NOVATEK

PAO NOVATEK

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

FOR THE THREE MONTHS ENDED
30 JUNE 2017 AND 2016

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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 2017 and 2016 together with our unaudited consolidated interim condensed financial statements as of and for the three and six months ended 30 June 2017. 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 2016 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

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

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

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. Yamal LNG holds the exploration and production license for the South-Tambeyskoye field located in the north-eastern part of the Yamal peninsula in the Yamal-Nenets Autonomous Region ("YNAO").

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

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

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

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

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

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 (the "Yamal LNG project"). The Yamal LNG project also includes the construction of transportation infrastructure, such as the seaport and the international airport. The launch of the first train 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.

RECENT DEVELOPMENTS

Increasing our resource base

In June 2017, the Group won the auction held by the Federal Agency for the Use of Natural Resources of the Russian Federation for the right for geological research works, exploration and production of hydrocarbons at the Gydanskiy license area. The acquisition of a new license area located on the Gydan peninsula in close proximity to our Salmanovskoye (Utrenneye) field expands the Group's resource base for implementing our future strategic projects in this region. As of 31 December 2016, the field's reserves and recoverable resources according to the Russian reserve classification ABC1+C2+D totaled approximately 645 bcm of natural gas and 60.5 million tons of liquid hydrocarbons. The payment for the license was set at RR 2,262 million.

Implementing our Yamal LNG project

Currently, the Yamal LNG project is in the final stage of preparation for the launch of the first train of the LNG plant and the start of liquefied natural gas shipments planned in 2017. Most of the infrastructure required for the launch is now completed, including the seaport and the international airport, the required production wells have been drilled, and all of the modules for the first LNG train have been delivered and installed. More than 95% of LNG volumes produced within the project have been contracted under long-term agreements and we have signed long-term agreements for time chartering of LNG ice class carriers to ensure future LNG deliveries. In March 2017, the first LNG carrier successfully passed ice trial tests and is now ready for LNG transportation.

The project's complete external financing needs were met with the signing of credit agreements with a number of Russian and foreign banks and bonds placement in 2015 and 2016. In June 2017, the number of creditors providing external project financing to Yamal LNG was further expanded without increasing the overall amount of financing. Yamal LNG signed credit agreements with European banks with insurance coverage provided by the Swedish export credit agency EKN and the German export credit agency Euler Hermes on 14-year credit line facilities for the total amount of up to EUR 425 million. The signing of the new credit line agreements optimizes Yamal LNG's credit portfolio and reduces its average borrowing cost, contributing to the economic efficiency of the project.

Development of our future LNG projects

The Group is conducting feasibility studies for the construction of a new LNG plant on the Gydan peninsula based on the hydrocarbon resources of the Salmanovskoye (Utrenneye) field (the "Arctic LNG 2 project"). It is contemplated to build the plant on gravity-based platforms which will be constructed, jointly with other major units for the plant, at our own center for construction of large-scale offshore structures located in Murmansk region (OOO Kola Yard). The Group signed a framework agreement with TechnipFMC, Linde AG and AO Research and Design Institute for Gas Processing (NIPIGAS) on strategic cooperation for designing and developing future LNG plants based on gravity-based platforms for Arctic LNG 2 project, as well as subsequent NOVATEK's LNG projects.

In the second quarter of 2017, the Group purchased licenses for natural gas liquefaction technology from Linde and commenced front-end engineering design (FEED) work for the LNG plant of the Arctic LNG 2 project.

Acquisition of a medium-scale LNG plant

In July 2017, NOVATEK acquired a 51% ownership interest in OOO Cryogas-Vysotsk which undertakes to construct the first train of a medium-scale LNG plant for natural gas liquefaction with annual capacity of 660 thousand tons, located at the port of Vysotsk on the Baltic Sea.

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 30 June: 2017	2016	Change %
Financial results			
Total revenues [(1)]	128,830	127,388	1.1%
Operating expenses	(94,033)	(90,019)	4.5%
EBITDA [(2)]	56,072	59,507	(5.8%)
Profit attributable to shareholders of PAO NOVATEK	3,243	45,934	(92.9%)
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses) [(3)]	33,772	29,610	14.1%
Earnings per share (in Russian roubles)	1.08	15.22	(92.9%)
Earnings per share, excluding the effect of foreign exchange gains (losses) [(3)] (in Russian roubles)	11.20	9.81	14.2%
Net debt [(4)]	115,075	216,010	(46.7%)
Production volumes [(5)]			
Hydrocarbons production (million barrels of oil equivalent)	124.6	134.1	(7.0%)
Daily production (million barrels of oil equivalent per day)	1.37	1.47	(7.0%)
Operating results			
Natural gas sales volumes (million cubic meters)	14,380	14,062	2.3%
Crude oil sales volumes (thousand tons)	1,211	1,157	4.7%
Naphtha sales volumes (thousand tons)	1,060	1,102	(3.8%)
Other gas condensate refined products (thousand tons) [(6)]	703	582	20.8%
Liquefied petroleum gas sales volumes (thousand tons)	645	656	(1.7%)
Stable gas condensate sales volumes (thousand tons)	450	639	(29.6%)
Cash flow results			
Net cash provided by operating activities	39,114	19,289	102.8%
Normalized net cash provided by operating activities [(7)]	39,114	29,221	33.9%
Cash used for capital expenditures [(8)]	8,123	7,233	12.3%
Free cash flow [(9)]	30,991	12,056	157.1%
Normalized free cash flow [(7),(9)]	30,991	21,988	40.9%

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

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

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

(4) 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.

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

(7) 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.

(8) 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.

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

From time to time our financial results are significantly impacted by a recognition of non-cash foreign exchange gains (losses) as a result of the Russian rouble appreciation/depreciation relative to the foreign currencies.

In the current reporting period, as a result of the Russian rouble depreciation relative to the US dollar and Euro by 5% and 11%, respectively, we recognized significant non-cash foreign exchange losses. These losses primarily related to the US dollar- and Euro-denominated borrowings of Yamal LNG, our joint venture. We believe the effects of currency movements arising in relation to the debt portfolio of Yamal LNG will be mitigated by its foreign currency denominated revenues as all liquefied natural gas volumes will be delivered to and sold in international markets once commercial production commences. In the 2016 reporting period, as a result of the Russian rouble appreciation relative to the US dollar and Euro we recognized non-cash foreign exchange gains.

Excluding the effect of foreign exchange gains and losses, the Group's profit attributable to shareholders of PAO NOVATEK increased by RR 4,162 million, or 14.1%, to RR 33,772 million from RR 29,610 million in the corresponding period of the prior year.

Reconciliation of EBITDA is as follows:

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2017**	**2016**	**%**
Profit	**5,243**	**48,324**	**(89.2%)**
Depreciation, depletion and amortization	8,572	8,363	2.5%
Net impairment reversals (expenses)	-	(40)	n/a
Loss (income) from changes in fair value of commodity derivative instruments	78	2,315	(96.6%)
Total finance expense (income)	(13,414)	(74)	n/a
Total income tax expense	9,551	7,011	36.2%
Share of loss (profit) of joint ventures, net of income tax	33,768	(19,623)	n/a
EBITDA from subsidiaries	**43,798**	**46,276**	**(5.4%)**
Share in EBITDA of joint ventures	12,274	13,231	(7.2%)
EBITDA	**56,072**	**59,507**	**(5.8%)**

SELECTED MACRO-ECONOMIC DATA

Exchange rate, Russian roubles for one foreign currency unit [1]	Three months ended 30 June: 2017	2016	Change %
US dollar (USD)			
Average for the period	57.15	65.89	(13.3%)
At the beginning of the period	56.38	67.61	(16.6%)
At the end of the period	59.09	64.26	(8.0%)
Depreciation (appreciation) of Russian rouble to US dollar	4.8%	(5.0%)	n/a
Euro			
Average for the period	62.79	74.40	(15.6%)
At the beginning of the period	60.60	76.54	(20.8%)
At the end of the period	67.50	71.21	(5.2%)
Depreciation (appreciation) of Russian rouble to Euro	11.4%	(7.0%)	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: 2017	2016	Change %
Benchmark crude oil prices [2]			
Brent, USD per barrel	49.6	45.6	8.8%
Urals, USD per barrel	48.7	43.8	11.2%
Urals, Russian roubles per barrel	2,783	2,886	(3.6%)
Benchmark crude oil prices excluding export duties [3]			
Urals, USD per barrel	37.2	34.6	7.5%
Urals, Russian roubles per barrel	2,126	2,280	(6.8%)
World market prices for oil products [4] **and liquefied petroleum gas** [5]**, USD per ton**			
Naphtha Japan	445	411	8.3%
Naphtha CIF NWE	432	400	8.0%
Jet fuel	483	437	10.5%
Gasoil	446	410	8.8%
Fuel oil	300	215	39.5%
Liquefied petroleum gas	336	225	49.3%
Export duties, USD per ton [6]			
Crude oil, stable gas condensate	84.3	67.2	25.4%
Naphtha	46.3	47.6	(2.7%)
Jet fuel, gasoil	25.3	26.8	(5.6%)
Fuel oil	84.3	55.0	53.3%
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

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

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

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

Political events in Ukraine in the beginning of 2014 have prompted a negative reaction by the world community, including economic sanctions levied by the United States of America, Canada and the European Union against certain Russian individuals and legal entities. In July 2014, NOVATEK was included on the OFAC's Sectoral Sanctions Identification List (the "List"), which imposed sanctions that prohibit individuals or legal entities registered or working on the territory of the United States from providing new credit facilities to the Group for longer than 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.

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

Prices for natural gas sold in the Russian Federation

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

In 2016 and during the first half of 2017, wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market remained unchanged.

Effective 1 July 2017, the Regulator increased wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market by 3.9%. The increase in the wholesale natural gas prices corresponded to the main parameters of the "Forecast of Socio-economic Development of the Russian Federation for 2017 and planned period 2018 and 2019" prepared by the Ministry of Economic Development of the Russian Federation and published in November 2016. The forecast envisages an increase in wholesale natural gas prices for sales to all customer categories (excluding residential customers) from 1 July 2018 and 2019 by 3.4% and 3.1%, respectively. The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth rates on the domestic market.

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

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

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

In the three months ended 30 June 2017, our average natural gas price on end-customers sales increased by 3.8% due to an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current reporting period as compared to the respective period in 2016. The change in the sales geography also increased our average transportation expense per mcm by 8.8%. As a result, the average natural gas price on end-customers sales excluding transportation expenses was relatively flat (increased by 0.7%).

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

	Three months ended 30 June:		**Change**
Russian roubles per mcm	**2017**	**2016**	**%**
Average natural gas price to end-customers [(1)]	3,870	3,727	3.8%
Average natural gas transportation expense for sales to end-customers	(1,550)	(1,425)	8.8%
Average natural gas price on end-customer sales excluding transportation expense	2,320	2,303	0.7%
Average natural gas price ex-field (wholesale traders)	2,051	2,051	0.0%
Total average natural gas price excluding transportation expense	**2,309**	**2,285**	**1.1%**

(1) Includes cost of transportation.

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

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

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

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

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

We commonly sell our stable gas condensate and refined products, as well as liquefied petroleum gas to the international markets with a premium to the respective international benchmark reference products prices. Our crude oil sold to the international markets is commonly traded with a discount to the benchmark Brent crude oil in case of SILCO grade sales (low-sulfur "Siberian Light Crude Oil") and with a premium to the benchmark Dubai crude oil in case of ESPO grade sales (crude oil delivered by the pipeline "East Siberia – Pacific ocean").

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

	Three months ended 30 June:		**Change**
Russian roubles or US dollars per ton	**2017**	**2016**	**%**
Stable gas condensate			
Export contract price, USD per ton	406	400	1.5%
Net export price, USD per ton	321	335	(4.2%)
Net export price, RR per ton	18,184	22,425	(18.9%)
Domestic price, RR per ton	15,546	16,002	(2.8%)
Naphtha			
Export contract price, USD per ton	446	441	1.1%
Net export price, USD per ton	399	395	1.0%
Net export price, RR per ton	22,910	26,073	(12.1%)
Other gas condensate refined products			
Export contract price, USD per ton	449	370	21.4%
Net export price, USD per ton	404	332	21.7%
Net export price, RR per ton	23,099	21,849	5.7%
Domestic price, RR per ton	18,981	19,464	(2.5%)
Crude oil			
Export contract price, USD per ton	356	321	10.9%
Net export price, USD per ton	272	253	7.5%
Net export price, RR per ton	15,536	16,538	(6.1%)
Domestic price, RR per ton	14,295	14,721	(2.9%)
LPG			
Export contract price, USD per ton (1)	555	384	44.5%
Net export price, USD per ton (1)	408	256	59.4%
Net export price, RR per ton	23,327	16,892	38.1%
Domestic price, RR per ton	9,329	4,187	122.8%

(1) LPG sales initially priced in Polish zloty were translated into US dollars using the average exchange rate of Russian rouble for the period.

Crude oil, stable gas condensate and its refined products

In the three months ended 30 June 2017, compared to the corresponding period in 2016 our average realized export contract prices for crude oil, stable gas condensate and its refined products increased due to increases in the underlying respective product prices on the international markets used in the price calculation (see "Selected macro-economic data" above).

The dynamics of our weighted-average export contract price for each product category also reflects the influence of uneven distribution of sales volumes within periods and changes in the geography of shipments which may significantly impact our average prices in periods of high benchmark crude oil prices volatility on international markets. In particular, changes in the geography of our stable gas condensate shipments flattened the impact of increased prices on international markets, which resulted in a marginal increase in our weighted-average export contract price (in the current reporting period, we sold our stable gas condensate only to the European markets by rail, while in the corresponding period in 2016, we also delivered our stable gas condensate to the APR by tankers at prices including a higher transportation cost element). Conversely, our weighted-average export contract prices for other gas condensate refined products outpaced the growth of benchmark prices on international markets primarily as a result of uneven distribution of sales volumes within periods.

An increase in average export duties for crude oil, stable gas condensate and fuel oil sales, as well as a 13.3% appreciation of the average exchange rate of the Russian rouble relative to the US dollar in the three months ended 30 June 2017 compared to the corresponding period in 2016 (see "Selected macro-economic data" above) had a negative impact on our average realized net export prices. As a result, our average realized net export prices in Russian rouble terms decreased for crude oil, stable gas condensate and fuel oil. Our average realized net export prices for other gas condensate refined products in Russian rouble terms increased but were also in line with the benchmark crude oil prices movements for these products net of the respective export duties.

In the three months ended 30 June 2017, our average realized domestic prices for crude oil, stable gas condensate and its refined products decreased compared to the corresponding period in 2016 as a result of the respective changes in the underlying benchmark prices for these products excluding export duties in Russian rouble terms, and specifics of pricing mechanism for each particular product on the domestic market (such as time lag of international benchmark crude oil prices and export duty rates used in price calculation, price setting on an individual transaction basis for some deliveries and others).

Liquefied petroleum gas

In the three months ended 30 June 2017, our average realized LPG export contract price increased significantly compared to the corresponding period in 2016 due to an increase 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 in Russian rouble terms increased to a lesser extent as a result of the appreciation of the average exchange rate of the Russian rouble relative to the US dollar (see "Selected macro-economic data" above).

In the three months ended 30 June 2017, our average realized LPG domestic price increased significantly compared to the corresponding period in 2016. The increase was mainly due to an increase in the underlying benchmark prices for LPG on international markets, as well as a decrease in volumes sold to customers directly from the Purovsky Plant without incurring additional transportation expenses (in the second quarter of 2016, we sold more volumes of our LPG directly from the Purovsky Plant as a result of planned repair works at the Tobolsk Refining Facilities). The impact of the aforementioned factors was partially offset by the appreciation of the average exchange rate of the Russian rouble relative to the US dollar.

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

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in November 2016, the increase in tariffs for natural gas transportation through the trunk pipeline in 2017 to 2019 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). There was no indexation of transportation tariffs effective 1 July 2017, and as of our report date no information regarding the effective date and the size of the next adjustment of transportation tariffs was available. 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 3 January 2016, railroad freight transportation tariffs for all types of hydrocarbons were increased by 9% relative to the 2015 tariffs and did not change until the end of 2016. In January 2017, the Regulator increased the aforementioned tariffs by 6.1% relative to the 2016 tariffs.

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

Stable gas condensate and refined products by tankers

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

Crude oil

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

Effective 1 January 2016, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 5.76% relative to the 2015 tariffs and remained unchanged until the end of 2016. Effective 1 January 2017, crude oil transportation tariffs were increased by an average of 3.6% compared to 2016 tariffs.

Our tax burden and obligatory payments

We are subject to a wide range of taxes imposed at the federal, regional, and local levels, many of which are based on revenue or volumetric measures. In addition to income tax, significant taxes and obligatory payments to which we are subject include VAT, unified natural resources production tax ("UPT", commonly referred as "MET" – mineral extraction tax), export duties, property tax and social contributions to non-budget funds.

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

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

The tax maneuver in the oil and gas industry

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

UPT – natural gas and gas condensate

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

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

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

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

UPT – crude oil

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

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

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

Export duties and excise taxes

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

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

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

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

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

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

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

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

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

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

Social contributions

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

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

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

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

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

In the three months ended 30 June 2017, our total natural gas sales volumes in Russia increased by 318 mmcm, or 2.3%, due to increased demand for natural gas from end-customers resulted, among other factors, from weather conditions. Natural gas volumes produced at mature fields of our subsidiaries and joint ventures decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons, which was partially offset by the improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field.

In the three months ended 30 June 2017, our liquids sales volumes decreased by 67 thousand tons, or 1.6%, due to a decrease in gas condensate production at mature fields of our subsidiaries and joint ventures.

Natural gas production volumes

In the three months ended 30 June 2017, our total natural gas production (including our proportionate share in the production of joint ventures) decreased by 1,198 mmcm, or 7.3%, to 15,323 mmcm from 16,521 mmcm in the corresponding period in 2016.

millions of cubic meters	**Three months ended 30 June: 2017**	**2016**	**Change %**
Production by subsidiaries from:			
Yurkharovskoye field	7,538	8,535	(11.7%)
East-Tarkosalinskoye field	1,805	2,006	(10.0%)
Khancheyskoye field	557	633	(12.0%)
Other fields	700	428	63.6%
Total natural gas production by subsidiaries	**10,600**	**11,602**	**(8.6%)**
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	3,404	3,355	1.5%
Nortgas	1,010	1,276	(20.8%)
Terneftegas	309	288	7.3%
Total Group's proportionate share in the natural gas production of joint ventures	**4,723**	**4,919**	**(4.0%)**
Total natural gas production including proportionate share in the production of joint ventures	**15,323**	**16,521**	**(7.3%)**

In the three months ended 30 June 2017, our natural gas volumes produced at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint venture Nortgas decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons. The decrease was partially offset by improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field.

Natural gas sales volumes in the Russian Federation

In the three months ended 30 June 2017, our total natural gas sales volumes in Russia increased by 318 mmcm, or 2.3%, to 14,380 mmcm from 14,062 mmcm in the corresponding period in 2016.

millions of cubic meters	**Three months ended 30 June: 2017**	**2016**	**Change %**
Production by subsidiaries	10,600	11,602	(8.6%)
Purchases from the Group's joint ventures	2,356	1,840	28.0%
Other purchases	1,936	1,939	(0.2%)
Total production and purchases	**14,892**	**15,381**	**(3.2%)**
Own usage [(1)]	(31)	(54)	(42.6%)
Decrease (increase) in GTS, UGSF and own pipeline infrastructure	(481)	(1,265)	(62.0%)
Total natural gas sales volumes in the Russian Federation	**14,380**	**14,062**	**2.3%**
Sold to end-customers	*13,780*	*13,045*	*5.6%*
Sold ex-field	*600*	*1,017*	*(41.0%)*

[(1)] Own usage associated primarily with the maintaining of refining process at the Purovsky Plant, as well as heat and electric energy generation in some of our subsidiaries.

In the three months ended 30 June 2017, natural gas purchases from our joint ventures increased by 516 mmcm, or 28.0%, to 2,356 mmcm from 1,840 mmcm in the corresponding period in 2016 primarily due to purchases from SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) in order to fulfill our contractual sales obligations.

Other natural gas purchases remained relatively flat (decreased by 3 mmcm, or 0.2%, to 1,936 mmcm from 1,939 mmcm in the corresponding period in 2016), and are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize end-customers portfolios.

As of 30 June 2017, our natural gas inventory balance in the GTS, the UGSF and our own pipeline infrastructure aggregated 611 mmcm and increased by 481 mmcm during the quarter as compared to an increase by 1,265 mmcm in the corresponding period in 2016. In the current reporting period, we injected lower volumes into the UGSF compared to the corresponding period in 2016 due to the Group's plan to inject natural gas into the UGSF in the third quarter of 2017. 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 2017, our total liquids production (including our proportionate share in the production of joint ventures) decreased by 201 thousand tons, or 6.4%, to 2,918 thousand tons from 3,119 thousand tons in the corresponding period in 2016.

thousands of tons	**Three months ended 30 June:** **2017**	**2016**	**Change %**
Production by subsidiaries from:			
Yarudeyskoye field	896	878	2.1%
Yurkharovskoye field	380	466	(18.5%)
East-Tarkosalinskoye field	315	340	(7.4%)
Khancheyskoye field	70	94	(25.5%)
Other fields	26	31	(16.1%)
Total liquids production by subsidiaries	**1,687**	**1,809**	**(6.7%)**
including crude oil	*1,181*	*1,193*	*(1.0%)*
including gas condensate	*506*	*616*	*(17.9%)*
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	1,036	1,068	(3.0%)
Terneftegas	105	108	(2.8%)
Nortgas	90	134	(32.8%)
Total Group's proportionate share in the liquids production of joint ventures	**1,231**	**1,310**	**(6.0%)**
Total liquids production including proportionate share in the production of joint ventures	**2,918**	**3,119**	**(6.4%)**

In the three months ended 30 June 2017, the volumes of liquids produced by subsidiaries and joint ventures decreased as a result of a decrease in gas condensate production mainly at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint ventures, Nortgas and SeverEnergia, due to the natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons. Crude oil production changed insignificantly.

Liquids sales volumes

In the three months ended 30 June 2017, our total liquids sales volumes decreased by 67 thousand tons, or 1.6%, to 4,072 thousand tons from 4,139 thousand tons in the corresponding period in 2016.

thousands of tons	Three months ended 30 June: 2017	2016	Change %
Production by subsidiaries	1,687	1,809	(6.7%)
Purchases from the Group's joint ventures	2,296	2,450	(6.3%)
Other purchases	41	13	215.4%
Total production and purchases	**4,024**	**4,272**	**(5.8%)**
Losses [(1)] and own usage [(2)]	(66)	(75)	(12.0%)
Decreases (increases) in liquids inventory balances	114	(58)	n/a
Total liquids sales volumes	**4,072**	**4,139**	**(1.6%)**
Naphtha export	*1,060*	*1,102*	*(3.8%)*
Other gas condensate refined products export [(3)]	*667*	*560*	*19.1%*
Other gas condensate refined products domestic [(3)]	*36*	*22*	*63.6%*
Subtotal gas condensate refined products	***1,763***	***1,684***	***4.7%***
Crude oil export	*462*	*360*	*28.3%*
Crude oil domestic	*749*	*797*	*(6.0%)*
Subtotal crude oil	***1,211***	***1,157***	***4.7%***
LPG export	*134*	*156*	*(14.1%)*
LPG domestic	*511*	*500*	*2.2%*
Subtotal LPG	***645***	***656***	***(1.7%)***
Stable gas condensate export	*57*	*250*	*(77.2%)*
Stable gas condensate domestic	*393*	*389*	*1.0%*
Subtotal stable gas condensate	***450***	***639***	***(29.6%)***
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 chartered tankers.

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

In the three months ended 30 June 2017, our purchases of liquid hydrocarbons from joint ventures decreased by 154 thousand tons, or 6.3%, due to a decrease in purchases of gas condensate from SeverEnergia and Nortgas (see "Liquids production volumes" above).

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

In the 2017 reporting period, our liquids inventory balances decreased by 114 thousand tons to 699 thousand tons as of 30 June 2017 as compared to an increase in inventory balances by 58 thousand tons to 670 thousand tons in the corresponding period in 2016. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 JUNE 2017 COMPARED TO THE CORRESPONDING PERIOD IN 2016

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2017 and 2016. Each line item is also shown as a percentage of our total revenues.

	Three months ended 30 June:			
millions of Russian roubles	**2017**	**% of total revenues**	**2016**	**% of total revenues**
Total revenues [(1)]	**128,830**	***100.0%***	**127,388**	***100.0%***
including:				
natural gas sales	54,569	*42.4%*	50,707	*39.8%*
liquids' sales	73,461	*57.0%*	75,756	*59.5%*
Operating expenses	(94,033)	*(73.0%)*	(90,019)	*(70.7%)*
Other operating income (loss)	351	*0.3%*	(1,731)	*(1.4%)*
Profit from operations	**35,148**	***27.3%***	**35,638**	***27.9%***
Finance income (expense)	13,414	*10.4%*	74	*0.1%*
Share of profit (loss) of joint ventures, net of income tax	(33,768)	*(26.2%)*	19,623	*15.4%*
Profit before income tax	**14,794**	***11.5%***	**55,335**	***43.4%***
Total income tax expense	(9,551)	*(7.4%)*	(7,011)	*(5.5%)*
Profit	**5,243**	***4.1%***	**48,324**	***37.9%***
Less: profit (loss) attributable to non-controlling interest	(2,000)	*(1.6%)*	(2,390)	*(1.8%)*
Profit attributable to shareholders of PAO NOVATEK	**3,243**	***2.5%***	**45,934**	***36.1%***
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	**33,772**	***26.2%***	**29,610**	***23.2%***

[(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 2017 and 2016:

	Three months ended 30 June:		Change	Change (1)		
millions of Russian roubles	**2017**	**2016**	**%**	**Total**	**Due to volume (2)**	**Due to price (3)**
Natural gas sales	**54,569**	**50,707**	**7.6%**	**3,862**	**1,891**	**1,971**
In the Russian Federation – end-customers sales	*53,332*	*48,621*	*9.7%*	*4,711*	*2,740*	*1,971*
In the Russian Federation – ex-field sales	*1,231*	*2,086*	*(41.0%)*	*(855)*	*(855)*	-
Outside the Russian Federation	*6*	-	*n/a*	*6*	*6*	-
Gas condensate refined products sales	**40,396**	**41,387**	**(2.4%)**	**(991)**	**2,280**	**(3,271)**
Export – naphtha	*24,294*	*28,734*	*(15.5%)*	*(4,440)*	*(1,085)*	*(3,355)*
Export – other refined products	*15,412*	*12,226*	*26.1%*	*3,186*	*3,084*	*102*
Domestic – other refined products	*690*	*427*	*61.6%*	*263*	*281*	*(18)*
Crude oil sales	**17,894**	**17,682**	**1.2%**	**212**	**995**	**(783)**
Export	*7,182*	*5,948*	*20.7%*	*1,234*	*1,697*	*(463)*
Domestic	*10,712*	*11,734*	*(8.7%)*	*(1,022)*	*(702)*	*(320)*
Liquefied petroleum gas sales	**7,882**	**4,729**	**66.7%**	**3,153**	**(334)**	**3,487**
Export	*3,114*	*2,632*	*18.3%*	*482*	*(378)*	*860*
Domestic	*4,768*	*2,097*	*127.4%*	*2,671*	*44*	*2,627*
Stable gas condensate sales	**7,134**	**11,837**	**(39.7%)**	**(4,703)**	**(4,288)**	**(415)**
Export	*1,024*	*5,614*	*(81.8%)*	*(4,590)*	*(4,353)*	*(237)*
Domestic	*6,110*	*6,223*	*(1.8%)*	*(113)*	*65*	*(178)*
Other products sales	**155**	**121**	**28.1%**	**34**	**n/a**	**n/a**
Domestic	*155*	*121*	*28.1%*	*34*	*n/a*	*n/a*
Total oil and gas sales	**128,030**	**126,463**	**1.2%**	**1,567**	**n/a**	**n/a**
Other revenues	800	925	(13.5%)	(125)	n/a	n/a
Total revenues	**128,830**	**127,388**	**1.1%**	**1,442**	**n/a**	**n/a**

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

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

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

Natural gas sales

Revenues from natural gas sales represent our revenues from natural gas sales in the Russian Federation (to end-customers and wholesale traders), as well as revenues from sales of regasified LNG to customers in Poland through our wholly owned subsidiary, Blue Gaz Sp. z o.o. In the three months ended 30 June 2017, our total revenues from natural gas sales increased by RR 3,862 million, or 7.6%, compared to the corresponding period in 2016.

Our revenues from natural gas sales in the Russian Federation increased by RR 3,856 million, or 7.6%, compared to the corresponding period in 2016 due to an increase in our average sales prices and volumes. Our average sales prices increased by 5.2% due to an increase in the proportion of sales to our end-customers located at more distant regions from our production fields, as well as a decrease from 7.2% to 4.2% in the proportion of natural gas sold to wholesale traders with lower average sales prices compared to end-customer sales (see "Natural gas prices" above). The increase in our total sales volumes by 2.3% was due to a higher demand for natural gas from our end-customers, resulted, among other factors, from weather conditions.

In the current reporting period, we sold 0.17 mmcm of natural gas in Poland received from regasification of LNG purchased in Poland, and recognized RR six million of respective revenues.

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 2017, our revenues from sales of gas condensate refined products decreased by RR 991 million, or 2.4%, as compared to the corresponding period in 2016 due to a decrease in naphtha sales volumes and average realized net export prices in Russian roubles that was partially offset by an increase in other refined products sales volumes and average realized net export prices.

In the three months ended 30 June 2017, our revenues from sales of naphtha decreased by RR 4,440 million, or 15.5%, as compared to the corresponding period in 2016 primarily due to a decrease in average realized net export prices in Russian roubles and, to a lesser extent, a decrease in sales volumes. In the three months ended 30 June 2017 and 2016, we exported 1,060 thousand and 1,102 thousand tons of naphtha, respectively. Nearly all our naphtha volumes were sold to the APR, and the European and North America markets. Our average realized net export price, excluding export duties, decreased by RR 3,163 per ton, or 12.1%, to RR 22,910 per ton (CFR, CIF, DES and FOB) from RR 26,073 per ton (CFR, CIF and DES) in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 June 2017, our revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 3,449 million, or 27.3%, as compared to the corresponding period in 2016 due to an increase in average realized net export prices and sales volumes. In the three months ended 30 June 2017 and 2016, we exported in aggregate 667 thousand and 560 thousand tons of these products mainly to the European markets, or 94.9% and 96.2% of total sales volumes (on the domestic and export markets), respectively. Our average realized net export price, excluding export duties, increased by RR 1,250 per ton, or 5.7%, to RR 23,099 per ton (CIF and FOB) from RR 21,849 per ton (CIF, DES and FOB) in the corresponding period in 2016 (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 2017, our revenues from crude oil sales increased by RR 212 million, or 1.2%, compared to the corresponding period in 2016 due to an increase in export sales volumes which was partially offset by a decrease in average realized prices in Russian roubles terms.

In the three months ended 30 June 2017, we sold 749 thousand tons, or 61.8% of our total crude oil sales volumes, domestically as compared to sales of 797 thousand tons, or 68.9%, in the corresponding period in 2016. Our average realized crude oil domestic price decreased by RR 426 per ton, or 2.9%, to RR 14,295 per ton from RR 14,721 per ton in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

The remaining 462 thousand tons of crude oil, or 38.2% of our total sales volumes, in the current reporting period and 360 thousand tons, or 31.1%, in the corresponding period in 2016 were sold to the European and the APR markets. The increase in our export sales volumes of 102 thousand tons, or 28.3%, was due to weather conditions in the port of loading, as a result of which a part of our sales volumes planned for the first quarter of 2017 was still in transit as of 31 March and was sold at the beginning of April. Our average net export price, excluding export duties, decreased by RR 1,002 per ton, or 6.1%, to RR 15,536 per ton from RR 16,538 per ton in the corresponding period in 2016 (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 2017, our revenues from sales of LPG increased by RR 3,153 million, or 66.7%, compared to the corresponding period in 2016 due to an increase in average realized prices.

In the three months ended 30 June 2017, we sold 134 thousand tons of LPG, or 20.8% of our total LPG sales volumes, to export markets as compared to sales of 156 thousand tons, or 23.8%, in the corresponding period in 2016. Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, increased by RR 6,435 per ton, or 38.1%, compared to the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In both reporting periods, our LPG export delivery terms were DAP at the border of the customer's country or free carrier (FCA) at terminal points in Poland. In addition, in the second quarter of 2016, we sold our LPG under FCA at Limbey rail station delivery terms due to planned repair works at the Tobolsk Refining Facilities and selling some of our export sales volumes directly from the Purovsky Plant. We sold most of our LPG export sales volumes to Poland in both reporting periods.

In the three months ended 30 June 2017, we sold 511 thousand tons of LPG, or 79.2% of our total LPG sales volumes, on the domestic market compared to sales of 500 thousand tons, or 76.2%, in the corresponding period in 2016. Our average realized LPG domestic price in the three months ended 30 June 2017 was RR 9,329 per ton representing an increase of RR 5,142 per ton, or 122.8%, compared to the corresponding period in 2016 (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 2017, our revenues from sales of stable gas condensate decreased by RR 4,703 million, or 39.7%, compared to the corresponding period in 2016 due to a decrease in sales volumes (see "Liquids sales volumes" above) and average realized prices.

In the three months ended 30 June 2017, we sold 57 thousand tons of stable gas condensate, or 12.7% of our total sales volumes, to the European markets, compared to sales of 250 thousand tons, or 39.1%, in the corresponding period in 2016 to the APR and the European markets. Our average realized stable gas condensate net export price, excluding export duties, decreased by RR 4,241 per ton, or 18.9%, to RR 18,184 per ton (DAP) from RR 22,425 per ton (CFR and DAP) (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 June 2017, we sold 393 thousand tons of stable gas condensate, or 87.3% of our total sales volumes, on the domestic market compared to 389 thousand tons, or 60.9%, in the corresponding period in 2016. Our average realized price decreased by RR 456 per ton, or 2.8%, to RR 15,546 per ton from RR 16,002 per ton in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Other products sales

Other products sales represent our revenues from the domestic sales of purchased oil products (diesel fuel and petrol) through our retail stations, sales of other purchased liquid hydrocarbons, and sales of our produced methanol. In the three months ended 30 June 2017, our revenues from other products sales increased by RR 34 million, or 28.1%, to RR 155 million from RR 121 million in the corresponding period in 2016.

Other revenues

Other revenues include revenue from transportation, geological and geophysical research services, repair and maintenance of energy equipment services, and other services. In the three months ended 30 June 2017, other revenues decreased by RR 125 million, or 13.5%, to RR 800 million from RR 925 million in the corresponding period in 2016 primarily due to a decrease in revenues from tankers transporting third party goods by RR 387 million. At the same time, in the three months ended 30 June 2017, other revenue from power generation services, as well as repair and maintenance of energy equipment services provided by our subsidiary NOVATEK-Energo increased by RR 179 million.

Operating expenses

In the three months ended 30 June 2017, our total operating expenses increased by RR 4,014 million, or 4.5%, to RR 94,033 million compared to RR 90,019 million in the corresponding period in 2016 mainly due to an increase in natural gas transportation expenses due to an increase of natural gas sales volumes and the proportion of sales to our end-customers located at more distant regions from our production fields (see "Transportation expenses" below), and a decrease of liquid hydrocarbons inventory balances (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below). Our total operating expenses as a percentage of total revenues increased to 73.0% from 70.7%.

	Three months ended 30 June:			
millions of Russian roubles	**2017**	**% of total revenues**	**2016 (1)**	**% of total revenues**
Transportation expenses	32,567	*25.2%*	30,579	*24.0%*
Purchases of natural gas and liquid hydrocarbons	30,990	*24.1%*	32,003	*25.1%*
Taxes other than income tax	11,531	*9.0%*	11,393	*8.9%*
Depreciation, depletion and amortization	8,572	*6.7%*	8,363	*6.6%*
Materials, services and other	5,084	*3.9%*	4,568	*3.6%*
General and administrative expenses	3,911	*3.0%*	5,230	*4.1%*
Exploration expenses	504	*0.4%*	181	*0.1%*
Impairment expenses (reversals), net	-	*n/a*	(40)	*n/a*
Changes in natural gas, liquid hydrocarbons and work-in-progress	874	*0.7%*	(2,258)	*n/a*
Total operating expenses	**94,033**	***73.0%***	**90,019**	***70.7%***

(1) Certain reclassifications have been made to the comparative figures to conform to the current period presentation with no effect on profit for the period or shareholder's equity. Namely, insurance expenses relating to production assets and major part of expenses of the Group's science and technology center for the three months ended 30 June 2016 in the total amount of RR 323 million were reclassified from General and administrative expenses to Materials, services and other expenses and Exploration expenses in the amount of RR 184 million and RR 139 million, respectively.

Transportation expenses

In the three months ended 30 June 2017, our total transportation expenses increased by RR 1,988 million, or 6.5%, to RR 32,567 million as compared to RR 30,579 million in the corresponding period in 2016.

	Three months ended 30 June:		Change
millions of Russian roubles	**2017**	**2016**	**%**
Natural gas transportation by trunk and low-pressure pipelines	21,361	18,579	15.0%
Stable gas condensate and liquefied petroleum gas transportation by rail	7,623	8,017	(4.9%)
Crude oil transportation by trunk pipelines	2,080	1,644	26.5%
Gas condensate refined products, stable gas condensate and crude oil transportation by tankers	1,488	2,300	(35.3%)
Other	15	39	(61.5%)
Total transportation expenses	**32,567**	**30,579**	**6.5%**

In the three months ended 30 June 2017, our expenses for natural gas transportation increased by RR 2,782 million, or 15.0%, to RR 21,361 million from RR 18,579 million in the corresponding period in 2016 due to a 5.6% increase in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current period as compared to the corresponding period of the prior year.

In the three months ended 30 June 2017, our total expenses for stable gas condensate and LPG transportation by rail decreased by RR 394 million, or 4.9%, to RR 7,623 million from RR 8,017 million in the corresponding period in 2016. The decrease was due to a 5.0% decrease in volumes of liquids sold and transported via rail. The weighted average transportation cost per unit remained relatively flat (increased by 0.1%): an increase in the regulated railroad transportation tariffs effective January 2017 (see "Transportation tariffs" above) was fully offset by a 13.3% appreciation of the average exchange rate of the Russian rouble relative to the US dollar since part of our expenses for LPG transportation by rail are US dollar denominated.

In the three months ended 30 June 2017, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 436 million, or 26.5%, to RR 2,080 million from RR 1,644 million in the corresponding period in 2016. The increase was due to an increase in the proportion of crude oil sales to more distant regions from our production fields, a 4.7% increase in crude oil sales volumes as compared to the corresponding period of the prior year, as well as due to a 3.6% increase in the regulated transportation tariffs effective 1 January 2017 (see "Transportation tariffs" above).

In the three months ended 30 June 2017, our total transportation expenses for liquids delivered by tankers to international markets decreased by RR 812 million, or 35.3%, to RR 1,488 million from RR 2,300 million in the corresponding period in 2016. The decrease was due to a 13.3% appreciation of the average exchange rate of the Russian rouble relative to the US dollar (since all our tankers transportation expenses are US dollar denominated), a 2.5% decrease in volumes of liquids sold and transported via tankers, as well as changes in the geography of shipments. In the current reporting period, our share of volumes shipped to the European countries with lower transportation costs increased by 19.4%, and, correspondingly, the share of volumes shipped to the APR and North America decreased.

Purchases of natural gas and liquid hydrocarbons

In the three months ended 30 June 2017, our purchases of natural gas and liquid hydrocarbons decreased by RR 1,013 million, or 3.2%, to RR 30,990 million from RR 32,003 million in the corresponding period in 2016.

millions of Russian roubles	**Three months ended 30 June: 2017**	**2016**	**Change %**
Unstable gas condensate	21,388	23,957	(10.7%)
Natural gas (excluding LNG)	8,904	7,819	13.9%
Other hydrocarbons	698	227	207.5%
Total purchases of natural gas and liquid hydrocarbons	**30,990**	**32,003**	**(3.2%)**

In the three months ended 30 June 2017, our purchases of unstable gas condensate from our joint ventures decreased by RR 2,569 million, or 10.7%, as compared to the corresponding period in 2016 mainly due to a decrease in purchases from Nortgas and SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) resulting from the natural declines in the concentration of gas condensate as a consequence of decreasing reservoir pressure at the current gas condensate producing horizons at some fields (see "Liquids production volumes" above). The decrease was also due to lower purchase prices, which are impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

In the three months ended 30 June 2017, our purchases of natural gas increased by RR 1,085 million, or 13.9%, as compared to the corresponding period in 2016 mainly as a result of purchases from SeverEnergia (its wholly owned subsidiary, OAO Arcticgas) in order to fulfill our contractual sales obligations.

Other hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products, as well as purchases of LNG in Poland for its further regasification and sale as natural gas to local customers. In the three months ended 30 June 2017, our purchases of other hydrocarbons increased by RR 471 million, or 3.1 times, as compared to the corresponding period in 2016 due to an increase in LPG purchases for subsequent small volume wholesale and retail sales.

Taxes other than income tax

In the three months ended 30 June 2017, taxes other than income tax increased marginally by RR 138 million, or 1.2%, to RR 11,531 million from RR 11,393 million in the corresponding period in 2016.

millions of Russian roubles	Three months ended 30 June: 2017	2016	Change %
Unified natural resources production tax (UPT)	10,626	10,641	(0.1%)
Property tax	847	658	28.7%
Other taxes	58	94	(38.3%)
Total taxes other than income tax	**11,531**	**11,393**	**1.2%**

In the three months ended 30 June 2017, our unified natural resources production tax expense changed marginally (decreased by 0.1%) as a result of the offsetting effects of two factors: an increase in UPT rates for crude oil and gas condensate effective 1 January 2017 as part of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above), on the one hand, and a decrease in hydrocarbon production, on the other hand (see "Hydrocarbon production and sales volumes" above).

In the three months ended 30 June 2017, our property tax expense increased by RR 189 million, or 28.7%, to RR 847 million from RR 658 million in the corresponding period in 2016 due to the termination of a property tax relief at one of our processing subsidiaries effective from January 2017, as well as a result of additions to property, plant and equipment at our production subsidiaries.

Depreciation, depletion and amortization

In the three months ended 30 June 2017, our depreciation, depletion and amortization ("DDA") expense increased by RR 209 million, or 2.5%, to RR 8,572 million from RR 8,363 million in the corresponding period in 2016 mainly due to additions of property, plant and equipment at the Yarudeyskoye field (launched in December 2015) and at other fields of 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.

Materials, services and other

In the three months ended 30 June 2017, our materials, services and other expenses increased by RR 516 million, or 11.3%, to RR 5,084 million compared to RR 4,568 million in the corresponding period in 2016.

millions of Russian roubles	Three months ended 30 June: 2017	2016	Change %
Employee compensation	2,295	2,008	14.3%
Repair and maintenance	628	754	(16.7%)
Complex of services for preparation, transportation and processing of hydrocarbons	498	202	146.5%
Materials and supplies	416	432	(3.7%)
Electricity and fuel	297	257	15.6%
Liquefied petroleum gas volumes reservation expenses	217	263	(17.5%)
Transportation services	193	141	36.9%
Fire safety and assets security expenses	182	164	11.0%
Rent expenses	77	58	32.8%
Insurance expense	56	132	(57.6%)
Other	225	157	43.3%
Total materials, services and other	**5,084**	**4,568**	**11.3%**

Operating employee compensation increased by RR 287 million, or 14.3%, to RR 2,295 million compared to RR 2,008 million in the corresponding period in 2016. The increase was due to an increase in the average number of employees (primarily due to the development of our activities at the Yarudeyskoye field, which was launched in December 2015, as well as at our service subsidiary NOVATEK-Energo), an indexation of base salaries effective from 1 July 2016 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Repair and maintenance services expenses decreased by RR 126 million, or 16.7%, to RR 628 million in the three months ended 30 June 2017 compared to RR 754 million in the corresponding period in 2016 primarily due to a decrease in current repair and maintenance works performed on wells at our core production subsidiaries.

Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our LPG produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses increased by RR 296 million, or 146.5%, to RR 498 million in the three months ended 30 June 2017 compared to RR 202 million in the corresponding period in 2016 as a result of planned repair works at the Tobolsk Refining Facilities in the second quarter of 2016.

In the three months ended 30 June 2017, electricity and fuel expenses increased by RR 40 million, or 15.6%, to RR 297 million from RR 257 million in the corresponding period in 2016 primarily due to higher electricity prices.

In the three months ended 30 June 2017, liquefied petroleum gas volumes reservation costs decreased by RR 46 million, or 17.5%, to RR 217 million from RR 263 million in the corresponding period in 2016 primarily as a result of the average Russian rouble appreciation relative to the Polish zloty, since this expense is denominated in Polish zloty. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

In the three months ended 30 June 2017, insurance expenses decreased by RR 76 million, or 57.6%, to RR 56 million compared to RR 132 million in the corresponding period in 2016 mainly as a result of the optimizing insurance contracts costs in our core production subsidiaries.

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

General and administrative expenses

In the three months ended 30 June 2017, our general and administrative expenses decreased by RR 1,319 million, or 25.2%, to RR 3,911 million compared to RR 5,230 million in the corresponding period in 2016. The main components of these expenses were employee compensation and social expenses and compensatory payments, which, on aggregate, comprised 78.4% and 80.6% of total general and administrative expenses in the three months ended 30 June 2017 and 2016, respectively.

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2017**	**2016**	**%**
Employee compensation	2,403	3,514	(31.6%)
Social expenses and compensatory payments	663	700	(5.3%)
Advertising expenses	191	220	(13.2%)
Business travel expense	166	209	(20.6%)
Legal, audit and consulting services	118	189	(37.6%)
Fire safety and security expenses	98	95	3.2%
Repair and maintenance expenses	50	45	11.1%
Rent expense	19	65	(70.8%)
Other	203	193	5.2%
Total general and administrative expenses	**3,911**	**5,230**	**(25.2%)**

Employee compensation relating to administrative personnel decreased by RR 1,111 million, or 31.6%, to RR 2,403 million in the three months ended 30 June 2017 from RR 3,514 million in the corresponding period in 2016 mainly due to a decrease in bonuses accrued to key management.

In the three months ended 30 June 2017, our social expenses and compensatory payments decreased by RR 37 million, or 5.3%, to RR 663 million compared to RR 700 million in the corresponding period in 2016. In both reporting periods we made compensatory payments which mainly related to the development of the Yarudeyskoye field and amounted to RR 336 million in the current reporting quarter compared to RR 440 million in the corresponding period in 2016. Our social expenses increased by RR 67 million and related to continued support of charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

Exploration expenses

In the three months ended 30 June 2017, our exploration expenses increased by RR 323 million, or 178.5%, to RR 504 million from RR 181 million in the corresponding period in 2016 primarily due to exploration works performed at the Trekhbugorniy license area in the current reporting period. Exploration expenses include geological and geophysical research services expenditures, expenditures associated with the maintenance of license areas with non-proven reserves and other expenditures relating to exploration activity, as well as expenses of our science and technology center associated with the exploration activities at our fields. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

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

In the three months ended 30 June 2017, we recorded a charge of RR 874 million to changes in inventory expense due to a decrease in most of our liquid hydrocarbons inventory balances as of 30 June compared to 31 March. In the corresponding period in 2016 there was a reverse situation – we recorded a reversal to changes in inventory expense of RR 2,258 million due to a significant increase in our hydrocarbons inventory balances.

In the three months ended 30 June 2017 and 2016, our cumulative natural gas inventory balance in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure increased by 481 mmcm and 1,265 mmcm, respectively, due to seasonal injection of natural gas for the subsequent sale in the period of higher seasonal demand in both reporting periods. Lower volumes of natural gas injected into the UGSF in the current quarter compared to the corresponding period in 2016 was due to the Group's plan to inject natural gas into the UGSF in the third quarter of 2017.

In the three months ended 30 June 2017, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, decreased by 114 thousand tons mainly due to a decrease in inventory balance of crude oil as we sold a part of our sales volumes planned for the first quarter in the current reporting period. A 58 thousand tons increase in liquid hydrocarbons inventory balances in the reporting period in 2016 was mainly due to an increase in inventory balances of stable gas condensate at the Purovsky Plant and in rail cars in transit. 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:

Inventory balances in transit or in storage	**2017** At 30 June	**2017** At 31 March	**2017** Increase / (decrease)	**2016** At 30 June	**2016** At 31 March	**2016** Increase / (decrease)
Natural gas (millions of cubic meters)	**611**	**130**	**481**	**1,694**	**429**	**1,265**
including Gazprom's UGSF	*550*	-	*550*	*1,603*	*363*	*1,240*
Liquid hydrocarbons (thousand tons)	**699**	**813**	**(114)**	**670**	**612**	**58**
including naphtha	*220*	*205*	*15*	*90*	*120*	*(30)*
stable gas condensate	*227*	*258*	*(31)*	*278*	*247*	*31*
crude oil	*108*	*177*	*(69)*	*106*	*121*	*(15)*

Other operating income (loss)

Other operating income (loss) includes realized income (loss) from hydrocarbons trading on the international markets, income (loss) from the change in the fair value of the aforementioned contracts, as well as other income (loss) relating to penalty charges, disposal of materials, fixed assets and other transactions. In the three months ended 30 June 2017, we recognized other operating income of RR 351 million compared to other operating loss of RR 1,731 million in the corresponding period in 2016.

In the three months ended 30 June 2017, within our trading activities we purchased and sold approximately 0.9 bcm of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized income from trading activities of RR 372 million as compared to RR 639 million of income in the corresponding period in 2016. At the same time, we recognized a non-cash loss of RR 78 million in the three months ended 30 June 2017, as a result of a decrease in the fair value of aforementioned contracts as compared to RR 2,315 million non-cash loss in the corresponding period in 2016.

Profit from operations and EBITDA

In the three months ended 30 June 2017, our profit from operations and EBITDA decreased due to lower average realized prices in Russian rouble terms for most of our liquid hydrocarbons products as well as due to a natural decline in gas condensate production volumes at mature fields of our subsidiaries and joint ventures. Our profit from operations amounted to RR 35,148 million compared to RR 35,638 million in the corresponding period in 2016 and our EBITDA amounted to RR 56,072 million compared to RR 59,507 million in the corresponding period in 2016.

Finance income (expense)

In the three months ended 30 June 2017, we recorded a net finance income of RR 13,414 million compared to a net finance income of RR 74 million in the corresponding period in 2016.

millions of Russian roubles	Three months ended 30 June: 2017	2016	Change %
Accrued interest expense on loans received	(2,582)	(4,070)	(36.6%)
Less: capitalized interest	896	1,522	(41.1%)
Provisions for asset retirement obligations:			
effect of the present value discount unwinding	(183)	(137)	33.6%
Interest expense on lease liabilities	(4)	-	n/a
Interest expense	**(1,873)**	**(2,685)**	**(30.2%)**
Interest income	4,359	4,809	(9.4%)
Change in fair value of non-commodity financial instruments	(2,841)	6,301	n/a
Foreign exchange gain (loss), net	13,769	(8,351)	n/a
Total finance income (expense)	**13,414**	**74**	**n/a**

In the three months ended 30 June 2017, our interest expense decreased by RR 812 million, or 30.2%, to RR 1,873 million primarily due to partial repayments of the Group's borrowings, as well as the appreciation of the average exchange rate of the Russian rouble relative to the US dollar and Euro (most of our long-term borrowings are denominated in foreign currencies).

Interest income decreased by RR 450 million, or 9.4%, to RR 4,359 million in the three months ended 30 June 2017 from RR 4,809 million in the corresponding period in 2016 primarily due to the appreciation of the average exchange rate of the Russian rouble relative to the US dollar and Euro in the three months ended 30 June 2017 compared to the average exchange rate in the corresponding period in 2016.

In the three months ended 30 June 2017, we recognized a non-cash loss of RR 2,841 million compared to a non-cash gain of RR 6,301 million in the corresponding period in 2016 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IAS 39 *"Financial instruments: recognition and measurement"*. The effect of the fair value remeasurement of shareholders' loans may change period-to-period due to the change in market interest rates and other macroeconomic parameters and does not affect real future cash flows of loans repayments.

The Group continues to record non-cash foreign exchange gains and losses each reporting period due to movements between currency exchange rates. In the three months ended 30 June 2017, we recorded a significant net foreign exchange gain of RR 13,769 million compared to a net loss of RR 8,351 million in the corresponding period in 2016 due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

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

In the three months ended 30 June 2017, the Group's proportionate share of loss of joint ventures amounted to RR 33,768 million as compared to the share of profit of joint ventures in the amount of RR 19,623 million in the corresponding period in 2016.

	Three months ended 30 June:		Change
millions of Russian roubles	2017	2016	%
Share in profit from operations	**7,892**	**8,571**	**(7.9%)**
Share in finance income (expense)			
Share in interest income (expense), net	(2,644)	(3,896)	(32.1%)
Share in foreign exchange gain (loss), net	(49,518)	27,291	n/a
Share in change in fair value of non-commodity financial instruments	4,000	(8,526)	n/a
Total share in finance income (expense)	**(48,162)**	**14,869**	**n/a**
Share in total income tax benefit (expense)	6,502	(3,817)	n/a
Total share of profit (loss) of joint ventures, net of income tax	**(33,768)**	**19,623**	**n/a**

Our proportionate share in the profit from operations of our joint ventures decreased by RR 679 million, or 7.9%, primarily due to a decrease in gas condensate production at mature fields of our joint ventures, Nortgas and SeverEnergia (see "Liquids production volumes" above), as well as a decrease in gas condensate average realized prices.

In the three months ended 30 June 2017, our proportionate share in the finance expense of our joint ventures amounted to RR 48,162 million compared to the share in the finance income of RR 14,869 million in the corresponding period in 2016. The change in our share in finance income (expense) was primarily due to a recognition of a significant non-cash foreign exchange loss on foreign currency denominated loans at our joint ventures Yamal LNG and Terneftegas in the second quarter of 2017 (our share amounted to RR 49.5 billion) as compared to a non-cash gain (our share amounted to RR 27.3 billion) in the corresponding period in 2016. The impact of foreign exchange gain (loss) effect was partially offset by a recognition of an aggregate non-cash gain from the remeasurement of the fair value of shareholders' loans in Yamal LNG and Terneftegas in the second quarter of 2017 (our share amounted to RR 4.0 billion) compared to a recognition of an aggregate non-cash loss (our share amounted to RR 8.5 billion) in the corresponding period in 2016. The remaining changes in both reporting periods primarily related to our share in interest expense of our joint ventures.

Income tax expense

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

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

Without the effect of net profit (loss) and dividends from joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of profit before income tax) in the three months ended 30 June 2017 and 2016, was 19.6% and 19.8%, respectively.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK decreased by RR 42,691 million, or 92.9%, to RR 3,243 million in the three months ended 30 June 2017 compared to RR 45,934 million in the corresponding period in 2016.

One of the major factors that had an effect on the Group's financial result was the recognition of significant non-cash foreign exchange gains (losses) on foreign currency denominated loans of the Group and its joint ventures in both reporting periods. Excluding the effect of foreign exchange gains and losses, our profit attributable to shareholders of PAO NOVATEK increased by RR 4,162 million, or 14.1%, and amounted to RR 33,772 million in the three months ended 30 June 2017 compared to RR 29,610 million in the corresponding period in 2016 (see the table below):

millions of Russian roubles	**Three months ended 30 June: 2017**	**2016**	**Change %**
Profit attributable to shareholders of PAO NOVATEK	**3,243**	**45,934**	**(92.9%)**
Foreign exchange (gains) losses	(13,769)	8,351	n/a
Income tax expense (benefit) relating to foreign exchange (gains) losses	2,754	(1,670)	n/a
Share of foreign exchange (gains) losses of joint ventures	49,518	(27,291)	n/a
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	(7,974)	4,286	n/a
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	**33,772**	**29,610**	**14.1%**

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK decreased by RR 14.14 per share, or 92.9%, to RR 1.08 per share in the three months ended 30 June 2017 from RR 15.22 per share in the corresponding period in 2016. Excluding the effects of foreign exchange gains and losses, our weighted average basic and diluted earnings per share increased by RR 1.39, or 14.2%, to RR 11.20 per share in the three months ended 30 June 2017 from RR 9.81 per share in the corresponding period in 2016.

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 2017 and 2016:

	Three months ended 30 June:		Change
millions of Russian roubles	**2017**	**2016**	**%**
Net cash provided by **operating** activities	39,114	19,289	102.8%
Net cash used for **investing** activities	(10,596)	(18,301)	(42.1%)
Net cash used for **financing** activities	(32,727)	(58,260)	(43.8%)

The dynamics of our net cash flows from operating and investing activities was significantly impacted by income tax payments made in the second quarter of 2016 relating to the sale of the 9.9% equity stake in OAO Yamal LNG in the first quarter of 2016.

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:

	Three months ended 30 June:		Change
millions of Russian roubles	**2017**	**2016**	**%**
Normalized net cash provided by **operating** activities (1)	39,114	29,221	33.9%
Normalized net cash used for **investing** activities (1)	(10,596)	(8,369)	26.6%

(1) Excluding advance and actual income tax payments of RR 9,932 million made in the second quarter of 2016 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 increased by RR 19,825 million, or 102.8%, to RR 39,114 million compared to RR 19,289 million in the corresponding period in 2016 mainly due to a decrease in income tax payments and changes in working capital.

millions of Russian roubles	Three months ended 30 June: 2017	2016	Change %
Profit from operations	35,148	35,638	(1.4%)
Non-cash adjustments (1)	8,768	10,588	(17.2%)
Changes in working capital and long-term advances given	182	(11,323)	n/a
Interest received	2,484	1,123	121.2%
Income taxes paid excluding amounts relating to disposal of stakes in joint ventures	(7,468)	(16,737)	(55.4%)
Net cash provided by operating activities	**39,114**	**19,289**	**102.8%**
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	**39,114**	**29,221**	**33.9%**

(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.

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 was offset in the subsequent reporting periods.

Excluding the effect of advance payments for income tax made in the second quarter of 2016 based on the gain on the disposal of the 9.9% equity stake in Yamal LNG, our net cash provided by operating activities increased by RR 9,893 million, or 33.9%. The increase was primarily due to changes in working capital (mainly, as a result of significant amounts of VAT recovered in the second quarter of 2017).

Net cash used for investing activities

In the three months ended 30 June 2017, our net cash used for investing activities decreased by RR 7,705 million, or 42.1%, to RR 10,596 million compared to RR 18,301 million in the corresponding period in 2016. Excluding the effect from the one-off transaction of the sale of the 9.9% equity stake in Yamal LNG in the first quarter of 2016, our net cash used for investing activities increased by RR 2,227 million, or 26.6%.

millions of Russian roubles	Three months ended 30 June: 2017	2016	Change %
Cash used for capital expenditures	(8,123)	(7,233)	12.3%
Payments for mineral licenses	(2,057)	(763)	169.6%
Purchases of intangible assets	(384)	-	n/a
Income taxes paid relating to disposal of stakes in joint ventures	-	(9,932)	n/a
Repayments of loans provided to joint ventures	309	-	n/a
Other	(341)	(373)	(8.6%)
Net cash used for investing activities	**(10,596)**	**(18,301)**	**(42.1%)**
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	**(10,596)**	**(8,369)**	**26.6%**

Cash used for capital expenditures increased by RR 890 million, or 12.3%, as compared to the 2016 reporting period. In the current reporting period, we used cash mainly for the development of our future LNG projects: Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale offshore structures located in the Murmansk region (Kola Yard). In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field, purchased licenses on natural gas liquefaction technology and commenced development of the front-end engineering design (FEED) for the new LNG plant. In addition, in both reporting periods, we invested funds related to the ongoing development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits.

In the three months ended 30 June 2017, we made a payment in the amount of RR 2,057 million for participation in an auction for the right for geological research works, exploration and production of hydrocarbons at the Gydanskiy license area (according to the results of the auction, the license fee payment was set at RR 2,262 million). In the 2016 reporting period, 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).

In the 2016 reporting period, 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 2017, we received RR 309 million due to a partial repayment of the loans provided to Terneftegas and Yamal Development.

Net cash used for financing activities

In the three months ended 30 June 2017, our net cash used for financing activities decreased by RR 25,533 million, or 43.8%, to RR 32,727 million as compared to RR 58,260 million in the corresponding period in 2016.

	Three months ended 30 June:		**Change**
millions of Russian roubles	**2017**	**2016**	**%**
Repayments of long-term debt	(8,839)	(11,067)	(20.1%)
Proceeds from (repayments of) short-term debt, net	(49)	(23,986)	(99.8%)
Dividends paid	(21,111)	(20,831)	1.3%
Interest paid	(2,038)	(2,372)	(14.1%)
Payments of lease liabilities	(35)	-	n/a
Purchase of treasury shares	(655)	(4)	n/a
Net cash used for financing activities	**(32,727)**	**(58,260)**	**(43.8%)**

In both reporting periods, we did not obtain any new long-term loans. In the three months ended 30 June 2017 and 2016, the Group partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,530 million and RR 6,853 million (USD 115 million), respectively, according to the loan's maturity schedule as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In the reporting periods of 2017 and 2016, we obtained short-term loans to finance trade activities. In the current reporting period, the total amount of short-term loans repayments substantially corresponded to the amount of proceeds while in the corresponding period in 2016 net repayments of short-term loans amounted to RR 3,986 million. In addition, in the second quarter of 2016, we repaid a short-term loan from a Russian bank in the amount of RR 20,000 million.

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

Liquidity and working capital

The following table shows the Group's liquidity and credit measures as of 30 June 2017 and 31 December 2016:

	30 June 2017	31 December 2016	Change, %
Absolute amounts, RR million			
Net debt (1)	115,075	168,464	(31.7%)
Net working capital position (2)	56,155	23,969	134.3%
Liquidity and credit ratios			
Current ratio (3)	1.72	1.22	41.0%
Total debt to total equity	0.25	0.33	(24.2%)
Long-term debt to long-term debt and total equity	0.17	0.20	(15.0%)
Net debt to total capitalization (4)	0.13	0.19	(31.6%)
Net debt to normalized EBITDA from subsidiaries (5)	0.61	0.89	(31.5%)

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

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

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

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

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

In the six months ended 30 June 2017, we repaid long-term debt in the aggregate amount of approximately RR 33 billion. As a result, the Group's net debt decreased by 31.7% and net working capital position amounted to RR 56.2 billion as of 30 June 2017.

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

Capital expenditures

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

	Three months ended 30 June:	
millions of Russian roubles	2017	2016
Arctic LNG 2 project	3,815	693
East-Tarkosalinskoye field	1,059	925
Infrastructure for future LNG projects (1)	1,049	169
Yarudeyskoye field	890	2,907
North-Russkiy and East-Tazovskiy license areas	827	341
North-Obskiy license area	575	14
West-Yurkharovskoye field	235	79
Other	890	1,885
Capital expenditures	**9,340**	**7,013**

(1) Includes the project for the construction of a center to build and fabricate large-scale offshore structures located in the Murmansk region (Kola Yard).

Total capital expenditures on property, plant and equipment in the three months ended 30 June 2017 increased by RR 2,327 million, or 33.2%, to RR 9,340 million from RR 7,013 million in the corresponding period in 2016. In the current reporting period, a major part of our capital expenditures related to the future development of our LNG projects: Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale offshore structures located in the Murmansk region (Kola Yard). In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field, purchased licenses on natural gas liquefaction technology and commenced development of the front-end engineering design (FEED) for the new LNG plant. In addition, in both reporting periods, we invested in the ongoing development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits.

The "Other" line in the table above represents our capital expenditures related to other fields and processing facilities of the Group, as well as unallocated capital expenditures as of the reporting date. The allocation of capital expenditures by fields 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, and cash used for capital investments:

millions of Russian roubles	**Three months ended 30 June: 2017**	**2016**	**Change %**
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	**13,892**	**8,070**	**72.1%**
Less: acquisition of mineral licenses	(2,057)	(1,057)	94.6%
Less: right-of-use assets [1] additions	(2,495)	-	n/a
Capital expenditures	**9,340**	**7,013**	**33.2%**
Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments	(1,217)	220	n/a
Cash used for capital expenditures [2]	**8,123**	**7,233**	**12.3%**

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

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

In the second quarter of 2017, the Group won the auction for the right for geological research works, exploration and production of hydrocarbons at the Gydanskiy license area and paid RR 2,057 million. The remaining amount of the license fee payment of RR 205 million will be made after the license state registration.

In the second quarter of 2016, we paid RR 1,057 million for the license for geological research works, exploration and production of hydrocarbons at the Nyakhartinskiy license area.

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 2017, the total amount of our debt denominated in US dollars was RR 164,883 million, or 92,1% of our total borrowings at that date. Changes in the value of the Russian rouble relative to foreign currencies will impact our foreign currency-denominated costs and expenses, our debt service obligations for foreign currency-denominated borrowings, as well as receivables at our foreign subsidiaries in Russian rouble terms. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, 39.7% in the three months ended 30 June 2017, was denominated in foreign currencies.

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

As of 30 June 2017, the Russian rouble appreciated by 2.6% against the US dollar and depreciated by 5.8% against the Euro, compared to 31 December 2016 (see "Selected macro-economic data" above).

Commodity risk

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

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

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

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

Pipeline access

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

Ability to reinvest

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

Forward-looking statements

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

Off balance sheet activities

As of 30 June 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

TERMS AND ABBREVIATIONS

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