PAO NOVATEK

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

FOR THE YEAR ENDED 31 DECEMBER 2017

CONTENTS **Page**

GENERAL PROVISIONS

You should read the following discussion and analysis of our financial condition and results of operations as of 31 December 2017 and for the year then ended in conjunction with our audited consolidated financial statements as of and for the year ended 31 December 2017. The consolidated financial statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are one of the Russia's largest natural gas producers and leaders in terms of proved natural gas reserves in the Russian Federation under the Petroleum Resources Management System ("PRMS") and the Securities and Exchange Commission ("SEC") reserve reporting methodologies.

Our exploration and development, production and processing of natural gas, gas condensate and crude oil are conducted mainly within the Russian Federation.

The natural gas assets of our subsidiaries and joint ventures include projects where we sell natural gas through the Unified Gas Supply System in the Russian domestic market and liquefied natural gas ("LNG") delivered to international markets. In the fourth quarter of 2017, OAO Yamal LNG, a Group's joint venture, commenced producing LNG at the first train of its liquefaction plant, and started LNG sales in December 2017.

We deliver our extracted unstable gas condensate through our own pipelines to our Purovsky Gas Condensate Plant (the "Purovsky Plant") for processing into stable gas condensate and liquefied petroleum gas ("LPG"). The Purovsky Plant allows us to process more than 12 million tons of unstable gas condensate per annum.

Most of our stable gas condensate is sent for further processing to our Gas Condensate Fractionation and Transshipment Complex located at the port of Ust-Luga on the Baltic Sea (the "Ust-Luga Complex"). The Ust-Luga Complex processes our stable gas condensate into light and heavy naphtha, jet fuel, gasoil and fuel oil, nearly all of which we sell to the international markets allowing us to increase the added value of our liquid hydrocarbons sales. The Ust-Luga Complex allows us to process about seven million tons of stable gas condensate annually.

The excess volumes of stable gas condensate received from the processing at the Purovsky Plant over volumes sent for further processing to the Ust-Luga Complex are sold on both the domestic and international markets (by rail and from the port of Ust-Luga on the Baltic Sea by tankers).

A significant part of our LPG produced at the Purovsky Plant is dispatched via pipeline for refining by OOO SIBUR Tobolsk at its refining facilities (the "Tobolsk Refining Facilities"). The remaining volumes are sold directly from the Purovsky Plant without incurring additional transportation expenses. After processing at the Tobolsk Refining Facilities we receive LPG with higher added value, the majority of which are transported by rail to our end-customers in the domestic and international markets with the remaining portion sold directly from the Tobolsk Refining Facilities without incurring additional transportation expenses.

We deliver our crude oil to both domestic and international markets.

RECENT DEVELOPMENTS

Implementing our Yamal LNG project

The Group, jointly with our international partners TOTAL S.A., China National Petroleum Corporation and Silk Road Fund Co. Ltd., through our joint venture OAO Yamal LNG, is constructing a large-scale liquefied natural gas plant based on the feedstock resources of the South-Tambeyskoye field (the "Yamal LNG project"). Yamal LNG is the holder of the LNG export license and currently more than 95% of LNG volumes produced within the three trains of the project have been contracted under long-term agreements for sale to international markets, mainly to the Asia-Pacific Region ("APR") and to the European market. To ensure these deliveries, long-term agreements for time chartering of LNG ice-class carriers have been signed. As at the date of this report, four LNG ice-class carriers transport LNG from the project.

In the fourth quarter of 2017, Yamal LNG started producing LNG at the first LNG train of 5.5 million tons annual capacity, and, in the beginning of December 2017, shipped the first LNG cargo from the port of Sabetta by the Arc7 ice-class tanker "Christophe de Margerie". In total, three cargoes were shipped from the port of Sabetta for sales to international markets in December 2017. The commencement of LNG production at the first train on schedule and on budget is an important step in the realization of the Yamal LNG project, and is a starting point for OAO Yamal LNG becoming a significant supplier of LNG to the international LNG market.

Currently, the second and the third LNG trains continue to be in advanced stage of construction: the required production wells for the launch of the second train have been drilled, all the modules for the second and third LNG trains have been delivered and most of them have been installed. The launches of the second and third LNG trains are planned in 2018 and 2019, respectively.

The initial LNG plant capacity was stated at 16.5 million tons of LNG per year (three trains of 5.5 million tons capacity each) and up to 1.2 million tons of stable gas condensate per year. At the end of 2017, the shareholders of Yamal LNG approved a decision on constructing the fourth LNG train with annual capacity of about 0.9 million tons of LNG per year that will expand the overall LNG plant capacity from 16.5 million tons to 17.4 million tons of LNG per year. The fourth LNG train is planned to be constructed based on a proprietary liquefaction technology developed by the Group's engineers and using mainly Russian-made equipment. In addition, the fourth train will use the existing infrastructure built for the first three LNG trains that will eventually reduce total LNG liquefaction cost. Presently, front-end engineering design ("FEED") works are being performed for the fourth train construction. The completion of the fourth train construction is planned in the end of 2019.

Implementing our Arctic LNG 2 project

The Group through our wholly owned subsidiary OOO Arctic LNG 2 undertakes a project to construct a new LNG plant on the Gydan peninsula based on the hydrocarbon resources of the Salmanovskoye (Utrenneye) field (the "Arctic LNG 2 project").

The project stipulates to build the LNG plant based on gravity-based platforms constructed, jointly with other major units for the plant, at our own center for construction of large-scale marine facilities located in the Murmansk region. The Group signed a framework agreement with companies TechnipFMC, Linde AG, and AO NIPIgaspererabotka, and a joint venture of the aforementioned companies, OOO LNG Novaengineering, on strategic cooperation for designing and developing future LNG plants based on gravity-based platforms for the Arctic LNG 2 project, as well as subsequent NOVATEK's LNG projects.

In the second quarter of 2017, the Group purchased licenses for natural gas liquefaction technology from Linde AG and commenced FEED work on the Arctic LNG 2 project. According to preliminary results, the LNG plant will consist of three processing trains with the aggregate capacity of approximately 20 million tons of LNG per year. The final decision on the plant capacity will be specified based on the FEED works performed which is expected to be completed in late 2018.

In 2017, we continued full-scale exploration activities at the Salmanovskoye (Utrenneye) field, conducted processing and interpretation of new and existing seismic data, drilled several exploration wells, and completed the field development plan. Simultaneously, in the second half of 2017, we started developing our center for construction of large-scale marine facilities in the Murmansk region.

Increasing our resource base for future LNG projects

The Group considers the territory of the Yamal peninsula, the Gulf of Ob and the Gydan peninsula as one of the most important regions for implementing our future LNG projects. Besides implementation of Arctic LNG 2 project (see above), the Group is studying different alternatives for developing activities in this region and has accumulated a significant resource base to support these initiatives. As at the beginning of 2017, the Group through its wholly owned subsidiaries OOO Arctic LNG 1, OOO Arctic LNG 2, and OOO Arctic LNG 3 held exploration and production licenses for the Salmanovskiy (Utrenniy), Geofizicheskiy, North-Obskiy and Trekhbugorniy license areas in this region. The aforementioned subsidiaries are the holders of the liquefied natural gas export licenses.

In 2017, we expanded our resource base in this strategic region. In June and August 2017, we won auctions held by the Federal Agency for the Use of Natural Resources of the Russian Federation for geological research works, exploration and hydrocarbons production at license areas, which include the Gydanskoye, the Shtormovoye, the Verhnetiuteyskoye and the West-Seyakhinskoye fields.

- The license area including the Shtormovoye field is located on the Gydan peninsula and is partly in the Gulf of Gydan and the Gulf of Ob in the Kara Sea bordering our Salmanovskoye (Utrenneye) field. As of 31 December 2017, the license area's reserves and recoverable resources according to the Russian reserve classification C+D totaled approximately 1.1 trillion cubic meters of natural gas and approximately 107 million tons of liquid hydrocarbons. The payment for the license amounted to RR 1,040 million.

- The license area including the Verhnetiuteyskoye and the West-Seyakhinskoye fields is located on the Yamal peninsula in close proximity to the South-Tambeyskoye field of our joint venture Yamal LNG. As of 31 December 2017, the aggregate proved, probable and possible reserves of these fields appraised under the PRMS reserve methodology totaled approximately 386 bilion cubic meters ("bcm") of natural gas and approximately 10.5 million tons of liquid hydrocarbons. The payment for the license amounted to RR 6,425 million.

- The license area including the Gydanskoye field is located on the Gydan peninsula in close proximity to our Salmanovskoye (Utrenneye) field. As of 31 December 2017, the aggregate proved, probable and possible reserves of the field appraised under the PRMS reserve methodology totaled approximately 115 bcm of natural gas. The payment for the license amounted to RR 2,262 million.

Acquisition of a medium-scale LNG plant

In July 2017, NOVATEK acquired a 51% ownership interest in OOO Cryogas-Vysotsk for RR 1,583 million. Cryogas-Vysotsk is constructing the first train of a medium-scale LNG plant for natural gas liquefaction with annual capacity of 660 thousand tons, located at the port of Vysotsk on the Baltic Sea. The participants of Cryogas-Vysotsk exercise joint control over the entity. Therefore, the Group recognizes Cryogas-Vysotsk as a joint venture and accounts for its share under the equity method.

Increasing our resource base and production facilities in YNAO

In addition to expanding our resource base to implement our future LNG projects, we increased our resource base in the main region of our activities, YNAO, as well as purchased new producing fields in close proximity the Group's production facilities.

In February 2018, the Group won an auction held by the ALROSA group to purchase 100% participation interest equity stakes in companies Maretiom Investments Limited and Velarion Investments Limited, the owners of 100% participation interest equity stakes in AO Geotransgas and OOO Urengoyskaya gasovaya companiya, respectively, for RR 30.3 billion. Geotransgas and Urengoyskaya gasovaya companiya hold licenses for geological research works, exploration and production of hydrocarbons within the Beregovoy and Ust-Yamsoveyskiy license areas located in the YNAO, respectively. The transaction is planned to be closed in the nearest future.

In January 2018, the Group acquired a 100% participation interest in OOO Chernichnoye for RR 616 million. Chernichnoye is a holder of the license for geological research works, exploration and production of hydrocarbons within the Chernichniy license area located in the YNAO in close proximity to the Termokarstovoye field of our joint venture ZAO Terneftegas. As of 31 December 2017, the license area's reserves according to the Russian reserve classification B totaled 17.7 bcm of natural gas and 7.8 million tons of liquid hydrocarbons.

In December 2017, the Group acquired for RR 2,711 million (net of cash acquired) 100% ownerships in AO South-Khadyryakhinskoye and AO Eurotek, the holders of the licenses for exploration and production of hydrocarbons within the South-Khadyryakhinskiy and the Syskonsyninskiy license area, respectively. The South-Khadyryakhinskiy license area is located in close proximity to the infrastructure of our North-Khancheyskoye field in YNAO. The Syskonsyninskiy license area is located in the Khanty-Mansiysk Autonomous Region and is currently producing hydrocarbons. As of 31 December 2017, the aggregate proved, probable and possible reserves of these fields appraised under the PRMS reserve methodology totaled approximately 17.6 bcm of natural gas.

In December 2017, the Group's joint venture OOO SeverEnergia through its wholly owned subsidiary AO Arcticgas won an auction held by the Federal Agency for the Use of Natural Resources of the Russian Federation for geological research works, exploration and hydrocarbons production at the Osenniy license area. The license area is located in YNAO and borders with the Samburgskiy license area of Arcticgas. As of 31 December 2017, the license area's recoverable resources according to the Russian reserve classification D totaled 527 bcm of natural gas and approximately 120 million tons of liquid hydrocarbons. The payment for the license was set at RR 1,402 million.

In November 2017, the Group acquired a 100% ownership interest in OOO Severneft-Urengoy for RR 12,995 million (net of cash acquired). Severneft-Urengoy produces hydrocarbons at the West-Yaroyakhinsky license area located in Purovskiy region in YNAO in close proximity to the Group's infrastructure. As of 31 December 2017, the aggregate proved, probable and possible reserves of this field appraised under the PRMS reserve methodology totaled approximately 31 bcm of natural gas and approximately 3.3 million tons of liquid hydrocarbons.

International oil and gas projects

In January 2018, the Group, Total S.A. and Eni S.p.A., through their subsidiaries NOVATEK Lebanon SAL, Total E&P Liban SAL and Eni Lebanon B.V. (hereinafter referred to as the "Right holders"), entered into Exploration and Production Agreements for Petroleum Activities with the Lebanese Republic for the exploration and production of hydrocarbons on offshore blocks 4 and 9 located in the Eastern Mediterranean (hereinafter referred to as the "Exploration and Production Agreements"). The Exploration and Production Agreements stipulate that the Right holders are committed to undertake specified joint upstream activities during the exploration phase within five years. The Group is assigned a 20% participating interest, and Total E&P Liban SAL was appointed as the operator.

BASIS OF PRESENTATION

Certain changes have been made to the presentation of production and reserves volumes, as well as average realized prices and revenue streams in this report to conform to the reporting practices of the Group's domestic and international peers in the oil and gas industry. The comparative data for 2016 have been recalculated in accordance with this approach.

The natural gas production and reserves reported include volumes of natural gas consumed in oil and gas producing and development activities. Previously, such own use volumes were excluded. The approach to calculate lifting costs per unit of production has not changed: in deriving lifting costs per barrel of oil equivalent, production volumes net of the volume of natural gas consumed are taken.

The Group has also reassessed its share in the production and reserves of the South-Tambeyskoye field developed by the Group's joint venture Yamal LNG. In addition to the 50.1% ownership interest in Yamal LNG, the Group's reported share in the production and reserves in Yamal LNG now includes a 9.9% interest not owned by the Group, since the Group assumes certain economic and operational risks related to this interest.

Our oil and gas revenues and average realized prices are presented for each product category without split by geographic destination reflecting the prevailing industry practice of presenting upstream revenue and prices based on product origination rather than its final destination, and taking into account that the Group's production activities are currently concentrated in the Russian Federation.

SELECTED DATA

millions of Russian roubles except as stated	Year ended 31 December: 2017	2016	Change %
Financial results			
Total revenues (1)	583,186	537,472	8.5%
Operating expenses	(419,859)	(385,499)	8.9%
Normalized EBITDA (2),(3)	256,464	242,407	5.8%
Normalized profit attributable to shareholders of PAO NOVATEK (3)	156,387	200,118	(21.9%)
Normalized profit attributable to shareholders of PAO NOVATEK (3), excluding the effect of foreign exchange gains (losses) (4)	156,166	133,759	16.8%
Normalized earnings per share (3) (in Russian roubles)	51.85	66.30	(21.8%)
Normalized earnings per share (3), excluding the effect of foreign exchange gains (losses) (4) (in Russian roubles)	51.78	44.31	16.8%
Net debt (5)	89,807	168,464	(46.7%)
Production volumes (6)			
Hydrocarbons production (million barrels of oil equivalent)	513.3	547.0	(6.2%)
Daily production (million barrels of oil equivalent per day)	1.41	1.49	(5.9%)
Sales volumes			
Natural gas sales volumes (million cubic meters)	65,004	64,709	0.5%
Crude oil sales volumes (thousand tons)	4,616	4,650	(0.7%)
Naphtha sales volumes (thousand tons)	4,102	4,113	(0.3%)
Liquefied petroleum gas sales volumes (thousand tons)	2,648	2,713	(2.4%)
Other gas condensate refined products (thousand tons)	2,641	2,549	3.6%
Stable gas condensate sales volumes (thousand tons)	1,918	2,812	(31.8%)
Oil and gas SEC reserves (6)			
Total proved reserves (billion barrels of oil equivalent)	15.1	13.4	12.8%
Total natural gas proved reserves (trillion cubic meters)	2.10	1.85	13.5%
Total liquids proved reserves (million tons)	164	154	6.5%
Cash flow results			
Net cash provided by operating activities	180,399	173,791	3.8%
Cash used for capital expenditures (7)	29,871	33,905	(11.9%)
Free cash flow (8)	150,528	139,886	7.6%

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

(2) EBITDA represents profit (loss) adjusted for the add-back of depreciation, depletion and amortization, net impairment expenses (reversals), finance income (expense), income tax expense, as well as income (loss) from changes in fair value of derivative financial instruments. EBITDA includes EBITDA from subsidiaries and our proportionate share in the EBITDA of our joint ventures.

(3) Excluding the effect from the disposal of interests in joint ventures.

(4) Excluding the effect of foreign exchange gains (losses) of subsidiaries and our proportionate share in foreign exchange gains (losses) of our joint ventures (see "Profit attributable to shareholders and earnings per share" below).

(5) Net Debt represents our total debt net of cash and cash equivalents.

(6) Oil and gas production and reserves are calculated based on 100% of production and reserves of our subsidiaries and our proportionate share in the production and reserves of our joint ventures including fuel gas. Production and reserves of the South-Tambeyskoye field of Yamal LNG are reported at 60% (see "Basis of presentation" above). Figures for 2016 were recalculated accordingly.

(7) Cash used for capital expenditures represents purchases of property, plant and equipment, materials for construction and capitalized interest paid per Consolidated Statement of Cash Flows net of payments for mineral licenses and acquisition of subsidiaries.

(8) Free cash flow represents the difference between Net cash provided by operating activities and Cash used for capital expenditures.

Reconciliation of EBITDA and normalized EBITDA is as follows:

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Profit	**166,470**	**265,073**	**(37.2%)**
Depreciation, depletion and amortization	34,523	34,631	(0.3%)
Impairment expenses (reversals), net	52	178	(70.8%)
Loss (income) from changes in fair value of derivative financial instruments	9	1,778	(99.5%)
Total finance expense (income)	(14,658)	7,941	n/a
Total income tax expense	34,369	43,091	(20.2%)
Share of loss (profit) of joint ventures, net of income tax	(22,430)	(90,839)	(75.3%)
EBITDA from subsidiaries	**198,335**	**261,853**	**(24.3%)**
Share in EBITDA of joint ventures	**58,129**	**53,626**	**8.4%**
EBITDA	**256,464**	**315,479**	**(18.7%)**
Net gain on disposal of interests in joint ventures	-	(73,072)	n/a
Normalized EBITDA	**256,464**	**242,407**	**5.8%**
Normalized EBITDA from subsidiaries	**198,335**	**188,781**	**5.1%**

SELECTED MACRO-ECONOMIC DATA

Exchange rate, RR for one foreign currency unit [(1)]	1Q		2Q		3Q		4Q		Year		Change
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**Y-o-Y, %**
US dollar (USD)											
Average for the period	58.84	74.63	57.15	65.89	59.02	64.62	58.41	63.07	58.35	67.03	(12.9%)
At the beginning of the period	60.66	72.88	56.38	67.61	59.09	64.26	58.02	63.16	60.66	72.88	(16.8%)
At the end of the period	56.38	67.61	59.09	64.26	58.02	63.16	57.60	60.66	57.60	60.66	(5.0%)
Depreciation (appreciation) of RR to US dollar	(7.1%)	(7.2%)	4.8%	(5.0%)	(1.8%)	(1.7%)	(0.7%)	(4.0%)	(5.0%)	(16.8%)	n/a
Euro											
Average for the period	62.65	82.34	62.79	74.40	69.29	72.15	68.78	68.13	65.90	74.23	(11.2%)
At the beginning of the period	63.81	79.70	60.60	76.54	67.50	71.21	68.45	70.88	63.81	79.70	(19.9%)
At the end of the period	60.60	76.54	67.50	71.21	68.45	70.88	68.87	63.81	68.87	63.81	7.9%
Depreciation (appreciation) of RR to euro	(5.0%)	(4.0%)	11.4%	(7.0%)	1.4%	(0.5%)	0.6%	(10.0%)	7.9%	(19.9%)	n/a

(1) Based on the data from the Central Bank of Russian Federation (CBR). The average rates for the period are calculated as the average of the daily exchange rates on each business day (rate is announced by the CBR) and on each non-business day (rate is equal to the exchange rate on the previous business day).

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Average for the period	1Q		2Q		3Q		4Q		Year		Change
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**Y-o-Y, %**
Benchmark natural gas prices [(2)]											
NBP, USD per mmbtu	6.0	4.4	4.8	4.5	5.5	4.1	6.9	5.7	5.8	4.6	26.1%
Benchmark crude oil prices [(3)]											
Brent, USD per barrel	53.7	33.9	49.6	45.6	52.1	45.9	61.3	49.3	54.2	43.7	24.0%
Urals, USD per barrel	52.2	32.2	48.7	43.8	50.9	44.0	60.4	48.1	53.1	42.1	26.1%
Urals, RR per barrel	3,071	2,403	2,783	2,886	3,004	2,843	3,528	3,034	3,098	2,822	9.8%
Benchmark crude oil prices excluding export duties [(4)]											
Urals, USD per barrel	40.4	24.7	37.2	34.6	40.0	31.8	47.2	35.5	41.2	31.7	30.0%
Urals, RR per barrel	2,377	1,843	2,126	2,280	2,361	2,055	2,757	2,239	2,404	2,125	13.1%
Benchmark oil products [(5)] **and liquefied petroleum gas** [(6)] **prices, USD per ton**											
Naphtha Japan	497	345	445	411	468	389	570	450	495	399	24.1%
Naphtha CIF NWE	485	320	432	400	463	382	555	440	484	386	25.4%
Jet fuel	513	342	483	437	520	437	591	484	527	425	24.0%
Gasoil	481	310	446	410	476	409	545	453	488	396	23.2%
Fuel oil	318	147	300	215	305	249	351	288	319	225	41.8%
Liquefied petroleum gas	395	232	336	225	391	326	459	403	396	299	32.4%
Export duties, USD per ton [(7)]											
Crude oil, stable gas condensate	86.5	54.9	84.3	67.2	79.8	88.7	96.3	91.7	86.7	75.6	14.7%
Naphtha	47.6	39.0	46.3	47.6	43.8	62.9	52.9	65.0	47.7	53.6	(11.0%)
Jet fuel, gasoil	25.9	22.0	25.3	26.8	23.9	35.4	28.9	36.6	26.0	30.2	(13.9%)
Fuel oil	86.5	45.0	84.3	55.0	79.8	72.7	96.3	75.1	86.7	62.0	39.8%
Liquefied petroleum gas	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n/a

(2) Based on natural gas prices at the National Balancing Point (NBP), the natural gas hub in the United Kingdom.

(3) Based on Brent (dtd) and Russian Urals CIF Rotterdam spot assessments prices.

(4) Export duties per barrel were calculated based on export duties per ton divided by the coefficient 7.3.

(5) Based on Naphtha C+F (cost plus freight) Japan, Naphtha CIF NWE, Jet CIF NWE, Gasoil 0.1% CIF NWE, Fuel Oil 1.0% CIF NWE prices.

(6) Based on spot prices for propane-butane mix at the Belarusian-Polish border (DAF, Brest).

(7) Export duties are determined by the Russian Federation government in US dollars and are paid in Russian roubles (see "Our tax burden and obligatory payments" below).

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current economic conditions

Commodity price volatility continues to exert significant influence on financial and operational results in the global oil and gas industry. Our financial results are obviously impacted by these global developments as our export sales are linked to the specific underlying benchmark commodity prices but we believe our business model, representing one of the lowest cost producers in the world, insulates us from severe financial and operational stress. In each reporting period, the Group achieved strong operating results and remained free cash flow positive.

Management continues to closely monitor the economic and political environment in Russia and abroad, including the domestic and international capital markets, to determine if any further corrective and/or preventive measures are required to sustain and grow our business. We also closely monitor the present commodity price environment and its impact on our business operations. We do not expect any asset impairments or write-offs resulting from a lower commodity price environment.

We conduct regular reviews of our capital expenditure program and existing debt obligations. In our opinion, the Group's financial position is stable and expected operating cash flows are sufficient to service and repay our debt, as well as to execute our planned capital expenditure programs.

Political events in Ukraine in the beginning of 2014 have prompted a negative reaction by the world community, including economic sanctions levied by the United States of America, Canada and the European Union against certain Russian individuals and legal entities. In July 2014, NOVATEK was included on the OFAC's Sectoral Sanctions Identification List (the "List"), which imposed sanctions that prohibit individuals or legal entities registered or working on the territory of the United States from providing new credit facilities to the Group for longer than 60 days (prior to 28 November 2017, the aforementioned restrictions related to new credit facilities with maturity of more than 90 days). Despite the inclusion on the List, the Group may conduct any other activities, including financial transactions, with U.S. investors and partners. NOVATEK was included on the List even though the Group does not conduct any business activities in Ukraine, nor does it have any impact on the political and economic processes taking place in this country. Management has assessed the impact of the sanctions described above on the Group's activities taking into consideration the current state of the world economy, the condition of domestic and international capital markets, the Group's business, and long-term projects with foreign partners. We have concluded that the inclusion on the List does not significantly impede the Group's operations and business activities in any jurisdiction, nor does it affect the Group's assets and debt, and does not have a material effect on the Group's financial position.

We together with our international partners are undertaking all necessary actions to implement our joint investment projects on time as planned, including, but not limited to, attracting financing from domestic and non-US capital markets.

Natural gas prices

We sell most of our natural gas mainly through trunk pipelines to customers in the Russian domestic market. We also sell LNG purchased from our joint venture OAO Yamal LNG to international markets (starting from December 2017) and perform LNG regasification activity in Poland (we purchase LNG in Poland, regasify it at our own regasification station and sell natural gas to customers in Poland).

The Group's natural gas prices in Russia are strongly influenced by the prices set by the Federal Anti-Monopoly Service, a federal executive agency of the Russian Federation that carries out governmental regulation of prices and tariffs for products and services of natural monopolies in energy, utilities and transportation (the "Regulator"), as well as present market conditions.

In 2016 and during the first half of 2017, wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market remained unchanged. Effective 1 July 2017, the Regulator increased wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market by 3.9%.

In November 2017, the Ministry of Economic Development of the Russian Federation published the "Forecast of Socio-economic Development of the Russian Federation for 2018 and planned period 2019 and 2020" stating that wholesale natural gas prices for sales to all customer categories (excluding residential customers) will be increased from 1 July 2018, 2019 and 2020 by an average of 3.4%, 3.1% and 3.0%, respectively. The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth rates on the domestic market.

The specific terms for delivery of natural gas affect our average realized prices. The majority of our natural gas volumes are sold directly to end-customers in the regions of natural gas consumption, so transportation tariff to the end customer's location is included in the contract sales price. The remaining volumes of natural gas are sold "ex-field" to wholesale gas traders, in which case the buyer is responsible for the payment of further gas transportation tariff. Sales to wholesale gas traders allow us to diversify our natural gas sales without incurring additional commercial expenses.

We deliver natural gas to residential customers in the Chelyabinsk and Kostroma regions of the Russian Federation at regulated prices through our subsidiaries OOO NOVATEK-Chelyabinsk and OOO NOVATEK-Kostroma, respectively. We disclose such residential sales within our end-customers category.

In addition, we periodically sell natural gas at the Saint-Petersburg International Mercantile Exchange based on market conditions. We disclose such sales within our sales to end-customers category.

The Group's natural gas prices on international markets are influenced by many factors, such as the balance between supply and demand fundamentals, the geography of sales, the delivery terms and others. In 2017, the Group sold LNG on international markets under short-term contracts with prices based on the underlying benchmark prices for natural gas at the major natural gas hubs. The Group's prices for regasified LNG sold as natural gas on the Polish market are based on the prices regulated by the Energy Regulatory Office of Poland.

The following table shows our aggregate average realized natural gas sales prices on the domestic and international markets (excluding VAT, where applicable):

	Year ended 31 December:		Change
	2017	2016	%
Average natural gas price, RR per mcm	3,810	3,550	7.3%
Average natural gas price, USD per mcm [(1)]	65.3	53.0	23.2%

[(1)] Operations initially priced in Russian roubles were translated into US dollars using the average exchange rate for the period.

In 2017, our aggregate average price for natural gas sold in the Russian Federation and on the international markets increased by 7.3% due to an increase in the proportion of sales to more distant regions from our production fields, an increase in the regulated Russian domestic price by 3.9% effective 1 July 2017, as well as the commencement of LNG sales to international markets from December 2017.

Stable gas condensate and refined products, crude oil and liquefied petroleum gas prices

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

The actual prices we receive for our liquid hydrocarbons on both the domestic and international markets are dependent on many external factors beyond the control of management. Among many other factors volatile movements in benchmark crude oil and oil products prices can have a positive and/or negative impact on the contract prices we receive for our liquids sales volumes.

In addition, our actual realized net export prices for crude oil, stable gas condensate and its refined products are affected by the so-called "export duty lag effect". This effect is due to the differences between actual crude oil prices for a certain period and crude oil prices based on which export duty rate is calculated for the same period (see "Our tax burden and obligatory payments" below). In periods when crude oil prices are rising, the duty lag effect normally has a positive impact on the Group's financial results, as the export duty rates are set on the basis of lower crude oil prices compared to the actual prices. Conversely, in periods of crude oil prices decline, the export duty rate is calculated based on higher prices compared to the actual prices, which results in a negative financial impact.

Most of our liquid hydrocarbons sales prices on both the international and domestic markets include transportation expenses in accordance with the specific terms of delivery. The remaining portion of our liquids volumes is sold without additional transportation expenses (ex-works sales of liquefied petroleum gas from the Purovsky Plant and the Tobolsk Refining Facilities, as well as certain other types of sales).

We commonly sell our stable gas condensate and refined products, as well as liquefied petroleum gas to the international markets with a premium to the respective international benchmark reference products prices. We export SILCO (low-sulfur "Siberian Light Crude Oil") and ESPO ("East Siberia – Pacific Ocean") grades of crude oil to international markets with a premium or a discount to the benchmark Brent and Dubai crude oil depending on current market situation.

The following table shows our average realized net stable gas condensate and refined products, crude oil and LPG sales prices. Average realized net prices are shown net of VAT, export and import duties, excise and fuel taxes expense, where applicable:

Russian roubles or US dollars per ton (1)	Year ended 31 December: 2017	2016	Change %
Stable gas condensate			
Average net price, RR per ton	17,719	16,814	5.4%
Average net price, USD per ton	303	249	21.7%
Naphtha			
Average net price, RR per ton	27,301	25,067	8.9%
Average net price, USD per ton	467	373	25.2%
Other gas condensate refined products			
Average net price, RR per ton	25,899	22,240	16.5%
Average net price, USD per ton	443	332	33.4%
Crude oil			
Average net price, RR per ton	16,702	13,968	19.6%
Average net price, USD per ton	286	210	36.2%
LPG			
Average net price, RR per ton	15,116	11,669	29.5%
Average net price, USD per ton	259	174	48.9%

(1) Operations initially priced in Russian roubles were translated into US dollars using the average exchange rate for the period.

In 2017, our weighted-average realized net prices for our liquid hydrocarbons increased compared to 2016 due to an increase in the underlying benchmark prices for these products excluding export duties (see "Selected macro-economic data" above). Our weighted-average realized net prices in Russian roubles terms increased to a lesser extent compared to US dollar prices as a result of 12.9% Russian rouble appreciation relative to the US dollar in 2017 compared to 2016.

The dynamics of our weighted-average realized net prices for each product category also reflects changes in volumes sold within periods and changes in the geography of shipments which may significantly impact our average prices in periods of high benchmark prices volatility on international markets. In addition, specifics of pricing mechanism for each particular product (such as time lag of international benchmark crude oil prices and export duty rates used in price calculation, price setting on an individual transaction basis for some deliveries and others) also have an impact on the dynamics of our weighted-average realized net prices.

Transportation tariffs

Natural gas

We transport our natural gas within the Russian Federation territory through our own pipelines into the Unified Gas Supply System ("UGSS"), which is owned and operated by PAO Gazprom, a Russian Federation government controlled monopoly. Transportation tariffs charged to independent producers for the use of the Gas Transmission System ("GTS"), as part of the UGSS, are set by the Regulator (see "Terms and abbreviations" below).

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

In 2016 and 2017, the average tariff for natural gas transportation through the trunk pipeline did not change. The transportation rate amounted to RR 13.04 per mcm per 100 km (excluding VAT), and the rate for utilization of the trunk pipeline was set in the range from RR 62.57 to RR 2,014.16 per mcm (excluding VAT).

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in November 2017, the increase in tariffs for natural gas transportation through the trunk pipeline in 2018 to 2020 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth on the domestic market.

Stable gas condensate and LPG by rail

We transport stable gas condensate and LPG (excluding volumes sold ex-works from the Purovsky Plant and the Tobolsk Refining Facilities) by rail owned by Russia's state-owned monopoly railway operator – OAO Russian Railways ("RZD").

The railroad transportation tariffs are set by the Regulator and vary depending on the type of a product, direction and the length of the transport route. In addition, the Regulator sets the range of railroad tariffs as a percentage of the regulated tariff within which RZD may vary railroad transportation tariffs within the Russian Federation territory based on the type of product, direction and length of the transportation route taking into account current railroad transportation and market conditions.

Effective January 2017, railroad freight transportation tariffs for all types of hydrocarbons were increased by 6.1% relative to the 2016 tariffs and did not change until the end of 2017. In January 2018, the Regulator increased the aforementioned tariffs by 5.4% relative to the 2017 tariffs.

In 2016 and 2017, we applied the discount coefficient of 0.94 to the existing railroad transportation tariffs for stable gas condensate deliveries from the Limbey rail station to the port of Ust-Luga and to end-customers on the domestic and export markets. In December 2017, the discount co-efficient was extended until the end of 2018. The discount coefficient is set by the decision of the Management Board of RZD as part of the Strategic Partnership Agreement between the Group and RZD.

Stable gas condensate and refined products by tankers

We deliver part of our stable gas condensate and substantially all stable gas condensate refined products to international markets by chartered tankers via the port of Ust-Luga on the Baltic Sea. The tanker transportation cost is determined by standard shipping terms, the distance to the final port of destination, tanker availability and seasonality of deliveries.

Crude oil

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

Effective 1 January 2017, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 3.6% relative to the 2016 tariffs and remained unchanged until the end of 2017. Effective 1 January 2018, crude oil transportation tariffs were increased by an average of 3.9% compared to 2017 tariffs.

Our tax burden and obligatory payments

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 and obligatory payments to which we are subject include VAT, unified natural resources production tax ("UPT", commonly referred as "MET" – mineral extraction tax), export duties, property tax and social contributions to non-budget funds.

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

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

The tax maneuver in the oil and gas industry

In November 2014, as part of the tax maneuver in the oil and gas industry, a federal law №366-FZ "Concerning introducing changes to the second part of the Tax Code of the Russian Federation and certain legislative acts of the Russian Federation" was adopted which envisages the increase in national budgetary income as a result of the phased (during three years) increases in UPT rates with a simultaneous decrease in excise taxes and export duties (see below).

UPT – natural gas and gas condensate

In accordance with the Tax Code of the Russian Federation, the UPT rates for natural gas and gas condensate are calculated monthly according to a formula based on which the set base UPT rate is multiplied by the base value of a standard fuel equivalent and a coefficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field. In addition, the formula for gas condensate UPT rate is multiplied by an adjusting coefficient, and the UPT rate for natural gas also takes into account a parameter characterizing natural gas transportation costs (the latter was set at zero in both reporting periods and did not affect the UPT rate).

The base UPT rate is set at RR 35 per one thousand cubic meters of extracted natural gas and at RR 42 per one ton of extracted gas condensate. The base value of a standard fuel equivalent is calculated monthly and depends primarily on natural gas prices, Urals crude oil prices and crude oil export duty rate.

A coefficient characterizing the difficulty of extracting natural gas and gas condensate is defined as a minimum value from the coefficients characterizing either the reserves' depletion, the field's geographical location, the deposit's (or reservoir's) depth, assignment of the field to the regional gas supply chain or particular features of certain field deposits development.

In 2016, the adjusting coefficient used for the UPT rate calculation in relation to gas condensate produced at the Groups' fields was set at 5.5 and was increased to 6.5, or 18.2%, from 1 January 2017.

In November 2017, the Tax Code of the Russian Federation was amended allowing companies to apply a tax deduction on gas condensate produced for processing into natural gas liquids ("NGL") effective January 2018. The amount of the tax deduction is calculated monthly by multiplying a coefficient of NGL recovery from gas condensate processing, the quantity of gas condensate produced and processed, and the tax deduction rate in Russian roubles per ton of NGL derived. The tax deduction rate will be determined as a serial number of the respective month starting from January 2018 multiplied by RR 147 per ton, and, from January 2021, the tax deduction rate will be fixed at RR 5,280 per ton of NGL.

UPT – crude oil

In 2016, the UPT rate for crude oil was calculated as a product of a coefficient characterizing the dynamics of world crude oil prices and the base UPT rate adjusted for parameters characterizing crude oil production peculiarities at the particular area.

In 2017, as a result of the amendments to the Tax Code of the Russian Federation, the crude oil UPT rate calculated using the above formula was additionally increased by RR 306 per ton for all crude oil producers (in 2018, the increase is set at RR 357 per ton, and in 2019 and 2020 – RR 428 per ton).

The base crude oil UPT rate in 2016 was set at RR 857 per ton and was increased to RR 919 per ton effective 1 January 2017. In both reporting periods, in accordance with the Tax Code of the Russian Federation, we applied a reduced UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye and Yarudeyskoye fields since these fields are located fully or partially to the north of the 65th degree of the northern latitude fully or partially in the YNAO. Therefore, the adjusted base UPT rate for crude oil produced at these fields for the Group amounted to RR 298 per ton in 2016 and to RR 360 per ton effective 1 January 2017.

Export duties and excise taxes

According to the Law of the Russian Federation "On Customs Tariff" we are subject to export duties on our exports of liquid hydrocarbons (stable gas condensate and refined products, LPG and crude oil). Formulas for export duty rates calculation are set by the Russian Federation government. Based on the set formulas the Ministry of Economic Development calculates and publishes export duty rates on a monthly basis (see "Selected macro-economic data" above).

The export duty rate for stable gas condensate and crude oil for the next calendar month is calculated based on the average Urals crude oil price for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month. In 2016, the calculation of the export duty rate in US dollars per ton when the average Urals crude oil price is more than USD 182.5 per ton (or USD 25 per barrel) was set as follows: USD 29.2 plus 42% of the difference between the average Urals crude oil price and USD 182.5 per ton. As part of the tax maneuver in the oil and gas industry (see above), effective 1 January 2017, the set percentage was reduced to 30%.

The export duty rates for oil products is calculated based on the export duty rate for crude oil which is adjusted by a coefficient set for each category of oil products. The export duty rates for our exported gas condensate refined products as a percentage of the crude oil export duty rate are presented below:

% from the crude oil export duty rate	**2016**	**2017 and further**
Naphtha	71%	55%
Jet fuel	40%	30%
Gasoil	40%	30%
Fuel oil	82%	100%

The phased decrease in export duty rates for oil products (except fuel oil) is also implemented as part of the tax maneuver in the oil industry with a simultaneous increase in the UPT rates for gas condensate and crude oil (see above).

The export duty rate for LPG for the next calendar month is calculated based on the average LPG price at the Polish border (DAF, Brest) for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month. The formula for LPG export duty rate calculation is presented in the table below:

Average LPG price, USD per ton (P)	**Formula for export duty rate calculation**
less 490 (inclusive)	Zero rate
between 490 and 640 (inclusive)	0.5 × (P – 490)
between 640 and 740 (inclusive)	75 + 0.6 × (P – 640)
above 740	135 + 0.7 × (P – 740)

As the average LPG price for the export duty rate calculation was below USD 490 per ton, in both reporting periods, we applied a zero export duty rate in respect of our LPG export sales.

In accordance with the Tax Code of the Russian Federation, producers of excisable goods (petrol, diesel fuel, medium distillates and others) that sell those goods on the domestic market are subject to excise tax payments. The Group does not sell excisable goods of own production on the domestic market and, therefore, does not pay excise taxes in Russia.

Most of our LPG sales in Poland are subject to excise and fuel taxes in accordance with the local legislation. The amount of excise and fuel tax payments depends on the volume of excisable goods sold and the respective tax rates (the excise and fuel tax rates in both reporting periods amounted to 670 and 159.71 Polish zloty per ton, respectively).

Social contributions

In both reporting periods, the rates for social contributions to the Pension Fund of the Russian Federation, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund of the Russian Federation paid by the employer on behalf of employees were set at 22.0%, 5.1% and 2.9%, respectively (cumulatively 30.0%).

The employer applies the aforementioned rates for social contributions to the Pension Fund of the Russian Federation and the Social Insurance Fund of the Russian Federation until the annual income of an employee exceeds the maximum taxable base set by the Russian Federation government. For the portion of the annual income exceeding the maximum base the reduced rates are applied: 10.0% for the Pension Fund of the Russian Federation and nil for the Social Insurance Fund of the Russian Federation.

The rate for social contributions to the Federal Compulsory Medical Insurance Fund does not vary with the employee's annual income.

The table below provides for the rates and maximum taxable bases set by the Russian Federation government for social contributions in 2016, 2017 and 2018:

	2016		**2017**		**2018**	
	Base, RR thousand	**Rate, %**	**Base, RR thousand**	**Rate, %**	**Base, RR thousand**	**Rate, %**
Pension Fund of the Russian Federation	less 796 above 796	22.0% 10.0%	less 876 above 876	22.0% 10.0%	less 1,021 above 1,021	22.0% 10.0%
Federal Compulsory Medical Insurance Fund	No limit	5.1%	No limit	5.1%	No limit	5.1%
Social Insurance Fund of the Russian Federation	less 718 above 718	2.9% 0.0%	less 755 above 755	2.9% 0.0%	less 815 above 815	2.9% 0.0%

OIL AND GAS RESERVES

We do not file with the Securities and Exchange Commission ("SEC") nor are obliged to report our reserves in compliance with these standards. However, we have consistently disclosed proved oil and gas reserves as unaudited supplemental information in the Group's IFRS audited consolidated financial statements. The Group's total proved reserves, comprised of proved developed and proved undeveloped reserves, as of 31 December 2017 and 2016, are provided using the SEC reserves reporting classification. We also provide additional information about our hydrocarbon reserves based on the widely-industry accepted PRMS reserves reporting classification, which in addition to total proved reserves discloses information on our probable and possible reserves.

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

The Group's oil and gas estimation and reporting process involves an annual independent external appraisal, as well as internal technical appraisals of reserves. The internal technical appraisals of reserves are performed by the Group's qualified technical staff working directly with the oil and gas reserves and are periodically updated during the year based on evaluations of new wells, performance reviews, new technical information and other studies.

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

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

The approval of the final reserve estimates is the sole responsibility of the Group's senior management.

The information below about oil and gas production and reserves under SEC and PRMS reserve classifications is presented based on 100% of production and reserves attributable to all consolidated subsidiaries (whether or not wholly owned) and our proportionate share in the production and reserves in companies accounted for by the equity method based on our equity ownership interest, including volumes of natural gas consumed in oil and gas production and development activities (primarily, as fuel gas). Production and reserves of the South-Tambeyskoye field of Yamal LNG are reported at 60% including an additional 9.9% interest not owned by the Group, since the Group assumes certain economic and operational risks related to this interest (previously was reported at 50.1%). Production and reserves under SEC and PRMS reserve classifications for 2016 were recalculated accordingly.

The table below provides proved oil and gas reserves under SEC reserve classification in metric units and on a total barrel of oil equivalent basis:

	As of and for the years ended 31 December:		Change
	2017	2016 (1)	%
Natural gas, billions of cubic meters	**2,098**	**1,848**	**13.5%**
Subsidiaries	1,274	1,047	21.7%
Share in joint ventures	824	801	2.9%
Liquids, millions of metric tons	**164**	**154**	**6.5%**
Subsidiaries	83	73	13.7%
Share in joint ventures	81	81	0.0%
Combined reserves, millions of boe	**15,120**	**13,402**	**12.8%**
Production, millions of boe	513	547	(6.2%)
Acquisitions (2), millions of boe	1,543	-	n/a
Reserves replacement ratio (3), %	**435%**	**163%**	
Normalized reserves replacement ratio (4), %	**134%**	**163%**	

(1) As a result of changes in the presentation for natural gas production and reserves taking into account fuel gas, as well as the revision of our reported share in production and reserves of the South-Tambeyskoye field of Yamal LNG (see "Basis of presentation" above), our SEC proved natural gas and liquids reserves as at 31 December 2016 were increased by 93 bcm and 2 million of metric tons, respectively (in the aggregate by 627 million boe).

(2) Represent reserves obtained in 2017 through participation in auctions (Gydanskoye, Verhnetiuteyskoye and West-Seyakhinskoye fields) and asset acquisitions (South-Khadyryakhinskoye, Syskonsynyinskoye fields and West-Yaroyakhinskiy license area) (see "Recent Developments" above).

(3) The reserves replacement ratio is calculated as the change in reserves excluding production for the year and dividing the sum by production for the year.

(4) Excluding new licenses acquired in 2017 through tender auctions and asset acquisitions.

Our total proved reserves under SEC reserve classification as at the end of 2017 increased by 1,718 million boe, or 12.8%, to 15,120 million boe and the reserve replacement ratio amounted to 435%.

Additions to our hydrocarbons SEC proved reserves were primarily due to successful exploration works at our Kharbeyskoye, Salmanovskoye (Utrenneye) and West-Yurkharovskoye fields, at the Urengoyskoye field (Samburgskiy license area) of our joint venture SeverEnergia, as well as production drilling at the South-Tambeyskoye field of our joint venture Yamal LNG. Moreover, additions to our hydrocarbons reserves were significantly impacted by acquisitions in 2017 through tender auctions of new licenses for geological research works, exploration and hydrocarbons production at the Verhnetiuteyskoye, the West-Seyakhinskoye and the Gydanskoye fields, as well as acquisitions of 100% ownerships in OOO Severneft-Urengoy, AO South-Khadyryakhinskoye and AO Eurotek, the holders of the licenses for exploration and production of hydrocarbons within the West-Yaroyakhinsky, the South-Khadyryakhinskiy and the Syskonsynyinskiy license areas, respectively (see "Recent Developments" above). Excluding new licenses acquired, our total proved reserves increased by 1.3% and the reserves replacement ratio amounted to 134%.

The following table provides for the Group's PRMS proved, proved and probable, and proved, probable and possible reserves in metric units and on a total barrel of oil equivalent basis:

	Natural gas, billions of cubic meters		**Liquid hydrocarbons, millions of metric tons**		**Combined reserves, millions of boe**	
	31 December 2017	**31 December 2016**	**31 December 2017**	**31 December 2016**	**31 December 2017**	**31 December 2016[(1)]**
Proved reserves (1P reserves)	2,300	2,101	192	183	16,661	15,294
Proved and probable reserves (2P reserves)	3,879	3,218	366	322	28,471	23,769
Proved, probable and possible reserves (3P reserves)	4,876	3,835	509	444	36,196	28,801

[(1)] As a result of changes in the presentation of natural gas production and reserves taking into account fuel gas, as well as the revision of our reported share in production and reserves of South-Tambeyskoye field of Yamal LNG (see "Basis of presentation" above), our PRMS 1P, 2P and 3P reserves as at 31 December 2016 were increased by 764 million, 1,013 million and 1,171 million boe, respectively.

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

The below table contains information about reserve to production ratios as of 31 December 2017 and 2016 under both reserves reporting methodologies:

	SEC		**PRMS**	
	At 31 December:		**At 31 December:**	
Number of years	**2017**	**2016**	**2017**	**2016**
Total proved reserves to production	29	24	32	28
Total proved and probable reserves to production	-	-	55	43
Total proved, probable and possible reserves to production	-	-	71	53

OPERATIONAL HIGHLIGHTS

Oil and Gas Production Costs

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

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Production costs:			
Lifting costs	14,527	13,865	4.8%
Taxes other than income tax	48,842	43,844	11.4%
Transportation expenses	73,356	76,356	(3.9%)
Total production costs before DDA	**136,725**	**134,065**	**2.0%**
Depreciation, depletion and amortization ("DDA")	31,644	32,049	(1.3%)
Total production costs	**168,369**	**166,114**	**1.4%**

RR per boe [1]	Year ended 31 December: 2017	2016	Change %
Production costs:			
Lifting costs	44.3	38.4	15.4%
Taxes other than income tax	148.9	121.4	22.7%
Transportation expenses	223.6	211.3	5.8%
Total production costs before DDA	**416.8**	**371.1**	**12.3%**
Depreciation, depletion and amortization	96.5	88.7	8.8%
Total production costs	**513.3**	**459.8**	**11.6%**

USD per boe [1],[2]	Year ended 31 December: 2017	2016	Change %
Production costs:			
Lifting costs	0.76	0.57	33.3%
Taxes other than income tax	2.55	1.81	40.9%
Transportation expenses	3.83	3.16	21.2%
Total production costs before DDA	**7.14**	**5.54**	**28.9%**
Depreciation, depletion and amortization	1.66	1.32	25.8%
Total production costs	**8.80**	**6.86**	**28.3%**

(1) Natural gas production volumes used for calculation of production costs per boe differ from the volumes presented in the section "Natural gas production volumes" as the former excludes volumes of natural gas consumed in oil and gas production and development activities (see "Basis of presentation" above).

(2) Production costs in US dollars per boe were translated from Russian roubles per boe using the average exchange rate for the period (see "Selected macro-economic data" above).

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

Our lifting costs, as presented in the tables above, differ from lifting costs as reflected in the "Unaudited Supplemental Oil and Gas Disclosures", in that the lifting costs as presented in the Group's IFRS consolidated financial statements include changes in balances of natural gas and liquid hydrocarbons to more appropriately match costs incurred to revenues under the IFRS matching principles. A reconciliation of lifting costs as reflected in the "Unaudited Supplemental Oil and Gas Disclosures" is set forth below:

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Lifting costs presented in "Oil and Gas Production Costs" above	14,527	13,865	4.8%
Change in balances of natural gas and hydrocarbon liquids stated at cost in the Group's Consolidated Statement of Financial Position	(456)	368	n/a
Lifting costs per "Unaudited Supplemental Oil and Gas Disclosures"	**14,071**	**14,233**	**(1.1%)**

Hydrocarbon production and sales volumes

In 2017, our total natural gas sales volumes increased by 295 mmcm, or 0.5%, due to a slight increase in volumes sold in the Russian Federation, as well as the commencement of sales of LNG purchased from our joint venture Yamal LNG to international markets from December 2017. Natural gas volumes produced at mature fields of our subsidiaries and joint ventures decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons. The decrease was partially offset by the improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field, as well as the commencement of LNG production at the first LNG train at Yamal LNG in the fourth quarter of 2017.

In 2017, our liquids sales volumes decreased by 911 thousand tons, or 5.4%, mainly due to a decrease in gas condensate production at mature fields of our subsidiaries and joint ventures.

Natural gas production volumes

In 2017, our total natural gas production (including our proportionate share in the production of joint ventures) decreased by 4,248 mmcm, or 6.3%, to 63,399 mmcm from 67,647 mmcm in 2016. Our average daily production decreased by 11.1 mmcm, or 6.0%, to 173.7 mmcm per day.

	Year ended 31 December:		Change
millions of cubic meters if not stated otherwise	**2017**	**2016**	**%**
Production by subsidiaries from:			
Yurkharovskoye field	30,540	34,554	(11.6%)
East-Tarkosalinskoye field	7,379	8,305	(11.1%)
Khancheyskoye field	2,242	2,529	(11.3%)
Other fields	2,952	2,122	39.1%
Total natural gas production by subsidiaries (1)	**43,113**	**47,510**	**(9.3%)**
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	13,964	13,790	1.3%
Nortgas	4,291	5,064	(15.3%)
Terneftegas	1,255	1,185	5.9%
Yamal LNG (2)	776	98	n/a
Total Group's proportionate share in the natural gas production of joint ventures (1)	**20,286**	**20,137**	**0.7%**
Total natural gas production including proportionate share in the production of joint ventures	**63,399**	**67,647**	**(6.3%)**
Average daily natural gas production including proportionate share in the production of joint ventures	*173.7*	*184.8*	*(6.0%)*
The Group's proportionate share in LNG production of joint ventures (thousands of tons) (2)	*162*	*-*	*n/a*

(1) Natural gas production includes natural gas volumes consumed in oil and gas production and development activities (primarily, as fuel gas).

in subsidiaries	1,382	1,275	8.4%
in joint ventures (Group's proportionate share)	307	269	14.1%

Production for 2016 was recalculated accordingly.

(2) Natural gas and LNG production at Yamal LNG are reported at 60% (see "Basis of presentation" above).

In 2017, our natural gas volumes produced at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint venture Nortgas decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons. The decrease was partially offset by improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field, as well as the commencement of natural gas production for subsequent liquefaction at Yamal LNG at the end of 2017.

Natural gas sales volumes

In 2017, our total natural gas sales volumes increased by 295 mmcm, or 0.5%, to 65,004 mmcm from 64,709 mmcm in 2016.

millions of cubic meters	**Year ended 31 December: 2017**	**2016**	**Change %**
Production by subsidiaries	43,113	47,510	(9.3%)
Purchases from the Group's joint ventures	15,297	10,058	52.1%
Other purchases	8,300	8,108	2.4%
Total production and purchases	**66,710**	**65,676**	**1.6%**
Own usage [(1)]	(1,507)	(1,460)	3.2%
Decrease (increase) in natural gas inventory balance	(199)	493	n/a
Total natural gas sales volumes in the Russian Federation	**65,004**	**64,709**	**0.5%**
Sold to end-customers	*61,560*	*59,646*	*3.2%*
Sold ex-field	*3,338*	*5,063*	*(34.1%)*
Subtotal sold in the Russian Federation	***64,898***	***64,709***	***0.3%***
Sold on international markets	***106***	***-***	***n/a***

[(1)] Own usage associated primarily with volumes of natural gas consumed in oil and gas producing and development activities (primarily, as fuel gas), the maintaining of refining process at the Purovsky Plant, and methanol production.

In 2017, natural gas purchases from our joint ventures increased by 5,239 mmcm, or 52.1%, to 15,297 mmcm from 10,058 mmcm in 2016 primarily due to an increase in purchases of natural gas from SeverEnergia (through its wholly owned subsidiary, AO Arcticgas) and Nortgas in order to fulfill our contractual sales obligations, as well as the commencement of purchases of LNG produced at Yamal LNG for sale on international markets from December 2017.

Other natural gas purchases increased by 192 mmcm, or 2.4%, to 8,300 mmcm from 8,108 mmcm in 2016, and are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize end-customers portfolios.

As of 31 December 2017, our cumulative natural gas inventory balance, representing our inventory balances in the GTS, the UGSF and our own pipeline infrastructure, aggregated 1,033 mmcm and increased by 199 mmcm during the year as compared to a decreased by 493 mmcm in 2016.

Liquids production volumes

In 2017, our total liquids production (including our proportionate share in the production of joint ventures) decreased by 667 thousand tons, or 5.4%, to 11,774 thousand tons from 12,441 thousand tons in 2016. Our average daily production decreased by 1.7 thousand tons, or 5.1%, to 32.3 thousand tons per day.

thousands of tons	**Year ended 31 December: 2017**	**2016**	**Change %**
Production by subsidiaries from:			
Yarudeyskoye field	3,596	3,556	1.1%
Yurkharovskoye field	1,489	1,813	(17.9%)
East-Tarkosalinskoye field	1,291	1,354	(4.7%)
Khancheyskoye field	274	353	(22.4%)
Other fields	109	118	(7.6%)
Total liquids production by subsidiaries	**6,759**	**7,194**	**(6.0%)**
including crude oil	*4,779*	*4,784*	*(0.1%)*
including gas condensate	*1,980*	*2,410*	*(17.8%)*
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	4,190	4,300	(2.6%)
Terneftegas	421	428	(1.6%)
Nortgas	379	519	(27.0%)
Yamal LNG [(1)]	25	-	n/a
Total Group's proportionate share in the liquids production of joint ventures	**5,015**	**5,247**	**(4.4%)**
Total liquids production including proportionate share in the production of joint ventures	**11,774**	**12,441**	**(5.4%)**
Average daily liquids production including proportionate share in the production of joint ventures	*32.3*	*34.0*	*(5.1%)*

(1) Production at South-Tambeyskoye field of Yamal LNG is reported at 60% (see "Basis of presentation" above).

In 2017, the volumes of liquids produced by subsidiaries and joint ventures decreased as a result of a decrease in gas condensate production mainly at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and at our joint ventures Nortgas and SeverEnergia due to the natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons. Crude oil production changed insignificantly.

Liquids sales volumes

In 2017, our total liquids sales volumes decreased by 911 thousand tons, or 5.4%, to 15,939 thousand tons from 16,850 thousand tons in 2016.

thousands of tons	**Year ended 31 December: 2017**	**2016**	**Change %**
Production by subsidiaries	6,759	7,194	(6.0%)
Purchases from the Group's joint ventures	9,315	9,809	(5.0%)
Other purchases	173	124	39.5%
Total production and purchases	**16,247**	**17,127**	**(5.1%)**
Losses [(1)] and own usage [(2)]	(249)	(284)	(12.3%)
Decreases (increases) in liquids inventory balances	(59)	7	n/a
Total liquids sales volumes	**15,939**	**16,850**	**(5.4%)**
Naphtha export	*4,102*	*4,113*	*(0.3%)*
Other gas condensate refined products export [(3)]	*2,524*	*2,430*	*3.9%*
Other gas condensate refined products domestic [(3)]	*117*	*119*	*(1.7%)*
Subtotal gas condensate refined products	***6,743***	***6,662***	***1.2%***
Crude oil export	*1,523*	*1,472*	*3.5%*
Crude oil domestic	*3,093*	*3,178*	*(2.7%)*
Subtotal crude oil	***4,616***	***4,650***	***(0.7%)***
LPG export	*536*	*549*	*(2.4%)*
LPG domestic	*2,112*	*2,164*	*(2.4%)*
Subtotal LPG	***2,648***	***2,713***	***(2.4%)***
Stable gas condensate export	*342*	*1,305*	*(73.8%)*
Stable gas condensate domestic	*1,576*	*1,507*	*4.6%*
Subtotal stable gas condensate	***1,918***	***2,812***	***(31.8%)***
Other oil products	***14***	***13***	***7.7%***

(1) Losses associated with processing at the Purovsky Plant, the Ust-Luga Complex and the Tobolsk Refining Facilities, as well as during railroad, trunk pipeline and tanker transportation.

(2) Own usage associated primarily with the maintaining of refining process at the Ust-Luga Complex, as well as bunkering of chartered tankers.

(3) Other gas condensate refined products include jet fuel, gasoil and fuel oil received from the processing of stable gas condensate at the Ust-Luga Complex.

In 2017, our purchases of liquid hydrocarbons from joint ventures decreased by 494 thousand tons, or 5.0%, due to a decrease in purchases of gas condensate from Nortgas and SeverEnergia (see "Liquids production volumes" above).

Our sales volumes of naphtha and other gas condensate refined products fluctuate from period-to-period depending on changes in inventory balances, with volumes of the products received from processing at the Ust-Luga Complex staying relatively flat. Our sales volumes of stable gas condensate represent the volumes remaining after we deliver most of our stable gas condensate for further processing to our Ust-Luga Complex.

In 2017, our liquids inventory balances increased by 59 thousand tons to 962 thousand tons as of 31 December 2017 as compared to a decrease in inventory balances by seven thousand tons to 903 thousand tons in 2016. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

RESULTS OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 2017 COMPARED TO THE YEAR ENDED 31 DECEMBER 2016

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2017 and 2016. Each line item is also shown as a percentage of our total revenues.

	Year ended 31 December:			
millions of Russian roubles	**2017**	**% of total revenues**	**2016**	**% of total revenues**
Total revenues [1]	**583,186**	***100.0%***	**537,472**	***100.0%***
including:				
natural gas sales	247,663	*42.5%*	229,716	*42.7%*
liquids sales	332,156	*57.0%*	304,141	*56.6%*
Operating expenses	(419,859)	*(72.0%)*	(385,499)	*(71.7%)*
Other operating income (loss)	424	*0.1%*	221	*0.0%*
Profit from operations before disposals of interests in joint ventures	**163,751**	***28.1%***	**152,194**	***28.3%***
Net gain on disposal of interests in joint ventures	-	*n/a*	73,072	*13.6%*
Profit from operations	**163,751**	***28.1%***	**225,266**	***41.9%***
Finance income (expense)	14,658	*2.5%*	(7,941)	*(1.5%)*
Share of profit (loss) of joint ventures, net of income tax	22,430	*3.8%*	90,839	*16.9%*
Profit before income tax	**200,839**	***34.4%***	**308,164**	***57.3%***
Total income tax expense	(34,369)	*(5.9%)*	(43,091)	*(8.0%)*
Profit	**166,470**	***28.5%***	**265,073**	***49.3%***
Less: profit (loss) attributable to non-controlling interest	(10,083)	*(1.7%)*	(7,278)	*(1.3%)*
Profit attributable to shareholders of PAO NOVATEK	**156,387**	***26.8%***	**257,795**	***48.0%***
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	**156,166**	***26.8%***	**133,759**	***24.9%***

[1] Net of VAT, export and import duties, excise and fuel taxes expense, where applicable.

Total revenues

The following table sets forth our sales (excluding VAT, export duties, excise and fuel taxes expense, where applicable) for the years ended 31 December 2017 and 2016:

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %	Change [(1)] Total	Due to volume [(2)]	Due to price [(3)]
Natural gas sales	247,663	229,716	7.8%	17,947	1,047	16,900
Gas condensate refined products sales	180,394	159,799	12.9%	20,595	1,763	18,832
Naphtha	*111,979*	*103,103*	*8.6%*	*8,876*	*(290)*	*9,166*
Other refined products	*68,415*	*56,696*	*20.7%*	*11,719*	*2,053*	*9,666*
Crude oil sales	77,102	64,952	18.7%	12,150	(472)	12,622
Liquefied petroleum gas sales	40,016	31,652	26.4%	8,364	(761)	9,125
Stable gas condensate sales	33,993	47,271	(28.1%)	(13,278)	(15,015)	1,737
Other products sales	651	467	39.4%	184	n/a	n/a
Total oil and gas sales	**579,819**	**533,857**	**8.6%**	**45,962**	**n/a**	**n/a**
Other revenues	3,367	3,615	(6.9%)	(248)	n/a	n/a
Total revenues	**583,186**	**537,472**	**8.5%**	**45,714**	**n/a**	**n/a**

(1) The figures reflect the impact of sales volumes and average realized net prices factors on the change in total revenues from hydrocarbons sales in millions of Russian roubles for the respective periods.

(2) The amount of the change in total revenues due to sales volumes is calculated for each product category as a product of the average realized net price for the previous reporting period and the change in sales volumes.

(3) The amount of the change in total revenues due to average realized net prices is calculated for each product category as a product of the volume sold in the current reporting period and the change in average realized net prices.

Natural gas sales

Revenues from natural gas sales represent our revenues from natural gas sales in the Russian Federation (to end-customers and wholesale traders), revenues from LNG sales to international markets, as well as revenues from sales of regasified LNG to customers in Poland through our wholly owned subsidiary, Blue Gaz Sp. z o.o. In 2017, our total revenues from natural gas sales increased by RR 17,947 million, or 7.8%, compared to 2016.

In 2017, our aggregate average price for natural gas sold in the Russian Federation and on the international markets increased by 7.3% due to an increase in the proportion of sales to more distant regions from our production fields, an increase in the regulated Russian domestic price by 3.9% effective 1 July 2017, and the commencement of LNG sales to international markets from December 2017 (see "Natural gas prices" above).

In 2017, our total natural gas sales volumes increased by 295 mmcm, or 0.5%, to 65,004 mmcm from 64,709 mmcm in 2016 as a result of a slight increase in volumes sold in the Russian Federation, as well as the commencement of LNG sales, purchased from Yamal LNG, to international markets from December 2017 (see "Natural gas sales volumes" above).

Gas condensate refined products sales

Gas condensate refined products sales represent revenues from sales of naphtha, jet fuel, gasoil and fuel oil produced from our stable gas condensate at the Ust-Luga Complex.

In 2017, our revenues from sales of gas condensate refined products increased by RR 20,595 million, or 12.9%, to 180,394 million from 159,799 million in 2016 primarily due to an increase in average realized net prices.

In 2017, our revenues from sales of naphtha increased by RR 8,876 million, or 8.6%, as compared to 2016. In the years ended 31 December 2017 and 2016, we exported 4,102 thousand and 4,113 thousand tons of naphtha, respectively. Nearly all our naphtha volumes were sold to the APR, and the European and North America markets. We sold naphtha at different delivery terms: DAP (only in 2017), CFR, CIF, DES and FOB. Our average realized net price, excluding export duties, where applicable, increased by RR 2,234 per ton, or 8.9%, to RR 27,301 per ton from RR 25,067 per ton in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In 2017, our total revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 11,719 million, or 20.7%, as compared to 2016. In the years ended 31 December 2017 and 2016, we exported in aggregate 2,524 thousand and 2,430 thousand tons of these products to the European markets, or 95.6% and 95.3% of total sales volumes (on the domestic and export markets), respectively. In both reporting periods, the export delivery terms were CIF, DAP, DES and FOB. Our average realized net price, excluding export duties, where applicable, increased by RR 3,659 per ton, or 16.5%, to RR 25,899 per ton from RR 22,240 per ton in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Crude oil sales

In 2017, our revenues from crude oil sales increased by RR 12,150 million, or 18.7%, compared to 2016 due to an increase in average realized prices while sales volumes remained relatively flat.

In 2017, we sold 3,093 thousand tons, or 67.0% of our total crude oil sales volumes, domestically as compared to sales of 3,178 thousand tons, or 68.3%, in 2016. The remaining 1,523 thousand tons of crude oil, or 33.0% of our total crude oil sales volumes in 2017, and 1,472 thousand tons, or 31.7%, in 2016 were sold to the European, the APR and the North America (only in 2016) markets under FOB and FCA (only in 2017) delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 2,734 per ton, or 19.6%, to RR 16,702 per ton from RR 13,968 per ton in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Liquefied petroleum gas sales

In 2017, our revenues from sales of LPG increased by RR 8,364 million, or 26.4%, compared to 2016 due to an increase in average realized prices.

In 2017, we sold 2,112 thousand tons of LPG, or 79.8% of our total LPG sales volumes, on the domestic market compared to sales of 2,164 thousand tons, or 79.8%, in 2016. The remaining 536 thousand tons of LPG, or 20.2% of our total LPG sales volumes, in 2017 and 549 thousand tons of LPG, or 20.2%, in 2016 were sold to the European markets (primarily to the Polish market) under DAP (at the border of the customer's country) or free carrier FCA (at terminal points in Poland and at the Limbey rail station in 2016) delivery terms.

Our average realized LPG net price, excluding export and import duties, excise and fuel taxes expense, where applicable, in 2017 increased by RR 3,447 per ton, or 29.5%, to RR 15,116 per ton from RR 11,669 per ton in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Stable gas condensate sales

In 2017, our revenues from sales of stable gas condensate decreased by RR 13,278 million, or 28.1%, compared to 2016 due to a decrease in export sales volumes (see "Liquids sales volumes" above) that was partially offset by an increase in average realized net prices.

In 2017, we sold 1,576 thousand tons of stable gas condensate, or 82.2% of our total stable gas condensate sales volumes, on the domestic market compared to sales of 1,507 thousand tons, or 53.6%, in 2016. The remaining 342 thousand tons of stable gas condensate, or 17.8% of our total stable gas condensate sales volumes, in 2017 and 1,305 thousand tons, or 46.4%, in 2016 we sold to the European markets and the APR under DAP, CIF, CFR and DES (only in 2016) delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 905 per ton, or 5.4%, to RR 17,719 per ton from RR 16,814 per ton in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Other products sales

Other products sales represent our revenues from the domestic sales of purchased oil products (diesel fuel and petrol) through our retail stations, sales of other purchased liquid hydrocarbons, and sales of our produced methanol. In 2017, our revenues from other products sales increased by RR 184 million, or 39.4%, to RR 651 million from RR 467 million in 2016.

Other revenues

Other revenues include revenue from transportation, geological and geophysical research services, repair and maintenance of energy equipment services, and other services. In 2017, other revenues decreased by RR 248 million, or 6.9%, to RR 3,367 million from RR 3,615 million in 2016 primarily due to a decrease in revenues from tankers transporting third party goods by RR 1,028 million. At the same time, in 2017, other revenue from power generation services, as well as repair and maintenance of energy equipment services provided by our subsidiary NOVATEK-Energo increased by RR 644 million.

Operating expenses

In 2017, our total operating expenses increased by RR 34,360 million, or 8.9%, to RR 419,859 million compared to RR 385,499 million in 2016. Our total operating expenses as a percentage of total revenues increased marginally from 71.7% to 72.0%.

	Year ended 31 December:			
millions of Russian roubles	**2017**	**% of total revenues**	**2016**	**% of total revenues**
Purchases of natural gas and liquid hydrocarbons	161,443	*27.7%*	134,268	*25.0%*
Transportation expenses	137,192	*23.5%*	133,462	*24.8%*
Taxes other than income tax	49,494	*8.5%*	44,053	*8.2%*
Depreciation, depletion and amortization	34,523	*5.9%*	34,631	*6.4%*
Materials, services and other	20,768	*3.6%*	19,133	*3.6%*
General and administrative expenses	17,170	*2.9%*	18,126	*3.4%*
Exploration expenses	1,819	*0.3%*	2,087	*0.4%*
Impairment expenses (reversals), net	52	*n/a*	178	*n/a*
Changes in natural gas, liquid hydrocarbons and work-in-progress	(2,602)	*n/a*	(439)	*n/a*
Total operating expenses	**419,859**	***72.0%***	**385,499**	***71.7%***

Purchases of natural gas and liquid hydrocarbons

In 2017, our purchases of natural gas and liquid hydrocarbons increased by RR 27,175 million, or 20.2%, to RR 161,443 million from RR 134,268 million in 2016.

	Year ended 31 December:		Change
millions of Russian roubles	**2017**	**2016**	**%**
Unstable gas condensate	107,082	93,854	14.1%
Natural gas	51,053	38,119	33.9%
Other hydrocarbons	3,308	2,295	44.1%
Total purchases of natural gas and liquid hydrocarbons	**161,443**	**134,268**	**20.2%**

In 2017, our purchases of unstable gas condensate from our joint ventures increased by RR 13,228 million, or 14.1%, as compared to 2016 due to an increase in purchase prices, which are impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

In 2017, our purchases of natural gas increased by RR 12,934 million, or 33.9%, as compared to 2016 mainly due to an increase in purchases from SeverEnergia (its wholly owned subsidiary, AO Arcticgas) and Nortgas in order to fulfill our contractual sales obligations on the domestic market. In addition, our purchases of natural gas increased due to an increase in purchase prices on the domestic market that are influenced by the regulated natural gas prices (see "Prices for natural gas sold in the Russian Federation" above). Moreover, in December 2017, we commenced purchases of LNG from Yamal LNG for subsequent resale to the international markets.

Other hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products. In 2017, our purchases of other hydrocarbons increased by RR 1,013 million, or 44.1%, as compared to 2016 mainly due to an increase in volumes of LPG purchases for subsequent small volume wholesale and retail sales.

Transportation expenses

In 2017, our total transportation expenses increased by RR 3,730 million, or 2.8%, to RR 137,192 million as compared to RR 133,462 million in 2016.

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Natural gas transportation by trunk and low-pressure pipelines	93,686	84,808	10.5%
Stable gas condensate and liquefied petroleum gas transportation by rail	29,832	31,838	(6.3%)
Crude oil transportation by trunk pipelines	7,622	6,654	14.5%
Gas condensate refined products, stable gas condensate and crude oil transportation by tankers	5,980	9,997	(40.2%)
Other	72	165	(56.4%)
Total transportation expenses	**137,192**	**133,462**	**2.8%**

In 2017, our expenses for natural gas transportation increased by RR 8,878 million, or 10.5%, to RR 93,686 million from RR 84,808 million in 2016 due to a 3.2% increase in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current period as compared to the previous year.

In 2017, our total expenses for stable gas condensate and LPG transportation by rail decreased by RR 2,006 million, or 6.3%, to RR 29,832 million from RR 31,838 million in 2016 due to a 8.1% decrease in volumes of liquids sold and transported via rail. The weighted average transportation cost per unit increased by 2.0%: an increase in the regulated railroad transportation tariffs effective January 2017 (see “Transportation tariffs” above) was partially offset by a 12.9% appreciation of the average exchange rate of the Russian rouble relative to the US dollar since part of our expenses for LPG transportation by rail are US dollar denominated.

In 2017, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 968 million, or 14.5%, to RR 7,622 million from RR 6,654 million in 2016. The increase was due to an increase in the proportion of crude oil sales to more distant regions from our production fields, as well as a 3.6% increase in the regulated transportation tariffs effective 1 January 2017 (see “Transportation tariffs” above).

In 2017, our total transportation expenses for liquids delivered by tankers to international markets decreased by RR 4,017 million, or 40.2%, to RR 5,980 million from RR 9,997 million in 2016. The decrease was due to a 10.2% decrease in volumes of liquids sold and transported via tankers, a 12.9% appreciation of the average exchange rate of the Russian rouble relative to the US dollar (since all our tankers transportation expenses are US dollar denominated), as well as changes in the geography of shipments. In the current reporting period, our share of volumes shipped to the European and North America markets with lower transportation costs increased by 7.3%, and, correspondingly, the share of volumes shipped to the APR decreased.

Taxes other than income tax

In 2017, taxes other than income tax increased by RR 5,441 million, or 12.4%, to RR 49,494 million from RR 44,053 million in 2016.

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Unified natural resources production tax (UPT)	45,459	40,997	10.9%
Property tax	3,673	2,793	31.5%
Other taxes	362	263	37.6%
Total taxes other than income tax	**49,494**	**44,053**	**12.4%**

In 2017, our unified natural resources production tax expense increased by RR 4,462 million, or 10.9%, to RR 45,459 million from RR 40,997 million in 2016 mainly due to an increase in UPT rates for crude oil and gas condensate effective 1 January 2017 as part of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above).

In 2017, our property tax expense increased by RR 880 million, or 31.5%, to RR 3,673 million from RR 2,793 million in 2016 due to the termination of a property tax relief at one of our processing subsidiaries effective from January 2017, as well as a result of additions to property, plant and equipment at our production subsidiaries.

Depreciation, depletion and amortization

In 2017, our depreciation, depletion and amortization ("DDA") expense changed marginally (decreased by RR 108 million, or 0.3%) as a result of the offsetting effects of two factors: natural declines in natural gas and liquid hydrocarbons production at mature fields of our subsidiaries, on the one hand, and additions of property, plant and equipment at our fields, on the other hand.

We accrue depreciation and depletion on oil and gas assets using the "units-of-production" method and straight-line method for other facilities. Our reserve base is only appraised on an annual basis as of 31 December and does not fluctuate during the year until the subsequent appraisal, whereas our depletable cost base does change each quarter due to the ongoing capitalization of our costs throughout the year.

Materials, services and other

In 2017, our materials, services and other expenses increased by RR 1,635 million, or 8.5%, to RR 20,768 million compared to RR 19,133 million in 2016.

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Employee compensation	9,032	7,558	19.5%
Repair and maintenance	2,853	3,026	(5.7%)
Materials and supplies	1,966	1,838	7.0%
Complex of services for preparation, transportation and processing of hydrocarbons	1,914	2,062	(7.2%)
Electricity and fuel	1,221	1,101	10.9%
Liquefied petroleum gas volumes reservation expenses	918	1,017	(9.7%)
Fire safety and assets security expenses	749	660	13.5%
Transportation services	727	641	13.4%
Rent expenses	308	257	19.8%
Insurance expense	307	372	(17.5%)
Other	773	601	28.6%
Total materials, services and other	**20,768**	**19,133**	**8.5%**

Operating employee compensation increased by RR 1,474 million, or 19.5%, to RR 9,032 million compared to RR 7,558 million in 2016. The increase was due to an increase in the average number of employees (primarily due to the development of our activities at the Yarudeyskoye field, which was launched in December 2015, as well as at our service subsidiary NOVATEK-Energo), an indexation of base salaries effective from 1 July 2017 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Repair and maintenance services expenses decreased by RR 173 million, or 5.7%, to RR 2,853 million in 2017 compared to RR 3,026 million in 2016 due to a decrease in repair and maintenance works performed on wells and production facilities at our core production subsidiaries. Repair expenses fluctuate period-to-period depending on the assets repair schedule at our production subsidiaries.

Materials and supplies expenses increased by RR 128 million, or 7.0%, to RR 1,966 million in 2017 compared to RR 1,838 million in 2016 primarily due to increased volume of power generation at our service subsidiary NOVATEK-Energo for our joint ventures and a resultant increase of raw materials consumed.

Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our LPG produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses decreased by RR 148 million, or 7.2%, to RR 1,914 million in 2017 compared to RR 2,062 million in 2016 primarily due to a decrease in the contract rate for services at the Tobolsk Refining Facilities from January 2017.

In 2017, electricity and fuel expenses increased by RR 120 million, or 10.9%, to RR 1,221 million from RR 1,101 million in 2016 primarily due to higher electricity prices.

In 2017, liquefied petroleum gas volumes reservation costs decreased by RR 99 million, or 9.7%, to RR 918 million from RR 1,017 million in 2016 primarily as a result of the average Russian rouble appreciation relative to the Polish zloty, since this expense is denominated in Polish zloty. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

Other items of our materials, services and other expenses changed marginally.

General and administrative expenses

In 2017, our general and administrative expenses decreased by RR 956 million, or 5.3%, to RR 17,170 million compared to RR 18,126 million in 2016. The main components of these expenses were employee compensation and social expenses and compensatory payments, which, on aggregate, comprised 80.4% and 80.1% of total general and administrative expenses in the years ended 31 December 2017 and 2016, respectively.

	Year ended 31 December:		**Change**
millions of Russian roubles	**2017**	**2016**	**%**
Employee compensation	11,065	12,327	(10.2%)
Social expenses and compensatory payments	2,735	2,184	25.2%
Legal, audit and consulting services	839	1,019	(17.7%)
Business travel expense	560	624	(10.3%)
Fire safety and security expenses	419	387	8.3%
Advertising expenses	410	370	10.8%
Repair and maintenance expenses	231	200	15.5%
Rent expense	90	214	(57.9%)
Other	821	801	2.5%
Total general and administrative expenses	**17,170**	**18,126**	**(5.3%)**

Employee compensation relating to administrative personnel decreased by RR 1,262 million, or 10.2%, to RR 11,065 million in 2017 from RR 12,327 million in 2016 mainly due to a decrease in accrued provision for bonuses to key management.

In 2017, our social expenses and compensatory payments increased by RR 551 million, or 25.2%, to RR 2,735 million compared to RR 2,184 million in 2016 mainly due to an increase in compensatory payments. These payments in both years mainly related to the development of the Yarudeyskoye field and amounted to RR 1,466 million in 2017 compared to RR 1,029 million in 2016. In addition, social expenses increased due to continued support of charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

Exploration expenses

In 2017, our exploration expenses decreased by RR 268 million, or 12.8%, to RR 1,819 million from RR 2,087 million in 2016 and mainly related to exploration works performed at the Trekhbugorniy and the North-Obskiy license areas in both periods, as well as at the Gydanskiy, the Verhnetiuteyskiy and the West-Seyakhinskiy license areas in 2017 and at the Nyakhartinskiy license area in 2016. Exploration expenses include geological and geophysical research services expenditures, expenditures associated with the maintenance of license areas with non-proven reserves and other expenditures relating to exploration activity, as well as expenses of our science and technology center associated with the exploration activities at our fields. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

Impairment expenses

In 2017, we recognized a net impairment expense of RR 52 million as compared to RR 178 million in 2016, which in both reporting periods related primarily to trade accounts receivable.

Changes in natural gas, liquid hydrocarbons and work-in-progress

In 2017, we recorded a reversal of RR 2,602 million to changes in inventory expense due to an increase in gas condensate refined products and natural gas inventory balances as of 31 December compared to 1 January, and an increase in the cost of liquid hydrocarbons mainly resulted from the increase in UPT rates for gas condensate and crude oil (see "Our tax burden and obligatory payments" above). In 2016, gas condensate refined products inventory balances also increased as of 31 December compared to 1 January, while other liquid hydrocarbons and natural gas inventory balances decreased, which in aggregate resulted in a reversal of RR 439 million to changes in inventory expense.

In 2017, our cumulative natural gas inventory balance in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure increased by 199 mmcm as compared to a decrease by 493 mmcm in 2016. Natural gas inventory balances tend to fluctuate period-to-period depending on the Group's demand for natural gas withdrawal for the sale in the subsequent periods.

In 2017, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, increased by 59 thousand tons mainly due to an increase in inventory balance of naphtha in tankers in transit and not realized at the reporting date. In 2016, our cumulative liquid hydrocarbons inventory balances changed marginally (decreased by seven thousand tons). Inventory balances of stable gas condensate and refined products tend to fluctuate period-to-period depending on shipment schedules and final destination of our shipments.

The following table highlights movements in our hydrocarbons inventory balances:

	2017			**2016**		
Inventory balances in transit or in storage	**At 31 December**	**At 1 January**	**Increase / (decrease)**	**At 31 December**	**At 1 January**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**1,033**	**834**	**199**	**834**	**1,327**	**(493)**
including Gazprom's UGSF	*870*	*787*	*83*	*787*	*1,245*	*(458)*
Liquid hydrocarbons (thousand tons)	**962**	**903**	**59**	**903**	**910**	**(7)**
including gas condensate refined products	*464*	*395*	*69*	*395*	*287*	*108*
stable gas condensate	*290*	*307*	*(17)*	*307*	*369*	*(62)*
crude oil	*103*	*105*	*(2)*	*105*	*157*	*(52)*

Other operating income (loss)

Other operating income (loss) includes realized income (loss) from hydrocarbons trading on the international markets, income (loss) from the change in the fair value of the aforementioned contracts, as well as other income (loss) relating to penalty charges, disposal of materials, fixed assets and other transactions. In 2017, we recognized other operating income of RR 424 million compared to other operating income of RR 221 million in 2016.

In 2017, within our trading activities we purchased and sold approximately 3.7 bcm of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized income from trading activities of RR 289 million as compared to RR 1,970 million of income in 2016. At the same time, we recognized insignificant non-cash loss of RR nine million in 2017 as a result of a decrease in the fair value of aforementioned contracts as compared to RR 1,778 million of non-cash loss in 2016.

Net gain on disposal of interests in joint ventures

In December 2015, the Group and China's Silk Road Fund Co. Ltd. signed an agreement on the acquisition of a 9.9% equity stake in Yamal LNG by the fund. In March 2016, the transaction was closed upon the completion of the conditions precedent and we recognized a gain on the disposal in the amount of RR 73,072 million.

Profit from operations and EBITDA

In 2017, our profit from operations and EBITDA including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in joint ventures, increased due to higher average realized liquid hydrocarbons and natural gas prices. Our profit from operations before disposals of interests in joint ventures amounted to RR 163,751 million compared to RR 152,194 million in 2016, our share in the profit from operations of our joint ventures increased to RR 39,854 million from RR 33,655 million in 2016, and our aggregate EBITDA including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in joint ventures, increased to RR 256,464 million compared to RR 242,407 million in 2016.

Finance income (expense)

In 2017, we recorded net finance income of RR 14,658 million compared to net finance expense of RR 7,941 million in 2016.

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Accrued interest expense on loans received	(10,235)	(16,297)	(37.2%)
Less: capitalized interest	3,391	5,314	(36.2%)
Provisions for asset retirement obligations:			
effect of the present value discount unwinding	(749)	(587)	27.6%
Interest expense on lease liabilities	(119)	-	n/a
Interest expense	**(7,712)**	**(11,570)**	**(33.3%)**
Interest income	15,872	18,732	(15.3%)
Change in fair value of non-commodity financial instruments	(7,178)	10,387	n/a
Foreign exchange gain (loss), net	13,676	(25,490)	n/a
Total finance income (expense)	**14,658**	**(7,941)**	**n/a**

In 2017, our interest expense decreased by RR 3,858 million, or 33.3%, to RR 7,712 million primarily due to partial repayments of the Group's borrowings, and, to a lesser extent, the appreciation of the average exchange rate of the Russian rouble relative to the US dollar and Euro (most of our long-term borrowings are denominated in foreign currencies).

Interest income decreased by RR 2,860 million, or 15.3%, to RR 15,872 million in 2017 from RR 18,732 million in 2016 primarily due to the appreciation of the average exchange rate of the Russian rouble relative to the US dollar and Euro in 2017 compared to the average exchange rate in 2016, and, to a lesser extent, due to a partial repayment of loans provided to our joint ventures for the development and expansion of their activities.

In 2017, we recognized a non-cash loss of RR 7,178 million compared to a non-cash gain of RR 10,387 million in 2016 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IAS 39 *"Financial instruments: recognition and measurement"*. The effect of the fair value remeasurement of shareholders' loans may change period-to-period due to the change in market interest rates and other macroeconomic parameters and does not affect real future cash flows of loans repayments.

The Group continues to record non-cash foreign exchange gains and losses each reporting period due to movements between currency exchange rates. In 2017, we recorded a net foreign exchange gain of RR 13,676 million compared to a net loss of RR 25,490 million in 2016 due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

Share of profit (loss) of joint ventures, net of income tax

In 2017, the Group's proportionate share of profit of joint ventures decreased by RR 68,409 million, or 75.3%, to RR 22,430 million as compared to RR 90,839 million in 2016.

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Share in profit from operations	**39,854**	**33,655**	**18.4%**
Share in finance income (expense)			
Share in interest income (expense), net	(10,805)	(15,250)	(29.1%)
Share in foreign exchange gain (loss), net	(12,828)	102,922	n/a
Share in change in fair value of non-commodity financial instruments	13,336	(13,436)	n/a
Total share in finance income (expense)	**(10,297)**	**74,236**	**n/a**
Share in total income tax benefit (expense)	(7,127)	(17,052)	(58.2%)
Total share of profit (loss) of joint ventures, net of income tax	**22,430**	**90,839**	**(75.3%)**

Our proportionate share in the profit from operations of our joint ventures increased by RR 6,199 million, or 18.4%, primarily due to an increase in revenues from liquids and natural gas sales as a result of higher average realized prices. The impact of this factor was partially offset by an increase in the unified natural resources production tax expense due to increased UPT rates for crude oil and gas condensate effective 1 January 2017 (see "Our tax burden and obligatory payments" above).

In 2017, our proportionate share in the finance expense of our joint ventures amounted to RR 10,297 million compared to the share in the finance income of RR 74,236 million in 2016. The main factor of the change in our share in finance income (expense) was recognition of non-cash foreign exchange loss on foreign currency denominated loans at our joint ventures Yamal LNG and Terneftegas in 2017 (our share amounted to RR 12.8 billion) as compared to a recognition of substantial non-cash foreign exchange gain in 2016 (our share amounted to RR 102.9 billion). This effect was partially offset by a recognition of a non-cash gain from the remeasurement of the fair value of shareholders' loans in Yamal LNG and Terneftegas in the current reporting period of RR 13.3 billion as compared to a recognition of a non-cash loss of RR 13.4 billion in 2016, as well as a RR 4.4 billion decrease in our share in interest expense.

Income tax expense

The Russian statutory income tax rate for both reporting periods was 20%.

The Group recognizes in profit before income tax its share of net profit (loss) from joint ventures, which influences the consolidated profit of the Group but does not result in additional income tax expense (benefit) at the Group's level. Net profit (loss) of joint ventures was recorded in their financial statements on an after-tax basis. The Group's dividend income from its joint ventures is subject to a zero withholding tax rate according to the Russian tax legislation as the Group holds at least a 50% interest in each of its joint ventures, and also does not result in a tax charge.

Without the effect of net profit (loss) and dividends from joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of profit before income tax) in 2017 and 2016, was 19.3% and 19.8%, respectively.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK decreased by RR 101,408 million, or 39.3%, to RR 156,387 million in 2017 compared to RR 257,795 million in 2016. The Group's financial results in 2016 were significantly impacted by the recognition of a gain on the disposal of a 9.9% participation interest in Yamal LNG and substantial non-cash foreign exchange effects on foreign currency denominated loans of the Group and its joint ventures (in 2017, the effect from foreign exchange differences was less significant). Excluding the one-time effect from the disposal of interests in joint ventures and the effect of foreign exchange gains (losses), our profit attributable to shareholders of PAO NOVATEK increased by RR 22,407 million, or 16.8%, and amounted to RR 156,166 million in 2017 compared to RR 133,759 million in 2016 (see the table below):

	Year ended 31 December:		Change
millions of Russian roubles	**2017**	**2016**	**%**
Profit attributable to shareholders of PAO NOVATEK	156,387	257,795	(39.3%)
Net gain on disposal of interests in joint ventures	-	(73,072)	n/a
Income tax expense relating to the disposal of interests in joint ventures	-	15,395	n/a
Normalized profit attributable to shareholders of PAO NOVATEK	**156,387**	**200,118**	**(21.9%)**
Foreign exchange (gains) losses	(13,676)	25,490	n/a
Income tax expense (benefit) relating to foreign exchange (gains) losses	2,735	(5,098)	n/a
Share of foreign exchange (gains) losses of joint ventures	12,828	(102,922)	n/a
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	(2,108)	16,171	n/a
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	**156,166**	**133,759**	**16.8%**

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK decreased by RR 33.56 per share, or 39.3%, to RR 51.85 per share in 2017 from RR 85.41 per share in 2016. Excluding the effects of the disposal of interests in joint ventures and foreign exchange gains (losses), our weighted average basic and diluted earnings per share increased by RR 7.47, or 16.8%, to RR 51.78 per share in 2017 from RR 44.31 per share in 2016.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2017 and 2016:

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Net cash provided by **operating** activities	180,399	173,791	3.8%
Net cash provided by (used for) **investing** activities	(58,275)	11,877	n/a
Net cash used for **financing** activities	(103,837)	(156,712)	(33.7%)

Net cash provided by operating activities

Our net cash provided by operating activities increased by RR 6,608 million, or 3.8%, to RR 180,399 million compared to RR 173,791 million in 2016 primarily due to an increase in profit from operations before disposals of interests in joint ventures adjusted for non-cash items, net of related income tax. In addition, interest and dividends received from our joint ventures increased in 2017 which was offset by changes in working capital. Working capital balances fluctuate from period-on-period depending on various factors.

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Profit from operations before disposals of interests in joint ventures	163,751	152,194	7.6%
Non-cash adjustments [(1)]	35,129	36,739	(4.4%)
Changes in working capital and long-term advances given	5,816	11,189	(48.0%)
Interest received	5,949	1,983	200.0%
Dividends received from joint ventures	2,383	-	n/a
Income taxes paid	(32,629)	(28,314)	15.2%
Total net cash provided by operating activities	**180,399**	**173,791**	**3.8%**

(1) Include adjustments for depreciation, depletion and amortization, net impairment expenses (reversals), change in fair value of non-commodity financial instruments and some other adjustments.

The profit from operations before disposals of interests in joint ventures adjusted for non-cash items increased mainly due to an increase in average realized liquid hydrocarbons and natural gas prices (see "Profit from operations and EBITDA" above).

Interest received increased primarily due to the repayment of interest on the loans provided to our joint venture Yamal Development. In addition, in 2017, we received dividends in the amount of RR 2,383 million from our joint venture Nortgas.

Net cash provided by (used for) investing activities

In 2017, our net cash used for investing activities amounted to RR 58,275 million compared to RR 11,877 million provided by investing activities in 2016.

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Cash used for capital expenditures	(29,871)	(33,905)	(11.9%)
Payments for mineral licenses	(9,786)	(1,928)	n/a
Payments for acquisition of subsidiaries net of cash acquired	(15,706)	(2,961)	n/a
Acquisition of joint ventures	(1,583)	-	n/a
Additional capital contributions to joint ventures	(2,269)	(19,565)	(88.4%)
Loans provided to joint ventures	(5,211)	(6,645)	(21.6%)
Repayments of loans provided to joint ventures	8,246	6,038	36.6%
Proceeds from disposal of stakes in joint ventures net of costs to sell and income tax paid, net	-	72,412	n/a
Other	(2,095)	(1,569)	33.5%
Net cash provided by (used for) investing activities	**(58,275)**	**11,877**	**n/a**

In 2017, cash used for capital expenditures decreased by RR 4,034 million, or 11.9%, as compared to 2016. In 2017, we used cash mainly for the development of our future LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field, purchased licenses for natural gas liquefaction technology and commenced development of the front-end engineering design (FEED) for the new LNG plant. In addition, in both reporting periods, our capital expenditures related to the ongoing development of crude oil deposits at the Yarudeyskoye and the East-Tarkosalinskoye fields, as well as development of the North-Russkiy and the East-Tazovskiy license areas.

In 2017, we made payments in the amount of RR 9,727 million for the acquisition of the right to use the Gydanskoye, the Shtormovoye, the Verhnetiuteyskoye and the West-Seyakhinskoye license areas (see "Recent Developments" above), as well as paid a part of a one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field in the amount of RR 59 million. In 2016, we paid RR 1,928 million for the acquisition of exploration and production licenses for the Nyakhartinskiy, the Syadorskiy and the Tanamskiy license areas.

In November 2017, the Group acquired a 100% ownership interest in OOO Severneft-Urengoy for RR 12,995 million net of cash acquired. In addition, in December 2017, we acquired 100% ownerships in AO Eurotek and AO South-Khadyryakhinskoye for the total amount of RR 2,711 million net of cash acquired (see "Recent Developments" above). In 2016, we made payments in the amount of RR 2,929 million (USD 39 million) for a 100% equity stake in AO Office acquired in August 2014. In addition, in April and December 2016, the Group acquired companies OOO Evrotek-Yuh and Blue Gaz Sp. z o.o. for RR six million and RR 26 million, respectively.

In July 2017, the Group acquired a 51% ownership interest in OOO Cryogas-Vysotsk for RR 1,583 million (see "Recent Developments" above).

In October 2017 and September 2016, we made capital contributions to Cryogas-Vysotsk and Yamal LNG in the amount of RR 2,269 million and RR 19,565 million, respectively.

In the years ended 31 December 2017 and 2016, we provided loans to our joint ventures Cryogas-Vysotsk and Yamal LNG in the amount of RR 5,211 million and 6,645 million, respectively. At the same time, in 2017 and 2016, we received RR 8,246 million and RR 6,038 million, respectively, due to repayments of the loans provided to Terneftegas and Yamal Development.

In 2016, we received RR 72,412 million (net of costs to sell and income tax paid) for the sale of the 9.9% equity stake in Yamal LNG in March 2016.

Net cash used for financing activities

In 2017, our net cash used for financing activities decreased by RR 52,875 million, or 33.7%, to RR 103,837 million as compared to RR 156,712 million in 2016.

millions of Russian roubles	**Year ended 31 December: 2017**	**2016**	**Change %**
Proceeds from (repayments of) long-term debt, net	(53,035)	(76,380)	(30.6%)
Proceeds from (repayments of) short-term debt, net	(192)	(26,340)	(99.3%)
Dividends paid to shareholders	(42,075)	(41,653)	1.0%
Interest paid	(6,526)	(11,423)	(42.9%)
Purchase of treasury shares	(1,442)	(916)	57.4%
Payments of lease liabilities	(567)	-	n/a
Net cash used for financing activities	**(103,837)**	**(156,712)**	**(33.7%)**

In 2017, we did not obtain any new long-term loans. At the same time, the Group partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 26,736 million (USD 462 million) according to the loan's maturity schedule, fully repaid the four-year Russian rouble denominated Eurobonds in the amount of RR 14 billion, as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In 2016, we obtained a long-term loan from a Russian subsidiary of a foreign bank in the amount of RR 6,373 million (EUR 100 million). At the same time, the Group fully repaid the five-year US dollar denominated Eurobonds in the amount of RR 46,756 million (USD 600 million), partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 30,265 million (USD 462 million) according to the loan's maturity schedule, as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In 2017, the total amount of short-term loans repayments substantially corresponded to the amount of proceeds and mainly related to operations with short-term loans to finance trade activities. In 2016, net repayments of short-term loans to finance trade activities amounted to RR 5,040 million. In addition, in 2016, we repaid short-term loans from a Russian bank in the amount of RR 20,000 million and from the non-controlling shareholder of our subsidiary in the amount of RR 1,300 million.

The remaining change primarily related to a decrease in interest paid on borrowings and loans.

Liquidity and working capital

The following table shows the Group's liquidity and credit measures as of 31 December 2017 and 2016:

	31 December 2017	31 December 2016	Change, %
Absolute amounts, RR million			
Net debt [(1)]	89,807	168,464	(46.7%)
Net working capital position [(2)]	69,478	23,969	189.9%
Liquidity and credit ratios			
Current ratio [(3)]	1.83	1.22	50.0%
Total debt to total equity	0.20	0.33	(39.4%)
Long-term debt to long-term debt and total equity	0.15	0.20	(25.0%)
Net debt to total capitalization [(4)]	0.09	0.19	(52.6%)
Net debt to normalized EBITDA from subsidiaries [(5)]	0.45	0.89	(49.4%)
Interest coverage ratio [(6)]	19	12	58.3%

(1) Net debt represents total debt less cash and cash equivalents.

(2) Net working capital position represents current assets less current liabilities.

(3) Current ratio is calculated as current assets divided by current liabilities.

(4) Total capitalization represents total debt, total equity and deferred income tax liability.

(5) Net debt to normalized EBITDA from subsidiaries ratio is calculated as Net debt divided by EBITDA from subsidiaries excluding the effect from the disposal of interests in joint ventures for the last twelve months.

(6) Interest coverage ratio is calculated as normalized EBITDA from subsidiaries divided by accrued interest on debt, including capitalized interest.

In 2017, we repaid long-term debt in the aggregate amount of RR 53 billion. As a result, the Group's net debt decreased by 46.7% and our net working capital position amounted to RR 69.5 billion as of 31 December 2017.

In each quarter of 2016 and 2017, the Group demonstrated high operating results and achieved positive free cash flow. The Group's management believes that it presently has and will continue to have the ability to generate sufficient cash flows (from operating and financing activities) to repay all its current liabilities as they become due and to finance the Group's capital construction programs.

Capital expenditures

In both reporting periods, our capital expenditures represent our investments primarily relating to developing our oil and gas properties. The following table shows capital expenditures at our main fields, processing facilities and other assets:

	Year ended 31 December:	
millions of Russian roubles	**2017**	**2016**
Arctic LNG 2 project	8,593	2,682
Yarudeyskoye field	4,489	8,677
East-Tarkosalinskoye field	4,215	4,393
North-Russkiy and East-Tazovskiy license areas	2,679	1,131
Infrastructure for future LNG projects [(1)]	2,641	1,342
Yurkharovskoye field	1,800	3,480
North-Obskiy license area	1,281	57
Other	4,721	8,626
Capital expenditures	**30,419**	**30,388**

(1) Includes, among others, the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region.

Total capital expenditures on property, plant and equipment in 2017 remained relatively flat (increased by 0.1%). In 2017, a major part of our capital expenditures related to the future development of our LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field, purchased licenses for natural gas liquefaction technology and commenced development of the front-end engineering design (FEED) for the new LNG plant. In addition, in both reporting periods, our capital expenditures related to ongoing development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, as well as the development of the North-Russkiy and East-Tazovskiy license areas.

The "Other" line in the table above represents our capital expenditures related to other fields and processing facilities of the Group, as well as unallocated capital expenditures as of the reporting date. The allocation of capital expenditures by fields or processing facilities takes place upon the completion of the fixed assets construction stages and depends on the approved fixed assets launch schedule. At the end of 2016, we purchased for RR 3,990 million a land plot with other immovable items in the northern part of the Ust-Luga port, adjacent to the territory of our Ust-Luga Complex, for implementing Group's future projects (expenditures are included in the line "Other" in the table above).

The following table presents the reconciliation of our capital expenditures and additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements, and cash used for capital investments:

millions of Russian roubles	Year ended 31 December: 2017	2016	Change %
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	**48,064**	**32,316**	**48.7%**
Less: acquisition of mineral licenses	(10,022)	(1,928)	n/a
Less: right-of-use assets [(1)] additions	(7,623)	-	n/a
Capital expenditures	**30,419**	**30,388**	**0.1%**
Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments	(548)	3,517	n/a
Cash used for capital expenditures [(2)]	**29,871**	**33,905**	**(11.9%)**

(1) Relate mainly to long-term agreements on time chartering of marine tankers.

(2) Represents purchases of property, plant and equipment, materials for construction and capitalized interest paid per Consolidated Statement of Cash Flows net of payments for mineral licenses and acquisition of subsidiaries and joint ventures.

In June and August 2017, the Group won auctions for geological research works, exploration and hydrocarbons production at license areas, which include the Gydanskoye, the Shtormovoye, the Verhnetiuteyskoye and the West-Seyakhinskoye fields (see "Recent Developments" above) and paid in the aggregate RR 9,727 million. In addition, in the "acquisition of mineral licenses" line in the table above we recognized RR 295 million related to the stated one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field, of which RR 59 million was paid in 2017.

In 2016, we purchased licenses for the usage of the Nyakhartinskiy, the Syadorskiy and the Tanamskiy license areas for RR 1,928 million.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 December 2017, the total amount of our debt denominated in US dollars was RR 147,841 million, or 94.9% of our total borrowings at that date. Changes in the value of the Russian rouble relative to foreign currencies will impact our foreign currency-denominated costs and expenses, our debt service obligations for foreign currency-denominated borrowings, as well as receivables at our foreign subsidiaries in Russian rouble terms. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, 39.3% in 2017, was denominated in foreign currencies.

In addition, our share of profit (loss) of joint ventures is also exposed to foreign currency exchange rate movements due to the significant amount of foreign currency-denominated borrowings in our joint ventures, mostly in Yamal LNG. We expect that foreign currency risk relating to the debt portfolio of Yamal LNG will be mitigated by the fact that all of its products will be delivered to international markets and its revenues will be denominated in foreign currencies.

As of 31 December 2017, the Russian rouble appreciated by 5.0% against the US dollar and depreciated by 7.9% against the Euro, compared to 31 December 2016 (see "Selected macro-economic data" above).

Commodity risk

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

The weather is another factor affecting demand for natural gas. Changes in weather conditions from year to year can influence demand for natural gas and to some extent gas condensate and refined products.

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

The Group purchases and sells natural gas on the European market under long-term contracts based on formulas with reference to benchmark natural gas prices quoted for the North-Western European natural gas hubs, crude oil and oil products prices and/or a combination thereof. Therefore, the Group's financial results from natural gas foreign trading activities are subject to commodity price volatility based on fluctuations or changes in the respective benchmark reference prices.

Pipeline access

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

Ability to reinvest

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

Forward-looking statements

This report includes forward-looking statements concerning future possible events that can impact operational and financial results of the Group. Forward-looking statements can be identified by words such as "believes", "anticipates", "expects", "estimates", "intends", "plans" and similar expressions. Forward-looking statements are made based on the current situation with definite and indefinite risks and uncertainties. Actual future results could differ materially from those discussed in the forward-looking statements as they are dependent on various factors beyond and under the control of management.

Off balance sheet activities

As of 31 December 2017, 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.

TERMS AND ABBREVIATIONS

APR	Asian-Pacific Region
bbl	barrel
bcm	billion cubic meters
boe	barrels of oil equivalent
CBR	Central Bank of Russian Federation
CFR	"Cost and freight"
CIF	"Cost, insurance and freight"
DAP	"Delivery at point of destination"
DDA	depreciation, depletion and amortization
DES	"Delivery to the port of destination ex-ship"
FCA	"Free carrier"
FEED	Front-End Engineering Design
FOB	"Free on board"
Forecast of the Ministry of Economic Development	The document *"Forecast of Socio-economic Development of the Russian Federation for 2017 and planned period 2018 and 2019"* prepared by the Ministry of Economic Development of the Russian Federation or the similar document prepared for another period
GTS	Gas Transmission System part of the UGSS
IFRS	International Financial Reporting Standards
List	the OFAC's Sectoral Sanctions Identification List
LNG	liquefied natural gas
LPG	liquefied petroleum gas
mcm	thousand cubic meters
MET	mineral extraction tax
OFAC	Office of Foreign Assets Control
PRMS	Petroleum Resources Management System
Purovsky Plant	Purovsky Gas Condensate Plant
Regulator	A federal executive agency of the Russian Federation that carries out governmental regulation of prices and tariffs for products and services of natural monopolies in energy, utilities and transportation. Effective July 2015, Federal Anti-Monopoly Service fulfills the Regulator's role.
RR	Russian rouble(s)
RZD	OAO Russian Railways, Russia's state-owned monopoly railway operator
SEC	Securities and Exchange Commission
Tobolsk Refining Facilities	Refining facilities of OOO SIBUR Tobolsk
UGSF	Underground Gas Storage Facilities
UGSS	Unified Gas Supply System owned and operated by PAO Gazprom
UPT	unified natural resources production tax
USD, US dollar	United States Dollar
Ust-Luga Complex	Gas Condensate Fractionation and Transshipment Complex located at the port of Ust-Luga on the Baltic Sea
VAT	value added tax
Yamal LNG project	A large-scale project on constructing a liquefied natural gas plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula that Group undertakes jointly with TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through its joint venture OAO Yamal LNG
YNAO	Yamal-Nenets Autonomous Region