NOVATEK

OAO NOVATEK

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

FOR THE THREE MONTHS ENDED 30 JUNE 2016 AND 2015

CONTENTS **Page**

GENERAL PROVISIONS

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 30 June 2016 and 2015 together with our unaudited consolidated interim condensed financial statements as of and for the three and six months ended 30 June 2016. The unaudited consolidated interim condensed financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". These consolidated interim condensed financial statements should be read together with the audited consolidated financial statements for the year ended 31 December 2015 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

We are Russia's largest independent natural gas producer and the second-largest producer of natural gas in Russia according to the Central Dispatch Administration of the Fuel and Energy Complex (commonly referred to as "CDU-TEK") for both reporting periods. In terms of proved natural gas reserves, we are the second largest holder of natural gas resources in Russia after PAO Gazprom, under the Petroleum Resources Management System ("PRMS") reserve reporting methodology.

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

In accordance with Russian law, we currently sell all of our produced natural gas volumes exclusively in the Russian domestic market.

Several wholly owned subsidiaries of the Group (OOO Arctic LNG 1, OOO Arctic LNG 2, and OOO Arctic LNG 3) and the Group's joint venture OAO Yamal LNG are the holders of liquefied natural gas ("LNG") export licenses. The aforementioned subsidiaries hold licenses for exploration and production on the Salmanovskoye (Utrenneye) and Geofizicheskoye fields, and the North-Obskiy and Trekhbugorniy license areas located on the Gydan peninsula and the Gulf of Ob.

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 (from the port of Ust-Luga on the Baltic Sea by tankers and/or to European markets by rail).

A significant part of our LPG produced at the Purovsky Plant is dispatched via pipeline for refining by OOO SIBUR Tobolsk (formerly OOO Tobolsk-Neftekhim) at its refining facility (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.

The Group, jointly with our international partners TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through our joint venture OAO Yamal LNG, undertakes 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 (the "Yamal LNG project"). The Yamal LNG project also requires the construction of transportation infrastructure, including the seaport and the international airport. The launch of the LNG plant and start of liquefied natural gas shipments is planned in 2017. It is expected that the produced LNG will be sold mainly to the Asian-Pacific Region ("APR") and to the European market. The Yamal LNG project has now concluded the sale of more than 95% of LNG volumes produced under long-term contractual agreements. The remaining portion of LNG will be sold on the spot market.

RECENT DEVELOPMENTS

Increasing our production and utilization of refining capacity

At the end of 2014 and in the first half of 2015, OOO SeverEnergia, the Group's joint venture with PAO Gazprom Neft, and ZAO Terneftegas, the Group's joint venture with TOTAL S.A., launched additional production facilities. As a result, the Group's gas condensate production has increased significantly enabling us to fully utilize the processing facilities of our Ust-Luga Complex (effective January 2015) and our Purovsky Plant (effective May 2015).

In December 2015, we commenced commercial production at the Yarudeyskoye oil field and at the end of the month we reached the nameplate production capacity of approximately 3.5 million tons of crude oil per annum. The successful launch and production ramp-up of the Yarudeyskoye field allows us to significantly increase our production of crude oil and will represent the majority of liquids production growth in 2016.

Increasing our resource base

In the first half of 2016, as part of our long-term development strategy, the Group expanded the resource base and obtained the rights for the usage of several license areas, located in the Yamal-Nenets Autonomous region ("YNAO").

In April 2016, based on auction results held by the Federal Agency for the Use of Natural Resources of the Russian Federation, the Group won the right for geological research works, exploration and production of hydrocarbons at the Nyakhartinskiy license area. The license area is located in the YNAO in close proximity to our Yurkharovskoye field, which will allow us to develop the new area using the existing well-developed infrastructure of one of our core production assets. As of 31 December 2015, the field's recoverable resources according to the Russian reserve classification C3+D totaled 215 billion cubic meters ("bcm") of natural gas and more than 70 million tons of liquid hydrocarbons. The payment for the license amounted to RR 1,057 million.

In April 2016, the Group acquired a 100% equity stake in OOO Evrotek-Yuh for RR six million. Evrotek-Yuh is a holder of the license for geological research works, exploration and production of hydrocarbons within Ladertoyskiy license area located on the Gydan peninsula in YNAO. As of 31 December 2015, the license area's reserves and recoverable resources according to the Russian reserve classification ABC1+C2+C3 totaled approximately 39 bcm of natural gas and approximately six million tons of liquid hydrocarbons.

In June 2016, the Group obtained mineral licenses for exploration works at the West-Solpatinskiy and Nyavuyahskiy license areas adjacent to the Ladertoyskiy license area, and the North-Tanamskiy license area located in the central part of the Gydan peninsula. As of 31 December 2015, the aggregate recoverable resources of these three new license areas according to the Russian reserve classification C3+D totaled approximately 560 bcm of natural gas and approximately 57 million tons of liquid hydrocarbons.

We continue to expand our resource base in the Gydan peninsula and are actively exploring the region's geological potential for future commercial projects. The acquisition of the four new license areas located in close proximity to each other allows us to use common infrastructure for the most efficient development of these license areas. We are currently developing an exploration work program for these license areas.

Implementing our Yamal LNG project

In December 2015, NOVATEK 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. Upon completing this transaction, the Group's interest in Yamal LNG was reduced from 60% to 50.1%. The Group continues to exercise joint control over Yamal LNG and, accordingly, recognizes the project as a joint venture. The entrance of Silk Road Fund Co. Ltd. to the Yamal LNG project is an important step in the execution of our long-term development strategy for this project.

In the second quarter of 2016, Yamal LNG signed 15-year credit line facility agreements with a number of Russian and foreign banks to raise project financing for the total amount of EUR 12.9 billion and CNY 9.8 billion. The signing of these credit agreements contributes to the planned financing of the project and its further successful realization.

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 30 June: 2016	2015	Change %
Financial results			
Total revenues [(1)]	127,388	112,244	13.5%
Operating expenses	(90,019)	(79,541)	13.2%
EBITDA [(2)]	59,507	49,511	20.2%
Profit attributable to shareholders of OAO NOVATEK	45,934	41,920	9.6%
Earnings per share (in Russian roubles)	15.22	13.88	9.6%
Net debt [(3)]	216,010	204,388	5.7%
Production volumes [(4)]			
Hydrocarbons production (million barrels of oil equivalent)	134.1	129.3	3.7%
Daily production (million barrels of oil equivalent per day)	1.47	1.42	3.7%
Operating results			
Natural gas sales volumes (million cubic meters)	14,062	14,498	(3.0%)
Crude oil sales volumes (thousand tons)	1,157	238	386.1%
Naphtha sales volumes (thousand tons)	1,102	997	10.5%
Liquefied petroleum gas sales volumes (thousand tons)	656	537	22.2%
Stable gas condensate sales volumes (thousand tons)	639	545	17.2%
Other gas condensate refined products (thousand tons) [(5)]	582	591	(1.5%)
Cash flow results			
Net cash provided by operating activities	19,289	30,447	(36.6%)
Normalized net cash provided by operating activities [(6)]	29,221	30,447	(4.0%)
Cash used for capital expenditures [(7)]	7,233	15,463	(53.2%)
Free cash flow [(8)]	12,056	14,984	(19.5%)
Normalized free cash flow [(6),(8)]	21,988	14,984	46.7%

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

(5) Hydrocarbons production and daily production are calculated based on 100% of net production of our subsidiaries and our proportionate share in the production of our joint ventures.

(5) Other gas condensate refined products include jet fuel, gasoil and fuel oil.

(6) Excluding advance income tax payments of RR 9,932 million in the second quarter of 2016 based on the gain on the disposal of the 9.9% equity stake in OAO Yamal LNG.

(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 is as follows:

millions of Russian roubles	**Three months ended 30 June:**		**Change**
	2016	**2015**	**%**
Profit	**48,324**	**41,269**	**17.1%**
Depreciation, depletion and amortization	8,363	4,681	78.7%
Net impairment reversals (expenses)	(40)	(261)	(84.7%)
Loss (income) from changes in fair value of commodity derivative instruments	2,315	352	n/a
Total finance expense (income)	(74)	(2,130)	(96.5%)
Total income tax expense	7,011	6,410	9.4%
Share of loss (profit) of joint ventures, net of income tax	(19,623)	(13,004)	50.9%
EBITDA from subsidiaries	**46,276**	**37,317**	**24.0%**
Share in EBITDA of joint ventures	13,231	12,194	8.5%
EBITDA	**59,507**	**49,511**	**20.2%**

SELECTED MACRO-ECONOMIC DATA

Exchange rate, Russian roubles for one foreign currency unit [1]	Three months ended 30 June: 2016	2015	Change %
US dollar (USD)			
Average for the period	65.89	52.65	25.1%
At the beginning of the period	67.61	58.46	15.7%
At the end of the period	64.26	55.52	15.7%
Depreciation (appreciation) of Russian rouble to US dollar	(5.0%)	(5.0%)	n/a
Euro			
Average for the period	74.40	58.24	27.7%
At the beginning of the period	76.54	63.37	20.8%
At the end of the period	71.21	61.52	15.8%
Depreciation (appreciation) of Russian rouble to Euro	(7.0%)	(2.9%)	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	Three months ended 30 June: 2016	2015	Change %
Benchmark crude oil prices [2]			
Brent, USD per barrel	45.6	61.9	(26.3%)
Urals, USD per barrel	43.8	61.7	(29.0%)
Urals, Russian roubles per barrel	2,886	3,249	(11.2%)
Benchmark crude oil prices excluding export duties [3]			
Urals, USD per barrel	34.6	43.8	(21.0%)
Urals, Russian roubles per barrel	2,280	2,306	(1.1%)
World market prices for oil products [4] **and liquefied petroleum gas** [5]**, USD per ton**			
Naphtha Japan	411	563	(27.0%)
Naphtha CIF NWE	400	538	(25.7%)
Jet fuel	437	603	(27.5%)
Gasoil	410	574	(28.6%)
Fuel oil	215	338	(36.4%)
Liquefied petroleum gas	225	364	(38.2%)
Export duties, USD per ton [6]			
Crude oil, stable gas condensate	67.2	130.6	(48.5%)
Naphtha	47.6	110.9	(57.1%)
Jet fuel, gasoil	26.8	62.6	(57.2%)
Fuel oil	55.0	99.2	(44.6%)
Liquefied petroleum gas	0.0	0.0	n/a

[2] Based on Brent (dtd) and Russian Urals CIF Rotterdam spot assessments prices as provided by Platts.

[3] Export duties per barrel were calculated based on export duties per ton divided by the coefficient 7.3.

[4] 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 provided by Platts.

[5] Based on spot prices for propane-butane mix at the Belarusian-Polish border (DAF, Brest) as provided by Argus.

[6] 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

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, OAO 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 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 exchange listed shares and debt, and does not have a material effect on the Group's financial position.

Simultaneously, during 2014, the Russian economy has experienced signs of weakness which became especially apparent during the fourth quarter of 2014 with the severe devaluation of the Russian rouble, the contraction of the Country's gross domestic product, a significant increase in the Central Bank's lending rates, increased inflation and other factors. The domestic economic situation was further exasperated by the rapid commodity price decline in global oil markets. As a result, in January and February 2015, both Standard & Poor's (S&P) and Moody's downgraded the Russian sovereign rating to below investment rating status as well as made the corresponding downward adjustments to Russian issuers, including OAO NOVATEK. We strongly disagree with the position taken by both S&P and Moody's regarding our credit rating because our operating results and cash flow generating capabilities to support our liquidity position remain strong.

In 2015 and during the first half of 2016, the Central Bank's lending rates gradually decreased, whereas the Russian rouble exchange rates relative to world currencies and benchmark commodity prices in international markets remained volatile during the whole year 2015 and throughout the first half of 2016. Commodity price volatility continues to exert significant influence on financial and operations results in the global oil and gas industry, and this present macro situation is expected to remain volatile throughout 2016 as present crude oil supplies exceed world demand. 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. We do not expect any asset impairments or write-offs resulting from a lower commodity price environment.

In June 2016, the United Kingdom through a referendum voted to exit the European Union, commonly referred to as "Brexit", which caused further economic and political uncertainties as well as significant volatility in the global financial markets.

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 are also closely monitoring the present commodity price environment and its impact on our business operations.

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.

We together with our international partners, TOTAL S.A., China National Petroleum Corporation and Silk Road Fund Co. Ltd., are undertaking all necessary actions to implement the joint investment projects on time as planned, including, but not limited to, attraction of financing from domestic and non-US capital markets.

Natural gas prices

The Group's natural gas prices on the domestic market are strongly influenced by the prices set by 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. During the first half of 2015, the Federal Tariffs Service ("FTS") fulfilled the Regulator's role. In July 2015, a Decree of the President of the Russian Federation became effective abolishing the FTS and transferring its functions to the Federal Anti-Monopoly Service.

During the first half of 2015, regulated natural gas prices for sales to all customer categories on the domestic market (excluding residential customers) did not change and were calculated using a price formula based on parameters set in December 2013.

Effective 1 July 2015, the Regulator adjusted the parameters used in the formula for wholesale natural gas prices calculation and, as a result, wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market were increased by 7.5% and remained unchanged until the end of the second quarter 2016.

In May 2016, the Ministry of Economic Development of the Russian Federation published "Scenario conditions, basic parameters of the Forecast of Socio-economic Development of the Russian Federation and overall price (tariff) level for services provided by the companies of infrastructure sector for 2017 and planned period 2018 and 2019" ("Parameters of the Forecast of Socio-economic Development for 2017-2019") providing for increases of wholesale natural gas prices for sales to all customer categories (excluding residential customers) in 2016-2019 on average by 2.0% on an annual basis effective 1 July of each respective year. As of our report date there was no information regarding the actual effective date and the size of wholesale natural gas price adjustments in 2016. 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.

In accordance with the Tax Code of the Russian Federation, adjustments to the natural gas prices and transportation expenses are taken into account as main parameters for the calculation of unified natural production tax ("UPT") rates for natural gas (see "Our tax burden and obligatory payments" below). Therefore, future potential deviations of natural gas prices and transportation tariffs from the parameters as defined in the current Forecasts of the Ministry of Economic Development will be considered in the determination of UPT rates, thus smoothing fluctuations and decreasing the volatility of gross profits of independent natural gas producers.

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, periodically we 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.

In the three months ended 30 June 2016, our average natural gas price on end-customers sales increased by 3.4% due to an increase in the average regulated price by 7.5% effective 1 July 2015 partially offset by an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the respective period in 2015. The change in the sales geography also reduced our average transportation expense per mcm by 5.2% despite a 2.0% increase in the natural gas transportation tariff set by the Regulator effective 1 July 2015 (see "Transportation tariffs" below). As a result, the average natural gas price on end-customers sales excluding transportation expenses increased by 9.5%.

The following table shows our average realized natural gas sales prices (excluding VAT):

Russian roubles per mcm	**Three months ended 30 June:** 2016	2015	**Change** %
Average natural gas price to end-customers [(1)]	3,727	3,605	3.4%
Average natural gas transportation expense for sales to end-customers	(1,425)	(1,503)	(5.2%)
Average natural gas price on end-customer sales excluding transportation expense	2,303	2,103	9.5%
Average natural gas price ex-field (wholesale traders)	2,051	1,868	9.8%
Total average natural gas price excluding transportation expense	**2,285**	**2,087**	**9.5%**

(1) Includes cost of transportation.

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

Our crude oil is transported through the pipeline system where it is blended with other producers' crude oil of varying qualities. Depending on the route of transportation we export different grades of crude oil: low-sulfur "Siberian Light Crude Oil" (grade SILCO), which is commonly traded with a discount to the international benchmark Brent crude oil and from the first quarter of 2016 – crude oil delivered by the pipeline "East Siberia – Pacific ocean" (grade ESPO), which is commonly traded with a premium to the international benchmark Dubai crude oil. Our crude oil domestic prices are set on an individual transaction basis.

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).

Stable gas condensate and refined products

In the three months ended 30 June 2016, our average realized stable gas condensate export contract price, including export duties, significantly decreased by USD 138, or 25.7%, to approximately USD 400 per ton compared to USD 538 in the corresponding period in 2015 as a result of a decrease in the underlying crude oil and oil products prices on the international markets used in the price calculation (see "Selected macro-economic data" above).

At the same time our average realized net export price, excluding export duties, for stable gas condensate decreased by a lesser extent by USD 68, or 16.9%, to USD 335 per ton due to a significant decrease in average export duties (see "Selected macro-economic data" above). Despite a decrease in the average realized net export price in US dollars, our average realized net export price for stable gas condensate in Russian roubles terms increased by 2.5% due to a 25.1% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 30 June 2016 compared to the corresponding period in 2015.

In the three months ended 30 June 2016, our average realized export contract prices for naphtha and other gas condensate refined products produced at the Ust-Luga Complex, including export duties, decreased by USD 141 and USD 174 per ton, or 24.2% and 32.0%, to approximately USD 441 and USD 370 per ton, respectively. The decrease in our average realized export contract prices was as a result of a decrease in the underlying commodity prices of the respective products on the international markets used in the price calculation (see "Selected macro-economic data" above).

At the same time our average realized net export prices, excluding export duties, for naphtha and other gas condensate refined products produced at the Ust-Luga Complex in the three months ended 30 June 2016, decreased to a lesser extent, by USD 85 and USD 134 per ton, or 17.7% and 28.8%, and amounted to USD 395 and USD 332 per ton, respectively, due to a significant decrease in average export duties (see "Selected macro-economic data" above). Our average realized net export prices for naphtha and other gas condensate refined products in Russian roubles increased by 0.9% and decreased by 10.9%, respectively, due to a 25.1% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 30 June 2016 compared to the corresponding period in 2015.

Our sales to international markets were conducted at different delivery terms: cost and freight (CFR), cost, insurance and freight (CIF), delivery to the port of destination ex-ship (DES), delivery at point of destination (DAP) and free on board (FOB).

In the three months ended 30 June 2016 and 2015, we sold a small portion of our volumes of other gas condensate refined products produced at the Ust-Luga Complex domestically. Prices were set on an individual transaction basis and in the three months ended 30 June 2016 our average realized price amounted to RR 19,464 per ton (excluding VAT), representing a decrease of RR 1,340 per ton, or 6.4%, as compared to the corresponding period in 2015. We expect that we will continue to sell some volumes of other gas condensate refined products domestically.

The following table shows our average realized stable gas condensate and refined products sales prices. Prices are shown net of VAT and export duties, where applicable:

Russian roubles or US dollars per ton	**Three months ended 30 June: 2016**	**2015**	**Change %**
Stable gas condensate			
Net export price, RR per ton	22,425	21,881	2.5%
Net export price, USD per ton	335	403	(16.9%)
Domestic price, RR per ton	16,002	16,320	(1.9%)
Naphtha			
Net export price, RR per ton	26,073	25,842	0.9%
Net export price, USD per ton	395	480	(17.7%)
Other gas condensate refined products			
Net export price, RR per ton	21,849	24,512	(10.9%)
Net export price, USD per ton	332	466	(28.8%)
Domestic price, RR per ton	19,464	20,804	(6.4%)

Liquefied petroleum gas

In the three months ended 30 June 2016, our average realized LPG export contract price, including export duties, excise and fuel taxes expense, and excluding trading activities, decreased by USD 146 per ton, or 27.5%, and was approximately USD 384 per ton compared to USD 530 per ton in the corresponding period in 2015. The decrease in our average realized contract price was mainly due to a decrease in the underlying benchmark prices for LPG on international markets used in price calculation (see "Selected macro-economic data" above).

Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, decreased by USD 158 per ton, or 38.3%, to USD 255 per ton from USD 413 per ton. Our average realized LPG net export price in Russian roubles terms decreased by 22.7% as the decline was partially offset by a 25.1% increase in the average exchange rate of US dollar to Russian rouble in the three months ended 30 June 2016 compared to the corresponding period in 2015 partially offset a decrease in the underlying benchmark prices.

In the three months ended 30 June 2016, our LPG export delivery terms were free carrier (FCA) at terminal points in Poland and Limbey rail station. In the three months ended 30 June 2015, we sold our LPG under DAP at the border of the customer's country, FCA at terminal points in Poland and carriage paid to the port of Temryuk (southern Russia) delivery terms.

In the three months ended 30 June 2016, our average realized LPG domestic price decreased by RR 6,061 per ton, or 60.4%, to RR 3,975 per ton from RR 10,036 per ton in the corresponding period in 2015. A decrease in our average realized price was mainly due to a significant decrease in the underlying benchmark prices for LPG on international markets and increased transportation tariffs as these figures form the basis for the price setting of some LPG deliveries.

The following table shows our average realized LPG sales prices, excluding trading activities. Prices are shown net of VAT, export duties, excise and fuel taxes expense, where applicable. Prices in US dollars were translated from Russian roubles using the average exchange rate for the period:

	Three months ended 30 June:		Change
Russian roubles or US dollars per ton	**2016**	**2015**	**%**
LPG			
Net export price, RR per ton	16,816	21,759	(22.7%)
Net export price, USD per ton	255	413	(38.3%)
Domestic price, RR per ton	3,975	10,036	(60.4%)

Crude oil

Our average realized crude oil export contract price, including export duties, decreased by USD 114 per ton, or 26.2%, and was approximately USD 321 per ton compared to USD 435 per ton in the corresponding period in 2015. The decrease in our average crude oil contract price was a result of a decrease in the Brent benchmark crude oil price on the international markets used as the base for price setting (see "Selected macro-economic data" above).

At the same time our average realized crude oil net export price, excluding export duties, decreased to a lesser extent, by USD 52 per ton, or 17.0%, to USD 253 per ton from USD 305 per ton in the corresponding period in 2015 due to a significant decrease in average export duties (see "Selected macro-economic data" above). Despite a decrease in the average realized net export price in US dollars, our average realized crude oil net export price in Russian roubles increased by 5.2% due to a 25.1% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 30 June 2016 compared to the corresponding period in 2015.

In both reporting periods, we exported our crude oil via the port of Novorossiysk under FOB delivery terms. In addition, from the first quarter of 2016, we commenced our crude oil deliveries via the port of Kozmino under FOB delivery terms.

In the three months ended 30 June 2016, our average realized crude oil domestic price was RR 14,721 per ton (excluding VAT) representing a decrease of RR 141 per ton, or 0.9%, from RR 14,862 per ton (excluding VAT) in the corresponding period in 2015 due to price changes on the domestic market (which were in line with the changes in benchmark crude oil prices excluding export duties), as well as an increase in crude oil deliveries to closer regions.

The following table shows our average realized crude oil sales prices. Prices are shown net of VAT and export duties, where applicable:

	Three months ended 30 June:		Change
Russian roubles or US dollars per ton	**2016**	**2015**	**%**
Crude oil			
Net export price, RR per ton	16,538	15,721	5.2%
Net export price, USD per ton	253	305	(17.0%)
Domestic price, RR per ton	14,721	14,862	(0.9%)

Transportation tariffs

Natural gas

We transport our natural gas 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 the first half of 2015, the transportation rate was set at RR 12.79 per mcm per 100 km (excluding VAT), and the rate for utilization of the trunk pipeline was set between RR 57.18 to RR 2,048.11 per mcm (excluding VAT).

Effective 1 July 2015, the average tariff for natural gas transportation through the trunk pipeline was increased by 2.0%. As a result, the transportation rate was increased to RR 13.04 per mcm per 100 km (excluding VAT), and the rate for utilization of the trunk pipeline was set between RR 62.57 to RR 2,014.16 per mcm (excluding VAT).

According to the "Parameters of the Forecast of Socio-economic Development for 2017 to 2019" prepared by the Ministry of Economic Development of the Russian Federation and published in May 2016, the increase in transportation tariffs for natural gas produced by independent producers in 2016 to 2019 should be in line with the increase in wholesale natural gas prices – in average by 2.0% effective 1 July of each respective year (see "Natural gas prices" above). There was no indexation of transportation tariffs effective 1 July 2016, and, as of our report date there was no information regarding the actual effective date and the size of the next adjustment of transportation tariffs. 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 1 January 2015, the Regulator increased railroad freight transportation tariffs for all types of hydrocarbons by 10%, and until the end of 2015 transportation tariffs did not change. Effective 3 January 2016, the Regulator increased railroad freight transportation tariffs for all types of hydrocarbons by an additional 9%.

In 2015 and in the first half of 2016, 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 (only in 2016) markets. 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 OAO AK 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 2015, crude oil transportation tariffs within the Russian Federation territory through the pipeline network were increased by an average of 6.75% and did not change until the end of 2015. Effective 1 January 2016, crude oil transportation tariffs were increased by an average of 5.76% relative to the 2015 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.

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. 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 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.

The UPT rate for natural gas also depends on the excess of the set average transportation tariff for the prior year over the 2013 tariff adjusted to the change in consumer prices.

As part of the tax maneuver in the oil and gas industry (see above), the formula for gas condensate UPT rate calculation was adjusted by a coefficient that increased the tax rate by 25.0% from 1 January 2016 (effective 1 January 2017, the UPT rate will be further increased by 18.2% in relation to the 2016 UPT rate).

UPT – crude oil

The UPT rate for crude oil is calculated as the base UPT rate multiplied by a coefficient characterizing the dynamics of world crude oil prices, and the resulting product is further decreased by a parameter characterizing crude oil production peculiarities. The base crude oil UPT rate in 2015 was set at RR 766 per ton and was increased to RR 857 per ton effective 1 January 2016. Effective 1 January 2017, the base UPT rate will be set at RR 919 per ton.

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. In 2016, the UPT rate for crude oil produced at the aforementioned fields was calculated using an effective rate of RR 298 per ton (increased by 26.3% compared to 2015) multiplied by a coefficient characterizing the dynamics of world crude oil prices. From 1 January 2017, the effective rate will be set at RR 360 per ton.

Export duties

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 2015, the calculation of the export duty rate when the average Urals crude oil price is more than USD 182.5 per ton 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 2016 and 2017, the set percentage should have been decreased to 36% and 30%, respectively. However, in order to increase state budget income in 2016 in the anticipation of a lower crude oil price environment, in November 2015, the Russian Federation government made a decision not to adjust the formula for crude oil export duty rate calculation in 2016 and to keep a set percentage at the 2015 level of 42%.

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	**2015**	**2016**	**2017 and further**
Naphtha	85%	71%	55%
Jet fuel	48%	40%	30%
Gasoil	48%	40%	30%
Fuel oil	76%	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.

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 did not change and 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 2015 and 2016:

	2015		2016	
	Base, RR thousand	**Rate, %**	**Base, RR thousand**	**Rate, %**
Pension Fund of the Russian Federation	less 711 above 711	22.0% 10.0%	less 796 above 796	22.0% 10.0%
Federal Compulsory Medical Insurance Fund	No limit	5.1%	No limit	5.1%
Social Insurance Fund of the Russian Federation	less 670 above 670	2.9% 0.0%	less 718 above 718	2.9% 0.0%

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

In the three months ended 30 June 2016, our natural gas sales volumes slightly decreased by 436 mmcm, or 3.0%, as a result of one of our major customers taking more volumes in the first quarter of 2016 and the respective reallocation of sales volumes in subsequent quarters. In addition, during the second quarter of 2016, we increased our natural gas inventory balances by 6.1% as compared to the corresponding period in 2015 for future sales in the peak winter season. Overall, in the first half of 2016, our natural gas sales volumes increased by 1,362 mmcm, or 4.5%, as compared to the corresponding period in 2015. In the three months ended 30 June 2016, natural gas production volumes at our main fields decreased, but were offset to a significant extent by an increase in the production of our joint ventures.

In the three months ended 30 June 2016, our liquids sales volumes increased significantly by 1,228 thousand tons, or 42.2%, primarily due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015, as well as an increase in the production of gas condensate in our joint ventures.

Natural gas production volumes

In the three months ended 30 June 2016, our total natural gas production (including our proportionate share in the production of joint ventures) marginally decreased by 369 mmcm, or 2.2%, to 16,521 mmcm from 16,890 mmcm in the corresponding period in 2015 due to a decrease in production by our subsidiaries, which was largely offset by an increase in production by our joint ventures.

millions of cubic meters	**Three months ended 30 June: 2016**	**2015**	**Change %**
Production by subsidiaries from:			
Yurkharovskoye field	8,535	8,938	(4.5%)
East-Tarkosalinskoye field	2,006	2,320	(13.5%)
Khancheyskoye field	633	601	5.3%
Other fields	428	419	2.1%
Total natural gas production by subsidiaries	**11,602**	**12,278**	**(5.5%)**
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	3,355	3,119	7.6%
Nortgas	1,276	1,364	(6.5%)
Terneftegas	288	129	123.3%
Total Group's proportionate share in the natural gas production of joint ventures	**4,919**	**4,612**	**6.7%**
Total natural gas production including proportionate share in the production of joint ventures	**16,521**	**16,890**	**(2.2%)**

In the three months ended 30 June 2016, the combined total volumes of natural gas produced by our subsidiaries decreased by 676 mmcm, or 5.5%, to 11,602 mmcm from 12,278 mmcm in the corresponding period in 2015 due to natural decline in the reservoir pressure at the current gas producing horizons at our mature fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye). The decrease in production was partially offset by the launch of additional facilities in August 2015 to improve the efficiency of associated petroleum gas utilization at our Khancheyskoye field.

In the three months ended 30 June 2016, our proportionate share in the production of our joint ventures increased by 307 mmcm, or 6.7%, to 4,919 mmcm from 4,612 mmcm in the corresponding period in 2015 primarily as a result of the production growth in SeverEnergia due to reaching the nameplate production capacity of the Yaro-Yakhinskoye field in June 2015 (the field was launched in April 2015). In addition, effective May 2015, our joint venture Terneftegas commenced production at the Termokarstovoye field and reached the nameplate production capacity in June 2015.

Natural gas sales volumes

In the three months ended 30 June 2016, our total natural gas sales volumes slightly decreased by 436 mmcm, or 3.0%, to 14,062 mmcm from 14,498 mmcm in the corresponding period in 2015 as a result of one of our major customers taking more volumes in the first quarter of 2016 and the respective reallocation of sales volumes in subsequent quarters. In addition, during the second quarter of 2016, we increased our natural gas inventory balances by 6.1% as compared to the corresponding period in 2015 for future sales in the peak winter season. Overall, in the first half of 2016, our natural gas sales volumes increased by 1,362 mmcm, or 4.5%, as compared to the corresponding period in 2015.

millions of cubic meters	**Three months ended 30 June: 2016**	**2015**	**Change %**
Production by subsidiaries	11,602	12,278	(5.5%)
Purchases from the Group's joint ventures	1,840	1,615	13.9%
Other purchases	1,939	1,596	21.5%
Total production and purchases	**15,381**	**15,489**	**(0.7%)**
Purovsky Plant, own usage and methanol production	(54)	(49)	10.2%
Decrease (increase) in GTS, UGSF and own pipeline infrastructure	(1,265)	(942)	34.3%
Total natural gas sales volumes	**14,062**	**14,498**	**(3.0%)**
Sold to end-customers	*13,045*	*13,502*	*(3.4%)*
Sold ex-field	*1,017*	*996*	*2.1%*

In the three months ended 30 June 2016, natural gas purchases from our joint ventures increased by 225 mmcm, or 13.9%, to 1,840 mmcm from 1,615 mmcm in the corresponding period in 2015 primarily due to an increase in purchases from Terneftegas as a result of the reaching the nameplate production capacity of the Termokarstovoye field in June 2015 (the field was launched in May 2015).

Other natural gas purchases increased by 343 mmcm, or 21.5%. Other natural gas purchases 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.

In both reporting periods, we used 19 mmcm of natural gas as feedstock for the production of methanol. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation during the production, preparation and transportation of hydrocarbons.

As of 30 June 2016, our natural gas inventory balance in the GTS, the UGSF and our own pipeline infrastructure aggregated 1,694 mmcm and increased by 1,265 mmcm during the quarter as compared to an increase by 942 mmcm in the corresponding period in 2015. In both reporting periods, an increase in inventory balances was due to the seasonal injection of natural gas into the UGSF for the subsequent sale in the period of high demand.

Liquids production volumes

In the three months ended 30 June 2016, our total liquids production (including our proportionate share in the production of joint ventures) increased by 921 thousand tons, or 41.9%, to 3,119 thousand tons from 2,198 thousand tons in the corresponding period in 2015 primarily due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015, as well as an increase in gas condensate production of our joint ventures.

thousands of tons	Three months ended 30 June: 2016	2015	Change %
Production by subsidiaries from:			
Yarudeyskoye field	878	-	n/a
Yurkharovskoye field	466	531	(12.2%)
East-Tarkosalinskoye field	340	329	3.3%
Khancheyskoye field	94	98	(4.1%)
Other fields	31	38	(18.4%)
Total liquids production by subsidiaries	**1,809**	**996**	**81.6%**
including crude oil	*1,193*	*299*	*299.0%*
including gas condensate	*616*	*697*	*(11.6%)*
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	1,068	997	7.1%
Nortgas	134	158	(15.2%)
Terneftegas	108	47	129.8%
Total Group's proportionate share in the liquids production of joint ventures	**1,310**	**1,202**	**9.0%**
Total liquids production including proportionate share in the production of joint ventures	**3,119**	**2,198**	**41.9%**

In the three months ended 30 June 2016, the volumes of liquids produced by our subsidiaries increased significantly by 813 thousand tons, or 81.6% primarily due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015 and reaching the nameplate production capacity by the end of the month (see "Recent developments" above). At the same time gas condensate production decreased due to the natural declines in the concentration of gas condensate at our mature fields (Yurkharovskoye and East-Tarkosalinskoye) as a result of decreasing reservoir pressure at the current gas condensate producing horizons.

In the three months ended 30 June 2016, our proportionate share in liquids production of joint ventures increased by 108 thousand tons, or 9.0%, to 1,310 thousand tons from 1,202 thousand tons in the corresponding period in 2015. The increase was as a result of production growth in SeverEnergia due to reaching the nameplate production capacity of the Yaro-Yakhinskoye field in June 2015 (the field was launched in April 2015), as well as the production commencement at the Termokarstovoye field of our joint venture Terneftegas in May 2015 (the nameplate production capacity was reached in June 2015).

Liquids sales volumes

In the three months ended 30 June 2016, our total liquids sales volumes increased significantly by 1,228 thousand tons, or 42.2%, to 4,139 thousand tons from 2,911 thousand tons in the corresponding period in 2015 due to an increase in the production of crude oil in our subsidiaries, as well as gas condensate production in our joint ventures.

thousands of tons	**Three months ended 30 June: 2016**	**2015**	**Change %**
Production by subsidiaries	1,809	996	81.6%
Purchases from the Group's joint ventures	2,450	2,184	12.2%
Other purchases	13	17	(23.5%)
Total production and purchases	**4,272**	**3,197**	**33.6%**
Losses [(1)] and own usage [(2)]	(75)	(66)	13.6%
Decreases (increases) in liquids inventory balances	(58)	(220)	(73.6%)
Total liquids sales volumes	**4,139**	**2,911**	**42.2%**
Naphtha export	*1,102*	*997*	*10.5%*
Other gas condensate refined products export	*560*	*560*	*0.0%*
Other gas condensate refined products domestic	*22*	*31*	*(29.0%)*
Subtotal gas condensate refined products	***1,684***	***1,588***	***6.0%***
Crude oil export	*360*	*110*	*227.3%*
Crude oil domestic	*797*	*128*	*n/a*
Subtotal crude oil	***1,157***	***238***	***386.1%***
LPG export	*156*	*136*	*14.7%*
LPG domestic	*500*	*401*	*24.7%*
Subtotal LPG	***656***	***537***	***22.2%***
Stable gas condensate export	*250*	*218*	*14.7%*
Stable gas condensate domestic	*389*	*327*	*19.0%*
Subtotal stable gas condensate	***639***	***545***	***17.2%***
Other oil products domestic	*3*	*3*	*0.0%*
Subtotal other oil products	***3***	***3***	***0.0%***

(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 charted tankers.

In the three months ended 30 June 2016, our purchases of liquid hydrocarbons from joint ventures increased by 266 thousand tons, or 12.2%, due to an increase in purchases of gas condensate from SeverEnergia and Terneftegas resulting from the launch of additional production facilities (see "Liquids production volumes" above).

Sales volumes of jet fuel, gasoil and fuel oil received from the processing of stable gas condensate are disclosed in lines "Other gas condensate refined products export" and "Other gas condensate refined products domestic".

In the 2016 reporting period, our liquids inventory balances increased by 58 thousand tons to 670 thousand tons as of 30 June 2016 as compared to an increase in inventory balances by 220 thousand tons to 811 thousand tons in the corresponding period in 2015. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations of stable gas condensate and its refined products shipments (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 JUNE 2016 COMPARED TO THE CORRESPONDING PERIOD IN 2015

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2016 and 2015. Each line item is also shown as a percentage of our total revenues.

	Three months ended 30 June:			
millions of Russian roubles	**2016**	**% of total revenues**	**2015**	**% of total revenues**
Total revenues [1]	**127,388**	***100.0%***	**112,244**	***100.0%***
including:				
natural gas sales	50,707	*39.8%*	50,534	*45.0%*
liquids' sales	75,756	*59.5%*	61,040	*54.4%*
Operating expenses	(90,019)	*(70.7%)*	(79,541)	*(70.9%)*
Other operating income (loss), net	(1,731)	*(1.4%)*	(158)	*(0.1%)*
Profit from operations	**35,638**	***27.9%***	**32,545**	***29.0%***
Finance income (expense)	74	*0.1%*	2,130	*1.9%*
Share of profit (loss) of joint ventures, net of income tax	19,623	*15.4%*	13,004	*11.6%*
Profit before income tax	**55,335**	***43.4%***	**47,679**	***42.5%***
Total income tax expense	(7,011)	*(5.5%)*	(6,410)	*(5.7%)*
Profit	**48,324**	***37.9%***	**41,269**	***36.8%***
Less: profit (loss) attributable to non-controlling interest	(2,390)	*(1.8%)*	651	*0.6%*
Profit attributable to shareholders of OAO NOVATEK	**45,934**	***36.1%***	**41,920**	***37.4%***

[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 three months ended 30 June 2016 and 2015:

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Natural gas sales	**50,707**	**50,534**	**0.3%**
End-customers	*48,621*	*48,673*	*(0.1%)*
Ex-field sales	*2,086*	*1,861*	*12.1%*
Gas condensate refined products sales	**41,387**	**40,120**	**3.2%**
Export – naphtha	*28,734*	*25,765*	*11.5%*
Export – other refined products	*12,226*	*13,716*	*(10.9%)*
Domestic – other refined products	*427*	*639*	*(33.2%)*
Crude oil sales	**17,682**	**3,639**	**385.9%**
Export	*5,948*	*1,732*	*243.4%*
Domestic	*11,734*	*1,907*	*n/a*
Stable gas condensate sales	**11,837**	**10,100**	**17.2%**
Export	*5,614*	*4,766*	*17.8%*
Domestic	*6,223*	*5,334*	*16.7%*
Liquefied petroleum gas sales	**4,729**	**7,064**	**(33.1%)**
Export	*2,632*	*2,966*	*(11.3%)*
Domestic	*2,097*	*4,098*	*(48.8%)*
Other products sales	**121**	**117**	**3.4%**
Domestic	*121*	*117*	*3.4%*
Total oil and gas sales	**126,463**	**111,574**	**13.3%**
Other revenues	925	670	38.1%
Total revenues	**127,388**	**112,244**	**13.5%**

Natural gas sales

Our revenues from natural gas sales increased marginally by RR 173 million, or 0.3%, compared to the corresponding period in 2015. The slight decrease in sales volumes of natural gas was fully offset by an increase in average sales prices. The increase in our natural gas average sales prices was mainly due to an increase in the average regulated prices by 7.5% effective 1 July 2015 that was partially offset by an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the reporting period of the prior year (see "Natural gas prices" above).

Our proportion of natural gas sold to end-customers to total natural gas sales volumes changed insignificantly and amounted to 92.8% and 93.1% in the three months ended 30 June 2016 and 2015, respectively.

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 the three months ended 30 June 2016, our revenues from sales of gas condensate refined products increased by RR 1,267 million, or 3.2%, as compared to the corresponding period in 2015 due to an increase in sales volumes of naphtha that was partially offset by a decrease in average realized net export prices for jet fuel, gasoil and fuel oil in Russian roubles.

In the three months ended 30 June 2016, our revenues from sales of naphtha increased by RR 2,969 million, or 11.5%, as compared to the corresponding period in 2015 primarily due to an increase in sales volumes by 10.5% while average realized net export prices in Russian roubles changed insignificantly.

In the three months ended 30 June 2016 and 2015, we exported 1,102 thousand and 997 thousand tons of naphtha, respectively. Our average realized net export price, excluding export duties, increased marginally by RR 231 per ton, or 0.9%, to RR 26,073 per ton (CFR, CIF and DES) from RR 25,842 per ton (CFR, CIF, DES, DAP and FOB) in the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 June 2016, our revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets decreased by RR 1,702 million, or 11.9%, as compared to the corresponding period in 2015 primarily due to a decrease in average realized net export prices in Russian roubles. In each reporting period we exported in aggregate 560 thousand tons of these products to the European markets, or 96.2% and 94.8% of total sales volumes (on the domestic and export markets), respectively. Our average realized net export price, excluding export duties, decreased by RR 2,663 per ton, or 10.9%, to RR 21,849 per ton (CIF, DES and FOB) from RR 24,512 per ton (CIF, DAP and FOB) in the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Crude oil sales

In the three months ended 30 June 2016, revenues from crude oil sales significantly increased by RR 14,043 million, or 4.9 times, compared to the corresponding period in 2015 due to a significant increase in sales volumes. Our crude oil sales volumes increased by 919 thousand tons, or 4.9 times, to 1,157 thousand tons from 238 thousand tons in the corresponding period in 2015 due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015 and reaching the nameplate production capacity by the end of the month.

In the three months ended 30 June 2016, we sold 797 thousand tons, or 68.9% of our total crude oil sales volumes, domestically at an average price of RR 14,721 per ton (excluding VAT) representing a decrease of RR 141 per ton, or 0.9%, as compared to the corresponding period in 2015.

The remaining 360 thousand tons, or 31.1% of our total sales volumes, were sold to export markets at an average net export price of RR 16,538 per ton (FOB, excluding export duties) representing an increase of RR 817 per ton, or 5.2%, as compared to the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Stable gas condensate sales

In the three months ended 30 June 2016, our revenues from sales of stable gas condensate increased by RR 1,737 million, or 17.2%, compared to the corresponding period in 2015 due to an increase in volumes sold (see "Hydrocarbon production and sales volumes" above).

In the three months ended 30 June 2016, we sold 250 thousand tons of stable gas condensate, or 39.1% of our total sales volumes, compared to 218 thousand tons, or 40.0%, in the corresponding period in 2015 to the APR and the European markets. Our average realized stable gas condensate net export price, excluding export duties, increased by RR 544 per ton, or 2.5%, to RR 22,425 per ton from RR 21,881 per ton (CFR and DAP in both reporting periods) (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 June 2016, we sold 389 thousand tons of stable gas condensate, or 60.9% of our total sales volumes, on the domestic market compared to 327 thousand tons, or 60.0%, in the corresponding period in 2015. Our average realized price for stable gas condensate sales on the domestic market in the three months ended 30 June 2016 amounted to RR 16,002 per ton (excluding VAT), representing a marginal decrease of RR 318 per ton, or 1.9%, as compared to the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Liquefied petroleum gas sales

In the three months ended 30 June 2016, our revenues from sales of LPG decreased by RR 2,335 million, or 33.1%, compared to the corresponding period in 2015 due to a decrease in average realized prices that was partially offset by an increase in total sales volumes.

In the three months ended 30 June 2016, we sold 156 thousand tons of LPG, or 23.8% of our total LPG sales volumes, to export markets as compared to sales of 136 thousand tons, or 25.3%, in the corresponding period in 2015. Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense and including trading activities, decreased by RR 4,867 per ton, or 22.4%.

In both reporting periods we sold most of our export volumes of LPG to Poland..

In the three months ended 30 June 2016, we sold 500 thousand tons of LPG, or 76.2% of our total LPG sales volumes, on the domestic market compared to sales of 401 thousand tons, or 74.7%, in the corresponding period in 2015. Our average realized LPG domestic price, including trading activities, in the three months ended 30 June 2016, was RR 4,187 per ton representing a decrease of RR 6,035 per ton, or 59.0%, compared to the corresponding period in 2015 (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 methanol, oil products (diesel fuel and petrol) purchased for resale and sold through our retail stations and other liquid hydrocarbons. In the three months ended 30 June 2016, our revenues from other products sales increased marginally by RR four million, or 3.4%, to RR 121 million from RR 117 million in the corresponding period in 2015.

Other revenues

Other revenues include revenue from geological and geophysical research services, rent, sublease, repair and maintenance of energy equipment services, as well as other services. In the three months ended 30 June 2016, other revenues increased by RR 255 million, or 38.1%, to RR 925 million from RR 670 million in the corresponding period in 2015 primarily due to an increase in revenues from the sublease of tankers by RR 199 million. The related chartering expenses are included in our transportation expenses in line "Gas condensate refined products and stable gas condensate transportation by tankers".

In addition, in the three months ended 30 June 2016, other revenues increased by RR 46 million due to an increase in revenues from repair and maintenance of energy equipment services provided by our subsidiary NOVATEK-Energo.

Operating expenses

In the three months ended 30 June 2016, our total operating expenses increased by RR 10,478 million, or 13.2%, to RR 90,019 million compared to RR 79,541 million in the corresponding period in 2015 mainly due to the launch of the Yarudeyskoye field in December 2015 and the respective increased transportation, taxes other than income tax expenses, depreciation, depletion and amortization, and materials, services and other expenses. Operating expenses also increased due to growth of purchases of natural gas and liquid hydrocarbons from our joint ventures that in turn allowed us to sell increased volumes of hydrocarbons to both domestic and international markets (see "Purchases of natural gas and liquid hydrocarbons" below). Our total operating expenses as a percentage of total revenues changed marginally (decreased to 70.7% from 70.9%).

	Three months ended 30 June:			
millions of Russian roubles	**2016**	**% of total revenues**	**2015**	**% of total revenues**
Purchases of natural gas and liquid hydrocarbons	32,003	*25.1%*	29,892	*26.6%*
Transportation expenses	30,579	*24.0%*	29,940	*26.7%*
Taxes other than income tax	11,393	*8.9%*	9,015	*8.0%*
Depreciation, depletion and amortization	8,363	*6.6%*	4,681	*4.2%*
General and administrative expenses	5,553	*4.4%*	4,907	*4.4%*
Materials, services and other	4,384	*3.4%*	3,294	*2.9%*
Exploration expenses	42	*n/a*	22	*n/a*
Impairment expenses (reversals), net	(40)	*n/a*	(261)	*n/a*
Changes in natural gas, liquid hydrocarbons and work-in-progress	(2,258)	*n/a*	(1,949)	*n/a*
Total operating expenses	**90,019**	***70.7%***	**79,541**	***70.9%***

Purchases of natural gas and liquid hydrocarbons

In the three months ended 30 June 2016, our purchases of natural gas and liquid hydrocarbons increased by RR 2,111 million, or 7.1%, to RR 32,003 million from RR 29,892 million in the corresponding period in 2015.

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2016**	**2015**	**%**
Unstable gas condensate	23,957	23,426	2.3%
Natural gas	7,819	6,171	26.7%
Other liquid hydrocarbons	227	295	(23.1%)
Total purchases of natural gas and liquid hydrocarbons	**32,003**	**29,892**	**7.1%**

In the three months ended 30 June 2016, our purchases of unstable gas condensate from our joint ventures increased by RR 531 million, or 2.3%, as compared to the corresponding period in 2015, due to an increase in purchases from SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) as a result of reaching in June 2015 the nameplate production capacity of the Yaro-Yakhinskoye field, which was launched in April 2015, as well as the commencement of purchases from Terneftegas effective May 2015 (see "Liquids production volumes" above).

In the three months ended 30 June 2016, our purchases of natural gas increased by RR 1,648 million, or 26.7%, as compared to the corresponding period in 2015 as a result of an increase in purchases from third parties, as well as the commencement of purchases from Terneftegas since May 2015 (see "Natural gas production volumes" above). In addition, purchase prices increased due to an increase in the average regulated price by 7.5% effective 1 July 2015.

Other liquid hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products. In the three months ended 30 June 2016, our purchases of other liquid hydrocarbons decreased by RR 68 million, or 23.1%, as compared to the corresponding period in 2015.

Transportation expenses

In the three months ended 30 June 2016, our total transportation expenses increased by RR 639 million, or 2.1%, to RR 30,579 million as compared to RR 29,940 million in the corresponding period in 2015.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Natural gas transportation by trunk and low-pressure pipelines	18,579	20,277	(8.4%)
Stable gas condensate and liquefied petroleum gas transportation by rail	8,017	6,650	20.6%
Gas condensate refined products, stable gas condensate and crude oil transportation by tankers	2,300	2,635	(12.7%)
Crude oil transportation by trunk pipelines	1,644	360	356.7%
Other	39	18	116.7%
Total transportation expenses	**30,579**	**29,940**	**2.1%**

Despite an average 2.0% increase in the natural gas regulated transportation tariff effective 1 July 2015 (see "Transportation tariffs" above), in the three months ended 30 June 2016, our expenses for natural gas transportation decreased by RR 1,698 million, or 8.4%, to RR 18,579 million from RR 20,277 million in the corresponding period in 2015. The decrease in expenses was due to a 3.4% decrease in our natural gas sales volumes to end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the respective period in 2015.

In the three months ended 30 June 2016, our total expenses for stable gas condensate and LPG transportation by rail increased by RR 1,367 million, or 20.6%, to RR 8,017 million from RR 6,650 million in the corresponding period in 2015 due to a 11.3% increase in our weighted average transportation cost per unit resulted from an increase in the regulated railroad transportation tariffs effective January 2016 (see "Transportation tariffs" above) and, to a lesser extent, an increase in volumes of liquids sold and transported via rail by 8.3%.

In the three months ended 30 June 2016, our total transportation expenses for liquids delivered by tankers to international markets decreased by RR 335 million, or 12.7%, to RR 2,300 million from RR 2,635 million in the corresponding period in 2015 as a result of a decrease in average freight rates which fluctuate period-on-period depending on worldwide demand for tankers transportation.

In the three months ended 30 June 2016, our expenses for crude oil transportation to customers by trunk pipeline significantly increased by RR 1,284 million, or 4.6 times, to RR 1,644 million from RR 360 million in the corresponding period in 2015 due to a significant 4.9 times increase in volumes transported as a result of the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015.

Taxes other than income tax

In the three months ended 30 June 2016, taxes other than income tax increased by RR 2,378 million, or 26.4%, to RR 11,393 million from RR 9,015 million in the corresponding period in 2015 primarily due to an increase in the unified natural resources production tax expense.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Unified natural resources production tax (UPT)	10,641	8,376	27.0%
Property tax	658	550	19.6%
Other taxes	94	89	5.6%
Total taxes other than income tax	**11,393**	**9,015**	**26.4%**

In the three months ended 30 June 2016, our unified natural resources production tax expense increased by RR 2,265 million, or 27.0%, to RR 10,641 million from RR 8,376 million in the corresponding period in 2015 primarily due to a significant increase in crude oil production as a result of the commercial production commencement at the Yarudeyskoye field in December 2015. In addition, as a part of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above), the formula used for gas condensate UPT rate calculation was adjusted by a coefficient that increased the rate by 25.0% from the 1 January 2016 in relation to 2015 which also increased our UPT expense.

In the three months ended 30 June 2016, our property tax expense increased by RR 108 million, or 19.6%, to RR 658 million from RR 550 million in the corresponding period in 2015 mainly due to the launch of the Yarudeyskoye field in December 2015, as well as additions to property, plant and equipment at our other production subsidiaries.

Depreciation, depletion and amortization

In the three months ended 30 June 2016, our depreciation, depletion and amortization ("DDA") expense increased by RR 3,682 million, or 78.7%, to RR 8,363 million from RR 4,681 million in the corresponding period in 2015 mainly due to the launch of the Yarudeyskoye field in December 2015, as well as additions of property, plant and equipment at our production subsidiaries during the 12 months preceding the reporting period. We accrue depreciation and depletion using the "units-of-production" method for our oil and gas assets and using a straight-line method for other facilities.

General and administrative expenses

In the three months ended 30 June 2016, our general and administrative expenses increased by RR 646 million, or 13.2%, to RR 5,553 million compared to RR 4,907 million in the corresponding period in 2015. The main components of these expenses were employee compensation, social expenses and compensatory payments, as well as legal, audit and consulting services, which, on aggregate, comprised 82.7% and 84.3% of total general and administrative expenses in the three months ended 30 June 2016 and 2015, respectively.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Employee compensation	3,650	3,361	8.6%
Social expenses and compensatory payments	700	502	39.4%
Legal, audit and consulting services	243	274	(11.3%)
Advertising expenses	220	138	59.4%
Business travel expense	209	132	58.3%
Insurance expense	132	74	78.4%
Fire safety and security expenses	95	79	20.3%
Rent expense	65	39	66.7%
Repair and maintenance expenses	45	109	(58.7%)
Other	194	199	(2.5%)
Total general and administrative expenses	**5,553**	**4,907**	**13.2%**

Employee compensation relating to administrative personnel increased by RR 289 million, or 8.6%, to RR 3,650 million in the three months ended 30 June 2016 from RR 3,361 million in the corresponding period in 2015. The increase was due to an increase in the average number of employees, an indexation of base personnel salaries effective 1 July 2015, and the related increase in social contributions for medical and social insurance and to the Pension Fund.

In the three months ended 30 June 2016, our social expenses and compensatory payments increased by RR 198 million, or 39.4%, to RR 700 million compared to RR 502 million in the corresponding period in 2015 mainly due to an increase in compensatory payments. These payments related to the development of Yarudeyskoye, Salmanovskoye and Geofizicheskoye fields and were RR 440 million in the current reporting period compared to RR 345 million in the corresponding period in 2015. 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.

Advertising expenses increased by RR 82 million, or 59.4%, to RR 220 million in the three months ended 30 June 2016 from RR 138 million in the corresponding period in 2015 mainly due to the conclusion of a corporate sponsorship contract for the Group's advertising during sporting events at the end of 2015.

Business travel expenses increased by RR 77 million, or 58.3%, to RR 209 million in the three months ended 30 June 2016 from RR 132 million in the corresponding period in 2015 mainly due to the expanding nature of the Group's business activities on international markets.

Insurance expenses increased by RR 58 million, or 78.4%, to RR 132 million in the three months ended 30 June 2016 from RR 74 million in the corresponding period in 2015 due to an increase in insurable property valuation and the number of items of insured property, plant and equipment in our major subsidiaries.

Repair and maintenance expenses decreased by RR 64 million, or 58.7%, to RR 45 million in the three months ended 30 June 2016 from RR 109 million in the corresponding period in 2015 mainly due to current repair works performed in the second quarter of 2015 at the Group's Moscow head office building (absent in the second quarter of 2016).

Other items of our general and administrative expenses changed marginally.

Materials, services and other

In the three months ended 30 June 2016, our materials, services and other expenses increased by RR 1,090 million, or 33.1%, to RR 4,384 million compared to RR 3,294 million in the corresponding period in 2015 primarily due to the launch of the Yarudeyskoye field in December 2015. The main components of this expense category were expenses relating to repair and maintenance services, materials and supplies, complex of services for preparation, transportation and processing of hydrocarbons, as well as employee compensation, which on aggregate comprised 76.7% and 78.9% of total materials, services and other expenses in the three months ended 30 June 2016 and 2015, respectively.

millions of Russian roubles	Three months ended 30 June: 2016	2015	Change %
Employee compensation	1,974	1,601	23.3%
Repair and maintenance	754	366	106.0%
Materials and supplies	432	220	96.4%
Liquefied petroleum gas volumes reservation expenses	263	123	113.8%
Electricity and fuel	257	213	20.7%
Complex of services for preparation, transportation and processing of hydrocarbons	202	413	(51.1%)
Security services	164	112	46.4%
Transportation services	141	87	62.1%
Rent expenses	58	19	205.3%
Other	139	140	(0.7%)
Total materials, services and other	**4,384**	**3,294**	**33.1%**

Operating employee compensation increased by RR 373 million, or 23.3%, to RR 1,974 million compared to RR 1,601 million in the corresponding period in 2015. The increase was due to an increase in the average number of employees as a result of launch of the Yarudeyskoye field in December 2015, an indexation of base salaries effective from 1 July 2015 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Repair and maintenance services expenses increased by RR 388 million, or 106.0%, to RR 754 million in the three months ended 30 June 2016 compared to RR 366 million in the corresponding period in 2015 due to increased well services works, current repair works of other assets performed at our production subsidiaries, as well as an increase in maintenance expenses as a result of the launch of the Yarudeyskoye field in December 2015.

Materials and supplies, transportation, security services and rent expenses increased mainly due to the launch of the Yarudeyskoye field in December 2015.

In the three months ended 30 June 2016, liquefied petroleum gas volumes reservation costs increased by RR 140 million, or 113.8%, to RR 263 million from RR 123 million in the corresponding period in 2015 primarily due to an increase in LPG volumes sold through our subsidiary in Poland, as well as an increase in the average exchange rate of the Polish zloty to the Russian rouble, 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.

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. As a result of planned repair works at the Tobolsk Refining Facilities in the second quarter of 2016, expenses of this category decreased by RR 211 million, or 51.1%, to RR 202 million in the three months ended 30 June 2016 compared to RR 413 million in the corresponding period in 2015.

Exploration expenses

In the three months ended 30 June 2016, our exploration expenses increased by RR 20 million to RR 42 million. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

Impairment expenses (reversals)

In the three months ended 30 June 2016, we reversed a portion of previously accrued provisions in the total amount of RR 40 million compared to RR 261 million in the corresponding period in 2015 as a result of revising management's estimates on the probability of recovering trade accounts receivable.

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

In the three months ended 30 June 2016, we recorded a reversal of RR 2,258 million to changes in inventory expense compared to a reversal of RR 1,949 million in the corresponding period in 2015 due to a significant increase in our hydrocarbons inventory balances as of 30 June compared to 31 March.

In the three months ended 30 June 2016, our cumulative natural gas inventory balance in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure increased by 1,265 mmcm compared to a 942 mmcm increase in the inventory balance in the corresponding period in 2015. In both reporting periods, an increase in inventory balances was due to the seasonal injection of natural gas for the subsequent sale in the period of higher seasonal demand.

In the three months ended 30 June 2016 and 2015, our cumulative liquid hydrocarbons inventory balance, recognized as inventory in transit or in storage, increased by 58 thousand and 220 thousand tons, respectively, due to an increase in inventory balances of stable gas condensate and refined products in storage facilities at the Ust-Luga Complex, as well as in rail cars in transit and not realized at the reporting date. 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:

	2016			**2015**		
Inventory balances in transit or in storage	**At 30 June**	**At 31 March**	**Increase / (decrease)**	**At 30 June**	**At 31 March**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**1,694**	**429**	**1,265**	**1,596**	**654**	**942**
including Gazprom's UGSF	*1,603*	*363*	*1,240*	*1,563*	*511*	*1,052*
Liquid hydrocarbons (thousand tons)	**670**	**612**	**58**	**811**	**591**	**220**
including naphtha	*90*	*120*	*(30)*	*223*	*189*	*34*
stable gas condensate	*278*	*247*	*31*	*348*	*256*	*92*
crude oil	*106*	*121*	*(15)*	*32*	*25*	*7*

Other operating income (loss)

Other operating income (loss) includes realized income (loss) from natural gas trading on the European market under long- and short-term purchase and sales contracts, income (loss) from the change in the fair value of aforementioned contracts, as well as other income (loss) related to penalty charges, disposal of materials, fixed assets and other transactions. In the three months ended 30 June 2016, we recognized other operating loss of RR 1,731 million compared to other operating loss of RR 158 million in the corresponding period in 2015.

In the three months ended 30 June 2016, within our trading activities on the European market we purchased and sold 10.2 terawatt-hours (or approximately 970 mmcm) of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized income from trading activities of RR 639 million as compared to RR 215 million of income in the corresponding period in 2015. At the same time, in the three months ended 30 June 2016, we recognized a non-cash loss of RR 2,315 million as a result of a decrease in the fair value of the hydrocarbons purchase and sales contracts as compared to RR 352 million of a non-cash loss in the corresponding period in 2015. All trading contracts are classified as derivative instruments in accordance with IAS 39 *"Financial instruments: recognition and measurement"*.

Profit from operations and EBITDA

Our profit from operations increased by RR 3,093 million, or 9.5%, to RR 35,638 million in the three months ended 30 June 2016, as compared to RR 32,545 million in the corresponding period in 2015 mainly due to a significant increase in crude oil sales volumes resulted from the commencement of commercial production at the Yarudeyskoye field in December 2015 and reaching the nameplate production capacity by the end of the month. At the same time our share in the profit from operations of our joint ventures increased by RR 552 million, or 6.9%, to RR 8,571 million as compared to RR 8,019 million (see "Share of profit (loss) of joint ventures, net of income tax" below).

Our EBITDA increased by RR 9,996 million, or 20.2%, to RR 59,507 million in the three months ended 30 June 2016 from RR 49,511 million in the corresponding period in 2015 mainly due to a significant increase in liquid hydrocarbons sales volumes.

Finance income (expense)

In the three months ended 30 June 2016, we recorded a net finance income of RR 74 million compared to net finance income of RR 2,130 million in the corresponding period in 2015. A decrease in our net finance income in the second quarter of 2016 was primarily due to the recognition of significant non-cash foreign exchange loss as a result of the Russian rouble appreciation relative to the US dollar and Euro, that was largely offset by the recognition of a non-cash gain from the remeasurement of the shareholders' loans issued by the Group to our joint ventures.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Accrued interest expense on loans received	(4,070)	(2,865)	42.1%
Less: capitalized interest	1,522	1,213	25.5%
Provisions for asset retirement obligations: effect of the present value discount unwinding	(137)	(68)	101.5%
Interest expense	**(2,685)**	**(1,720)**	**56.1%**
Interest income	4,809	2,669	80.2%
Change in fair value of non-commodity financial instruments	6,301	(95)	n/a
Foreign exchange gain (loss), net	(8,351)	1,276	n/a
Total finance income (expense)	**74**	**2,130**	**(96.5%)**

In the three months ended 30 June 2016, our interest expense increased by RR 965 million, or 56.1%, to RR 2,685 million due to an increase in the aggregate amount of the Group's borrowing obligations in Russian roubles terms as a result of the depreciation of the average Russian rouble exchange rate relative to the US dollar (see "Selected macro-economic data" above), as well as an increase in the weighted average interest rate due to changes in our debt portfolio.

Interest income increased by RR 2,140 million, or 80.2%, to RR 4,809 million in the three months ended 30 June 2016 from RR 2,669 million in the corresponding period in 2015 due to an increase in loans provided to our joint ventures for the development and expansion of their activities, as well as a result of the average Russian rouble depreciation relative to the US dollar and Euro in the three months ended 30 June 2016 compared to the average exchange rate in the corresponding period in 2015.

In the three months ended 30 June 2016, we recognized non-cash gain of RR 6,301 million compared to a non-cash loss of RR 95 million in the corresponding period in 2015 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 the three months ended 30 June 2016, we recorded a net foreign exchange loss of RR 8,351 million compared to a net gain of RR 1,276 million in the corresponding period in 2015 primarily 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 the three months ended 30 June 2016, the Group's proportionate share of profit of joint ventures increased by RR 6,619 million, or 50.9%, to RR 19,623 million compared to RR 13,004 million in the corresponding period in 2015.

	Three months ended 30 June:		Change
millions of Russian roubles	**2016**	**2015**	**%**
Share in profit from operations	8,571	8,019	6.9%
Share in finance income (expense)	14,869	7,906	88.1%
Share in total income tax expense	(3,817)	(2,921)	30.7%
Total share of profit (loss) of joint ventures, net of income tax	**19,623**	**13,004**	**50.9%**

Our proportionate share in the profit from operations of our joint ventures increased by RR 552 million, or 6.9%, due to higher operating results of SeverEnergia (as a result of reaching the nameplate production capacity of the Yaro-Yakhinskoye field in June 2015) and Terneftegas (as a result of reaching the nameplate production capacity of the Termokarstovoye field in June 2015). The impact of these factors was partially offset by an increase in the unified natural resources production tax expense, as well as depreciation, depletion and amortization expense.

In the three months ended 30 June 2016, our proportionate share in the finance income of our joint ventures increased by RR 6,963 million, or 88.1%, mainly due to an increase in non-cash foreign exchange profit on foreign currency denominated loans at our joint venture Yamal LNG (our share amounted to RR 15.6 billion), that was partially offset by a recognition of a significant non-cash loss in this joint venture from the remeasurement of the fair value of shareholders' loans in the current reporting period as compared to a marginal non-cash profit in the corresponding period of the prior year (our share amounted to RR 8.1 billion).

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 our reported IFRS profit before income tax) in the three months ended 30 June 2016 and 2015, was 19.8% and 18.8%, respectively.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed in the respective sections above, our profit for the period increased by RR 7,055 million, or 17.1%, to RR 48,324 million in the three months ended 30 June 2016 from RR 41,269 million in the corresponding period in 2015. The profit attributable to shareholders of OAO NOVATEK increased by RR 4,014 million, or 9.6%, to RR 45,934 million in the three months ended 30 June 2016 as compared to RR 41,920 million in the corresponding period in 2015.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by RR 1.34 per share, or 9.6%, to RR 15.22 per share in the three months ended 30 June 2016 from RR 13.88 per share in the corresponding period in 2015.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 30 June 2016 and 2015:

millions of Russian roubles	Three months ended 30 June: 2016	2015	Change %
Net cash provided by **operating** activities	19,289	30,447	(36.6%)
Net cash used for **investing** activities	(18,301)	(17,771)	3.0%
Net cash used for **financing** activities	(58,260)	(22,870)	154.7%

In the second quarter of 2016, our net cash flows from operating and investing activities were significantly impacted by income tax payments in connection with the sale in the first quarter of 2016 of the 9.9% equity stake in OAO Yamal LNG.

In the three months ended 30 June 2016, we paid RR 9,932 million of actual income tax related to the sale, which was recorded within the cash used for investing activities. In addition, according to the existing Russian tax legislation, in the second quarter of 2016, we also made advance payments for income tax calculated based on the actual income for the first quarter of 2016, which included, among others, the gain on the disposal of the 9.9% equity stake in Yamal LNG. These advance payments were recorded within our cash flows from operating activities.

As a result, the overall advance and actual payments for income tax based on the gain on the disposal of the 9.9% equity stake in Yamal LNG amounted to RR 19,864 million. The following table shows our net cash flows from operating and investing activities excluding the effect from the one-off transaction of the sale of the 9.9% equity stake in Yamal LNG on our tax payments:

millions of Russian roubles	Three months ended 30 June: 2016	2015	Change %
Normalized net cash provided by **operating** activities [(1)]	29,221	30,447	(4.0%)
Normalized net cash used for **investing** activities [(1)]	(8,369)	(17,771)	(52.9%)

[(1)] Excluding advance and actual income tax payments of RR 9,932 million calculated based on the gain on the disposal of the 9.9% equity stake in OAO Yamal LNG.

Net cash provided by operating activities

Our net cash provided by operating activities decreased by RR 11,158 million, or 36.6%, to RR 19,289 million compared to RR 30,447 million in the corresponding period in 2015. The increase in the profit from operations adjusted for non-cash items was offset by the significant increase in income tax payments, as well as the working capital changes. In the second quarter of 2016, besides payment of the balance of the actual income tax for the first quarter of 2016, the Group, according to the Russian tax legislation, also made significant advance payments for income tax relating to the second quarter of 2016 based on the actual income for the first quarter of 2016, which included, among others, the gain on the disposal of the 9.9% equity stake in Yamal LNG. The amount of income tax advance payments will be offset against future income tax payments. Working capital balances fluctuate from period to period depending on various factors.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Profit from operations	35,638	32,545	9.5%
Non-cash adjustments [(1)]	10,588	4,916	115.4%
Changes in working capital and long-term advances given	(11,323)	(4,977)	127.5%
Interest received	1,123	392	186.5%
Income taxes paid excluding amounts relating to disposal of stakes in joint ventures	(16,737)	(2,429)	n/a
Net cash provided by operating activities	**19,289**	**30,447**	**(36.6%)**
Adjustment for advance income tax payments calculated based on the gain on the disposal of the 9.9% equity stake in Yamal LNG	9,932	-	n/a
Normalized net cash provided by operating activities	**29,221**	**30,447**	**(4.0%)**

[(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.

Net cash used for investing activities

In the three months ended 30 June 2016, our net cash used for investing activities increased by RR 530 million, or 3.0%, to RR 18,301 million compared to RR 17,771 million in the corresponding period in 2015.

millions of Russian roubles	**Three months ended 30 June: 2016**	**2015**	**Change %**
Cash used for capital expenditures	(7,233)	(15,463)	(53.2%)
Income taxes paid relating to disposal of stakes in joint ventures	(9,932)	-	n/a
Payments for mineral licenses	(763)	-	n/a
Loans provided to joint ventures	-	(2,308)	n/a
Other	(373)	-	n/a
Net cash used for investing activities	**(18,301)**	**(17,771)**	**3.0%**
Adjustment for actual income tax paid related to the gain on the disposal of the 9.9% equity stake in Yamal LNG	9,932	-	n/a
Normalized net cash used for investing activities	**(8,369)**	**(17,771)**	**(52.9%)**

Cash used for capital expenditures decreased by RR 8,230 million, or 53.2%, as compared to the 2015 reporting period. In the 2016 reporting period, the cash was mainly used for the development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, maintenance of production at our Yurkharovskoye field, as well as the development of the Salmanovskoye (Utrenneye) field.

In the three months ended 30 June 2016, we paid income tax relating to the sale of the 9.9% equity stake in Yamal LNG in March 2016 in the amount of RR 9,932 million.

In the three months ended 30 June 2016, we made a final payment in the amount of RR 763 million for the acquisition of exploration and production license for the Nyakhartinskiy license area, located in the YNAO (an advance payment in the amount of RR 294 million was made in the first quarter of 2016 (see "Recent developments" above)).

In the 2015 reporting period, we provided loans to our joint venture Yamal Development in the amount of RR 2,308 million. In the current reporting quarter we did not provide loans to our joint ventures.

Net cash used for financing activities

In the three months ended 30 June 2016, our net cash used for financing activities increased by RR 35,390 million, or 154.7%, to RR 58,260 million compared to RR 22,870 million in the corresponding period in 2015.

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2016**	**2015**	**%**
Proceeds from (repayments of) long-term debt, net	(11,067)	(6,451)	71.6%
Proceeds from (repayments of) short-term debt, net	(23,986)	566	n/a
Dividends paid	(20,831)	(15,702)	32.7%
Other	(2,376)	(1,283)	85.2%
Net cash used for financing activities	**(58,260)**	**(22,870)**	**154.7%**

In both reporting periods we did not obtain long-term loans. In the 2016 reporting period, the Group partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,853 million (USD 115 million) according to the loan's maturity schedule and a loan obtained by one of the Group's subsidiaries from its minority shareholder in the amount of RR 4,214 million. In the second quarter of 2015, we partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,451 million (USD 115 million).

In the three months ended 30 June 2016, we repaid a short-term loan from the Russian bank in the amount of RR 20,000 million. In addition, in both reporting periods, we obtained short-term loans to finance trade activities. In the current reporting period, net repayments of short-term loans amounted to RR 3,986 million, while in the corresponding period in 2015 net proceeds amounted to RR 566 million.

The remaining change related to dividends paid, the repayment of interest on borrowings and loans and shares buy-back.

Liquidity and working capital

The following table shows our liquidity and credit measures as of 30 June 2016 and 31 December 2015:

	30 June 2016	31 December 2015	Change, %
Absolute amounts, RR million			
Net debt [(1)]	216,010	329,518	(34.4%)
Net working capital position [(2)]	23,205	(41,203)	n/a
Liquidity and credit ratios			
Current ratio	1.23	0.76	61.8%
Total debt to total equity	0.42	0.84	(50.0%)
Long-term debt to long-term debt and total equity	0.25	0.37	(32.4%)
Net debt to total capitalization [(3)]	0.26	0.41	(36.6%)
Net debt to normalized EBITDA from subsidiaries [(4)]	1.23	2.05	(40.0%)

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

(2) Net working capital position represents current assets plus assets held for sale less current liabilities.

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

(4) 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.

Our net working capital position as of 30 June 2016 was a positive RR 23,205 million compared to a negative RR 41,203 million as of 31 December 2015. The change in our net working capital was primarily due to a decrease in the short-term debt and current portion of our long-term debt by RR 59,007 million from the full repayment of Eurobonds in the amount of USD 600 million in February 2016, as well as the repayment of the short-term debt from a Russian bank in the amount of RR 20 billion in May 2016.

In each quarter of 2015 and 2016, the Group achieved strong operating results and remained free cash flow positive. 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 and to finance the 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 and processing facilities:

	Three months ended 30 June:	
millions of Russian roubles	**2016**	**2015**
Yarudeyskoye field	2,907	7,105
East-Tarkosalinskoye field	925	2,283
Yurkharovskoye field	917	1,915
Salmanovskoye (Utrennee) field	693	1,450
Khancheyskoye field	443	341
North-Russkoye field	341	261
Purovsky Plant	140	32
Ust-Luga Complex	71	170
Other	576	992
Capital expenditures	**7,013**	**14,549**

Total capital expenditures on property, plant and equipment in the three months ended 30 June 2016 decreased by RR 7,536 million, or 51.8%, to RR 7,013 million from RR 14,549 million in the corresponding period in 2015. In both reporting periods, our main capital expenditures related to the development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, Yurkharovskoye field's production maintenance, as well as the development of the Salmanovskoye (Utrenneye) field.

The "Other" line in the table above represents our capital expenditures related to other fields of the Group, as well as unallocated capital expenditures as of the reporting date. The allocation of capital expenditures by fields takes place upon the completion of the fixed assets construction stages and depends on the approved fixed assets launch schedule.

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, as well as cash used for capital investments:

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2016**	**2015**	**%**
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	**8,070**	**14,549**	**(44.5%)**
Less: acquisition of mineral licenses	(1,057)	-	n/a
Capital expenditures	**7,013**	**14,549**	**(51.8%)**
Less: increase (decrease) in accounts payable and other non-cash adjustments	220	914	(75.9%)
Cash used for capital expenditures [1]	**7,233**	**15,463**	**(53.2%)**

[1] 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.

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 30 June 2016, the total amount of our long-term debt denominated in US dollars was RR 177,439 million, or 73.4% 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, 41.7% in the three months ended 30 June 2016, was denominated in US dollars.

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 once commercial production commences, the effects of the foreign currency movements in relation to foreign currency-denominated debt portfolio of Yamal LNG will be mitigated by the fact that all of its products will be delivered to international markets and revenues will be denominated in foreign currencies.

As of 30 June 2016, the Russian rouble appreciated by 11.8% and 10.7% against the US dollar and the Euro, respectively, compared to 31 December 2015.

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.

Off balance sheet activities

As of 30 June 2016, 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"
CNY	Chinese Yuan
DAP	"Delivery at point of destination"
DDA	depreciation, depletion and amortization
DES	"Delivery to the port of destination ex-ship"
FCA	"Free carrier"
FOB	"Free on board"
Forecast of the Ministry of Economic Development	The document *"Forecast of Socio-economic Development of the Russian Federation for 2015 and planned period 2016 and 2017"* prepared by the Ministry of Economic Development of the Russian Federation or the similar document prepared for another period
FTS	Federal Tariffs Service
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. During the first half of 2015, the Federal Tariffs Service fulfilled the Regulator's role. In July 2015, a Decree of the President of the Russian Federation became effective abolishing the FTS and transferring its functions to the Federal Anti-Monopoly Service
RR	Russian rouble(s)
RZD	OAO Russian Railways, Russia's state-owned monopoly railway operator
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
Tobolsk Refining Facilities	Refining facilities of OOO SIBUR Tobolsk (formerly OOO Tobolsk-Neftekhim)
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