323
Crude oil	mmt	1	7	8	30	38
	mmbbls	6	52	58	225	287
Total	mmboe⁽²⁾	2,683	1,425	4,108	6,666	5,602

(1) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034, the end of the expected economic life of the field. Excluding the reserves estimated to be producible at the East Tarkosalinskoye and Khancheykoye fields beyond the primary terms of our licenses, as of 31 December 2004 we calculate we would have had estimated total proved reserves of 3,272 mmboe, consisting of 464 bcm of natural gas and 18 mmt of gas condensate and crude oil. See “Business—Exploration and Production—Reserves.”

(2) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

The following table sets forth as of 31 December 2004, 2003 and 2002 estimates of the proved reserves, proved-plus-probable reserves and ABC1 reserves of natural gas, gas condensate and crude oil at

all our current fields and license areas. Proved and proved-plus-probable reserves are shown for our three core fields only, since these are the only material fields appraised by D&M.

Reserves⁽¹⁾		Proved Developed⁽²⁾	Proved Undeveloped⁽²⁾	Total Proved⁽²⁾	SPE Proved- plus- Probable	ABC1
As of 31 December 2004						
Natural gas:						
Yurkharovskoye field	bcm	79	153	232	522	291
East Tarkosalinskoye field . .	bcm	275	31	307	324	363
Khancheyetskoye field	bcm	35	9	44	74	109
Other	bcm	—	—	—	—	51
Total natural gas	bcm	389	194	583	920	815
Gas condensate:						
Yurkharovskoye field	mmt	4	6	10	26	13
East Tarkosalinskoye field . .	mmt	7	4	11	13	12
Khancheyetskoye field	mmt	5	2	6	10	13
Other	mmt	—	—	—	—	11
Total gas condensate	mmt	16	12	28	49	48
Crude oil:						
Yurkharovskoye field	mmt	—	—	—	—	1
East Tarkosalinskoye field . .	mmt	1	7	8	29	34
Khancheyetskoye field	mmt	—	—	—	—	2
Other	mmt	—	—	—	—	3
Total crude oil	mmt	1	7	8	30	40
Total reserves	mmboe⁽³⁾	2,683	1,425	4,108	6,666	6,047
As of 31 December 2003						
Natural gas:						
Yurkharovskoye field	bcm	21	187	208	370	298
East Tarkosalinskoye field . .	bcm	282	35	317	327	379
Khancheyetskoye field	bcm	16	33	49	88	111
Other	bcm	—	—	—	—	7
Total natural gas	bcm	319	255	574	784	794
Gas condensate:						
Yurkharovskoye field	mmt	2	11	12	22	13
East Tarkosalinskoye field . .	mmt	8	5	13	15	13
Khancheyetskoye field	mmt	3	4	7	14	13
Other	mmt	—	—	—	—	1
Total gas condensate	mmt	13	20	33	50	41
Crude oil:						
Yurkharovskoye field	mmt	—	—	—	—	1
East Tarkosalinskoye field . .	mmt	1	7	8	30	34
Khancheyetskoye field	mmt	—	—	—	—	2
Other	mmt	—	—	—	—	3
Total crude oil	mmt	1	7	8	30	40
Total reserves	mmboe⁽³⁾	2,197	1,885	4,081	5,771	6,179

Reserves⁽¹⁾		Proved Developed⁽²⁾	Proved Undeveloped⁽²⁾	Total Proved⁽²⁾	SPE Proved- plus- Probable	ABC1
As of 31 December 2002						
Natural gas:						
Yurkharovskoye field	bcm	—	186	186	332	301
East Tarkosalinskoye field . .	bcm	292	21	313	334	383
Khancheynskoye field	bcm	13	31	44	81	112
Other	bcm	—	—	—	—	6
Total natural gas	bcm	305	238	544	747	802
Gas condensate:						
Yurkharovskoye field	mmt	—	11	11	21	13
East Tarkosalinskoye field . .	mmt	8	3	11	14	13
Khancheynskoye field	mmt	2	3	6	10	14
Other	mmt	—	—	—	—	1
Total gas condensate	mmt	10	17	28	46	41
Crude oil:						
Yurkharovskoye field	mmt	—	—	—	—	1
East Tarkosalinskoye field . .	mmt	1	7	8	30	38
Khancheynskoye field	mmt	—	—	—	—	2
Other	mmt	—	—	—	—	2
Total crude oil	mmt	1	7	8	30	44
Total reserves	mmboe⁽³⁾	2,081	1,759	3,841	5,489	5,921

(1) Reserves for subsidiaries and equity investments are presented in proportion to our shareholding, except in the case of reserves for the East Tarkosalinskoye and Khancheynskoye fields as of 31 December 2003 and 2002, which are presented on a 100% ownership basis. Reserves for Geoilbent, Tambeyneftegas and Selkupneftegas are excluded for all periods. See “Presentation of Reserves and Production Information.”

(2) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses. In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034, the end of the expected economic life of the field. Excluding the reserves estimated to be producible at the East Tarkosalinskoye and Khancheynskoye fields beyond the primary terms of our licenses, as of 31 December 2004 we calculate we would have had estimated total proved reserves of 3,272 mmboe, consisting of 464 bcm of natural gas and 18 mmt of gas condensate and crude oil. See “Classification of Reserves—SEC Standards.”

(3) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

Licenses and Fields

Licenses

We and our subsidiaries and equity investments hold 13 subsoil licenses, consisting of seven combined exploration and production licenses and six exploration licenses. See “Regulation” for a description of the

Russian regulatory regime relating to the use of subsoil licenses. The table below sets out certain information relating to our licenses.

License ⁽¹⁾	License Holder	Stage of Development	License Expiry	License Area (sq. km)
Yurkharovskoye field ⁽²⁾	Yurkharovneftegas	Commercial production of natural gas and gas condensate began in 2003	2034	291
East Tarkosalinskoye field ⁽²⁾	Tarkosaleneftegas	Commercial production of crude oil began in 1994, natural gas in 1998 and gas condensate in 2001	2018	2,714
Khancheyskoye field ⁽²⁾	Tarkosaleneftegas	Commercial production of gas condensate began 2002 and natural gas in 2003	2019	1,456
Termokarstovoye field	Terneftegas	Commercial production of gas condensate targeted to begin in 2009	2021	860
Olimpiskiy license area	Purneftegasgeologiya	Commercial production of gas condensate targeted to begin in 2007	2026	3,010
Ust Purpeyskiy license area	Purneftegasgeologiya	Commercial production of natural gas, gas condensate and crude oil began in 1993	2018	388
Yumantilskiy license area	NOVATEK	Commercial production of natural gas and gas condensate began in 2001	2024	530
New Yurkharovskiy license area ⁽³⁾	Yurkharovneftegas	Exploration	2008	827
North Yubileyniy license area ⁽³⁾	Yurkharovneftegas	Exploration	2009	834
Tabiyakha Tarkinskiy license area ⁽³⁾	Yurkharovneftegas	Exploration	2009	1,069
North Khancheyskiy license area ⁽³⁾	NOVATEK	Exploration	2009	571
Raduzhniy license area ⁽³⁾	Novasib ⁽⁴⁾	Exploration	2009	704
Yarudeyskiy license area ⁽³⁾	Yargeo ⁽⁴⁾	Exploration	2009	2,036

(1) We also hold the licenses to the South Pyreynoye field and the Tapskiy license area. Based on our exploration work at the Tapskiy license area, we believe that the resources in this license area are not commercially viable, and we have notified the licensing authorities of our intention to relinquish this license. In addition, we no longer intend to develop the South Pyreynoye field and have notified the licensing authorities of our intention to relinquish the license for the field.

(2) The license for the Yurkharovskoye field was extended to 2034 in February 2005. We intend to file for extension of the terms of the licenses for the East Tarkosalinskoye and Khancheyskoye fields.

(3) Exploration license only.

(4) Equity investments. See “—Corporate Structure” for our ownership interest in these equity investments.

Location and Geology

Our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye, together with all other fields and license areas to which we have rights, are located in the northeastern part of the West Siberian basin in an area known as the Nadym-Pur-Taz region. The West Siberian 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 platform in the east, and covers roughly four million square km. The Nadym-Pur-Taz region covers an area of approximately 340,000 square km and is home to several large gas fields, the largest of which in terms of currently estimated volumes of reserves is the Urengoiyskoye field operated by Gazprom. Major gas accumulations in the Nadym-Pur-Taz are in the Aptian-Cenomanian Pokur Formation, which is estimated to contain approximately 90 percent of the gas reserves in the region.

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), Valanginian horizon (1,500 to 3,000 meters), Achimov horizon (3,000 to 4,000 meters) and Jurassic horizon (4,000 to 4,500 meters). The names of the horizons refer to the

geological period during which they were initially formed. In general, Cenomanian horizons yield mostly dry gas, primarily methane, and Valanginian horizons yield mostly wet gas, a mixture of natural gas and gas condensate (primarily ethane, propane and butane) in liquid form. Wet gas must be separated into dry gas and gas condensate in a low-temperature separation unit, usually located at the field. Gas condensate must, in turn, be de-ethanised and further processed 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 crude oil.

All of our D&M-appraised reserves at our three core fields are found in the Cenomanian and Valanginian horizons. The table below sets forth a breakdown of these reserves by horizon as of 31 December 2004.

Reserves by Horizon	Proved	SPE Proved-plus-Probable
Cenomanian ⁽¹⁾	47.6%	33.5%
Valanginian ⁽¹⁾	52.4%	66.5%
Total	100%	100%

(1) The reserves by horizon are based on our calculations.

Yurkharovskoye Field

The Yurkharovskoye field, discovered in 1970, is a natural gas and gas condensate field situated within the Arctic Circle, in the south-eastern part of the Tazov Peninsula in the Nadym-Pur-Taz region. The field is approximately 224 square km in area and lies 50 km east of Gazprom's Yamburgskoye field and approximately 300 km north of Gazprom's Urengoiyskoye field. The western part of the field lies on the Tazov Peninsula, while the central and eastern parts of the field are situated on the shelf of the Tazov Bay where water depths average four meters. The field is being developed from onshore, using a combination of directional and horizontal wells. The Yurkharovskoye field is our largest field in terms of proved-plus-probable reserves and we expect it to be the primary source of our production growth over the medium term.

The field has one natural gas reservoir, nine gas condensate reservoirs and three gas condensate/crude oil reservoirs. The occurrence depth ranges from approximately 1,062 to 2,923 meters. The Valanginian horizon is our principal area of focus and is characterized by permeable sandstone. The producing reservoirs are located over a small area, which enhances the efficiency of the development of these reserves in terms of both capital expenditures and operating costs.

The following table sets forth reserve information for the Yurkharovskoye field as of 31 December 2004.

Reserves	Proved Developed⁽¹⁾	Proved Undeveloped⁽¹⁾	Total Proved⁽¹⁾	SPE Proved-plus-Probable	ABC1
Total natural gas bcm	79	153	232	522	291
Cenomanian gas ⁽³⁾ bcm	10	57	66	106	75
Valanginian gas ⁽³⁾ bcm	69	96	166	416	216
Gas condensate mmt	4	6	10	26	13
Crude oil mmt	—	—	—	—	1
Total mmboe⁽²⁾	550	1,059	1,609	3,646	2,024

(1) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the term of our license to the end of the expected economic life of the field and (ii) proceed accordingly with the development and operation of the field, in order to include certain volumes of reserves estimated to be producible beyond the primary term of our license. See "Classification of Reserves—SEC Standards." In February 2005, we extended the term of our license for the Yurkharovskoye field to 2034, the end of the expected economic life of the field.

(2) See "Presentation of Reserves and Production Information" for conversion factors used in calculating barrels of oil equivalent.

(3) The breakdown by horizon is based on our calculations.

The following table sets forth the number of natural gas and gas condensate wells at the Yurkharovskoye field as of 31 March 2005.

Natural gas and gas condensate wells	Horizontal	Vertical and Deviated	Total
Cenomanian	4	1	5
Valanginian	5	7	12
Total	9	8	17

The average daily output per well in the first quarter of 2005 was 1,547 mcm of natural gas, based on the actual operating hours of the wells.

Development drilling at the field commenced in May 2002. Commercial production of natural gas and gas condensate began in January 2003. Other key milestones in the development of the field 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 preparation facility. The facility is capable of simultaneously preparing Cenomanian and Valanginian gases by low temperature separation.
- *May 2004.* Commissioning of a 3.6 bcm per annum gas preparation facility, bringing the total gas preparation capacity to 9 bcm per annum. We also completed the construction of a 16 km spur gas pipeline connecting our existing pipeline to an additional point on the UGSS.

The following table sets forth our planned capital expenditures at the Yurkharovskoye field and the number of wells expected to be drilled at the field for the periods indicated.

	2005	2006	2005-2010
Capital expenditures (RR millions)	423	1,133	19,101
Wells to be drilled (exploration and production)	2	6	37

Natural gas is transported via our 51 km pipeline to an injection point into a UGSS feeder pipeline owned by Gazprom. We also own an additional 16 km spur connecting our pipeline to the same feeder pipeline at a second injection point. These pipelines give us the ability to transport a total of 9.2 bcm of natural gas per annum from the field to the UGSS. In line with planned increases in production and in accordance with the technical requirements of Gazprom, we intend to construct another spur connecting our pipeline to a third injection point into the feeder pipeline. Eventually, we plan to complete a system of large diameter pipelines connecting directly into the trunk pipeline of the UGSS, which would give us a total gas injection capacity of up to 32 bcm per annum. See also "—Transportation."

Gas condensate is transported via our two 52 km pipelines to Gazprom's gas condensate pipeline network. These two pipelines give us the ability to transport up to 2.5 mmt annually. The field's gas condensate is de-ethanised at Gazprom's Urengoigazprom plant along with gas condensate from other producers, which we believe tends to be of lower quality than our gas condensate. This plant's output is piped to Gazprom's Surgutsky refinery, where it is stabilized and processed. Currently, we have a pipeline connecting into the pipeline between the Urengoigazprom plant and the Surgutsky refinery, allowing us to withdraw our share of de-ethanised gas condensate for stabilization and processing at our Purovsky processing plant. In addition, most of the gas condensate from the field is processed at the Surgutsky refinery. However, we have begun to migrate substantially all of the field's gas processing to our Purovsky processing plant. The total pipeline distance from the Yurkharovskoye field to our Purovsky processing plant is 338 km. We may elect to construct our own de-ethanisation facilities at the field and our own gas condensate pipeline connecting the field to our Purovsky processing plant in the future, if sufficient processing capacity is not available at Gazprom's Urengoigazprom plant. We believe having our own de-ethanisation facilities and a connecting gas condensate pipeline would improve the quality of the gas condensate ultimately supplied to our Purovsky processing plant, however we would incur significant capital expenditures constructing such infrastructure.

The Yurkharovskoye field's historical production results are shown in the table below.

Production		Three months ended 31 March		Year ended 31 December		
		2005	2004	2004	2003	2002
Total natural gas	mmcm	2,239	1,313	6,674	3,066	—
Cenomanian gas	mmcm	234	—	332	6	—
Valanginian gas	mmcm	2,005	1,313	6,342	3,060	—
Gas condensate	mt	169	153	700	333	—
Crude oil	mt	—	—	—	—	—
Total production	mboe	16,133	9,950	49,854	23,004	—
Total number of wells in operation (end of period) .		17	11	17	9	—

East Tarkosalinskoye Field

The East Tarkosalinskoye field, discovered in 1971, is a natural gas, gas condensate and crude oil field situated in the northern central area of the West Siberian lowlands, a territory known locally as the Purovsky district of the Nadym-Pur-Taz region. The field is approximately 1,314 square km in area and lies 40 km northeast of the town of Tarko Sale. We are currently developing the Cenomanian and Valanginian horizons in this field, which are characterized by sandy and porous reservoirs. The East Tarkosalinskoye field is currently our largest producer of hydrocarbons.

The field has one natural gas reservoir. The crest of the reservoir is found at approximately 1,235 meters. The field has 16 reservoirs of gas condensate, with an occurrence depth ranging from approximately 2,858 to 3,199 meters. The field has nine reservoirs of crude oil, with an occurrence depth ranging from approximately 2,922 to 3,209 meters.

The following table sets forth reserve information for the East Tarkosalinskoye field as of 31 December 2004.

Reserves		Proved Developed ⁽¹⁾	Proved Undeveloped ⁽¹⁾	Total Proved ⁽¹⁾	SPE Proved-plus-Probable	ABC1
Total natural gas	bcm	275	31	307	324	363
Cenomanian gas	bcm	225	6	232	235	269
Valanginian gas	bcm	50	25	75	89	94
Gas condensate	mmt	7	4	11	13	12
Crude oil	mmt	1	7	8	29	34
Total	mmboe⁽²⁾	1,862	293	2,155	2,446	2,740

(1) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the term of our license to the end of the expected economic life of the field and (ii) proceed accordingly with the development and operation of the field, in order to include certain volumes of reserves estimated to be producible beyond the primary term of our license. Excluding the reserves estimated to be producible at the field beyond the primary term of our license, as of 31 December 2004 we calculate we would have had estimated total proved reserves at the field of 1,328 mmboe, consisting of 189 bcm of natural gas and 12 mmt of gas condensate and of crude oil. See "Classification of Reserves—SEC Standards."

(2) See "Presentation of Reserves and Production Information" for conversion factors used in calculating barrels of oil equivalent.

The following table sets forth the number of natural gas and gas condensate wells at the East Tarkosalinskoye field as of 31 March 2005.

Natural gas and gas condensate wells	Horizontal	Vertical and Deviated	Total
Cenomanian	39	41	80
Valanginian	7	12	19
Total	46	53	99

The average daily output per well in the first quarter of 2005 was 415 mcm of natural gas, based on the actual operating hours of the wells.

Development drilling in the Cenomanian horizon commenced in May 1998 and commercial production of natural gas began in December 1998. Development drilling in the Valanginian horizon commenced in May 2000 and commercial production of gas condensate began in February 2001. Other key milestones in the development of the field 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 2001.* Completion of a gas condensate pipeline connecting the field to Gazprom's gas condensate pipeline network.
- *December 2002.* Commissioning of a 2.4 bcm per annum low temperature separation unit for separating gas condensate from Valanginian gas. We expect to expand the capacity of this unit to 4.3 bcm per annum in the fourth quarter of 2005.
- *June 2004.* Commissioning of a 1.5 million tonnes per annum de-ethanisation unit consisting of two technological lines: one for de-ethanisation of gas condensate from this field and the other for de-ethanisation of gas condensate from our Khancheykoye field.

The following table sets forth our planned capital expenditures at the East Tarkosalinskoye field and the number of wells expected to be drilled at the field for the periods indicated.

	2005	2006	2005-2010
Capital expenditures (RR millions)	1,496	644	2,475
Wells to be drilled (exploration and production)	2	2	6

Natural gas is transported through our 24 km pipeline (and an additional 11 km spur) to an injection point into the trunk pipeline of the UGSS, providing us with the capacity to transport up to 28 bcm of gas per annum from the field to the UGSS. Gas condensate is de-ethanised at the field and is transported via our 35 km pipeline to our Purovsky processing plant. This pipeline has an annual transportation capacity of up to 2.4 mmt per year.

The East Tarkosalinskoye field's historical production results are shown in the table below.

Production	Three months ended 31 March		Year ended 31 December		
	2005	2004 ⁽¹⁾	2004 ⁽¹⁾	2003 ⁽¹⁾	2002 ⁽¹⁾
Total natural gas mmcm	3,690	3,068	11,409	14,033	11,646
Cenomanian gas mmcm	3,100	2,567	9,176	12,155	10,290
Valanginian gas mmcm	590	502	2,232	1,878	1,356
Gas condensate mt	148	131	567	462	305
Crude oil mt	34	30	123	122	139
Total production mboe	25,588	21,361	80,156	96,459	79,706
Total number of wells in operation (end of period)	132	123	134	129	126

(1) Production figures are presented on a 100% ownership basis, although prior to December 2004 we did not hold a 100% interest in this field. See "Presentation of Reserves and Production Information."

Khancheykoye Field

The Khancheykoye field, discovered in 1990, is a natural gas and gas condensate field situated in the Nadym-Pur-Taz region 65 km east of our East Tarkosalinskoye field. The field is approximately 145 square km in area. We are currently developing the Cenomanian and Valanginian horizons in this field, which are characterized by sandy porous reservoirs.

The field has 10 natural gas reservoirs, with an occurrence depth ranging from approximately 1,690 to 2,049 meters. The field has 11 reservoirs of gas condensate, with an occurrence depth ranging from approximately 2,535 to 3,332 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. The field also has two reservoirs of crude oil, with an occurrence depth ranging from approximately 2,240 to 2,560 meters.

The following table sets forth reserve information for the Khancheykskoye field as of 31 December 2004.

Reserves		Proved Developed ⁽¹⁾	Proved Undeveloped ⁽¹⁾	Total Proved ⁽¹⁾	SPE Proved- plus- Probable	ABC1
Total natural gas	bcm	35	9	44	74	109
Cenomanian gas ⁽³⁾	bcm	16	—	16	29	19
Valanginian gas ⁽³⁾	bcm	19	9	28	45	89
Jurassic gas	bcm	1				
Gas condensate	mmt	5	2	6	10	13
Crude oil	mmt	—	—	—	—	2
Total	mmboe⁽²⁾	271	73	344	573	838

(1) Proved reserves have been appraised by D&M in accordance with SEC standards, provided that due to a lack of clear SEC guidance, D&M has relied on our representations that we intend to (i) extend the term of our license to the end of the expected economic life of the field and (ii) proceed accordingly with the development and operation of the field, in order to include certain volumes of reserves estimated to be producible beyond the primary term of our license. Excluding the reserves estimated to be producible at the field beyond the primary term of our license, as of 31 December 2004 we calculate we would have had estimated total proved reserves at the field of 335 mmboe, consisting of 43 bcm of natural gas and 6 mmt of gas condensate and crude oil. See “Classification of Reserves—SEC Standards.”

(2) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

(3) The breakdown by horizon is based on our calculations.

The following table sets forth the number of natural gas and gas condensate wells at the Khancheykskoye field as of 31 March 2005.

Natural gas and gas condensate wells	Horizontal	Vertical and Deviated	Total
Cenomanian	4	—	4
Valanginian	8	6	14
Total	12	6	18

The average daily output per well in the first quarter of 2005 was 465 mcm of natural gas, based on the actual operating hours of the wells.

Development drilling at the field commenced in July 2001. Commercial production of gas condensate began in February 2002 and natural gas in October 2003. Other key milestones in the development of the field include:

- *May 2001.* Completion of a 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. The second phase of the unit, which will increase the total capacity of the unit to 5.8 bcm per annum, is planned for the end of 2006.

The following table sets forth our planned capital expenditures at the Khancheykskoye field and the number of wells expected to be drilled at the field for the periods indicated.

	2005	2006	2005-2010
Capital expenditures (RR millions)	245	956	6,978
Wells to be drilled (exploration and production)	2	6	62

All of the Khancheyskoye field's natural gas production is transported via our 72 km pipeline to our East Tarkosalinskoye field, and then further transported to the UGSS using the East Tarkosalinskoye field's connection to the UGSS. This intrafield pipeline has a capacity of 5.8 bcm per annum. All of the Khancheyskoye field's gas condensate production is transported via our 58 km pipeline to our East Tarkosalinskoye field, where it is de-ethanised and further transported to our Purovsky processing plant using the East Tarkosalinskoye field's 35 km pipeline to the plant. This intrafield pipeline has a capacity of 1.1 mmt per annum.

The Khancheyskoye field's historical production results are shown in the table below.

Production		Three months ended 31 March		Year ended 31 December		
		2005	2004 ⁽¹⁾	2004 ⁽¹⁾	2003 ⁽¹⁾	2002 ⁽¹⁾
Total natural gas	mmcm	677	449	2,341	687	404
Cenomanian gas	mmcm	279	104	739	—	—
Valanginian gas	mmcm	398	345	1,602	687	404
Gas condensate	mt	143	119	576	370	210
Crude oil	mt	—	—	—	—	—
Total production	mboe	5,647	3,948	20,218	7,648	4,426
Total number of wells in operation (end of period)		18	16	18	11	10

(1) Production figures are presented on a 100% ownership basis, although prior to December 2004 we did not hold a 100% interest in this field. See "Presentation of Reserves and Production Information."

Production

We currently produce natural gas, gas condensate and crude oil at the following fields and license areas:

Product	Fields and license areas
Natural gas	Yurkharovskoye field, East Tarkosalinskoye field, Khancheyskoye field, Yumantil'skiy license area, Ust Purpeyskiy license area
Gas condensate	Yurkharovskoye field, East Tarkosalinskoye field, Khancheyskoye field, Yumantil'skiy license area, Ust Purpeyskiy license area
Crude oil	East Tarkosalinskoye field, Ust Purpeyskiy license area

Approximately 99% of our current production comes from our three core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheyskoye.

The following table sets forth the production from our current fields of natural gas, gas condensate and crude oil for the three months ended 31 March 2005 and 2004 and the years ended 31 December 2004, 2003 and 2002.

Production ⁽²⁾		Three months ended 31 March		Year ended 31 December		
		2005	2004 ⁽¹⁾	2004 ⁽¹⁾	2003 ⁽¹⁾	2002 ⁽¹⁾
Natural gas	mmcm	6,628	5,063	20,869	19,776	13,880
	mmcf	233,312	178,208	734,601	696,129	488,593
Gas condensate	mt	470	434	1,948	1,269	567
	mbbls	4,003	3,694	16,609	10,735	4,708
Crude oil ⁽²⁾	mt	50	57	207	207	231
	mbbls	376	422	1,553	1,552	1,732
Total	mboe⁽³⁾	47,728	37,227	154,647	141,624	97,219

(1) Production figures for our East Tarkosalinskoye and Khancheyskoye fields are presented on a 100% ownership basis, although prior to December 2004 we did not hold a 100% interest in these fields. See "Presentation of Reserves and Production Information."

- (2) This table does not include historical production of Geoilbent, which we disposed of in June 2005, and the South Pyreynoye field, the license for which we intend to relinquish.
- (3) See “Presentation of Reserves and Production Information” for conversion factors used in calculating barrels of oil equivalent.

Production Targets

The following table sets forth our production targets for natural gas and liquids (gas condensate and crude oil) for our three core fields for the year 2010.

	Annual natural gas production (bcm)	Annual liquids production (mmt)
2010 Targets	45	4.6

We have estimated a target natural gas production level of our three core fields for the year 2010 of approximately 45 bcm. This target is higher than the estimate made by D&M in their report of 31 December 2004 because it is based on a different set of factual assumptions than those used in preparing the D&M report. Among other things, the difference in the forecasted production is attributable to changes in the following assumptions made by our management:

- without increasing the number of wells taken into account by D&M in their estimate, we currently plan to develop our core fields and drill the forecasted wells at a rate faster than had been indicated to D&M. We may, as a result, incur the related capital expenditure earlier than had been originally forecast;
- since 31 December 2004 we have obtained indications from our development of, and production at, the Yurkharovskoye field that the flow rates are greater than previously forecast; and
- we have increased our current and prospective use of extended reach horizontal wells which improves our current and forecast well completion rates.

The targets set forth above are forward looking statements and may not be achieved due to a number of factors, many of which are beyond our control. See “Cautionary Note Regarding Forward-Looking Statements” for a discussion of these factors. See also “Risk Factors” for a discussion of risks we face in conducting our business, which, if they materialize, may prevent us from achieving these targets.

Exploration and Development Activities

We continue to focus on the development of our three core fields. The following table sets forth the number of exploration and development wells drilled in our three core fields in the three months ended 31 March 2005 and the years ended 31 December 2004, 2003 and 2002.

Number of Wells	Three months ended 31 March 2005	Year ended 31 December		
		2004	2003	2002
Yurkharovskoye field	1	7	6	3
East Tarkosalinskoye field	—	4	6	23
Khancheykoye field	1	1	6	7
Total	2	12	18	33

We use Dowell Schlumberger software to process and interpret seismic materials and to develop three-dimensional geological and hydrodynamic models of our fields, enabling us to utilize a relatively high percentage of horizontal and deviating wells to develop natural gas fields and reduce the number of planned development wells. Currently, we use this software at all three of our core fields—Yurkharovskoye, East Tarkosalinskoye and Khancheykoye—and at our Termokarstovoye field and our Olimpiskiy, Yumantilskiy and New Yurkharovskiy license areas.

We continually seek to increase our hydrocarbon resource base through selective geological and geophysical exploration in our fields. We employ modern exploration methods and data processing techniques in an attempt to maximize the ultimate recovery of hydrocarbons in a cost-effective manner. Presently, our principal areas of exploration activity include the Yurkharovskoye and Khancheykoye fields and the Olimpiskiy license area.

The following table sets out certain information about our exploration activities for the three months ended 31 March 2005 and the years ended 31 December 2004, 2003 and 2002.

Exploration Activities	Unit	Three months ended	Year ended 31 December		
		31 March 2005	2004	2003	2002
Exploration drilling	meters	3,723	2,873	10,110	9,189
	RR million	20.9	180	150	98
Seismic 2D	km	713	931	575	759
	RR millions	19.5	136	75	135
Seismic 3D	square km	440.3	—	190	—
	RR millions	148	—	73	12
Assessment	RR millions	7.7	33	36	12
Total	RR millions	196	349	334	257

We have a total of 19 engineers in our Department of Geology, Field Development and Licensing and the Department of Gas and Gas Condensate Processing. These engineers have an average of 18 years of experience. Their expertise, experience and successful implementation of innovative techniques have been critically important to our successful efforts in using our knowledge of Yamal-Nenets regional geological conditions and experience with exploration and development activities in that area.

We have 21 engineers in our Investment and Engineering Department, which is responsible for implementing our strategy of increasing production, preparation, processing and transportation of our natural gas, gas condensate and oil products through cost-effective, targeted and disciplined capital expenditures. These engineers have an average of 11 years of experience. This department is also tasked with monitoring developments in state-of-the-art construction technologies, construction management processes and modern construction materials and introducing them into our development plans and operations.

Other Fields

Set forth below are brief descriptions of our exploration and development activities at the other fields and license areas for which we have an exploration and development license. All of these fields are located in the Nadym-Pur-Taz region of Yamal-Nenets.

Termokarstovoye field. The Termokarstovoye field is approximately 111 square km in area and lies 30 km south of the town of Krasnoselkup. The field has five gas condensate reservoirs, with an occurrence depth ranging from approximately 2,600 to 2,940 meters. There are seven exploration wells in the field. The field has estimated ABC1 reserves of 348 mmboe, consisting of 41.6 bcm of natural gas and 9 mmt of gas condensate. Currently a plan of development and operation is being prepared, and commercial production is targeted to begin in 2009.

Olimpiskiy license area. The Olimpiskiy license area covers approximately 3,010 square km and lies 30 km northwest of the town of Tarko Sale. There are two fields within the Olimpiskiy license area: the Sterkhovoye field and the Dobrovolskoye field. We are in the process of developing a detailed geological model, based on 2D seismic covering 217 linear km of the license area completed in 2004 and 3D seismic covering 300 square km of the license area expected to be completed in the second half of 2005. We commenced exploratory drilling at the Sterkhovoye field in 2000, and commercial production is targeted to begin in 2007. Exploratory drilling was commenced at the Dobrovolskoye field in 1988. The license area has estimated ABC1 reserves of 71 mmboe, consisting of 8.5 bcm of natural gas, 1.5 mmt of gas condensate and 292 mt of crude oil.

Yumantilskiy license area. The Yumantilskiy license area covers approximately 530 square km and lies 45 km northeast of Tarko Sale. The Yumantilskoye field within the license area covers approximately 26 square km and has two gas condensate reservoirs, with an occurrence depth ranging from approximately 2,880 to 3,111 meters. Commercial production began in 2001. The field has estimated ABC1 reserves of 11 mmboe, consisting of 1.5 bcm of natural gas and 140 mt of gas condensate.

Ust Purpeyskiy license area. The Ust Purpeyskiy license area covers approximately 388 square km and lies 50 km southwest of Tarko Sale. There are four fields within the Ust Purpeyskiy license area: the Central Purpeyskoye, Gubkinskoye, Prisklonovoye and Kreschenskoye fields. The Central Purpeyskoye

field covers approximately five square km and has two oil reservoirs, with an occurrence depth ranging from approximately 2,730 to 2,952 meters. The Gubkinskoye field covers approximately 37 square km and has three oil reservoirs with an occurrence depth ranging from approximately 2,640 to 3,159 meters. The Prisklonovoye field covers approximately 33 square km and has one gas condensate/crude oil reservoir, with an occurrence depth of approximately 2,804 meters. The Kreschenskoye field covers approximately 5 square km and has one oil reservoir with an occurrence depth of approximately 2,964 meters. The Central Purpeyskoye, Gubkinskoye and Prisklonovoye fields are currently producing, and the Kreschenskoye field is under exploration.

Set forth below are brief descriptions of our exploration activities at the other license areas for which we have only an exploration license. If the resources in any of these license areas prove to be commercially viable, we intend to apply to the Ministry of Natural Resources to convert the exploration license into a combined exploration and production license.

New Yurkharovskiy license area. The New Yurkharovskiy license area is about three times the size of and surrounds the license area for our Yurkharovskoye field on all sides except the southeast side. The eastern half of the license area straddles the Tazov Bay. We are studying the Achimov and Jurassic horizons in the license area.

North Yubileyniy license area. The North Yubileyniy license area covers approximately 834 square km and lies 42 km northwest of Noviy Urengoi. We are studying the Cenomanian, Achimov and Jurassic horizons in the license area. In the second half of 2005, we expect to complete 2D seismic covering 300 linear km of the license area.

Tabiyakha Tarkinskiy license area. The Tabiyakha Tarkinskiy license area covers approximately 1,069 square km and lies 18 km northwest of Noviy Urengoi. In 2005, we completed 2D seismic covering 300 linear km of the license area. We are studying the Achimov and Jurassic horizons in the license area.

North Khancheyskiy license area. The North Khancheyskiy license area covers approximately 571 square km and lies 60 km northwest of our Khancheyskoye field and 50 km east of the East Tarkosalinskoye field. We are in the process of developing a detailed geological model, based on 2D seismic interpretation covering 1,200 linear km of the license area.

Equity Investments

We also hold interests in the companies described below, which have subsoil licenses and are engaged in the exploration and development of oil and gas fields in Yamal-Nenets. These interests are accounted for under the equity method and the results of operations of these companies are not consolidated in our financial statements.

Novasib

We hold a 50% interest in OOO Novasib. The other 50% interest is held by Sibirsky Nauchno-Analyticheski Tsentr, an unaffiliated Russian company engaged in exploration activities. Novasib holds a license to the Raduzhnyi license area. The Raduzhnyi license area covers approximately 704 square km and lies 120 km northeast of Noviy Urengoi and 63 km southwest of the village of Korotchaevo. Novasib expects to complete 2D seismic covering 70 linear km of the license area and 3D seismic covering 200 square km of the license area in the second half of 2005.

Yargeo

We hold a 41% interest in OOO Yargeo. The remaining interest is held by Sibirsky Nauchno-Analyticheski Tsentr (26%), and ZAO Toplivno-energeticheskaya Korporatsiya (33%), an unaffiliated Russian company with investments in oil and gas companies. Yargeo holds a license to the Yarudeyskiy license area. The Yarudeyskiy license area covers approximately 2,036 square km and lies on the south side of the Ob river and 54 km northwest of Nadym. Yargeo is in the process of developing a detailed geological model, based on 2D seismic interpretation covering 1,289 linear km of the license area. The field has natural gas and crude oil resources within the Jurassic horizon.

Processing of Gas Condensate

Gas condensate is produced at our fields in unstable form and requires further processing before it can be delivered to end customers. Prior to the commissioning of our Purovsky processing plant in

June 2005, we used Gazprom's Surgutsky refinery under a tolling arrangement, whereby we paid a processing fee per tonne for unstable gas condensate and received a proportionate amount of the stabilized gas condensate, gasoline, diesel fuel, liquefied gases and pentane-hexane fractions produced at the refinery from our and other producers' feedstock. In using the Surgutsky refinery, we did not have control over technological methods, processing prices or the slate of products we received and had limited options for the sale of certain processed products. For example, we distributed and sold most of the stabilized gas condensate through the Transneft network as Urals blend. In June 2005, we commissioned our new gas condensate stabilization and processing plant in the town of Purovsk, close to our producing fields and existing infrastructure. We are migrating the processing of substantially all of our gas condensate to our Purovsky processing plant, and we expect this migration to be completed at the end of the third quarter of 2005.

The Purovsky processing plant currently has capacity to process up to 2 mmt of unstable gas condensate per year into approximately 1.6 mmt of stable gas condensate and 0.4 mmt of liquefied petroleum gas (propane, butane and propane/butane mix). The plant has storage facilities for stable condensate (30 mcm), for liquefied petroleum gas (6 mcm) and for raw materials (4 mcm). The plant also has facilities for loading stable condensate and liquefied petroleum gas into rail tank cars. Two railway lines connect the plant to the Limbey rail crossing, thus connecting the plant to the Russian railway network.

The plant receives unstable gas condensate through our pipeline directly from our East Tarkosalinskoye field, which includes gas condensate produced at both our East Tarkosalinskoye and Khancheykoye fields. All of the gas condensate produced at our Yurkharovskoye field is de-ethanised at Gazprom's Urengoigazprom and then sent to our Purovsky processing plant for stabilization and further processing. We may elect to construct our own de-ethanisation facilities and a gas condensate pipeline connecting the Yurkharovskoye field to the Purovsky processing plant in the future. See also "—Fields and Licenses—Yurkharovskoye Field."

We believe having our own processing facility reduces our reliance on third party pipelines and processing plants, and improves our ability to control the products to be manufactured from our gas condensate. It also allows us to increase our processing capacity in anticipation of expected increases in gas condensate production and to better control product costs and quality. Moreover, through rail transport of our stabilized condensate to the Port of Vitino, by the end of the third quarter of 2005 we expect to be able to export substantially all of our stabilized gas condensate to international markets where the price for gas condensate has historically exceeded the Urals blend price. Based on the current pricing environment, we believe that greater export sales should allow us to achieve more attractive netbacks per one tonne of stable gas condensate than those we have realized historically.

We are planning to expand the Purovsky processing plant's processing capacity to 5 mmt per annum in line with planned increases in unstable gas condensate production. We currently expect this expansion to be completed in 2008 and we believe it will allow us to process 100% of our future gas condensate production and provide processing services to third parties.

Transportation

Natural Gas Transportation

We use the UGSS for the transportation of all our natural gas. The UGSS is an integrated gas transportation and supply network owned and operated by Gazprom and used by Gazprom and other Russian producers for the transportation of substantially all natural gas produced within Russia. All three of our current gas producing fields are close to the Northern, Central and Southern Corridors of the UGSS, and are connected by our pipelines to the UGSS. See "—Exploration and Production—Licenses and Fields." Before contracting with Gazprom for the transportation of natural gas through the UGSS, we must have in place certain technical permissions from Gazprom to inject specified annual volumes of natural gas into the UGSS.

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 Ministry of Natural Resources. 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. The development plans for our fields, as approved by the Ministry of Natural Resources, then serve as a basis for our request to Gazprom to access the UGSS. The request to

use the UGSS must specify the exact entry point to the UGSS and the quantity to be injected on an annual basis at such entry point. Provided that there is spare transport capacity and the quality of our natural gas meets technical standards, Gazprom is required by law to grant our request to access the UGSS and issue technical permissions for connection to the UGSS. We currently have permission from Gazprom to access the UGSS at the following points and for the indicated annual volumes:

- *The Gazprom intersystem pipeline between the Urengoi Gas Preparation Unit No. 15 and the Yamburg Compressor Station (31st km point).* From this point we have access to the Central Corridor of the UGSS, which carries gas westward from Western Siberia over the Urals to the European part of Russia. In addition, due to connecting pipelines, we also have access to the Northern Corridor of the UGSS. We have permission to inject 9.2 bcm of natural gas per annum into this Gazprom pipeline. Our Yurkharovskoye field is 52 km from this connection point, and our pipelines connecting to this Gazprom pipeline have a capacity of 9.2 bcm of natural gas per annum. Actual volume injected at this point in 2004 was 6.7 bcm.
- *The Urengoi-Surgut-Chelyabinsk Gas Pipeline (128th km point).* The Urengoi-Surgut-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. While normally gas flows only westward and southward in the UGSS, due to the location of our injection point in the Urengoi-Chelyabinsk Gas Pipeline gas flow can be reversed to transport gas northward into the Central and Northern Corridors of the UGSS. We have permission to inject 14.8 bcm of natural gas per annum into this point in the UGSS. Our East Tarkosalinskoye field is 24 km from this connection point, and is connected to the UGSS by our intrafield pipeline with a capacity of 28 bcm of natural gas per year. Production at our Khancheyevskoye field is transported to the East Tarkosalinskoye field through our pipeline with a capacity of 5.8 bcm per annum, from where it is then transported to the UGSS connection point. Actual volume injected at this point in 2004 was 13.6 bcm.

These permissions do not have an expiration date, and we are not required to renew these permissions on a periodic basis. Moreover, the continuation of these existing permitted allocated volumes for future periods is not tied to production from the specific fields identified above. Provided that we develop fields close to these entry points and can construct intra-field connecting pipelines, we believe we will be able to maintain our existing allocated volumes.

In April 2005, we submitted a revised development plan for our Yurkharovskoye field to Gazprom to obtain technical permission to increase the injection volume levels entering the UGSS to 30.5 bcm per annum by year 2012 and thereafter. Although we have been successful in the past in obtaining technical permissions from Gazprom to increase our injection volumes, we cannot assure you that Gazprom will approve our future requests. See “Risk Factors—Risks Relating to Our Business—We are dependent on Gazprom, our largest competitor, for the transportation of our natural gas and a part of our unstable condensate.”

Transportation Contracts with Gazprom

We may sell gas either to wholesale gas traders or end-users. The wholesale gas traders usually arrange for transportation with Gazprom themselves. The transportation of natural gas to end-users, however, usually requires a separate transportation contract with Gazprom for transportation of the specified volumes through the UGSS to the final destination point, which is usually the local gas distribution station. The end-user is responsible for transporting gas from the local gas distribution stations to its facilities, and generally uses either the local gas distribution company or the local municipality. Before Gazprom enters into a transportation contract, we must submit an executed gas supply agreement or letter of intent with a gas customer, which must include the contract volumes to be shipped and the final destination point. While our contract with the consumer may be for more than one year, Gazprom in general only agrees to one-year transportation contracts, although governmental regulations also provide for mid-term (one to five years) and long-term (exceeding five years) contracts. We have a long-term transportation contract with Gazprom under which we separately negotiate transportation arrangements relating to particular customers, usually on an annual basis. In 2005, under this agreement we have arranged for the transportation of approximately 13 bcm of natural gas. In agreeing to accept gas from us for delivery to a particular customer, Gazprom assesses the availability of transport capacity for the relevant time period and route requested, the compliance of our natural gas with applicable technical standards and the availability of input and output connections to and from the main pipeline equipped with

measuring and control units. If the transport capacity is not sufficient to grant the requests of all independent suppliers, Gazprom is required to give preferences to suppliers for utility and residential users.

In 2004, the weighted average transportation distance for our gas in the UGSS was 1,925 km and our gas transportation expense was RR 2,938 million. In the past, we have not experienced any unreasonable denials by Gazprom to enter into transportation contracts, but we cannot assure you that Gazprom will not deny our requests for transportation contracts in the future. See “Risk Factors—Risks Relating to Our Business—We are dependent on Gazprom, our largest competitor, for the transportation of our natural gas and a part of our unstable condensate” for a further discussion of potential risks in dealing with Gazprom.

In the first quarter of 2005, approximately 48% of our natural gas sales were to end-users requiring transportation contracts with Gazprom. The remainder of our natural gas sales are made on an “ex-field” basis, where the customer is responsible for negotiating the gas transportation contracts directly with Gazprom. See “—Sales and Marketing.”

The tariff charged by Gazprom for the transportation of natural gas, which is set by the FTS, is currently RR 19.37 per mcm per 100 km (excluding VAT) for shipments to customers located within the Russian Federation. In general, we are required to prepay on a monthly basis for transportation of our natural gas. Consequently, we require our customers to make similar prepayments for natural gas in an amount covering at least our transportation costs.

Under our form gas supply agreement for customers for whom we are responsible for arranging transportation through the UGSS to the final destination point, title to the natural gas being delivered passes to the customer at the local gas distribution station. For these end-user sales, we have received permission to transport 12.7 bcm of natural gas through the UGSS for 2005. For ex-field sales, title to gas passes to the buyer when we have injected the gas into the UGSS at our connection points.

We deliver natural gas to some of the end-users in the Chelyabinsk region via the Bukhara-Ural Pipeline, a part of the Southern Corridor of the UGSS. A section of this pipeline (42.9 km) travels through the territory of Kazakhstan. In order to secure transportation through this territory, we have an agreement with Gazprom for customs clearance services through 2010.

Our natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with monthly sales peaking in December and dipping in the summer months of July and August. In the future, to better optimize our sales and production, we plan to seek usage of Gazprom’s storage facilities with total capacity from 1 to 2 bcm to store gas in order to supplement our production during periods of peak demand. Based on our current negotiations with Gazprom, we believe that storage facilities located in Severo-Stavropolskiy Krai and Tyumen region will be made available to us.

Gas Condensate and LPG Transportation

Substantially all of the stabilized gas condensate produced at our Purovsky processing plant is delivered by rail to the Port of Vitino on the White Sea in the Murmansk region. At the Port of Vitino, the gas condensate is loaded on ocean-going tankers for further transportation to international markets. We have recently completed the construction of facilities for loading and storage of stabilized gas condensate at the Port of Vitino. Two storage reservoirs, each with a capacity of 30 mcm, and the loading facilities were commissioned in June 2005. Our own storage and loading facilities enable us to better market and sell our gas condensate in international markets. We expect the total cost of building the storage and loading facilities at the Port of Vitino to be approximately RR 245.4 million, of which we had spent RR 166.1 million as of 31 March 2005.

We ship our LPG produced at our Purovsky processing plant through our subsidiary NovaTrans, which operates a fleet of 420 LPG railway tank cars.

Oil Transportation

We transport most of our crude oil through the pipeline system operated by Transneft, Russia’s monopoly pipeline operator. The Russian Ministry of Industry and Energy allocates usage of the pipeline network for export deliveries to oil producers on a quarterly basis. The Ministry generally distributes pipeline export capacity to producers on a pro rata basis based on output and delivery to the Transneft system. Tariff rates for using Transneft pipelines are set by the FTS. The overall price per tonne for the

transport of crude oil depends on the length of the transport route utilized to transport the oil from the field to the ultimate destination. We require 100% prepayment for crude oil sold on the domestic market and offer industry-standard terms on export markets.

The crude oil that we transport through Transneft is blended with oil produced by other oil companies transporting their oil through Transneft. The sales made by us and all such other oil companies are of the blend that results from the combination of different types and qualities of oil in the system, which is known as Urals blend.

Sales and Marketing

Sales of Natural Gas

We sell 100% of our natural gas to customers in Russia. We supply gas to the Russian industrial heartland located in the Southern Urals (Sverdlovsk, Chelyabinsk, Tyumen and Kurgan regions), the heavily-populated European part of Russia (Perm, Samara, Kirov, Tatarstan, Kostroma and Chuvashiya regions) and the St. Petersburg area. In the heavily industrial Sverdlovsk and Chelyabinsk regions we have contracts to supply 42% and 21%, respectively, of the expected natural gas demand in these regions in 2005.

We believe we have a strong reputation among gas consumers in the regions where we operate for delivering uninterrupted supplies of natural gas throughout the year. One of our key competitive advantages is the location of our fields in areas where the UGSS currently has available capacity to transport natural gas, allowing us to serve markets not easily accessible to other Russian independent gas producers and where Gazprom may not be able to meet market demand. Our marketing strategy has the following objectives:

- optimize product sales to ensure the most appropriate balance of end-users and wholesale gas traders;
- become the sole regional supplier of gas wherever possible;
- actively participate in regional gasification programs in the future;
- increase the number of regional sales markets in Russia;
- increase the number of customers for whom we are the primary gas supplier; and
- increase our production capacity to guarantee supply to buyers in periods of maximum gas usage in order to capture peak prices in periods of high demand.

Most of our end-user customers use natural gas supplied both by Gazprom and us. When end-users have exhausted their supply quotas with Gazprom, which generally have not been increasing in the past few years, end-users look to other sources like us to meet their additional needs. Typically, before the beginning of each calendar year, we receive indications of interest from gas customers, which historically have exceeded our total expected gas production available for sale in the relevant year. Based on such indications of interest, we enter into gas supply agreements with customers whom we wish to supply in the coming year and transportation contracts with Gazprom. We are generally able to sell gas at prices above the prices established by the FTS for gas sold by Gazprom domestically.

We sell our gas in two primary ways:

- *End-user sales.* We agree gas prices directly with the end-user and then apply to Gazprom for use of the UGSS to transport the gas to the end-user. The prices are usually set on a delivered 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 to the UGSS and ensure their own transportation to their end customers. Gazprom also buys natural gas directly from us on occasion in order to cover temporary shortages in its domestic gas supply commitments.

The following table sets forth, by volume and percentage, sales of natural gas to different category of customers for the periods indicated:

Gas Sales, mmcm	Three months ended 31 March				Year ended 31 December					
	2005		2004		2004		2003		2002	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
End-users⁽¹⁾:										
Utilities	1,956	28%	1,251	25%	4,623	27%	3,048	23%	—	0%
Regional gas distributors	970	14%	1,647	33%	3,346	19%	974	7%	—	0%
Metals and other industrial users	461	6%	345	7%	2,001	12%	597	5%	159	4%
Total end-users	3,387	48%	3,243	65%	9,970	58%	4,619	35%	159	4%
Wholesale gas traders⁽²⁾:										
The Itera Group	2,322	33%	800	15%	1,670	10%	1,675	13%	2,154	60%
Others	1,301	19%	1,012	20%	5,637	32%	6,866	52%	1,270	36%
Total wholesale gas traders	3,623	52%	1,812	35%	7,307	42%	8,541	65%	3,424	96%
Total	7,010	100%	5,055	100%	17,277	100%	13,160	100%	3,583	100%

(1) Including those end-users purchasing our natural gas on an ex-field basis.

(2) Including those wholesale gas traders purchasing our natural gas on a delivered basis.

Our largest customers, by volume, in the first quarter of 2005 were the Itera Group, Trustinvestgas and Centerusgas, which are independent wholesale traders, and Permenergo and Samaraenergo, which are regional power generating companies, accounting for 33.3%, 8.8%, 5.3%, 5.7% and 5.2%, respectively, of our total gas sales volume. In the same period, we had 51 customers in total, of which 46 were end-users.

The Itera Group, Trustinvestgas and Centerusgas buy natural gas from us and other suppliers and sell to the same types of end-users as we do. Our main contract with the Itera Group is for five years providing for the sale of 37.5 bcm of natural gas over the period from 2005 through 2009 at prices determined annually. The price is calculated as a percentage (which at no time during the term of the contract may be less than 95%) of the price set by the FTS for the Sverdlovsk region. The Itera Group sells this gas in the Sverdlovsk region. We currently have a one year contract with Trustinvestgas and three year contracts with Centerusgas and Mezhhregiongas, both expiring on December 31, 2007. These contracts provide for certain volumes of supply at negotiated prices. We also enter into one year contracts with wholesale traders, including the Itera Group, to cover their additional demands. We have a five year contract with Samaraenergo expiring on December 31, 2010 for the sale of 950 mmcm of natural gas per annum. During the term of this contract we have varying prices for our gas, but generally the price is determined as the regulated price for this region increased by a certain premium. In addition, we have a contract to annually supply up to 1.3 bcm of natural gas to Magnitogorsk Iron & Steel Works through 31 December 2010.

The table below sets forth our sales volumes for the first quarter of 2005 to end-users by region and wholesale traders.

	Sales Volume (mmcm)
End-users⁽¹⁾ by regions:	
Chelyabinsk	598.6
Tyumen	495.6
Perm	402.0
Samara	370.7
Kurgan	324.5
Leningrad	285.6
Kirov	255.4
Tatarstan	155.0
Chuvashiya	199.5
Other regions	300.1
Total end-users	3,387.0
Wholesale gas traders⁽²⁾:	
The Itera Group	2,322.0
Others	1,301.0
Total wholesale gas traders	3,623.0
Total	7,010.0

(1) Including those end-users purchasing our natural gas on an ex-field basis.

(2) Including those wholesale gas traders purchasing our natural gas on a delivered basis.

We price our natural gas based on a combination of factors, including unsatisfied demand in the region where the customer is located, the regulated price in that region and the price level of reduced crude and coal in that region. In addition, the price, where applicable, includes a charge for the transportation tariff expected to be paid for the use of the UGSS to deliver the gas to the final destination point. The following table sets forth certain information with respect to the pricing of our natural gas.

	Three months ended 31 March 2005	Year ended 31 December	
Prices in RR per mcm, VAT not included		2004	2003
Weighted average realized price for end-users	1,054.75	957.69	868.63
Weighted average price of transit and commercial services	378.94	330.50	336.80
Weighted average realized price for end-users at the input connection	675.81	627.19	531.83
Weighted average price at the gate to wholesale traders (ex-field)	653.57	528.10	452.88
Regulated price	996.29	822.10	685.91
Weighted Average Transportation Distance, km	2,037	1,925	2,020

As part of the transfer of the West Tarkosalinskoye field to a Gazprom subsidiary, we entered into an agreement with the Gazprom subsidiary pursuant to which we are entitled to purchase 10.0% of the natural gas production from the Cenomanian horizon and all of the gas condensate production from the Valanginian horizon of the West Tarkosalinskoye field for the duration of the license, which expires in 2018. Prices for 2005 purchases are agreed, and prices for future years are subject to further agreement, based in part on production costs. In the first quarter of 2005, our purchases from Gazprom pursuant to this contract amounted to approximately 553 mmcm of natural gas, which we sold in the same manner as our own production.

In 2005, our natural gas deliveries to the Kurgan and the southern part of the Tyumen regions are expected to supply 91% and 89%, respectively, of the total expected natural gas demand in these regions. These sales amounted to approximately 11.7% of our total sales in the first quarter of 2005. Although we are not required to follow the regulated prices for our sales, we sell natural gas to consumers in these regions primarily at the price set by the FTS for Gazprom's sales.

When our end-user customers take delivery of less than agreed-upon volumes of gas, we attempt to locate alternative customers for such excess gas. Typically in such circumstances, we take delivery of gas from the UGSS at a point earlier than the original destination point and redistribute to existing customers, thus we avoid the potentially time-consuming process of obtaining an amendment to the gas transportation contract. We also generally relieve our existing customer from the obligations under the gas supply agreement to take full delivery of agreed-upon volumes if they notify us sufficiently in advance. In addition to meeting the needs of our customers, we believe that our ability to withdraw gas in a timely, pre-agreed manner from the UGSS facilitates the optimal use of the overall capacity of the UGSS.

We use similar forms of a gas supply agreement for a majority of our sales to wholesale traders and end-users differing primarily in payment terms. The standard agreement specifies, among other things, the price and volume of gas to be delivered for the term of the agreement. A majority (by volume) of our gas supply agreements have a one year term, but an increasing percentage of our gas supply agreements with end-user customers have a multiple-year term. We generally require monthly advance payments from wholesale traders. Prices can be recalculated quarterly due to, among other things, changes in VAT, production taxes and Gazprom transportation tariffs. A refusal of access to the UGSS is included as a *force majeure* event in all our gas supply agreements. Gas supply agreements are also regulated by and contain terms required by Russian legislation and other applicable regulations. See “Regulation.”

Sales of Natural Gas Liquids

Prior to the commissioning of the Purovsky processing plant in June 2005, we sold gas condensate and natural gas liquids primarily in the domestic market. With the commissioning of the Purovsky processing plant, by the end of the third quarter of 2005 we expect to be able to export substantially all of our stable gas condensate and up to half of our natural gas liquids. We also export a portion of our crude oil and oil products such as diesel fuel and naphtha. All of our export liquid sales are made through Kerden Trading Limited, which is owned by our principal shareholders. Sales of liquids through Kerden Trading Limited are conducted on what we believe to be an arm’s length basis, using market terms and conditions. See “Transactions with Affiliates” and “Risk Factors—Risks Relating to Our Business—We have been and will continue to be controlled by a group of majority shareholders whose interests could conflict with those of the holders of the shares and GDRs.” In June 2005, our Board of Directors approved the establishment of a wholly-owned subsidiary through which all of our export sales and marketing will be conducted, starting sometime in 2006. We expect to cease using Kerden Trading in the future.

The following tables set forth, by volume, our sales of crude oil, gas condensate and oil products by geographical market for the periods indicated.

	Three months ended 31 March		Year ended 31 December		
	2005	2004	2004	2003	2002
Export Sales, mt					
Crude oil and gas condensate	88	144	502	253	54
Oil products	—	20	20	265	—
Total	88	164	522	518	54
Domestic Sales, mt					
Crude oil and gas condensate	272	228	1,087	481	333
Oil products	243	72	503	236	24
Total	515	300	1,590	717	357

Novatek-Polimer

Headquartered in the city of Novokuybyshevsk in the Samara region, Novatek-Polimer is the largest producer of anti-corrosive insulating materials used in the oil and gas industry for the insulation of underground pipelines in Russia. Most of its facilities are located in the Samara region. It produces more than a dozen types of polyethylene-based insulating tapes, including polymer tapes and wraps, heat-shrinkable tapes and sleeves for the protection of welded pipe joints. Major customers of our insulating materials include Gazprom, Slavneft, LUKOIL, Rosneft, Bashneft, Transneft and Orenburgneft. In 2004, Novatek-Polimer produced 12.2 mt of product, operating at 40.7% of its annual capacity of 30 mt. Novatek-Polimer also produces plastic pipes of varying diameters for the oil and gas industry and civil

construction, and polypropylene compounds, which are purchased by, among others, Russian automotive parts suppliers. Novatek-Polimer maintains a quality management system in accordance with the requirements set forth by International Standards Organization for the ISO 9001:2000 certification.

In June 2005, we commissioned a modern, BOPP wrap film plant. BOPP film is widely used as a packaging material in the food, tobacco, perfume, medicine and textile industries. The plant has an annual production capacity of 25 mt. We currently estimate that production from the plant will supply up to a quarter of the Russian market for consumer packaging film materials, which we estimate to be \$270 million per year.

We have commissioned a feasibility study for the construction of a petrochemical complex in the city of Novokuybyshevsk in the Samara region. We have not taken a decision on proceeding with the project.

Health, Safety and Environment

Our operations are subject to a number of health, safety and environmental laws and regulations. These laws govern, among other things, the composition of emissions 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 a high level of environmental risk. We must comply with applicable requirements of the environmental laws and regulations of the Russian Federation in performing our business activities. Infringements may lead to the suspension of our production operations following a decision of the relevant authorities, or the permanent cessation of production operations following a court judgment.

We believe that our operations are generally in compliance with applicable health, safety and environmental regulations. To date, we have not had any serious accidents that have had a significant environmental impact. We have not recorded any provision for environmental payments in our consolidated financial statements included herein.

Russian environmental legislation establishes a “pay-to-pollute” regime. Under this regime, our four key subsidiaries paid RR 0.8 million, RR 2.6 million, RR 3.0 million and RR 2.3 million in the three months ended 31 March 2005 and the years ended 31 December 2004, 2003 and 2002, respectively. Forthcoming changes in environmental legislation are expected to eliminate the “pay-to-pollute” regime in favor of increasing punitive payments for environmental violations.

We have established special programs for monitoring harmful leaks, water contamination, and the quality of air, water and soil at production fields. The table below sets out the environmental costs incurred by our four key subsidiaries for the periods indicated. Typically, these environmental costs include costs of ecological monitoring and expertise, costs of wastes recycling, reclamation costs, costs of water and air protection activities, payments for pollution of the environment, compensatory payments and other expenses.

	Three months ended 31 March 2005	Year ended 31 December		
		2004	2003	2002
		(RR millions)		
Yurkharovneftegas	0.4	16.1	8.9	3.6
Tarkosaleneftgas	—	41.0	38.4	24.3
Khancheyneftgas	0.7	27.3	8.6	2.0
Purneftgasgeologiya	1.3	13.3	15.0	3.5
Total	2.4	97.7	70.9	33.4

We are also in the process of introducing an environmental management control system in accordance with the requirements set forth by International Standards Organization for the ISO 14000 certification.

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 oil spills, blowouts, cratering, gas leaks and fires, 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.

Currently, our property at Yurkharovneftegas, Tarkosaleneftgas, Khancheyneftgas and Novatek-Polimer is insured against property loss. We also have insurance for transported hydrocarbons and the required insurance for hazardous facilities.

Currently, we are not insured against loss of control of wells, construction risks, business interruption and third party liability. We believe that the level and types of our insurance coverages are within industry norms and practice within the Russian oil and gas market. See “Risk Factors—Risks Relating to Our Business—There are numerous operating risks inherent in the oil and gas industry, and insurance may not be adequate, affordable or available to protect us against all these risks.”

Litigation

Other than as set forth below, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which we are aware), during a period covering at least the previous 12 months which may have, or have had in the recent past significant effects on our financial position or profitability.

In October 2004, the tax inspectorate required Tarkosaleneftgas to pay additional income tax in the amount of RR 81 million. Tarkosaleneftgas challenged this in the Arbitration Court of the City of Moscow. In February 2005, the Arbitration Court ruled in favor of Tarkosaleneftgas. The tax inspectorate filed an appeal in February 2005. On 30 May 2005, the Ninth Arbitration Appellate Court dismissed the appeal and upheld the Arbitration Court judgment. However, we are not aware of whether the tax inspectorate has challenged the 30 May ruling or the 25 February judgment.

On 21 June 2005, the Prosecutors Office of the Yamal-Nenets Autonomous District (the Prosecutors Office), issued a search warrant to us for certain documents it wanted to review in connection with a criminal investigation of Mr. Marksmir Kim relating to the alleged abuse of his duties as the President of the Yamal Fund. Among other things, the Prosecutors Office alleges that in connection with the May 2003 subscription by the Yamal Fund to our shares, Mr. Kim caused the Yamal Fund to contribute its 40%, 25.1% and 11% equity interests in Yamalneftgasdobycha, Tambeyneftgas and Minlay, respectively, with NOVATEK for a 7.6% interest in NOVATEK at a valuation below the market value of such interests. Pursuant to the warrant, the Prosecutors Office is examining, among other things, our accounting and financial documents, financial documentation, valuation documents, correspondence and other documents and information relating to the May 2003 subscription by the Yamal Fund to our shares. The Yamal Fund was formerly a shareholder of NOVATEK, and, in addition to the exchange described above, we have engaged in other transactions with the Fund as described elsewhere in this prospectus. We have been informed by the Prosecutors Office that we are not a target of the investigation, although prosecutors in Russia have broad discretion to expand the scope of investigations and currently we are not in a position to quantify the impact, if any, on our financial position or profitability. We are cooperating with the Prosecutors Office and have produced all requested documents in our possession. See “Risk Factors—Risks Relating to Our Business—Corruption, investigations thereof and negative publicity associated therewith could disrupt our ability to conduct our business and could materially adversely affect our business, financial condition, results of operations or prospects and the market price of the shares and GDRs.”

Employees

We had approximately 3,700 employees as of the date of this prospectus, of which approximately 75% were members of a trade union. We had approximately 3,600, 6,800 and 6,900 employees as of 31 December 2004, 2003 and 2002, respectively.

The following table sets out the number of employees of NOVATEK and our key subsidiaries as of 31 March 2005 and 31 December 2004 and 2003.

<u>Entity</u>	<u>As of 31 March 2005</u>	<u>% Unionized as of 31 March 2005</u>	<u>As of 31 December 2004</u>	<u>As of 31 December 2003</u>
NOVATEK	318	2%	309	275
Yurkharovneftegas	378	90%	263	290
Tarkosaleneftegas ⁽¹⁾	1,217	99%	1,208	1,143
Purneftegasgeologiya	424	99%	485	611

(1) Includes employees of Khancheyneftegas, which was merged into Tarkosaleneftegas in May 2005. Employees of Tarkosaleneftegas and Khancheyneftegas are presented for periods prior to the December 2004 acquisitions of the remaining interests therein.

We have not experienced any work stoppages or other significant labor disputes, and we consider our relationship with our employees to be good.

We and our subsidiaries make mandatory contributions to the governmental pension scheme in the Russian Federation. Discretionary pensions and other post-retirement benefits at 31 December 2004 are not significant.

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 standards and SPE standards, 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.

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; preliminary 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 explored reserves, or reserves in categories A, B and C1.

Category A reserves are calculated on the part of a deposit 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 computed 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) whose 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 have been determined from the results of drilling exploration and production wells and by those 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. In the case of an oil and natural gas deposit, the commercial potential of its oil-bearing fringe has been determined. Well productivity, hydro- and piezo-conductivity of the stratum, stratum pressures and crude oil, natural gas and gas condensate temperatures and yields have been studied on the basis of well testing and well exploration results. The hydro-geological and geocryological conditions have been determined on the basis of well drilling results and comparisons with neighboring explored fields.

Category C1 reserves are computed 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 preliminary 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.

Category C3 resources are prospective reserves prepared for the drilling of (i) traps within the oil-and-gas bearing area, delineated by geological and geophysical exploration methods tested for such area and (ii) the formation of explored fields which have not yet been exposed by drilling. The form, size and stratification conditions of the assumed deposit are estimated from the results of geological and geophysical research. The thickness, reservoir characteristics of the formations, the composition and the characteristics of hydrocarbons are assumed to be analogous to those for explored fields. Category C3 resources are used in the planning of prospecting and exploration work in areas known to contain other reserve bearing fields.

Category D1 resources are calculated based on the results the region's geological, geophysical and geochemical research and by analogy with explored fields within the region being evaluated. Category D1 resources are reserves in lithological and stratigraphic series that are evaluated within the boundaries of large regional structures confirmed to contain commercial reserves of oil and natural gas.

Category D2 resources are calculated using assumed parameters on the basis of general geological concepts and by analogy with other, better studied regions with explored oil and natural gas fields. Category D2 resources are reserves in lithological and stratigraphic series that are evaluated within the boundaries of large regional structures not yet confirmed to contain commercial reserves of oil and natural gas. The prospects for these series to prove to be oil-and gas-bearing are evaluated based on geological, geophysical and geochemical research.

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 subsidiary organizations of the Federal Agency on Subsoil Use, including the State Reserve Commission, Central Reserve Commission and its regional departments. If the commercial feasibility of certain reserves is approved by any such organization, the reserves are entered in the State Balance of Mineral Products. Once a subsoil user is granted an exploration, development or production license, it is required to file annual statistical reports reflecting changes in reserves. In addition, subsoil users' reserve reports are submitted annually for examination and approval by the Central Reserve Commission or its regional organizations or, if there has been a substantial change in reserves, by the State Reserve Commission. We retain an independent research institute to prepare such reports for us.

Additionally to annual reports, our licenses may require us to estimate our reserves in certain years or upon completion of certain phases of fields' development. Such estimations are submitted for examination and approval by the State Reserve Commission.

Estimation 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.

SPE Standards

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, SPE 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 SPE standards, reserves are classified as “proved,” “probable” and “possible,” based on both geological and commercial factors. We have included in this prospectus information about our proved and probable reserves under SPE standards based on the evaluations of our fields by DeGolyer and MacNaughton.

Proved reserves include reserves that are confirmed with a high degree of certainty through an analysis of the development history and/or volume method analysis of the relevant geological and engineering data. Proved reserves are those that, based on the available evidence and taking into account technical and economic factors, have a better than 90% chance of being produced.

Probable reserves are those reserves in which hydrocarbons have been located within the geological structure with a lesser degree of certainty because fewer wells have been drilled and/or certain operational tests have not been conducted. Probable reserves are those reserves that, on the available evidence and taking into account technical and economic factors, have a better than 50% chance of being produced.

Possible reserves are those unproven reserves that, on the available evidence and taking into account technical and economic factors, have a 10% chance of being produced.

An evaluation of proved, probable and possible natural gas 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 audit 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 audit date.

SEC Standards

SEC standards differ in certain material respects from SPE standards. The principal differences include the following:

Certainty of Existence. Under SPE standards, reserves in undeveloped drilling sites that are located more than one well location from a commercial producing well may be classified as proved reserves if there is “reasonable certainty” that they exist. Under SEC standards, it must be “demonstrated with certainty” that reserves exist before they may be classified as proved reserves.

Duration of License. Under SPE standards, proved reserves are projected to the economic production life of the evaluated fields. Under SEC standards, oil and gas deposits may not be classified as proved reserves if they will be recovered after the expiration of a current license period unless the license holder has the right to renew the license and there is a demonstrated history of license renewal. The Subsoil Resources Law of the Russian Federation provides that a license holder may request an extension of an existing license where extractable reserves remain upon the expiration of the primary term of the license, provided that the license holder is in material compliance with the license. In addition, we prepare and submit for government approval 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, and intend to request to extend them to the full economic lives of the associated fields upon the expiration of their primary terms. In February 2005, we extended the term of our license for the Yurkharovskoye field from 2020 to 2034, the end of the expected economic life of the field. We intend to file for the extension of the terms of the licenses for our two other core fields—East Tarkosalinskoye and Khancheyskoye. While we believe that we have the right to extend our licenses as they expire, the absence of a significant demonstrated history of extension makes it uncertain whether extractable reserves we plan to recover only after the expiration of a current license period may be considered proved reserves under SEC standards as of 31 December 2004. We understand that the SEC has not provided definitive guidance on whether in these circumstances such extractable reserves could be

considered proved under SEC standards. In its appraisal of our proved reserves under SEC standards as of 31 December 2004, D&M has relied on our representations that we intend to (i) extend the terms of our licenses to the ends of the expected economic lives of the fields and (ii) proceed accordingly with the development and operation of the fields, in order to include certain volumes of reserves estimated to be producible beyond the primary terms of the licenses.

Accordingly, information relating to our estimated proved natural gas, gas condensate and crude oil reserves is not necessarily indicative of information that would be reported under SEC standards in an offering document registered with the SEC. In addition, SEC standards do not permit the presentation of reserves other than proved reserves.

SEC Regulation S-X Rule 4-10 paragraph (a) defines proved reserves as follows:

Proved oil and gas reserves. Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, *i.e.*, prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

- (i) Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes:
 - (A) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any; and
 - (B) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir.
- (ii) Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the “proved” classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.
- (iii) Estimates of proved reserves do not include the following:
 - (A) oil that may become available from known reservoirs but is classified separately as “indicated additional reserves”;
 - (B) crude oil, natural gas, and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics, or economic factors;
 - (C) crude oil, natural gas, and natural gas liquids, that may occur in undrilled prospects; and
 - (D) crude oil, natural gas, and natural gas liquids, that may be recovered from oil sales, coal, gilsonite and other such sources.

Proved developed oil and gas reserves. Proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as “proved developed reserves” only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

Proved undeveloped reserves. Proved undeveloped oil and gas reserves are reserves 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. Reserves on undrilled acreage shall be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances should estimates for proved 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 tests in the area and in the same reservoir.

REGULATION

Below is a brief description of some key aspects of the current regulatory regime for the natural gas industry.

Overview

The following laws primarily govern the natural gas industry in the Russian Federation:

- the Constitution of the Russian Federation;
- the Civil Code of the Russian Federation;
- Federal Law No. 2395-I “On Subsoil,” dated 21 February 1992, restated as Federal Law No. 27-FZ “On Subsoil,” dated March 3, 1995 (the “Subsoil Law”);
- Federal Law No. 147-FZ “On the Natural Monopolies,” dated 17 August 1995;
- Federal Law No. 69-FZ “On Gas Supply in the Russian Federation,” dated 31 March 1999 (the “Gas Supply Law”);
- Federal Law No. 187-FZ “On the Continental Shelf of the Russian Federation,” dated 30 November 1995; and
- Federal Law No. 225-FZ “On Production Sharing Agreements,” dated 30 December 1995.

The Gas Supply Law grants the Russian federal legislative and executive authorities jurisdiction over natural gas supplies, including, *inter alia*:

- the development and implementation of a governmental policy on natural gas supply;
- the development and implementation of federal programs for promoting the use of natural gas as a fuel and energy source;
- the regulation of strategic natural gas reserves;
- supervision and control over industrial and environmental safety of sites and facilities within the natural gas supply system; and
- standardization and certification in the gas supply industry.

Pursuant to the Gas Supply Law, the government:

- sets projected natural gas production and sales balances in Russia;
- approves rules for natural gas deliveries, use and supply; the federal natural gas supply program; safety rules for trunk pipelines, natural gas distribution networks and other gas system units; procedures for giving independent producers access to natural gas transportation and distribution networks; procedures for using natural gas as fuel; and a list of end customers whose natural gas deliveries may not be suspended or terminated; and
- establishes the principles for determining natural gas prices and transportation tariffs for gas transportation and distribution networks, and for reimbursing gas distributors for losses incurred in connection with gas deliveries to individual customers.

Other federal executive bodies with regulatory authority in the gas industry include, in particular:

- the Ministry of Industry and Energy of the Russian Federation, that, *inter alia*, determines governmental policy and drafts legal acts regulating the energy sector;
- the Federal Energy Agency, an agency subordinate to the Ministry of Industry and Energy of the Russian Federation that regulates the production and use of energy resources, prepares proposals for the development of investment projects in the energy sector and for use of the oil and gas pipeline systems, and implements government policy on production sharing agreements;
- the FTS, an entity subordinate to the government, that establishes regulated natural gas prices and transportation tariffs;
- the Ministry of Natural Resources, that, *inter alia*, regulates the procedures used in accounting for natural resources on the state balances, transferring licenses, classifying reserves, monitoring geological research and permitting the use of historical data owned by the state;

- the Federal Agency for Subsoil Use, an agency subordinate to the Ministry of Natural Resources, that, *inter alia*, issues geological studies, issues exploration and production subsoil licenses and supervises the holders compliance with the terms of such licenses, organizes geological exploration of the subsoil by the state, maintains the federal and territorial funds of geological data on the subsoil, organizes the conduct of tenders and auctions for the right to use subsoil, and maintains the state cadastre of deposits;
- the Federal Service for Environmental, Technological and Nuclear Surveillance, an entity subordinate to the government, that, *inter alia*, issues industrial safety certificates and operating licenses, including for the operation of oil and gas extracting facilities and gas pipelines, as well as licenses for performing various types of other activities, including the transportation of oil and gas products;
- the Federal Service for Surveillance in the Sphere of Environmental Use, an entity subordinate to the Ministry of Natural Resources, that, *inter alia*, monitors environmental protection and the rational use and protection of the subsoil; and
- the Federal Anti-Monopoly Service, an entity subordinate to the government, that, *inter alia*, oversees compliance with the laws on competition on the commodity markets and those concerning natural monopolies.

The structure of the federal executive bodies is established by the President of the Russian Federation and is subject to frequent change.

Regional authorities have limited jurisdiction in the area of gas industry regulation.

Production

In order to produce natural gas, a company must obtain a number of licenses and permits, including, in particular, a subsoil license, a mining allotment, land use permits, operating licenses and a favorable environmental assessment.

Subsoil Licenses

Pursuant to the Subsoil Law, the subsoil is considered the property of the state and can be used only upon grant of a subsoil license. Natural resources extracted from the subsoil become the property of the subsoil user upon extraction. Subsoil licenses are generally awarded through auctions or tenders. The most important criterion for awarding a subsoil license at auction is the total amount the bidder is prepared to pay for the right to use the subsoil. Other factors are also considered such as scientific, technical, economic, environmental and national security issues. Since 2003, subsoil licenses have been granted through auctions only and no tenders have been conducted. In certain limited instances, a subsoil license may be issued without a tender or an auction, such as, upon discovery of a deposit pursuant to a license for exploration, execution of a production sharing agreement, certain corporate reorganizations, the transfer of a subsoil license to a subsidiary of a license holder or the acquisition of a license in the course of a bankruptcy proceeding against the license holder.

Until recently, most subsoil licenses, including licenses for geological research, exploration and production of natural gas, were issued jointly by the Ministry of Natural Resources and the relevant authority of the regional government in which the field was located. Currently, such licenses are issued solely by the Federal Agency for Subsoil Use.

A subsoil license grants the license holder an exclusive right to use a particular subsoil plot and on the terms and conditions specified in the license (e.g. purpose of the subsoil use, borders of the land plot granted for subsoil use, deadlines, such as the start and end of the production, production volume, payments for subsoil use, etc.) and may be specified in more detail in a license agreement entered into by a competent state authority and the license holder.

There are several types of subsoil licenses granted in relation to geological research and exploration and production of natural resources, including: (i) a license for the geological exploration and assessment of a subsoil plot that may be issued for up to five years; (ii) a license for the production of natural resources that may be issued for the expected operational life of the field as determined by a feasibility study; or (iii) a combined exploration and production license allowing for geological exploration and assessment and subsequent production of natural resources.

The term of a license can be extended upon the license holder's request if necessary to finalize exploration, appraisal, production or remediation activities, provided, that, the license holder did not violate the terms of its license. In such case, no tender or auction is conducted. The Subsoil Law does not include detailed regulations on the procedure for extending a subsoil license. As a matter of practice, license holders often reach agreement with the authorities on such extension. Upon expiration of a license, a license holder must, at its own expense, recultivate the land and return it to a condition adequate for future use.

Generally, a subsoil license cannot be held by more than one legal entity. Licenses granted in accordance with the Subsoil Law cannot be sold or transferred to another entity, except in limited circumstances, such as a transfer to a spin-off company or a subsidiary in which the license holder owns not less than 50%. No restrictions are imposed by the Subsoil Law on a change of control over a license holder.

The license, the license agreement and/or other documents enclosed with the license impose certain obligations on the license holder to reach agreed levels of production, provide employment, develop local infrastructure, pay local and federal taxes and meet certain environmental requirements, as well as other obligations that may be agreed between the license issuer and the license holder.

The right to use the subsoil license can be suspended or terminated, in a number of cases, and, in particular, if:

- there is a direct threat to the life and health of people working or living in the area affected by the subsoil use;
- the license holder has breached the material terms of the license;
- the license holder systematically violates the stipulated subsoil use procedures;
- there is an emergency situation (disaster, military action, etc.);
- the license holder's production does not reach the volumes required by the terms of the license;
- the license holder has been liquidated;
- the license holder requests suspension or termination; or
- the license holder has failed to file reports in accordance with the subsoil laws.

Mining Allotment

Pursuant to the Subsoil Law, the subsoil area is provided to a subsoil user as a "mining allotment," *i.e.* a geometric block of subsoil. Preliminary mining allotment boundaries are determined at the time the license is issued. Exact mining allotment boundaries are established upon preparation of a development plan and its approval by state mining supervision authorities and an environmental examination committee and are certified in a mining allotment act issued to the license holder. Currently, the Federal Service for Environmental, Technological and Nuclear Surveillance has authority to approve development plans.

Title to the Land

Pursuant to the Subsoil Law, subsoil licenses are issued subject to the land resources management authorities' consent to the allotment of a land plot covering the surface of the license area. The boundaries of the land plot are determined upon approval of a development plan based upon an agreement between the owner of the land plot and the subsoil user. Should the subsoil user and the land plot owner fail to reach agreement on the final boundaries and other substantial terms (payments, time etc.) for the use of the land plot, the government may take over the land plot necessary for the subsoil extraction subject to paying equivalent compensation to the land owner or user.

A subsoil user is provided rights to the land pursuant to the land legislation of the Russian Federation and a subsoil user can either purchase or lease the land plot covering its mining allotment.

Operational Licenses

The production, storage, transportation, processing and sale of gas are subject to licensing requirements. Most operational licenses are issued by the Federal Service for Environmental, Technological and Nuclear Surveillance. The principal operational license for gas production is the license

to operate oil and gas extracting facilities. This license is issued for a maximum term of five years. In addition to other documents, to receive the license, the applicant must provide evidence that it meets the operational license requirements, which include, *inter alia*, availability of qualified personnel and equipment required for operations, as well as adequate environmental, health and safety measures. In addition, all equipment used at the oil and gas extracting facilities must be certified by the Federal Service for Environmental, Technological and Nuclear Surveillance for such use.

Certain other gas industry operations, in particular, operations that carry the risk of explosion or fire, oil and gas storage, and transportation of oil and gas products, also require a separate license.

Environmental Permits

Russian environmental legislation establishes a pay-to-pollute regime administered by the Federal Service for Environmental, Technological and Nuclear Surveillance, which issues pollution discharge permits. Separate fees are assessed for pollution under the maximum permitted discharge limits and for pollution in excess of such limits. There are additional fines for certain other violations of environmental regulations. The environmental protection legislation contains an obligation to make compensatory payments into the federal and/or local budgets for all environmental losses caused by pollution. In the event of a dispute concerning losses caused by violations of environmental laws and regulations, the prosecutor's office or other authorized governmental bodies may bring suit, though no private party has a right to file an action. Courts may impose clean-up obligations in lieu of, or in addition to, imposing fines.

Construction projects, including oil and gas production projects, require both an environmental impact assessment by an independent environmental expert and a prior favorable environmental opinion issued by competent public authorities. The purpose of such evaluation is to verify that the project ensures protection of the environment, a rational use and restoration of natural resources as well as an assessment of short-term and long-term environmental, economic and demographic impact of the subsoil use. The documents developed in the course of the environmental impact assessment are presented to the state body responsible for the issuance of environmental opinions.

Subsoil licenses are granted on the condition that the license holder undertakes to comply with Russian environmental standards and norms (air, water and soil pollution limits, waste management requirements, animal protection, human health, etc.). Prior to the issuance of a subsoil license, the Federal Agency for Subsoil Use agrees the environmental requirements with the Federal Service for Environmental, Technological and Nuclear Surveillance. Once a subsoil license is issued, the license holder's compliance with licensing requirements is supervised by the Federal Agency for Subsoil Use, while general state ecological supervision is conducted by the Federal Service for Environmental, Technological and Nuclear Surveillance.

Processing

Gas can be processed either by the producer at its own processing facilities or by third parties upon an agreement with the producer. Gas processing requires a license issued by the Federal Service for Environmental, Technological and Nuclear Surveillance.

Sale and Transportation

Gas

Pursuant to the Gas Supply Law, gas suppliers and their agents may not unreasonably refuse to enter into gas supply agreements with end customers provided that such gas suppliers have gas available and there are ways to transport that gas to the end customer. If these criteria are met but a gas supplier refuses to enter into a gas supply contract, a purchaser is entitled to initiate an action against the gas supplier before a competent court in order to force the gas supplier to enter into such a contract. Priority to enter into gas supply agreements is given to off-takers who purchase natural gas for government needs, utilities, and off-takers wishing to extend their existing gas supply agreements. The state regulates the price of gas sold by Gazprom and the tariff charged to independent gas producers to transport their gas through the UGSS owned and operated by Gazprom.

In accordance with the Rules of Gas Supply in the Russian Federation, approved by government Resolution No. 162, dated 5 February 1998, in order to enter into a gas supply agreement, a purchaser must send an application to a supplier. Upon receipt of the application, the supplier makes an offer to the purchaser, which, as a general rule, the purchaser can consider within 30 days. A gas supply agreement

must comply with the requirements of paragraph 3 of Chapter 30 of the Civil Code of the Russian Federation and must set forth, *inter alia*, the daily average gas supply volume or a dispatching schedule. If, without the prior consent of the supplier, a customer takes more gas from the system than the agreement allows, the prices and transportation tariffs are multiplied by a ratio of 1.1 to 1.5 (depending on the season) for the additional gas.

Access to the UGSS and Regional Gas Supply Systems

In accordance with the Law On Natural Monopolies and government Resolution No. 858, 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 is subject to the availability of capacity on the UGSS, the compliance of the gas being transported with established quality and technical parameters, and the availability of connecting and branch pipelines to consumers. According to the Law On Natural Monopolies, in determining whether to provide access to independent producers, Gazprom is required to take into account the protection of the rights and legitimate interests of citizens, the security of the State, and the protection of environmental and cultural heritage. The Decree of the President of the Russian Federation “On Transformation of the State Gas Concern Gazprom into the Russian Joint Stock Company Gazprom” No. 1333, dated 5 November 1992, as amended, makes Gazprom responsible for providing transportation access to gas producers in proportion to the volume of gas produced by them on the territory of Russia.

Similar access rights to regional gas supply systems are established pursuant to Resolution of the government No. 1370, dated 24 November 1998. According to this Resolution, any legal entity on the territory of the Russian Federation has the right to access the regional gas supply systems to facilitate delivery.

Prices and Tariffs

Natural gas prices and transportation tariffs in Russia are regulated pursuant to the Law on Natural Monopolies and the Gas Supply Law, as well as pursuant to a number of government resolutions. Government Resolution No. 1021 “On State Regulation of Gas Prices and Tariffs for Gas Transportation on 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. Wholesale price regulation applies to gas produced by Gazprom and its subsidiaries, Yakutgazprom, Norilskgazprom, Kamchatgazprom and Rosneft-Sakhalinmorneftegas, but does not apply to gas produced by entities not affiliated with Gazprom.

The wholesale price of natural gas produced by independent gas suppliers is not regulated. However, certain consumers, such as residential consumers, are entitled to fixed retail gas prices.

If a consumer fails to pay in a timely manner for gas, a supplier has the right to limit or suspend natural gas deliveries to the consumer in accordance with procedures established by the government. The government also establishes a list of end customers whose natural gas deliveries may not be suspended or terminated, such as military units, penitentiaries and fire fighting units.

FTS regulates the price of gas sold by Gazprom and the tariff charged to independent gas producers to transport their gas through the UGSS. The principles of pricing are, *inter alia*, the recovery of economically reasonable expenses by suppliers and transportation companies, maintenance of reasonable operating margins, and satisfaction of demand for gas.

As of 1 October 2004, the tariff for transporting gas produced by independent producers on the territory of the Russian Federation through the UGSS was determined by the FTS in the amount of RR 19.37 per mcm per 100 km, excluding VAT (Decree of the FTS of 16 September 2004). This tariff applies to the entire UGSS.

Taxation

Mineral Resources Extraction Tax

Federal Law No. 126-FZ of August 8, 2001, which became effective on January 1, 2002, amended the previously existing regime of mineral resource restoration payments, royalties and excise tax on the production of oil, gas and gas condensate and replaced all such taxes with a mineral resources extraction tax.

Effective January 1, 2005 natural resources production tax for natural gas is charged at a fixed rate of RR 135/mcm, the tax rate for gas condensate is 17.5% of the value of produced gas condensate.

From January 1, 2002 until December 31, 2006, mineral resources extraction tax with respect to crude oil shall be calculated as the amount of oil produced multiplied by a basic tax rate set in RR per tonne subject to an adjustment based on a special coefficient (C) reflecting the dynamics of world oil prices and the rouble/US. dollar exchange rate. For the period from 1 January 2002 to 31 December 2003 the basic tax rate was RR 340 per tonne. Starting from 1 January 2005 the basic tax rate is RR 419 per tonne. From 1 January 2002 to 31 December 2006 the above coefficient C is applied on a monthly basis and starting from January 1, 2005 is calculated as follows:

$$C = (P-9)*R/261, \text{ where:}$$

P is the average for the tax period price for Urals grade oil per barrel; and

R is the average the rouble/US dollar exchange rate as determined by the Central Bank of Russia over the relevant tax period (a month).

Starting 1 January 2007, mineral resources extraction tax should be determined as the value of extracted oil, which may be calculated by reference to actual sales prices of oil or the deemed value of oil multiplied by the rate of 16.5%.

Oil and Gas Related Export Duties

In early 1999, the government re-introduced export customs duties on crude oil and oil products. Following increases in world oil prices, the export customs duties have been steadily increasing. In September 2001 the Law On Customs Tariff was amended to establish the procedure for determination of the maximum rates of export customs duties for crude oil. Under this procedure export customs duties for crude oil are reviewed by the Russian government every two months based on the average price of "Urals" blend. The average "Urals" crude oil blend price is calculated as the price for Urals blend on world markets (Mediterranean and Rotterdam) for the two months immediately preceding the current two-month period.

The maximum rates of customs duties that may be established by the Russian government in accordance with the Law On Customs Tariff were significantly increased as follows:

Average Price for "Urals" Crude Oil Blend	Export customs duties
Up to \$109.50 per tonne (\$15.00 per barrel)	0%
\$109.50 to \$146.00 per tonne (\$15.00 to \$20 per barrel)	35% of the difference between the average price (per tonne) and \$109.50
\$146.00 to \$182.50 per tonne (\$20 to \$25.00 per barrel)	\$12.78 plus 45% of the difference between the average price (per tonne) and \$146.00
Greater than \$182.50 per tonne (\$25.00 per barrel)	\$29.20 plus 65% of the difference between the average price (per tonne) and \$182.50

The actual rate of export duties is \$136.2 per tonne.

Payments for the Use of Subsoil

A holder of a subsoil license must make payments for subsoil use stipulated by the Subsoil Law. The payments depend on the size of the license area provided to the exclusive subsoil user. The current annual minimum and the maximum rates of regular payments are set as follows:

- (i) one-time payments in cases specified in the license;
- (ii) regular payments for subsoil use, including the following:
 - payment for the right to prospect and evaluate mineral resources fields (the rate ranges from 120 roubles/sq. km (50 roubles/sq. km for offshore areas) to 360 roubles/sq. km (150 roubles/sq. km for offshore areas));
 - payment for the right to explore mineral resources fields (the rate ranges from 5,000 roubles/sq. km (4,000 roubles/sq. km for offshore areas) to 20,000 roubles/sq. km (16,000 roubles/sq. km for offshore areas));

- payment for the use of subsoil assets in the process of construction and operation of underground structures intended for storage of mineral resources (the rate ranges from 0.2 roubles/tonne to 5 roubles/tonne)
- (iii) payments for geological subsoil information,
- (iv) fees for the right to participate in auctions/tenders and
- (v) fees for the issuance of licenses.

The rate at which rentals are to be levied may be established by the executive bodies of the administrative subdivisions of the Russian Federation within a range of minimum and maximum rates established by the Russian government. In the event that such executive bodies do not establish such a rate, the maximum rate established by the Russian government will be applicable.

Excise Tax on Oil Products

Effective January 1, 2003, excise tax is charged on the following transactions involving gasoline, diesel fuel and motor oils:

- (i) purchase and receipt of oil products, including receipt of oil products manufactured by a taxpayer from its own raw materials, except for certain cases;
- (ii) import of oil products;
- (iii) transfer of oil products by the producer to the owner of oil products made under tolling arrangements, except for certain cases.

Starting January 1, 2005, the following excise tax rates for oil products apply:

<u>Oil Product</u>	<u>Rate per tonne</u>
Gasoline under 80 octane	2,657 roubles
Gasoline over 80 octane	3,629 roubles
Diesel fuel	1,080 roubles
Motor oil	2,951 roubles

Gas Flaring Operations

We are currently flaring a portion of the gas produced in our fields, for which we are subject to insignificant state imposed charges for excess gas flared. These charges are levied in accordance with regulations of the Ministry of Natural Resources and of the Russian government. Limitations on gas flaring may be established in our licenses.

Legal Trends that Impact the Russian Gas Industry

The primary recent legal trend that impacts the energy industry in Russia is restriction of the powers of regional authorities, both in general, through changes to constitutional legislation, and in connection with subsoil use, through changes to subsoil legislation.

Changes in Constitutional Legislation

Pursuant to Federal Law of 11 December 2004 No. 159-FZ the leaders of each member state of the Russian Federation, instead of being elected, are now appointed by legislative bodies of the respective member state upon proposal by the President of the Russian Federation.

Changes in Subsoil Legislation

The changes to legislation restricting the powers of regional authorities in connection with subsoil use were introduced by Federal Law of 22 August 2004 No. 122-FZ, which amended, in particular, the Subsoil Law. These amendments became fully effective as of 1 January 2005 and are aimed at limitation of corruption related to the issuance of subsoil licenses and at the simplification of the subsoil licensing procedures.

Background. The Constitution of the Russian Federation provides that subsoil resources are within the joint jurisdiction of the Russian Federation and the Regions. The so-called “two-key principle” for

subsoil management was based on this constitutional provision and constituted a system by which subsoil licenses were issued by the federal Ministry of Natural Resources, or its regional body, together with the executive body of the relevant Region (Article 10.1 of the old version of the Subsoil Law (Old Law)). The amendments to the Subsoil Law effectively abolished the two-key principle.

Licensing. Whereas under the Old Law, subsoil licenses required the approval of both the Ministry of Natural Resources and the executive body of the applicable Region, under the amended law (Amended Law), regional government approval is no longer required (except in the limited circumstances described below). According to Article 10.1 of the Amended Law, subsoil use rights are granted based on resolutions of the federal government, the Ministry of Natural Resources or its regional body, and tender/auction commissions. The Regions' role in the constitutionally declared joint jurisdiction is now limited to merely being represented in tender/auction commissions. However, regional governments retain the right to issue licenses to common resources fields or fields of local importance, primarily sand and gravel fields.

Whereas under the Old Law, federal and regional authorities shared in the decision whether to hold a tender or auction, under the Amended Law, only the federal government (in the case of offshore resources) and the Ministry of Natural Resources (in the case of onshore resources) have such authority. The amendments also provide that information on tenders and auctions must be published in a nation-wide media publication as well as a regional media publication selected by the Ministry of Natural Resources or its regional body at least 45 days prior to the auction or 90 days prior to the tender. This changes the Old Law, which required notification as much as three to six months in advance and allowed notification requirements to be satisfied through the use of obscure or limited-circulation publications selected by the local government.

Extension of Subsoil Use Right. Whereas pursuant to the Old Law the right to use the subsoil could be extended upon the license holder's request if it was necessary to finalize exploration, appraisal, production or remediation activities provided that the license holder did not violate the terms of the license, the Amended Law provides that the term of subsoil use will be extended in such circumstances. This new provision gives a subsoil user better guarantees of extension of the subsoil use term.

Obtaining Subsoil Use Right in the Event of Discovery of a Deposit. The Amended Law and the subsequent regulations adopted in 2005 assures the right of the holder of a geological exploration license in the event of discovery of a deposit, as a result of the conduct of exploration by the license holder at its own expense or with the use of loaned funds, to apply to the Federal Agency for Subsoil Use for a production license to develop the discovered deposit. The decision on granting the license shall be taken in a relatively straightforward procedure.

Fees and Payments. Another change implemented by the amendments regards licensing fees and payments. From 1 January 2005, fees for issuing licenses and for participation in tenders and auctions will constitute solely federal revenue (except with respect to common resources and fields of local importance, which will constitute regional revenue). In addition, the Ministry of Natural Resources will now be solely responsible for setting the rate of regular payments for exploration, evaluation and geological surveys within the ranges set in the law, whereas prior to the amendments, regional government set such rates after recommendations by the regional body of the Ministry, although within the same ranges.

Proposed Changes in Legislation

The draft law "On Subsoil" has been prepared by the Ministry of Natural Resources and has been submitted to the State Duma for adoption. The draft contains a number of provisions that may result in significant changes in current regulatory regime for the natural gas industry, including, among other things, the following:

- subsoil use rights will be granted only through contracts and not through licenses, however, licenses that have already been issued will continue to be valid and will not have to be replaced by contracts;
- subsoil use rights will be granted only through auctions to avoid corruption potentially associated with tenders; if the auction does not take place due to availability of only one participant, the contract can be entered into with such participant; and
- Russian legal entities directly or indirectly controlled by, controlling, or under common control with, foreign citizens and/or entities may not be admitted to participate in auctions for subsoil use rights. See "Risk Factors—Risks Relating to Our Business—Proposed changes in law could

adversely affect our ability to participate in certain future auctions for exploration and production licenses and could subject us to the statutory requirement to sell our natural gas to the government”; and

- producers of strategic natural resources may be required to sell all or a portion of their production to the government.

The draft law “On Trunk Pipeline Transport” is scheduled for the second reading by the State Duma of the Russian Federation during its 2005 spring session. It appears that the law (if passed) will provide for the access to the gas trunk pipeline system based on the non-discriminatory principle and in proportion to the volumes of gas produced.

MANAGEMENT

Board of Directors

The members of our Board of Directors and their respective ages and positions are as follows:

Name	Age	Position
Alexander Y. Natalenko ⁽¹⁾	58	Chairman
Leonid V. Mikhelson ⁽²⁾	49	Director, Chairman of the Management Committee
Mark A. Gyetvay ⁽²⁾⁽⁵⁾	47	Director, Chief Financial Officer
Anatoly M. Brekhuntsov ⁽¹⁾⁽⁴⁾⁽⁵⁾	63	Director
Victor I. Giryay ⁽⁴⁾⁽⁵⁾	46	Director
Vladimir A. Dmitriev ⁽¹⁾⁽³⁾	51	Director
Iosif L. Levinzon ⁽⁴⁾	49	Director
Ruben K. Vardanian ⁽³⁾⁽⁵⁾	37	Director

(1) Also a member of the Audit Committee of the Board of Directors.

(2) Also a member of the Management Committee.

(3) An Independent Director as defined by the Federal Service for Financial Markets.

(4) Also a member of the Strategy and Investments Committee of the Board of Directors.

(5) Also a member of the Corporate Governance Committee of the Board of Directors.

All of our directors were elected on 10 June 2005, and their terms expire on the date of our next annual shareholders' meeting, which will take place in June 2006 or earlier. The business address of each of our directors is 8/2 Olsufyevsky Pereulok, Moscow 119021, Russian Federation.

Alexander Y. Natalenko has served as Chairman of our Board of Directors since May 2004. He served as the First Deputy Chairman of the Management Committee during 2003 and as First Deputy General Director of OAO Pur-Land, our former subsidiary that merged into Tarkosaleneftegaz in June 2005, since 2001. Mr. Natalenko has served as a member of the Supervisory Board of ZAO Joint Stock Investment Commercial Bank Novaya Moskva since October 2003. From 1996 to 2001, Mr. Natalenko served as Deputy Minister of Natural Resources of the Russian Federation. He also served as a member of the boards of directors of OAO Purneftegazgeologiya from 2002 to 2004, Nakhodkaneftegaz in 2002, and Selkupneftegas from 2003 to 2004 and as the Deputy Chairman of the Management Board of OOO NGK Itera in 2002. From 2002 to 2003, Mr. Natalenko served as the First Deputy Chairman of the Management Committee of NFI, our predecessor company. Mr. Natalenko graduated from Irkutsk State University in 1969 with a degree in geology. He is a recipient of the State Prize and the Honored Geologist of Russia award.

Leonid V. Mikhelson has served as our chief executive officer since our founding in August 1994, as further described in "Business—History." In particular, he has served as the Chairman of our Management Committee since 2003. Mr. Mikhelson served as our General Director from 1994 to 1998. From 1996 to 2005, he also served as the Chairman of the Board of Directors of Tarkosaleneftegaz, which is one of our key subsidiaries. From May 2002 to August 2002, he served as the General Director and Chairman of the Management Board of OOO NGK Itera. Mr. Mikhelson served as General Director of OAO Pur-Land from 2001 to 2002 and as General Director of OAO Nordpipes, our former affiliated company, from 1998 to 2001. Since 1998, he has also served as a member of the Board of Directors of OAO Mangazeya. Mr. Mikhelson served as the Chairman of the Boards of Directors of NOVA Bank from 2000 to 2001 and OAO Truboizolyatsia from 1998 to 2003. From 1999 to 2001, he served as a member of the Supervisory Board of ZAO Novokuybyshevsk TV. From 1987 to 1994, he was the head of the state owned construction firm ("Trest") Kuybyshevtruboprovodstroy (currently OAO SNP NOVA). Mr. Mikhelson graduated from the Samara Institute of Civil Engineering in 1977 with a degree in industrial and civil engineering. He was awarded the Order of Honor from the Russian Federation.

Mark A. Gyetvay has served as a member of our Board of Directors and as our Chief Financial Officer since June 2003. Since February 2005, Mr. Gyetvay has served as a Deputy Chairman of our Management Committee. He is also currently a member of the Board of Directors of Tarkosaleneftegaz and a Director of SWGI Capital Management Limited and SWGI Growth Fund (Cyprus) Limited. From 1994 to 2003, he worked at Coopers & Lybrand, which merged into PricewaterhouseCoopers in 1998, where he was admitted as a partner in 1996. Prior to that, Mr. Gyetvay worked in various financial capacities at a number of independent oil and gas companies, including Amerada Hess Corporation (1988-1994), Ensource Inc. (1983-1986) and Champlin Petroleum (1981-1983). Mr. Gyetvay is a Certified Public Accountant, a

member of the American Institute of CPA, a former member of PricewaterhouseCoopers Petroleum Council and an Associate Member of the Society of Petroleum Engineers. Mr. Gyetvay graduated from Arizona State University in 1981 with a bachelor's degree in accounting and undertook graduate studies in strategic management at Pace University in 1995.

Anatoly M. Brekhuntsov has served as a member of our Board of Directors since March 2004. Since 2001, Mr. Brekhuntsov has served as a member of the Board of Directors of OAO Sibneftbank. Since 1997, Mr. Brekhuntsov has served as the General Director of OAO Sibirskiy Nauchno-Analyticheskiy Tsentr and a Director of OAO Sibirskaya Neftyanaya Korporatsia. From 1992 to 1997, he held various positions at OAO Sibirskaya Neftyanaya Korporatsia, including Senior Vice President, First Vice President and Executive Director. Since 1999, he has served as the Director of ZAO NPO Urengoygeoresurs and the Chairman of the Board of Directors of ZAO Poliarnaya Geofizicheskaya Ekspeditsia. Since 2001, Mr. Brekhuntsov has served as a Director of OAO Sibneftbank. Mr. Brekhuntsov graduated from the Tomsk Polytechnical Institute named after S.M. Kirov in 1963 with a degree in geology and exploration of oil and natural gas fields. He has received a number of government awards, including the Labor Red Flag Order, the Order for Peoples Friendship, the State Prize in Science and Technology and the Gubkin Prize. In addition, Mr. Brekhuntsov was awarded the title of Honored Oil Worker, Honored Gas Worker and Honored Geologist by the Russian Federation.

Victor I. Girya has served as a member of our Board of Directors since March 2003. Since 1994, Mr. Girya has served as the General Director of Tarkosalenftegas, our subsidiary, and currently serves as a deputy of the Yamal-Nenets parliament. From 2001 to 2003, he also served as a member of the Board of Directors of OAO Yamal-Avia. Mr. Girya graduated from the Tyumen Industrial Institute in 1981 with a degree in the operation of oil and natural gas fields, and later earned a degree in 1994 in the development of oil and gas fields from the same institute.

Vladimir A. Dmitriev has served as a member of our Board of Directors since May 2004 and currently serves as Chairman of Vnesheconombank. He has served as the Chairman of the Board of Directors of OAO Gostinitza Budapesht since 2001. Since 2004 Mr. Dmitriev has served as a Director of Russkiy Kommercheskiy Bank, Cyprus, and a member of the Supervisory Board of Donau Bank, Austria. From 2002 to 2004, Mr. Dmitriev served as Deputy Chairman of the Management Committee of Vneshtorgbank and from 1997 to 2002 as First Deputy Chairman of Vnesheconombank. From February 1995 to August 1997, he served as Deputy Head of the Foreign Credits and External Debt Department of the Ministry of Finance of the Russian Federation. Mr. Dmitriev graduated from the Moscow Financial Institute in 1975 with a Ph.D. in economics.

Iosif L. Levinzon has served as a member of our Board of Directors since March 2003. From 2000 to 2005, he served as the Vice-Governor of Yamal-Nenets. Mr. Levinzon has also served as a member of the Boards of Directors of OAO NK Rosneft-Purneftegas since 1996, OAO Yamal Mining Company since 1999, OAO Sibirskiy Nauchno-Analyticheskiy Tsentr since 1999, OAO Yamal Aviation and Transport Company since 2003 and OAO Yamal Railroad Company since 2004. Since 2001, he also served as a member of the Management Board of the Yamal Fund. From 1996 to 2000, Mr. Levinzon held the position of Deputy Governor, and then First Deputy Governor of Yamal-Nenets. From 1987 to 1995, he served as the General Director of Purneftegasgeologiya. Mr. Levinzon graduated from the Tyumen Industrial Institute in 1978 with a degree in geology and has a Ph.D. in geological and mineralogical sciences. He has received a number of government awards, including the Order of Honor, the Order for Peoples Friendship and the title of Honored Geologist of the Russian Federation.

Ruben K. Vardanian has served as a member of our Board of Directors since June 2005. Mr. Vardanian has served as Chairman of the Boards of Directors of Troika Dialog Group since 2005 and OAO Rosgorstrakh since 2004. He has also served as Adviser on Strategic Matters for ZAO Troika Dialog Investment Company since 2004 and as a member of the Boards of Directors of OOO Amtel since 2004 and the National Association of Stock Market Participants (NAUFOR) since 1997. Mr. Vardanian served as General Director of OAO Rosgosstrakh from 2002 to 2004 and as Chairman of the Board of Directors of OOO Gorodskoy Hypotekniy Bank from 2003 to 2004. From 2000 to 2002, he served as President of ZAO Troika Dialog Investment Company, and as a member of the Board of Directors of AKB Bank of Moscow from 1998 to 2002. Mr. Vardanian is a member of the Management Committee of the Russian Union of Industrialists and Entrepreneurs. In addition, he serves as Chairman of the Corporate Governance Committee, Arbitrator of the United Committee on Corporate Ethics and a member of the National Council for Corporate Governance of the Russian Union of Industrialists and Entrepreneurs. He is a member of the Supervisory Board of the Higher School of Corporate Governance at the Russian

Government Academy of National Economics. Mr. Vardanian graduated from the Moscow State University in 1992 with a degree in economics.

Management Committee

The members of our Management Committee and their respective ages and positions are as follows:

Name	Age	Position
Leonid V. Mikhelson ⁽¹⁾	49	Chairman of the Management Committee
Mikhail V. Popov	36	First Deputy Chairman of the Management Committee
Mark A. Gyetvay ⁽¹⁾	47	Deputy Chairman of the Management Committee, Chief Financial Officer
Vladimir A. Smirnov	38	Deputy Chairman of the Management Committee
Nikolai N. Titarenko	46	Deputy Chairman of the Management Committee
Alexander M. Fridman	54	Deputy Chairman of the Management Committee
Tatyana S. Kuznetsova	44	Deputy Chairman of the Management Committee, Director of Legal Department
Anatoly D. Antipin	57	Advisor to the Chairman of the Management Committee
Vladimir A. Baskov	44	Director of Project Monitoring Department
Kirill N. Yanovskiy	38	Director of Financial Department
Sergei V. Protosenya	39	Chief Accountant

(1) Also a member of the Board of Directors.

The business address of each of the members of our Management Committee is 8, 2nd Brestskaya Street, Moscow 125047, Russian Federation.

Leonid V. Mikhelson has served as the Chairman of our Management Committee since 2003. For additional information, see “—Board of Directors” above.

Mikhail V. Popov has served as a member of the Management Committee since March 2003 and is currently First Deputy Chairman of the Management Committee. From October 2002 to April 2003, he served as our Deputy General Director. From 2001 to 2002, he served as Director of the Engineering Capital Investment Department at OAO Pur-Land and from July 2002 to October 2002 as Director of Field Development at OOO NGK Itera. From 1996 to 2001, Mr. Popov was Deputy Chairman of the Executive Board and subsequently a member of the Board of Directors of AOOT Bankomsvyaz (Kiev). Mr. Popov graduated from the Kiev National Economic University in 2000 with a degree in management. He also studied in the Moscow Institute of Petrochemical and Gas Industry named after I.M. Gubkin from 1985 to 1992.

Mark A. Gyetvay has served as our Chief Financial Officer since June 2003. He has served as a Deputy Chairman of the Management Committee since February 2005. For additional information, see “—Board of Directors” above.

Vladimir A. Smirnov has served as Deputy Chairman of the Management Committee since January 2005. Since 1999 he has served as a director of ZAO Truboplast. Mr. Smirnov has served as the Chairman of the Board of Directors of OAO Yamaltelecom since 2004, a Director of OAO Novatek-Polimer (formerly Truboizolyatsia) and a Director of OAO Pursvyaz since 2004, and the Chairman of the Board of Directors of ZAO NOVA Bank since 2001. From 2002 to 2005, Mr. Smirnov served as General Director of NFI, our former subsidiary. From 2000 to 2002, he served as our General Director and as our Deputy General Director from 1995 to 2000. He also served as a member of the Boards of Directors of OAO Purneftegasgeologiya, OAO Minlay and Fakel Insurance Company from 2002 to 2003, OAO Purneftegasgeologiya Drilling Company from 2002 to 2004 and OOO NGK Itera in 2002. Mr. Smirnov graduated from the Moscow Institute of Petrochemical and Gas Industry named after I.M. Gubkin in 1991 with a degree in engineering.

Nikolai N. Titarenko has served as Deputy Chairman of the Management Committee since March 2003 and also currently serves as our Commercial Director. He has served as a Director of OAO Kineshmalesprom since December 2001 and the Chairman of the Board of Directors of OAO Archnovagas since 2004. From 2002 to March 2003 he served as our Deputy General Director. He also served as a member of the Boards of Directors of Yamaltelecom from 2001 to 2003 and OAO Truboizolyatsiya from 2003 to 2004. From 2001 to 2002, Mr. Titarenko served as Deputy General Director of OAO Pur-Land and, from 1999 to 2001, as Deputy General Director of ZAO TEK ITERA-Rus. From 1996 to 1999, he

worked as General Director of OOO Rigein. From 1990 to 1994, Mr. Titarenko served as the First Deputy of the Head of Krasnoselkup Region Administration. Mr. Titarenko graduated from the Azerbaijan Institute of Oil and Gas named after M. Azizbekov in 1981 with a degree in oil and gas wells drilling.

Alexander M. Fridman has served as First Deputy Chairman of the Management Committee from March 2003 to January 2005, and currently serves as Deputy Chairman of the Management Committee. He served as our Deputy General Director from January 2003 to July 2004. Mr. Fridman served as a member of the Boards of Directors of Purneftegasegeologiya and OOO Nova Energy Services from 2003 to 2004. From 1992 to 2002, he served as the Technical Director and later as the First Deputy General Director of DKG-EAST, a Hungarian company engaged in the manufacture of oil and gas industrial equipment. Mr. Fridman graduated from the Moscow Institute of Petrochemical and Gas Industry named after I.M. Gubkin in 1973 with a degree in the development and operation of oil and natural gas fields.

Tatyana S. Kuznetsova has served as a member of the Management Committee since March 2003 and Deputy Chairman of the Management Committee since May 2004. Ms. Kuznetsova also currently serves as a Director of OAO Selkupneftegas. She has served as Director of our Legal Department since 2002. From 2003 to 2004, Ms. Kuznetsova served as the Chairman of the Board of Directors of OAO Minlay. She also served on the Boards of Directors of Nakhodkaneftegas and OAO Pursvyaz from 2002 to 2003 and OAO NK Mangazeya and OAO Nordpipes from 2002 to 2003. From 2001 to 2002, she served as the Director of the Department for Legal and Corporate Matters of OAO Pur-Land. From 1998 to 2001, Ms. Kuznetsova worked as Deputy General Director of OAO Nordpipes. Ms. Kuznetsova graduated from the Far-Eastern State University in 1983 with a law degree.

Anatoly D. Antipin has served as a member of the Management Committee since March 2003 and currently serves as the Advisor of the Chairman of the Management Committee. From 2001 to 2003, Mr. Antipin held various positions at OAO Pur-Land, OOO NGK Itera and NOVATEK. From 2000 to 2001, he served as Deputy Representative of the President of the Russian Federation to the Ural Federal District. From 1991 to 2000, Mr. Antipin served as the Head of the Regional Division of the Federal Security Service in the Tyumen Region. Mr. Antipin graduated from the Tyumen Industrial Institute in 1970 with a degree in industrial and civil engineering.

Vladimir A. Baskov has served as a member of the Management Committee and as the Director of our Project Monitoring Department since 2003. Prior to 2003, Mr. Baskov held various positions in the Ministry of Interiors of the Russian Federation and its Moscow Region division. Mr. Baskov graduated from the Moscow High Militia School in 1986 and from the Academy of Management of the Ministry of Internal Affairs in 2000. He has been awarded the Order for Personal Courage and the Order of Honor by the Russian government.

Kirill N. Yanovskiy has served as a member of the Management Committee since May 2004 and as Director of our Financial Department since 2002. Since 2003, he has served as a member of the Board of Director of ZAO NOVA Bank, our former subsidiary. From 2001 to 2002, Mr. Yanovskiy served as the head of the Financial Department of OAO Pur-Land. From 1996 to 2001, he served as Deputy General Director of OOO IK Mega. Mr. Yanovskiy graduated from the Moscow Institute of Petrochemical and Gas Industry named after I.M. Gubkin in 1991 with a degree in maritime oil and gas works.

Sergei V. Protosenya has served as a member of the Management Committee since February 2005. Since 2002, he has served as our Chief Accountant. Mr. Protosenya served as first deputy chief accountant of OOO NGK Itera in 2002. From 2001 to 2002, he served as head of the accounting department of OAO Pur-Land. From 1997 to 2001, he served as Chief Financial Officer of Tarkosaleneftegas. Mr. Protosenya served as deputy director of OAO SNP NOVA from 1995 to 1997. Mr. Protosenya graduated from the Moscow Institute of Engineering and Construction named after Kuibyshev in 1991 with a degree in engineering and economics.

Remuneration of Directors

The aggregate amount of remuneration paid by us to our directors as a group for services in all capacities provided to us during the year ended 31 December 2004 was RR 49.5 million in salary and in bonuses. Employment contracts with our directors do not provide for special benefits upon termination of employment.

Loans to Directors and Officers

We have not provided any loans to our directors and members of the Management Committee.

Interests of Directors and Officers

Certain of our directors and members of our Management Committee have direct and/or beneficial interests in our shares. See “Principal Shareholders and Selling Shareholder.” None of these persons has any options over our shares.

Certain of our directors and members of our Management Committee have direct and beneficial interests in companies with which we have engaged in transactions, including those in the ordinary course of business. See “Transactions with Affiliates.” As a result, potential conflicts of interests between their duties to us and their private interests could arise. Under Russian legislation, certain transactions defined as “interested party transactions” require approval by our disinterested directors or shareholders. See “Description of Share Capital and Certain Requirements of Russian Legislation—Interested Party Transactions.”

Board Practices

Board of Directors

Our Board of Directors has eight members elected by a majority vote of shareholders at each annual General Meeting of Shareholders through cumulative voting. Directors may be re-elected an unlimited number of times. Two of our directors are independent as defined by the Federal Service for Financial Markets. The Board of Directors is responsible for our overall management, except matters reserved for our shareholders or the Management Committee. See “Description of Share Capital and Certain Requirements of Russian Legislation—General Meetings of Shareholders” for more information regarding the competence of our General Meeting of Shareholders.

Strategy and Investments Committee of the Board of Directors

Our strategy and investments committee consists of Anatoly Brekhuntsov (the chairman), Victor Giryа and Iosif Levinzon. The purpose of this committee is to (i) analyze our concepts, programs and strategic development plans, (ii) identify high priority strategic and investment areas, (iii) evaluate the efficiency of potential investment projects and their impact on increasing our value and (iv) make recommendations to the Board of Directors with respect to our capitalization and borrowing of funds.

Audit Committee of the Board of Directors

Our audit committee consists of Vladimir Dmitriev (the chairman), Anatoly Brekhuntsov and Alexander Natalenko. The purpose of this committee is to (i) 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, (ii) oversight of our financial and economic activities, (iii) develop internal control procedures and (iv) evaluate internal control efficiency and prepare proposals for its improvement.

Corporate Governance Committee of the Board of Directors

Our corporate governance committee consists of Ruben Vardanian (the chairman), Mark Gyetvay and Victor Giryа. The purpose of this committee is to (i) develop and regularly review our corporate governance documents, (ii) develop and regularly review our documents regulating corporate conflicts, (iii) develop recommendations with respect to our dividend policy, (iv) develop procedures for and perform an annual evaluation of the work performed by our Board of Directors and (v) determine the annual compensation for our Board of Directors’ members. We comply with the corporate governance regime of the Russian Federation.

Management Committee

Our day-to-day activities are managed by the Management Committee, which is led by the Chairman of the Management Committee. Our Management Committee consists of eleven members. The Chairman of the Management Committee acts as the chief executive officer of NOVATEK. The Chairman is elected by the General Meeting of Shareholders for a term of five years. Other members of the Management Committee are elected for five years by the Board of Directors by submission of the Chairman of the Management Committee. Both the Chairman and the Management Committee report to the Board of Directors and the General Meeting of Shareholders. The Chairman heads the Management Committee, 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.

Review Commission

The review commission verifies the accuracy of our financial reporting under Russian law and generally supervises our financial activity. The members of our review 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 review commission. The review commission consists of four members: Vitaly Bulat; Galina Guryashina; Galina Kachalina; and Maria Konovalova.

Management Share Bonus and Option Plans

We are considering establishing additional share bonus plans and/or share option plans for officers and key employees.

IFRS No. 2, *Share Based Payments*, requires that compensation expense be recognized for payments to employees made by shareholders attributable to the employee's service to us. In the second quarter of 2005, certain of our shareholders provided share-based compensation to our chief financial officer and to our head of exploration and production activities. The share awards comprise shares in a limited liability company that indirectly holds our shares. Management's preliminary estimate of the maximum fair value of the awards is approximately RR 900 million, which relates only to services provided to NOVATEK. We will recognize RR 900 million as compensation expense evenly over a five year vesting period beginning in the second quarter of 2005. A corresponding increase will be recorded to additional paid in capital as expense is recorded to reflect the shareholders contribution in providing the award. The awards do not involve any issuance of shares by us.

Litigation Statement about Directors and Officers

At the date of this prospectus, except as described below, none of our directors or members of our Management Committee for at least the previous five years:

- has any convictions in relation to fraudulent offences; 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, 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.

OA O Kineshmalesprom, where Mr. Titarenko currently serves as a director and holds a 19.48% interest, is under external management, which is one of the bankruptcy procedures imposed by a court, since November 2004.

ZAO Burovaya Kompaniya Purneftegaseologiya, where Mr. Smirnov served as a director, is under bankruptcy procedures since March 2004.

Mr. Mikhelson and Ms. Kuznetsova served as members of the Board of Director of OA O Seneco, a company specializing in exploration works. In June 2004, following the company's voluntary filing for bankruptcy, the court established bankruptcy proceedings, and in June 2005, this company was formally liquidated.

TRANSACTIONS WITH AFFILIATES

The following is a summary of significant transactions with affiliates for the three months ended 31 March 2005 and 2004 and for the years ended 31 December 2004, 2003 and 2002 up to the date of this prospectus. For further details of these transactions, see Note 21 of the Consolidated Financial Statements. For more information on the related parties described in this section, see “Principal Shareholders and Selling Shareholder” and “Business—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*.

We engage in transactions with related parties. Our reported statements of income, balance sheets and cash flows would be different had such transactions been carried out amongst unrelated parties. We may enter into transactions with related parties which unrelated parties might not, and such transactions may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

In 2004, 2003 and 2002 we had significant activities with companies, related to our shareholders, particularly Levit and SWGI, in connection with purchases and sales of natural gas, crude oil and gas condensate, construction and other related services, and purchase, and sales of equity securities.

Purchases of Hydrocarbons (Natural Gas, Gas Condensate and Crude Oil)

Historically, we have purchased significant quantities of natural gas, gas condensate and crude oil for resale from related parties. In particular, we purchased significant quantities of natural gas, gas condensate and crude oil from Tarkosalenftegas in 2002, 2003 and 2004, and from Khancheynftegas in 2003 and 2004. Effective December 2004, our purchases of natural gas and crude oil and gas condensate from these entities ceased because these entities became fully consolidated subsidiaries. In addition:

- In 2004, we began purchasing crude oil directly from Geoilbent, a company we acquired a 66% interest in during March 2004. We disposed of our interest in Geoilbent in June 2005. As a result of that disposition, we will cease to purchase crude oil from Geoilbent.
- In 2002, we entered into various agreements to purchase natural gas and oil products from Pur-Land. After Pur-Land became a subsidiary of our significant shareholders in December 2004, purchases of natural gas and oil products from Pur-Land ceased.

The following table shows purchases of crude oil and gas condensate for the periods indicated:

Related party	Three months ended 31 March				Year ended 31 December					
	2005		2004		2004		2003		2002	
	mt	mm RR	mt	mm RR	mt	mm RR	mt	mm RR	mt	mm RR
Tarkosalenftegas	—	—	77	124	348	557	306	597	117	258
Khancheynftegas	—	—	107	171	520	832	336	674	—	—
Geoilbent	109	288	98	266	358	920	—	—	—	—

The following table shows purchase of natural gas from related parties for the periods indicated:

Related party	Three months ended 31 March				Year ended 31 December					
	2005		2004		2004		2003		2002	
	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR
Tarkosalenftegas	—	—	1,702	509	5,738	1,727	5,223	1,050	1,978	222
Khancheynftegas	—	—	425	177	2,297	958	588	245	—	—
Pur-Land	—	—	—	—	—	—	2,873	467	—	—

Sales of hydrocarbons (natural gas, gas condensate and crude oil)

Historically, we have entered into agreements for the sale of our hydrocarbons with related parties.

- Beginning in 2003, we sold crude oil and gas condensate to Kerden Trading Limited, which is indirectly wholly owned by SWGI (Cayman), SWGI’s parent company. In addition to short-term agreements with Kerden, in November 2003, we entered into two long-term agreements, each of which provides for the sale of up to 1 million tonnes of crude oil through 31 December 2008 and sets out formulae for the calculation of price. We also entered into agreements with Kerden to sell our LPG and gas condensate during 2005. Pursuant to a

decision of our Board of Directors on 10 June 2005, we decided to create a 100% subsidiary to export hydrocarbons going forward.

- We also sell crude oil and gas condensate to TNG, another company indirectly wholly owned by SWGI (Cayman), pursuant to various agreements that have been in place during the review period.
- Prior to 2004 we sold natural gas to NGK Itera and Pur-Land. NGK Itera was established in May 2002, for purposes of combining our experience in exploration and production of natural gas with the Itera Group's expertise in marketing natural gas, and to possibly combine our oil and gas interests under joint management. In February 2003, our shareholders decided not to pursue the business combination with the Itera Group. In 2002, we signed a number of gas sales agreements with NGK Itera.

The following table shows sales of crude oil and gas condensate to related parties for the periods indicated:

Related party	Three months ended 31 March				Year ended 31 December					
	2005		2004		2004		2003		2002	
	mt	mm RR	mt	mm RR	mt	mm RR	mt	mm RR	Mt	mm RR
Kerden Trading	34	187	144	684	389	1,772	33	190	—	—
TNG Energy	55	304	—	—	73	395	—	—	—	—
Pur-Land	—	—	—	—	—	—	—	—	195	415

The following table shows sales of natural gas to related parties for the periods indicated:

Related party	Three months ended 31 March				Year ended 31 December					
	2005		2004		2004		2003		2002	
	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR	mmcm	mm RR
NGK Itera	—	—	—	—	—	—	348	149	2,314	629

Provision of Construction and Drilling Services

SNP NOVA, NFI and Nova Energy Services, which companies were our consolidated subsidiaries, provided oil and gas construction and drilling services to us for the years ended 31 December 2004, 2003 and 2002.

Our oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation. Contracts were typically signed with customers that allowed for the determination of the agreed construction schedules, estimated costs, including a margin over the cost of materials and supplies, customer approval of deliverables and invoicing.

During 2003 and 2004, NFI acted as general contractor for the construction of the Khancheyskoye and Yurkharovskoye fields. As of the date of disposal, NFI also held interests in certain companies, including SNP NOVA, which was the primary provider of construction services to us. Such activities represented substantially all of the activities of our oil and gas construction services segment. We expect to continue existing contractual relationships, and may enter into additional contracts, with NFI and its subsidiaries in the future at market terms and conditions.

In June 2004, our Board of Directors approved the sale of substantially all of our oil and gas construction services business. In June 2004, we sold our 99% interest in the share capital of NFI to our shareholders: SWGI (40.9%); Levit (53.6%); and Kopitek (4.5%), for total cash consideration of RR 240 million, recognizing a loss of RR 296 million. The disposal was consistent with our long-term strategy to focus our activities on oil and gas exploration, production and processing and to divest non-core businesses.

Purchase and Sale of Securities and Participation Interests

Acquisition of Our Shares by SWGI

In October 2004, SWGI (Cayman) contributed approximately 24.6% of our shares as payment for the charter capital increase in SWGI. In December 2004, Levit acquired approximately 5.6% of our shares from SWGI. In February 2005, TNG sold its entire stake in us to SWGI.

Acquisition of Shares in Purneftegasgeologiya

Pursuant to agreements reached in August 2002 and May 2003 we purchased equity stakes in Purneftegasgeologiya totalling 39% from OOO IK Mega, a company owned by some of our shareholders, as part of consolidation of interests in our subsidiaries and associates.

Acquisition of Shares in Tarkosaleneftegas

In January 2003, Levit acquired approximately 3.7% of Tarkosaleneftegas shares from the Itera Group and in March 2003 Levit acquired approximately 9.1% of Tarkosaleneftegas shares from Purneftegasgeologiya. In May and June 2003, we entered into two share purchase agreements with Levit and as a result of these transactions we acquired approximately 13.7% of shares in Tarkosaleneftegas. During that period we additionally acquired approximately 0.5% of Tarkosaleneftegas shares from IK Mega and in August 2004 approximately 0.1% from Mr. Mikhelson. In December 2004 we acquired the remaining 67.7% in Tarkosaleneftegas through an additional share issue in December 2004 as described below.

Acquisition of Shares in Khancheyneftegas

Pursuant to an agreement reached in May 2003 we acquired 43% interest in Khancheyneftegas from Levit. We acquired the remaining 57% through our additional share issue in December 2004 as described below. In March 2005 we contributed our 100% interest in Khancheyneftegas into the charter capital of Tarkosaleneftegas.

Acquisition of Minlay

During 2002, IK Mega acquired an additional 19% equity stake in Minlay from third parties for which the consideration provided was interests in several other companies owned by the shareholders. The fair value of the consideration provided by the shareholders was RR 108 million.

In February 2003, White Bay Limited, a 100% subsidiary of SWGI (Cayman), sold its 100% participation interest in Yurkharovneftegas to our subsidiary, Minlay, as part of the reorganization and consolidation into us of the interests of shareholders in our subsidiaries and associates. In 2003, White Bay sold its 56% equity stake in Minlay to SWGI. In October 2003 we acquired the remaining 86% interest in Minlay through our additional share issue as described below, which was followed by the merger of Minlay into us in March 2004.

Acquisition of Shares in Novatek-Polimer and Selkupneftegas

In June 2003, we acquired additional equity stakes in Novatek-Polimer of 35% and in Selkupneftegas of 34% from Levit.

Sale of Interest in NGK Itera

In January 2003, we sold our 50% interest in NGK Itera, a joint venture we had formed with the Itera Group.

Sale of Non-core Subsidiaries

In 2004, we contributed 74.3% of the ordinary shares of SNP NOVA into the charter capital of NFI. In June 2004, we sold our 99% interest in NFI, which company owns SNP NOVA and Nova Energy Services, to SWGI (40.9%), Levit (53.6%), and Kopitek (4.5%) for total cash consideration of RR 240 million. As a result of this sale, we divested SNP NOVA, our most significant non-core asset engaged in oil and gas construction services. In May 2005, we contributed our 66.0% interest in Geoilbent into our wholly owned subsidiary OOO Oil Holding Company and subsequently sold it to LUKOIL. In May 2005, we sold our entire stake in NOVA Bank to Levit.

During 2002, Kanwal Trading Limited, a trading company owned by SWGI (Cayman), contributed equipment valued at RR 64 million to SNP NOVA, one of our subsidiaries at the time, in return for 606,168 shares, or 23.8%, of SNP NOVA.

Share Issuances to Related Parties

In December 2004, we issued 789,276 new ordinary shares to TNG and Levit in exchange for their contribution of assets acquired in December 2004. TNG contributed 50.1% of its equity stake in Tarkosalenftegas and 51% of its participation interest in Khancheynftegas in exchange for 607,151 NOVATEK ordinary shares. Levit contributed 17.6% of its equity stake in Tarkosalenftegas and 6% of its participation interest in Khancheynftegas in exchange for 182,125 new ordinary shares. As a result of this share issuance, we and our shareholders completed a series of transactions enabling us to consolidate 100% of our key operating subsidiaries, Tarkosalenftegas and Khancheynftegas.

In the third quarter of 2003, we issued 653,348 new ordinary shares: 483,104 to Levit, SWGI and IK Mega in exchange for the transfer of their 75% equity stake in Minlay; and 170,244 to the Yamal Fund in exchange for its 25.1%, 40%, and 11% equity stakes in Tambeynftegas, Yamalnftegasdobycha, and Minlay, respectively.

During 2002, we issued 1,000,000 new ordinary shares for RR 300 million in cash consideration consisting of ordinary share capital of RR 100 (par value) per share and RR 200 per share in additional share premium, of which 533,330 new ordinary shares were issued to Levit and 466,670 new ordinary shares were issued to SWGI.

Loans from Related Parties

We and our related parties have received a number of loans from the Yamal Fund, our former shareholder, Truboizolyatsia and SWGI for various corporate purposes during the period under review. These loans have been repaid in full and, as of the date of the prospectus, we had no outstanding loans from related parties.

Yamal Fund

- In April 2005, we received a Russian rouble denominated loan from the Yamal Fund in the aggregate principal amount of RR 500 million. The loan had an interest rate of 10.0% per annum and was scheduled to mature in March 2010. We repaid this loan in full in June 2005.
- In February 2005, we received a Russian rouble denominated loan from the Yamal Fund in the aggregate principal amount of RR 1,000 million. The loan had an interest rate of 10.0% per annum and was scheduled to mature in January 2010. The principal amount outstanding as at 31 March 2005 was RR 1,000 million. We repaid this loans in full in June 2005.
- In March 2004, we received a Russian rouble denominated loan from the Yamal Fund in the aggregate principal amount of RR 155 million. The loan had an interest rate of 10.0% per annum and was scheduled to mature in March 2007. The principal amount outstanding as at 31 March 2005 was RR 155 million and we repaid this loan in full in June 2005.
- From February 2002 to March 2003, Khancheynftegas received a series of US dollar denominated loans from the Yamal Fund in the aggregate principal amount of USD 15.3 million. The loans had an interest rate of 10.0% per annum. We repaid the loans in full in February 2005.
- In December 2001, Minlay received a US dollar denominated loan from the Yamal Fund, which was a shareholder of Minlay at the time, in the aggregate principal amount of USD 40 million. The principal amount outstanding at 31 December 2004 was USD 35 million. We repaid this loan in full in the first quarter of 2005.

SWGI

- At 31 December 2002, short-term and long-term loans payable to related parties included US dollar denominated loans from SWGI in the aggregate amount of USD 42 million (RR 1,336 million). The loans were unsecured and bore interest at a rate ranging from nil to 15% per annum. During 2003, these loans were repaid.
- In March 2003, we obtained a US dollar denominated loan from SWGI in the aggregate principal amount of USD 2.2 million. The loan had an interest rate of 10% per annum. We repaid the this loan in May 2003.

Loans to Related Parties

We and our related parties have extended a number of US dollar and Russian rouble denominated loans to related parties for various corporate purposes during the period under review. Each of these loans is or was unsecured. Prior to their acquisition, we regularly provided unsecured loans to Tarkosaleneftegas and Khancheyneftegas. Following the acquisition of 100% interest of these companies in December 2004, our outstanding loans to them were eliminated in consolidation.

Levit

- In December 2004, we provided a US dollar denominated loan to Levit in the aggregate principal amount of USD 290 million. The loan has an interest rate of 10% per annum and is scheduled to mature on 30 June 2006. The proceeds from this loan were used by Levit to purchase minority stakes in Tarkosaleneftegas and Khancheyneftegas from third parties as part of their December 2004 acquisition. The aggregate principal amount outstanding as at 31 March 2005 was USD 270 million.
- In December 2002 and April 2003, we provided a series of Russian rouble denominated loans to Levit in the aggregate principal amount of RR 366 million. The loans bore interest at a rate of 17.5% per annum. Levit repaid the loans in full in June 2003.

Loans to Divested Companies

- Upon its divestiture in June 2004, NFI had various Russian rouble denominated loans outstanding to us in the aggregate principal amount of RR 98 million. In October 2004, we provided an additional loan in the aggregate principal amount of RR 55 million, which bore interest at the rate of 12% per annum and was scheduled to mature in July 2005. The aggregate principal amount outstanding as at 31 March 2005 was RR 143 million. NFI repaid all the outstanding loans in full in June 2005.
- Upon its divestiture in June 2004, Nova Energy Services had various Russian rouble denominated loans outstanding to us in the aggregate principal amount of RR 95 million. The loans were initially interest-free through November 2004 and since then bear interest at a rate of 12% per annum. The loans mature in December 2008 and are outstanding as of the date of this prospectus.
- Upon its divestiture in June 2004, SNP NOVA had a US dollar denominated loan outstanding to us in the aggregate principal amount of USD 2.8 million. The loan had an interest rate of 10% per annum. The loan was repaid in full in February 2005.

Others

- In 2005, we extended a Russian rouble denominated loan to OOO Novasib in the aggregate principal amount of RR 75 million. The loan bears interest at a rate of 10% per annum and is scheduled to mature in March 2006. The loan is outstanding as of the date of this prospectus.
- In 2004, we extended a Russian rouble denominated loan to OOO Novasib in the aggregate principal amount of RR 23 million. The loan bears interest at a rate of 12% per annum and is scheduled to mature in April 2006. The loan is outstanding as of the date of this prospectus.
- In 2004, we extended a Russian rouble denominated loan to Yargeo in the aggregate principal amount of RR 36.2 million. The loan bears interest at a rate of 12% per annum and is scheduled to mature in April 2006. The loan is outstanding as of the date of this prospectus.
- In August 2004, we extended a Russian rouble denominated loan to Tambeyneftegas in the aggregate principal amount of RR 15.3 million. The loan bore interest at a rate of 12% per annum and was scheduled to mature in August 2005. Tambeyneftegas repaid this loan in October 2004.
- In 2003, we extended a US dollar denominated loan to Geoilbent in the aggregate principal amount of USD 5 million. The loan had an interest rate of 2% per annum. Geoilbent repaid the loan in full in 2004.

We had guaranteed bank debt and interest obligations of related parties totaling RR 999 million and RR 682 million at 31 December 2004 and 31 December 2003, respectively.

PRINCIPAL SHAREHOLDERS AND SELLING SHAREHOLDER

The following table sets forth information regarding the ownership of our shares as of the date of this prospectus and as adjusted to reflect the offering and the exercise of the over-allotment option in full:

Owner	Shares Owned Before the Offering		Shares Offered	Shares Owned After the Offering		Shares Offered Pursuant to the Over-Allotment Option	Shares Owned After the Offering Assuming Exercise of Over-Allotment Option	
	Number	Percent		Number	Percent		Number	Percent
ZAO Levit ⁽¹⁾	1,413,641	46.5579%	—	1,413,641	46.5579%	—	1,413,641	46.5579%
SWG I Growth Fund (Cyprus) Ltd ⁽¹⁾⁽²⁾	1,139,151	37.5177%	524,453	614,698	20.2449%	52,445	562,253	18.5177%
Vnesheconombank	170,243	5.6069%	—	170,243	5.6069%	—	170,243	5.6069%
OOO Kopitek ⁽¹⁾	113,454	3.7366%	—	113,454	3.7366%	—	113,454	3.7366%
International Finance Corporation	30,364	1.0000%	—	30,364	1.0000%	—	30,364	1.0000%
Leonid Mikhelson ⁽¹⁾⁽³⁾	13,676	0.4504%	—	13,676	0.4504%	—	13,676	0.4504%
Other	155,777	5.1305%	—	680,230	22.4032%	—	732,675	24.1305%
Total	3,036,306	100.00%	524,453	3,036,306	100.00%	52,445	3,036,306	100.00%

(1) Members of our Board of Directors, Management Committee and employees effectively control Levit, SWGI and Kopitek, which companies, together with Mr. Mikhelson's direct ownership, own 88.2626% of our shares as of the date of this prospectus. See beneficial ownership table below.

(2) Business address: Office 5, 67 Ayias Phylaxeos Str. Drakos House, Limassol, Cyprus.

(3) Chairman of our Management Committee and a member of our Board of Directors. See table below for information on Mr. Mikhelson's total direct and indirect interests in NOVATEK.

None of our shareholders has voting rights different from any other holders of our shares.

The following table sets forth beneficial ownership information as of the date of this prospectus regarding our major shareholders and members of our management as identified in "Management":

Beneficial Owner	Shares Beneficially Owned Before the Offering		Shares Beneficially Owned After the Offering		Shares Beneficially Owned After the Offering Assuming Exercise of Over-Allotment Option	
	Number	Percent	Number	Percent	Number	Percent
Leonid Mikhelson ⁽¹⁾⁽²⁾⁽³⁾⁽⁶⁾	1,078,775	35.53%	896,826	29.54%	878,632	28.94%
Leonid Simanovsky ⁽⁵⁾⁽⁶⁾	185,744	6.12%	185,744	6.12%	185,744	6.12%
Konstantin Sorokin ⁽⁶⁾⁽⁷⁾	121,801	4.01%	92,935	3.06%	90,049	2.97%
Mikhail Popov ⁽³⁾⁽⁶⁾⁽⁷⁾	107,821	3.55%	77,047	2.54%	73,969	2.44%
Vladimir Smirnov ⁽³⁾⁽⁶⁾⁽⁷⁾	102,891	3.39%	79,745	2.63%	77,430	2.55%
Kirill Yanovskiy ⁽³⁾⁽⁶⁾⁽⁷⁾	88,541	2.92%	63,598	2.09%	61,103	2.01%
Sergei Protosenya ⁽³⁾⁽⁶⁾⁽⁷⁾	87,283	2.87%	62,261	2.05%	59,759	1.97%
Nikolai Titarenko ⁽³⁾⁽⁶⁾⁽⁷⁾	85,700	2.82%	60,698	2.00%	58,197	1.92%
Tatyana Kuznetsova ⁽³⁾⁽⁶⁾⁽⁷⁾	83,444	2.75%	60,961	2.01%	58,712	1.93%
Mark Gyetvay ⁽²⁾⁽³⁾⁽⁶⁾⁽⁸⁾	45,440	1.50%	27,538	0.91%	25,748	0.85%
Alexander Fridman ⁽³⁾⁽⁶⁾⁽⁷⁾⁽⁹⁾	16,863	0.55%	12,681	0.42%	12,263	0.40%
Victor Girya ⁽²⁾⁽⁷⁾	6,073	0.20%	6,073	0.20%	6,073	0.20%
Alexander Natalenko ⁽²⁾⁽⁷⁾	4,554	0.15%	4,554	0.15%	4,554	0.15%
Anatoly Antipin ⁽³⁾⁽⁷⁾	1,518	0.05%	1,518	0.05%	1,518	0.05%
Vladimir Baskov ⁽³⁾⁽⁷⁾	1,518	0.05%	1,518	0.05%	1,518	0.05%
NOVATEK officers, directors and other employees as a group ⁽⁴⁾	1,913,769	63.03%	1,509,427	49.71%	1,468,993	48.38%

(1) Mr. Mikhelson, Chairman of our Management Committee and a member of our Board of Directors, is a beneficial owner of 0.4504% of our ordinary shares held directly, a further 22.0628% held indirectly through Levit and a further 13.0160% held indirectly through SWGI.

(2) Member of our Board of Directors.

(3) Member of our Management Committee.

- (4) Represents the aggregate number of shares in NOVATEK owned, directly and indirectly, by officers, directors and other employees of NOVATEK and its subsidiaries, as a group.
- (5) Mr. Simanovsky is a beneficial owner of 0.0002% of our shares directly and a further 6.12% indirectly through Levit. Mr. Simanovsky is a member of the State Duma, the lower chamber of the Russian Parliament, who, after his election to the State Duma in December 2003, transferred all of our shares that he directly holds to NOVA Bank, a Russian commercial bank, under a fiduciary management agreement in order to comply with certain ownership restrictions under Russian law. Under the agreement, NOVA Bank has the right to vote the shares but cannot pledge, sell or otherwise dispose of the shares without Mr. Simanovsky's consent. Voting rights in respect of our shares held indirectly by Mr. Simanovsky have been put under the same fiduciary management agreement with NOVA Bank. Mr. Simanovsky was formerly Chairman of our Board of Directors and a senior manager of Kuybyshevtruboprovodstroy (now NOVA).
- (6) Holds shares in NOVATEK indirectly through SWGI and/or Levit.
- (7) Holds shares in NOVATEK indirectly through Kopitek.
- (8) Mr. Gyetvay received his shares under agreements in the second quarter of 2005. The agreements require that Mr. Gyetvay serve as NOVATEK's Chief Financial Officer for five years and as a director at both SWGI (Cayman) and SWGI for five years. In our consolidated financial statements, 1.09% of our ordinary shares beneficially owned by Mr. Gyetvay are attributable to his service as a director for shareholder companies and 0.41% are attributable to his service as NOVATEK's Chief Financial Officer. We will recognize compensation expense of up to RR 459 million related to Mr. Gyetvay's services as Chief Financial Officer of NOVATEK in our consolidated income statements over the five year period beginning in the second quarter of 2005. We will not recognize any expense in our consolidated income statements for the shares he has received for services provided to shareholder companies.
- (9) Mr. Fridman received his shares under agreements in the second quarter of 2005. The agreements require that Mr. Fridman serve as Deputy Chairman of our Management Committee, responsible for exploration and production for five years.

Changes in Shareholders' Equity

The following table sets forth in Russian roubles, as of the date of this prospectus, the changes in our share capital that have occurred within the past three financial years.

Year	Consideration received	Number of shares issued	Nominal value per share	Amount of increase (in RR millions)	Total issued share capital at end of period (in RR millions)	Total number of issued shares at end of period
2002	Cash	1,000,000	100	107	249	1,593,682
2003	Securities	653,348	100	65	314	2,247,030
2004	Securities	789,276	100	79	393	3,036,306

DESCRIPTION OF SHARE CAPITAL AND CERTAIN REQUIREMENTS OF RUSSIAN LEGISLATION

We describe below our registered shares, the material provisions of our charter in effect on the date of this prospectus and certain requirements of Russian legislation.

Our Purpose

Our objects and purposes are set out in Section 2.2 of our charter. Our primary purpose as set out therein is to explore, develop, produce and market natural gas, gas condensate and oil and related products.

Description of Share Capital

General

Pursuant to the Joint Stock Companies Law, we have the right to issue registered ordinary shares, preferred shares and other securities provided for by the legislation of the Russian Federation with respect to securities. Our share capital consists of 3,036,306 ordinary shares, each with a nominal value of 100 roubles, which are fully paid, issued and outstanding. In addition, we are authorized by our charter to issue an additional 7,557,376 ordinary shares. Under Russian legislation, charter capital refers to the aggregate nominal value of the issued and outstanding shares. No preferred shares are authorized or outstanding. Preferred shares may only be issued if amendments have been made to our charter pursuant to a resolution of the general meeting of shareholders.

The Joint Stock Companies Law requires us to dispose of any of our shares that we acquire within one year of their acquisition or, failing that, reduce our charter capital. We refer to such shares as treasury shares for purposes hereof. Russian legislation does not allow for the voting of such treasury shares. Any of our shares that are owned by our subsidiaries are not considered treasury shares under Russian law (*i.e.*, they are considered outstanding shares), and our subsidiaries are able to vote such shares and dispose of such shares without any further corporate actions by our shareholders or board of directors. Currently neither we nor any of our subsidiaries have treasury shares and none of our subsidiaries hold shares of NOVATEK.

Currently, we have fewer than 1,000 shareholders, which determines the applicability of certain provisions of the Joint Stock Companies Law, as described below. We expect that immediately following this offering we will continue to have fewer than 1,000 shareholders, in particular due to the status of the Depositary as the holder of all of the shares underlying the GDRs.

Rights Attaching to Shares

Holders of our shares have the right to vote at all shareholders' meetings. As required by the Joint Stock Companies Law and our charter, all of our shares have the same nominal value and grant to their holders identical rights. Each fully paid share, except for treasury shares, gives its holder the right to:

- freely transfer the shares without the consent of other shareholders;
- receive dividends;
- participate in shareholders' meetings and vote on all matters within shareholders competence;
- transfer voting rights to its representative on the basis of a power of attorney;
- participate in the election and dismissal of members of the board of directors and the review commission;
- if holding, alone or with other holders, 2% or more of the voting stock, within 30 days after the end of our fiscal year, make proposals for the annual shareholders' meeting and nominate candidates to the board of directors, collective and sole executive bodies, the review commission and the counting commission;
- if holding, alone or with other holders, 10% or more of the voting stock, demand from the board of directors the calling of an extraordinary shareholders' meeting or an unscheduled audit by the review commission;

- demand, under the following circumstances, the repurchase by us of all or some of the shares owned by it, as long as such holder voted against or did not participate in the voting on the decision approving the following:
 - any reorganization;
 - the conclusion of a major transaction, as defined under Russian law; and
 - any amendment of our charter that restricts the holder's rights;
- upon liquidation, receive a proportionate amount of our property after our obligations are fulfilled;
- have access to certain company documents, receive copies for a reasonable fee and, if holding alone or with other holders, 25% or more of the voting stock, have free access to accounting documents and minutes of the management board meetings; and
- exercise other rights of a shareholder provided by our charter, Russian legislation and decisions of shareholders' meetings approved in accordance with its competence.

Pre-emptive Rights

The Joint Stock Companies Law provides existing shareholders with a pre-emptive right to purchase shares or convertible securities during an open subscription in an amount proportionate to their existing shareholdings. In addition, the Joint Stock Companies Law provides shareholders with a pre-emptive right to purchase shares or convertible securities during a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. The pre-emptive right does not apply to a closed subscription to existing shareholders, provided that such shareholders may each acquire a whole number of shares or convertible securities being placed in an amount proportionate to their existing holdings of such securities. We must provide shareholders with written notice of the proposed sale of shares at least 45 days prior to the offering, during which time shareholders may exercise their pre-emptive rights.

Dividends

The Joint Stock Companies Law and our charter set forth the procedure for determining the quarterly and annual dividends that we distribute to our shareholders. According to our charter, we may declare dividends based on our first quarter, six month, nine month or annual results. Dividends are recommended to a shareholders' meeting by a majority vote of the board of directors, and approved by the shareholders' meeting by a majority vote. A decision on quarterly, six month and nine month dividends must be taken within three months of the end of the respective quarter at a shareholders' meeting; and a decision on annual dividends must be taken at the annual general shareholders' meeting. The dividend approved at the shareholders' meeting may not be more than the amount recommended by the board of directors. Dividends are distributed to holders of our shares as of the record date for the shareholders' meeting approving the dividends. See "—General Meetings of Shareholders—Notice and Participation." Dividends are not paid on treasury shares.

The company charter may provide that unpaid or partially unpaid dividends on preferred shares of a certain type, the amount of which is determined in the charter, shall accumulate and be paid not later than the deadline set out in the charter (cumulative preferred shares). If no such deadline is stipulated in the company charter, preferred shares are not cumulative shares. The ordinary shares are not cumulative shares.

The Joint Stock Companies Law allows dividends to be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- the charter capital of the company has been paid in full;
- the value of the company's net assets on the date of adoption of decision to pay dividends is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred shares of the company;

- the company has repurchased all shares from shareholders having the right to demand repurchase; and
- the company is not, and would not become, insolvent as the result of the proposed dividend payment.

Distributions to Shareholders on Liquidation

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. The Joint Stock Companies Law and our charter allows us to be liquidated:

- by a three-quarters majority vote of a shareholders' meeting; or
- by a court order.

Following a decision to liquidate the company, the right to manage our affairs would pass to a liquidation commission which, in the case of voluntary liquidation, is appointed by a shareholders' meeting and, in an involuntary liquidation, is appointed by the court. Creditors may file claims within a period to be determined by the liquidation commission, but such period must not be less than two months from the date of publication of notice of liquidation by the liquidation commission.

The Civil Code gives creditors the following order of priority during liquidation:

- individuals owed compensation for injuries or deaths;
- employees;
- creditors in obligations secured by a pledge;
- federal and local governmental entities claiming taxes and similar payments to the budgets and non-budgetary funds; and
- other creditors in accordance with Russian legislation.

The remaining assets of a company are distributed among shareholders in the following order of priority:

- payments to repurchase shares from shareholders having the right to demand repurchase;
- payments of declared but unpaid dividends on preferred shares and the liquidation value of the preferred shares determined by the company's charter, if any; and
- payments to holders of ordinary and preferred shares.

Liability of Shareholders

The Civil Code and the Joint Stock Companies Law generally provide that shareholders in a Russian joint stock company are not liable for the obligations of a joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person or entity is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is called an "effective parent." The person or entity whose decisions are capable of being so determined is called an "effective subsidiary." The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such persons; and
- the effective parent gives binding instructions to the effective subsidiary.

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective parent. Accordingly, you will not be personally liable for our debts or those of our effective subsidiaries unless you control our business, and the conditions set forth above are met.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the fault of an effective parent only when the effective parent has used the right to give binding instructions, knowing that the consequence of carrying out this action would be insolvency of this effective subsidiary. This is the case no matter how the effective

parent's capability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent that caused the effective subsidiary to take any action or fail to take any action knowing that such action or failure to take action would result in losses.

Charter Capital Increase

We may increase our charter capital by:

- issuing new shares, or
- increasing the nominal value of previously issued shares.

A decision on any issuance of shares or securities convertible into shares by closed subscription, or an issuance by open subscription of ordinary shares or securities convertible into ordinary shares constituting 25% or more of the number of issued ordinary shares, requires a three-quarters majority vote by our shareholders. Otherwise, as provided in our charter, a decision to increase the charter capital may be taken by our board of directors. In addition, the issuance of shares above the number of authorized and non-issued shares provided in our charter necessitates a charter amendment, which requires a three-quarters majority vote of a shareholders' meeting.

The Joint Stock Companies Law requires that the value of newly issued shares be determined by the board of directors based on their market value but not less than their nominal value, except in limited circumstances where (i) existing shareholders exercise a pre-emptive right to purchase shares at not less than 90% of the price paid by third parties, or (ii) fees of up to 10% are paid to intermediaries, in which case the fees paid may be deducted from the price. The price may not be set at less than the nominal value of the shares. The board of directors shall value any in-kind contributions for new shares, based on the appraisal report of an independent appraiser.

Russian securities regulations set out detailed procedures for the issuance and registration of shares of a joint stock company. These procedures require:

- prior registration of a share issuance with the Federal Service for the Financial Markets;
- public disclosure of information relating to the share issuance; and
- following the placement of the shares, registration and public disclosure of the results of the placement of shares.

Charter Capital Decrease; Share Buy-backs

The Joint Stock Companies Law does not allow a company to reduce its charter capital below the minimum charter capital required by law, which is 100,000 roubles for an open joint stock company. Our charter requires that any decision to reduce our charter capital, whether through a repurchase and cancellation of shares or a reduction of the nominal value of the shares, be made by a majority vote of a shareholders' meeting. Additionally, within 30 days of a decision to reduce our charter capital, we must issue written notice to our creditors and publish this decision. Our creditors would then have the right to demand, within 30 days of publication or receipt of our notice, early termination or discharge of relevant obligations by us, as well as compensation for damages.

The Joint Stock Companies Law and our charter allows our shareholders or our board of directors to authorize the repurchase of up to 10% of our shares in exchange for cash. The repurchased shares must be resold at market price within one year of their repurchase or, failing that, the shareholders must decide to cancel such shares and decrease the charter capital. The shares repurchased pursuant to a decision of our shareholders' meeting to decrease the overall number of shares are cancelled at their redemption.

The Joint Stock Companies Law allows us to repurchase our shares only if, at the time of repurchase:

- our charter capital is paid in full;
- we are not and would not become, as a result of the repurchase, insolvent;
- the value of our net assets at the time of repurchase of our shares is not less (and would not become less, as a result of the proposed repurchase) than the sum of our charter capital, the

reserve fund and the difference between the liquidation value and par value of our issued and outstanding preferred shares; and

- we have repurchased all shares from shareholders having the right to demand repurchase of their shares in accordance with the Russian law, as described immediately below.

The Joint Stock Companies Law and our charter provide that our shareholders may demand repurchase of all or some of their shares so long as the shareholder demanding repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

- reorganization;
- conclusion of a major transaction, as defined under Russian law; or
- amendment of our charter or approval of a restated version of our charter in a manner which results in restrictions of the shareholder's rights.

We may spend up to 10% of our net assets calculated under Russian accounting standards on the date of the adoption of the decision which gives rise to a share redemption demanded by the shareholders. If the value of shares in respect of which shareholders have exercised their right to demand repurchase exceeds 10% of our net assets, we will repurchase shares from each such shareholder on a pro-rata basis.

Registration and Transfer of Shares

Russian legislation requires that a joint stock company maintain a register of its shareholders. Ownership of our registered shares is evidenced solely by entries made in such register. Any of our shareholders may obtain an extract from our register certifying the number of shares that such shareholder holds. The National Registry Company, located at 6 Veresaeva Str., Moscow 121357, Russia, maintains our shareholder register.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the shareholder register, or the registration of the transfer with a depositary if shares are held by a depositary. The registrar or depositary may not require any documents in addition to those required by Russian legislation in order to transfer shares in the register. Refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is not allowed and may be challenged in court.

Reserve Fund

Russian legislation requires that each joint stock company establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and repurchase the company's shares in cases when other funds are not available. Our charter provides for a reserve fund of 5% of our charter capital, funded through mandatory annual transfers of at least 5% of our net profits until the reserve fund has reached the 5% requirement.

Disclosure of Information

Russian securities regulations require us to make the following public disclosures and filings on a periodical basis:

- filing quarterly reports with the FSFM containing information about us, our shareholders and depositary, the structure of our management bodies, the members of the board of directors, our branches and representative offices, our shares, bank accounts and auditors, important developments during the reporting quarter and other information about our financial and business activity;
- filing with the FSFM and publishing in the FSFM's periodical print publication, as well as in other media, any information concerning material facts and changes in our financial and business activity, including our reorganization, certain changes in the amount of our assets, decisions on share issuances, certain changes in ownership and shareholding, as well as shareholder resolutions;
- disclosing information on various stages of share placement, issuance and registration through publication of certain data as required by the securities regulations;

- disclosing our annual report and annual financial statements prepared in accordance with Russian accounting standards;
- filing with the FSFM on a quarterly basis a list of our affiliated persons and disclosing the same on our website, on the same basis; and
- other information as required by applicable Russian securities legislation.

General Meetings of Shareholders

Procedure

The powers of a shareholders' meeting are set forth in the Joint Stock Companies Law and in our charter. A shareholders' meeting may not decide issues that are not included in the list of its competence by the Joint Stock Companies Law and our charter. Among the issues which the shareholders have the power to decide are:

- charter amendments;
- reorganization or liquidation;
- determination of the number, nominal value and category (type) of authorized shares and rights granted by such shares;
- changes in the company's charter capital;
- appointment and early removal of the members of the company's board of directors, review commission and counting commission;
- appointment and early removal of the company's chairman;
- appointment of the company's independent auditor;
- determination of the procedure for conducting the general shareholders' meetings;
- approval of the annual report and annual financial statements, including the balance sheet and the profit and loss statement;
- approval of certain interested party transactions and major transactions;
- distribution of profits and losses, including approval of dividends;
- decision on our participation in holding companies, commercial or industrial groups, or other associations of commercial entities;
- approval of certain internal documents;
- redemption by the company of issued shares in cases provided for by the Joint Stock Companies Law; and
- other issues, as provided for by the Joint Stock Companies Law and our charter.

Voting at a shareholders' meeting is generally based on the principle of one vote per ordinary share, with the exception of the election of the board of directors, which is done through cumulative voting. Decisions are generally passed by a majority vote of the voting shares present at a shareholders' meeting. However, Russian law requires a three-quarters majority vote of the voting shares present at a shareholders' meeting to approve the following:

- charter amendments;
- reorganization or liquidation;
- major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company;
- determination of the number, nominal value and category (type) of authorized shares and the rights granted by such shares;
- repurchase by the company of its issued shares;
- any issuance of shares or securities convertible into ordinary shares by closed subscription; or

- issuance by open subscription of ordinary shares or securities convertible into ordinary shares, in each case, constituting 25% or more of the number of issued and outstanding ordinary shares.

The quorum requirement for our shareholders' meeting is met if shareholders (or their representatives) accounting for more than 50% of the issued voting shares are present. If the 50% quorum requirement is not met, another shareholders' meeting with the same agenda may (and, in the case of an annual shareholders' meeting, must) be scheduled and the quorum requirement is satisfied if shareholders (or their representatives) accounting for at least 30% of the issued voting shares are present at that meeting.

The annual shareholders' meeting must be convened by the board of directors between 1 March and 30 June of each year, and the agenda must include the following items:

- election of members of the board of directors;
- approval of the annual report and annual financial statements, including the balance sheet and profit and loss statement;
- approval of distribution of profits, including approval of annual dividends, if any;
- approval of an independent auditor; and
- appointment of the members of the review commission.

A shareholder or group of shareholders owning in the aggregate at least 2% of the issued voting shares may introduce proposals for the agenda of the annual shareholders' meeting and may nominate candidates for the board of directors, collective and sole executive bodies, the review commission and counting commission. Any agenda proposals or nominations must be provided to the company no later than 30 calendar days after the preceding financial year end.

Extraordinary shareholders' meetings may be called by the board of directors on its own initiative, or at the request of the review commission, the independent auditor or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued voting shares as of the date of the request.

A general meeting of shareholders may be held in a form of a meeting or by absentee ballot. The form of a meeting contemplates the adoption of resolutions by the general meeting of shareholders through the attendance of the shareholders or their authorized representatives for the purpose of discussing and voting on issues of the agenda, provided that if a ballot is mailed to shareholders for participation at a meeting convened in such form, the shareholders may complete and mail the ballot back to the company without personally attending the meeting. A general meeting of the shareholders by absentee ballot contemplates the determination of shareholders' opinions regarding issues on the agenda by means of a written poll.

The following issues cannot be decided by a shareholders' meeting by absentee ballot:

- election of the members of the board of directors;
- election of the review commission;
- approval of a company's independent auditor; and
- approval of the annual report, the annual financial statements, including balance sheet, profit and loss statement, and any distributions of profits, including approval of annual dividends and losses, if any.

Notice and Participation

All shareholders entitled to participate in a general shareholders' meeting must be notified of the meeting, whether the meeting is to be held in direct form or by absentee ballot, no less than 30 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. However, if it is an extraordinary shareholders' meeting to elect the board of directors, shareholders must be notified at least 50 days prior to the date of the meeting. Only those items that were set out in the agenda to shareholders may be voted upon at a general shareholders' meeting.

The list of persons entitled to participate in a general shareholders' meeting is to be compiled on the basis of data in our shareholder register on the date established by the board of directors, which date may neither be earlier than the date of adoption of the board resolution to hold a general shareholders' meeting nor more than 50 days before the date of the meeting (or, in the case of an extraordinary

shareholders' meeting to elect the board of directors, not more than 65 days before the date of the meeting).

The right to participate in a general meeting of shareholders may be exercised by a shareholder as follows:

- by personally participating in the discussion of agenda items and voting thereon;
- by sending an authorized representative to participate in the discussion of agenda items and to vote thereon;
- by absentee ballot; or
- by delegating the right to fill out the absentee ballot to an authorized representative.

Board of Directors

Our charter provides that our entire board of directors is up for election at each annual general shareholders' meeting and that our board of directors is elected through cumulative voting. Under cumulative voting, each shareholder may cast an aggregate number of votes equal to the number of voting shares held by such shareholder multiplied by the number of persons to be elected to our board of directors, and the shareholder may give all such votes to one candidate or spread them between two or more candidates. Before the expiration of their term, the directors may be removed as a group at any time without cause by a majority vote of a shareholders' meeting.

The Joint Stock Companies Law requires at least a five-member board of directors for all joint stock companies, at least a seven-member board of directors for a joint stock company with more than 1,000 holders of voting shares, and at least a nine-member board of directors for a joint stock company with more than 10,000 holders of voting shares. Only natural persons (as opposed to legal entities) are entitled to sit on the board. Members of the board of directors are not required to be shareholders of the company. The actual number of directors is determined by the company's charter. Our charter provides that our board of directors shall consist of eight members.

The Joint Stock Companies Law generally prohibits the board of directors from acting on issues that fall within the exclusive competence of the general shareholders' meeting. Our board of directors has the power to perform the general management of the company, and to decide, among others, the following issues:

- determining our business priorities;
- convening annual and extraordinary shareholders' meetings, except in certain circumstances specified in the Joint Stock Companies Law;
- approval of the agenda of the shareholders' meeting and determination of the record date for shareholders entitled to participate in a shareholders' meeting;
- placement of our bonds and other securities, in cases specified in the Joint Stock Companies Law;
- increasing our charter capital by issuing additional shares within the limits of the authorized charter capital, except in certain circumstance specified in our charter;
- introducing certain changes to our charter;
- determination of the price of our property and of our securities to be placed or repurchased, as provided for by the Joint Stock Companies Law;
- repurchase of our shares, bonds and other securities in certain cases provided for by the Joint Stock Companies Law;
- formation and early termination of our management board, excluding appointment of its chairman;
- recommendation on the amount of a dividend and the payment procedure;
- recommendation on the amount of remuneration and compensation to be paid to the members of our review commission and on the fees payable for the services of an independent auditor;
- the use of our reserve fund and other funds;

- the creation and liquidation of branches and representative offices;
- approval of our internal documents, except for those documents whose approval fall within the competence of the company's shareholders or executive bodies;
- approval of major and interested party transactions in the cases provided for by the Joint Stock Companies Law;
- approval of our share registrar and the terms of the agreement with it;
- approval of decisions on share issuances and of the prospectus relating to such share issuances, as well as of reports on the results of such share issuances;
- approval of our long-term and annual business plans, including investment projects;
- adoption of decisions relating to obtaining, renewing or rejecting subsoil licenses, including participation in tenders and auctions pursuant to subsoil legislation; and
- other issues, as provided for by the Joint Stock Companies Law and our charter.

Our charter generally requires a majority vote of the directors present for an action to pass, with the exception of certain issues that require the vote of seven directors and actions for which Russian legislation requires a unanimous vote or a majority vote of the disinterested and independent directors, as described herein. A board meeting is considered duly assembled and legally competent to act when at least half of the number of elected directors are present.

Interested Party Transactions

Under the Joint Stock Companies Law, certain transactions defined as “interested party transactions” require approval by disinterested directors or shareholders of the company. “Interested party transactions” include transactions involving a member of the board of directors or member of any executive body of the company (including the company's chief executive officer and/or the company's managing organization), any person that owns, together with any affiliates, at least 20% of a company's issued voting stock or any person who is able to direct the actions of the company, if that person, and/or that person's spouse, parents, children, adoptive parents or children, brothers or sisters or affiliates, is/are:

- a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- the owner of at least 20% of the issued voting shares of a legal entity that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- a member of the board of directors or a member of any management body of a company that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary, or a member of the board of directors or of any management body of a management organization of such a company.

The Joint Stock Companies Law requires that an interested party transaction by a company with more than 1,000 shareholders be approved by a majority vote of the independent directors of the company who are not interested in the transaction. For purposes of this rule, an “independent director” is a person who is not, and within the year preceding the decision to approve the transaction was not, the general director, a member of any executive body or an affiliate of the company, or a member of the board of directors or of any management body of the company's management organization. Additionally, such person's spouse, parents, children, adoptive parents or children, brothers or sisters may not occupy positions in the executive bodies of the company. For companies with 1,000 or fewer shareholders, an interested party transaction must be approved by a majority vote of the directors who are not interested in the transaction if the number of these directors is sufficient to constitute a quorum.

Approval by a majority of shareholders who are not interested in the transaction is required if:

- the value of such transaction or a number of interrelated transactions is 2% or more of the balance sheet value of the company's assets determined under Russian accounting standards;
- the transaction or a number of interrelated transactions involves the issuance, by subscription, of voting shares or securities convertible into voting shares, or secondary market sale of such securities, in an amount exceeding 2.0% of the company's issued voting stock;

- the number of directors who are not interested in the transaction is not sufficient to constitute a quorum; or
- all the members of the board of directors of the company are interested parties, or none of them is an independent director.

Approval by a majority of shareholders who are not interested in the transaction may not be required for an interested party transaction if such transaction is substantially similar to transactions concluded by the company and the interested party in the ordinary course of business before such party became an interested party with respect to the transaction.

The approval of interested party transactions is not required in the following instances:

- the company has only one shareholder that simultaneously performs the functions of the executive body of the company;
- all shareholders of the company are deemed interested in such transactions;
- the transactions arise from the shareholders executing their pre-emptive rights to purchase newly issued shares of the company;
- the transactions arise from the repurchase, whether mandatory or not, by the company of its issued shares; or
- the company is merging with another company, and the latter owns more than three-fourths of the voting capital stock of the company.

Major Transactions

The Joint Stock Companies Law defines a “major transaction” as a transaction, or a number of interrelated transactions, involving the acquisition or disposal, or a possibility of disposal (whether directly or indirectly), of property having a value of 25% or more of the balance sheet value of the assets of a company as determined under Russian accounting standards, with the exception of transactions conducted in the ordinary course of business or transactions involving the placement of ordinary shares or securities convertible into ordinary shares. Major transactions involving assets ranging from 25% to 50% of the balance sheet value of the assets of a company require unanimous approval by all members of the board of directors or, failing to receive such approval, a simple majority vote of a shareholders’ meeting. Major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company require a three-quarters majority vote of a shareholders’ meeting.

Change in Control

Anti-takeover Protection

Russian legislation requires that any person that intends, either individually or together with its affiliates, to acquire 30% or more (including, for such purposes, the shares already owned by this person or its affiliates) of the ordinary shares of a company having more than 1,000 holders of ordinary shares must give at least 30, but no more than 90, days’ prior written notice to the company. Additionally, the Joint Stock Companies Law provides that a person that has acquired either individually, or together with its affiliates, 30% or more (including, for such purposes, the shares already owned by this person or its affiliates) of the ordinary shares of a company with more than 1,000 holders of ordinary shares, within 30 days of acquiring the shares, must offer to buy all of the ordinary shares or securities that are convertible into ordinary shares at a market price which shall not be lower than the weighted average price of the ordinary shares over the six month period before the date of acquisition. These requirements also apply to any acquisitions of each subsequent 5% or more of the issued ordinary shares of a company by a person already holding (together with its affiliates) over 30% of the issued ordinary shares of such company. If the acquirer fails to observe these requirements, its voting power will be limited to only those shares purchased in compliance with these requirements. The requirement to make a buyout offer of securities may be waived in a company’s charter or by a resolution adopted by a majority vote of a shareholders’ meeting, excluding the votes of the acquirer (and its affiliates). New Russian securities regulations strongly discourage listed companies from waiving the buyout offer requirement, and regulators have advised Russian companies to abandon any waiver of this requirement by 1 July 2005. Our charter does not contain a waiver of this requirement.

Approval of the Russian Federal Anti-Monopoly Service

Pursuant to Russian antimonopoly legislation, transactions exceeding a certain amount, involving companies with a combined value of the assets under Russian accounting standards that exceeds a certain threshold or companies registered as having more than a 35% share of a certain commodity market, and which would result in a shareholder (or a group of affiliated shareholders) holding more than 20.0% of the voting capital stock of such company, or in a transfer between such companies of assets or rights to assets, the value of which exceeds a certain amount, must be approved in advance by the Russian Federal Anti-Monopoly Service.

Because the rights of beneficial owners of our GDRs may not be recognized under Russian law, the depositary bank for our GDRs obtained such approval for deposits of up to 29.99% of our shares, and may be required to obtain such approval for any subsequent deposits.

Exchange Controls

The Federal Law on Currency Regulation and Currency Control which came into effect on 18 June 2004, empowers the government and the Central Bank of Russia to regulate and restrict certain foreign currency operations, including certain types of payments in foreign currency, operations involving foreign securities (including GDRs) and domestic securities (including our shares), as well as certain types of settlements in roubles between residents and non-residents of Russia. As the new regulatory regime is very recent and untested, it is currently unclear how it will be applied in practice. In particular, it remains uncertain whether it will be more or less restrictive than the prior laws and regulations it replaced.

Capital Import and Export Restrictions

Pursuant to the Federal Law on Currency Regulation and Currency Control, the government and the Central Bank of Russia have the power to restrict, in particular, the following operations:

- investments (not involving the acquisition of securities) by Russian residents into participatory interests in joint ventures with foreign investors or acquired from foreign investors;
- acquisition of Russian securities by foreign investors and foreign securities by Russian investors;
- grants or receipts of loans and credits between residents and non-residents of Russia;
- payments for export-import transactions with settlement over 180 days (and, in limited cases, from three to five years) following completion, and
- the opening by Russian residents of bank accounts outside Russia and the transfers by Russian residents to such accounts of their funds from domestic accounts.

Restrictions that may be introduced include:

- the requirement for Russian residents to register their accounts in foreign banks with Russian tax authorities prior to the opening of such accounts (the “prior registration requirement”);
- the requirement to perform the operations listed above through special banking accounts with authorized Russian banks (the “requirement to use a special account”); and
- the requirement to deposit in a special non-interest bearing account with an authorized Russian bank (the “reservation requirement”) a monetary sum of:
 - up to 100% of the amount of the foreign currency operation in question for a period of time not exceeding 60 days; or
 - up to 20% of the amount of the foreign currency operation in question for a period of time not exceeding one year.

As of the date hereof, the prior registration requirement has been introduced in respect of the Russian rouble foreign currency accounts in banks located in countries which are not members of the Organization for Economic Co-operation and Development (OECD) and the Financial Action Task Force on Money Laundering (FATF) established by the G-7, and in respect of rouble accounts in banks located in countries which are members of OECD or FATF.

As of the date hereof, the requirement to use a special account has been introduced in respect of acquisitions of Russian securities by foreign investors and foreign securities by Russian investors and in

respect of the grant or receipt of loans and credits between residents and non-residents of Russia. In particular, the following operations are subject to the requirement to use special accounts:

- the receipt by residents of Russia from non-residents of foreign currency and rouble loans and credits with maturities of less than three years;
- the acquisition of foreign securities (such as GDRs) by Russian investors; and
- the acquisition of Russian securities (such as our shares) by foreign investors.

As of the date hereof, the reservation requirement has been introduced, in particular, in respect of:

- investments by Russian residents into participatory interests in joint ventures with foreign investors or acquired from foreign investors in the amount of 25% of the sum of the performed currency transaction for 15 days;
- the receipt by residents of Russia of foreign currency and rouble loans and credits with maturities of less than three years, in the amount of 2% of the loan/credit for one year;
- the acquisition of foreign securities (such as GDRs) by Russian investors, in the amount of 25% of the sum payable for the securities for 15 days;
- pre-payment by Russian residents for the import of works, services and rights to intellectual property to be transferred by non-residents more than 180 days following the pre-payment, in the amount of 10% of the sum of pre-payment, excluding the value of the consideration received from non-residents, for a period of time not exceeding 15 days; and
- transfer of funds by Russian companies and individual entrepreneurs from their accounts in Russian banks to their accounts in foreign banks, in the amount of 25% of the sum of the transfer for 15 days (except for transfers to support foreign representative offices of Russian companies).

Up to \$150,000 worth of foreign securities in one calendar year may be purchased/sold by Russian individuals from/to non-residents without any of the above restrictions.

While at present restrictions imposed on foreign currency operations are limited in scope, the statutory powers of the government and the Central Bank of Russia enable them to:

- increase the reservation requirements by an increase in the amount and/or the period of reservation; and/or
- extend the reservation requirements and other restrictions to other types of foreign currency operations envisaged by the Federal Law on Currency Regulation and Currency Control.

Additionally, Russian companies must repatriate 100% of their receivables from the export of goods and services (with a limited number of exceptions concerning, in particular, certain types of secured financing) and convert 10% of export receivables in foreign currency into roubles within seven days of the date on which they were received (also with a limited number of exemptions). Furthermore, certain types of cross-border operations may be performed only in roubles, including, for example, transactions with domestic securities, such as our shares, between residents and non-residents of Russia. These requirements increase balances in our rouble-denominated accounts and, consequently, our exposure to currency devaluation risk.

Restrictions on the Remittance of Dividends, Interest or Other Payments to Non-residents

The Federal Law on Foreign Investments in the Russian Federation of 9 July 1999, specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the evolving Russian exchange control regime may materially affect your ability to do so.

Currently, rouble dividends on ordinary shares may be converted into US dollars without restriction. However, the ability to convert roubles into US dollars is also subject to the availability of US dollars in Russia's currency markets. Although there is an existing market within Russia for the conversion of roubles into US dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of roubles into foreign currencies outside of Russia and no viable market in which to hedge rouble and rouble-denominated investments.

Notification of Foreign Ownership

Foreign persons registered as individual entrepreneurs in Russia who acquire shares in a Russian joint stock company and foreign companies that acquire shares in a Russian joint stock company may need to notify the Russian tax authorities within one month following such acquisition if they are already registered with the Russian tax authorities at the time of acquisition. Russian law is unclear as to whether foreign persons and companies that are not registered with the Russian tax authorities at the time of their share acquisitions must register solely because of such share acquisitions. Other than this notification requirement, there are no requirements or restrictions with respect to foreign ownership of our shares.

DESCRIPTION OF THE GLOBAL DEPOSITARY RECEIPTS

Deutsche Bank Trust Company Americas has agreed to act as the depositary for the GDRs. The Depositary's principal New York offices are located at 60 Wall Street, New York, New York 10005, United States and its principal London offices are located at Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom. In this summary we use the term "GDRs" to refer to the Rule 144A GDRs and to the Regulation S GDRs. GDRs are represented by certificates that are ordinarily known as "Global Depositary Receipt Certificates" or "GDR Certificates." The GDRs we are selling in the United States are referred to and will be issued as Rule 144A GDR and the GDRs we are selling outside the United States are referred to and will be issued as the Regulation S GDRs. GDRs represent ownership interests in securities, cash or other property on deposit with the Depositary.

The Depositary has appointed Deutsche Bank Ltd. as the custodian for the safekeeping of the securities, cash or other property on deposit (hereinafter, the Custodian). The Custodian's principal office is at 4 Shepkina Street, Moscow 129090, Russia.

We have appointed the Depositary pursuant to two separate deposit agreements, one for the Rule 144A GDRs (hereinafter, the Rule 144A Deposit Agreement) and one for the Regulation S GDRs (hereinafter, the Regulation S Deposit Agreement), each of which is governed by New York law. Copies of the Deposit Agreements are available for inspection by any holder of the GDRs at the principal offices of the Depositary during business hours. This is a summary description of the material terms of the GDRs and of your material rights as an owner of the GDRs. Please remember that summaries by their nature lack the precision of the information summarized and that the rights and obligations of an owner of GDRs will be determined by reference to the terms of the applicable Deposit Agreement and not by this summary.

One hundred GDRs represent the right to receive one share on deposit with the Custodian. Each GDR will also represent the right to receive cash or any other property received by the Depositary or the Custodian on behalf of the owner of the GDR but that has not been distributed to the owners of GDRs because of legal restrictions or practical considerations.

If you become an owner of GDRs, you will become a party to the applicable Deposit Agreement and therefore will be bound by its terms and by the terms of the GDR Certificate that represents your GDRs. The applicable Deposit Agreement and the GDR Certificate specify our rights and obligations as well as your rights and obligations as owner of GDRs and those of the Depositary. As a GDR owner you appoint the Depositary as your attorney-in-fact, with full power to delegate, to act on your behalf and to take any and all actions contemplated in the applicable Deposit Agreement, to adopt any and all procedures necessary to comply with applicable laws and to take such action as the Depositary in its sole discretion may deem necessary or appropriate to carry out the purposes of the applicable Deposit Agreement.

Presently, you may hold your GDRs only through a brokerage or safekeeping account. As such, you must rely on the procedures of your broker or bank to assert your rights as GDR owner. Please consult with your broker or bank to determine what those procedures are. When we refer to "you," we assume the reader owns GDRs and will own GDRs at the relevant time. When we refer to a "holder" we assume the person owns GDRs and such person's agent (*i.e.*, broker, custodian, bank or trust company) is the holder of the applicable GDR.

No temporary Master GDRs or other temporary documents of title have been or will be issued.

Distinctions Between Rule 144A GDRs and Regulation S GDRs

The Rule 144A GDRs and the Regulation S GDRs are similar in many ways but are different primarily on account of the requirements of the US securities laws. The Rule 144A GDRs are "restricted securities" under the US securities laws and as such are subject to limitations on their issuance, transfer and cancellation. The Regulation S GDRs are not *per se* "restricted securities" under the US securities laws.

The differences between the Regulation S GDRs and the Rule 144A GDRs and the restrictions imposed on the Rule 144A GDRs and the Regulation S GDRs cover primarily the following:

- The venue for trading the GDRs in the United States: the Rule 144A GDRs may be traded in PORTAL among QIBs only.

- The restrictions on the transfers, deposits and withdrawals of the shares represented by the GDRs. See “—Transfer Restrictions.”
- The eligibility for book-entry transfer. See “—Settlement and Safekeeping.”
- Special restrictions on deposits and withdrawals apply to our affiliates. See “—Ownership of GDRs by our Affiliates” below.

These distinctions and the requirements of the US securities laws may require us and the Depositary to treat the Regulation S GDRs and the Rule 144A GDRs differently at any time in the future. There can be no guarantee that holders of Rule 144A GDRs will receive the same entitlements as holders of Regulation S GDRs and vice versa.

Settlement and Safekeeping

Rule 144A GDRs

The Depositary has made arrangements with DTC to act as securities depository for the Rule 144A GDRs. All Rule 144A GDRs issued in the offering will be registered in the name of Cede & Co. (DTC’s nominee). One Master Rule 144A GDR Certificate will represent all Rule 144A GDRs that will be issued to and registered in the name of Cede & Co. Transfers of ownership interests in Rule 144A GDRs are to be accomplished by entries made on the books of DTC and participants in DTC acting on behalf of Rule 144A GDR owners. Owners of Rule 144A GDRs will not receive certificates representing their ownership interests in the Rule 144A GDRs, except in the event that a successor securities depository cannot be appointed.

DTC may discontinue providing its services as securities depository with respect to the Rule 144A GDRs at any time by giving reasonable notice to the Depositary. Under such circumstances and in the event a successor securities depository cannot be appointed, individual Rule 144A GDR Certificates representing the applicable number of Rule 144A GDRs held by each owner of Rule 144A GDRs will be printed and delivered to the relevant Rule 144A GDR owners.

Regulation S GDRs

The Depositary has made arrangements with Euroclear and Clearstream to act as securities depositories for the Regulation S GDRs. All Regulation S GDRs issued in the offering will be registered in the name of BT Globenet Nominees Limited, as nominee for the common depository for Euroclear and Clearstream. One Master Regulation S GDR will represent all Regulation S GDRs issued to and registered in the name of BT Globenet Nominees Limited. Euroclear and Clearstream will hold the Regulation S GDRs on behalf of their participants (any such participant of Euroclear or Clearstream, a “Participant”), and, transfers will be permitted only within Euroclear and Clearstream in accordance with usual rules and operating procedures of the relevant system. Transfers of ownership interests in Regulation S GDRs are to be accomplished by entries made on the books of Euroclear and Clearstream and of participants in Euroclear and Clearstream, acting in each case on behalf of Regulation S GDR owners. Owners of Regulation S GDRs will not receive certificates representing their ownership interests in the Regulation S GDRs, except in the event that use of the Euroclear and Clearstream book-entry system for the Regulation S GDRs is discontinued.

If at any time Euroclear or Clearstream, as the case may be, ceases to make its respective book-entry settlement systems available for the Regulation S GDRs, we and the Depositary will attempt to make other arrangements for book-entry settlement. If alternative book-entry settlement arrangements cannot be made, the Depositary will make available Regulation S GDRs in physical certificated form.

Transfer Restrictions

The GDRs may be reoffered, resold, pledged or otherwise transferred only in compliance with the US securities laws and are subject to the following restrictions:

Restrictions upon the Transfer of GDRs

Rule 144A GDRs	Regulation S GDRs
The Rule 144A GDRs may be reoffered, resold, pledged or otherwise transferred only: (i) outside the United States in accordance with Regulation S; or (ii) to a QIB in a transaction meeting the requirements of Rule 144A; or (iii) pursuant to Rule 144 under the Securities Act, if available; or (iv) pursuant to an effective registration statement under the Securities Act.	None.

Please also see “—Ownership of GDRs by our Affiliates” below.

Restrictions upon Deposit of Shares

Rule 144A GDRs	Regulation S GDRs
Shares will be accepted for deposit under the Rule 144A Deposit Agreement only if delivered by, or on behalf of, a person that is: (i) not NOVATEK or an affiliate of NOVATEK or a person acting on behalf of NOVATEK or an affiliate of NOVATEK; and (ii) a QIB or a person outside the United States that is not a US person (as defined in Regulation S).	Shares will be accepted for deposit under the Regulation S Deposit Agreement only if delivered by, or on behalf of, a person that is: (i) not NOVATEK or an affiliate of NOVATEK or a person acting on behalf of NOVATEK or an affiliate of NOVATEK; and (ii) not in the business of buying or selling securities, or if such person is in the business of buying or selling securities, such person did not acquire the shares to be deposited from NOVATEK or an affiliate of NOVATEK; and (iii) is a person outside the United States that is not a US person (as defined in Regulation S). Shares withdrawn from deposit under the Rule 144A Deposit Agreement will not be accepted for deposit pursuant to the Regulation S Deposit Agreement unless such shares are not and may not be deemed to be “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act.

Please also see “—Ownership of GDRs by our Affiliates” below.

Restrictions upon the Withdrawal of Shares

Rule 144A GDRs	Regulation S GDRs
Shares may be withdrawn from the Rule 144A Deposit Agreement only by:	Shares may be withdrawn from the Regulation S Deposit Agreement by the holders of Regulation S GDRs.
(i) a person other than a US person (as defined in Regulation S) outside the United States who will be the beneficial owner of the shares upon withdrawal;	
or	
(ii) a QIB who	
(a) has sold the Rule 144A GDRs to another QIB in a transaction meeting the requirements of Rule 144A, or to a person other than a US person (as defined in Regulation S) outside the United States in accordance with Regulation S,	
or	
(b) will be the beneficial owner of the shares and agrees to observe the transfer restrictions applicable to Rule 144A GDRs in respect of the shares so withdrawn.	

Please also see “—Ownership of GDRs by our Affiliates” below.

We may restrict transfers of the shares where such transfer might result in ownership of shares exceeding the limits applicable to the shares under applicable law or our charter. We may also restrict transfers of the GDRs where such transfer may result in the total number of shares represented by the GDRs owned by a single holder or beneficial owner to exceed any such limits. We may, in our sole discretion, but subject to applicable law, instruct the Depositary to take action with respect to the ownership interest of any holder or beneficial owner in excess of the limits set forth in the preceding sentence, including but not limited to, the imposition of restrictions on the transfer of GDRs, the removal or limitation of voting rights or the mandatory sale or disposition on behalf of a holder or beneficial owner of the shares represented by the GDRs held by such holder or beneficial owner in excess of such limitations, if and to the extent such disposition is permitted by applicable law and our charter.

The registration of any transfer of GDR certificates in particular instances may be refused, or the registration of transfers generally may be suspended, during any period when the transfer books of the Depositary, us, the registrar or the Russian share registrar are closed, or if any such action is deemed necessary or advisable by us or the Depositary, in good faith, at any time or from time to time because of any requirement of law, any government or governmental body or commission or any securities exchange on which the GDRs or shares are listed, or under any provision of the Deposit Agreements or provisions of, or governing, the shares, or any meeting of our shareholders or for any other reason.

The Depositary may close the transfer books with respect to GDR certificates, at any time or from time to time, when deemed necessary or advisable by it in good faith in connection with the performance of its duties hereunder, or at our reasonable request.

Dividends and Distributions

As a holder, you generally have the right to receive the distributions we make on the securities deposited with the Custodian. Your receipt of these distributions may be limited, however, by practical considerations and legal limitations. Holders will receive such distributions under the terms of the Deposit Agreements in proportion to the number of GDRs held as of a specified GDR record date, which the

Depository will use reasonable efforts to establish as close as possible to the record date set by us for the shares.

Distributions of Cash

Whenever we make a cash distribution in respect of securities on deposit with the Custodian, we will deposit the funds with the Custodian. Upon receipt of confirmation from the Custodian of the deposit of the requisite funds, the Depository will arrange for the funds to be converted into US dollars and for the distribution of the US dollars to the holders, if in the reasonable judgment of the Depository it is practicable and lawful. See “—Foreign Currency Conversion” below for actions the Depository is entitled to take if conversion, transfer and distribution cannot be so made by the Depository.

The amounts distributed to holders will be net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. The Depository will apply the same method for distributing the proceeds of the sale of any property (such as undistributed rights) held by the Custodian in respect of the securities on deposit.

Distributions of Shares

Whenever we make a free distribution of shares in respect of the shares on deposit with the Custodian, we will deposit the applicable number of shares with the Custodian. Upon receipt of confirmation of such deposit from the Custodian, the Depository will either distribute to holders new GDRs representing the shares deposited or modify, to the extent permissible by law, the GDR-to-shares ratio, in which case each GDR you hold will represent rights and interests in the additional shares so deposited. Only whole new GDRs will be distributed. Fractional entitlements will be sold and the proceeds of such sale will be distributed as in the case of a cash distribution.

The distribution of new GDRs or the modification of the GDR-to-shares ratio upon a distribution of shares will be made net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. In order to pay such taxes or governmental charges, the Depository may sell all or a portion of the new shares so distributed.

No such distribution of new GDRs will be made if it would violate US law (*i.e.*, the US securities laws). If the Depository does not distribute new GDRs as described above, it may sell the shares received and will distribute the proceeds of the sale as in the case of a distribution of cash. The Depository will hold and/or distribute any unsold balance of such property in accordance with the provisions of the applicable Deposit Agreement.

Distributions of Rights

Whenever we intend to distribute rights to purchase additional shares, we will give timely prior notice to the Depository and state whether or not we wish such rights to be made available to you. If we wish such rights to be made available to you, we will assist the Depository in determining whether it is lawful and reasonably practicable to distribute rights to purchase additional GDRs to holders.

The Depository will establish procedures to distribute rights to purchase additional GDRs to holders and to enable such holders to exercise such rights only if the Depository has received our request to make such distribution in a timely manner, and the Depository shall have determined that it is lawful and reasonably practicable to make the rights available to holders of GDRs, and we have provided all of the documentation contemplated in the applicable Deposit Agreement (such as opinions to address the lawfulness of the transaction). You will have to pay fees, expenses, and any taxes and other governmental charges to subscribe for the new GDRs upon the exercise of your rights. The Depository is not obligated to establish procedures to facilitate the distribution and exercise by holders of rights to purchase new shares other than in the form of GDRs.

The Depository will not distribute the rights to you if:

- we do not request that the rights be distributed to you in a timely manner, or we request that the rights not be distributed to you;
- we fail to deliver satisfactory documents to the Depository;
- any rights made available are not exercised and appear to be about to lapse; or
- it determines that it is not reasonably practicable to distribute the rights.

The Depositary will sell the rights that are not exercised or not distributed if it determines that such sale is lawful and reasonably practicable in a riskless principal capacity, at such place and upon terms (including public and private sale) as it may deem practicable. The proceeds of such sale will be distributed to holders as in the case of a cash distribution. If the Depositary is unable to sell the rights, it will allow the rights to lapse.

The Depositary shall not be responsible for (i) any failure to determine whether it may be lawful or practicable to make such rights available to holders in general or to you in particular, (ii) any foreign exchange exposure or loss incurred in connection with any sale or exercise, or (iii) the content of any materials forwarded to the holders on behalf of the Company in connection with the rights distribution. There can be no assurance that holders in general or you in particular will be given the opportunity to exercise rights on the same terms and conditions as the holders of shares or to exercise such rights.

Elective Distributions

Whenever we intend to distribute a dividend payable at the election of shareholders either in cash or in additional shares, we will give timely prior notice thereof to the Depositary and will indicate whether we wish the elective distribution to be made available to you. In such case, we will assist the Depositary in determining whether such distribution is lawful and reasonably practicable.

The Depositary will make the election available to you only if it has received timely prior notice from us, if it is reasonably practicable and if we have provided all of the documentation contemplated in the applicable Deposit Agreement. In such case, the Depositary will establish procedures to enable you to elect to receive either cash or additional GDRs, in each case as described in the Deposit Agreements.

If the election is not made available to you, you will, to the extent permitted by law, receive either cash or additional GDRs, depending on what a shareholder in Russia would receive upon failing to make an election, as more fully described in the corresponding Deposit Agreement.

The Depositary is not obligated to make available to holders a method to receive the elective dividend in the shares rather than in the form of GDRs. There can be no assurance that holders of GDRs or beneficial interests therein generally, or you in particular, will be given the opportunity to receive elective distributions on the same terms and conditions as the holders of the shares.

Other Distributions

Whenever we intend to distribute property other than cash, shares or rights to purchase additional shares, we will timely notify the Depositary in advance and will indicate whether we wish such distribution to be made to you. If so, we will assist the Depositary in determining whether such distribution to holders is lawful and reasonably practicable.

If the Depositary has received timely prior notice from us, it is reasonably practicable to distribute such property to you and if we have provided all of the documentation contemplated in the Deposit Agreements, the Depositary will distribute the property to the holders in a manner it deems practicable.

The distribution will be made net of fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. In order to pay such taxes and governmental charges, the Depositary may, after consultation with us to the extent reasonably practicable, sell all or a portion of the property received.

The Depositary will *not* distribute the property to you and will sell the property if:

- we do not request that the property be distributed to you or we do not make such request in a timely manner or we ask that the property not be distributed to you;
- we fail to deliver satisfactory documents to the Depositary; or
- the Depositary determines that all or a portion of the distribution to you is not lawful or reasonably practicable.

The proceeds of any such sale will be distributed to holders as in the case of a cash distribution. If the Depositary is unable to sell such property, the Depositary may dispose of such property in any way it deems reasonably practicable under the circumstances.

Redemption

Whenever we decide to redeem any of the securities on deposit with the Custodian, we will timely notify the Depositary in advance. If the Depositary has received timely prior notice from us, determined that such redemption is practicable and received from us all of the documentation contemplated in the Deposit Agreements, the Depositary will mail notice of the redemption to the holders.

The Custodian will be instructed to surrender the shares being redeemed against payment of the applicable redemption price. The Depositary will convert the redemption funds received into US dollars upon the terms of the Deposit Agreements and will establish procedures to enable holders to receive the net proceeds from the redemption upon surrender of their GDRs to the Depositary. See “—Foreign Currency Conversion” below for actions the Depositary is entitled to take if conversion, transfer and distribution of funds by the Depositary is not practicable or lawful. You will have to pay fees and charges of, and the expenses incurred by, the Depositary, and any taxes and other governmental charges upon the redemption of your GDRs. If less than all GDRs are being redeemed, the GDRs to be redeemed will be selected by lot or on a *pro rata* basis, as the Depositary may determine.

Changes Affecting Shares

The shares held on deposit for your GDRs are subject to change from time to time. For example, there may be a change in nominal or par value, a split-up, cancellation, consolidation or reclassification of such shares or a recapitalization, reorganization, merger, consolidation or sale of assets affecting us.

If any such change were to occur, any securities which shall be received by the Depositary or the Custodian in exchange for, or in conversion, replacement or otherwise in respect of, such shares shall, to the extent permitted by law, be treated as new shares under the Deposit Agreements, and the GDR certificates shall, subject to the terms of the Deposit Agreements and applicable law, evidence the GDRs representing the right to receive such replacement securities. The Depositary in such circumstances may with our approval, and shall if we so request and provide the Depositary a satisfactory opinion of counsel that such action is not in violation of applicable laws or regulations, execute and deliver additional GDR certificates to you or make appropriate adjustments in its records, or call for the exchange of your existing GDRs for new GDRs. If the Depositary may not lawfully distribute such securities to you, the Depositary may with our approval sell such securities and distribute the net proceeds to you as in the case of a cash distribution, and shall do so if we so request and provide the Depositary a satisfactory opinion of counsel that such action is not in violation of applicable laws or regulations. You will have to pay fees and charges of, and the expenses incurred by, the Depositary, and any taxes and other governmental charges upon the sale of such securities.

The Depositary shall not be responsible for (i) any failure to determine that it is lawful or practicable to make such securities available to holders of GDRs in general or to you in particular, (ii) any foreign exchange exposure or loss incurred in connection with such sale, or (iii) any liability to the purchaser of such securities.

Issuance of GDRs Upon Deposit of Shares

Subject to limitations set forth in the Deposit Agreements and the GDRs, the Depositary may create GDRs on your behalf if you or your broker deposit shares with the Custodian. The Depositary will deliver these GDRs to the person you indicate only after you pay any applicable issuance fees and any charges and taxes payable for the transfer of the shares to the Custodian and you provide the applicable deposit certification. Your ability to deposit shares and receive GDRs may be limited by US and Russian legal considerations applicable at the time of deposit. Notwithstanding the terms of the Deposit Agreements, you may also not be able to deposit shares and receive GDRs where to do so would require us to produce a further prospectus or a supplemental prospectus. See “Risk Factors—Risks Relating to the GDRs, the Shares and the Trading Market—You may not be able to deposit shares in the GDR program in order to receive GDRs” and “—We may not be able to prepare a prospectus that may be required in connection with the deposit of additional shares into the GDR program.”

The Depositary will refuse to accept shares for deposit whenever it is notified in writing by us that such deposit would result in any violation of applicable laws, including ownership restrictions under Russian laws. The Depositary will also refuse to accept certain shares for deposit under the Rule 144A Deposit Agreement if notified in writing that the shares are listed on a US securities exchange or quoted on a US automated inter-dealer quotation system, unless accompanied by evidence satisfactory to the

Depository that any shares presented for deposit are eligible for resale pursuant to Rule 144A. The Depository shall also, upon instruction from us, limit at any time the number of shares accepted for deposit under the terms of the Deposit Agreements to comply with any ownership restrictions referred to in the Deposit Agreements or under applicable laws or our charter.

The issuance of GDRs may be delayed until the Depository or the Custodian receives confirmation that all required approvals have been given and that the shares have been duly transferred to the Custodian. The Depository will only issue GDRs in whole numbers.

When you make a deposit of shares, you will be responsible for transferring good and valid title to the Depository, as evidenced by documents satisfactory to the Depository or the Custodian. As such, you will be deemed to represent and warrant that:

- the shares are duly authorized, validly issued, fully paid, non-assessable and legally obtained;
- all pre-emptive (and similar) rights, if any, with respect to such shares have been validly waived or exercised;
- you are duly authorized to deposit the shares;
- the shares presented for deposit are free and clear of any lien, encumbrance, security interest, charge, mortgage or adverse claim;
- in the case of a deposit of shares under the Regulation S Deposit Agreement, the shares are not, and the Regulation S GDRs issuable upon such deposit will not be, “Restricted Securities” (as defined in the Regulation S Deposit Agreement), except in the case of deposits of a kind described in “—Ownership of GDRs by our Affiliates” below;
- the shares presented for deposit have not been stripped of any rights or entitlements;
- the shares are not subject to any unfulfilled requirements of Russian law;
- except as provided in the Deposit Agreements and summarized under “—Ownership of GDRs by our Affiliates” below, you are not, and you shall not become while holding GDRs, one of our affiliates; and
- the deposit of the shares complies with the restrictions in transfer set forth in the legend on the GDRs.

If any of the representations or warranties are incorrect in any way, we and the Depository may, at your cost and expense, take any and all actions necessary to correct the consequences of the misrepresentations.

When you deposit shares to receive Rule 144A GDRs, you will be required to provide the Depository with a deposit certification stating, inter alia, that:

- you acknowledge that the shares and the Rule 144A GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States;
- you are not an affiliate of NOVATEK and you are not acting on behalf of NOVATEK or one of its affiliates;
- you are (i) a QIB or (ii) a person (other than a US person, as defined in Regulation S) outside the United States and acquired or have agreed to acquire and will acquire the shares to be deposited outside the United States; and
- you agree, as the owner of the Rule 144A GDRs, to offer, sell, pledge and otherwise transfer the Rule 144A GDRs or the shares represented by the Rule 144A GDRs in accordance with the applicable US state securities laws and only:
 - to a QIB in a transaction meeting the requirements of Rule 144A; or
 - outside the United States to a person (other than a US person, as defined in Regulation S) outside the United States in accordance with Regulation S; or
 - in accordance with Rule 144 under the Securities Act, if available; or
 - pursuant to an effective registration statement under the Securities Act.

A copy of the form of deposit certification for Rule 144A GDRs is attached to the Rule 144A Deposit Agreement and may be obtained from the Depositary upon request.

When you deposit shares to receive Regulation S GDRs, you will be required to provide the Depositary with a deposit certification stating, inter alia, that:

- you acknowledge that the shares and the Regulation S GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States;
- you are not an affiliate of NOVATEK and you are not acting on behalf of NOVATEK or one of its affiliates;
- you are, or at the time the shares are deposited you will be, the beneficial owner of the shares and GDRs to be issued upon deposit of such shares;
- you are a person (other than a US person, as defined in Regulation S) outside the United States and acquired or have agreed to acquire and will acquire the shares to be deposited outside the United States; and
- you are not in the business of buying and selling securities or, if you are in such business, you did not acquire the shares presented for deposit from us or any of our affiliates.

A copy of the form of deposit certification for Regulation S GDRs is attached to the Regulation S Deposit Agreement and may be obtained from the Depositary upon request.

Withdrawal of Shares Upon Cancellation of GDRs

Subject always to the withdrawal of deposited property being permitted under applicable laws and the terms of the applicable Deposit Agreement, as a holder you will be entitled to present your GDRs to the Depositary for cancellation and then receive the corresponding number of underlying shares at the Custodian's offices. Your ability to withdraw the shares may be limited by US and Russian law considerations applicable at the time of withdrawal.

In order to withdraw the shares represented by your GDRs, you will be required to pay to the Depositary the fees for cancellation of GDRs and any charges and taxes payable upon the transfer of the shares being withdrawn and you will be required to provide to the Depositary the applicable withdrawal certification. You assume the risk for delivery of all funds and securities upon withdrawal. Once cancelled, the GDRs will not have any rights under the corresponding Deposit Agreement.

If you hold a GDR registered in your name, the Depositary may ask you to provide proof of identity and genuineness of any signature and such other documents as the Depositary may deem appropriate before it will cancel your GDRs. The withdrawal of the shares represented by your GDRs may be delayed until the Depositary receives satisfactory evidence of compliance with all applicable laws and regulations. Please keep in mind that if GDRs representing fractional securities are presented for cancellation, the Depositary shall be entitled to sell such fractional securities and remit the proceeds of such sale to you net of fees, expenses, charges and taxes.

When you request the withdrawal of the shares represented by your Rule 144A GDRs, you will be required to represent and warrant that the withdrawal of the shares complies with the restrictions on transfer set forth in the legend on the GDRs and provide the Depositary with a withdrawal certification stating, *inter alia*, that:

- (A) you acknowledge that the shares represented by your Rule 144A GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States; and
- (B) you certify that:
 - (1) you are a QIB, acting for your own account or for the account of one or more other QIBs, who is the beneficial owner of the Rule 144A GDRs presented for cancellation; and either:
 - you have sold or agreed to sell the shares to a person (other than a US person, as defined in Regulation S) outside the United States in accordance with Regulation S;
 - you have sold or agreed to sell the shares to a QIB in a transaction meeting the requirements of Rule 144A; or

- you will be the beneficial owner of the shares upon withdrawal and:
 - you (or the person on whose behalf you are acting) will sell the shares only to another QIB in a transaction meeting the requirements of Rule 144A; to a person (other than a US person, as defined in Regulation S) outside the United States in accordance with Regulation S; in accordance with Rule 144, if available; or pursuant to an effective registration statement under the US Securities Act; and
 - you will not deposit the shares in any depositary receipts facility that is not a “restricted” depositary receipts facility; or
- (2) you are a person (other than a US person, as defined in Regulation S) located outside the United States and acquired or agreed to acquire the shares outside the United States and will be the beneficial owner of the shares upon withdrawal.

Holders of Regulation S GDRs are not required to provide the Depositary with a withdrawal certification under the Regulation S Deposit Agreement, except in the case of an exchange of Rule 144A GDRs for sale of Regulation S GDRs by one of our affiliates. See “—Ownership of GDRs by our Affiliates” below.

Proofs, Certificates and Other Information

You may be required (i) to provide to the Depositary and the Custodian proof of citizenship or residence, taxpayer status, payment of all applicable taxes or other governmental charges, exchange control approvals, legal or beneficial ownership of GDRs, compliance with all applicable laws and the terms of the Deposit Agreements, and (ii) to execute certifications and to make representations and warranties and to provide such other information and documentation as the Depositary or the Custodian may deem necessary or proper or as we may reasonably require by written request to the Depositary consistent with its obligations under the Deposit Agreements. The Depositary may withhold the execution or delivery or registration of transfer or cancellation of any GDR certificate, or the distribution or sale of any dividend or distribution of rights, until such proof or other information is filed or such certifications are executed, or such representations are made, or such other documentation or information is provided, in each case, to the Depositary’s and our reasonable satisfaction.

Ownership of GDRs by Our Affiliates

We permit our affiliates to deposit shares against the issuance of Rule 144A GDRs, so long as they satisfy the requirements, including delivery of the requisite certifications to the Depositary, of the Rule 144A Deposit Agreement. We also permit our affiliates to exchange their Rule 144A GDRs for Regulation S GDRs solely to allow them to sell their GDRs in transactions meeting the requirements of Regulation S, so long as each exchanging affiliate delivers the requisite certifications to the Depositary and otherwise satisfies the requirements of the Deposit Agreements. We do not otherwise permit our affiliates to deposit shares against the issuance of Regulation S GDRs unless they certify to the Depositary that they have sold or irrevocably agreed to sell the Regulation S GDRs to be issued in respect of the shares so deposited in a transaction meeting the requirements of Regulation S, and deliver the other requisite certifications to the Depositary.

The requirements for such deposits and exchanges of GDRs by our affiliates are more fully described in the Deposit Agreements.

Voting Rights

As a holder, you generally have the right under the Deposit Agreements to instruct the Depositary to exercise the voting rights for the shares represented by your GDRs. The voting rights of holders of shares are described in “Description of Share Capital and Certain Requirements of Russian Legislation.”

Upon our timely written request, and provided no US, English or Russian legal prohibitions exist, the Depositary will distribute to you any notice of shareholders’ meetings or solicitation of consents or proxies from holders of shares received from us together with information explaining how to instruct the Depositary to exercise the voting rights of the shares represented by the GDRs.

If the Depositary timely receives voting instructions from a holder of GDRs in the manner specified by the Depositary, it will endeavor, insofar as practicable and permitted under applicable law, the provisions of the applicable Deposit Agreement, our charter and the terms of our shares, to vote or cause

the Custodian to vote the shares represented by the holder's GDRs in accordance with such voting instructions. Russian securities regulations expressly permit a Depositary to split the vote of shares registered in its name in accordance with the instructions from GDR holders. However, because the Depositary does not have express statutory authority to split the vote with respect to the shares in accordance with instructions from GDR holders, and given the untested nature of such securities regulations, the Depositary may refrain from voting at all unless all GDR holders have instructed it to vote the shares in the same manner. Consequently, you may have significant difficulty in exercising voting rights with respect to the underlying shares. See "Risk Factors—Risks Relating to the GDRs, the Shares and the Trading Market—Your voting rights with respect to the shares represented by the GDRs are limited by the terms of the Deposit Agreements for the GDRs and relevant requirements of Russian law."

Neither the Depositary nor the Custodian will, under any circumstances, exercise any discretion as to voting, vote any number of shares other than an integral number thereof or vote shares in a manner that would be inconsistent with any applicable law, and neither the Depositary nor the Custodian will vote, attempt to exercise the right to vote, or in any way make use of for purposes of establishing a quorum or otherwise, the shares except pursuant to and in accordance with instructions from holders of the GDRs. If the Depositary timely receives voting instructions from a holder of GDRs which fail to specify the manner in which the Depositary is to vote the shares represented by such holder's GDRs, the Depositary will deem the holder to have instructed the Depositary not to vote the shares with respect to the items for which no instruction was given.

Notwithstanding anything else contained in the Deposit Agreements, the Depositary shall not have any obligation to take any action with respect to any meeting, or solicitation of consents or proxies, of holders of the shares if the taking of such action would violate US, English or Russian legal prohibitions. The Company has agreed in the Deposit Agreements that it shall not establish internal procedures that would prevent the Depositary from complying with, or that are inconsistent with, the terms and conditions of the section of the Deposit Agreements which deals with voting.

Please note that the ability of the Depositary to carry out voting instructions may be limited by practical, legal and regulatory limitations and the terms of the securities on deposit. We cannot assure you that you will receive voting materials in time to enable you to return voting instructions to the Depositary in a timely manner. Securities for which no voting instructions have been received from GDR holders will not be voted. See "Risk Factors—Risks Relating to the GDRs, the Shares and the Trading Market—Your voting rights with respect to the shares represented by the GDRs are limited by the terms of the Deposit Agreements for the GDRs and relevant requirements of Russian law."

Fees and Charges

The holders, the beneficial owners and the persons depositing shares or surrendering GDRs for cancellation agree to pay the following fees of the Depositary:

- (i) for the issue of GDRs (other than upon the issue of GDRs pursuant to the initial offering) or the cancellation of GDRs upon the withdrawal of deposited securities: US \$0.05 or less per GDR issued or cancelled (except for issuances and cancellations covered by paragraph (ix) below);
- (ii) for the issue of GDR Certificates in definitive registered form in replacement for mutilated, defaced, lost, stolen or destroyed GDR Certificates: a sum per GDR Certificate which is determined by the Depositary to be a reasonable charge to reflect the work, costs and expenses involved;
- (iii) for issuing GDR Certificates in definitive registered form (other than pursuant to paragraph (ii) above): a sum per GDR Certificate which is determined by the Depositary to be a reasonable charge to reflect the work, costs (including, but not limited to, printing costs) and expenses involved;
- (iv) for receiving and paying any cash dividend or other cash distribution on or in respect of the deposited securities: a fee of US \$0.02 or less per GDR Certificate for each such dividend or distribution;
- (v) in respect of any issue of rights or distribution of shares (whether or not evidenced by GDRs) or other securities or other property (other than cash) upon exercise of any rights, any free

distribution, stock dividend or other distribution (except where converted to cash): US \$0.05 or less per outstanding GDR for each such issue of rights, dividend or distribution;

- (vi) for the operation and maintenance costs associated with the administration of the GDRs: an annual fee of US \$0.02 or less per GDR; provided however, that if the Depositary imposes a fee under this paragraph (vi), then the total of fees assessed under this paragraph (vi), combined with the total of fees assessed under paragraph (iv) above, shall not exceed US \$0.02 per GDR in any calendar year;
- (vii) for the expenses incurred by the Depositary, the Custodian or their respective agents in connection with inspections of the relevant share register maintained by the local registrar, if applicable: an annual fee of US \$0.01 or less per GDR (such fee to be assessed against holders of record as at the date or dates set by the Depositary as it sees fit and collected at the sole discretion of the Depositary by billing such holders for such fee or by deducting such fee from one or more cash dividends or other cash distributions);
- (viii) for the issue of GDRs pursuant to a change for any reason in the number of shares represented by each GDR, regardless of whether or not there has been a deposit of shares to the Custodian or the Depositary for such issuance: a fee of US \$0.05 or less per GDR (or portion thereof); and
- (ix) for transferring interests from and between the Regulation S GDRs and the Rule 144A GDRs: a fee of up to US \$0.05 per GDR.

As a GDR holder you will also be responsible to pay the following charges incurred by the Depositary:

- taxes (including applicable interest and penalties) and governmental charges;
- fees for the transfer and registration of shares charged by the share registrar (i.e., upon deposit and withdrawal of shares);
- fees and expenses incurred for converting foreign currency into US dollars and compliance with exchange control regulations;
- expenses for cable, telex and fax transmissions and for delivery of securities; and
- fees and expenses incurred in connection with the delivery or servicing of shares on deposit.

We have agreed to pay certain other charges and expenses of the Depositary. Note that the fees and charges you may be required to pay may vary over time and may be changed by us and by the Depositary. You will receive prior notice of such changes.

Amendments and Termination

We may agree with the Depositary to modify the Deposit Agreements at any time without your prior consent. We undertake to give holders 30 days' prior notice of any modifications that would materially prejudice any of their substantial rights under the Deposit Agreements or that shall impose or increase fees or charges (other than charges in connection with foreign exchange control regulations and taxes and other governmental charges, delivery expenses and other such expenses). We will not consider to be materially prejudicial to your substantial rights, among other things, any modifications or supplements that are reasonably necessary for the GDRs to be settled solely in book-entry form, in each case without imposing or increasing the fees and charges you are required to pay. In addition, we may not be able to provide you with prior notice of any modifications or supplements that are required to accommodate compliance with applicable provisions of law.

You will be bound by the modifications to the Deposit Agreements if you continue to hold your GDRs after the modifications to the applicable Deposit Agreements become effective.

The Deposit Agreements cannot be amended to prevent you from withdrawing the shares represented by your GDRs. Notwithstanding any such restriction on amendments or supplements to the Deposit Agreements, we and the Depositary may at any time amend or supplement the Deposit Agreements or the GDR Certificates in order to comply with mandatory provisions of applicable laws, rules or regulations, and such amendments or supplements may become effective before notice thereof is given to holders or within any other period required to comply with such laws, rules or regulations.

We have the right to direct the Depositary to terminate the Deposit Agreements. Similarly, the Depositary may in certain circumstances on its own initiative terminate the Deposit Agreements. In

addition, the Depositary may resign, with such resignation to take effect upon the earlier of 90 days notice or the acceptance of appointment by a successor depositary, or we may remove the Depositary, with such removal to take effect upon the later of 90 days notice or the acceptance of appointment by a successor depositary, and if in either such case no successor depositary shall have accepted appointment by us, then the Depositary may terminate the Deposit Agreements. In either case, the Depositary must give notice to the holders of the GDRs at least 30 days before termination.

Upon termination, the following will occur under the Deposit Agreements:

- for a period of six months after termination, you will be able to request the cancellation of your GDRs and the withdrawal of the shares represented by your GDRs and the delivery of all other property held by the Depositary in respect of those shares on the same terms as prior to the termination, including the payment of any applicable taxes or governmental charges. During such six months' period the Depositary will continue to collect all distributions received on the shares on deposit (i.e., dividends) but will not distribute any such property to you until you request the cancellation of your GDRs.
- after the expiration of such six-month period, the Depositary may sell the securities held on deposit. The Depositary will hold the proceeds from such sale and any other funds then held for the holders of GDRs in an unsegregated, non-interest bearing account, without liability for interest. At that point, the Depositary will have no further obligations to holders other than to account for the funds then held for the holders of GDRs still outstanding, net of fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements.

Books of Depositary

The Depositary will maintain GDR holder records at its principal office in New York and, if no book-entry settlement system is available for the relevant GDRs, at its principal office in London as well. You may inspect such records at such office during regular business hours but solely for the purpose of communicating with other holders in the interest of business matters relating to the GDRs and the Deposit Agreements.

The Depositary will maintain facilities in New York and London to record and process the issuance, cancellation, combination, split-up and transfer of GDRs. These facilities may be closed from time to time, to the extent not prohibited by law.

Transmission of Notices to Shareholders

We will promptly transmit to the Depositary those communications that we make generally available to our shareholders. If those communications were not originally in English, we will translate them. Upon our request and at our expense, the Depositary will arrange for the mailing of copies of such communications to all GDR holders and will make a copy of such communications available for inspection at its principal offices in New York and London.

Limitations on Obligations and Liabilities

The Deposit Agreements limit our obligations and the Depositary's obligations to you. Please note the following:

- We and the Depositary are obligated only to take the actions specifically stated in the Deposit Agreements without negligence or bad faith.
- Neither we nor the Depositary, nor any of our or their respective controlling persons or agents, shall be under any obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any shares or in respect of the GDR certificates, which in our or their respective opinion may involve us or them (as the case may be) in expense or liability, unless indemnity satisfactory to us or them (as the case may be) against all expense (including fees and disbursements of counsel) and liability be furnished as often as may be required (and no Custodian shall be under any obligation whatsoever with respect to such proceedings, the responsibility of the Custodian being solely to the Depositary).

- The Depositary disclaims any liability for any failure to carry out voting instructions, for any manner in which a vote is cast or for the effect of any vote, provided it acts without negligence and in good faith and in accordance with the terms of the Deposit Agreements.
- The Depositary disclaims any liability for any failure to determine the lawfulness or practicality of any action, for the content of any document forwarded to you on our behalf or for the accuracy of any translation of such a document, for the investment risks associated with investing in shares, for the validity or worth of the shares, for any tax consequences that result from the ownership of GDRs, for the credit-worthiness of any third party, for allowing any rights to lapse under the terms of the Deposit Agreements or for the failure or timeliness of any of our notices.
- The Depositary and the Custodian disclaim any liability with respect to Russia's system of share registration and custody, including any liability in respect of the unavailability of the shares or other deposited securities (or any distribution in respect thereof).
- The Depositary disclaims any liability for any acts or omissions made by a successor depositary whether in connection with a previous act or omission of the Depositary or in connection with any matter arising wholly after the removal or resignation of the Depositary, provided the Depositary performed its obligations as Depositary without negligence or bad faith.
- We and the Depositary and any of our or the Depositary's respective directors, employees, agents or affiliates will not be obligated to perform any act that is inconsistent with the terms of the Deposit Agreements.
- We and the Depositary disclaim any liability if we are prevented or forbidden from or delayed in acting on account of any law or regulation, any provision of our charter, any provision of any securities on deposit or by reason of any act of God or war or other circumstances beyond our control (including, without limitation, nationalization, expropriation, currency restrictions, work stoppage, strikes, civil unrest, acts of terrorism, revolutions, rebellions, explosions and computer failure).
- We and the Depositary and any of our or the Depositary's respective directors, employees, agents or affiliates disclaim any liability by reason of any exercise of, or failure to exercise, any discretion provided for in the Deposit Agreements or in our charter or in any provisions of deposited securities.
- We and the Depositary further disclaim any liability for any action or inaction in reliance on the advice or information received from legal counsel, accountants, any person presenting shares for deposit, any holder of GDRs or any other person believed by either of us in good faith to be competent to give such advice or information.
- We and the Depositary also disclaim liability for the inability by a holder to benefit from any distribution, offering, right or other benefit which is made available to holders of shares but is not, under the terms of the Deposit Agreements, made available to you.
- We and the Depositary may rely without any liability upon any written notice, request or other document believed to be genuine and to have been signed or presented by the proper parties.
- We and the Depositary also disclaim any liability for consequential or punitive damages for any breach of the terms of the applicable Deposit Agreement.
- The Depositary disclaims liability for any actions taken in accordance with our instructions to take action with respect to the ownership interest of any holder or beneficial owner in excess of the limits applicable to the shares under applicable law or our charter.

Indemnification

The Depositary has agreed to indemnify us and our directors, officers, employees, agents and affiliates against, and hold each of us harmless from, any direct loss, liability, tax, charge or expense of any kind whatsoever (including the reasonable fees and expenses of counsel) which may arise out of acts performed or omitted by the Depositary or the Custodian, provided, that the Custodian is a branch or subsidiary of Deutsche Bank AG at the time of such act or omission, under the Deposit Agreements due to the negligence or bad faith of the Depositary or the Custodian.

We have agreed to indemnify the Depositary, the Custodian and any of their respective directors, officers, employees, agents and affiliates against, and hold each of them harmless from, any direct loss, liability, tax, charge or expense of any kind whatsoever (including the reasonable fees and expenses of counsel) that may arise, *inter alia*, (i) out of any offer or sale of the GDRs or the shares, (ii) out of any offering document in respect thereof, except to the extent relating to any information provided by the Depositary, or (iii) out of acts performed or omitted in accordance with the provisions of the Deposit Agreements, in any such case by the Depositary, the Custodian or any of their respective directors, officers, employees, agents and affiliates, except to the extent such loss, liability, tax, charge or expense is due to the negligence or bad faith of any of them, or by us or any of our directors, officers, employees, agents and affiliates.

Pre-Release Transactions

The Depositary may, in certain circumstances, issue GDRs before receiving a deposit of shares or release shares before receiving GDRs for cancellation. These transactions are ordinarily referred to as “pre-release transactions.” The Deposit Agreements limit the aggregate size of pre-release transactions and imposes a number of conditions on such transactions (*i.e.*, the need to receive collateral, the type of collateral required, the representations required from brokers, etc.). The Depositary may retain the compensation received from the pre-release transactions.

Taxes

You will be responsible for the taxes and other governmental charges payable on the GDRs and the securities represented by the GDRs. We, the Depositary and the Custodian may deduct from any distribution the taxes and governmental charges payable by holders and may sell any and all shares on deposit to pay the taxes and governmental charges payable by holders. You will be liable for any deficiency if the sale proceeds do not cover the taxes that are due.

The Depositary may refuse to issue GDRs, to deliver, transfer, split and combine GDRs or to release securities on deposit until all taxes and charges are paid by the applicable holder. The Depositary and the Custodian may, but are not obligated to, take reasonable administrative actions to obtain tax refunds and reduced tax withholding for any distributions on your behalf. However, you may be required to provide to the Depositary and to the Custodian proof of taxpayer status and residence and such other information as the Depositary and the Custodian may require to fulfill legal obligations. You are required to indemnify us, the Depositary, the Custodian and any of their agents, officers, employees and affiliates for any claims with respect to taxes (including applicable interest and penalties thereon) based on any tax benefit obtained for you.

The Depositary is under no obligation to provide you with any information about our tax status. The Depositary shall not incur any liability for any tax consequences that may be incurred by you on account of your ownership of the GDRs, including without limitation by virtue of our tax status.

By purchasing GDRs, you agree to indemnify the Depositary, us, the Custodian and any of their or our agents, officers, employees and affiliates for, and to hold each of them and us harmless from, any claims with respect to taxes (including applicable interest and penalties thereon) arising from any tax benefit obtained for you as a GDR holder.

Disclosure of Interests

By purchasing GDRs, you agree to comply with requests from us or the Depositary pursuant to Russian law, the rules and requirements of any stock exchange on which the shares are, or may be, registered, traded or listed, or our charter, which are made to provide information, *inter alia*, as to the capacity in which you hold or own a beneficial interest in the GDRs (and the shares, as the case may be) and regarding the identity of any other person interested in such GDRs, the nature of such interest and various related matters, whether or not you are a holder or owner of a beneficial interest in the GDRs at the time of such request.

Foreign Currency Conversion

The Depositary will arrange for the conversion into US dollars of all foreign currency received if such conversion is practicable, and it will distribute the US dollars in accordance with the terms of the Deposit Agreements. You will have to pay fees and expenses incurred in converting foreign currency, such as fees

and expenses incurred in complying with currency exchange controls and other governmental requirements.

The Depositary may, but is not obliged to, make any filing with any governmental authority required to obtain an approval or license necessary for any conversion of any foreign currency into or distribution of US dollar funds. If the conversion of foreign currency is not practicable or lawful, or if any required approvals are denied or, in the reasonable opinion of the Depositary, not obtainable at a reasonable cost or within a reasonable period, the Depositary may take the following actions in its discretion:

- Convert the foreign currency to the extent practicable and lawful and distribute the US dollars to the holders for whom the conversion and distribution is lawful and practicable.
- Distribute the foreign currency to holders for whom the distribution is lawful and practicable.
- Hold the foreign currency (without liability for interest) for the applicable holders.

The Depositary will not invest the currency it cannot convert and it will not be liable for any interest thereon. If exchange rates fluctuate during a time when the Depositary cannot convert the roubles, you may lose some or all of the value of the distribution.

Governing Law and Arbitration of Disputes

Although New York law has been chosen to govern the construction and interpretation of the Deposit Agreements and the GDRs, the rights of holders of the shares and other deposited securities and our obligations and duties in respect of such holders shall be governed by the laws of Russia (or such other jurisdiction's laws as may govern the deposited securities).

Under the terms of the Deposit Agreements owners of GDRs agree that any dispute, controversy or cause of action against us and/or the Depositary arising out of the GDRs, the Deposit Agreements, the shares or other deposited securities will be referred to and resolved by arbitration in accordance with the rules of the London Court of International Arbitration in proceedings in London, England, as more fully described in the Deposit Agreements.

EACH PARTY TO THE DEPOSIT AGREEMENTS (INCLUDING, FOR AVOIDANCE OF DOUBT, EACH HOLDER AND BENEFICIAL OWNER) IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY SUIT, ACTION OR PROCEEDING AGAINST THE COMPANY AND/OR THE DEPOSITARY DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THE SHARES OR OTHER DEPOSITED SECURITIES, THE GDRS OR THE DEPOSIT AGREEMENTS OR ANY TRANSACTION CONTEMPLATED THEREIN, OR THE BREACH THEREOF, INCLUDING WITHOUT LIMITATION ANY QUESTION REGARDING EXISTENCE, VALIDITY OR TERMINATION (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER THEORY).

TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, EACH PARTY TO THE DEPOSIT AGREEMENTS (INCLUDING FOR AVOIDANCE OF DOUBT EACH HOLDER AND BENEFICIAL OWNER) IRREVOCABLY AND UNCONDITIONALLY WAIVES AND AGREES NOT TO ASSERT ANY RIGHT IT MAY HAVE TO COMMENCE, MAINTAIN OR SEEK TO MAINTAIN ANY CLASS ACTION, CLASS SUIT OR CLASS PROCEEDING, IN ANY COURT OR ARBITRATION, ARISING OUT OF OR RELATING TO THE SHARES OR OTHER DEPOSITED SECURITIES, THE GDRs, OR THE DEPOSIT AGREEMENTS, OR ANY TRANSACTION CONTEMPLATED THEREIN, OR THE BREACH THEREOF, INCLUDING WITHOUT LIMITATION ANY QUESTION REGARDING EXISTENCE, VALIDITY OR TERMINATION.

Russian Share Register

We have appointed National Registry Company as the registrar of our shares in Russia and we have agreed to continue such appointment so long as the GDRs remain outstanding or any of the Deposit Agreements remain in force.

We have agreed in the Deposit Agreements to:

- take any and all actions reasonably necessary to ensure the accuracy and completeness of all of the information contained in the register of shareholders maintained by the share registrar;

- provide or use our reasonable efforts to cause the share registrar to provide unrestricted access by the Depositary and the Custodian to the register of shareholders regularly (and not less than monthly) so as to permit verification of the registration of shares represented by the GDRs in the name of the Depositary or the Custodian or their respective nominees;
- use our reasonable efforts to cause the share registrar to promptly notify the Depositary (i) of any material and uncured breaches by the share registrar of the terms of the Deposit Agreements, and (ii) any time the share registrar will no longer be able materially to comply with, or has engaged in conduct that indicates it will not materially comply with, the provisions of the Deposit Agreements relating to it;
- use our reasonable efforts to cause the share registrar to promptly (and, in any event, within three business days in Moscow, Russia of receipt by the share registrar of such documentation as may be required by applicable law and regulation and the reasonable and customary internal regulations of the share registrar, or as soon as practicable thereafter) re-register the shares being deposited into or withdrawn from the GDR facilities; and
- use our reasonable efforts to cause the share registrar to promptly notify the Depositary (i) of any alleged unlawful elimination of shareholders from the shareholder register (or any alleged unlawful alteration of shareholder records), (ii) of any alleged unlawful refusal to register shares, and (iii) any time the share registrar holds the shares for its own account.

In the Deposit Agreements we have agreed to assume sole liability for:

- any act or failure to act of the share registrar (other than as a result of any act or failure to act by the Depositary or the Custodian or their respective directors, employees, agents or affiliates);
- unavailability of shares on deposit under the terms of the Deposit Agreements; and
- failure of the Depositary to make any distributions contemplated by the Deposit Agreements as a result of our actions or those of our agents, the actions of the share registrar (other than as a result of any act or failure to act by the Depositary or the Custodian or their respective directors, employees, agents or affiliates), and actions of our present or future charter (or other instrument governing the deposited securities), and any provisions of any securities we issue or distribute and any related distribution or offering.

The Depositary has agreed, for the benefit of the owners of GDRs, to confirm not less frequently than monthly, the number of shares identified on the share register as being on deposit pursuant to the terms of the Deposit Agreements. We have agreed with the Depositary that the Custodian shall maintain in custody duplicate share extracts provided by the share registrar and that any known material discrepancies between the records of the Depositary and the Custodian, on the one hand, and the records of the share registrar, on the other hand, will be brought to our attention promptly. We will use our reasonable efforts to cause the share registrar to reconcile any discrepancies and to effectuate the requisite corrections to the share register. In the event we are unable to obtain such reconciliation of records and the discrepancy exceeds 0.5% of the number of shares identified on the records of the Depositary or the Custodian as being on deposit under the terms of any one of the Deposit Agreements, we will give notice thereof to the owners of GDRs (through the Depositary) and the Depositary shall cease issuance of new GDRs until the records have been appropriately reconciled.

Securities Act and Other Legends

Legends for Rule 144A GDRs

NEITHER THIS RULE 144A GDR CERTIFICATE, NOR THE RULE 144A GDRs EVIDENCED HEREBY, NOR THE SHARES REPRESENTED THEREBY HAVE BEEN OR WILL BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE OFFER, SALE, PLEDGE OR OTHER TRANSFER OF THIS RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY IS EACH SUBJECT TO CERTAIN CONDITIONS AND RESTRICTIONS. THE HOLDERS AND THE BENEFICIAL OWNERS HEREOF, BY PURCHASING OR OTHERWISE ACQUIRING THIS RULE 144A GDR CERTIFICATE AND THE RULE 144A GDRs EVIDENCED HEREBY, ACKNOWLEDGE THAT

SUCH RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT AND AGREE FOR THE BENEFIT OF THE COMPANY AND THE DEPOSITARY THAT THIS RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY MAY BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY IN COMPLIANCE WITH THE SECURITIES ACT AND APPLICABLE LAWS OF THE STATES, TERRITORIES AND POSSESSIONS OF THE UNITED STATES GOVERNING THE OFFER AND SALE OF SECURITIES AND ONLY (1) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, (2) TO A PERSON WHOM THE HOLDER AND THE BENEFICIAL OWNER REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT.

THE BENEFICIAL OWNER OF SHARES RECEIVED UPON CANCELLATION OF ANY RULE 144A GDR MAY NOT DEPOSIT OR CAUSE TO BE DEPOSITED SUCH SHARES INTO ANY DEPOSITARY RECEIPT FACILITY ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK, OTHER THAN A RULE 144A RESTRICTED DEPOSITARY RECEIPT FACILITY, SO LONG AS SUCH SHARES ARE “RESTRICTED SECURITIES” WITHIN THE MEANING OF RULE 144(a)(3) UNDER THE SECURITIES ACT. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALE OF THE SHARES OR THE RULE 144A GDRs.

EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS RULE 144A GDR CERTIFICATE OR A BENEFICIAL INTEREST IN THE RULE 144A GDRs EVIDENCED HEREBY, AS THE CASE MAY BE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

IT IS EXPECTED THAT THE SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR OF THE COMPANY IN THE NAME OF DEUTSCHE BANK TRUST COMPANY AMERICAS, AS DEPOSITARY, OR ITS NOMINEE, OR OF THE CUSTODIAN, OR ITS NOMINEE. HOLDERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF SHARE REGISTRATION AND CUSTODY CREATES RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN OTHER SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

THE DEPOSITARY HAS BEEN ADVISED BY RUSSIAN COUNSEL THAT COURTS IN THE RUSSIAN FEDERATION ARE NOT REQUIRED TO RECOGNIZE OR ENFORCE JUDGMENTS OBTAINED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF NEW YORK.

Legends for Regulation S GDRs

NEITHER THIS REGULATION S GDR CERTIFICATE, NOR THE REGULATION S GDRs EVIDENCED HEREBY, NOR THE SHARES REPRESENTED THEREBY HAVE BEEN OR WILL BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE HOLDERS AND THE BENEFICIAL OWNERS HEREOF, BY PURCHASING OR OTHERWISE ACQUIRING THIS REGULATION S GDR CERTIFICATE AND THE REGULATION S GDRs EVIDENCED HEREBY, ACKNOWLEDGE THAT SUCH REGULATION S GDR CERTIFICATE, THE REGULATION S GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT AND AGREE FOR THE BENEFIT OF THE

COMPANY AND THE DEPOSITARY THAT THIS REGULATION S GDR CERTIFICATE, THE REGULATION S GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY MAY BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY IN COMPLIANCE WITH THE SECURITIES ACT AND APPLICABLE LAWS OF THE STATES, TERRITORIES AND POSSESSIONS OF THE UNITED STATES GOVERNING THE OFFER AND SALE OF SECURITIES.

EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS REGULATION S GDR CERTIFICATE OR A BENEFICIAL INTEREST IN THE REGULATION S GDRs EVIDENCED HEREBY, AS THE CASE MAY BE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

IT IS EXPECTED THAT THE SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR OF THE COMPANY IN THE NAME OF DEUTSCHE BANK TRUST COMPANY AMERICAS, AS DEPOSITARY, OR ITS NOMINEE, OR OF THE CUSTODIAN, OR ITS NOMINEE. HOLDERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF SHARE REGISTRATION AND CUSTODY CREATES RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN OTHER SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

THE DEPOSITARY HAS BEEN ADVISED BY RUSSIAN COUNSEL THAT COURTS IN THE RUSSIAN FEDERATION ARE NOT REQUIRED TO RECOGNIZE OR ENFORCE JUDGMENTS OBTAINED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF NEW YORK.

TAXATION

The following discussion describes the material UK, US federal and Russian income and withholding tax consequences to an owner of ordinary shares or GDRs. This discussion is not intended as tax advice to any particular investor. It is also not a complete analysis or listing of all potential UK, US federal or Russian income and withholding tax consequences to you of ownership of ordinary shares or GDRs. We urge you to consult your own tax adviser regarding the specific UK, US federal, state and local and Russian tax consequences of the ownership and disposition of the ordinary shares or GDRs in your own particular factual circumstances.

A resident of the United States for purposes of the United States-Russia double tax treaty that is fully eligible for benefits under the United States-Russia double tax treaty and holds the ordinary shares or GDRs is referred to herein as a “US holder.” Subject to certain provisions of the United States-Russia double tax treaty relating to limitations on benefits, you generally will be a resident of the United States for treaty purposes and entitled to treaty benefits if you are:

- liable, under the laws of the United States, for US federal income tax (other than taxes in respect only of income from sources in the United States or capital situated therein) by reason of your domicile, residence, citizenship, place of incorporation, or any other similar criterion (and, for income derived by a partnership, trust or estate, residence is determined in accordance with the residence of the person liable for tax with respect to such income); and
- not also a resident of the Russian Federation for Russian tax purposes.

A resident of the United Kingdom for purposes of the United Kingdom-Russia double tax treaty that is fully eligible for benefits under the United Kingdom-Russia double tax treaty and holds the ordinary shares or GDRs is referred to herein as a “UK holder.” You generally will be a resident of the United Kingdom for treaty purposes and entitled to treaty benefits if you are:

- liable, under the laws of the United Kingdom, for UK tax (other than taxes in respect only of income from sources in the United Kingdom or capital situated therein) by reason of your domicile, residence, place of management, or any other similar criterion; and
- not also a resident of the Russian Federation for Russian tax purposes.

The benefits under the United States-Russia double tax treaty and the United Kingdom-Russia double tax treaty discussed in this prospectus are not generally available to US or UK persons who hold GDRs or ordinary shares in connection with the conduct of a business in the Russian Federation through a permanent establishment as defined in the relevant tax treaty. Subject to certain exceptions, a US or UK person’s permanent establishment under the relevant tax treaty is a fixed place of business through which such person carries on business activities in the Russian Federation (generally including, but not limited to, a place of management, a branch, an office and a factory). Under certain circumstances, a US or UK person may be deemed to have a permanent establishment in the Russian Federation as a result of activities carried on in the Russian Federation through agents of the US or UK person. This summary does not address the treatment of those holders.

The following discussion is based on:

- the US Internal Revenue Code of 1986, as amended, the US Treasury regulations promulgated thereunder and judicial and administrative interpretations thereof;
- Russian legislation (in particular, the Tax Code);
- the United States-Russia double tax treaty (and judicial and administrative interpretations thereof);
- UK tax law and HM Revenue and Customs published practice; and
- the United Kingdom-Russia double tax treaty;

all as in effect on the date of this prospectus. All of the foregoing are subject to change, possibly on a retroactive basis, after the date of this prospectus. This discussion is also based, in part, on representations of the Depositary, and assumes that each obligation in the Deposit Agreements and any related agreements will be performed in accordance with its terms. The discussion with respect to Russian legislation is based on our understanding of current Russian law and Russian tax rules, which are subject to frequent change and varying interpretations. See “Risk Factors—Risks Relating to the Russian Federation—Legal Risks and Uncertainties—Weaknesses relating to the legal system and legislation

create an uncertain environment for investment and business activity, which could have a material adverse effect on our business, financial condition, results of operations or prospects or the price of the shares and GDRs” and “—Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and an investment in the shares and GDRs.”

We believe, and the following discussion assumes, that for US federal income tax purposes, we are not a passive foreign investment company for the current taxable year and will not become a passive foreign investment company in the future. For a discussion of the consequences if we are determined to be a passive foreign investment company in this taxable year or if we become a passive foreign investment company in the future, see “—United States Federal Income Tax Considerations—Passive Foreign Investment Company.”

Certain Russian Tax Law Considerations

Russian tax law and procedures are not well developed, and local tax inspectors have considerable autonomy and often interpret tax rules inconsistently. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax and financial authorities may be subject to more rapid and unpredictable change than in jurisdictions with more developed capital markets.

Taxation of Dividends

Dividends paid to a non-resident holder of our ordinary shares generally will be subject to Russian withholding tax, which will be withheld by us acting as a tax agent. The applicable tax rate on dividends will depend on whether the dividend recipient is a legal entity or an individual. Dividends paid to a non-resident holder of shares that is a legal entity generally will be subject to Russian withholding tax at a rate of 15%. Dividends paid to non-resident holders of shares that are individuals will be subject to Russian withholding tax at a rate of 30%.

Withholding tax on dividends may be reduced under the terms of a double tax treaty between the Russian Federation and the country of residence of the non-resident holder of our ordinary shares. For example, the Convention between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, or the United States-Russia Tax Treaty, provides for reduced withholding rates on dividends paid to US holders who are beneficial owners of the dividends. For example, a 10% rate applies to dividends paid to US holders owning less than 10% of the entity’s outstanding shares and a 5% rate applies to dividends paid to US holders that are companies owning 10% or more of the entity’s outstanding shares. The Convention between the Government of the Russian Federation and the Government of the United Kingdom and Northern Ireland on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, or the UK-Russia Tax Treaty, also provides for a 10% withholding rate on dividends paid to UK holders who are beneficial owners of the dividends and are subject to taxation with respect to these dividends in the United Kingdom.

Notwithstanding the foregoing, treaty relief may not be available to non-resident holders of GDRs because of the absence of any interpretative guidance on the beneficial ownership concept in Russia and the fact that the Depositary (and not the holders of the GDRs) is the legal holder of the shares under Russian law. In the absence of any clarification from the Russian tax authorities on the application of relevant double tax treaties, we likely will not be able to apply the reduced rates and will likely withhold tax at applicable domestic rates on dividends payable on ordinary shares represented by the GDRs. Although non-resident holders of GDRs may apply for a refund of a portion of the withholding tax under an applicable double tax treaty, we cannot assure you that the Russian tax authorities will grant a refund. See “—Tax Treaty Procedures.”

Taxation of Capital Gains

Under current Russian legislation, capital gains arising from the sale of GDRs by non-resident holders (legal entities or organizations) should not be subject to tax in Russia if the immovable property located in Russia constitutes 50% or less of our assets. Because the determination of whether 50% or more of our assets consist of immovable property located in Russia is inherently factual and is made on an on-going basis, and because the relevant legislation and regulations are not entirely clear, there can be no assurance that immovable property located in Russia does not currently, or will not, constitute 50% or more of our assets. If more than 50% of our assets were to consist of immovable property located in Russia, (unless

such GDRs are disposed of at a foreign stock exchange) non-resident holders (legal entities or organizations) may be subject to a 20% withholding tax on the gross proceeds from the sale of GDRs or 24% withholding tax on the capital gain realized from the sale being the difference between the sales price and acquisition costs of GDRs. However, so long as the GDRs remain listed on the London Stock Exchange, gains arising from the sale of GDRs by non-resident holders (legal entities or organizations) should not be subject to taxation in Russia.

Under Russian personal income tax law, the sale of GDRs outside of Russia by non-resident holders (individuals) will not be considered Russian source income and will not be taxable in Russia. The sale of GDRs by non-resident holders (individuals) in Russia will be considered Russian source income and will be subject to tax at the rate of 30% on the difference between the sales price and acquisition value of GDRs or underlying shares. However, the acquisition price can only be deducted at the source of payment if the sale was made by a non-resident holder through a professional dealer or broker that is a Russian legal entity or a foreign company with a permanent establishment in Russia. In all other cases, no withholding needs to be made and the non-resident holder will have an obligation to file an annual tax return, report his or her income realized and apply for a deduction of acquisition expenses (which includes filing of support documentation). If the sale of GDRs occurs in Russia, the purchaser will be required to report to the Russian tax authorities on the income realized by the non-resident individual upon the sale of GDRs by April 1 of the year following the reporting year.

A non-resident holder may be exempt from Russian withholding tax on the sale of GDRs under the terms of a double tax treaty between the Russian Federation and the country of residence of the non-resident holder. For example, under the United States-Russia Tax Treaty, US holders are exempt from the withholding tax on capital gains unless 50% or more of the assets of the issuer are represented by immovable property. The UK-Russia Tax Treaty provides for an exemption from withholding tax on capital gains received by UK holders unless the gains relate to shares that: (a) derive all or substantially all of their value directly or indirectly from immovable property in Russia; and (b) are not quoted on an approved stock exchange. See “—Tax Treaty Procedures.”

Tax Treaty Procedures

The Profits Tax Chapter of the Tax Code, which became effective on 1 January 2002, eliminates the requirement that a non-resident holder that is a legal entity must obtain tax treaty clearance from Russian tax authorities prior to receiving any income in order to qualify for benefits under an applicable tax treaty.

A non-resident legal entity seeking to obtain relief from Russian withholding tax under a tax treaty must provide a confirmation of its tax residence that complies with the applicable double tax treaty in advance of receiving income. In accordance with the Tax Code, a non-resident holder who is an individual must present to the tax authorities a document confirming the income received and the tax paid off-shore, confirmed by the foreign tax authorities. Technically, such requirement means that an individual cannot rely on the tax treaty until he or she pays the tax in the jurisdiction of his or her residence. For example, a US Holder may obtain the appropriate certification by mailing completed Form 8802, Application for United States Residency Certification, together with any additional information required to: Internal Revenue Service, Philadelphia Service Center, US Residency Certification Request, P.O. Box 16347, Philadelphia, PA 19114-0447. The procedures for obtaining certification are described in greater detail in Internal Revenue Service Publication 686. Obtaining the required certification from the Internal Revenue Service may take at least six to eight weeks. If the US Holder is eligible for certification, he will receive a Form 6166, Certification of United States Residency, upon filing a completed Form 8802 with the Internal Revenue Service.

If a non-resident does not obtain double tax treaty relief at the time that income or gains are realized and tax is withheld by a Russian payer, the non-resident holder may apply for a refund within three years from the end of the tax period in which the tax was withheld, if the recipient is a legal entity, or within the one-year period from the end of the tax period in which the tax was withheld, if the recipient is an individual. To process a claim of a refund, the Russian tax authorities require (i) a confirmation of the residence of the non-resident at the time the income was paid, (ii) an application for refund of the tax withheld in a format provided by the Russian tax authorities and (iii) copies of the relevant contracts and payment documents confirming the payment of the tax withheld to the appropriate Russian authorities (Form 1012DT for dividends and interest and 1011DT for other income is designed to combine (i) and (ii) for foreign legal entities). The Russian tax authorities may require a Russian translation of some documents. The refund of the tax withheld should be granted within one month of the filing of the

application for the refund and the relevant documents have been filed with the Russian tax authorities. However, procedures for processing such claims have not been clearly established and there is significant uncertainty regarding the availability and timing of such refunds.

The above-mentioned procedures may be more complicated with respect to GDRs, due to separation of legal ownership and beneficial ownership to the Russian shares, underlying the GDRs. Russian tax legislation does not provide for clear guidance regarding availability of double tax treaty relief for GDRs. Therefore, we cannot assure you that relief will be available under the applicable tax treaty in respect of Russian taxes payable or withheld in respect of dividends on ordinary shares represented by GDRs without unreasonable effort or delay, or at all. See “Risk Factors—Risks Relating to the GDRs, the Shares and the Trading Market—You may not be able to benefit from double tax treaties.”

United States Federal Income Tax Considerations

TO COMPLY WITH TREASURY DEPARTMENT CIRCULAR 230, YOU ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF US FEDERAL TAX ISSUES CONTAINED OR REFERRED TO IN THIS PROSPECTUS AND RELATED MATERIALS IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY YOU, FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON YOU UNDER THE CODE; (B) ANY SUCH DISCUSSION IS BEING USED IN CONNECTION WITH THE PROMOTION OR MARKETING BY THE ISSUER OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) YOU SHOULD SEEK ADVICE BASED ON YOUR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

The following is a general description of the material US federal income tax consequences that apply to you if you are, for US federal income tax purposes, a beneficial owner of GDRs or shares that acquired the GDRs or shares pursuant to this prospectus and you are a citizen or resident of the United States, a corporation (including any entity treated as a corporation for US federal income tax purposes) created or organized in or under the laws of the United States or a political subdivision thereof, an estate the income of which is subject to US tax regardless of its source, or a trust, if a US court can exercise primary supervision over the administration of such trust and one or more US persons can control all substantial trust decisions or, if such trust was in existence on 20 August 1996 and has properly elected to continue to be treated as a US person. If a partnership (including any entity treated as a partnership for US federal income tax purposes) is a beneficial owner of GDRs or shares, the US federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Since your US federal income and withholding tax treatment may vary depending upon your particular situation, you may be subject to special rules not discussed below. Special rules will apply, for example, if you are:

- an insurance company;
- a tax-exempt organization;
- a financial institution;
- a person subject to the alternative minimum tax;
- a person who is a broker-dealer in securities;
- an S corporation;
- an expatriate subject to Section 877 of the US Internal Revenue Code;
- an owner of, directly, indirectly or by attribution, 10% or more of the outstanding shares; or
- an owner holding GDRs or shares as part of a hedge, straddle, synthetic security or conversion transaction.

In addition, this summary is generally limited to persons holding shares or GDRs as “capital assets” within the meaning of Section 1221 of the US Internal Revenue Code and whose functional currency is the US dollar. The discussion below does not address the effect of any US state or local tax law or foreign tax law. The discussion below also assumes that the representations contained in the Deposit Agreements are true and that the obligations in the Deposit Agreements and any related agreement will be complied with in accordance with their terms.

For purposes of applying United States federal income and withholding tax law, a holder of a GDR should be treated as the owner of the underlying shares represented by that GDR.

The US Treasury has expressed concerns that parties to whom GDRs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by US persons for US federal income tax purposes. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate US persons, as described below. Accordingly, the analysis of the creditability of Russian taxes described below, and the availability of the reduced tax rate for dividends received by certain non-corporate US persons, could be affected by future actions that may be taken by the US Treasury.

Taxation of Dividends on Shares or GDRs

Subject to the passive foreign investment company rules discussed below, for US federal income tax purposes, the gross amount of a distribution, including any Russian withholding taxes, with respect to shares or GDRs will be treated as a taxable dividend to the extent of our current and accumulated earnings and profits, computed in accordance with United States federal income tax principles. For taxable years beginning before 1 January 2009, if you are a non-corporate taxpayer, such dividends may be taxed at the lower applicable capital gains rate provided (1) certain holding period requirements are satisfied, (2) we are eligible for the benefits of the United States-Russia double tax treaty, and (3) we are not a “passive foreign investment company” for either our taxable year in which the dividend was paid or the preceding taxable year. Non-corporate US holders are strongly urged to consult their tax advisors as to the applicability of the lower capital gains rate to dividends received with respect to GDRs or shares. Distributions in excess of our current or accumulated earnings and profits will be applied against and will reduce your tax basis in shares or GDRs and, to the extent in excess of such tax basis, will be treated as gain from a sale or exchange of such shares or GDRs. You should be aware that we do not intend to calculate our earnings and profits for US federal income tax purposes; and unless we make such calculations, you should assume that any distributions with respect to shares or GDRs will constitute ordinary dividend income. If you are a corporation, you will not be allowed a deduction for dividends received in respect of distributions on shares or GDRs, which is generally available for dividends paid by US corporations.

If a dividend distribution is paid in roubles, the amount includible in income will be the US dollar value of the dividend, calculated using the exchange rate in effect on the date the dividend is includible in income by you, regardless of whether the payment is actually converted into US dollars. Any gain or loss resulting from currency exchange rate fluctuations during the period from the date the dividend is includible in your income to the date the roubles are converted into US dollars will be treated as ordinary income or loss. In addition, you may be required to recognize as ordinary income or loss foreign currency gain or loss on the receipt of a refund of Russian withholding tax pursuant to the United States-Russia double tax treaty to the extent the US dollar value of the refund differs from the US dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian tax withheld from distributions at the rate applicable to you under the United States-Russia double tax treaty should be treated as a foreign income tax that, subject to generally applicable limitations and conditions, is eligible for credit against your US federal income tax liability or, at your election, may be deducted in computing taxable income, provided, in each case, that the amounts withheld and paid to Russian tax authorities are treated as satisfying your tax liability. If, however, the holder of a GDR is not treated as the owner of the underlying shares represented by the GDR for US federal income tax purposes, then Russian withholding tax would not be treated as a foreign income tax eligible for credit as described in the preceding sentence. If Russian tax is withheld at a rate in excess of the rate applicable to you under the United States-Russia double tax treaty, you may not be entitled to credits for the excess amount because such amounts might be treated as recoverable by you for US federal income tax purposes, even though the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

A dividend distribution will be treated as foreign source income and will generally be classified as “passive income” or, in some cases, “financial services income” for US foreign tax credit purposes. The recently enacted American Jobs Creation Act of 2004, or the Act, modifies the foreign tax credit limitation by reducing the number of classes of foreign source income to two for taxable years beginning after 31 December 2006. Under the Act, dividends generally constitute “passive category income” but could, in the case of certain US holders, constitute “general category income.” The rules relating to the determination of the foreign tax credit, or deduction in lieu of the foreign tax credit, are complex and you should consult your tax advisors with respect to those rules.

Taxation on Sale or Exchange of Shares or GDRs

Subject to the passive foreign investment company rules discussed below, the sale or other disposition of shares or GDRs will generally result in the recognition of gain or loss in an amount equal to the difference between the US dollar value of the amount realized on the sale and your adjusted basis in such shares or GDRs, such value to be calculated at the spot rate on the settlement date. That gain or loss will be capital gain or loss if the shares or GDRs are capital assets in your hands and will be long-term capital gain or loss if the shares or GDRs have been held for more than one year. If you are an individual, such realized long-term capital gain is generally subject to a reduced rate of US federal income tax. Limitations may apply to your ability to offset capital losses against ordinary income.

Deposits and withdrawals of shares by you in exchange for GDRs should not result in the realization of gain or loss for US federal income tax purposes.

A gain realized on the sale of shares or GDRs will generally be treated as US source income and therefore the use of foreign tax credits relating to any Russian taxes imposed upon such sale may be limited. You are strongly urged to consult your own tax advisors as to the availability of tax credits for any Russian taxes withheld on the sale of shares or GDRs.

Passive Foreign Investment Company

A non-US corporation will be considered a passive foreign investment company (PFIC) for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) at least 50% of the value of its assets is attributable to assets that produce or are held for the production of passive income.

Based on our current and projected activities and operations, we do not expect to be considered a PFIC for our current taxable year ending 31 December 2005. However, we must make a separate determination each year as to whether we are a PFIC (after the close of each taxable year) and we cannot assure you that we will not be a PFIC for our current taxable year or any future taxable year. In addition, the market value of our assets may be determined in large part by the market price of our GDRs and shares, which is likely to fluctuate, and thus could impact the asset test described above. If we are a PFIC for any year during which you hold GDRs or shares, we will generally continue to be treated a PFIC for all succeeding years during which you hold GDRs or shares.

If we are a PFIC either currently or in any future taxable year during which you hold GDRs or shares, you will be subject to special tax rules with respect to any “excess distribution” that you receive and any gain you realize from a sale or other disposition of the GDRs or shares, unless you make a “mark-to-market” election described below. Distributions you receive in a taxable year that are greater than 125% of the average annual distributions you received during the shorter of the three preceding taxable years or your holding period for the GDRs or shares will be treated as an excess distribution. Under these special tax rules: (i) the excess distribution or gain will be allocated ratably over your holding period for the GDRs or shares, (ii) the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we became a PFIC will be treated as ordinary income, and (iii) the amount allocated to each other year will be subject to the highest applicable marginal tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

The tax liability for amounts allocated to years prior to the year of disposition or “excess distribution” cannot be offset by any net operating losses for such years, and gains (but not losses) realized on the sale of the GDRs or shares cannot be treated as capital, even if you hold the GDRs or shares as capital assets.

Alternatively, holders of “marketable stock” (as defined below) in a PFIC may make a mark-to-market election for such stock to elect out of the tax treatment discussed in the two preceding paragraphs. If you make a mark-to-market election for the GDRs or shares, you will include in income each year an amount equal to the excess, if any, of the fair market value of the GDRs or shares as of the close of your taxable year over your adjusted basis in such GDRs or shares. You are allowed a deduction for the excess, if any, of the adjusted basis of the GDRs or shares over their fair market value as of the close of the taxable year. However, deductions are allowed only to the extent of any net mark-to-market gains on the GDRs or shares included in your income for prior taxable years. Amounts included in your income under a mark-to-market election, as well as gain on the actual sale or other disposition of the GDRs or shares, are treated as ordinary income. Ordinary loss treatment also applies to the deductible portion of any mark-to-market loss on the GDRs or shares, as well as to any loss realized on the actual sale or disposition of the GDRs or shares, to the extent that the amount of such loss does not exceed the net

mark-to-market gains previously included for such GDRs or shares. Your basis in the GDRs or shares will be adjusted to reflect any such income or loss amounts. The tax rules that apply to distributions by corporations which are not PFICs would apply to distributions by us.

The mark-to-market election is available only for “marketable stock,” which is stock that is traded in other than de-minimis quantities on at least 15 days during each calendar quarter on a qualified exchange or other market, as defined in applicable US Treasury regulations.

If you hold GDRs or shares in any year in which we are a PFIC, you will be required to file Internal Revenue Service Form 8621 regarding distributions received on the GDRs or shares and any gain realized on the disposition of the GDRs or shares.

You are strongly urged to consult your tax advisor regarding the application of the PFIC rules to your investment in the GDRs or shares.

Information Reporting and Backup Withholding

Dividends and proceeds from the sale or other disposition of shares or GDRs that are paid in the United States or by a US-related financial intermediary will be subject to US information reporting rules and US backup withholding tax, unless you are a corporation or other exempt recipient. In addition, you will not be subject to backup withholding if you provide your taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. Holders that are not US persons generally are not subject to information reporting or backup withholding, but such holders may be required to provide certification as to their non-US status.

United Kingdom Tax Considerations

The comments below are of a general nature based on current UK law and published practice and only apply to persons who are resident in the UK for tax purposes or who carry on a trade profession or vocation through a permanent establishment (including a branch or agency) in the UK to which the GDRs or shares are attributable. They do not necessarily apply where the income is deemed for tax purposes to be the income of persons other than persons who are the absolute beneficial owners of GDRs or shares. In particular these comments do not apply to the following:

- investors who do not hold their GDRs or shares as capital assets;
- investors that own (or are deemed to own) 10% or more of our voting rights or shares (including shares represented by GDRs);
- special classes of investors such as dealers or traders in securities; or
- individuals who are resident but not domiciled in the UK and who do not remit income, profit or gain derived from the GDRs or shares to the UK.

Withholding tax on dividends

Dividend payments in respect of GDRs or shares issued by a company organized under the laws of the Russian Federation should not be subject to UK withholding tax. As discussed in “—Certain Russian Tax Law Considerations—Taxation of Dividends,” such dividends will be subject to Russian withholding taxes.

Taxation of Dividends

A UK holder of interests in GDRs or shares that receives a dividend on the GDRs or shares may be subject to UK income tax or corporation tax, as the case may be, on the gross amount of any dividend paid before the deduction of any Russian withholding taxes, subject to the availability of any credit for Russian tax withheld.

Taxation of Disposals

The disposal, or part disposal, by a UK holder of interests in GDRs or shares may give rise to a chargeable gain or allowable loss for the purposes of UK taxation or chargeable gains depending upon the UK holder’s individual circumstances (including the availability of exemptions and reliefs and in particular any credit or deduction for any Russian tax withheld, if applicable). See “—Certain Russian Tax Law Considerations—Taxation of Capital Gains.”

Stamp Duty

Payment of UK stamp duty will not normally be required in connection with a transfer of interests in GDRs or shares, provided that the instrument of transfer is executed and retained outside the United Kingdom and the shareholder register and the GDR register are not held in the United Kingdom.

No UK stamp duty reserve tax will be payable in respect of any agreement to transfer interests in GDRs or shares provided that no UK shareholder register or GDR register is maintained in the UK.

PLAN OF DISTRIBUTION

Description of the Distribution

The offering consists of an international simultaneous offering of shares and GDRs. The GDRs are being offered in the United States to QIBs in reliance on Rule 144A and outside the United States and the Russian Federation to certain persons in offshore transactions in reliance on Regulation S. The shares are being offered only in the Russian Federation.

Under the terms of, and subject to, the conditions contained in an Underwriting Agreement dated 21 July 2005 (the “Underwriting Agreement”) entered into between us, the Selling Shareholder and the underwriters, the underwriters named below have severally agreed to procure purchases for, or failing which, themselves to purchase, at the offer price, the number of shares (including a portion in the form of GDRs) indicated below. The Selling Shareholder has agreed to make available, at the offer price, to the underwriters, the number of shares (including a portion in the form of GDRs) indicated below:

Name	Shares
Morgan Stanley & Co. International Limited	174,119
UBS Limited	174,119
Credit Suisse First Boston (Europe) Limited	87,059
Troika Dialog (Bermuda) Ltd.	52,445
Alfa Capital Holdings (Cyprus) Limited	23,600
Vnesheconombank	13,111
Total	524,453

We estimate that our and the Selling Shareholder’s total expenses of the offering, other than commissions, will be approximately \$7.7 million.

The Underwriting Agreement contains, among others, the following further provisions:

- The Selling Shareholder has granted to the underwriters an over-allotment option to acquire up to 52,445 additional shares in the form of GDRs at the offer price for the purposes of meeting over-allotments in connection with the offering. The over-allotment option is exercisable upon written notice to the Selling Shareholder by the underwriters, given not later than 30 days following the announcement of the offer price. If the underwriters exercise this option, the Selling Shareholder will be obligated to sell, and each underwriter will be severally obligated, subject to the conditions contained in the Underwriting Agreement, to purchase, a number of additional shares in the form of GDRs proportionate to that underwriter’s initial amount reflected in the table above.
- The underwriters will deduct from the proceeds of the offering:
 - (i) costs and expenses incurred by the underwriters in connection with the offering; and
 - (ii) certain commissions, including an incentive fee, payable by the Selling Shareholder, of 3.65% of the amount equal to the offer price multiplied by the number of shares. Such commissions will equate to a total of \$32,063,745 with respect to the number of shares sold in the form of shares and GDRs indicated in the table above and, with respect to any additional shares in the form of GDRs acquired by the underwriters as a result of the exercise of the over-allotment option, a total of \$3,206,356 (on the assumption that the over-allotment option is exercised in full).
- The obligations of the parties to the Underwriting Agreement are subject to certain conditions that are typical for an agreement of this nature. These conditions include, amongst others, the accuracy of the representations and warranties under the Underwriting Agreement and the application for admission to the official list of the UK Listing Authority and to trading on the London Stock Exchange having been approved on or prior to the closing date. The underwriters, may terminate the Underwriting Agreement prior to the closing date in certain specified circumstances that are typical for an agreement of this nature. These include the occurrence of certain material changes in our condition (financial or otherwise), or in our earnings, business affairs, business prospects, trading position or property and certain changes in financial, political or economic conditions (as more fully set out in the Underwriting

Agreement). If any of the above-mentioned conditions are not satisfied (or waived, where capable of being waived) by, or the Underwriting Agreement is terminated prior to, the closing date, then the offering will lapse.

- We have given customary representations and warranties to the underwriters, including in relation to our business, our accounting records and our legal compliance, in relation to shares and GDRs and in relation to the contents of this prospectus. The Selling Shareholder has given certain warranties to the underwriters, including in relation to its capacity, its good title to the shares and GDRs and its conduct.
- We and the Selling Shareholder have given customary indemnities to the underwriters in connection with the offering.
- If an underwriter defaults, the underwriting agreement provides that in certain circumstances, the purchase commitments of the non-defaulting underwriters may be increased or the underwriting agreement may be terminated.

We, the Selling Shareholder and certain other shareholders have agreed, subject to exceptions for transfers to family members and trusts and among certain existing shareholders, as part of the Underwriting Agreement, not to issue, offer, sell, contract to sell, pledge, charge, grant options over or otherwise dispose of, directly or indirectly, any shares in us or securities convertible or exchangeable into or exercisable for any shares in us or warrants or other rights to purchase such shares or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying securities, including equity swaps, forward sales and options or GDRs representing the right to receive any such securities or publicly announce any intention to do any of the foregoing, for a period of 180 days from the closing date, without the prior written consent of the underwriters.

In connection with the offering, Morgan Stanley & Co. International Limited (or any agent or other person acting for Morgan Stanley & Co. International Limited), as stabilizing manager, may over-allot or effect transactions intended to enable it to satisfy any over-allocations or which stabilize, maintain, support or otherwise affect the market price of the GDRs at a level higher than that which might otherwise prevail for a period of 30 days after the announcement of the offer price. However, there may be no obligation on Morgan Stanley & Co. International Limited, or any agent of Morgan Stanley & Co. International Limited, to do this. Such transactions may be effected on the London Stock Exchange and any other securities market, over the counter market, stock exchange or otherwise. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end 30 days after the announcement of the offer price. Save as required by law, Morgan Stanley & Co. International Limited does not intend to disclose the extent of any over-allotments and/or stabilization transactions under the offering.

In connection with the offering, each of the underwriters and any affiliate acting as an investor for its own account may take up the shares and in that capacity may retain, purchase or sell the shares, in the form of shares or GDRs (or related investments), for its own account and may offer or sell such securities (or other investments) otherwise than in connection with the offering. The underwriters do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

Application has been made to (i) the UK Listing Authority for a listing of up to 121,452,200 GDRs, consisting of up to 52,445,300 GDRs to be issued on the closing date, up to 5,244,500 additional GDRs issued pursuant to the over-allotment option, as described herein, and up to 63,762,400 additional GDRs to be issued from time to time against the deposit of shares with the Depositary, to be admitted to the Official List and (ii) the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange's regulated market for listed securities. Application has also been made to have the Rule 144A GDRs designated eligible for trading in PORTAL. Our existing shares are listed on the RTS Stock Exchange and the MICEX Stock Exchange. Prior to the offering, there has been no market for the GDRs. Trading in the GDRs on the London Stock Exchange is expected to commence on 21 July 2005, on a when and if issued basis. Closing and settlement are expected to take place on 26 July 2005, and admission to the Official List of the UK Listing Authority and to trading on the London Stock Exchange's regulated market for listed securities are expected to take place on 27 July 2005.

Investors wishing to enter into transactions in the GDRs prior to the closing date of the offering, whether such transactions are effected on the London Stock Exchange or otherwise, should be aware that the closing of the offering may not take place on 26 July 2005 or at all if certain conditions or events referred to in the Underwriting Agreement are not satisfied or waived or do not occur on or prior to such

date. All such transactions will be of no effect if the offering does not become unconditional. In addition, the GDRs are expected to be eligible for trading in PORTAL. However, we cannot assure you that an active public or other market will develop for the GDRs or shares or that a liquid trading market will exist for the GDRs or shares. We do not intend to list the GDRs or shares on any U.S. national securities exchange or to seek the admission thereof to trading on the Nasdaq National Market System.

Some of the underwriters and their respective affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with us or members of our group. They have received customary fees and commissions for these transactions and services. Vnesheconombank currently holds approximately 5.6% of our issued and outstanding ordinary shares.

Selling Restrictions

Each of the underwriters has represented that the shares and GDRs have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except in accordance with Regulation S or pursuant to an exemption from the registration requirements of the Securities Act. Each of the underwriters has further represented that it has offered and sold the GDRs, and has agreed that it will offer and sell the GDRs, only in accordance with Rule 903 of Regulation S or Rule 144A. Accordingly, neither it, its affiliates nor any persons acting on its or their behalf have engaged or will engage in any directed selling efforts with respect to the shares and GDRs.

Each of the underwriters has represented that neither it nor any of its affiliates, nor any person acting on its or their behalf has engaged or will engage in any form of general solicitation or general advertising (within the meaning of Regulation D under the Securities Act) in connection with any offer and sale of the shares and GDRs in the United States and that the underwriters only may directly or through their respective U.S. broker-dealer affiliates arrange for the offer and resale of GDRs in the United States only to qualified institutional buyers in accordance with Rule 144A.

In addition, until 40 days after the commencement of the offering of the shares and GDRs, an offer or sale of the GDRs within the United States by a dealer that is not 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 underwriters propose to offer the shares (i) in the form of GDRs to institutional investors outside the United States and the Russian Federation in accordance with Regulation S, (ii) in the form of GDRs through the US selling agents of certain of the underwriters, only to QIBs in the United States in accordance with Rule 144A, and (iii) in the form of shares to investors within the Russian Federation. Each of the underwriters has agreed that, except as permitted in the Underwriting Agreement, it will not offer, sell or deliver shares or the GDRs within the United States.

Each of the underwriters has represented and agreed that: (i) it has not made and will not make an offer of GDRs to the public in the United Kingdom prior to admission of the GDRs to listing in accordance with Part VI of the FSMA, except (a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities; (b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or (c) in any other circumstances which do not require a prospectus to be made available to the public pursuant to Section 85 of the FSMA; (ii) 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 GDRs in circumstances in which section 21(1) of the FSMA does not apply to NOVATEK; and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares or GDRs in, from or otherwise involving the United Kingdom.

Each of the underwriters has represented and agreed that, in relation to each member state of the European Economic Area which has implemented the Prospectus Directive 2003/71/EC (each a Relevant Member State), with effect from and including the date on which the Prospectus Directive 2003/71/EC is implemented in that Relevant Member State (the Relevant Implementation Date) it has not made and will not make an offer of GDRs to the public in that Relevant Member State prior to the publication of a prospectus in relation to the GDRs which has been approved by the competent authority in that Relevant

Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive 2003/71/EC, except that it may, with effect from and including the Relevant Implementation Date, make an offer of GDRs to the public in that Relevant Member State at any time: (a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities; (b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or (c) in any other circumstances which do not require the publication of a prospectus pursuant to Article 3 of the Prospectus Directive 2003/71/EC.

Each of the underwriters has represented and agreed that the GDRs will only be offered or sold, directly or indirectly, in Canada only in the Canadian provinces of British Columbia, Ontario and Québec and in compliance with applicable Canadian securities laws and accordingly, any sales of GDRs will be made (i) through an appropriately registered securities dealer or in accordance with an available exemption from the registered securities dealer requirements of applicable Canadian securities laws and (ii) pursuant to an exemption from the prospectus requirements of such laws.

Each of the underwriters has represented and agreed that it has not offered or sold and will not offer or sell any GDRs to or for the benefit of any persons resident, incorporated, established or having their usual residence in Russia or to any person located within the territory of Russia.

Each of the underwriters has represented and agreed that the shares and GDRs have not been and will not be registered under the Securities and Exchange Law of Japan and that it has not offered or sold, and it will not offer or sell, directly or indirectly, any of the shares or GDRs in Japan or to, or for the account or benefit of, any resident of Japan or to, or for the account or benefit of, any persons for reoffering or resale, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, or otherwise in compliance with, the Securities and Exchange Law and other relevant laws and regulations of Japan.

Each of the underwriters has represented and agreed that no action has been taken or will be taken in any jurisdiction that would permit a public offering of the shares or the GDRs, or the possession or distribution of this prospectus or any other material relating to the offering or the shares and GDRs, in any jurisdiction where action for such purpose is required. Accordingly, the shares and GDRs may not be offered or sold, directly or indirectly, nor may this prospectus or any other offering material or advertisement in connection with such securities be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

No dealer, salesperson or other person has been authorized to give any information or to make any representation not contained in this prospectus, and, if given or made, such information or representation must not be relied upon as having been authorized by us or any underwriter. This prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or an offer to sell or the solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs since the date hereof or that the information contained in this prospectus is correct as of a date after its date.

Information For Canadian Investors

This document is not, and under no circumstances is to be construed as, a prospectus, an advertisement or a public offering of the securities described herein in Canada. No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein, and any representation to the contrary is an offence.

The offering is being made in Canada only in the Canadian provinces of British Columbia, Ontario and Québec (the “Private Placement Provinces”) by way of a private placement of GDRs. The offering in the Private Placement Provinces is being made pursuant to this document through the underwriters named in this document or through their selling agents who are permitted under applicable law to distribute such securities in Canada.

Representations and Agreements by Purchasers

Confirmations of the acceptance of offers to purchase any GDRs will be sent to purchasers in the Private Placement Provinces who have not withdrawn their offers to purchase prior to the issuance of such confirmations. Each purchaser of GDRs in the Private Placement Provinces who receives a purchase confirmation regarding the purchase of GDRs will, by the purchaser's receipt thereof, be deemed to have represented to NOVATEK, the Selling Shareholder and the dealer from which such purchase confirmation is received, that such purchaser and any ultimate purchaser for which such initial purchaser is acting as agent (i) is entitled under applicable provincial securities laws to purchase such GDRs without the benefit of a prospectus qualified under such securities laws and, in the case of purchasers in provinces other than Ontario, without the services of a dealer registered pursuant to such securities laws, (ii) is basing its investment decision solely on this document and not on any other information concerning NOVATEK or the offering, (iii) has reviewed the terms referred to below under the heading "Canadian Resale Restrictions" and (iv) is in compliance with the following:

- where the purchaser is purchasing in British Columbia, such purchaser is purchasing GDRs with the benefit of the prospectus exemption and dealer registration exemption provided by section 5.1 of Multilateral Instrument 45-103—Capital Raising Exemptions ("MI 45-103") (that is, such purchaser is purchasing as principal and is an "accredited investor" within the meaning of section 1.1 of MI 45-103);
- where the purchaser is purchasing in Ontario, such purchaser is either a "designated institution" within the meaning of section 204 of the Regulation to the Securities Act (Ontario) purchasing from a person or company registered as an "international dealer" under the Securities Act (Ontario) or is a purchaser purchasing from a fully registered dealer and, in either case, is purchasing the GDRs with the benefit of the prospectus exemption provided by section 2.3 of Ontario Securities Commission Rule 45-501—Exempt Distributions ("Rule 45-501") (that is, such purchaser is purchasing the GDRs as a principal and is an "accredited investor" within the meaning of section 1.1 of Rule 45-501);
- where the purchaser is purchasing in Québec, such purchaser is either a purchaser to which the prospectus exemption in section 43 applies, is a "sophisticated purchaser" within the meaning of section 44 of the Securities Act (Québec) purchasing the GDRs as principal, or is a "sophisticated purchaser" within the meaning of section 45 of the Securities Act (Québec) purchasing for the portfolio of a person managed solely by it or is purchasing as principal GDRs with an aggregate acquisition cost to such purchaser of at least Cdn\$150,000 from a registered dealer with an unrestricted practice;
- if the purchaser is a person or a company, the purchaser had a pre-existing purpose and was not established solely or primarily for the purpose of acquiring GDRs in reliance on an exemption from applicable prospectus requirements in the Private Placement Provinces;
- such purchaser is either purchasing GDRs as principal for its own account, or is deemed to be purchasing GDRs as principal for its own account in accordance with the applicable securities laws of the province in which such purchaser is resident, by virtue of being either (a) a designated trust company; (b) a designated insurance company; (c) a portfolio manager; or (d) another entity similarly deemed by those laws to be purchasing as principal for its own account when purchasing on behalf of other beneficial purchasers;
- such purchaser is purchasing in respect of a trade for which there is an exemption from the registration requirements of applicable Canadian securities laws or which is otherwise in compliance with such laws;
- such purchaser acknowledges and agrees that the offer and sale of GDRs was made exclusively through this document and was not made through an advertisement of the GDRs in any printed media of general and regular paid circulation, radio or television or any other form of advertising; and
- acknowledges that the GDRs are being distributed in Canada on a private placement basis only and that any resale of GDRs must be in accordance with the requirements of applicable securities laws, which will vary depending on the relevant jurisdictions.

Language of Document

Each purchaser of GDRs in Canada that receives a purchase confirmation hereby agrees that it is such purchaser's express wish that all documents evidencing or relating in any way to the sale of such GDRs be drafted in the English language only. *Chaque acheteur au Canada des valeurs mobilières recevant un avis de confirmation à l'égard de son acquisition reconnaît que c'est sa volonté expresse que tous les documents faisant foi ou se rapportant de quelque manière à la vente des valeurs mobilières soient rédigés uniquement en anglais.*

Canadian Resale Restrictions

The distribution of the GDRs in the Private Placement Provinces is being made on a private placement basis. Accordingly, any resale of the GDRs must be made (i) through an appropriately registered dealer or in accordance with an exemption from the dealer registration requirements of applicable provincial securities laws and (ii) in accordance with, or pursuant to an exemption from, the prospectus requirements of such laws. Such resale restrictions may not apply to resales made outside of Canada, depending on the circumstances. Purchasers of GDRs are advised to seek legal advice prior to any resale of GDRs.

Statutory Rights of Action (Ontario Purchasers)

Section 4.2 of Rule 45-501 provides that when a prospectus, such as this document, is delivered to an investor to whom securities are distributed in reliance upon the "accredited investor" prospectus exemption in section 2.3 of Rule 45-501, the right of action referred to in section 130.1 of the Securities Act (Ontario) ("Section 130.1") is applicable. Section 130.1 provides purchasers who purchase securities offered by a prospectus with a statutory right of action against the issuer of securities and any selling securityholder for rescission or damages in the event that the prospectus and any amendment to it contains a "misrepresentation". "Misrepresentation" means an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make any statement not misleading or false in the light of the circumstances in which it was made.

Where this document, together with any amendment to it, is delivered to a prospective purchaser of GDRs in connection with a trade made in reliance on section 2.3 of Rule 45-501, and this document contains a misrepresentation which was a misrepresentation at the time of purchase of the GDRs, the purchaser will have a statutory right of action against NOVATEK and the Selling Shareholder for damages or, while still the owner of GDRs, for rescission, in which case, if the purchaser elects to exercise the right of rescission, the purchaser will have no right of action for damages, provided that the right of action for rescission will be exercisable by the purchaser only if the purchaser gives notice to the defendant, not more than 180 days after the date of the transaction that gave rise to the cause of action, that the purchaser is exercising this right; or, in the case of any action, other than an action for rescission, the earlier of: (i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or (ii) three years after the date of the transaction that gave rise to the cause of action.

The defendant shall not be liable for a misrepresentation if it proves that the purchaser purchased the GDRs with knowledge of the misrepresentation.

In an action for damages, the defendant shall not be liable for all or any portion of the damages that the defendant proves do not represent the depreciation in value of the GDRs as a result of the misrepresentation relied upon.

Subject to the paragraph below, all or any one or more of NOVATEK and the Selling Shareholder are jointly and severally liable, and every person or company who becomes liable to make any payment for a misrepresentation may recover a contribution from any person or company who, if sued separately, would have been liable to make the same payment, unless the court rules that, in all the circumstances of the case, to permit recovery of the contribution would not be just and equitable.

Despite the paragraph above, NOVATEK shall not be liable where it is not receiving any proceeds from the distribution of the GDRs being distributed and the misrepresentation was not based on information provided by NOVATEK, unless the misrepresentation,

- (a) was based on information that was previously publicly disclosed by NOVATEK;
- (b) was a misrepresentation at the time of its previous public disclosure; and

- (c) was not subsequently publicly corrected or superseded by NOVATEK prior to the completion of the distribution of the GDRs.

In no case shall the amount recoverable for the misrepresentation exceed the price at which the GDRs were offered.

The foregoing statutory right of action for rescission or damages conferred is in addition to and without derogation from any other right the purchaser may have at law.

This summary is subject to the express provisions of the Securities Act (Ontario) and the regulations and rules made under it, and you should refer to the complete text of those provisions.

Enforcement of Legal Rights

All of the directors and officers (or their equivalents) of NOVATEK and the Selling Shareholder, as well as any experts named herein may be located outside of Canada and, as a result, it may not be possible for purchasers to effect service of process within Canada upon NOVATEK, the Selling Shareholder or such experts. All or a substantial portion of the assets of NOVATEK, the Selling Shareholder and such experts may be located outside of Canada and, as a result, it may not be possible to satisfy a judgment against NOVATEK, the Selling Shareholder or such experts in Canada or to enforce a judgment obtained in Canadian courts against NOVATEK, the Selling Shareholder or such experts outside of Canada.

Canadian Tax Considerations and Eligibility for Investment

This document does not address the Canadian tax consequences of ownership of the GDRs. Prospective purchasers of GDRs should consult their own tax advisers with respect to the Canadian and other tax considerations applicable to their individual circumstances and with respect to the eligibility of the GDRs for investment by purchasers under relevant Canadian legislation.

SETTLEMENT AND DELIVERY

Clearing and Settlement of GDRs

Custodial and depositary links have been established between Euroclear, Clearstream and DTC to facilitate the initial issue of the GDRs and cross-market transfers of the GDRs associated with secondary market trading.

The Clearing Systems

Euroclear and Clearstream

Euroclear and Clearstream each hold securities for participating organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Euroclear and Clearstream have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Indirect access to Euroclear or Clearstream is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

Distributions of dividends and other payments with respect to book-entry interests in the GDRs held through Euroclear or Clearstream will be credited, to the extent received by the Depositary, to the cash accounts of Euroclear or Clearstream participants in accordance with the relevant system's rules and procedures.

DTC

DTC has advised NOVATEK as follows: DTC is a limited-purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of the New York Banking Law, a member of the United States 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 holds securities for DTC participants and facilitates the clearance and settlement of securities transactions between DTC participants through electronic computerized book-entry changes in DTC participants' accounts. DTC participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. Indirect access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly.

Holders of book-entry interests in the GDRs holding through DTC will receive, to the extent received by the Depositary, all distributions of dividends or other payments with respect to book-entry interests in the GDRs from the Depositary through DTC and DTC participants. Distributions in the United States will be subject to relevant US tax laws and regulations. See "Taxation—United States Federal Income Tax Considerations."

As DTC can act on behalf of DTC direct participants only, who in turn act on behalf of DTC indirect participants, the ability of beneficial owners who are indirect participants to pledge book-entry interests in the GDRs to persons or entities that do not participate in DTC, or otherwise take actions with respect to book-entry interests in the GDRs, may be limited.

Registration and Form

Book-entry interests in the GDRs held through Euroclear and Clearstream will be represented by the Master Regulation S GDR Certificate registered in the name of BT Globenet Nominees Limited as common nominee Deutsche Bank AG London, as common depositary for Euroclear and Clearstream. Book-entry interests in the GDRs held through DTC will be represented by the Master Rule 144A GDR Certificate registered in the name of Cede & Co., as nominee for DTC, which will be held by the Depositary as custodian for DTC. As necessary, the Registrar will adjust the amounts of GDRs on the relevant register for the accounts of the common nominee and nominee, respectively, to reflect the

amounts of GDRs held through Euroclear, Clearstream and DTC, respectively. Beneficial ownership in the GDRs will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream and DTC.

The aggregate holdings of book-entry interests in the GDRs in Euroclear, Clearstream and DTC will be reflected in the book-entry accounts of each such institution. Euroclear, Clearstream and DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the GDRs, will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the GDRs. The Depositary will be responsible for maintaining a record of the aggregate holdings of GDRs registered in the name of the common nominee for Euroclear and Clearstream and the nominee for DTC. The Depositary will be responsible for ensuring that payments received by it from us for holders holding through Euroclear and Clearstream are credited to Euroclear or Clearstream, as the case may be, and the Depositary will also be responsible for ensuring that payments received by it from us for holders holding through DTC are received by DTC.

We will not impose any fees in respect of the GDRs; however, holders of book-entry interests in the GDRs may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream or DTC and certain fees and expenses payable to the Depositary in accordance with the terms of the Deposit Agreements.

Settlement and Delivery of Shares

Each purchaser of the shares in the offering is required to pay for any shares in same-day funds and the shares will be delivered to such purchasers on or about 26 July 2005 or a later date. In order to take delivery of the shares, potential purchasers may be required to have a depo account at one or more depositaries designated by us. Upon taking delivery of the shares, purchasers may choose to hold the shares through a direct account with our share registrar; however, directly-held shares are ineligible for trading on the MICEX Stock Exchange or the RTS. In addition, in order to trade your shares on the MICEX Stock Exchange or the RTS, you may have to further transfer your shares to an account at a different depositary.

Global Clearance and Settlement Procedures

Initial Settlement

The GDRs will be in global form evidenced by the two Global Master GDRs. Purchasers electing to hold book-entry interests in the GDRs through Euroclear and Clearstream accounts will follow the settlement procedures applicable to depositary receipts. DTC participants acting on behalf of purchasers electing to hold book-entry interests in the GDRs through DTC will follow the delivery practices applicable to depositary receipts.

Secondary Market Trading

Transfer Restrictions

For a description of the transfer restrictions relating to the GDRs, see “Description of the Global Depositary Receipts—Transfer Restrictions.”

Trading between Euroclear and Clearstream Participants

Secondary market sales of book-entry interests in the GDRs held through Euroclear or Clearstream to purchasers of book-entry interests in the GDRs through Euroclear or Clearstream will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the normal procedures applicable to depositary receipts.

Trading between DTC Participants

Secondary market sales of book-entry interests in the GDRs held through DTC will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to depositary receipts, if payment is effected in US dollars, or free of payment, if payment is not effected in US dollars. Where payment is not effected in US dollars, separate payment arrangements outside DTC are required to be made between the DTC participants.

Trading between DTC Seller and Euroclear/Clearstream Purchaser

When book-entry interests in the GDRs are to be transferred from the account of a DTC participant to the account of a Euroclear or Clearstream participant, the DTC participant must send to DTC a delivery free of payment instruction at least two business days prior to the settlement date. DTC will in turn transmit such instruction to Euroclear or Clearstream, as the case may be, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant. On the settlement date, DTC will debit the account of its DTC participant and will instruct the Depositary to instruct Euroclear or Clearstream, as the case may be, to credit the relevant account of the Euroclear or Clearstream participant, as the case may be. In addition, on the settlement date, DTC will instruct the Depositary to (i) decrease the amount of book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Master Rule 144A GDR Certificate and (ii) increase the amount of book-entry interests in the GDRs registered in the name of the common nominee for Euroclear and Clearstream and represented by the Master Regulation S GDR Certificate.

Trading between Clearstream/Euroclear Seller and DTC Purchaser

When book-entry interests in the GDRs are to be transferred from the account of a Euroclear or Clearstream participant to the account of a DTC participant, the Euroclear or Clearstream participant must send to Euroclear or Clearstream a delivery free of payment instruction at least one business day prior to the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant, as the case may be. On the settlement date, Euroclear or Clearstream, as the case may be, will debit the account of its participant and will instruct the Depositary to instruct DTC to credit the relevant account of Euroclear or Clearstream, as the case may be, and will deliver such book-entry interests in the GDRs free of payment to the relevant account of the DTC participant. In addition, Euroclear or Clearstream, as the case may be, shall on the settlement date instruct the Depositary to (i) decrease the amount of the book-entry interests in the GDRs registered in the name of the common nominee and evidenced by the Master Regulation S GDR Certificate and (ii) increase the amount of the book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Master Rule 144A GDR Certificate.

General

Although the foregoing sets out the procedures of Euroclear, Clearstream and DTC in order to facilitate the transfers of interests in the GDRs among participants of Euroclear, Clearstream and DTC, none of Euroclear, Clearstream or DTC are under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time.

None of us, the underwriters, the Depositary, the Custodian or our or their respective agents will have any responsibility for the performance by Euroclear, Clearstream or DTC or their respective participants of their respective obligations under the rules and procedures governing their operations.

INFORMATION RELATING TO THE DEPOSITARY

The Depositary is Deutsche Bank Trust Company Americas. Deutsche Bank Trust Company Americas was incorporated on 5 March 1903 as a bank with limited liability in the State of New York and is an indirect wholly-owned subsidiary of Deutsche Bank AG. The Depositary is subject to regulation and supervision by the New York State Banking Department, the Federal Reserve Board and the Federal Deposit Insurance Corporation. The registered office of the Depositary is located at 60 Wall Street, New York, NY 10005 and the registered number is BR1026. A copy of the Depositary's By-laws, as amended, together with copies of the most recent financial statements and annual report of the Depositary will be available for inspection at the principal administrative establishment of the Depositary located at 60 Wall Street, DR Department, 25th Floor, New York, NY 10005 and at the office of the Depositary located at Winchester House, 1 Great Winchester Street, London EC2N 2DB. Such information will be updated as long as the GDRs are admitted to listing on the Official List.

LIMITATION ON SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

All of our directors and executive officers named in this prospectus reside outside the United States and the United Kingdom. All or a substantial portion of their and our assets are located outside the United States and the United Kingdom, principally in the Russian Federation. As a result, it may not be possible for you to:

- effect service of process within the United States or the United Kingdom upon any of our directors and executive officers named in this prospectus; or
- enforce, in the United States or the United Kingdom, court judgments obtained in courts of the United States or the United Kingdom, as the case may be, 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 federal securities laws 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 US or UK securities laws.

Judgments rendered by a court in any jurisdiction outside the Russian Federation will be recognized by courts in Russia only if an international treaty providing for 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 Russia providing for the recognition and enforcement of foreign court judgments. No such treaty exists between the United States or the United Kingdom and the Russian Federation for the reciprocal enforcement of foreign court judgments and no relevant federal law on enforcement of foreign court judgments has been adopted in the Russian Federation.

The Deposit Agreements for the GDRs provide for actions brought against us by any party to the Deposit Agreements to be settled by arbitration in London, England, in accordance with the rules of the London Court of International Arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, it may be difficult to enforce arbitral awards in the Russian Federation due to:

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

We have appointed Law Debenture as our agent for service of process in any suit, action or proceeding with respect to the GDRs. However, such appointment may not be respected by a Russian court.

For a 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 Relating to the GDRs and the Trading Market—You may have limited recourse against us and our directors and executive officers because we generally conduct our operations outside the United States and the United Kingdom and all of our directors and executive officers reside outside the United States and the United Kingdom."

LEGAL MATTERS

Certain legal matters with respect to the offering will be passed upon for us by Latham & Watkins, London, England and Latham & Watkins LLP, New York, New York and by Vinson & Elkins LLP, Moscow, Russian Federation. Certain legal matters with respect to the offering will be passed upon for the underwriters by Skadden, Arps, Slate, Meagher & Flom (UK) LLP, London, England and Skadden, Arps, Slate, Meagher & Flom LLP, Moscow, Russian Federation.

INDEPENDENT AUDITORS

The consolidated financial statements of NOVATEK and its subsidiaries as of and for the years ended 31 December 2002, 2003 and 2004 have been audited by ZAO PricewaterhouseCoopers Audit, independent auditors, Kosmodamianskaya Nab. 52., Bld. 5, Moscow 115054, Russian Federation.

OIL AND GAS CONSULTANTS

DeGolyer and MacNaughton has appraised the reserves at our three core field—Yurkharovskoye, East Tarkosalinskoye, Khancheyskoye, as of 31 December 2004 and is the author of the report thereon included in Appendix A.

DeGolyer and MacNaughton is a Delaware corporation with offices at One Energy Square, Dallas, Texas 75206, 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 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.

GENERAL INFORMATION

1. It is expected that the GDRs will be admitted, subject only to the issue of the Master Regulation S GDR and the Master Rule 144A GDR, to the Official List on or about 27 July 2005. Application has been made for the GDRs to be traded on the London Stock Exchange. Prior to admission to the Official List, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction. A copy of this prospectus has been delivered to the Registrar of Companies in England and Wales, as required by Section 83 of the FSMA.
2. We have obtained all consents, approvals and authorizations in Russia in connection with the issue of the GDRs.
3. Copies of the following documents will be available for inspection free of charge, during normal business hours on any weekday, at the offices of UBS Limited, 1 Finsbury Avenue, London EC2M 2PP, United Kingdom for 14 days from the date of this prospectus:
 - our charter (English translation);
 - the Deposit Agreements;
 - the Underwriting Agreement;
 - our audited consolidated financial statements as of 31 December 2004, 2003 and 2002 and for the years then ended, together with the auditors' report relating thereto;
 - our unaudited consolidated interim condensed financial information as of 31 March 2005 and for the three-month period then ended;
 - the financial statements of OAO Tarkosalenftegas as of 31 December 2004, 2003 and 2002 and for the years then ended, together with the auditors' report relating thereto; and
 - the report of DeGolyer and MacNaughton included herein.
4. If definitive certificates are issued in exchange for the Master GDRs, NOVATEK will appoint an agent in the United Kingdom.
5. The GDRs will be accepted for clearance through DTC. The CUSIP for the Regulation S GDRs is 669888 10 9, the ISIN for the Regulation S GDRs is US6698881090 and the Common Code for the Regulation S GDRs is 020623926. The CUSIP for the Rule 144A GDRs is 669888 20 8, the ISIN for the Rule 144A GDRs is US6698882080 and the Common Code for the Rule 144A GDRs is 022011472. The ISIN for the shares is RU000A0DKVS5.
6. Except as described in "Business—Recent Developments," since 31 March 2005, the end of the last financial period for which interim financial information has been published, no significant change in the financial or trading position of the group has occurred.
7. The following table sets forth the registered offices of our key subsidiaries:

Name	Jurisdiction of Incorporation	Business	Ownership Interest (%)	Registered Office
OOO Yurkharovneftegas	Russia	Exploration and production	100%	Zavodskaya Street Nadym 626711 Russian Federation
OOO Tarkosalenftegas	Russia	Exploration and production	100%	28 Tarasov Street Tarko-Sale, Purovsky Area Yamal-Nenets Autonomous District Tyumen Region 626720 Russian Federation
OAO Purneftegasgeologiya	Russia	Exploration and production	80.6%	2a Gubkin Street Tarko-Sale, Purovsky Area Yamal-Nenets Autonomous District Tyumen Region 629850 Russian Federation

8. The GDRs are not denominated in any currency and have no nominal or par value. The offer price was determined based on the results of the bookbuilding exercise conducted by the Joint Global Coordinators. The results of the offering will be made public by us through a press release and notice to the Regulatory Information Service promptly upon the closing of the offering.
9. DeGolyer and MacNaughton has given and not withdrawn its written consent to the inclusion of its report, appearing in Appendix A of this prospectus, in the form and context in which it is included, and has authorized the contents of those parts of the prospectus for the purposes of Regulation 6(1)(e) of The Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001. D&M accepts responsibility for the information contained in the D&M report set out in Appendix A of this prospectus, and to the best of D&M's knowledge and belief that, having taken all reasonable care to ensure that such is the case, the information contained in the report is in accordance with the facts and does not omit anything likely to affect the import of such information.
10. Holders of GDRs may contact Deutsche Bank Trust Company Americas, as depositary for the GDRs (Attn: Broker Services, Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom, tel. +44 207 547 6500) with questions relating to the transfer of GDRs on the books of the depositary, which shall be maintained at the Depositary's corporate trust office at 60 Wall Street, New York, New York 10005 (tel. +1 212 250 9100).
11. Set forth below are summaries of each material contract, other than contracts entered into in the ordinary course of business, to which we are a party, for the two years immediately preceding publication of the prospectus, or any other contracts, other than contracts entered into in the ordinary course of business, entered into by us, which contain any provisions under which we have any obligation or entitlement material to us at the date of this prospectus.

11.1. Material Loan and Credit Agreements:

- 11.1.1. Credit Agreement dated 30 June 2005, between us and the Novokuibyshevsk Branch No. 7723 of the Sberbank of Russia, pursuant to which we may borrow up to RR 1,000 million at a rate of 8% per annum, payable in October 2005.
- 11.1.2. The Loan Agreement dated 10 June 2005, between us and ZAO International Moscow Bank, pursuant to which we obtained a \$20 million loan at an interest rate of LIBOR+3.5% per annum, payable in June 2006. The loan is secured by Tarkosaleneftegaz pursuant to a suretyship agreement dated 10 June 2005.
- 11.1.3. The Loan Agreement dated 23 May 2005, between us and ZAO Standart Bank, pursuant to which we obtained a \$9 million loan at an interest rate of LIBOR+3.25% per annum, payable in May 2006.
- 11.1.4. The Loan Agreement dated 25 January 2005, between us and ZAO International Moscow Bank, pursuant to which we obtained a \$7 million loan at an interest rate of LIBOR+4.25% per annum, payable in January and February 2006 in equal installments. This loan is secured by Tarkosaleneftegaz pursuant to an amendment to a suretyship agreement dated 25 May 2005.
- 11.1.5. The Loan Agreement dated 25 January 2005, between us and Novokuibyshevsk Branch No. 7723 of the Sberbank of Russia, pursuant to which we obtained a RR 400 million loan at an interest rate of 12% per annum, payable in tranches of RR 200 million in June 2009 and RR 200 million in December 2009. This loan is secured by the property of Khancheyneftegas valued at RR 412 million, pursuant to a mortgage agreement dated 25 January 2005. (Following the merger of Khancheyneftegas with and into Tarkosaleneftegaz in May 2005, Tarkosaleneftegaz assumed obligations of Khancheyneftegas under this agreement.)
- 11.1.6. The Credit Line Agreement dated 27 December 2004, between us and ZAO BNP Paribas, pursuant to which we obtained a \$20 million loan at an interest rate of LIBOR+3.5% per annum, payable from March 2005 to May 2006. The loan is secured by (i) Yurkharovneftegas pursuant to a suretyship agreement dated 13 January 2005 and (ii) an assignment agreement between us and BNP Paribas dated 27 December 2004 with respect to the Gas Sales Agreement between us and the Magnitogorskiy Metallurgicheskiy Kombinat.

- 11.1.7. The Loan Agreement dated 23 December 2004, between Tarkosalenftegas and West-Siberian Branch of the Sberbank of Russia, pursuant to which Tarkosalenftegas obtained a RR 560 million at an interest rate of 12% per annum, payable from March to December 2007 in six tranches. The loan is secured by the property of Tarkosalenftegas valued at RR 593.8 million pursuant to a mortgage agreement dated 24 December 2004.
- 11.1.8. The Loan Agreement dated 14 December 2004, between us and C.R.R. B.V., pursuant to which we received a loan in the amount of \$200 million with an annual interest rate of 7.75%, payable in June 2006. The loan is guaranteed by Yurkharovneftegas pursuant to a deed of guarantee dated 14 December 2004 and by Tarkosalenftegas pursuant to a deed of guarantee dated 18 February 2005.
- 11.1.9. The Loan Agreement dated 14 December 2004, between us and Levit, providing for a \$290 million unsecured loan from us to Levit, at an interest rate of 10% per annum, payable in June 2006 (of which \$20 million has been repaid).
- 11.1.10. The Loan Agreement dated 6 December 2004, between us and Novokuibyshevsk Branch No. 7723 of the Sberbank of Russia, pursuant to which we obtained a RR 900 million loan at an interest rate of 12% per annum, payable in tranches of RR 450 million in December 2008, RR 250 million in June 2009 and RR 200 million in December 2009. The loan is secured by the property of Khancheyneftegas valued at RR 930 million pursuant to a mortgage agreement dated 6 December 2004. (Following the merger of Khancheyneftegas with and into Tarkosalenftegas in May 2005, Tarkosalenftegas assumed obligations of Khancheyneftegas under this agreement.)
- 11.1.11. The Loan Agreement dated 3 December 2004, between Yurkharovneftegas and Alfa-Bank, pursuant to which Yurkharovneftegas obtained a RR 500 million loan at an interest rate of 12% per annum, payable in July and December 2005. This loan is secured by Khancheyneftegas pursuant to a suretyship agreement dated 3 December 2004. (Following the merger of Khancheyneftegas with and into Tarkosalenftegas in May 2005, Tarkosalenftegas assumed obligations of Khancheyneftegas under this agreement.)
- 11.1.12. The agreement dated 25 December 2003, between us and OAO Investment Bank "Trust," relating to the issuance on 2 December 2004 of Russian rouble denominated bonds at the aggregate principal amount of RR 1,000 million, with an annual coupon rate of 9.4%, payable in November 2006. The bonds are secured by Yurkharovneftegas pursuant to a suretyship agreement approved on 20 April 2004.
- 11.1.13. The Loan Agreement dated 17 June 2004, between Tarkosalenftegas and West-Siberian Branch of the Sberbank of Russia, pursuant to which Tarkosalenftegas obtained a RR 300 million loan at an interest rate of 10.5% per annum, payable in December 2005. The loan is secured by the property of Tarkosalenftegas valued at RR 331.5 million pursuant to a pledge agreement dated 17 June 2004.
- 11.1.14. The First Loan Agreement dated 9 April 2004, or the First ING Loan Agreement, between us and ING Bank N.V., pursuant to which we received a loan in the amount of \$50 million backed by unsecured 18-month credit-linked notes with annual coupon rates of 9.125%, payable semi-annually, as modified by the Deed of Assignment dated 9 April 2004, among us, ING Bank N.V. and C.R.R. B.V., pursuant to which ING Bank N.V. assigned its rights under the First ING Loan Agreement to C.R.R. B.V. Our obligations under the First ING Loan Agreement are guaranteed by Tarkosalenftegas and Yurkharovneftegas, pursuant to deeds of guarantee each dated 9 April 2004, between Tarkosalenftegas and ING Bank N.V., and Yurkharovneftegas and ING Bank N.V., which deeds were assigned to C.R.R. B.V.
- 11.1.15. The Second Loan Agreement dated 9 April 2004, or the Second ING Loan Agreement, between us and ING Bank N.V., pursuant to which we received a loan in the amount of \$50 million backed by unsecured 18-month credit-linked notes with annual coupon rates of 9.125%, payable semi-annually, as modified by the Deed of Assignment dated 9 April 2004, among us, ING Bank N.V. and C.R.R. B.V., pursuant to which ING Bank N.V. assigned its rights under the Second ING Loan Agreement to C.R.R. B.V. Our obligations under the Second ING Loan Agreement are guaranteed by

Yurkharovneftegas, pursuant to a deed of guarantee dated 9 April 2004, between Yurkharovneftegas and ING Bank N.V., which deed was assigned to C.R.R. B.V.

- 11.1.16. The Loan Agreement dated 21 August 2003, between us and the Finance Department of the Yamal Administration, pursuant to which we obtained a loan in the amount of RR 1,130 million with an annual interest rate of 12.75% (since August 2004 the interest rate was reduced to 11.75%), payable in July 2008, which is secured by 4.69% participatory interest in Tarkosaleneftegas pursuant to an interest pledge agreement dated 30 May 2005, between us and the Department of Finances of the Administration of the Yamal-Nenets Autonomous District.
 - 11.1.17. The Loan Agreement dated 25 April 2003, between us and Vneshtorgbank, pursuant to which we obtained a \$100 million loan with an annual interest of 9.75%, payable between 2005 and 2008. This loan is collateralized by 26% of participatory interest in Tarkosaleneftegas pursuant to the Interest Pledge Agreement dated 1 June 2005, between us and Vneshtorgbank and is guaranteed by Yurkharovneftegas and Khancheyneftegas pursuant to security agreements each dated 27 May 2003. (Following the merger of Khancheyneftegas with and into Tarkosaleneftegas in May 2005, Tarkosaleneftegas assumed obligations of Khancheyneftegas under this agreement.)
 - 11.1.18. The Loan Agreement dated 30 January 2003, between Khancheyneftegas and Raiffeisen Bank RT and Magyar Export-Import Bank RT pursuant to which, Khancheyneftegas obtained a \$5 million loan at an interest rate of 4.43%, payable in semi-annual equal installments of \$500 thousand from July 2003 to January 2008. (Following the merger of Khancheyneftegas with and into Tarkosaleneftegas in May 2005, Tarkosaleneftegas assumed obligations of Khancheyneftegas under this agreement.) The loan is secured by a guarantee from Guta Bank, which guarantee is secured by our guarantee and equipment of Tarkosaleneftegas valued at RR 131 million.
- 11.2. Other Material Agreements:
- 11.2.1. The Underwriting Agreement dated 21 July 2005 between us, the Selling Shareholder and the underwriters as described in “Plan of Distribution.”
 - 11.2.2. The Partnership Agreement dated 5 July 2005, between us and Gazprom providing for general mutual cooperation in the natural gas industry.
 - 11.2.3. The Contribution Agreement dated 27 May 2005, between us and OOO Oil Holding Company, providing for the non-cash contribution to the charter capital of Oil Holding Company of our shares of capital stock of OOO Geoilbent, representing a 66% equity interest in Geoilbent.
 - 11.2.4. The Sales and Purchase Contract dated 31 May 2005, between us and OOO LUKOIL-West Siberia, pursuant to which we sold to LUKOIL-West Siberia a 99.99% equity interest in Oil Holding Company at a price equal to \$179.9 million.
 - 11.2.5. The Agreement dated 14 December 2004, between us and ING Bank N.V., pursuant to which we paid ING Bank N.V. an amount of \$1.8 million for the services in connection with credit-linked notes issuance.
 - 11.2.6. The Lease Agreement dated 1 November 2004, among Purneftegasgeologiya, OOO Noyabrskgasdobycha and OOO Energotekhhgroup, relating to the lease of property located in the West Tarkosalinskoye field for the term expiring in December 2017.
 - 11.2.7. The Relationship Agreement dated 18 May 2004, between us and OAO Gazprom, pursuant to which (a) we agreed to procure that Purneftegasgeologiya shall sell its wholly owned subsidiary (OAO Purgasdobycha) holding the exploration and production license for the West Tarkosalinskoye field to a subsidiary of Gazprom and (b) Gazprom agreed to procure that (i) its subsidiary (OAO Zapsibgazprom) shall sell to us its remaining 8.3% equity interest in Purneftegasgeologiya, (ii) its subsidiary (OAO Purgazdobycha) shall enter into an operating agreement with Purneftegasgeologiya relating to the operation of oil reservoir of the West Tarkosalinskoye field and (iii) Gazprom or its subsidiary shall enter into agreement with us or our subsidiary entitling us to purchase 10% of the natural gas production from the Cenomanian

reservoir and all of the gas and gas condensate production from the Valanginian reservoir of the West Tarkosalinskoye field.

- 11.2.8. The Stock Purchase Agreement dated 22 October 2004, between us and OAO Zapsibgazprom, pursuant to which we acquired from Zapsibgazprom its shares of capital stock of Purneftegasgeologiya, equal to an 8.3% equity interest in Purneftegasgeologiya.
- 11.2.9. The Agreement dated 6 October 2003, between us and Gazprom providing for transportation of natural gas from Yurkharovskoye, Yumantylskoye, Khancheyskoye, West Tarkosalinskoye, East Tarkosalinskoye and Gubkinskoye fields to end-users in various regions of the Russian Federation and Kazakhstan via the Bukhara-Ural Pipeline, a part of the Southern Corridor of the UGSS. This agreement expires on 31 December 2008. We also have a corresponding five-year customs clearance agreement with Gazprom for these deliveries dated 1 February 2005, which expires on 1 February 2010.
- 11.2.10. The Gas Sale and Purchase Contract dated 29 July 2004, between us and OOO NGK Itera, as amended by Amendments Nos. 1, 2 and 3, each dated 29 July 2004, providing for the sale by us to Itera of up to 37.5 bcm of natural gas from 2005 to 2009 at prices determined annually and calculated as a percentage of the price set by the FTS for the Sverdlovsk region.
- 11.2.11. The Return of Investment Agreement dated 22 November 2004, between Zapsibgazprom and Purneftegasgeologiya, pursuant to which Purneftegasgeologiya paid RR 342 million to Zapsibgazprom, which represented the amount Zapsibgazprom invested into Purneftegasgeologiya in the course of its privatization.

GLOSSARY

The following is a description of the meanings of some of the oil and gas terms used in this prospectus.

“2-D seismic” means geophysical data that depicts the subsurface strata in two dimensions.

“3-D seismic” means geophysical data that depict the subsurface strata in three dimensions. 3-D seismic typically provides a more detailed and accurate interpretation of the subsurface strata than 2-D seismic.

“BOPP” means biaxially oriented polypropylene plant.

“Cenomanian gas” means dry largely methane gas produced from shallow reservoirs of average depth from 1,200 to 1,800 meters.

“Condensate” means liquid hydrocarbons associated with the production from a primarily natural gas reservoir.

“Field” means 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” means capital costs incurred in the acquisition, exploitation and exploration of proved oil and natural gas reserves divided by proved reserve additions and revisions to proved reserves.

“hydrocarbons” means compounds formed from the elements hydrogen (H) and carbon (C) and existing in solid, liquid or gaseous forms.

“License area” means 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” means liquefied petroleum gas.

“natural gas” means hydrocarbons that are gaseous at one atmosphere of pressure at 20°C. 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.

“Proved developed reserves” means reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

“Proved-plus-probable reserves” means the sum of the proved reserves and the probable reserves calculated in accordance with SPE standards. See “Classification of Reserves” SPE Standards.”

“Proved reserves” means the estimated quantities of oil, natural gas and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in future years from known reservoirs under existing economic and operating conditions.

“Proved undeveloped reserves” means proved reserves 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.

“Reservoir” means a porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

“SPE standards” means reserves definitions consistent with those approved in March 1997 by the Society of Petroleum Engineers and the World Petroleum Congresses.

“Valanginian gas” means wet gas produced from the gas condensate reservoirs usually found at depths from 2,200 to 2,800 meters.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Financial Statements of OAO NOVATEK and its subsidiaries for the years ended 31 December 2004, 2003 and 2002

Auditors' Report of ZAO PricewaterhouseCoopers Audit	F-2
Consolidated Balance Sheets at 31 December 2004, 2003 and 2002	F-3
Consolidated Statements of Income for the years ended 31 December 2004, 2003 and 2002	F-4
Consolidated Statements of Cash Flows for the years ended 31 December 2004, 2003 and 2002 .	F-5
Consolidated Statements of Changes in Shareholders' Equity for the years ended 31 December 2004, 2003 and 2002	F-6
Notes to Consolidated Financial Statements	F-7
Unaudited Supplemental Oil and Gas Disclosures	F-41

Consolidated Interim Condensed Financial Information of OAO NOVATEK and its subsidiaries for the three months ended 31 March 2005 and 2004 (unaudited)

Consolidated Balance Sheets at 31 March 2005 and 2004	F-46
Consolidated Statements of Income for the three months ended 31 March 2005 and 2004	F-47
Consolidated Statements of Cash Flows for the three months ended 31 March 2005 and 2004 . .	F-48
Consolidated Interim Condensed Statement of Changes in Equity for the three months ended 31 March 2005 and 2004	F-49
Notes to Consolidated Interim Condensed Financial Information	F-50

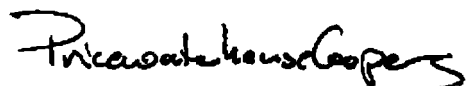
Financial Statements of OAO Tarkosalenftegas Oil Company for the years ended 31 December 2004, 2003 and 2002

Auditors' Report of ZAO PricewaterhouseCoopers Audit	F-62
Balance Sheets at 31 December 2004, 2003 and 2002	F-63
Statements of Income for the years ended 31 December 2004, 2003 and 2002	F-64
Statements of Cash Flows for the years ended 31 December 2004, 2003 and 2002	F-65
Statements of Changes in Shareholders' Equity for the years ended 31 December 2004, 2003 and 2002	F-66
Notes to Financial Statements	F-67

AUDITORS' REPORT

To the shareholders and directors of OAO NOVATEK

- 1 We have audited the accompanying consolidated balance sheets of OAO NOVATEK and its subsidiaries (the "Group") as at 31 December 2004, 2003 and 2002 and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the years then ended. These financial statements as set out on pages F-3 to F-40 are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2004, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.



Moscow, Russian Federation
27 May 2005

ОАО NOVATEK
Consolidated Balance Sheets

(in millions of Russian roubles)

		At 31 December:		
	Notes	2004	2003	2002
ASSETS				
Non-current assets				
Property, plant and equipment, net	16	62,449	10,057	5,626
Other non-current assets		1,090	340	239
Investments in associates	13	1,945	5,291	4,187
Long-term loans receivable	15	7,832	2,933	157
Total non-current assets		73,316	18,621	10,209
Current assets				
Prepayments and other current assets	10	1,039	1,284	578
Inventories	11	929	1,372	1,428
Trade and other receivables	9	3,456	2,939	3,080
Short-term loans receivable		707	552	254
Cash and cash equivalents		3,003	1,618	306
Total current assets		9,134	7,765	5,646
Total assets		82,450	26,386	15,855
EQUITY AND LIABILITIES				
Non-current liabilities				
Long-term debt	18	13,232	5,752	3,279
Deferred income tax liability	20	8,855	1,591	1,096
Other non-current liabilities		1,188	202	208
Total non-current liabilities		23,275	7,545	4,583
Current liabilities				
Short-term debt	17	10,768	2,069	1,717
Other taxes payable	20	1,280	867	894
Income taxes payable		228	567	162
Trade payables and accrued liabilities	12	1,963	3,325	2,274
Total current liabilities		14,239	6,828	5,047
Total liabilities		37,514	14,373	9,630
Minority interest	23	449	468	781
Shareholders' equity				
Ordinary share capital		393	314	249
Additional paid-in capital		29,797	5,963	3,173
Asset revaluation surplus		5,345	—	—
Retained earnings		8,952	5,268	2,022
Total shareholders' equity	19	44,487	11,545	5,444
Total shareholders' equity, minority interest and liabilities		82,450	26,386	15,855

The accompanying notes are an integral part of these consolidated financial statements.

OAO NOVATEK
Consolidated Statements of Income

(in millions of Russian roubles)

	Notes	Year ended 31 December:		
		2004	2003	2002
Revenues				
Oil and gas sales	6	21,489	12,024	2,302
Oil and gas construction services		2,053	3,258	2,212
Sales of polymer and insulation tape . . .		617	286	—
Other revenues		456	490	771
Total revenues		24,615	16,058	5,285
Net gain (loss) on disposal of investments in oil and gas producing subsidiaries and associates		(12)	1,015	88
Net gain (loss) on disposal of construction services and other subsidiaries		210	(4)	(9)
Other income		385	187	315
Total revenues and other income		25,198	17,256	5,679
Operating expenses				
Materials, services and other	7	(4,175)	(4,982)	(2,844)
Purchases of oil, gas condensate and natural gas		(5,708)	(3,310)	(607)
Transportation expenses	8	(4,234)	(2,390)	(321)
Taxes other than income tax	20	(1,569)	(847)	(296)
General and administrative expenses . . .		(1,152)	(700)	(584)
Depreciation, depletion and amortization	16	(681)	(425)	(151)
Net impairment reversal (expense)		118	(308)	(283)
Exploration expenses		(183)	(122)	(56)
Total operating expenses		(17,584)	(13,084)	(5,142)
Income from operations		7,614	4,172	537
Finance income (expense)				
Foreign exchange gain (loss)		109	192	(75)
Interest income		462	175	21
Interest expense		(863)	(523)	(175)
Monetary gain		—	—	296
Total finance income (expense)		(292)	(156)	67
Share of income from associates	13	721	524	737
Income before income tax and minority interest		8,043	4,540	1,341
Income tax expense				
Current income tax expense		(1,906)	(1,434)	(405)
Deferred income tax benefit (expense) . .		(212)	191	(146)
Share of income tax benefit (expense) of associates	13	43	(88)	(198)
Total income tax expense	20	(2,075)	(1,331)	(749)
Income before minority interest		5,968	3,209	592
Minority interest	23	(274)	72	52
Net income		5,694	3,281	644
Basic and diluted earnings per share (in Russian roubles)	26	2,510	1,895	565
Weighted average shares outstanding		2,268,654	1,731,512	1,139,636

The accompanying notes are an integral part of these consolidated financial statements.

OAO NOVATEK
Consolidated Statements of Cash Flows

(in millions of Russian roubles)

	Year ended 31 December:		
	2004	2003	2002
Net income before income tax and minority interest	8,043	4,540	1,341
Adjustments to income before income tax and minority interest:			
Depreciation, depletion and amortization	681	425	151
Net impairment loss (reversal of impairment)	(118)	308	283
Net unrealized foreign exchange loss (gain)	(109)	(192)	75
Net gain on disposal of assets, subsidiaries and associates	(586)	(1,127)	(181)
Monetary effects on non-operating balances	—	—	(201)
Interest expense	863	523	175
Interest income	(462)	(175)	(21)
Share of income from associates	(721)	(524)	(737)
Working capital changes			
Decrease (increase) in trade and other receivables	989	80	(1,488)
Decrease (increase) in inventories	171	99	(392)
Decrease (increase) in prepayments and other current assets	11	(75)	196
Increase (decrease) in trade payables and accrued liabilities, excluding interest and dividends	(1,535)	1,161	83
Increase (decrease) in other taxes payable	(211)	(57)	236
Total effect of working capital changes	(575)	1,208	(1,365)
Income taxes paid	(2,217)	(1,174)	(307)
Net cash provided by (used in) operating activities	4,799	3,812	(787)
Cash flows from investing activities			
Purchases of property, plant and equipment	(5,424)	(3,117)	(2,667)
Acquisition of subsidiaries and associated companies, net of cash acquired	298	(218)	(51)
Proceeds from disposals of subsidiaries and associates	361	1,298	154
Proceeds from sales of property, plant and equipment and other long-term assets	80	64	75
Interest paid and capitalized	(305)	(259)	(153)
Loans provided	(11,661)	(4,127)	(314)
Repayments of loans provided	3,289	976	95
Dividends and non banking interest received	488	72	65
Net cash used in investing activities	(12,874)	(5,311)	(2,796)
Cash flows from financing activities			
Proceeds from long-term borrowings	11,493	5,080	2,510
Proceeds from short-term borrowings	5,633	3,880	1,717
Repayments of long-term borrowings	(624)	(1,605)	—
Repayments of short-term borrowings	(4,350)	(3,522)	(1,308)
Proceeds from issuance of additional shares	—	—	319
Interest paid: non-banking	(709)	(597)	(147)
Dividends paid	(2,010)	(35)	(8)
Other distributions to shareholders	—	(336)	—
Net cash from financing activities	9,433	2,865	3,083
Effect of inflation and exchange rate on cash and cash equivalents	(21)	(14)	(85)
Net change in restricted cash	48	(40)	(24)
Net increase (decrease) in cash and cash equivalents	1,385	1,312	(609)
Cash and cash equivalents at beginning of the year	1,618	306	915
Cash and cash equivalents at end of the year	3,003	1,618	306

Significant non-cash transactions are disclosed in Note 5.

The accompanying notes are an integral part of these consolidated financial statements.

ОАО NOVATEK

Consolidated Statements of Changes in Shareholders' Equity

(in millions of Russian roubles, unless otherwise stated)

	Number of ordinary shares	Ordinary share capital	Additional paid in capital	Asset revaluation surplus	Retained earnings	Shareholders' equity
31 December 2001	593,682	142	2,451	—	1,328	3,921
Issuance of shares (<i>Note 19</i>)	1,000,000	107	212	—	—	319
Dividends	—	—	—	—	(8)	(8)
Contribution from Shareholders (<i>Note 19</i>) .	—	—	510	—	—	510
Share of associates' other equity	—	—	—	—	58	58
Net income	—	—	—	—	644	644
31 December 2002	1,593,682	249	3,173	—	2,022	5,444
Acquisition (<i>Note 19</i>)	653,348	65	2,656	—	—	2,721
Dividends	—	—	—	—	(35)	(35)
Contribution from Shareholders (<i>Note 19</i>) .	—	—	524	—	—	524
Distribution to shareholders (<i>Note 19</i>)	—	—	(390)	—	—	(390)
Net income	—	—	—	—	3,281	3,281
31 December 2003	2,247,030	314	5,963	—	5,268	11,545
Acquisition (<i>Note 4</i>)	789,276	79	23,849	5,345	—	29,273
Dividends	—	—	—	—	(2,010)	(2,010)
Distribution to shareholders	—	—	(15)	—	—	(15)
Net income	—	—	—	—	5,694	5,694
31 December 2004	3,036,306	393	29,797	5,345	8,952	44,487

The accompanying notes are an integral part of these consolidated financial statements.

OAO NOVATEK

Notes to the Consolidated Financial Statements

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

1. Organization and Principal Activities

OAO 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 operations of oil and gas properties located in the Yamal-Nenets Autonomous Region (“YNAO”).

These consolidated financial statements reflect the financial position and results of operations of the principal subsidiaries listed below, all of which are incorporated in the Russian Federation.

Subsidiary	Nature of operations	Percentage of total share capital at 31 December:		
		2004	2003	2002
OAO NK Tarkosalenftegas (“Tarkosalenftegas”)	Oil and gas exploration and production	100.0%	32.2%	27.6%
OOO Yurkharovneftegas (“Yurkharovneftegas”)	Oil and gas exploration and production	100.0%	100.0%	89.0%
OOO Khancheyneftegas (“Khancheyneftegas”)	Oil and gas exploration and production	100.0%	43.0%	43.0%
OAO Purneftegasgeologiya (“PNGG”)	Oil and gas exploration and production	78.0%	79.6%	75.3%
OAO Minlay (“Minlay”)	Holding company	—	100.0%	89.0%
OAO SNP NOVA (“SNP NOVA”) . . .	Construction services	—	74.3%	74.3%
ZAO NOVA Bank	Banking	62.0%	88.6%	60.1%
OAO NOVATEK-Polymer (“NOVATEK-Polymer”, formerly OAO Truboizolyatsia)	Pipeline insulation production	97.9%	52.2%	17.1%
OOO Novafininvest (“Novafininvest”)	Construction contractor and holding company	—	99.0%	100.0%
OOO Yutneftegas (“Yutneftegas”) . . .	Holding company	—	100.0%	100.0%

In May 2005, the Group disposed of its equity stake in NOVA Bank to ZAO Levit (“Levit”), a Group shareholder.

In December 2004, the Group completed an acquisition of two key operating subsidiaries, Tarkosalenftegas and Khancheyneftegas, resulting in 100 percent ownership of both entities. Prior to December 2004, Tarkosalenftegas and Khancheyneftegas were accounted for as equity associates (see Note 4).

In June 2004, the Group sold its subsidiaries that represent substantially all of the Group’s oil and gas construction services segment to focus its activities on oil and gas exploration, production and processing of hydrocarbons (see Note 26).

During 2003, the ultimate controlling shareholders of NOVATEK (the “Shareholders”) restructured their shareholding interests in various companies to place all entities controlled by NOVATEK formally under the legal ownership of NOVATEK. The transfers of controlling interests to NOVATEK represented a reorganization of enterprises under common control and, accordingly, were accounted for at their predecessor book value in a manner similar to a pooling of interests.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

1. Organization and Principal Activities (continued)

The Group's respective interests in its principal associates were as follows:

Associate	Nature of operations	Percentage of total share capital at 31 December:		
		2004	2003	2002
OOO Geoilbent ("Geoilbent")	Oil and gas exploration and production	66.0%	66.0%	66.0%
OAO Tambeyneftegas ("Tambeyneftegas")	Oil and gas exploration and production	25.1%	25.1%	—
OOO NGK Itera	Gas sales	—	—	50.0%

During 2002 and through November 2003, the Group was controlled by the Chairman of the Company's Management Board, Leonid V. Mikhelson. In December 2003, such control ceased (see Note 21).

The Group had approximately 3,600, 6,800 and 6,900 employees as at 31 December 2004, 2003 and 2002, respectively. In June 2004, the Group sold substantially all of its oil and gas construction services business, which caused the majority of the decrease in employees between 2004 and 2003.

2. Basis of Presentation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS"), and Interpretations issued by the International Accounting Standards Board ("IASB") and the International Accounting Standards Board's International Financial Reporting Interpretations Committee ("IFRIC"). 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 insofar as they do not conflict with IFRS principles.

The Group maintained their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"). The Group's financial statements are based on the statutory records with adjustments and reclassifications recorded in the 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, (5) restatement of financial statements to reflect the effect of hyperinflation through 31 December 2002, and (6) valuation of unrecoverable assets, expense recognition and other provisions.

The consolidated financial statements have been prepared under the historical cost convention. The Group's functional currency is the Russian rouble ("RR").

Use of estimates. The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. Estimates have principally been made in respect to fair values of assets and liabilities, impairment provisions and deferred income taxes. Actual results may differ from such estimates.

Exchange rates, restrictions and controls. The official rate of exchange of the Russian rouble to the US dollar ("USD") at 31 December 2004, 2003 and 2002 was 27.75, 29.45 and 31.78 Russian roubles to USD 1.00, respectively. The Russian rouble has historically been devaluing against the US dollar due to significant inflation in the Russian Federation as well as other factors. However, the Russian rouble appreciated by 5.8 percent and 7.3 percent in 2004 and 2003, respectively, and depreciated 5.7 percent against the US dollar in 2002. The official Russian inflation rates were 11.7 percent, 12.0 percent and 15.1 percent in 2004, 2003 and 2002, respectively. Additionally, exchange restrictions and controls exist

2. Basis of Presentation (continued)

relating to converting Russian roubles into other currencies. At present, the Russian rouble is not a convertible currency outside of the Russian Federation and, further, the Group is required to convert 10 percent (25 percent from July 2003 through December 2004 and 50 percent prior to July 2003) of its hard currency earnings into Russian roubles. Any translation of Russian rouble amounts to US dollars or any other hard 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 hard currency at the exchange rate shown or at any other exchange rate.

Accounting for the effects of inflation. Prior to 1 January 2003, the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the Russian rouble in accordance with International Accounting Standard No. 29, *Financial Reporting in Hyperinflationary Economies* ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003, the Company no longer applies the provisions of IAS 29. Accordingly, no adjustments for the effects of changes in general purchasing power have been made for the years ended 31 December 2004 and 2003.

Reclassifications. The Group previously disclosed sales of polymer and insulation tape, oil and gas transportation and handling services, telecommunication services and exploration services within other income in the consolidated statements of income. Management believes that their inclusion within revenue is a more appropriate presentation. Comparative amounts for the years ended 31 December 2003 and 2002 have been adjusted accordingly. As a result, the following significant reclassifications were made: revenues totaling RR 776 million and RR 771 million, respectively, have been reclassified from other income to other revenues and polymer sales for the years ended 31 December 2003 and 2002; revenues totaling RR 900 million for light distillate product formerly included in oil and gas condensate sales was reclassified to oil product sales to more appropriately reflect its nature; and in 2002, RR 143 million of revenues relating to dry gas and gas condensate formerly included in oil products sales have been reclassified to more appropriately reflect their nature. Certain other reclassifications not detailed here have been made to prior year balances to conform to the current year presentation. Management believes that the current year presentations more accurately represent the Group's activities.

Changes in accounting policies. During 2003, the Group early adopted IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The effect of adoption was immaterial.

3. Summary of Significant Accounting Policies

Principles of consolidation. The accompanying consolidated financial statements include the operations of all controlled companies in which NOVATEK directly or indirectly owns more than 50 percent of the voting stock or otherwise has the power to govern the financial and operating policies. Subsidiaries are consolidated from the date on which control is obtained unless the acquisition occurred between entities under common control, which are accounted for from the beginning of the earliest period presented, and are no longer consolidated from the date that control ceases. Except for the acquisition of entities under common control, the purchase method of accounting is used to account for the acquisition of subsidiaries.

Upon achieving a controlling interest in an entity in which the Group previously held a non-controlling interest, the acquiree's identifiable assets, liabilities and contingent liabilities are restated to their fair values as of the date of achieving control and then upon each subsequent step acquisition. The effect of revaluing previously held interests to current fair values is recorded within asset revaluation surplus in the consolidated statement of shareholders' equity.

3. Summary of Significant Accounting Policies (continued)

Purchases of subsidiaries from entities under common control are accounted for using the pooling of interest method. The assets and liabilities of the subsidiary transferred under common control are recorded in these financial statements at the historical cost of the controlling entity (the "Predecessor"). Related goodwill inherent in the Predecessor's original acquisition is also recorded in these financial statements. Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to the shareholders' equity.

Investments in associates. Associated companies 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 percent and 50 percent of the voting rights. Associated companies are accounted for using the equity method.

The Group's interest in each associated company is carried in the balance sheet at an amount that reflects cost, including goodwill or negative goodwill at acquisition, plus its share of income and losses and other equity movements during the year. Provisions are recorded for any impairment in value. Unrealized gains on transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated companies; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

Cash and cash equivalents. Cash and cash equivalents comprises cash on hand, cash deposits held with banks, and 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.

Trade and other receivables. Trade and other receivables are presented at recoverable amounts and include value-added and excise taxes, which are payable to tax authorities upon collection of such receivables. An estimate is made for impairment of receivables based on a review of all outstanding amounts at year end, and the movement in the estimate is charged or credited to the consolidated statement of income. Bad debts are written off during the year in which they are identified.

Construction receivables from customers are the net amount of costs incurred, plus recognized income, less progress billings and recognized losses, on construction contracts at the end of the reporting period.

Inventories. Natural gas, crude oil, gas condensate and natural gas liquids 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 overhead expenses and is recorded at average cost. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Materials and supplies inventories are recorded at average cost and are carried at amounts which do not exceed their respective amounts recoverable in the normal course of business.

Property, plant and equipment. Property, plant and equipment are carried at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion, 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 are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

3. Summary of Significant Accounting Policies (continued)

Depreciation, depletion and amortization of capitalized costs of oil and gas properties and equipment is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for capitalized costs from acquisitions of proved properties. Reserve amounts used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation 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 license expiry dates. In February 2005, the Group successfully extended its license on Yurkharovskoye field from 2020 through 2034, which year represents the expected end of the economic life of the field. The cost of license extension was not material.

The 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 and, at 31 December 2004, 2003 and 2002, the Group's principal reserves have been independently estimated by internationally recognized petroleum engineers. 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, and therefore subject to depletion thereon using the unit-of-production method.

Interest costs 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.

Gains or losses from retirements or sales are included in the determination of net income.

Major renewals and improvements are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of the asset beyond its original capability.

Property, plant and equipment, other than oil and gas properties and equipment, are depreciated on a straight-line basis. Assets under construction are not depreciated.

The estimated useful lives of the Group's other assets are as follows:

	<u>Years</u>
Machinery and equipment	5-15
Buildings	25-50

Impairment of assets. An assessment is made at each balance sheet date to determine whether there is objective evidence that an asset or a group of assets may be impaired. When there is an indication that an asset may be impaired, the asset is measured at its estimated recoverable amount, which is the higher of the net selling price and value in use.

Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment loss is recognized for the difference between the estimated recoverable amount and the carrying value. The carrying amount of the asset is reduced to its estimated recoverable amount either directly or through the use of an allowance account and the amount of the loss is included in the consolidated statement of income for the period.

3. Summary of Significant Accounting Policies (continued)

An impairment loss is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

Deferred income taxes. Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12, *Income Taxes*.

The Group uses the balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income nor loss, it is not accounted for. A deferred income tax asset is recorded only to the extent that it is probable that taxable income will be available against which the deductible temporary differences can be utilized. Deferred income tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Borrowings. Borrowings received or provided are recognized initially at cost, which is the fair value of the consideration received or provided, net of transaction costs incurred, if any. Borrowings denominated in foreign currencies are re-measured at each period end at the foreign exchange rate as of the balance sheet date. Borrowings received or provided that are originated by the Group are subsequently measured at amortized cost and, for borrowings provided, net of any impairment losses.

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 financial statements are issued.

Revenue recognition. Revenues from the production and sale of natural gas, crude oil and gas condensate are recognized when such products are delivered to customers and title has transferred. Revenues are stated net of value-added tax, excise tax and export duties.

Revenues from rendering construction services are based on the stage of completion determined by reference to services performed to date as a percentage of total services to be performed.

Pension and post-employment benefits. The Group's mandatory contributions to the governmental pension scheme in the Russian Federation are expensed when incurred. Discretionary pension and other post-employment benefits are not material.

Provisions. Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events and 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. Provisions are reassessed annually and changes in the provisions resulting from the passage of time are reflected in the statement of income each year within non-operating income and expenses. Other changes in provisions, related to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation or changes in the discount rates, are treated as a change in an accounting estimate in the period of the change and, with the exception of asset retirement obligations, reflected in the statement of income. Such changes in estimated asset retirement obligations are reflected as adjustments to the carrying value of property, plant and equipment.

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

3. Summary of Significant Accounting Policies (continued)

obligation, determined using pre-tax risk free discount rates adjusted for risks specific to the obligation. Changes in the obligation resulting from the passage of time are recognized 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.

Value-added tax. The tax authorities permit the settlement of sales and purchases value added tax ("VAT") on a net basis.

VAT payable represents VAT related to sales payable to tax authorities upon collection of receivables from customers net of VAT on purchases which have been settled at the balance sheet date. In addition, VAT related to sales which have not been settled at the balance sheet date (VAT deferred) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

VAT recoverable relates to purchases which have not been settled at the balance sheet date and property, plant and equipment not put into operation. VAT recoverable is reclaimable against sales VAT upon payment for the purchases and putting property, plant and equipment into operation.

Foreign currency transactions. The Russian rouble is the Group's functional currency. Transactions denominated in foreign currencies are converted into Russian roubles at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income.

Financial instruments. Financial instruments carried on the balance sheet include cash and cash equivalents, receivables, trade payables and debt. The particular recognition methods adopted are disclosed in the individual policies related to each item. Except for long-term debt, the difference, where material, between the fair value at inception of the financial instruments, where these can be estimated reliably, and the nominal amount of financial instruments at their inception are recognized in the consolidated statement of income, consolidated balance sheet, or consolidated statement of changes in shareholders' equity in accordance with the underlying nature of such differences.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in other non-current assets. Goodwill on an acquisition of an associate is included in investments in associates.

The Group applies the transitional rules of IFRS 3, *Business Combinations*, in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. Consequently, on 1 January 2005, previously recognized goodwill will no longer be amortized and will be tested for impairment in accordance with IAS 36, *Impairment of Assets*, and previously recognized negative goodwill will be derecognized with a corresponding adjustment to the opening balance of retained earnings. At 31 December 2004, the Group had negative goodwill of RR 762 million recorded within other long-term assets in its consolidated balance sheet. On 1 January 2005, this negative goodwill will be derecognized in accordance with IFRS 3 and retained earnings will be increased by the same amount.

Negative goodwill represents the excess of the fair value of the Group's share of the net assets acquired over the cost of acquisition. Negative goodwill is presented in the same balance sheet category as goodwill. To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the Group's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities, that portion of negative goodwill is recognized in the consolidated statement of income when the future losses and expenses are recognized. For acquisitions prior to 31 March 2004, any remaining negative goodwill, not exceeding the fair values of the non-monetary assets acquired, was

3. Summary of Significant Accounting Policies (continued)

recognized in the consolidated statement of income over the remaining weighted average useful life of depreciable and amortizable assets acquired.

In accordance with IFRS 3, goodwill arising from business combinations for which the agreement date is on or after 31 March 2004 is tested annually for impairment and carried at cost less accumulated impairment losses. Negative goodwill arising from a business combination for which the agreement is on or after 31 March 2004 is recognized directly in the consolidated statement of income.

The gain or loss on disposal of an entity includes the unamortized balance of goodwill relating to the disposed entity.

New accounting developments. In December 2003, the IASB released 15 revised International Accounting Standards and withdrew one IAS standard. The revised standards are all mandatory for periods starting on or after 1 January 2005. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004.

The revised and amended standards are as follows: IAS 1, *Presentation of Financial Statements*; IAS 2, *Inventories*; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 10, *Events after the Balance Sheet Date*; IAS 16, *Property, Plant and Equipment*; IAS 17, *Leases*; IAS 19, *Employee Benefits*; IAS 21, *The Effects of Changes in Foreign Exchange Rates*; IAS 24, *Related Party Disclosures*; IAS 27, *Consolidated and Separate Financial Statements*; IAS 28, *Investments in Associates*; IAS 32, *Financial Instruments: Disclosure and Presentation*; IAS 33, *Earnings per Share*; IAS 39, *Financial Instruments: Recognition and Measurement*; IAS 36, *Impairment of Assets* and IAS 38, *Intangible Assets*.

The new standards and interpretations are as follows: IFRS 2, *Share-based Payment*; IFRS 3, *Business Combinations*; IFRS 4, *Insurance Contracts*; IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*; IFRS 6, *Exploration for and Evaluation of Mineral Resources*; IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*; IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments*; IFRIC 3, *Emission Rights*; IFRIC 4, *Determining whether an Arrangement contains a Lease*; IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12.

The Group expects to adopt all relevant new, revised and amended standards and the new IFRIC interpretations from their respective effective date, the majority of which are effective as of 1 January 2005.

Other than the effect of adoption of IFRS 3 discussed above, management does not believe the adoption of these standards will have a material impact on the Group's financial position, statements of income or of cash flows.

4 Acquisition of Tarkosalenftegas and Khancheynftegas

Description of the transaction. In December 2004, the Group's interest in Tarkosalenftegas and Khancheynftegas was increased to 100 percent as a result of its purchase of an additional 67.7 percent interest in Tarkosalenftegas and 57.0 percent in Khancheynftegas. The Group purchased these stakes from its significant shareholders, SWGI Growth Fund (Cyprus) Limited and Levit, by issuing 789,276 new ordinary shares in NOVATEK. Immediately prior to the acquisition, SWGI Growth Fund (Cyprus) Limited and Levit purchased 43.9 percent of Tarkosalenftegas and 26.8 percent of Khancheynftegas from the ITERA Group. Also prior to the acquisition, Levit purchased six percent of Khancheynftegas from individuals. The shareholder purchases from the ITERA Group were partially funded through loans from the Group (see Notes 15, 18 and 21). As part of the acquisition, the Group agreed to the early repayment of loans from Tarkosalenftegas to the ITERA Group and entered into a five-year commitment to sell gas to the ITERA Group at negotiated market prices.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

4. Acquisition of Tarkosalenftegas and Khancheynftegas (continued)

Accordingly, the total purchase price for 67.7 percent of Tarkosalenftegas and 57.0 percent of Khancheynftegas comprises the following:

Issuance of 789,276 new ordinary shares of NOVATEK	23,928
Cost of early repayment of long-term debt by Tarkosalenftegas	578
Value of five-year gas sales contract	701
Total purchase price	<u>25,207</u>

Management's purchase accounting allocation is preliminary and resulted in no goodwill being recognized. The excess of purchase price over identifiable assets excluding oil and gas properties and equipment was allocated to oil and gas properties and equipment. The resulting tax effect was recorded within deferred tax liabilities in the consolidated balance sheet. The preliminary net fair values disclosed below comprise 100 percent of the assets and liabilities of the acquirees, including the stakes in Tarkosalenftegas and Khancheynftegas held by the Group prior to the acquisition. The IFRS carrying values before the acquisition reported below relate to the IFRS carrying values in the separate accounts of the acquirees. Such stakes were also revalued to their fair values at the acquisition date. The results of such revaluation totaled RR 5,345 million and were recorded in the consolidated statement of shareholders' equity. Other differences between the fair values of the acquirees' total net assets and the purchase price include the cost of the early repayment of long-term debt and the value of the five-year gas sales contract.

	Tarkosalenftegas		Khancheynftegas	
	IFRS carrying amounts before the acquisition	Fair values at the acquisition date	IFRS carrying amounts before the acquisition	Fair values at the acquisition date
Current assets	2,165	2,165	654	654
Oil and gas properties and equipment	14,137	34,732	3,166	12,425
Other non-current assets ..	174	174	25	25
Current liabilities	(4,783)	(4,783)	(1,863)	(1,863)
Non-current liabilities	(722)	(5,664)	(1,297)	(3,519)

Summary combined financial information. The following table sets forth summary combined financial information for the year ended 31 December 2004 that is presented to provide information to evaluate the financial effects of the acquisition of Tarkosalenftegas ("TSNG") and Khancheynftegas ("KhNG") as if it had occurred on 1 January 2004. The following information comprises financial data for the full financial year ended 31 December 2004.

	Group results excluding its share of income from TSNG and KhNG	TSNG	KhNG	Summary combined
Total revenues	24,615	4,680	2,749	32,044
Net income (loss)	5,513	(104)	421	5,830

The summary combined financial information should not be construed to represent consolidated financial information. Specifically, no adjustments have been made for the following: (a) revenues were not adjusted to conform with the terms of the five-year gas sales contract with the ITERA Group; (b) depreciation, depletion and amortization was not increased to reflect the higher carrying values of property, plant and equipment following fair value adjustments; (c) intercompany eliminations; and (d) income taxes.

OAO NOVATEK**Notes to the Consolidated Financial Statements (continued)**

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

5. Supplemental Cash Flow Information

Significant non-cash transactions during 2004 were as follows: the Group issued 789,276 new ordinary shares as consideration for the acquisition of its 67.7 percent of Tarkosalenftegas and 57.0 percent of Khancheyneftegas (See Note 4).

Significant non-cash transactions during 2003 were as follows: during the year, the Group issued 170,244 new ordinary shares to the Yamal Regional Fund of Development, a Group shareholder, as consideration for shares acquired in Minlay, Tambeyneftegas, and Yamalneftegasdobycha (See Note 19); outstanding loan obligations to Lukoil West Siberia in the amount of RR 821 million were settled as a part of the consideration for the sale of shares in Nakhodkaneftegas to Lukoil West Siberia (See Note 13).

Significant non-cash transactions during 2002 were as follows: Kanwal Trading Limited, a related party (see Note 21), contributed equipment with a cost of RR 64 million to SNP NOVA, a company subsidiary, and Shareholders made non-cash contributions of capital in the amount of RR 510 million.

6. Oil and Gas Sales

	Year ended 31 December:		
	2004	2003	2002
Natural gas sales	12,943	7,612	1,094
Crude oil and gas condensate sales	6,387	2,268	1,084
Oil product sales	2,159	2,144	124
Total oil and gas sales	21,489	12,024	2,302

7. Materials, Services and Other

	Year ended 31 December:		
	2004	2003	2002
Materials and supplies	1,606	1,932	1,040
Employee compensation	756	946	736
Construction services	415	679	462
Tolling fees	365	457	—
Electricity and fuel	138	173	21
Extraction services	247	156	62
Rent expense	158	65	52
Repair and maintenance services	124	88	64
Other	366	486	407
Total materials, services and other	4,175	4,982	2,844

Included within total materials, services and other was RR 711 million and RR 436 million of expenses directly related to the extraction of natural gas, crude oil and gas condensate by our primary operating subsidiaries for the years ended 31 December 2004 and 2003, respectively.

In 2003, the Group commenced tolling of unstable condensate and oil and gas mix for processing into natural gas liquids and oil products.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

8. Transportation Expenses

	Year ended 31 December:		
	2004	2003	2002
Natural gas transportation to customers	2,938	1,338	62
Crude oil and gas condensate transportation to customers	555	249	56
Oil products transported by railroad	131	82	—
Insurance expense	357	499	—
Other internal transportation costs	253	222	203
Total transportation expenses	4,234	2,390	321

In 2003, the Group obtained insurance coverage for the transportation, via pipeline, of its natural gas, crude oil and gas condensate.

Other internal transportation costs comprise transport costs associated with gathering and delivering hydrocarbons at the field level to third party transportation networks. Additionally, for the years ended 31 December 2004 and 2003, respectively, other internal transportation costs include RR 44 million and RR 62 million of transportation costs from the Group's oil and gas construction services segment that was disposed of during 2004.

9. Trade and Other Receivables

	31 December:		
	2004	2003	2002
Trade receivables (net of provision of RR 21 million, RR 18 million and nil at 31 December 2004, 2003 and 2002, respectively)	825	747	543
Trade and other receivables—related parties	606	341	960
Construction balances due from customers (net of provision of nil, RR 5 million and nil at 31 December 2004, 2003 and 2002, respectively)	—	48	87
Construction receivables due from related parties	—	54	766
Recoverable value added tax	1,740	1,317	536
Interest on loans receivable—related parties	42	96	3
Other receivables (net of provision of RR 47 million, RR 28 million and RR 6 million at 31 December 2004, 2003 and 2002, respectively)	243	336	185
Total trade and other receivables	3,456	2,939	3,080

During 2003, the Group wrote off trade receivables and interest on loans receivable of RR 76 million from OOO Yangpur, an associate until 2002.

10. Prepayments and Other Current Assets

	31 December:		
	2004	2003	2002
Prepayments and advances to suppliers (net of provision of RR 1 million, RR 6 million and nil at 31 December 2004, 2003 and 2002, respectively)	361	961	565
Prepayments and advances to related parties	30	19	—
Prepaid taxes	609	292	3
Other current assets	39	12	10
Total prepayments and other current assets	1,039	1,284	578

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

11. Inventories

	31 December:		
	2004	2003	2002
Materials and supplies at net realizable value (net of provisions of RR 87 million, RR 136 million and RR 147 million at 31 December 2004, 2003 and 2002, respectively)	479	644	—
Materials and supplies at cost	252	275	1,155
Materials and supplies held by contractors	25	252	37
Construction contract work-in-progress	—	97	137
Natural gas and hydrocarbon liquids	105	60	28
Polymer and insulation tape products	66	22	—
Apartments available-for-sale	2	22	71
Total inventories	929	1,372	1,428

At 31 December 2004, certain materials and supplies inventories were pledged as collateral for short- and long-term bank borrowings (see Notes 17 and 18).

12. Trade Payables and Accrued Liabilities

	31 December:		
	2004	2003	2002
Trade payables	532	1,103	891
Trade and other payables—related parties	63	532	365
Construction advances	—	714	320
Bank customer deposits	462	206	157
Bank customer deposits—related parties	84	106	107
Trade advances from customers	572	269	70
Salaries payable	76	111	108
Interest payable	143	67	112
Other payables	31	217	144
Total trade payables and accrued liabilities	1,963	3,325	2,274

In June 2004, the Group sold its subsidiaries that represent substantially all of the Group's oil and gas construction services (see Note 26).

13. Investments in Associates

	31 December:		
	2004	2003	2002
Tarkosalenftegas	—	3,840	3,170
Geoilbent	1,835	1,247	890
Khancheyneftegas	—	75	64
Tambeyneftegas	109	114	—
Other	1	15	63
Total investments in associates	1,945	5,291	4,187

Acquisition of stakes in Tarkosalenftegas and Khancheyneftegas. In December 2004, the Group completed an acquisition of two key operating subsidiaries, Tarkosalenftegas and Khancheyneftegas, resulting in 100 percent ownership of both entities (see Note 4).

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

Tarkosaleneftegas. During 2003, the Group acquired an additional 4.7 percent of Tarkosaleneftegas' outstanding shares: 3.7 percent from third parties for RR 102 million and one percent from Group shareholders for RR 15 million. The 3.7 percent acquired from third parties was valued at its estimated fair value of RR 432 million, resulting in negative goodwill of RR 330 million. The one percent acquired from Group shareholders was valued at its predecessor basis of RR 98 million. The excess of carrying value over the purchase price of RR 15 million was recorded as contributions from shareholders within the Group's consolidated statement of shareholders' equity. Additionally, the Group transferred a portion of its holdings in Tarkosaleneftegas from PNGG to NOVATEK, resulting in a reduction of minority interest of RR 160 million.

Khancheyneftegas. During 2002, the Group sold six percent of its holdings in Khancheyneftegas for RR 60 thousand. The difference between the sales proceeds and the Group's carrying value in the investment of RR 5 million was recorded as a loss in the Group's consolidated statement of income.

Geoilbent. During 2004, Geoilbent was successful in its legal claim for recovery of RR 344 million of overpaid income taxes relating to prior fiscal periods and, accordingly, recorded an income tax benefit during the period.

In November 2004, the Group resolved to sell its 66 percent participation interest in Geoilbent.

Acquisition from Yamal Regional Fund of Development. In October 2003, NOVATEK acquired from the Yamal Regional Fund of Development 25.1 percent, 40 percent, and an additional 11 percent, of the total outstanding new ordinary shares of Tambeyneftegas, OAO Yamalneftegasdobysha, and Minlay, respectively, for 170,244 new ordinary shares in NOVATEK with an estimated total fair value of RR 2,721 million (see Note 19). The acquisition of the additional shares in Minlay, a Group subsidiary, increased the Group's effective interest in its associates, Geoilbent and Nakhodkaneftegass. Through the acquisition, the Group acquired an additional equity stake in Yurkharovneftegas, a Minlay subsidiary. The fair values for the acquired assets and liabilities were as follows:

Fair value of acquired interest in Tambeyneftegas	93
Fair value of acquired additional interest in Nakhodkaneftegass	99
Fair value of acquired additional interest in Geoilbent	159
Fair value of acquired interest in Yamalneftegasdobysha	783
Goodwill on acquisition of associates	247
Additional stake in Yurkharovneftegas	1,803
Reduction in carrying value of minority interest	125
Deferred tax liabilities recognized	(588)
Fair value of consideration provided	<u>2,721</u>

During 2002, the Group sold 60 percent of its interest in Nakhodkaneftegass, with a carrying value of RR 3 million, for RR 30 million to a Group shareholder. The resulting gain of RR 27 million was recorded within gain on disposal of investments in oil and gas producing subsidiaries and associates in the 2002 consolidated statement of income.

In November 2003, the Group sold its remaining 40 percent stake in Nakhodkaneftegass and 40 percent in Yamalneftegasdobysha to Lukoil West Siberia for RR 1,331 million (USD 44.6 million) and RR 759 million (USD 25.4 million), respectively, which included the full settlement of outstanding loan obligations totaling RR 821 million to Lukoil West Siberia. As a result of the sales, the Group recognized gains of RR 1,015 million.

Disposal of Yangpur. During 2002, the Group sold its 32 percent interest in OOO Yangpur to ZAO Deport for RR 58 million, realizing a gain on disposal of RR 49 million.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

13. Investments in Associates (continued)

Movement in the carrying value of investment in associates.

	Year ended 31 December:		
	2004	2003	2002
Balance at the beginning of the year	5,291	4,187	3,789
Share of income before tax	721	524	737
Share of income tax benefit (expense)	43	(88)	(198)
Net income from associates	764	436	539
Goodwill recognized on acquisition	—	247	—
Goodwill derecognized on disposal	—	(190)	—
Negative goodwill recognized on acquisition	—	(509)	—
Acquisition of associates	35	2,045	34
Disposals of associates	(37)	(922)	(39)
Acquisition of controlling stakes in associates (see Note 4)	(4,106)	—	—
Other movements	(2)	(3)	(136)
Balance at the end of year	1,945	5,291	4,187

14. Investments in Subsidiaries

Acquisition of stakes in NOVATEK-Polymer. In May 2004, the Group acquired an additional 19 percent of the total outstanding shares of NOVATEK-Polymer from a third party for RR 67 million in cash, and, in August 2004, an additional 25.5 percent of the total outstanding shares of NOVATEK-Polymer in an auction from the Russian Federal Property Fund for RR 61 million in cash. In addition, in August 2004, the Group also purchased an additional 1.25 percent for RR 4 million.

Acquisition of additional stake in PNGG. During 2004, the Group entered into an agreement with OAO Gazprom, the Russian gas monopoly, whereby the Group exchanged its title to the mineral license in the West Tarkosalinskoye field, held by PNGG's wholly-owned subsidiary OOO Purgazdobycha, for an 8.34 percent interest in PNGG. The acquisition increased the Group's effective interest in PNGG to 78.0 percent. Within the framework of this agreement, the Group retained its rights to 10 percent of the natural gas extracted from the Cenomanian reservoir and 50 percent of the hydrocarbon liquids from the Neocomian reservoir from the West Tarkosalinskoye field for the whole period of the license (which expires in 2021). At the same time, the Group leased the gas production assets from the field to OAO Gazprom under a long-term finance lease. The Group recognized a gain of RR 278 million, net of tax of RR 88 million, on the disposal.

Disposals. During 2004, the Group disposed of its interest in various non-core business entities to both third and related parties realizing a net gain of RR 480 million. Additionally, during 2004, the Group sold 10 percent interest of PNGG, with a carrying value of RR 41 million for RR 12 million.

In June 2004, the Group disposed of substantially all of its oil and gas construction services segment (see Note 26).

In December 2004, the Group disposed of its 66.7 percent interest in OAO Yamaltelecom, a telecommunication company for total consideration of RR 19 million, recognizing a gain of RR 6 million on the transaction.

In September 2004, NOVA Bank issued an additional six million shares to Levit, a Group shareholder, for total consideration of RR 60 million. As a result, the Group's interest in NOVA Bank decreased from 88.6 percent to 62 percent, and correspondingly, the Group recognized a loss on the transaction of RR 6 million.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

15. Long-Term Loans Receivable

	31 December:		
	2004	2003	2002
US dollar denominated loans to related parties	7,492	1,972	157
Russian rouble denominated loans to related parties	165	879	—
Banking loans receivable	138	74	—
Banking loans receivable from related parties	37	—	—
Russian rouble denominated loans	—	8	—
Total long-term loans receivable	<u>7,832</u>	<u>2,933</u>	<u>157</u>

US Dollar denominated loans to related parties. In December 2004, the Group provided a 10 percent loan in the amount of USD 290 million (RR 8,094 million) to Levit, a Group shareholder. Levit repaid USD 20 million (RR 558 million) of this loan in December 2004. The loan was originally repayable in December 2005. However, in March 2005, the loan maturity date was extended to 30 June 2006. Accordingly, the outstanding balance of USD 270 million (RR 7,492 million) was reclassified from short-term to long-term loans receivable at 31 December 2004.

At 31 December 2003, US dollar denominated loans to related parties included unsecured, 10 percent loans in the amount of RR 794 million (USD 27 million) and RR 1,178 million (USD 40 million) to Tarkosalenftegas and Khancheynftegas, respectively. Following the acquisitions of Tarkosalenftegas and Khancheynftegas, these loans were eliminated in consolidation.

Russian rouble denominated loans to related parties. At 31 December 2004, the weighted average interest rate on Russian rouble denominated loans to related parties was 11.5 percent. These related party loans are unsecured, repayable between 2006 and 2008 and are receivables from former subsidiaries that were disposed of in 2004.

At 31 December 2003, Russian rouble denominated loans to related parties included loans of RR 879 million to Khancheynftegas. The loans are unsecured and bore interest of 16 percent. In April 2004, the loans were repaid.

16. Property, Plant and Equipment

	31 December:		
	2004	2003	2002
<i>Cost</i>			
Oil and gas properties and equipment	53,749	6,893	1,341
Assets under construction	8,596	2,553	3,780
Machinery and equipment	—	1,281	1,168
Other	1,016	496	183
	<u>63,361</u>	<u>11,223</u>	<u>6,472</u>
<i>Accumulated depreciation, depletion and amortization</i>			
Oil and gas properties and equipment	(806)	(431)	(177)
Assets under construction	—	—	—
Machinery and equipment	—	(674)	(664)
Other	(106)	(61)	(5)
	<u>(912)</u>	<u>(1,166)</u>	<u>(846)</u>
Property, plant and equipment, net	<u>62,449</u>	<u>10,057</u>	<u>5,626</u>

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

16. Property, Plant and Equipment (continued)

The net movement in property, plant and equipment, for the year ended 31 December 2004 was as follows:

	Oil and gas properties and equipment	Assets under construction	Machinery and equipment	Other	Total
31 December 2003	6,462	2,553	607	435	10,057
Acquisitions	44,718	2,210	—	288	47,216
Additions	1,062	6,220	—	130	7,412
Transfers	1,909	(2,105)	—	196	—
Disposals	(687)	(282)	(557)	(123)	(1,649)
Depreciation, depletion and amortization	(584)	—	(50)	(65)	(699)
Impairments	63	—	—	49	112
31 December 2004	52,943	8,596	—	910	62,449

The net movement in property, plant and equipment for the year ended 31 December 2003 was as follows:

	Oil and gas properties and equipment	Assets under construction	Machinery and equipment	Other	Total
31 December 2002	1,164	3,780	504	178	5,626
Acquisitions	—	6	—	189	195
Additions	1,518	3,216	159	109	5,002
Transfers	4,089	(4,405)	131	185	—
Disposals	(22)	(20)	(79)	(103)	(224)
Depreciation, depletion and amortization	(287)	—	(108)	(57)	(452)
Impairments	—	(24)	—	(66)	(90)
31 December 2003	6,462	2,553	607	435	10,057

The net movement in property, plant and equipment for the year ended 31 December 2002 was as follows:

	Oil and gas properties and equipment	Assets under construction	Machinery and equipment	Other	Total
31 December 2001	1,217	647	460	145	2,469
Additions	9	3,333	—	109	3,451
Transfers	22	(183)	148	13	—
Disposals	(5)	(17)	(10)	(4)	(36)
Depreciation, depletion and amortization	(79)	—	(94)	(2)	(175)
Impairments	—	—	—	(83)	(83)
31 December 2002	1,164	3,780	504	178	5,626

Included within oil and gas properties and equipment at 31 December 2004, 2003 and 2002 are property acquisition costs of RR 32,102 million, RR 2,262 million and RR 826 million, net of accumulated depreciation, depletion and amortization and impairment expense of RR 69 million, RR 66 million and RR 39 million, respectively.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, amounting to RR 268 million, RR 33 million and 38 million at 31 December 2004, 2003

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

16. Property, Plant and Equipment (continued)

and 2002, respectively, are included in the cost of oil and gas properties and equipment. The Group has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred through 2045. The corresponding obligation is recorded within other non-current liabilities in the Group's consolidated balance sheets. Governmental authorities are continually considering environmental regulations and their enforcement. Consequently, the Group's ultimate environmental liabilities may differ from the recorded amounts.

Included in additions to property, plant and equipment for the years ending 31 December 2004, 2003 and 2002 was capitalized interest of RR 446 million, RR 322 million and RR 265 million, respectively.

At 31 December 2004, certain property, plant and equipment were pledged as collateral for short- and long-term bank borrowings (see Notes 17 and 18).

17. Short-Term Debt

	31 December:		
	2004	2003	2002
Russian rouble denominated loans	3,680	1,276	1,420
US dollar denominated loans	—	660	159
Loans from related parties	425	—	127
Promissory notes	1,275	133	11
Add: current portion of long-term debt	5,388	—	—
Total short-term debt and current portion of long-term debt	10,768	2,069	1,717

Russian rouble denominated loans. Short-term Russian rouble denominated loans had a weighted average interest rate of 10.5 percent (interest ranging from 8.8 to 12 percent) and 14.4 percent (interest ranging from 12 to 16 percent), at 31 December 2004 and 2003, respectively. At 31 December 2002, Russian rouble denominated loans had an interest range between 18 to 20 percent.

US dollar denominated loans. Short-term US dollar denominated loans had a weighted average interest rate of 7.9 percent (interest ranging from 6 percent to 10 percent) and 10.0 percent at 31 December 2003 and 2002, respectively.

Loans from related parties. At 31 December 2004, loans from related parties included US dollar denominated loans from the Yamal Regional Fund of Development, a Group shareholder, in the amount of RR 425 million (USD 15.3 million). The loan was obtained by Khancheyneftegas and was consolidated after the acquisition of Khancheyneftegas (see Note 4). The loan bears interest of 10 percent per annum and is repayable in February 2005. Subsequent to 31 December 2004, the loan was repaid.

At 31 December 2002, short-term loans payable to related parties included US dollar denominated loans from SWGI Growth Fund (Cyprus) Limited, a Group shareholder, in the amount of approximately RR 127 million (USD 4 million). The loans were unsecured and bear interest from nil to 10 percent. During 2003, these loans were repaid.

Promissory notes. At 31 December 2004, promissory notes consist of Tarkosaleneftegas promissory notes which are denominated in Russian roubles and repayable within one year of the balance sheet date. Subsequent to the balance sheet date, RR 712 million of these promissory notes were repaid. At 31 December 2003, promissory notes consisted of NOVA Bank promissory notes which were denominated in Russian roubles and repayable within one year of the respective balance sheet date.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

18. Long-Term Debt

	31 December:		
	2004	2003	2002
Russian rouble denominated loans	4,537	1,628	4
US dollar denominated loans	11,586	2,946	2,066
Loans from related parties	1,497	1,178	1,209
Russian rouble denominated bonds	1,000	—	—
Total	18,620	5,752	3,279
Less: current portion of long-term debt	(5,388)	—	—
Total long-term debt	13,232	5,752	3,279

At 31 December 2004, 2003 and 2002, long-term debt by facility is outlined below.

	31 December:		
	2004	2003	2002
C.R.R. B.V.	8,324	—	—
Sberbank	3,354	459	—
Vneshtorgbank	2,775	2,945	—
Yamal Regional Fund of Development	1,126	1,178	1,271
Finance Department of YNAO	1,130	1,130	—
Russian rouble denominated bonds	1,000	—	—
Other Russian rouble denominated loans	424	40	4
SWG I Growth Fund (Cyprus) Limited	—	—	1,209
Other loans	487	—	795
Total	18,620	5,752	3,279
Less: current portion of long-term debt	(5,388)	—	—
Total long-term debt	13,232	5,752	3,279

C.R.R. B.V. In December 2004, the Group received a loan for general commercial purposes in the amount of USD 200 million (RR 5,549 million) from C.R.R. B.V. backed by unsecured, 18-month credit-linked notes with an annual coupon rate of 7.75 percent, payable semi-annually. The loan is repayable in June 2006 and was guaranteed by Yurkharovneftegas in full. Subsequent to 31 December 2004, an additional guarantee was provided by Tarkosaleneftegas to comply with the terms of the loan agreement.

In April 2004, the Group received a loan in the amount of USD 100 million (RR 2,775 million) from ING Bank N.V. backed by unsecured, 18-month credit-linked notes with an annual coupon rate of 9.125 percent, payable semi-annually. The proceeds of the loan were used toward developing the Group's oil and gas fields and the construction of the Purovsky Gas Condensate Plant. The loan is payable in October 2005 and was guaranteed by Yurkharovneftegas and Tarkosaleneftegas for USD 100 million and USD 50 million, respectively. In April 2004, ING Bank N.V. transferred the loan to C.R.R. B.V.

Sberbank. During 2004, the Group received additional loans from Sberbank in the amounts of RR 900 million at 12 percent per annum payable between 2008 and 2009, RR 495 million at interest rates between 12 and 13 percent per annum payable in 2007, and RR 499 million at 10.5 percent per annum payable in 2005. The loans are collateralized by the Group's property, plant and equipment. During 2004, RR 459 million of outstanding loans at the beginning of the year were repaid.

The Group also consolidated Tarkosaleneftegas' outstanding RR 1,460 million Sberbank debt after the date of acquisition (see Note 4). These borrowings are collateralized by the Group's property, plant and equipment, bear annual interest rates ranging between 10.5 percent and 12 percent and are repayable between 2005 and 2007. A portion of these loans in the amount of RR 600 million was secured by the

18. Long-Term Debt (continued)

Group's 2.5 percent share in Tarkosaleneftegas. Subsequent to the balance sheet date, that portion of the loan amounting to RR 600 million was repaid ahead of schedule and the shares pledged were released.

Vneshtorgbank. At 31 December 2004 and 2003, US dollar denominated loans consisted of a USD 100 million loan from Vneshtorgbank in the amounts of RR 2,775 million and RR 2,945 million, respectively. The loan is collateralized by the Group's share in Tarkosaleneftegas (25 percent plus one share), and is guaranteed by Yurkharovneftegas and Khancheyneftegas. The loan bears annual interest of 9.75 percent and is repayable between 2005 and 2008. As described in Note 27, along with a legal re-organization of Tarkosaleneftegas to a limited liability company, the collateral of 25 percent plus one share was substituted by the 26 percent participation interest in Tarkosaleneftegas.

Yamal Regional Fund of Development. In December 2001, the Group entered into a USD 40 million loan agreement with the Yamal Regional Fund of Development, a Group shareholder. The borrowings were secured by the 100 percent participation interest in Yurkharovneftegas, bore interest of 10 percent per annum, and matured in December 2006. At 31 December 2003 and 2002, the outstanding loan amounts were RR 1,178 million and RR 1,271 million, respectively. During 2003, the Group and the Yamal Regional Fund of Development re-negotiated the collateral requirements of the loan, reducing the security from 100 percent to 31 percent of the participation interest in Yurkharovneftegas.

During 2004, the Group repaid USD 5 million of its outstanding loan (RR 156 million), and subsequently obtained another Russian rouble denominated loan for RR 155 million. The new rouble-denominated loan is guaranteed by Yurkharovneftegas, bears annual interest of 12 percent and matures in March 2007. The proceeds from this loan will be used for the construction of the Purovsky Gas Condensate Plant. In April 2005, the annual interest rate was reduced to 10 percent.

Subsequent to the balance sheet date, the Group repaid the US dollar denominated loan of USD 35 million to the Yamal Regional Fund of Development, and the Group's 31 percent of the participation interest in Yurkharovneftegas has been released from the pledge.

Finance Department of YNAO. In August 2003, the Group received a Russian rouble denominated loan from the Finance Department of YNAO in the amount of RR 1,130 million for the construction of the Purovsky Gas Condensate Plant. The loan is collateralized by the Group's 4.7 percent share in Tarkosaleneftegas, bears interest of 12.75 percent per annum, and matures in July 2008. In August 2004, the annual interest rate was reduced to 11.75 percent. As described in Note 27, along with a legal re-organization of Tarkosaleneftegas to a limited liability company, the collateral of 4.7 percent share was substituted by the 4.7 percent participation interest in Tarkosaleneftegas.

Russian rouble denominated bonds. In December 2004, the Group placed one million non-convertible Russian rouble denominated bonds with a nominal value of RR 1,000, payable in 728 days and an annual coupon rate of 9.4 percent, payable semi-annually. The bond issue was guaranteed by Yurkharovneftegas.

Other Russian rouble denominated loans. At 31 December 2004, other Russian rouble denominated loans included interest free loans from Pur-Land, a related party, in the total amount of RR 371 million due to mature in December 2005 and interest free promissory notes issued by Tarkosaleneftegas in the amount of RR 53 million due to mature in June 2007. The loans were consolidated by the Group after the acquisition of Khancheyneftegas and Tarkosaleneftegas (see Note 4). In January 2005, RR 371 million of loans from Pur-Land were repaid.

At 31 December 2003, other Russian rouble denominated loans totaling RR 40 million were interest free and payable between 2004 and 2006. At 31 December 2002, other Russian rouble denominated loans total RR 4 million, were interest free and payable between 2004 and 2006.

SWG Growth Fund (Cyprus) Limited. At 31 December 2002, loans from SWGI Growth Fund, a Group shareholder, consisted of US dollar denominated loans in the amount of USD 38 million

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

18. Long-Term Debt (continued)

(RR 1,209 million). These loans were unsecured and bore annual interest ranging from 12 to 15 percent. During 2003, these loans were repaid in full.

Other loans. At 31 December 2004, other loans included US dollar denominated loans totaling RR 487 million (USD 17.6 million) with a weighted average interest rate of 8.3 percent. The loans mature between 2005 and 2010. At 31 December 2002, other loans consisted of a US dollar denominated loan in the amount of RR 795 million (USD 25 million) from Lukoil Western Siberia, which was settled in full during 2003.

Scheduled maturities of long-term debt outstanding are as follows:

Year ended 31 December:	Scheduled maturities as at 31 December:		
	2004	2003	2002
2004	—	—	4
2005	—	950	1,209
2006	7,920	2,160	1,271
2007	2,697	982	795
2008	2,093	1,660	—
2009	515	—	—
Thereafter	7	—	—
Total long-term debt	13,232	5,752	3,279

19. Shareholders' Equity

Dividends. In May 2005, the Board of Directors recommended a dividend of RR 256 per share to be paid to shareholders of record as of 25 April 2005. This recommended dividend totaling RR 777 million is subject to approval by shareholders at the Annual General Meeting of Shareholders.

Increases in ordinary share capital. During 2002, NOVATEK issued one million new ordinary shares for RR 319 (nominal RR 300) per share in cash, consisting of ordinary share capital of RR 100 (nominal) per share, and RR 200 (nominal) per share in additional paid in capital. Of these new shares, 533,330 shares were issued to Levit, and 466,670 shares were issued to SWGI Growth Fund (Cyprus) Limited.

During 2003, NOVATEK issued an additional 653,348 new ordinary shares. In October 2003, NOVATEK acquired from the Yamal Regional Fund of Development 25.1 percent, 40 percent, and an additional 11 percent, of the total outstanding shares of Tambeyneftegas, OAO Yamalneftegasdobysha, and Minlay, respectively (see Note 13) in exchange for 170,244 new shares of NOVATEK with a par value of RR 100 per share and an estimated total fair value of RR 15.983 thousand per share. The total consideration provided of RR 2,721 million consisted of RR 17 million in share capital and RR 2,704 million in additional paid in capital.

At the same time, the Group shareholders transferred their 75 percent share in Minlay to NOVATEK in exchange for 483,104 new shares in NOVATEK. As the shareholders' equity in Minlay was previously included into the consolidated financial statements of the Group, this transaction resulted in a reclassification of RR 48 million from additional paid in capital to ordinary share capital, representing the par value of the issued shares, in the statement of changes in shareholders' equity during 2003.

In December 2004, NOVATEK issued 789,276 new ordinary shares with a market value of RR 23,928 million to Group shareholders in exchange for 67.7 percent of Tarkosaleneftegas and 57 percent of Khancheyneftegas, bringing the Group's ownership in both entities to 100 percent (see Note 4).

Other contributed capital to and from shareholders. During 2003, as part of the re-organization of the shareholders' controlling interests into NOVATEK, the shareholders transferred their 89 percent interest in Yurkharovneftegas to Minlay. As the shareholders' equity in Yurkharovneftegas was previously included

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

19. Shareholders' Equity (continued)

into the consolidated financial statements of the Group, the purchase price of RR 367 million payable by Minlay to the shareholders has been recorded as a distribution to shareholders in the consolidated statement of changes in shareholders' equity.

As a result of other transfers between shareholders and the Group, additional distributions to shareholders of RR 23 million were recorded in the consolidated statements of changes in shareholders' equity during 2003.

During 2003, the shareholders contributed an additional one percent stake in Tarkosaleneftegaz, 35 percent of NOVATEK-Polymer and 4.3 percent of PNGG. As a result of these transactions, net contributions from shareholders in the gross amount of RR 524 million were recorded in the consolidated statements of changes in shareholders' equity during 2003.

During 2002, the shareholders acquired an additional 19 percent of Minlay from third parties for which the consideration provided was interests in several other companies owned by the shareholders. The fair value of the consideration provided by the shareholders was RR 108 million. In addition, the shareholders contributed RR 402 million to the Group's property, plant and equipment during the year. The contributions from shareholders have been recorded in the consolidated statements of changes in shareholders' equity for 2002.

Distributable retained earnings. The statutory accounting reports of NOVATEK are the basis for income distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net income calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation. For the years ended 31 December 2004, 2003 and 2002, NOVATEK had a statutory net income of RR 5,182 million, RR 3,037 million and RR 524 million, respectively, as reported in NOVATEK's statutory accounting reports.

20. Taxes

Reconciliation of income tax. The table below reconciles actual income tax expense and theoretical income tax, determined by applying the statutory tax rate to income before income tax and minority interest.

	Year ended 31 December:		
	2004	2003	2002
Income before income tax and minority interest	8,043	4,540	1,341
Theoretical income tax expense at statutory rate of			
24 percent	1,930	1,090	322
Increase (decrease) due to:			
Non-deductible expenses	156	200	113
Non-temporary elements of monetary gains and losses	—	—	190
Associates' taxation at higher (lower) effective rate	(216)	(38)	21
Net deductible temporary differences not recognized as assets	6	4	61
Inflation effect on deferred tax balance at beginning of year	—	—	(13)
Other non-temporary differences	199	75	55
Total income tax expense	2,075	1,331	749

Total income tax expense for the year ended 31 December 2004, 2003 and 2002 represents 25.8 percent, 29.3 percent and 55.9 percent, respectively of income before income tax and minority interest for the year.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

20. Taxes (continued)

The tax charges and benefits arising from the restatement for the effects of inflation on non-monetary assets and liabilities are recorded as non-temporary elements of monetary gains and losses.

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.

Movements in deferred income tax assets and liabilities during the year ended 31 December 2004 were as follows:

	31 December 2004	Income statement effect	Acquisitions and disposals	31 December 2003
Liabilities				
Property, plant and equipment	(9,032)	(149)	(8,147)	(736)
Investments in associates	(347)	(175)	859	(1,031)
Inventories	—	11	—	(11)
Trade payables and accrued liabilities	(149)	(86)	(16)	(47)
Total deferred income tax liabilities	(9,528)	(399)	(7,304)	(1,825)
Assets				
Property, plant and equipment	158	41	—	117
Inventories	98	(4)	26	76
Trade and other receivables	167	89	10	68
Trade payables and accrued liabilities	260	54	190	16
Other	31	7	(31)	55
Total deferred income tax assets	714	187	195	332
Net deferred income tax liabilities	(8,814)	(212)	(7,109)	(1,493)

Movements in deferred income tax assets and liabilities during the year ended 31 December 2003 were as follows:

	31 December 2003	Income statement effect	Acquisitions and disposals	31 December 2002
Liabilities				
Property, plant and equipment	(736)	(64)	(341)	(331)
Investments in associates	(1,031)	48	(247)	(832)
Inventories	(11)	39	—	(50)
Trade payables and accrued liabilities	(47)	(12)	—	(35)
Total deferred income tax liabilities	(1,825)	11	(588)	(1,248)
Assets				
Property, plant and equipment	117	51	—	66
Inventories	76	51	—	25
Trade and other receivables	68	67	—	1
Trade payables and accrued liabilities	16	(14)	—	30
Other	55	25	—	30
Total deferred income tax assets	332	180	—	152
Net deferred income tax liabilities	(1,493)	191	(588)	(1,096)

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

20. Taxes (continued)

Movements in deferred income tax assets and liabilities during the year ended 31 December 2002 were as follows:

	31 December 2002	Income statement effect	Acquisitions and disposals	31 December 2001
Liabilities				
Property, plant and equipment	(331)	(149)	—	(182)
Investments in associates	(832)	(41)	—	(791)
Inventories	(50)	(29)	—	(21)
Trade payables and accrued liabilities	(35)	(35)	—	—
Total deferred income tax liabilities	(1,248)	(254)	—	(994)
Assets				
Property, plant and equipment	66	65	—	1
Inventories	25	16	—	9
Trade and other receivables	1	—	—	1
Trade payables and accrued liabilities	30	1	—	29
Other	30	26	—	4
Total deferred income tax assets	152	108	—	44
Net deferred income tax liabilities	(1,096)	(146)	—	(950)

At 31 December 2004, 2003 and 2002, deductible temporary differences, relating to certain property, plant and equipment with carrying values less than their respective tax bases of nil, RR 306 million and RR 370 million, respectively, have not been recognized as management does not believe that it is probable that these temporary differences will result in future economic benefits to the Group in the foreseeable future.

Deferred income tax balances are presented in the consolidated balance sheets as follows:

	31 December:		
	2004	2003	2002
Long-term deferred income tax asset (other non-current assets)	41	98	—
Long-term deferred income tax liability	(8,855)	(1,591)	(1,096)
Net deferred income tax liability	(8,814)	(1,493)	(1,096)

Deferred income tax assets expected to be recovered within 12 months of 31 December 2004, 2003 and 2002 were RR 221 million, RR 145 million and RR 61 million, respectively. Deferred tax liabilities expected to be recovered within 12 months of 31 December 2004, 2003 and 2002 were RR 58 million, RR 17 million and RR 50 million respectively.

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

20. Taxes (continued)

The Group is subject to a number of taxes other than on income, which are detailed as follows:

	Year ended 31 December:		
	2004	2003	2002
Unified natural resources production tax	1,293	538	154
Property tax	106	95	31
Excise tax	93	72	—
Tax penalties and interest	43	25	12
Value added tax	10	26	—
Road users tax	—	—	53
Other	24	91	46
Total taxes other than income tax	1,569	847	296

Under the Tax Code of the Russian Federation, the rate for the unified natural resources production tax on natural gas production was RR 107 per thousand cubic meters through 31 December 2004. Beginning 1 January 2005, the unified natural resources production tax for natural gas is changed at a fixed rate of RR 135 per thousand cubic meters.

Under the Tax Code of the Russian Federation, from 1 January 2004, the unified natural resources production tax rate for gas condensate is set at 17.5 percent of gas condensate revenues recognized by the Group.

Under the Tax Code of the Russian Federation, the base rate for the unified natural resources production tax for crude oil was set at RR 347 per metric ton of crude oil produced at 31 December 2004. The rate for crude oil is adjusted depending on the market price of Urals blend and the RR/USD exchange rate. Between 1 January 2005 and 31 December 2006 the base rate will be increased to RR 419 per metric ton of crude oil. From 1 January 2007, the tax rate was set at 16.5 percent of crude oil revenues recognized by the Group.

Current taxes payable, other than income taxes, at 31 December 2004, 2003 and 2002 were as follows:

	31 December:		
	2004	2003	2002
Value added tax	474	303	534
Tax penalties and interest	—	153	123
Social security and other social taxes	16	129	113
Unified natural resources production tax	704	82	17
Property tax	79	51	30
Road users tax	—	20	43
Other	7	179	87
Less: long-term portion of restructured tax liabilities	—	(50)	(53)
Total other taxes payable	1,280	867	894

During 2004, the Group paid RR 22 million to settle previously restructured taxes with a net carrying value of RR 50 million. The remaining balance was forgiven by the tax authorities resulting in the recognition of a gain of RR 28 million that was recorded in interest income.

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

21. Related Party Transactions

In 2004, 2003 and 2002, the Group had significant activities with companies related to its shareholders in connection with purchases and sales of natural gas, crude oil and gas condensate, construction and other related services, and purchases and sales of equity securities. The Group's reported statements of income, balance sheets and cash flows would be different had such transactions been carried out amongst unrelated parties. 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.

During 2002 and through November 2003, the Group was controlled by the Chairman of the Company's Management Board, Leonid V. Mikhelson, through his ownership of controlling stakes in two holding companies, SWGI Growth Fund (Cyprus) Limited and Levit. SWGI Growth Fund (Cyprus) Limited and Levit are direct shareholders of the Group. In December 2003, Mr. Mikhelson ceased being the controlling shareholder of the Group as a result of disposal of a portion of his holdings in Levit, bringing his total ownership in Levit to less than 50 percent.

The Group operates primarily in the YNAO and has other transactions with the Yamal-Nenets Regional Administration in the ordinary course of business.

The Group had transactions with the following related parties during 2004, 2003 and 2002:

<u>Name of related party</u>	<u>Nature of transactions</u>
Shareholders	
Levit	Provision of loans, transactions in shares of Group companies (see Note 4)
SWGI Growth Fund (Cyprus) Limited	Receipt of loans, transactions in shares of Group companies (see Note 4)
Yamal Regional Fund of Development	Receipt of loans, transactions in shares of Group companies
ООО IK Mega	Transactions in shares of shares of Group companies
TNG Energy*	Crude oil and gas condensate sales, transactions in shares of Group companies. TNG Energy was a shareholder of the Group from December 2004 through January 2005.
Associates	
Khancheyneftegas (through December 2004)	Purchases of natural gas and gas condensate, provision of construction services, provision of loans and guarantees
ООО NGK Itera (through February 2003)	Sales of natural gas
Tarkosaleneftegas (through December 2004)	Purchases of natural gas and gas condensate, provision of construction and well services, provision of loans and guarantees, settlement of receivables and loan payable, sales of inventory
Geoilbent	Purchases of crude oil, provision of loan, sales of construction materials and services, settlement of promissory notes held
ОАО Nordpipes (liquidated)	Construction services (2002)
ООО Yangpur (through 2002)	Provision of loans and construction services

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

21. Related Party Transactions (continued)

Name of related party	Nature of transactions
<i>Subject to control by significant shareholders</i>	
Kanwal Trading Limited**	Transactions in shares of Group companies
ZAO Natas**	Agent for sales of shares in Group companies (2002)
White Bay Limited** (liquidated)	Contribution of assets to the share capital of subsidiary, receipt of guarantees
Kerden Trading Limited**	Sales of crude oil and oil products
ООО Novafininvest (from July 2004)	Provision of construction services (see Note 26)
ОАО SNP NOVA (from July 2004)	Provision of construction services (see Note 26)
ООО NOVA Energy Services (from July 2004)	Provision of construction services (see Note 26)
ОАО Pur-Land*	Sales of crude oil and gas condensate, purchases of oil products (2003)

* Beginning December 2004, TNG Energy and ОАО Pur-Land were subsidiaries of the significant shareholders. From December 2003 to the beginning of December 2004, TNG Energy and ОАО Pur-Land were associate investments of the significant shareholders. Prior to December 2003, TNG Energy and ОАО Pur-Land were associate investments of a control shareholder.

** For periods up to and including November 2003, these entities were under common control with the Group.

ООО NGK Itera was established to merge the interests held by ОАО FIK Novafininvest (predecessor company to NOVATEK) and the ITERA Group. In February 2003, the Group shareholders decided not to pursue the merger with the ITERA Group.

Purchases and sales of crude oil and gas condensate:

Name of related party	Year ended 31 December:					
	2004		2003		2002	
	Volumes (tons)	Russian roubles	Volumes (tons)	Russian roubles	Volumes (tons)	Russian roubles
Sales to Kerden Trading Limited	388,645	1,772	33,201	190	—	—
Sales to TNG Energy	72,700	395	—	—	—	—
Sales to Pur-Land	—	—	—	—	195,106	415
Purchases from Khancheyneftegas	519,666	832	335,683	674	—	—
Purchases from Tarkosaleneftegas	348,297	557	306,192	597	116,701	258
Purchases from Geoilbent	358,372	920	—	—	—	—

Purchases and sales of natural gas:

Name of related party	Year ended 31 December:					
	2004		2003		2002	
	Volumes (m³ 000s)	Russian roubles	Volumes (m³ 000s)	Russian roubles	Volumes (m³ 000s)	Russian roubles
Sales to NGK Itera (until February 2003)	—	—	348,220	149	2,314,002	629
Purchases from Tarkosaleneftegas	5,738,201	1,727	5,222,756	1,050	1,978,404	222
Purchases from Khancheyneftegas	2,297,180	958	587,640	245	—	—
Purchases from Pur-Land	—	—	2,873,407	467	—	—

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

21. Related Party Transactions (continued)

Other balances and transactions with related parties:

	As at and for the year ended 31 December:		
	2004	2003	2002
Balances			
Trade and other receivables	606	395	1,726
Short-term loans receivable	251	205	148
Prepayments and advances	30	19	—
Prepayments and advances (for construction)	235	—	—
Long-term loans receivable (Note 15)	7,694	2,851	157
Other non-current assets	70	—	—
Short-term debt	425	—	127
Long-term debt	1,497	1,178	1,209
Trade and other payables	147	638	472
Interest payable	—	—	112
Interest receivable	42	96	3
Transactions			
Purchases of inventory	—	18	45
Sales of inventory and oil products	151	1,465	42
Interest expense	85	266	65
Interest income	425	157	21
Construction sales	209	1,447	917
Other (Notes 4,5,13,19,24)			

SNP NOVA, Novafininvest and NOVA Energy Services provided construction services to the Group totaling RR 486 million subsequent to their disposal.

Short-term loan receivable. At 31 December 2003, the short-term loan receivable was an unsecured, US dollar denominated loan to Geoilbent totalling RR 147 million (USD 5 million). The loan bore interest of 2 percent and was repaid in 2004.

At 31 December 2002, short-term loans receivable included unsecured, Russian rouble denominated loans to Levit totaling RR 85 million and to OOO Yangpur totaling RR 63 million. The loan to Levit was repaid in 2003, whereas the loan to OOO Yangpur was written off by the Group in 2003.

22. Segment Information

The Group operates principally in the oil and gas industry in the Russian Federation. The Group evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Group as a whole. However, the Group's activities are considered by management to comprise one geographic segment and the following business segments:

- Exploration and production—acquisitions, exploration, production, processing, marketing and transportation of oil and gas;
- Oil and gas construction services—drilling and construction of oil and gas infrastructure and facilities (discontinued in June 2004);
- Other—other activities, including head office services, banking and telecommunications.

OAO NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

22. Segment Information (continued)

Segment information as of 31 December 2004 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment assets	67,920	—	856	68,776
Associated companies	1,945	—	—	1,945
Unallocated assets				11,729
Total assets	69,865	—	856	82,450
Segment liabilities	(3,531)	—	(65)	(3,596)
Unallocated liabilities				(33,918)
Total liabilities	(3,531)	—	(65)	(37,514)

Segment information for the year ended 31 December 2004 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment revenues				
External revenues and other income	21,721	2,005	1,274	25,000
Inter-segment sales	12	915	8	935
Total segment revenues	21,733	2,920	1,282	25,935
Segment expenses				
External expenses	(13,660)	(2,773)	(743)	(17,176)
Inter-segment expenses	—	(16)	—	(16)
Total segment expenses	(13,660)	(2,789)	(743)	(17,192)
Segment result	8,073	131	539	8,743
Unallocated gains on sales of investments				198
Unallocated operating expenses				(1,320)
Unrealized margin in segment assets				(7)
Income from operations				7,614
Income of associated companies	721	—	—	721
Acquisitions	47,216	—	—	47,216
Capital expenditures	7,212	—	200	7,412
Depreciation, depletion and amortization	594	79	26	699
Charges for impairment	(184)	(1)	67	(118)

Segment information as of 31 December 2003 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment assets	14,947	2,460	1,757	19,164
Associated companies	5,267	—	24	5,291
Unallocated assets				1,931
Total assets	20,214	2,460	1,781	26,386
Segment liabilities	(1,851)	(1,336)	(420)	(3,607)
Unallocated liabilities				(10,766)
Total liabilities	(1,851)	(1,336)	(420)	(14,373)

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

22. Segment Information (continued)

Segment information for the year ended 31 December 2003 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment revenues				
External revenues and other income	12,097	3,293	855	16,245
Inter-segment sales	—	720	42	762
Total segment revenues	12,097	4,013	897	17,007
Segment expenses				
External expenses	(8,345)	(3,765)	(840)	(12,950)
Inter-segment expenses	—	(42)	—	(42)
Total segment expenses	(8,345)	(3,807)	(840)	(12,992)
Segment result	3,752	206	57	4,015
Unallocated gains on sales of investments				1,011
Unallocated operating expenses				(800)
Unrealized margin in segment assets				(54)
Income from operations				4,172
Income of associated companies	524	—	—	524
Acquisitions	—	—	195	195
Capital expenditures	4,376	474	152	5,002
Depreciation, depletion and amortization	286	110	56	452
Charges for impairment	175	(58)	191	308

Segment information as of 31 December 2002 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment assets	6,765	3,184	1,621	11,570
Associated companies	4,066	5	116	4,187
Unallocated assets				98
Total assets	10,831	3,189	1,737	15,855
Segment liabilities	(694)	(977)	(615)	(2,286)
Unallocated liabilities				(7,344)
Total liabilities	(694)	(977)	(615)	(9,630)

OA O NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

22. Segment Information (continued)

Segment information for the year ended 31 December 2002 was as follows:

	Exploration and production	Oil and gas construction services	Other	Total
Segment revenues				
External revenues and other income	2,395	2,366	839	5,600
Inter-segment sales	—	1,489	23	1,512
Total segment revenues	2,395	3,855	862	7,112
Segment expenses				
External expenses	(1,785)	(3,226)	(767)	(5,778)
Inter-segment expenses	—	(23)	—	(23)
Total segment expenses	(1,785)	(3,249)	(767)	(5,801)
Segment result	610	606	95	1,311
Unallocated gains on sales of investments				79
Unallocated operating expenses				(778)
Unrealized margin in segment assets				(75)
Income from operations				537
Income of associated companies	732	2	3	737
Capital expenditures	3,194	148	109	3,451
Depreciation, depletion and amortization	79	94	2	175
Charges for impairment	91	152	40	283

At 31 December 2004, 2003 and 2002, external expenses of oil and gas construction services segment included RR 912 million, RR 666 million and RR 1,414 million, respectively, of costs capitalised be exploration and production segment.

Segment assets consist primarily of property, plant and equipment and current assets. Unallocated assets include other investments and deferred tax assets. Segment liabilities comprise operating liabilities, excluding items such as taxes payable, borrowings and deferred tax liabilities.

Capital expenditures include purchases of property, plant, and equipment, and acquisitions of subsidiaries and associates. Charges for impairment above include impairment provisions for accounts and loans receivable, assets under construction, inventory, and other long-term assets.

The inter-segment revenues mainly consist of:

- Oil and gas construction services—rendering drilling and construction services to the exploration and production segment, for which prices are determined on a cost plus basis; and
- Other—provision of telecommunication and banking services to the other segments, for which prices are based on market prices.

Included within unallocated operating expenses are corporate expenses, including provision for the impairment of other investments.

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

23. Minority Interest

	Year ended 31 December:		
	2004	2003	2002
Minority interest at the beginning of the year	468	781	829
Minority interest share of net income (loss)	274	(72)	(52)
Net change in minority interest as a result of disposals and acquisitions	(293)	(241)	4
Minority interest at the end of year	449	468	781

24. 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 not freely convertible in most countries outside of the Russian Federation, currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

While there have been improvements in the economic trends, 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.

Guarantees and pledges. At 31 December 2004, the Group pledged 32.2 percent of Tarkosalenftegas and 31.0 percent of Yurkharovneftegas as collateral for long-term borrowings. In March 2005, the pledges of 2.5 percent of Tarkosalenftegas and 31.0 percent of Yurkharovneftegas were released (see Note 18). Additionally, the Group's 66 percent participation interest in Geoilbent was pledged to the EBRD as collateral for a long-term loan received by Geoilbent from the EBRD. The total amount payable by Geoilbent to the EBRD under the loan facility was USD 30 million.

Due to the absence of any market for such financial instruments, it is not practicable to estimate the fair value of the Group's commitment on behalf of Geoilbent. However, the Group does not expect to incur losses as a result of this commitment.

At 31 December 2004, the Group had pledged property, plant and equipment aggregating approximately RR 7,839 million.

At 31 December 2003 and 2002, the Group had outstanding guarantees on behalf of related parties totaling RR 999 million and RR 682 million, respectively.

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 activity of the Group may be challenged by the relevant regional and federal authorities. Recent 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. 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 2004, 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 for in these financial statements.

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 immediately, if no current or future benefit is discernible.

24. Contingencies and Commitments (continued)

Potential liabilities which might arise as a result of stricter enforcement 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, statements of income or of cash flows.

Legal contingencies. During the year, the Group was involved in 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 these consolidated financial statements.

Oilfield licenses. The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield 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 materially adverse effect on the Group's financial position, statements of income or of cash flows.

The Group's oil and gas fields are situated on land belonging to the Yamal-Nenets Regional Administration. Licenses are issued by the Ministry of Natural Resources and the Group pays unified production tax to explore and produce oil and gas from these fields. The principal licenses of the Group, including its subsidiaries and associates, and their expiry dates are:

Field	License holder		License expiry date
Yurkharovskoye	Yurkharovneftegas	Subsidiary	2034
Khancheynskoye	Khancheyneftegas	Subsidiary	2019
East Tarkosalinskoye	Tarkosalneftegas	Subsidiary	2018
North Gubkinskoye	Geoilbent	Associate	2018

The licenses expire between 2018 and 2034. 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. In February 2005, the Group was successful in extending the license for the Yurkharovskoye field from 2020 to 2034. In May 2005, the Group was preparing its application for the extension of the terms of the licenses for its two other core fields, East Tarkosalinskoye and Khancheynskoye.

Commitments. The Group had entered into commitments aggregating approximately RR 2,682 million to complete the construction of the Purovsky Gas Condensate Plant in 2005.

25. Financial Instruments

Foreign exchange. The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar, and it does not use foreign exchange or forward contracts. At 31 December 2004, cash, trade and other receivables, short-term and long-term loans receivable and short-term and long-term debt denominated in US dollars amounted to RR 27 million, RR 424 million, RR 78 million, RR 7,492 million, RR 425 million and RR 12,547 million, respectively, translated at the official Russian rouble to US dollar exchange rate used by the Central Bank of the Russian Federation.

Interest rates. The Group obtains funds from and deposits surpluses with banks at current market interest rates, and does not use any hedging instruments to manage its exposure to changes in interest rates. Management does not believe that it has significant exposure to interest rate risk as the majority of its borrowings are at fixed interest rates.

Credit risks. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to have minimal risk of default. The Group does not require collateral or

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

25. Financial Instruments (continued)

other security to support receivables from customers or related parties. A portion of the Group's accounts receivable is from shareholders and related parties. Although collection of accounts receivable could be influenced by economic factors affecting these entities, management believes there is no significant risk of loss to the Group beyond the provisions already recorded.

Fair values. The fair value of financial instruments is determined with reference to various market information and other valuation methods as considered appropriate. At 31 December 2004, the fair values, where determinable, of financial instruments held by the Group did not materially differ from their carrying values.

26. Discontinued Operations

The Group's oil and gas construction services activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation. Contracts were typically signed with customers that allowed for the determination of agreed construction schedules, estimated costs, including a margin over the cost of materials and supplies, customer approval of deliverables, and invoicing.

During 2003 and 2004, ООО Novafininvest ("NFI") acted as general contractor for the construction of the Khancheynskoye and Yurkharovskoye fields. As of the date of disposal, NFI also held interests in certain companies, including ОАО SNP NOVA, which was the primary provider of construction services to the Group. Such activities (the "NFI discontinuing operations") represent substantially all of the activities of the oil and gas construction services segment of the Group. The Group expects to continue existing contractual relationships, and may enter into additional contracts, with NFI and its subsidiaries in the future at market terms and conditions.

In June 2004, NOVATEK's board of directors approved the sale of substantially all of the Group's oil and gas construction services business.

In June 2004, the Group sold its 99 percent investment in the share capital of ООО Novafininvest to shareholders of the Group: SWGI Growth Fund (Cyprus) Limited (40.9 percent), a Group shareholder, Levit (53.6 percent), a Group shareholder, and ООО Kopitek (4.5 percent), for total cash consideration of RR 240 million, recognizing a loss of RR 296 million. The disposal is consistent with the Group's long-term strategy to focus its activities on oil and gas exploration and production, and to divest non-core activities.

ОАО NOVATEK

Notes to the Consolidated Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

26. Discontinued Operations (continued)

The financial position, results of operations and of cash flows of the discontinued operations are presented in the table below.

	2004 as of and through Disposal	Year ended 31 December:	
		2003	2002
Total assets	2,569	3,580	1,951
Total liabilities	1,419	2,464	944
Total revenues and other income	2,186	3,227	1,084
Total operating expenses	(2,194)	(3,341)	(1,032)
Income (loss) before income tax	(8)	(114)	52
Income tax expense	(31)	(8)	(75)
Loss after tax	(39)	(122)	(23)
Loss on disposal, net of tax of nil	(296)	—	—
Loss for discontinued operations	(335)	(122)	(23)
Net cash provided by operating activities	29	49	25
Net cash used in investing activities	(701)	(969)	(188)
Net cash provided by financing activities	1,078	1,090	(177)
Basic and diluted earnings per share from continuing operations (in Russian roubles)	2,658	1,965	585
Basic and diluted loss per share for discontinued operations (in Russian roubles)	(148)	(70)	(20)
Basic and diluted earnings per share (in Russian roubles)	2,510	1,895	565
Weighted average shares outstanding	2,268,654	1,731,512	1,139,636

27. Subsequent Events

During 2005, the Group reorganized Tarkosalenftegas into a limited liability company (“ООО”), and merged Khancheynftegas into Tarkosalenftegas.

In May 2005, the Group disposed of its equity stake in NOVA Bank to Levit, a Group shareholder for RR 156 million. NOVA Bank recognized net income of RR 7 million and RR 5 million for the years ended 31 December 2004 and 2002, respectively, and a net loss of RR 3 million for the year ended 31 December 2003. NOVA Bank’s net assets at 31 December 2004, 2003 and 2002 were RR 219 million, RR 152 million and RR 57 million, respectively. The results of the disposal will be reflected in the Group’s consolidated income statement during the second quarter of 2005.

Subsequent to 31 December 2004, certain shareholders provided share-based compensation to the Group’s chief financial officer and to the Group’s head of exploration and production activities. The share awards comprise shares in a limited liability company that indirectly holds shares of the Group. Management’s preliminary estimate of the maximum fair value of the award is approximately RR 900 million, which relates only to services provided to the Group. The fair value of the awards will be recognized as compensation expense evenly over their five year vesting period beginning the second quarter of 2005. A corresponding increase will be recorded to additional paid in capital as expense is recorded to reflect the shareholders contribution in providing the award.

OAO NOVATEK

Unaudited Supplemental Oil and Gas Disclosures

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”), including International Accounting Standards (“IAS”), and Interpretations issued by the International Accounting Standards Board (“IASB”) and the International Accounting Standards Board’s International Financial Reporting Interpretations Committee (“IFRIC”). In the absence of specific IFRS guidance which establishes a comprehensive set of disclosures for oil and gas producing companies, the Company has reverted to other relevant disclosure standards 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 oil and gas activities.

The Company’s exploration and production activities are exclusively within the Russian Federation; therefore, all of the information provided in this section pertains to this country. The Company operates through various oil and gas production subsidiaries. The Company also owns interest in oil and gas producing entities, referred to as Associates 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 2004 and 2003 (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2004	2003
Costs incurred in property acquisition, exploration and development activities		
Acquisition costs	46,910	1,462
Exploration costs	183	122
Development costs	6,391	2,219
Total costs incurred in property acquisition, exploration and development activities	53,484	3,803
	31 December:	
	2004	2003
Capitalized costs relating to oil and gas producing activities		
Oil and gas properties and equipment	42,689	5,100
Support facilities and equipment	10,586	1,354
Assets under construction	8,199	2,189
Total capitalized costs relating to oil and gas producing activities	61,474	8,643
Accumulated depreciation, depletion and amortization	(806)	(431)
Net capitalized costs relating to oil and gas producing activities	60,668	8,212
Share of net capitalized costs relating to oil and gas producing activities of associates	2,009	6,944

Results of Operations for Oil and Gas Producing Activities

The Company’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 for the year adjusted for tax deductions, tax credits and allowances (amounts in millions of Russian roubles).

	Year ended 31 December:	
	2004	2003
Revenues from oil and gas sales	21,489	12,024
Operating expenses	(6,735)	(4,203)
Transportation expenses	(3,833)	(1,829)
Taxes other than income tax	(1,393)	(641)
Depreciation, depletion and amortization	(584)	(287)
Exploration expenses	(183)	(122)
Results of operations for oil and gas producing activities before income tax .	8,761	4,942
Related income tax expense	(2,103)	(1,186)
Results of operations for oil and gas producing activities	6,658	3,756
Share in associates' results of operations for oil and gas producing activities .	845	498

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 technical staff working directly with the oil and gas properties. The Group's technical staffs periodically updates reserve estimates during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

The oil and gas reserve estimates reported below are determined by the Group's independent petroleum reservoir engineers, DeGolyer and MacNaughton ("D&M"), for primary producing fields—Yurkharovskoye, East Tarkosalinskoye, and Khancheykskoye—as wells as other oil and gas producing fields, North Gubkinskoye and South Tarasovskoye, that are appraised by independent consulting firm, Ryder Scott Co. LP. 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.

The following information presents the quantities of proved oil and gas reserves and changes thereto as at and for the years ended 31 December 2004 and 2003.

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 2034, with the most significant license, Yurkharovskoye field, expiring in 2034. Management believes that there is requisite legislation 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 license expiry dates. In February 2005, the Group successfully extended its license on Yurkharovskoye field from 2020 through 2034, which year represents the expected end of the economic life of the field. The cost of license extension was not material. In May 2005, the Group was preparing its application for the extension of the terms of the licenses for its two other core fields, East Tarkosalinskoye and Khancheykskoye.

The Company 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

OAO NOVATEK
Unaudited Supplemental Oil and Gas Disclosures (continued)

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 below reserve quantities include 100 percent of the net proved reserve quantities attributable to the Company’s consolidated subsidiaries. A portion of the Company’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.

The prices used in the forecast of future net revenues are the year-end weighted-average of the prices received for sales domestically, for exports to CIS countries and for exports to non-CIS countries. Due to the absence of a developed market for crude oil in Russia, the Company employs a “net-back” method to estimate a domestic price for crude oil.

Net proved reserves of natural gas, crude oil, condensate and natural gas liquids are presented below. For convenience, volumes are provided both in English and metric units.

Net proved reserves of natural gas are presented below.

	Net proved reserves of natural gas recoverable up to license expiry dates		Net proved reserves of natural gas recoverable past license expiry dates		Total net proved reserves of natural gas	
	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters
Reserves at 31 December 2002 . .	6,573	186	—	—	6,573	186
Changes attributable to:						
Revisions	890	24	—	—	890	24
Extensions and discoveries . . .	—	—	—	—	—	—
Acquisitions	—	—	—	—	—	—
Production	(107)	(3)	—	—	(107)	(3)
Reserves at 31 December 2003 . .	7,356	207	—	—	7,356	207
Changes attributable to:						
Revisions	1,256	36	—	—	1,256	36
Extensions and discoveries . . .	—	—	—	—	—	—
Acquisitions	9,571	272	2,830	80	12,401	352
Production	(343)	(10)	—	—	(343)	(10)
Reserves at 31 December 2004 . .	17,840	505	2,830	80	20,670	585
Net proved developed reserves (included above)						
At 31 December 2002	—	—	—	—	—	—
At 31 December 2003	736	21	—	—	736	21
At 31 December 2004	11,016	312	2,728	77	13,744	389

OAo NOVATEK
Unaudited Supplemental Oil and Gas Disclosures (continued)

The Company's interests in proved developed and undeveloped reserves of associates were not included in the table above and were as follows:

	Net proved reserves of natural gas recoverable up to license expiry dates		Net proved reserves of natural gas recoverable past license expiry dates		Total net proved reserves of natural gas	
	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters	Billions of cubic feet	Billions of cubic meters
At 31 December 2002	3,114	86	608	19	3,722	105
At 31 December 2003	3,498	99	849	24	4,347	123
At 31 December 2004	—	—	—	—	—	—

The tables below represent reserve quantities attributable to the Company's consolidated subsidiaries. Net proved reserves of crude oil, gas condensate and natural gas liquids are presented below.

	Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable up to license expiry dates		Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable past license expiry dates		Total net proved reserves of crude oil, gas condensate and natural gas liquids	
	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons
Reserves at 31 December 2002 . .	93	11	—	—	93	11
Changes attributable to:						
Revisions	16	2	—	—	16	2
Extensions and discoveries . . .	—	—	—	—	—	—
Acquisitions	—	—	—	—	—	—
Production	(3)	(1)	—	—	(3)	(1)
Reserves at 31 December 2003 . .	106	12	—	—	106	12
Changes attributable to:						
Revisions	(4)	(1)	—	—	(4)	(1)
Extensions and discoveries . . .	—	—	—	—	—	—
Acquisitions	167	21	36	5	203	26
Production	(7)	(1)	—	—	(7)	(1)
Reserves at 31 December 2004 . .	262	31	36	5	298	36
Net proved developed reserves (included above)						
At 31 December 2002	—	—	—	—	—	—
At 31 December 2003	14	2	—	—	14	2
At 31 December 2004	130	15	8	1	138	16

The Company's interests in proved developed and undeveloped reserves of associates were not included in the table above and were as follows:

	Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable up to license expiry dates		Net proved reserves of crude oil, gas condensate and natural gas liquids recoverable past license expiry dates		Total net proved reserves of crude oil, gas condensate and natural gas liquids	
	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons	Millions of barrels	Millions of metric tons
At 31 December 2002	106	13	10	1	116	14
At 31 December 2003	113	14	16	2	129	16
At 31 December 2004	51	6	2	—	53	6

ОАО NOVATEK

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OAO NOVATEK

Consolidated Interim Condensed Balance Sheet (unaudited)

(in millions of Russian roubles)

	Notes	31 March 2005	31 December 2004
ASSETS			
Non-current assets			
Property, plant and equipment, net	6	63,181	62,449
Other non-current assets		1,702	1,090
Investments in associates		2,023	1,945
Long-term loans receivable		7,761	7,832
Total non-current assets		74,667	73,316
Current assets			
Prepayments and other current assets		1,224	1,039
Inventories		980	929
Trade and other receivables		3,695	3,456
Short-term loans receivable		794	707
Cash and cash equivalents		1,725	3,003
Total current assets		8,418	9,134
Total assets		83,085	82,450
LIABILITIES AND EQUITY			
Non-current liabilities			
Long-term debt	8	12,898	13,232
Deferred income tax liability		8,987	8,855
Other non-current liabilities		1,239	1,188
Total non-current liabilities		23,124	23,275
Current liabilities			
Short-term debt	7	6,952	10,768
Other taxes payable		1,598	1,280
Income taxes payable		393	228
Trade payables and accrued liabilities		3,016	1,963
Total current liabilities		11,959	14,239
Total liabilities		35,083	37,514
Equity attributable to Group shareholders			
Ordinary share capital		393	393
Additional paid-in capital		29,797	29,797
Asset revaluation surplus		5,345	5,345
Retained earnings		12,029	8,952
Total equity attributable to shareholders of the Group		47,564	44,487
Minority interest		438	449
Total equity		48,002	44,936
Total liabilities and equity		83,085	82,450

The accompanying notes are an integral part of this consolidated interim condensed financial information.

OAO NOVATEK
Consolidated Interim Condensed Statement of Income (unaudited)

(in millions of Russian roubles, except share and per share amounts)

	Notes	Three months ended 31 March:	
		2005	2004
Revenues			
Oil and gas sales	4	8,693	5,238
Oil and gas construction services		—	1,067
Sales of polymer and insulation tape		212	159
Other revenues		99	203
Total revenues		9,004	6,667
Net loss on disposals		—	(43)
Other income (expense)		(4)	2
Total revenues and other income		9,000	6,626
Operating expenses			
Materials, services and other		(867)	(1,710)
Purchases of oil, gas condensate and natural gas		(611)	(1,485)
Transportation expenses	5	(1,740)	(1,040)
Taxes other than income tax	9	(1,301)	(392)
General and administrative expenses		(228)	(235)
Depreciation, depletion and amortization		(814)	(149)
Net impairment expense		(42)	(33)
Exploration expenses		(149)	(63)
Total operating expenses		(5,752)	(5,107)
Income from operations		3,248	1,519
Finance income (expense)			
Foreign exchange gain (loss)		(127)	44
Interest income		227	93
Interest expense		(341)	(126)
Total finance income (expense)		(241)	11
Share of net income of associates		77	374
Profit before income tax and minority interest		3,084	1,904
Income tax expense			
Current income tax expense		(866)	(435)
Deferred income tax benefit (expense)		90	(44)
Total income tax expense		(776)	(479)
Profit before minority interest		2,308	1,425
Minority interest		7	9
Net income		2,315	1,434
Basic and diluted earnings per share (in Russian roubles)		762	638
Weighted average shares outstanding		3,036,306	2,247,030

The accompanying notes are an integral part of this consolidated interim condensed financial information.

OAQ NOVATEK
Consolidated Interim Condensed Statement of Cash Flows (unaudited)

(in millions of Russian roubles)

	Three months ended 31 March:	
	2005	2004
Net income before income tax and minority interest	3,084	1,904
Adjustments to income before income tax and minority interest:		
Depreciation, depletion and amortization	814	149
Net impairment loss	42	33
Net unrealized foreign exchange loss (gain)	127	(44)
Net loss on disposals	—	43
Interest expense	341	126
Interest income	(227)	(93)
Share of income from associates	(77)	(374)
Working capital changes		
Increase in trade and other receivables, prepayments and other current assets	(86)	(811)
Increase in inventories	(51)	(39)
Increase in trade payables and accrued liabilities	752	985
Increase in other taxes payable	651	164
Total effect of working capital changes	1,266	299
Income taxes paid	(689)	(828)
Net cash provided by operating activities	4,681	1,215
Cash flows from investing activities		
Purchases of property, plant and equipment	(1,148)	(1,668)
Acquisition of additional shares in subsidiaries	(25)	—
Proceeds from disposal of property, plant and equipment and other non- current assets	14	4
Interest paid and capitalized	(233)	(84)
Short and long-term loans provided	(167)	(66)
Repayment of short and long-term loans	173	152
Non-banking interest received	44	88
Net cash used in investing activities	(1,342)	(1,574)
Cash flows from financing activities		
Proceeds from long-term borrowings	1,557	155
Proceeds from short-term borrowings	755	487
Repayments of long-term borrowings	(3,428)	(167)
Repayments of short-term borrowings	(3,338)	(169)
Non-banking interest paid	(156)	(133)
Net cash from financing activities	(4,610)	173
Net effect of exchange rate on cash and cash equivalents	3	(6)
Net movements in restricted cash accounts	(10)	(12)
Net decrease in cash and cash equivalents	(1,278)	(204)
Cash and cash equivalents at the beginning of the reporting period	3,003	1,618
Cash and cash equivalents at the end of the reporting period	1,725	1,414

The accompanying notes are an integral part of this consolidated interim condensed financial information.

ОАО NOVATEK

Consolidated Interim Condensed Statement of Changes in Equity (unaudited)

(in millions of Russian roubles, unless otherwise stated)

	Number of ordinary shares	Ordinary share capital	Additional paid in capital	Asset Revaluation Surplus	Retained earnings	Equity attributable to Group shareholders	Minority interest	Total equity
<i>For the three months ended</i>								
<i>31 March 2004</i>								
31 December 2003	2,247,030	314	5,963	—	5,268	11,545	468	12,013
Profit (loss) for the period . . .	—	—	—	—	1,434	1,434	(9)	1,425
31 March 2004	2,247,030	314	5,963	—	6,702	12,979	459	13,438
<i>For the three months ended</i>								
<i>31 March 2005</i>								
31 December 2004	3,036,306	393	29,797	5,345	8,952	44,487	449	44,936
Cumulative effect of adoption of IFRS 3, <i>Business</i> <i>Combinations (Note 3)</i>	—	—	—	—	762	762	—	762
31 December 2004, as restated for adoption of IFRS 3, Business Combinations	3,036,306	393	29,797	5,345	9,714	45,249	449	45,698
Profit (loss) for the period . . .	—	—	—	—	2,315	2,315	(11)	2,304
31 March 2005	3,036,306	393	29,797	5,345	12,029	47,564	438	48,002

The accompanying notes are an integral part of this consolidated interim condensed financial information.

ОАО NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

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 operations of oil and gas properties located in the Yamal-Nenets Autonomous Region (“YNAO”).

In June 2004, the Group disposed of its oil and gas construction services segment (the “disposed segment”) to focus its activities on oil and gas exploration and production. The disposed segment’s activities primarily consisted of drilling services and construction of oil and gas infrastructure and facilities for related and external parties within the Russian Federation.

In December 2004, the Group acquired controlling stakes in two of its primary equity affiliates, ОАО НК Таркосаленфтегас (“Таркосаленфтегас”) and ООО Ханчейнефтегас (“Ханчейнефтегас”) (collectively the “acquired subsidiaries”). Following the acquisition, the Group’s ownership in these subsidiaries was 100 percent.

As a result of the sale of the disposed segment and the purchase of the acquired subsidiaries, the Group’s results of operations for the three months ended 31 March 2005 differ significantly from those of prior periods. Most notably, prior to the acquisition, a significant proportion of the hydrocarbon production of Таркосаленфтегас and all of the production of Ханчейнефтегас was previously purchased by the Group and then sold on to third parties. Accordingly, in prior periods the Group’s statements of income included purchases from the acquired subsidiaries. Following the acquisition, the Group consolidated the activities of the acquired subsidiaries and all intragroup transactions were eliminated.

Conversely, in prior periods, the Group included those activities of the disposed segment to the extent the disposed segment provided services to third parties. Beginning in July 2004, the Group no longer includes such operations and any oil and gas drilling and construction services purchased from third parties are either capitalized to property, plant and equipment or expensed within materials, services and other, as appropriate.

The Group’s natural gas sales fluctuate on a seasonal basis due mostly to Russian weather conditions, with sales peaking in December and dipping in the summer months of July and August.

This unaudited consolidated interim condensed financial information reflects the financial position and results of operations of the principal subsidiaries listed below, all of which are incorporated in the Russia Federation:

Subsidiary	Percentage of total share capital at:			
	31 March 2005	31 December 2004	31 March 2004	31 December 2003
Oil and gas exploration and production				
Таркосаленфтегас	100.0%	100.0%	32.2%	32.2%
ООО Yurkharovneftegas	100.0%	100.0%	100.0%	100.0%
Ханчейнефтегас	100.0%	100.0%	43.0%	43.0%
ОАО Purneftegasgeologiya	78.0%	78.0%	79.6%	79.6%
Construction services				
ОАО SNP NOVA	—	—	74.3%	74.3%
ООО Novafininvest	—	—	99.0%	99.0%
Banking				
ЗАО NOVA Bank	62.0%	62.0%	88.6%	88.6%
Pipeline insulation production				
ОАО NOVATEK-Polymer	97.9%	97.9%	52.2%	52.2%

In May 2005, the Group disposed of its equity stake in NOVA Bank to ЗАО Levit (“Levit”), a Group shareholder and merged Ханчейнефтегас into Таркосаленфтегас.

ОАО NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued) (in Russian roubles (tabular amounts in millions), unless otherwise stated)

1. Organisation and Principal Activities (continued)

The Group's respective interests in its principal associates were as follows:

Associate	Percentage of total share capital at:			
	31 March 2005	31 December 2004	31 March 2004	31 December 2003
ООО Geoilbent ("Geoilbent")	66.0%	66.0%	66.0%	66.0%
ООО Tambeyneftegas	25.1%	25.1%	25.1%	25.1%

In June 2005, the Group disposed of its 66 percent participation interest in Geoilbent (see Note 13).

2. Basis of Presentation

The consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard No. 34, *Interim Financial Reporting* ("IAS 34"). This consolidated interim condensed financial information should be read in conjunction with NOVATEK's consolidated financial statements as of and for the year ended 31 December 2004 prepared in accordance with International Financial Reporting Standards ("IFRS"). The 31 December 2004 consolidated balance sheet data has been derived from audited financial statements.

Use of estimates. The preparation of consolidated interim condensed financial information in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. Estimates have principally been made in respect to fair values of assets and liabilities, impairment provisions and deferred income taxes. Actual results may differ from such estimates.

Exchange rates, restrictions and controls. The official rate of exchange of the Russian rouble to the US dollar ("USD") at 31 March 2005, and 31 December 2004 was 27.83 and 27.75 Russian roubles to USD 1.00, respectively. Any translation of Russian rouble amounts to US dollars or any other hard 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 hard currency at the exchange rate shown or at any other exchange rate.

3. Accounting Policies

Except as discussed below, the principal accounting policies followed by the Group are consistent with those disclosed in the financial statements for the year ended 31 December 2004.

New accounting developments. In December 2003, the International Accounting Standards Board ("IASB") released 15 revised International Accounting Standards ("IAS"s) and withdrew one IAS standard. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004. Significant changes relevant to the Group are discussed below.

The revisions to IAS 1, *Presentation of Financial Statements*, clarify certain presentation requirements. Most significantly, the revised standard requires that minority interest be presented within equity. The Company has retroactively reflected the revised presentation standard for equity in the consolidated interim condensed financial information.

IAS 24, *Related Party Disclosures*, as revised, requires the disclosure of compensation of key management personnel and clarifies that such personnel include non-executive directors.

Other revised and amended standards effective on 1 January 2005 are as follows: IAS 2, *Inventories*; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 10, *Events after the Balance Sheet Date*; IAS 16, *Property, Plant and Equipment*; IAS 17, *Leases*; IAS 19, *Employee Benefits*; IAS 21, *The Effects of Changes in Foreign Exchange Rates*; IAS 27, *Consolidated and Separate Financial Statements*;

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)
(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Accounting Policies (continued)

IAS 28, *Investments in Associates*; IAS 31, *Investments in Joint Ventures*; IAS 32, *Financial Instruments: Disclosure and Presentation*; IAS 33, *Earnings per Share*; IAS 36, *Impairment of Assets*; IAS 38, *Intangible Assets*; and IAS 39, *Financial Instruments: Recognition and Measurement*. The adoption of these revised and amended standards has not had a material effect on the Group's financial position, statements of income or of cash flows.

Other new standards and interpretations early adopted by the group on 1 January 2005 are as follows: IAS 19 (amended), *Employee Benefits*, IFRS 4, *Insurance Contracts*; IFRIC 3, *Emission Rights*; IFRIC 4, *Determining whether an Arrangement contains a Lease*; IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12. The adoption of these standards did not have a material impact on the Group's financial position, statements of income or of cash flows.

Accounting policies significant to the Group that were adopted or modified on 1 January 2005 are discussed below.

Share based payments. The Group accounts for share-based payments 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 recognised 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. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised. For transactions with parties other than employees, the Group accounts for the transaction based upon the fair value of goods or services provided, unless the fair values are not reliably estimable. The adoption of IFRS 2 did not have a material effect on the Group as the Group had no outstanding share-based awards at 1 January 2005.

For share-based payments made to employees by shareholders, an increase to additional paid in capital is recorded equal to the associated compensation expense each period.

Business combinations. The Group accounts for business combinations in accordance with the provisions of IFRS 3, *Business Combinations* ("IFRS 3"). IFRS 3 applies to accounting for business combinations where the agreement date is on or after 31 March 2004. Upon acquisition, the Group initially measures both its share and the share of any minority shareholders in the acquiree's identifiable assets, liabilities and contingent liabilities at their fair values as at the acquisition date. For business combinations where the agreement date is on or after 31 March 2004, goodwill is not amortized but rather tested for impairment annually at the cash generating unit level unless an event occurs during the year which requires the goodwill to be tested more frequently. Intangibles with indefinite useful lives acquired in those business combinations are not amortized and are tested annually for impairment to ensure the carrying value does not exceed the recoverable amount regardless of whether an indicator of impairment is present.

The Group applied the transitional rules of IFRS 3, *Business Combinations*, in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. Consequently, beginning 1 January 2005, previously recognized goodwill was no longer amortized and will be tested for impairment in accordance with IAS 36, *Impairment of Assets*, and, on 1 January 2005, previously recognized negative goodwill of RR 762 million was derecognized with a corresponding adjustment to the opening balance of retained earnings.

Non-current assets held for sale and discontinued operations. The Group accounts for non-current assets held for sale and discontinued operations in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 replaced IAS 35, *Discontinuing Operations*. Assets or disposal groups that are classified as held for sale are presented separately on the balance sheet and are carried at the lower of the carrying amount and fair value less costs to sell. Additionally, the results of discontinued operations are shown separately on the face of statement of income. The adoption of IFRS 5 did not have a material effect on the Group.

ОАО NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Accounting Policies (continued)

On 1 January 2005, the Group early adopted IFRS 6, *Exploration for and Evaluation of Mineral Resources*. This standard provides guidance on accounting for costs incurred in the exploration for and evaluation of mineral resources. Adoption of the standard did not have a material effect on the Group and did not result in changes of the Group's accounting policies.

4. Oil and Gas Sales

	Three months ended 31 March:	
	2005	2004
Gas sales	5,938	3,476
Oil and gas condensate sales	1,560	1,497
Oil product sales	1,195	265
Total oil and gas sales	<u>8,693</u>	<u>5,238</u>

5. Transportation Expenses

	Three months ended 31 March:	
	2005	2004
Gas transportation to customers	1,281	709
Crude oil transportation to customers	163	149
Insurance expense	115	124
Oil products transported by railroad	100	19
Other internal transportation costs	81	39
Total transportation expenses	<u>1,740</u>	<u>1,040</u>

6. Property, Plant and Equipment

	Operating assets	Assets under construction	Total
Cost	54,765	8,596	63,361
Accumulated depreciation, depletion and amortization	(912)	—	(912)
Net book value at 31 December 2004	<u>53,853</u>	<u>8,596</u>	<u>62,449</u>
Additions	257	1,320	1,577
Transfers	222	(222)	—
Disposals and impairments, net	(18)	(6)	(24)
Depreciation, depletion and amortization	(821)	—	(821)
Cost	55,226	9,688	64,914
Accumulated depreciation, depletion and amortization	(1,733)	—	(1,733)
Net book value at 31 March 2005	<u>53,493</u>	<u>9,688</u>	<u>63,181</u>

Included in additions to property, plant and equipment for the three months ended 31 March 2005 and 2004 is capitalized interest of RR 233 million and RR 84 million, respectively.

ОАО NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)
(in Russian roubles (tabular amounts in millions), unless otherwise stated)

7. Short-Term Debt

	31 March 2005	31 December 2004
Russian rouble denominated loans	1,230	3,680
US dollar denominated loans	705	—
Loans from related parties	—	425
Promissory notes issued	991	1,275
Add: current portion of long-term debt	4,026	5,388
Total short-term debt and current portion of long-term debt	6,952	10,768

Russian rouble denominated loans. Short-term Russian rouble denominated loans had a weighted average interest rate of 11.2 percent (interest ranging from 9 to 12 percent) and 10.5 percent (interest ranging from 8.8 to 12 percent) at 31 March 2005 and 31 December 2004, respectively. During the three months ended 31 March 2005, the Group repaid loans to Sberbank in the amount of RR 2,450 million.

US dollar denominated loans. Short-term US dollar denominated loans had a weighted average interest rate of 6.3 percent (interest ranging from 6.1 percent to 6.8 percent) at 31 March 2005. In February 2005, the Group borrowed RR 196 million (USD 7 million) from International Moscow Bank. The loan bears interest of LIBOR plus 4.25 percent. Additionally, in February 2005, the Group obtained a loan from BNP Paribas in the amount of RR 559 million (USD 20 million) of which RR 46 million (USD 1.7 million) were repaid in the March 2005. The loan bears interest of LIBOR plus 3.5 percent.

Loans from related parties. At 31 December 2004, loans from related parties included US dollar denominated loans from the Yamal Regional Fund of Development, a Group shareholder, in the amount of RR 425 million (USD 15.3 million). The loan bore interest of 10 percent per annum. In February 2005, the loan was repaid.

Promissory notes. At 31 March 2005 and 31 December 2004, promissory notes consist of Tarkosalenftegas promissory notes which are denominated in Russian roubles and repayable within one year of issuance. Subsequent to 31 March 2005, the Group repaid an additional RR 678 million of these promissory notes.

8. Long-Term Debt

	31 March 2005	31 December 2004
Russian rouble denominated loans	3,300	4,537
US dollar denominated loans	11,469	11,586
Loans from related parties	1,155	1,497
Russian rouble denominated bonds	1,000	1,000
Total	16,924	18,620
Less: current portion of long-term debt	(4,026)	(5,388)
Total long-term debt	12,898	13,232

OAO NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)
(in Russian roubles (tabular amounts in millions), unless otherwise stated)

8. Long-Term Debt (continued)

At 31 March 2005 and 31 December 2004, long-term debt by facility is outlined below.

	<u>31 March 2005</u>	<u>31 December 2004</u>
C.R.R. B.V.	8,348	8,324
Sberbank	2,160	3,354
Vneshtorgbank	2,569	2,775
Yamal Regional Fund of Development	1,155	1,126
Finance Department of YNAO	1,130	1,130
Russian rouble denominated bonds	1,000	1,000
Other Russian rouble denominated loans	10	424
Other	552	487
Total	16,924	18,620
Less: current portion of long-term debt	(4,026)	(5,388)
Total long-term debt	<u>12,898</u>	<u>13,232</u>

Sberbank. During the three months ended 31 March 2005, the Group repaid loans in amount of RR 1,741 million and obtained additional loans for RR 547 million. The new loans bear interest of 12 percent and mature in 2009. A portion of these payments were ahead of schedule. As a result of the early repayment, the Group was released from a corresponding pledge of 2.5 percent of its shares in Tarkosaleneftegaz.

Yamal Regional Fund of Development. In March 2005, the Group repaid the US dollar denominated loan of RR 1,053 million (USD 35 million) and the Group's 31 percent participation interest in Yurkharovneftegas has been released from the pledge.

In February 2005, the Group received an additional five-year loan for one billion roubles with a stated interest rate of 10 percent. The proceeds from the loan will be used for the construction of the Purovsky Gas Condensate Plant.

Other Russian rouble denominated loans. In January 2005, RR 371 million of loans from Pur-Land, a subsidiary of a significant shareholder, were repaid.

Other loans

At 31 March 2005 and 31 December 2004, other loans included US dollar denominated loans totalling RR 552 million (USD 20 million) and RR 487 million (USD 17.6 million), respectively. At 31 March 2005 and 31 December 2004, other loans had a weighted average interest rate of 8.8 and 8.3 percent, respectively. The loans mature between 2005 and 2010.

OAO NOVATEK**Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)**
*(in Russian roubles (tabular amounts in millions), unless otherwise stated)***8. Long-Term Debt (continued)**

Scheduled maturities of long-term debt at 31 March 2005 were as follows:

Twelve months ended 31 March:

2007	7,837
2008	1,446
2009	1,681
2010	1,934
Total long-term debt	<u>12,898</u>

9. Taxes

The Group is subject to a number of taxes other than on income, which are detailed as follows:

	Three months ended 31 March:	
	2005	2004
Unified natural resources production tax	1,151	350
Property tax	76	18
Excise tax	51	15
Other taxes	23	9
Total taxes other than income tax	<u>1,301</u>	<u>392</u>

Unified natural resources production tax. Taxes other than income tax for the three months ended 31 March 2005 include RR 743 million of unified natural resources production tax attributable to the Group's subsidiaries Tarkosalenftegas and Khancheyneftegas that were acquired in December 2004.

Effective income tax rate. For the three months ended 31 March 2005 and 2004, respectively, the Group's effective tax rate was 25.7 percent and 16.1 percent, respectively. The rate for the three months ended 31 March 2005 approximates the enacted tax rate in the Russian Federation. The effective tax rate of 16.1 percent for the three months ended 31 March 2004 is lower than the enacted tax rate primarily due to income tax concessions obtained by certain Group subsidiaries and associates that are no longer effective in 2005.

10. Related Party Transactions

During 2004, the Group had significant activities with companies related to its shareholders in connection with purchases and sales of crude oil, natural gas, gas condensate, construction and other related services, and purchases and sales of equity securities. The Group's reported results of operations, financial position and cash flows would have been different had such transactions been carried out amongst unrelated parties. 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.

Subsequent to the acquisition of Tarkosalenftegas and Khancheyneftegas in December 2004 (see Note 1), the acquired subsidiaries' activities were consolidated into the Group's financial position and results of operations. Accordingly, all purchases from, sales to and balances with the acquired subsidiaries have been eliminated in the Group's consolidated balance sheets at 31 March 2005 and 31 December 2004 and in the Group's consolidated statement of income for the three months ended 31 March 2005. Such activities are presented on a gross basis in the Group's consolidated statement of income for the three months ended 31 March 2004.

ОАО NOVATEK

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued) (in Russian roubles (tabular amounts in millions), unless otherwise stated)

10. Related Party Transactions (continued)

Purchases and sales of crude oil and gas condensate:

Name of related party	Three months ended 31 March:			
	2005		2004	
	Sales volumes	Russian roubles	Sales volumes	Russian roubles
	(tons)	(millions)	(tons)	(millions)
Sales to Kerden Trading Limited	33,500	187	144,303	684
Sales to TNG Energy	54,900	304	—	—
Purchases from Tarkosalenftegas	—	—	77,204	124
Purchases from Khancheyneftegas	—	—	106,749	171
Purchases from Geoilbent	109,289	288	98,000	266

Purchases of natural gas:

Name of related party	Three months ended 31 March:			
	2005		2004	
	Sales volumes	Russian roubles	Sales volumes	Russian roubles
	(m ³ 000s)	(millions)	(m ³ 000s)	(millions)
Purchases from Tarkosalenftegas	—	—	1,701,879	509
Purchases from Khancheyneftegas	—	—	425,312	177

Balances with related parties:

	31 March 2005	31 December 2004
Trade and other receivables	525	606
Short-term loans receivable	171	251
Prepayments and advances	200	30
Prepayments and advances (for construction)	232	235
Long-term loans receivable	7,676	7,694
Other non-current assets	278	70
Short-term debt	—	425
Long-term debt	1,155	1,497
Trade payables	106	147
Interest receivable	17	42

Long-term loans receivable. At 31 March 2005 and 31 December 2004, long-term loans receivable include US dollar denominated loans to Levit, a Group shareholder, of USD 270 million (RR 7,513 million). The loan is unsecured, bears interest of 10 percent and is repayable by 30 June 2006.

Other transactions with related parties:

	Three months ended 31 March:	
	2005	2004
Sales of inventory and oil products	7	99
Interest expense	41	10
Interest income	196	83
Construction service sales	—	135
Construction services rendered	201	—

11. Segment Information

The Group operates principally in the oil and gas industry in the Russian Federation. The Group evaluates performance and makes investment and strategic decisions based upon a review of profitability

Notes to the Consolidated Interim Condensed Financial Information (unaudited) (continued)
(in Russian roubles (tabular amounts in millions), unless otherwise stated)

11. Segment Information (continued)

for the Group as a whole. However, the Group's activities are considered by management to comprise one geographic segment and, for the period to March 2005 (Note 1), the following business segments:

- Exploration and production—exploration, production, processing, marketing and transportation of oil and gas;
- Oil and gas construction services—drilling and construction of oil and gas infrastructure and facilities (discontinued from 30 June 2004—Note 1);
- Corporate and other—other activities, including head office services, banking and telecommunications.

Segment information for the three months ended 31 March 2005 was as follows:

	Exploration and production	Other	Total
Segment revenues			
External revenues and other income	8,713	287	9,000
Inter-segment sales	4	—	4
Total segment revenues	8,717	287	9,004
Segment result	3,453	47	3,500

Segment information for the three months ended 31 March 2004 was as follows:

	Oil and gas construction services	Exploration and production	Other	Total
Segment revenues				
External revenues and other income	1,067	5,280	322	6,669
Inter-segment sales	409	—	—	409
Total segment revenues	1,476	5,280	322	7,078
Segment result	47	1,780	27	1,854

All of the Group's operating assets are located in the Russian Federation.

12. 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 not freely convertible in most countries outside of the Russian Federation, currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

While there have been improvements in the economic trends, 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.

Guarantees and pledges. At 31 March 2005, the Group pledged 29.7 percent of Tarkosalenftegas as collateral for long-term borrowings. Additionally, the Group's 66 percent participation interest in Geoilbent was pledged to the EBRD as collateral for a long-term loan received by Geoilbent from the EBRD. The total amount payable by Geoilbent to the EBRD under the loan facility was USD 30 million.

Due to the absence of any market for such financial instruments, it is not practicable to estimate the fair value of the Group's commitment on behalf of Geoilbent. However, the Group does not expect to incur losses as a result of this commitment.

12. Contingencies and Commitments (continued)

At 31 March 2005, the Group had pledged property, plant and equipment aggregating approximately RR 4,500 million.

Commitments. The Group had entered into commitments aggregating approximately RR 1,954 million to complete the construction of the Purovsky Gas Condensate Plant in 2005.

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 activity of the Group may be challenged by the relevant regional and federal authorities. Recent 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. 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.

Oilfield licenses. The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield 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 materially adverse effect on the Group's financial position, statements of income or of cash flows.

The Group's oil and gas fields are situated on land belonging to the Yamal-Nenets Regional Administration. Licenses are issued by the Ministry of Natural Resources and the Group pays unified production tax to explore and produce oil and gas from these fields. The principal licenses of the Group, including its subsidiaries and associates, and their expiry dates are:

Field	License holder		License expiry date
Yurkharovskoye	Yurkharovneftegas	Subsidiary	2034
Khancheynskoye	Khancheyneftegas	Subsidiary	2019
East Tarkosalinskoye	Tarkosaleneftegas	Subsidiary	2018
North Gubkinskoye	Geoilbent	Associate	2018

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. In February 2005, the Group was successful in extending the license for the Yurkharovskoye field from 2020 to 2034. The Group was preparing its application for the extension of the terms of the licenses for its two other core fields, East Tarkosalinskoye and Khancheynskoye.

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 immediately, if no current or future benefit is discernible. Potential liabilities which might arise as a result of stricter enforcement 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, statements of income or of cash flows.

Legal contingencies. During the period, the Group was involved in 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

12. Contingencies and Commitments (continued)

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.

13. Subsequent Events

In May 2005, the Group merged Khancheyneftegas into Tarkosaleneftegas.

In May 2005, the Group disposed of its equity stake in NOVA Bank to Levit, a Group shareholder for RR 156 million, recognizing a gain on sale of RR 12 million net of associated income tax of RR 8 million. NOVA Bank recognized net income of RR 2 million and RR 1 million for the three months ended 31 March 2005 and 2004, respectively. NOVA Bank's net assets at 31 March 2005 and 31 December 2004 were RR 220 million and RR 218 million, respectively. The results of the disposal will be reflected in the Group's consolidated statement of income during the second quarter of 2005. NOVA Bank's financial position and results of operations were included within "other" in the Group's segment information.

In June 2005, the Group sold its 66 percent participation interest in Geoilbent to a subsidiary of OAO Lukoil for gross proceeds of approximately RR 5.1 billion plus other commitments. The Group includes its investment in Geoilbent within "exploration and production" in the Group's segment information.

At the Annual General Meeting of Shareholders on 10 June 2005, the Group's shareholders approved a dividend of RR 777 million (RR 256 per share). The dividend is to be paid to shareholders of record as of 25 April 2005.

Subsequent to 31 March 2005, certain shareholders provided share-based compensation to the Group's chief financial officer and to the Group's head of exploration and production activities. The share awards comprise shares in a limited liability company that indirectly holds shares of the Group. Management's preliminary estimate of the maximum fair value of the award is approximately RR 900 million, which relates only to services provided to the Group. The fair value of the awards will be recognized as compensation expense evenly over their five year vesting period beginning the second quarter of 2005. A corresponding increase will be recorded to additional paid in capital as expense is recorded to reflect the shareholders contribution in providing the award.

ОАО NOVATEK

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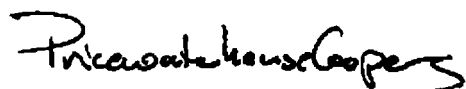
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AUDITORS' REPORT

To the shareholders and directors of OAO Tarkosaleneftegas Oil Company

- 1 We have audited the accompanying balance sheets of OAO Tarkosaleneftegas Oil Company (the "Company") as at 31 December 2004, 2003 and 2002 and the related statements of income, of cash flows and of changes in shareholders' equity for the years then ended. These financial statements as set out on pages F-63 to F-87 are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2004, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.



Moscow, Russian Federation
27 May 2005

OA O TARKOSALENEFTEGAS OIL COMPANY
Balance Sheets

(in millions of Russian roubles)

		At 31 December:		
	Notes	2004	2003	2002
ASSETS				
Non-current assets				
Property, plant and equipment, net	8	14,140	13,737	12,820
Other long-term assets		173	378	420
Total non-current assets		14,313	14,115	13,240
Current assets				
Prepayments and advances	6	350	157	97
Prepaid income tax		81	21	—
Inventories	7	440	473	452
Trade and other receivables	5	1,255	1,248	1,686
Cash and cash equivalents		505	246	43
Total current assets		2,631	2,145	2,278
Total assets		16,944	16,260	15,518
LIABILITIES AND SHAREHOLDERS' EQUITY				
Non-current liabilities				
Long-term debt	11	935	2,739	1,567
Deferred income tax liability	15	655	725	793
Asset retirement obligations	17	269	204	109
Total non-current liabilities		1,859	3,668	2,469
Current liabilities				
Short-term debt	9	3,940	1,424	1,437
Other taxes payable	15	472	197	735
Income taxes payable		—	—	48
Trade payables and accrued liabilities	10	266	460	1,074
Total current liabilities		4,678	2,081	3,294
Total liabilities		6,537	5,749	5,763
Shareholders' equity				
Share capital	12	3,543	3,543	3,543
Additional paid-in capital		6,140	6,140	6,130
Retained earnings		724	828	82
Total shareholders' equity		10,407	10,511	9,755
Total liabilities and shareholders' equity		16,944	16,260	15,518

The accompanying notes are an integral part of these financial statements.

OAO TARKOSALENEFTEGAS OIL COMPANY
Statements of Income

(in millions of Russian roubles)

	Notes	Year ended 31 December:		
		2004	2003	2002
Operating revenues				
Natural gas sales		3,432	2,508	1,536
Crude oil and gas condensate sales		1,025	1,035	836
Other revenues		223	126	9
Total revenues		4,680	3,669	2,381
Operating expenses and other deductions				
Taxes other than income tax	15	(1,625)	(1,059)	(708)
Materials, services and other	13	(836)	(535)	(388)
Depreciation, depletion and amortization	8	(521)	(568)	(374)
General and administrative expenses		(414)	(210)	(156)
Loss on disposal of property, plant and equipment		(130)	(142)	—
Transportation expenses	14	(78)	(70)	(297)
Other operating income (expense)		74	(26)	18
Total operating expenses		(3,530)	(2,610)	(1,905)
Income from operations		1,150	1,059	476
Finance income (expense)				
Foreign exchange gain (loss)		94	100	(28)
Interest expense		(429)	(361)	(335)
Monetary gain		—	—	265
Loss on early extinguishment of debt	11	(782)	(27)	—
Total finance expense		(1,117)	(288)	(98)
Income before income tax		33	771	378
Income tax expense				
Current income tax expense		(207)	(93)	(55)
Deferred income tax benefit (expense)		70	68	(68)
Total income tax expense	15	(137)	(25)	(123)
Net income (loss)		(104)	746	255
Basic and diluted earning (loss) per share (in Russian roubles)		(0.32)	2.23	0.76
Weighted average shares outstanding	12	334,786,706	334,786,706	334,786,706

The accompanying notes are an integral part of these financial statements.

OA O TARKOSALENEFTEGAS OIL COMPANY
Statements of Cash Flows

(in millions of Russian roubles)

	Year ended 31 December:		
	2004	2003	2002
Cash flows from operating activities			
Cash receipts from customers	6,002	4,655	2,778
Cash paid to suppliers and employees	(2,248)	(1,257)	(595)
Other taxes paid	(1,970)	(2,041)	(862)
Cash generated from operations	1,784	1,357	1,321
Interest paid but not capitalized	(374)	(86)	(303)
Income tax paid	(268)	(173)	(80)
Net cash provided by operating activities	1,142	1,098	938
Cash flows from investing activities			
Purchase of property, plant and equipment	(727)	(1,886)	(1,540)
Proceeds from sales of property, plant and equipment . .	5	105	86
Interest paid and capitalized	(50)	(232)	(49)
Return of share subscription funds	—	129	—
Short-term loans given	(3)	(9)	(122)
Short-term loans settled	5	—	—
Interest and dividends received	—	1	—
Net cash used in investing activities	(770)	(1,892)	(1,625)
Cash flows from financing activities			
Proceeds from long-term borrowings	1,049	1,933	1,020
Payments on long-term borrowings	(1,388)	(87)	—
Proceeds from short-term borrowings	1,956	1,238	2,886
Payments on short-term borrowings	(1,577)	(2,023)	(2,749)
Dividends paid	(1)	(16)	(133)
Proceeds from issuance of promissory notes	—	—	137
Redemption of promissory notes	(152)	(48)	(527)
Net cash provided by (used in) financing activities	(113)	997	634
Increase (decrease) in cash and cash equivalents	259	203	(53)
Effect of inflation and exchange rate changes on cash and cash equivalents	—	—	(20)
Net increase (decrease) in cash and cash equivalents	259	203	(73)
Cash and cash equivalents at beginning of the year	246	43	116
Cash and cash equivalents at end of the year	505	246	43

Significant non-cash transactions are discussed in Note 4.

The accompanying notes are an integral part of these financial statements.

OA O TARKOSALENEFTEGAS OIL COMPANY

Statements of Changes in Shareholders' Equity

(in millions of Russian roubles, except number of shares)

	Number of ordinary shares	Share capital	Additional paid-in capital	Retained earnings (accumulated deficit)	Total shareholders' equity
Balance at 1 January 2002	334,786,706	3,543	5,921	(14)	9,450
Dividends	—	—	—	(159)	(159)
Other contributed capital from shareholders (<i>see Note 12</i>)	—	—	209	—	209
Net income	—	—	—	255	255
Balance at 31 December 2002	334,786,706	3,543	6,130	82	9,755
Other contributed capital from shareholders (<i>see Note 12</i>)	—	—	10	—	10
Net income	—	—	—	746	746
Balance at 31 December 2003	334,786,706	3,543	6,140	828	10,511
Net loss	—	—	—	(104)	(104)
Balance at 31 December 2004	334,786,706	3,543	6,140	724	10,407

The accompanying notes are an integral part of these financial statements.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

1. Organization and Principal Activities

OA O Tarkosaleneftegaz Oil Company (hereinafter referred to as the “Company”) is engaged in oil and gas field development, production and transportation of crude oil, natural gas and gas condensate in the Yamal-Nenets Autonomous Region (“YNAO”) within the Russian Federation. The Company’s registered office is 626720, YNAO, Purovsky Region, Tarko-Sale, ul. Tarasova 28, Russian Federation.

The average number of employees of the Company was 1,163, 1,067 and 918 for the years ended 31 December 2004, 2003 and 2002, respectively.

In December 2004, OA O NOVATEK (“NOVATEK”) completed an acquisition that resulted in its owning 100 percent of the Company.

In January 2005, NOVATEK took the decision to reorganize the Company from an open joint stock company (“OA O”) to a limited liability company (“OOO”). In March 2005, NOVATEK resolved to contribute 100 percent of OOO Khancheyneftegas to the Company’s charter capital. In May 2005, OOO Khancheyneftegas was merged into OOO Tarkosaleneftegaz. Management has not yet completed the accounting for the merger with OOO Khancheyneftegas. However, preliminary estimates of the fair value of OOO Khancheyneftegas’ assets and liabilities at 31 December 2004 are indicated in the table below.

	IFRS carrying amounts	Fair values
Current assets	654	654
Oil and gas properties and equipment	3,166	12,425
Other non-current assets	25	25
Current liabilities	(1,863)	(1,863)
Non-current liabilities	(1,297)	(3,519)

2. Basis of Presentation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”), including International Accounting Standards (“IAS”), and Interpretations issued by the International Accounting Standards Board (“IASB”) and the International Accounting Standards Board’s International Financial Reporting Interpretations Committee (“IFRIC”). In the absence of specific IFRS guidance for oil and gas producing companies, the Company has developed accounting policies in accordance with other generally accepted accounting principles for oil and gas producing companies insofar as they do not conflict with IFRS principles.

The Company maintained their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation (“RAR”). The Company’s financial statements are based on the statutory records with adjustments and reclassifications recorded in the 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) accounting for income taxes, (3) restatement of financial statements to reflect the effect of hyperinflation through 31 December 2002, and (4) valuation of unrecoverable assets, expense recognition and other provisions.

The financial statements have been prepared under the historical cost convention. The Company’s functional currency is the Russian rouble (“RR”).

Reclassifications. Certain reclassifications have been made to prior year balances to conform to the current year presentation. Management believes that these reclassifications result in a fairer presentation of the Company’s activities.

Use of estimates. The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. Estimates

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

2. Basis of Presentation (continued)

have principally been made in respect to fair values of assets and liabilities, impairment provisions and deferred income taxes. Actual results may differ from such estimates.

Exchange rates, restrictions and controls. The official rate of exchange of the Russian rouble to the US dollar ("USD") at 31 December 2004, 2003 and 2002 was 27.75, 29.45 and 31.78 Russian roubles to USD 1.00, respectively. The Russian rouble has historically been devaluing against the US dollar due to significant inflation in the Russian Federation as well as other factors. However, the Russian rouble appreciated by 5.8 percent and 7.3 percent in 2004 and 2003, respectively, while it depreciated by 5.7 percent against the US dollar in 2002. The official inflation rates were 11.7 percent, 12.0 percent and 15.1 percent in 2004, 2003 and 2002, respectively. Additionally, exchange restrictions and controls exist relating to converting Russian roubles into other currencies. At present, the Russian rouble is not a convertible currency in most countries outside of the Russian Federation and, further, the Company is required to convert 10 percent (25 percent from July 2003 through December 2004 and 50 percent prior to July 2003) of its hard currency earnings into Russian roubles. Any translation of Russian rouble amounts to US dollars or any other hard 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 hard currency at the exchange rate shown or at any other exchange rate.

Accounting for the effects of inflation. Prior to 1 January 2003, the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the Russian rouble in accordance with International Accounting Standard No. 29, *Financial Reporting in Hyperinflationary Economies* ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflationary has ceased, effective 1 January 2003, the Company no longer applies the provisions of IAS 29. Accordingly, no adjustments for the effects of changes in general purchasing power have been made for the years ended 31 December 2004 and 2003.

Changes in accounting policies. In 2003, the Company has early adopted IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The effect of the adoption was immaterial to the Company's financial statements.

3. Summary of Significant Accounting Policies

Cash and cash equivalents. Cash and cash equivalents comprises cash on hand, cash deposits held with banks, and 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.

Trade and other receivables. Trade and other receivables are presented at recoverable amounts and include value-added tax, which is payable to tax authorities upon collection of such receivables. An estimate is made for impairment of receivables based on a review of all outstanding amounts at year end, and the movement in the estimate is charged or credited to the statement of income. Bad debts are written off during the year in which they are identified.

Inventories. Natural gas, crude oil, condensate and natural gas liquids inventories are valued at the lower of cost or net realizable value. The cost of inventory includes applicable purchase costs of raw materials, direct operating costs, and related overhead expenses and is recorded at average cost. Net realizable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

Materials and supplies inventories are recorded at average cost and are carried at amounts which do not exceed their respective amounts recoverable in the normal course of business.

Property, plant and equipment. Property, plant and equipment are carried at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion, and impairment.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Summary of Significant Accounting Policies (continued)

The Company 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 are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortization of capitalized costs of oil and gas properties and equipment is calculated using the unit-of-production method for each field based upon proved developed reserves for development costs, and total proved reserves for capitalized costs from acquisitions of proved properties. Assets under construction are not depreciated. Reserve amounts used for depreciation, depletion and amortization calculations include reserves expected to be produced beyond license expiry dates. Management believes that there is requisite legislation to extend mineral licenses at the initiative of the Company and, as such, intends to extend its licenses for properties expected to produce beyond the license expiry dates at minimal cost to the Company.

The oil and gas reserves of the Company have been determined based on estimates of mineral reserves prepared by management in accordance with internationally recognized definitions and, at 31 December 2004, 2003 and 2002, the Company's reserves have been independently estimated by internationally recognized petroleum engineers. 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, and therefore subject to depletion thereon using the unit-of-production method.

Interest costs 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.

Gains or losses from retirements or sales are included in the determination of net income.

Major renewals and improvements are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of the asset beyond its original capability.

Impairment of assets. An assessment is made at each balance sheet date to determine whether there is objective evidence that an asset or a group of assets may be impaired. When there is an indication that an asset may be impaired, the asset is measured at its estimated recoverable amount, which is the higher of the net selling price or value in use.

Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment loss is recognized for the difference between the estimated recoverable amount and the carrying value. The carrying amount of the asset is reduced to its estimated recoverable amount either directly or through the use of an allowance account and the amount of the loss is included in the statement of income for the period.

An impairment loss is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. An impairment loss is only

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Summary of Significant Accounting Policies (continued)

reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

Business combinations. The Company accounts for business combinations in accordance with IFRS 3, *Business Combinations*. Upon achieving a controlling interest in an entity, including those from entities under common control, the acquiree's identifiable assets, liabilities and contingent liabilities are restated to their fair values as of the date of achieving control and then upon each subsequent step acquisition. The effect of revaluing previously held interests to current fair values is recorded within asset revaluation surplus in the consolidated statement of shareholders' equity.

Deferred income taxes. Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12, *Income Taxes*.

The Company uses the balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income nor loss, it is not accounted for. A deferred income tax asset is recorded only to the extent that it is probable that taxable income will be available against which the deductible temporary differences can be utilized. Deferred income tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Borrowings. Borrowings received or provided are recognized initially at cost, which is the fair value of the consideration received or provided, net of transaction costs incurred, if any. Borrowings denominated in foreign currencies are re-measured at each period end at the balance sheet date foreign exchange rate. Borrowings received or provided that are originated by the Company are subsequently measured at amortized cost and, for borrowings provided, net of any impairment losses.

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 financial statements are issued.

Revenue recognition. Revenues from the production and sale of natural gas, crude oil and gas condensate are recognized when such products are delivered to customers and title has transferred. Revenues are stated net of value-added tax and customs duties.

Pension and post-employment benefits. The Company's mandatory contributions to the governmental pension scheme in the Russian Federation are expensed when incurred. Discretionary pension and other post-employment benefits are not material.

Provisions. Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events and 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. Provisions are reassessed annually and changes in the provisions resulting from the passage of time are reflected in the statement of income each year within non-operating income and expenses. Other changes in provisions, related to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation or changes in the discount rates, are treated as a change in an accounting estimate in the period of the change and, with the exception of asset retirement obligations, reflected in the statement of income. Such changes in estimated asset retirement obligations are reflected as adjustments to the carrying value of property, plant and equipment.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Summary of Significant Accounting Policies (continued)

An asset retirement obligation is recognized when the Company 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 pre-tax risk free discount rates adjusted for risks specific to the obligation. Changes in the obligation resulting from the passage of time are recognized 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.

Value-added tax. The tax authorities permit the settlement of sales and purchases value-added tax ("VAT") on a net basis.

VAT payable represents VAT related to sales payable to tax authorities upon collection of receivables from customers net of VAT on purchases which have been settled at the balance sheet date. In addition, VAT related to sales which have not been settled at the balance sheet date (VAT deferred) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

VAT recoverable relates to purchases which have not been settled at the balance sheet date and property, plant and equipment not put into operation. VAT recoverable is reclaimable against sales VAT upon payment for the purchases and putting property, plant and equipment into operation.

Foreign currency transactions. The Russian rouble is the Company's functional currency. Transactions denominated in foreign currencies are converted into Russian roubles at the exchange rates prevailing on the date of transactions. Exchange gains and losses resulting from foreign currency translation are included in the determination of net income.

Financial instruments. Financial instruments carried on the balance sheet include cash and cash equivalents, receivables, trade payables and debt. The particular recognition methods adopted are disclosed in the individual policies related to each item. Except for long-term debt, the difference, where material, between the fair value at inception of the financial instruments, where these can be estimated reliably, and the nominal amount of financial instruments at their inception are recognized in the statement of income, balance sheet, or statement of changes in shareholders' equity in accordance with the underlying nature of such differences.

New accounting developments. In December 2003, the IASB released 15 revised International Accounting Standards and withdrew one IAS standard. The revised standards are all mandatory for periods starting on or after 1 January 2005. In 2004, the IASB published five new standards, two revisions and two amendments to existing standards. In addition, the IFRIC issued six new interpretations in 2004.

The revised and amended standards are as follows: IAS 1, *Presentation of Financial Statements*; IAS 2, *Inventories*; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 10, *Events after the Balance Sheet Date*; IAS 16, *Property, Plant and Equipment*; IAS 17, *Leases*; IAS 19, *Employee Benefits*; IAS 21, *The Effects of Changes in Foreign Exchange Rates*; IAS 24, *Related Party Disclosures*; IAS 27, *Consolidated and Separate Financial Statements*; IAS 28, *Investments in Associates*; IAS 32, *Financial Instruments: Disclosure and Presentation*; IAS 33, *Earnings per Share*; IAS 39, *Financial Instruments: Recognition and Measurement*; IAS 36, *Impairment of Assets* and IAS 38, *Intangible Assets*.

The new standards and interpretations are as follows: IFRS 2, *Share-based Payment*; IFRS 3, *Business Combinations*; IFRS 4, *Insurance Contracts*; IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*; IFRS 6, *Exploration for and Evaluation of Mineral Resources*; IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*; IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments*; IFRIC 3, *Emission Rights*; IFRIC 4, *Determining whether an Arrangement contains a Lease*; IFRIC 5, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* and IFRIC Amendment to SIC-12.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

3. Summary of Significant Accounting Policies (continued)

The Company expects to adopt all relevant new, revised and amended standards and the new IFRIC interpretations from their respective effective date, the majority of which are effective as of 1 January 2005.

Management does not believe the adoption of these standards will have a material impact on the Company's financial position, statements of income or of cash flows.

4. Supplemental Cash Flow Information

The statement of cash flows is prepared under the direct method and provides information about changes in cash and cash equivalents. Included in cash and cash equivalents at 31 December 2004, 2003 and 2002 are Russian rouble denominated promissory notes issued by a Russian financial institution which have no stated interest rate and are redeemable on demand in the amount of nil, RR 58 million and RR 36 million, respectively.

Cash flows related to value-added tax received from customers and paid to suppliers are included in cash receipts from customers and cash paid to suppliers and employees, respectively. Value-added tax paid to tax authorities is included in other taxes paid.

During 2002, the Company settled receivables of RR 17 million from OOO ITERA Holding, a related party, in exchange for OOO ITERA Holding settling the Company's payables to OOO Mezhrregionkomplekt, a related party. No gain or loss was recognized on the above transaction.

5. Trade and Other Receivables

	31 December:		
	2004	2003	2002
Trade and other receivables—related parties (see Note 16) . . .	419	602	756
Recoverable value-added tax	455	551	750
Trade receivables	309	63	31
Receivables from employees	13	7	7
Other receivables (net of provision of nil, RR 17 million and RR 14 million at 31 December 2004, 2003 and 2002, respectively)	59	25	142
Total trade and other receivables	1,255	1,248	1,686

6. Prepayments and Advances

	31 December:		
	2004	2003	2002
Advances to suppliers (net of provision of RR 12 million, nil and nil at 31 December 2004, 2003 and 2002, respectively) .	129	104	81
Prepaid other taxes	221	53	16
Total prepayments and advances	350	157	97

OAo TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

7. Inventories

	31 December:		
	2004	2003	2002
Materials and supplies (net of provision of RR 45 million, RR 45 million and RR 19 million at 31 December 2004, 2003 and 2002, respectively)	386	424	428
Crude oil	54	49	24
Total inventories	440	473	452

8. Property, Plant and Equipment

Property, plant and equipment comprised of the following at 31 December 2004, 2003 and 2002:

	31 December:		
	2004	2003	2002
Oil and gas properties and equipment	15,162	13,923	11,637
Assets under construction	2,102	2,449	3,289
Total cost	17,264	16,372	14,926
Less accumulated depreciation, depletion and amortization . . .	(3,124)	(2,635)	(2,106)
Property, plant and equipment, net	14,140	13,737	12,820

The movement in property, plant and equipment, net, for the year ended 31 December 2004 was as follows:

	Oil and gas properties and equipment	Assets under construction	Total
31 December 2003	11,288	2,449	13,737
Additions	43	1,037	1,080
Transfers	1,373	(1,373)	—
Disposals	(145)	(11)	(156)
Depreciation, depletion and amortization	(521)	—	(521)
31 December 2004	12,038	2,102	14,140

The movement in property, plant and equipment, net, for the year ended 31 December 2003 was as follows:

	Oil and gas properties and equipment	Assets under construction	Total
31 December 2002	9,531	3,289	12,820
Additions	107	1,666	1,773
Transfers	2,420	(2,420)	—
Disposals	(202)	(86)	(288)
Depreciation, depletion and amortization	(568)	—	(568)
31 December 2003	11,288	2,449	13,737

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

8. Property, Plant and Equipment (continued)

The movement in property, plant and equipment, net, for the year ended 31 December 2002 was as follows:

	Oil and gas properties and equipment	Assets under construction	Total
31 December 2001	7,947	3,485	11,432
Additions	11	1,812	1,823
Transfers	1,947	(1,947)	—
Disposals	—	(61)	(61)
Depreciation, depletion and amortization	(374)	—	(374)
31 December 2002	9,531	3,289	12,820

Estimated costs of dismantling oil and gas production facilities, including asset retirement costs, net of accumulated depletion, amounting to RR 167 million, RR 131 million and RR 61 million at 31 December 2004, 2003 and 2002, respectively, are included in the cost of oil and gas assets. The Company has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred beginning 2006 through 2038. Governmental authorities are continually considering environmental regulations and their enforcement. Consequently, the Company's ultimate environmental liabilities may differ from the recorded amounts (see Note 18).

The Company's primary oil and gas field, the East Tarkosalinskoye field, is situated on land belonging to the Yamalo-Nenets Regional Administration. The Company obtained a license from the government and pays unified production tax to explore and produce oil, gas and gas condensate from this field. The license expires in 2018. In May 2005, the Company was preparing its application for the extension of the terms of the license. Management believes that the risk of its application being rejected is remote (see Note 18).

Included in additions to property, plant and equipment for 2004, 2003 and 2002 is capitalized interest of RR 50 million, RR 183 million and RR 130 million, respectively.

At 31 December 2004, 2003 and 2002, certain of the Company's property, plant and equipment was pledged as collateral for the Company's borrowings totaling RR 1.4 billion.

9. Short-term Debt

	31 December:		
	2004	2003	2002
Russian rouble—denominated promissory notes	1,362	—	—
NOVATEK—related party (see Note 16)	615	—	—
Sberbank	350	600	472
Khancheyneftegas—related party (see Note 16)	—	10	—
Yamal Regional Fund of Development	—	—	156
Pur-Land—related party (see Note 16)	—	—	100
Noyabrsk City Bank	—	—	16
Add: current portion of long-term debt	1,613	814	693
Total short-term debt and current portion of long-term debt . .	3,940	1,424	1,437

At 31 December 2004, 2003 and 2002, the weighted average interest rates for short-term debt were 6 percent (interest ranging from nil to 13 percent), 13 percent (interest ranging from nil to 13 percent) and 14 percent (interest ranging from nil percent to 19 percent), respectively. At 31 December 2004, the short-term debt includes interest free Russian rouble-denominated promissory notes which result in a

ОАО ТАРКОСАЛЕНЕФТЕГАС ОИЛ КОМПАНИ

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

9. Short-term Debt (continued)

lower weighted average for 2004. The Sberbank loans are collateralized by the Company's oil and gas property, plant and equipment.

10. Trade Payables and Accrued Liabilities

	31 December:		
	2004	2003	2002
Trade payables	171	210	147
Trade and other payables—related parties (see Note 16)	52	161	721
Salaries payable	30	25	28
Accrued interest	2	3	53
Dividends payable	—	1	17
Other payables	11	60	108
Total trade payables and accrued liabilities	266	460	1,074

11. Long-Term Debt

	31 December:		
	2004	2003	2002
Russian rouble-denominated debt	1,752	2,147	1,502
US dollar-denominated debt	796	1,406	758
Subtotal	2,548	3,553	2,260
Less: current portion of long-term debt	(1,613)	(814)	(693)
Total long-term debt	935	2,739	1,567

At 31 December 2004, 2003 and 2002, long-term debt by facility is outlined below.

	31 December:		
	2004	2003	2002
Sberbank	1,460	1,208	708
NOVATEK—related party (see Note 16)	796	794	—
Pur-Land—related party (see Note 16)	292	140	110
NGK ITERA—related party (see Note 16)	—	612	90
ITERA International Energy Corporation—related party (see Note 16)	—	444	352
Yamal-Nenets Regional Administration	—	—	693
TNG Energy AG—related party (see Note 16)	—	—	17
Russian rouble-denominated promissory notes payable to related parties (see Note 16)	—	355	290
Subtotal	2,548	3,553	2,260
Less: current portion of long-term debt	(1,613)	(814)	(693)
Total long-term debt	935	2,739	1,567

Sberbank. Between 2001 and 2004, the Company obtained five separate loans from Sberbank to fund the development of the East Tarkosalinskoye field. All of the loans were collateralized by the Company's oil and gas equipment.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

11. Long-Term Debt (continued)

During 2001, the Company obtained a credit facility in the amount of RR 600 million. The facility bore variable interest of 20 to 22 percent through August 2003, and 15 percent thereafter. The facility was guaranteed by NOVATEK and was repaid in November 2004 (see Note 16).

During 2002, the Company borrowed an additional RR 108 million. This loan was guaranteed by Pur-Land, an entity under common control (see Note 16), and bore interest of 20 percent through August 2003, and 15 percent thereafter. The loan originally matured between April 2005 and November 2006 but was repaid during 2004.

During 2003 and 2004, the Company borrowed another RR 500 million and RR 100 million, respectively, at 13 percent maturing between April 2005 and November 2006.

In June 2004, the Company entered into a borrowing arrangement for RR 300 million bearing interest of 10.5 percent and maturing in December 2005. In December 2004, the Company borrowed an additional RR 560 million. The December 2004 loan bears interest of 12 percent and matures in 2007.

NOVATEK. During 2003, the Company obtained three loans totaling RR 794 million (USD 26.9 million) from NOVATEK (see Note 16). The loans are unsecured, bear interest of 10 percent and mature between February 2007 and February 2008. During 2004, the Company borrowed an additional RR 51 million (USD 1.8 million), which, after foreign exchange effects of RR 49 million, brought its total borrowings to RR 796 million (USD 28.7 million).

Pur-Land. During 2002 and 2003, the Company borrowed a total of RR 292 million (nominal value) from Pur-Land, an entity under common control (see Note 16). The borrowings were unsecured, bore no interest and originally matured in December 2007. At inception, the loans were recorded at fair value, using a discount rate of 20 percent. The discounts of RR 10 million and RR 180 million on the loans for 2003 and 2002, respectively, were recorded as other contributed capital from shareholders (see Note 12). During 2004, the Company agreed to repay the loan early and a loss of RR 128 million was recognized in the statement of income within loss on early extinguishment of debt.

Yamal-Nenets Regional Administration. During 1998, the Company borrowed USD 21.8 million from Yamal-Nenets Regional Administration. The loan was secured by property, plant and equipment of the Company, bore interest of 12.25 percent and was repaid during 2003.

TNG Energy AG. During 2002, the Company borrowed RR 17 million (USD 550 thousand) from TNG Energy AG (see Note 16). The loan was unsecured, bore interest of 12 percent and was repaid during 2003.

NGK ITERA. During 2002 and 2003, the Company received loans totaling RR 642 million (USD 20.8 million) from NGK ITERA (see Note 16). The loans were unsecured, bore interest of 10 percent and originally matured between January 2007 and December 2008. During 2004 the loans were repaid in full.

Additionally, during 2002, the Company received a loan with the total nominal value of RR 70 million from NGK ITERA (see Note 16). The loan was unsecured, bore no interest and matured in September 2005. At inception, the loan was recorded at fair value, using a discount rate of 20 percent. The discount of RR 29 million on the loan was recorded as other contributed capital from shareholders (see Note 12). During 2003, the loan was repaid early at its face value, and a loss of RR 27 million was recognized in the statement of income equal to the difference between the face value of the loan and its carrying value.

Interest free loans from related parties for purchases of materials and equipment. During 2002, the Company purchased certain construction materials and equipment from OOO Mezhregionkomplekt ("Mezhregionkomplekt"), a related party of ITERA International Energy Corporation, at prices higher than prevailing market prices (see Note 16). In connection with these purchases, ITERA International Energy Corporation and its related parties agreed to provide the Company with interest free loans. Management believes the difference between the loan proceeds and the fair value of these loans at their inception approximated the premium paid for the materials and equipment purchased. Accordingly, the

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

11. Long-Term Debt (continued)

Company recorded both the loans payable and the materials and equipment purchases at their respective fair values during 2002.

ITERA International Energy Corporation. During 2001 and 2002, the Company received two loans with the total nominal value of RR 1,060 million from ITERA International Energy Corporation, an entity controlled by a shareholder (see Note 16). The loans were unsecured, bore no interest and were payable between January 2004 and December 2016. At inception, the loans were recorded at their fair values, using a discount rate of 20 percent. During 2004, the Company settled the loans by issuing short-term promissory notes of RR 1,013 million. The resulting loss of RR 578 million was recognized in the statement of income within loss on early extinguishment of debt.

Russian rouble-denominated promissory notes. During 2002 and 2003, Russian rouble denominated promissory notes were issued to Mezhhregionkomplekt (see Note 16) for the purchase of materials and equipment. At 31 December 2003 and 2002, the carrying values of these promissory notes were RR 355 million (nominal value of RR 491 million) and RR 290 million (nominal value of RR 480 million), respectively. The non-interest bearing notes were to be redeemed between 2005 and 2007. At inception the notes were recorded at fair value, using a discount rate of 20 percent, and the resulting discount of RR 192 million was recorded as a reduction in the respective purchases of materials and equipment. During 2004, the Company repaid promissory notes with a face value of RR 142 million and converted promissory notes with a face value of RR 137 million into short-term promissory notes. A loss of RR 40 million was recognized equal to the difference between the carrying value of the long-term promissory notes and that of the short-term promissory notes.

Also during 2004, long-term promissory notes with face value of 212 million were converted into short-term promissory notes. As a result of this conversion, the Company recognized a loss of RR 36 million equal to the difference between the carrying value of the long-term promissory notes and that of the short-term promissory notes.

During 2004, 2003 and 2002, accretion expense of RR 130 million, RR 173 million and RR 63 million, respectively, related to the discounts on interest free loans (including promissory notes) from related parties was recognized within interest expense in the statement of income.

Aggregate maturities of long-term debt outstanding at 31 December 2004 are as follows:

Year ended 31 December:	Scheduled maturities as at 31 December:		
	2004	2003	2002
2004	—	—	758
2005	—	470	314
2006	375	458	168
2007	560	1,383	183
2008	—	297	35
2009	—	35	29
Thereafter	—	96	80
Total long-term debt	935	2,739	1,567

12. Shareholders' Equity

Shares authorized. The total number of ordinary shares authorized and issued is 334,786,706, with an adjustment for the effect of inflation on nominal value of RR 10.58 per share (statutory value of RR 5 per share) at 31 December 2004, 2003 and 2002.

OAO TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

12. Shareholders' Equity (continued)

Other contributed capital from shareholders. As discussed in Note 11, in 2003 and 2002, the Company received various interest free loans from shareholders and their related parties as consideration for other transactions at non-market prices. Where the Company could demonstrate a clear link between the interest free loans and the associated transactions, both the loans and the associated transactions were recorded at their respective fair values. Where the Company was not able to document a clear link, the loans were recorded at their fair values and the corresponding differences between the fair value of the loans and the loan proceeds, amounting to RR 10 million and RR 209 million in 2003 and 2002, respectively, were recorded as other contributed capital from shareholders in the statement of changes in shareholders' equity.

Dividends. Dividends of RR 159 million (nominal RR 150 million) or RR 0.4751 per ordinary share (nominal RR 0.4480 per ordinary share) were declared during 2002 with respect to the year ended 31 December 2001 by the Company's Board of Directors. No dividends were declared during 2003 and 2004.

Distributable retained earnings. The statutory accounting reports of the Company are the basis for income distribution and other appropriations. Russian legislation identifies the basis of distribution as the net income calculated in accordance with Russian accounting regulations. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements. For the years ended 31 December 2004, 2003 and 2002, the Company had a statutory net income of RR 957 million, RR 66 million and RR 213 million, respectively, as reported in the Company's statutory accounting reports.

13. Materials, Services and Other

	Year ended 31 December:		
	2004	2003	2002
Wages	446	315	238
Materials and supplies	199	97	66
Electricity and fuel	38	35	29
Exploration expense	18	—	8
Well services	15	6	9
Other	120	82	38
Total materials, services and other	836	535	388

Wages. For the years ended 31 December 2004, 2003 and 2002, RR 67 million, RR 54 million and RR 45 million, respectively, of administrative staff wages were included in general and administrative expenses.

14. Transportation Expenses

	Year ended 31 December:		
	2004	2003	2002
Transportation costs incurred in operations	78	70	65
Natural gas transportation costs	—	—	232
Total transportation expenses	78	70	297

Natural gas transportation costs. During the first half of 2002, the Company sold natural gas to its final customers pursuant to its sales commission agreements with ITERA-Rus and ITERA-M, entities

OAO TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

14. Transportation Expenses (continued)

controlled by one of the Company's shareholders. Under these contracts, transportation fees were paid for by the Company. Beginning 1 July 2002, the Company began selling its natural gas ex-field.

15. Taxes

Reconciliation of income tax. Presented below is a reconciliation between actual income tax expense and theoretical income tax, determined by applying the statutory tax rate to income before income tax

	Year ended 31 December:		
	2004	2003	2002
Income before income tax	33	771	378
Theoretical income tax expense at statutory rate of 24 percent	8	185	91
Increase (decrease) due to:			
Loss on early extinguishment of debt	188	7	—
Non-deductible expenses	85	76	44
Income tax exemptions	(62)	(177)	(61)
Income tax reversal	(49)	(61)	—
Non-taxable income	(42)	(14)	(37)
Effects of inflation	—	—	197
Effects of changes in tax treatment of exchange differences	—	—	(115)
Other non-temporary differences	9	9	4
Total income tax expense	137	25	123

Russian tax legislation allows companies to receive exemptions from income tax on income derived from certain new production activities during the period of cost recovery up to the point that all invested costs have been recovered, but for no longer than three years. Income tax exemptions in the amount of RR 62 million, RR 177 million and RR 61 million, respectively, for the years ended 31 December 2004, 2003 and 2002 relate to the Company's sales of natural gas and oil that meet the above criteria. This income tax exemption will not be available after 31 December 2004.

During 2003 and 2004, the Company pursued a series of claims of overpayment of income tax paid during prior periods. The regional court ruled in favor of the Company and, accordingly, the Company and the tax authorities agreed to offset RR 49 million and RR 61 million, respectively, awarded in 2004 and 2003 against the Company's current income tax payable.

The tax charges and benefits arising from the restatement for the effects of inflation on non-monetary assets and liabilities were recorded as non-temporary elements of monetary gains and losses.

Deferred income tax. Differences between IFRS and Russian statutory taxation 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.

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

15. Taxes (continued)

Movements in deferred income tax assets and liabilities during the year ended 31 December 2004 were as follows:

	31 December 2004	Income statement effect	31 December 2003
Liabilities			
Property, plant and equipment	862	(33)	895
Accounts payable	12	2	10
Deferred income tax liabilities	874	(31)	905
Assets			
Inventories	(8)	(3)	(5)
Accrued interest and other liabilities	(106)	5	(111)
Asset retirement obligation	(65)	(16)	(49)
Accounts receivable	(6)	3	(9)
Taxes	(15)	(15)	—
Other temporary differences	(19)	(13)	(6)
Deferred income tax assets	(219)	(39)	(180)
Net deferred income tax liabilities	655	(70)	725

Movements in deferred income tax assets and liabilities during the year ended 31 December 2003 were as follows:

	31 December 2003	Income statement effect	31 December 2002
Liabilities			
Property, plant and equipment	895	(61)	956
Accounts payable	10	10	—
Deferred income tax liabilities	905	(51)	956
Assets:			
Inventories	(5)	(4)	(1)
Accrued interest and other liabilities	(111)	24	(135)
Asset retirement obligation	(49)	(23)	(26)
Accounts receivable	(9)	(9)	—
Other temporary differences	(6)	(5)	(1)
Deferred income tax assets	(180)	(17)	(163)
Net deferred income tax liabilities	725	(68)	793

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

15. Taxes (continued)

Movements in deferred income tax assets and liabilities during the year ended 31 December 2002 were as follows:

	31 December 2002	Income statement effect	31 December 2001
Liabilities			
Property, plant and equipment	956	205	751
Trade receivables	—	(46)	46
Inventories	—	(13)	13
Deferred income tax liabilities	956	146	810
Assets			
Inventories	(1)	10	(11)
Accrued interest and other liabilities	(135)	(97)	(38)
Asset retirement obligation	(26)	4	(30)
Accounts receivable	—	5	(5)
Other temporary differences	(1)	—	(1)
Deferred income tax assets	(163)	(78)	(85)
Net deferred income tax liabilities	793	68	725

The Company is subject to a number of taxes other than on income, which are detailed as follows:

	Year ended 31 December:		
	2004	2003	2002
Unified natural resources production tax	1,413	808	502
Property tax	105	173	159
Penalties and interest	93	69	18
Road users tax	—	—	20
Other	14	9	9
Total taxes other than income tax	1,625	1,059	708

Beginning 1 January 2003, the assessment of road users tax was abolished.

In 2004 the Company recalculated the unified natural resources production tax expense for 2002 and the first half of 2003 and recognized net benefit of RR 70 million. Additionally, the Company accrued a provision for penalties and interest in the amount of RR 87 million.

Under the Tax Code of the Russian Federation, the rate for the unified natural resources production tax on natural gas production was RR 107 per thousand cubic meters through 31 December 2004. Beginning 1 January 2005, the unified natural resources production tax for natural gas is changed at a fixed rate of RR 135 per thousand cubic meters.

Under the Tax Code of the Russian Federation, from 1 January 2004, the unified natural resources production tax rate for gas condensate is set at 17.5 percent of gas condensate revenues recognized by the Company.

Under the Tax Code of the Russian Federation, the base rate for the unified natural resources production tax for crude oil was set at RR 347 per metric ton of crude oil produced at 31 December 2004. The rate for crude oil is adjusted depending on the market price of Urals blend and the RR/USD exchange rate. Between 1 January 2005 and 31 December 2006 the base rate will be increased to RR 419 per metric ton of crude oil. From 1 January 2007, the tax rate was set at 16.5 percent of crude oil revenues recognized by the Company.

OAO TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

15. Taxes (continued)

Current other taxes payable at 31 December 2004, 2003 and 2002 were as follows:

	At 31 December:		
	2004	2003	2002
Value added tax	112	111	340
Unified natural resources production tax	230	30	225
Penalties and interest	87	—	3
Property tax	28	45	40
Royalty tax	2	—	101
Other	13	11	26
Total other taxes payable	472	197	735

16. Related Party Transactions

In 2004, 2003 and 2002, the Company had significant activities with companies related to its shareholders in connection with purchases and sales of crude oil, natural gas, gas condensate, construction and other related services, and purchases and sales of equity securities. The Company's reported statement of income, balance sheet and statement of cash flows would be different had such transactions been carried out among unrelated parties. 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 Company had transactions with the following related parties during 2004, 2003 and 2002:

Name of related party	Nature of transactions
<i>Shareholders</i>	
TNG Energy AG	Crude oil and condensate sales
NOVATEK	Gas and condensate sales, purchases of inventory, equipment and construction services, guarantees, debt financing
OOO NGK ITERA	Gas and condensate sales, debt financing
<i>Subject to control or significant influence of shareholders</i>	
OAO Purneftegasgeologiya	Purchases of warehousing services, loading operations, well drilling and construction services
OOO Khancheyneftegas	Sale of assets under construction, sales of condensate separation and transportation services
OAO Pur-Land	Crude oil, condensate and gas sales, purchases of crude oil, condensate, and tolling services, debt financing, guarantees (2002, 2003)
ITERA International Energy Corporation LLC . .	Debt financing, guarantor of obligations
OOO ITERA-Holding	Gas sales, purchases of gas transportation services, mutual settlements (2002)
ZAO TEK ITERA-Rus	Gas sales, purchases of gas transportation services (2002)
OO ITERA Gasneftekhim	Gas and gas condensate sales
OOO Korvers	Mutual settlements (2002)
OOO Mezhregionkomplekt	Purchases of inventory and equipment, guarantor of obligations
OAO SNP Nova	Purchases of construction services, sales of equipment and materials, guarantees

ОАО ТАРКОСАЛЕНЕФТЕГАС ОИЛ КОМПАНИ

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

16. Related Party Transactions (continued)

<u>Name of related party</u>	<u>Nature of transactions</u>
ООО Nova Energy Services	Construction services
ООО Nova Energo	Equipment maintenance and power supply
ЗАО Nova Bank	Banking services
ОАО БК PNGG	Purchases of construction services, sales of assets under construction
ОАО ТС НГРЕИС	Purchases of well repairs services
ООО Yang-Pur	Joint activity

Sales of crude oil and gas condensate:

<u>Name of related party</u>	Year ended 31 December:					
	2004		2003		2002	
	Sales volumes (ton 000s)	Russian roubles	Sales volumes (ton 000s)	Russian roubles	Sales volumes (ton 000s)	Russian roubles
ОАО NOVATEK	348	557	306	597	117	258
ООО ИТЕРА Газнефтехим	292	467	—	—	—	—
ООО НГК ИТЕРА	—	—	231	436	—	—
ОАО Pur-Land	—	—	—	—	68	157
Other related parties	—	1	1	2	—	—

Sales of natural gas:

<u>Name of related party</u>	Year ended 31 December:					
	2004		2003		2002	
	Sales volumes (m ³ millions)	Russian roubles	Sales volumes (m ³ millions)	Russian roubles	Sales volumes (m ³ millions)	Russian roubles
ОАО NOVATEK	5,738	1,727	5,223	1,050	1,978	222
ООО НГК ИТЕРА	5,559	1,678	2,667	581	3,384	407
ОАО Pur-Land	—	—	6,049	857	5,234	458
ООО ИТЕРА-Holding	—	—	—	—	894	328
ЗАО ТЕК ИТЕРА-Rus	—	—	—	—	84	13

Purchases of materials and supplies. Construction materials and supplies are generally purchased or contracted at commercial terms and conditions, except for purchases of construction supplies and equipment from ООО Межрегионкомплект. During 2002, materials and supplies from ООО Межрегионкомплект were sold to the Company at prices higher than the prevailing market prices of similar goods in the region (see Note 11). During 2004 and 2003, purchases from ООО Межрегионкомплект were at market prices. Purchases at contracted prices were as follows:

<u>Name of related party</u>	Year ended 31 December:		
	2004	2003	2002
ООО Межрегионкомплект	83	71	366
NOVATEK and its' affiliated entities	7	—	13
Purchases of materials and supplies	90	71	379

OAo TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

16. Related Party Transactions (continued)

Other balances and transactions with related parties:

	As at and for the year ended 31 December:		
	2004	2003	2002
Balances			
Trade and other receivables	419	602	756
Construction advances	—	109	10
Short-term debt	615	10	100
Long-term debt	1,088	2,345	859
Trade payables and accrued liabilities	52	76	721
Interest payable	—	85	—
Transactions			
Other operating revenues	192	121	5
Purchases of services	188	335	760
Interest expense	287	259	68
Loss on early extinguishment of debt	782	27	—

Other transactions. During 2004, 2003 and 2002, the Company provided oil and gas extraction, gathering and transportation services to OOO Khancheyneftegas for which prices are determined on a cost plus basis. The revenue from the sale of such services is recorded in other operating revenues.

During 2004, 2003 and 2002, the Company purchased, primarily, construction and drilling services from related parties. Management believes the prices for the services approximated market prices.

During 2003, the Company sold assets under construction for amounts approximating their carrying values of RR 20 million and RR 17 million to OOO Khancheyneftegas and OAO BK PNGG, respectively.

At 31 December 2004, short-term debt included US dollar-denominated unsecured loans from NOVATEK in the amount of RR 615 million (see Note 9).

At 31 December 2003, short-term debt included Russian rouble-denominated unsecured interest free loan from OOO Khancheyneftegas in the amount of RR 10 million (see Note 9).

At 31 December 2002, short-term debt included Russian rouble-denominated unsecured interest free loan from Pur-Land in the amount of RR 100 million (see Note 9).

At 31 December 2003 and 2002, long-term debt included Russian rouble-denominated promissory notes issued to Mezhhregionkomplekt in the amount of RR 355 million and RR 290 million, respectively (see Note 11). At 31 December 2004, Mezhhregionkomplekt ceased to be a related party following to the NOVATEK's buy-out of the other shareholders' interests in the Company (see Note 1).

During 2004, 2003 and 2002, compensation comprising wages, fees, bonuses, and benefits, paid to the Company's directors and executive management amounted to RR 21 million, RR 15 million and RR 13 million, respectively.

Guarantees and pledges. At 31 December 2004 and 2003, the Company guaranteed bank debt and interest obligations of OOO Khancheyneftegas totaling RR 155 million and RR 165 million, respectively. The debt matures in February 2008. OOO Khancheyneftegas was merged into the Company subsequent to year end (see Note 20).

In 2004, the Company also guaranteed bank debt and interest obligations of NOVATEK totaling RR 1,387 million (USD 50 million).

At 31 December 2004, 2003 and 2002, the loans from Sberbank in the amount of RR 600 million, RR 600 million and RR 108 million, respectively, were guaranteed by NOVATEK and OAO Pur-Land (see Note 11).

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

16. Related Party Transactions (continued)

At 31 December 2002, ITERA International Energy Corporation guaranteed repayment of the Company's loan from Yamal Regional Fund of Development (see Note 9).

At 31 December 2002, the Company guaranteed bank debt and interest obligations of Mezhhregionkomplekt totaling RR 75 million. During 2003, the guarantee was terminated due to settlement of the obligations by Mezhhregionkomplekt.

17. Asset Retirement Obligations

	Year ended 31 December		
	2004	2003	2002
Asset retirement obligations at the beginning of the year	204	109	96
Additional obligations recognized	15	104	11
Accretion expense	23	18	21
Change in estimates	27	(27)	(19)
Asset retirement obligations	269	204	109

18. 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 not freely convertible in most countries outside of the Russian Federation, currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

While there have been improvements in the economic trends, 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.

Guarantees. The Company has guaranteed bank debt and interest obligations of related and other parties totaling RR 1,555 million, RR 171 million and RR 81 million at 31 December 2004, 2003 and 2002, respectively. The guaranteed debt and interest obligations are due on various dates in 2005 through 2009.

Due to the absence of any market for these financial instruments, it is not practicable to estimate the fair value of the above guarantees. However, the Company does not expect to incur losses as a result of these guarantees.

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 activity of the Company may be challenged by the relevant regional and federal authorities. Recent 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. 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 2004, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company'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 for in these financial statements.

Environmental liabilities. The Company has 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

OA O TARKOSALENEFTEGAS OIL COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

18. Contingencies and Commitments (continued)

Company periodically evaluates its obligations under environmental regulations and, as obligations are determined, they are recognized immediately, if no current or future benefit is discernible. Potential liabilities which might arise as a result of stricter enforcement 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 financial position or the operation results of the Company.

Legal contingencies. During the year, the Company was involved in 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 Company and which have not been accrued or disclosed in these financial statements.

Oilfield licenses. The Company is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licenses. Management of the Company correspond 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 Company's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Company.

Certain objects of immovable property, with a total cost of approximately RR 253 million, included in the Company's balance sheet, are located on plots of land for which the Company has not yet completed all land licensing activities. Management has submitted applications to the relevant authorities and expects to complete the procedure of receiving the relevant land licenses within the next year. Management believes that the risk of negative consequences from the absence of land licenses is remote.

Commitments. In October 2003, the Board of Directors approved the purchase of equipment for a gas pumping station for the East Tarkosalinskoye field with a total cost of RR 472 million. By 31 December 2004, the Company had made payments for the equipment totalling RR 418 million. The remaining RR 54 million will be paid upon receipt of the equipment.

19. Financial Instruments

Foreign exchange. The Company's overall strategy is to have no significant exposure in currencies other than the Russian rouble or the US dollar, and it does not use foreign exchange or forward contracts. At 31 December 2004, long-term debt and short-term debt denominated in US dollars amounted to RR 796 million and RR 615 million, respectively. At 31 December 2003, long-term debt and accrued interest liabilities denominated in US dollars amounted to RR 1,406 million, RR 85 million, respectively. At 31 December 2002, cash, accounts receivable, long-term loans payable, and accrued interest liabilities denominated in US dollars amounted to RR 242 thousand, RR 30 million, RR 758 million, and RR 485 thousand, respectively. The balances were translated at the official rouble to US dollar exchange rates quoted by the Central Bank of the Russian Federation at the respective balance sheet date.

Interest rates. The Company obtains funds from and deposits surpluses with banks at current market interest rates, and does not use any hedging instruments to manage its exposure to changes in interest rates. Management does not believe that it has significant exposure to interest rate risk as the majority of its borrowings are at fixed interest rates.

Credit risks. Cash and cash equivalents are deposited only with banks that are considered by the Company at the time of deposit to have minimal risk of default. The Company does not require collateral or other security to support receivables from customers or related parties. A portion of the Company's accounts receivable is from shareholders and related parties. Although collection of accounts receivable

ОАО ТАРКОСАЛЕНЕФТЕГАС ОИЛ COMPANY

Notes to the Financial Statements (continued)

(in Russian roubles (tabular amounts in millions), unless otherwise stated)

19. Financial Instruments (continued)

could be influenced by economic factors affecting these entities, management believes there is no significant risk of loss to the Company beyond the provisions already recorded.

Fair values. The fair value of financial instruments is determined with reference to various market information and other valuation methods as considered appropriate. At 31 December 2004, the fair values, where determinable, of financial instruments held by the Company did not materially differ from their carrying values.

20. Subsequent Events

In January 2005, NOVATEK, the sole shareholder of the Company, took the decision to reorganize the company from an open joint stock company (“ОАО”) to a limited liability company (“ООО”). In March 2005, NOVATEK resolved to contribute 100 percent of ООО Ханчейнефтегас to the Company’s charter capital. In May 2005, ООО Ханчейнефтегас was merged into ООО Таркосаленефтегас (see Note 1).

In February 2005, the Company acquired a 100 percent interest in ООО Pur-Land (formerly ОАО Pur-Land) from TNG Energy AG for RR 27 million. In April 2005, NOVATEK, the sole stockholder of the Company, resolved to merge ООО Pur-Land into the Company.

In March 2005, the Company received a loan from NOVATEK totaling RR 450 million. The loan bears interest of 10 percent and matures in March 2006. Additionally, in May 2005, the Company obtained a loan facility from NOVATEK totaling RR 3,445 million. The loan bears interest of 10 percent and matures in June 2006.

In February 2005, the Company guaranteed a loan for NOVATEK in the amount of RR 5.6 billion (USD 200 million). In March and April 2005, the Company guaranteed two loans for NOVATEK totaling RR 1,130 million and RR 500 million, respectively. Additionally, in May 2005, the Company guaranteed two short-term loans for NOVATEK in the aggregate amount of RR 196 million (USD 7 million). Under these agreements the Company’s debt balance, subject to certain adjustments, may not exceed 125 percent of the Company’s revenue for the four preceding months.

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July 21, 2005

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Gentlemen:

At the request of OA0 Novatek (Novatek), we have prepared estimates, as of December 31, 2004, of the extent and value of the proved and probable natural gas, condensate, and oil reserves of certain fields in Russia represented by Novatek to be owned by Novatek through its wholly-owned subsidiaries, which hold the licenses for these fields. These estimates are also presented in reports for each field, which were prepared for and provided to Novatek by DeGolyer and MacNaughton. The three fields evaluated are located in western Siberia, Russia and include the following:

East Tarkosalinsk
 Khancheiskoye
 Yurkharovskoye

The proved reserves presented have been prepared in accordance with the United States Securities and Exchange Commission (SEC) definitions. Probable reserves presented here have been prepared in accordance with reserves definitions consistent with those approved in March 1997 by the Society of Petroleum Engineers (SPE) and the World Petroleum Congresses (WPC).

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. Furthermore, we have been advised that the Law on Subsoil was amended in 2000 to provide that new production or combined production and exploration licenses for new fields or upon the expiration of the term of existing licenses will no longer be limited to a specified number of years and may now be issued for the full useful life of the fields associated with such license. We understand that the principal requirements 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, the license holder 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 of the associated license. Novatek has represented that upon completion of the primary term of its current licenses it intends to extend these licenses to the end of the economic life of the associated fields, and that it intends 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 the licenses.

Reserves estimated in this report are expressed as gross reserves, which are defined as the total estimated petroleum to be produced after December 31, 2004. Novatek has an ownership interest of 100 percent in the fields; therefore, gross reserves are equal to net reserves and are reported herein as Novatek reserves.

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, through its wholly-owned subsidiaries. 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.

DEGOLYER AND MACNAUGHTON

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 volumes shown herein include ethane volumes that are liberated from the field condensate stream during processing and reintroduced into the gas stream for processing and sales. Gas volumes estimated herein are expressed at a temperature base of 20 °C and a pressure base of 1 atmosphere.

The estimated proved and probable sales gas, condensate, and oil reserves, as of December 31, 2004, in the fields evaluated, expressed in millions of cubic feet (10⁶ft³) and millions of cubic meters (10⁶m³), or thousands of barrels (10³bbl) and thousands of metric tons (10³mt), are summarized as follows:

	English Units				
	Novatek Sales Gas				
	Proved Developed (10⁶ft³)	Proved Undeveloped (10⁶ft³)	Total Proved (10⁶ft³)	Probable (10⁶ft³)	Proved Plus Probable (10⁶ft³)
East Tarkosalinsk	9,727,897	1,111,794	10,839,691	604,469	11,444,160
Khancheiskoye	1,235,342	325,814	1,561,156	1,056,050	2,617,206
Yurkharovskoye	2,783,150	5,408,299	8,191,449	10,251,496	18,442,945
Total	13,746,389	6,845,907	20,592,296	11,912,015	32,504,311

Note: Probable reserves have not been adjusted for risk.

	Metric Units				
	Novatek Sales Gas				
	Proved Developed (10⁶m³)	Proved Undeveloped (10⁶m³)	Total Proved (10⁶m³)	Probable (10⁶m³)	Proved Plus Probable (10⁶m³)
East Tarkosalinsk	275,463	31,483	306,946	17,117	324,063
Khancheiskoye	34,981	9,226	44,207	29,904	74,111
Yurkharovskoye	78,810	153,146	231,956	290,290	522,246
Total	389,254	193,855	583,109	337,311	920,420

Note: Probable reserves have not been adjusted for risk.

DEGOLYER AND MACNAUGHTON

	English Units				
	Novatek Condensate				
	Proved Developed (10 ³ bbl)	Proved Undeveloped (10 ³ bbl)	Total Proved (10 ³ bbl)	Probable (10 ³ bbl)	Proved Plus Probable (10 ³ bbl)
East Tarkosalinsk	54,533	35,379	89,912	15,015	104,927
Khancheiskoye	42,085	12,968	55,053	30,614	85,667
Yurkharovskoye	34,745	57,046	91,791	138,566	230,357
Total	131,363	105,393	236,756	184,195	420,951

Note: Probable reserves have not been adjusted for risk.

	Metric Units				
	Novatek Condensate				
	Proved Developed (10 ³ mt)	Proved Undeveloped (10 ³ mt)	Total Proved (10 ³ mt)	Probable (10 ³ mt)	Proved Plus Probable (10 ³ mt)
East Tarkosalinsk	6,682	4,395	11,077	1,849	12,926
Khancheiskoye	4,946	1,524	6,470	3,598	10,068
Yurkharovskoye	3,915	6,428	10,343	15,613	25,956
Total	15,543	12,347	27,890	21,060	48,950

Note: Probable reserves have not been adjusted for risk.

	English Units				
	Novatek Oil				
	Proved Developed (10 ³ bbl)	Proved Undeveloped (10 ³ bbl)	Total Proved (10 ³ bbl)	Probable (10 ³ bbl)	Proved Plus Probable (10 ³ bbl)
East Tarkosalinsk	5,989	52,018	58,007	164,065	222,072
Khancheiskoye	0	0	0	3,130	3,130
Yurkharovskoye	0	0	0	0	0
Total	5,989	52,018	58,007	167,195	225,202

Note: Probable reserves have not been adjusted for risk.

	Metric Units				
	Novatek Oil				
	Proved Developed (10 ³ mt)	Proved Undeveloped (10 ³ mt)	Total Proved (10 ³ mt)	Probable (10 ³ mt)	Proved Plus Probable (10 ³ mt)
East Tarkosalinsk	786	6,831	7,617	21,545	29,162
Khancheiskoye	0	0	0	411	411
Yurkharovskoye	0	0	0	0	0
Total	786	6,831	7,617	21,956	29,573

Note: Probable reserves have not been adjusted for risk.

The estimated total proved and probable reserves, as of December 31, 2004, in the fields evaluated, expressed in thousands of barrels of oil equivalent (10³boe) are summarized as follows:

	Barrels of Oil Equivalent				Proved Plus Probable (10 ³ boe)
	Proved Developed (10 ³ boe)	Proved Undeveloped (10 ³ boe)	Total Proved (10 ³ boe)	Probable (10 ³ boe)	
East Tarkosalinsk	1,862,050	293,296	2,155,346	291,025	2,446,371
Khancheiskoye	270,861	73,306	344,167	229,316	573,483
Yurkharovskoye	550,162	1,058,621	1,608,783	2,037,063	3,645,846
Total	2,683,073	1,425,223	4,108,296	2,557,404	6,665,700

Notes:

1. Probable reserves have not been adjusted for risk.
2. In converting gas to oil equivalent, 1,000 cubic meters of gas equals 6.54 barrels of oil equivalent.

Certain petroleum reserves included in this report are classified as proved and 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 as of the date the estimate is made, including consideration of changes in existing prices provided only by contractual arrangements but not including escalations based upon future conditions. Proved reserves classifications used in this report are in accordance with the reserves definitions of Rules 4–10(a) (1)–(13) of Regulation S–X of the SEC. The petroleum reserves are classified as follows:

Proved oil and gas reserves – Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

- (i) Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes (A) that

portion delineated by drilling and defined by gas-oil and/or oil/water contacts, if any; and (B) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir.

(ii) Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the “proved” classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.

(iii) Estimates of proved reserves do not include the following: (A) oil that may become available from known reservoirs but is classified separately as “indicated additional reserves”; (B) crude oil, natural gas, and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics, or economic factors; (C) crude oil, natural gas, and natural gas liquids, that may occur in undrilled prospects; and (D) crude oil, natural gas, and natural gas liquids, that may be recovered from oil shales, coal, gilsonite, and other such sources.

Proved developed oil and gas reserves – Proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as “proved developed reserves” only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

Proved undeveloped reserves – Proved undeveloped oil and gas reserves are reserves 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. Reserves on undrilled acreage shall be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances should estimates for proved 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 tests in the area and in the same reservoir.

Probable reserves are based on geologic and/or engineering data similar to that used in estimates of proved reserves; but technical, contractual, economic, or regulatory uncertainties preclude such reserves being classified as proved. They may be estimated assuming future economic conditions different from those prevailing at the time of the estimate. The effect of possible future improvements in economic conditions and technological developments can be expressed by allocating appropriate quantities of reserves to the probable classifications.

Probable Reserves – Probable reserves are those unproved reserves which analysis of geological and engineering data suggests are more likely than not to be recoverable. In this context, when probabilistic methods are used, there should be at least a 50-percent probability that the quantities actually recovered will equal or exceed the sum of estimated proved plus probable reserves.

In this report, values of the proved and proved-plus-probable 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 transportation costs, operating expenses, capital and abandonment costs, and production and other taxes, and profit tax from the future gross revenue. Operating expenses include field operating expenses, compression charges, the estimated expenses of direct supervision, and minor general administrative costs. 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 rates of 10 and 15 percent.

Estimates of future net revenue and present worth derived from anticipated production and sales profile as of December 31, 2004, of the proved and proved-plus-probable reserves in the three fields evaluated, as of December 31, 2004, are summarized as follows, expressed in thousands of United States dollars (10³U.S.\$). Values were estimated in United States dollars (U.S.\$) using the exchange rate effective December 31, 2004, which was 27.7487 Russian Rubles per U.S.\$1.00. Based on production profiles as of December 31, 2004, provided by Novatek, the total annual gas production in the three fields will reach approximately 37 billion cubic meters by the year 2010.

Field	Future Net Revenue		Present Worth at 10 Percent		Present Worth at 15 Percent	
	Total Proved (10 ³ U.S.\$)	Proved plus Probable (10 ³ U.S.\$)	Total Proved (10 ³ U.S.\$)	Proved plus Probable (10 ³ U.S.\$)	Total Proved (10 ³ U.S.\$)	Proved plus Probable (10 ³ U.S.\$)
East Tarkosalinsk	5,286,563	6,483,453	2,109,941	2,278,049	1,541,583	1,615,022
Khancheiskoye	1,117,334	1,816,492	660,837	857,790	530,984	644,673
Yurkharovskoye	3,652,648	8,492,467	1,559,423	2,521,833	1,134,893	1,654,071
Total	9,056,545	16,792,412	4,330,201	5,657,672	3,207,460	3,913,766

Note: There has been no adjustment applied to the value of probable reserves to account for risk.

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, 2004.

In our opinion, the information relating to estimated proved reserves, estimated future net revenue from proved reserves, and present worth discounted at

10 percent of estimated future net revenue from proved reserves of gas, condensate, and oil contained in this report has been prepared in accordance with Paragraphs 10–13, 15 and 30(a)–(b) of Statement of Financial Accounting Standards No. 69 (November 1982) of the Financial Accounting Standards Board and Rules 4–10(a) (1)–(13) of Regulation S–X and Rule 302(b) of Regulation S–K of the SEC; provided, however, that while certain economically producible volumes 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 it intends to extend its current production licenses to the end of the economic life of the fields, we are not in a position to offer an opinion on the duration of Novatek’s production licenses under the Russian Law on Subsoil. In February 2005, Novatek was successful in extending the production license of the Yurkharovskoye field to 2034.

To the extent the above-enumerated rules, regulations, and statements require determinations of an accounting or legal nature or information beyond the scope of our report, we are necessarily unable to express an opinion as to whether the above-described information is in accordance therewith or sufficient therefor.

Oil, condensate, and gas prices were provided by Novatek. An oil price of 123.69 United States dollars per metric ton (U.S.\$/mt) was used in the evaluation of all fields. The condensate price used in the evaluation of the East Tarkosalinsk and Khancheiskoye fields was 118.63 U.S.\$/mt through May 31, 2005, and 162.48 U.S.\$/mt thereafter. In the Yurkharovskoye field, the condensate price used was 118.18 U.S.\$/mt through May 31, 2005, and 163.74 U.S.\$/mt thereafter. The gas price used for all fields was 23.70 United States dollars per thousand cubic meters (U.S.\$/10³m³). Prices were held constant through the life of the fields.

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 royalty and tax provisions were assumed to remain unchanged from current legislation.

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, 2004, was maintained.

DEGOLYER AND MACNAUGHTON

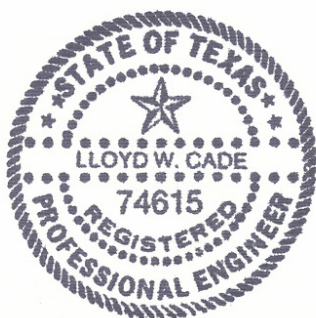
DeGolyer and MacNaughton is a Delaware corporation with offices at One Energy Square, Dallas, Texas 75206, U.S.A. The firm has been providing petroleum consulting services throughout the world for more than 65 years. The firm's professional engineers, geologists, geophysicists, petrophysicists, and economists are engaged in the independent appraisal of 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. Lloyd W. Cade. Mr. Cade 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 23 years of oil and gas industry experience.

Submitted,

DeGolyer and MacNaughton

DeGOLYER and MacNAUGHTON



Lloyd W. Cade, P.E.

Lloyd W. Cade, P.E.
Senior Vice President
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