



PAO NOVATEK

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

FOR THE THREE MONTHS ENDED 30 JUNE 2018

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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 2018 together with our unaudited consolidated interim condensed financial statements as of and for the three and six months ended 30 June 2018. 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 2017 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

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

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

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

We deliver our extracted unstable gas condensate through our own pipelines to our Purovsky Gas Condensate Plant (the "Purovsky Plant") for processing into stable gas condensate and natural gas liquids ("NGL"). 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 NGL 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 liquefied petroleum gas ("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. NGL sold directly from the Purovsky Plant and sales of LPG received from the processing at the Tobolsk Refining Facilities are presented within LPG sales in this report.

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

RECENT DEVELOPMENTS

Implementing our Yamal LNG project

In the fourth quarter of 2017, Yamal LNG started producing LNG at the first LNG train of 5.5 million tons annual capacity, and, in December 2017, shipped three LNG cargoes from the port of Sabetta by Arc7 ice-class LNG tankers.

In late February 2018, Yamal LNG completed the main performance tests to confirm the design parameters of the plant's first LNG train. Average production rate per hour in winter conditions exceeded the plant's design capacity, demonstrating a higher efficiency of liquefying natural gas in the arctic climatic environment.

In total, during the first half of 2018, 2.5 million tons of LNG and 234 thousand tons of stable gas condensate were shipped from the port of Sabetta. LNG was delivered under both short-term and long-term contracts.

In July 2018, two Arc7 ice-class LNG tankers with LNG produced at the Yamal LNG project have successfully completed the Northern Sea Route passage from the port of Sabetta via the Eastern direction to the Chinese port of Jiangsu Rudong. The net voyage time from the port of Sabetta to the destination point was 19 days as compared to 35 days for the traditional route via the Suez Canal and the Strait of Malacca. These shipments are the first voyages with Russian LNG via the Northern Sea Route without escort of an icebreaker and mark the start of regular LNG shipments via the Northern Sea Route.

Currently, the second and the third LNG trains are nearing completion, and the design of the fourth LNG train has commenced. In April 2018, the first firing of compressor gas turbines was performed at the second LNG train and, in July, natural gas was introduced into the process pipelines indicating the near launch of the second train.

Signing an agreement with TOTAL on the terms to enter the Arctic LNG 2 project

In May 2018, NOVATEK and TOTAL S.A. signed a binding agreement on the terms to enter the Arctic LNG 2 project. The agreement provides for the acquisition by TOTAL of a 10% participation interest in the project, as well as the right to acquire additionally up to 5% in case the Group decides to decrease its participation interest in the project below 60%. The agreement stipulates that final transaction documents on the sale of a 10% participation interest in OOO Arctic LNG 2 to TOTAL will be signed in 2018 and the transaction will be closed no later than 31 March 2019. Signing the agreement with TOTAL is an important step in implementing the Arctic LNG 2 project and evidences outstanding economic attractiveness and perspectives of future Group's LNG projects on the Yamal and Gydan peninsulas.

Obtaining a patent for natural gas liquefaction technology

In March 2018, the Group obtained a patent for its proprietary natural gas liquefaction technology called "Arctic Cascade". The patented LNG technology is based on a two-stage liquefaction process ensuring high energy efficiency due to the maximum use of the colder ambient temperature in the arctic climate. Our proprietary technology intends to use mainly Russian-made equipment and achieve a decrease in the overall cost of liquefaction, as well as develop a domestic technological base for the Group's future LNG projects.

Logistics improvement and transportation costs optimization

In the second quarter of 2018, the Group established two wholly owned subsidiaries as part of its long-term strategy to effectively manage logistics and to optimize shipping costs of our Arctic projects:

- In May 2018, the Group established a subsidiary OOO Maritime Arctic Transport to manage and optimize transportation costs, build up the unique competencies of Arctic navigation and ensure centralized management of the Arctic fleet.

- In April 2018, we established a subsidiary OOO NOVATEK-Kamchatka to build an LNG transshipment terminal on the Kamchatka Peninsula with throughput of 20 million tons of LNG per annum. Construction of the transshipment complex will contribute to the logistics optimization of LNG deliveries from the Arctic region to the customers in the Asian Pacific Region ("APR"), promoting the Northern Sea Route, as well as the gasifying the peninsula using boil-off gas delivered to the Kamchatka gas supply system.

Increasing our resource base and production facilities

In February 2018, based on the results of an auction held by AK ALROSA (PAO), the Group acquired 100% participation interests in companies Maretiom Investments Limited and Velarion Investments Limited, the owners of 100% participation interests in AO Geotransgas and OOO Urengoyanskaya gasovaya kompaniya, respectively, for RR 30.3 billion. Geotransgas holds the license for exploration and production of hydrocarbons within the Beregovoy license area, which is currently producing hydrocarbons. As of 31 December 2017, the license area's reserves under the category A+B of the Russian reserve classification totaled 73 bcm of natural gas and five million tons of liquid hydrocarbons. Urengoyanskaya gasovaya kompaniya holds the license for exploration and production of hydrocarbons within the Ust-Yamsoveyskiy license area. As of 31 December 2017, the license area's reserves under the category B of the Russian reserve classification totaled 89 bcm of natural gas and 14 million tons of liquid hydrocarbons.

In addition, in the first half of 2018, the Group obtained rights for the usage of four more license areas located in close proximity to other Group's assets:

- In April 2018, we obtained the right for geological research works at the Palkurtoiskiy license area. The license area is located in the YNAO and borders with other license areas of the Group (the North-Tanamskiy, the Nyavuyahskiy, the West-Solpatinskiy and the Centralno-Nadoyakhskiy). As of 31 December 2017, the license area's recoverable resources under the category D of the Russian reserve classification totaled 278 bcm of natural gas and approximately 49 million tons of liquid hydrocarbons.
- In April 2018, we obtained the right for geological research works at the Centralno-Nadoyakhskiy license area. The license area is located in the YNAO and borders with the West-Solpatinskiy and the Tanamskiy license areas of the Group. As of 31 December 2017, the license area's recoverable resources under the category D of the Russian reserve classification totaled 258 bcm of natural gas and 144 million tons of liquid hydrocarbons.
- In March 2018, the Group won an 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 Payutskiy license area. The license area is located in the Krasnoyarsk Region in close proximity to the Group's license areas on the Gydan peninsula, the West-Solpatinskiy, the North-Tanamskiy, the Nyavuyahskiy and Tanamskiy license areas. As of 31 December 2017, the license area's reserves and recoverable resources under the category C+D of the Russian reserve classification totaled 54 bcm of natural gas. The payment for the license was set at RR 66 million.
- In January 2018, the Group acquired a 100% participation interest in OOO Chernichnoye for RR 616 million. OOO Chernichnoye is a holder of the license for geological research works, exploration and production of hydrocarbons within the Chernichniy license area located in the YNAO in close proximity to the Termokarstovoye field of our joint venture ZAO Terneftegas. As of 31 December 2017, the license area's reserves under the category B of the Russian reserve classification totaled 17.7 bcm of natural gas and 7.8 million tons of liquid hydrocarbons.

The change in the participation interest in AO Arcticgas

In the first quarter of 2018, the Group and PAO Gazprom Neft completed the final stage of the previously commenced restructuring procedures to achieve parity shareholdings in our joint venture AO Arcticgas:

- In January 2018, Yamal Development and SeverEnergiya were merged with Arcticgas. As a result, the Group and Gazprom Neft obtained direct participation interests in Arcticgas of 53.3% and 46.7%, respectively.

- In March 2018, Gazprom Neft subscribed to an additional share emission of Arcticgas for a total cash consideration of RR 32.1 billion.

As a result of the aforementioned transactions, the Group's participation interest in Arcticgas decreased from 53.3% to 50.0%. The Group continues to recognize the entity as a joint venture and accounts for this investment under the equity method.

International oil and gas projects

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

BASIS OF PRESENTATION

Certain changes have been made to the presentation of production volumes, as well as average realized prices and revenue streams in this report to conform to the reporting practices of the Group's domestic and international peers in the oil and gas industry. The comparative data for 2017 have been recalculated in accordance with this approach.

Oil and gas production is calculated based on 100% of our subsidiaries production and our proportionate share in the production of our joint ventures including volumes of natural gas consumed in oil and gas producing and development activities (previously, such own use volumes were excluded). Production of the South-Tambeyskoye field developed by the Group's joint venture Yamal LNG is reported at 60% including an additional 9.9% interest not owned by the Group, since the Group assumes certain economic and operational risks related to this interest. The comparative figures for 2017 were recalculated accordingly.

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 30 June 2018****SELECTED DATA**

<i>millions of Russian roubles except as stated</i>	Three months ended 30 June:		Change %
	2018	2017	
Financial results			
Total revenues ⁽¹⁾	195,822	128,830	52.0%
Operating expenses	(135,606)	(94,033)	44.2%
EBITDA ⁽²⁾	101,339	56,072	80.7%
Profit attributable to shareholders of PAO NOVATEK	32,041	3,243	n/a
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses) ⁽³⁾	54,289	33,772	60.8%
Earnings per share (in Russian roubles)	10.63	1.08	n/a
Earnings per share, excluding the effect of foreign exchange gains (losses) ⁽³⁾ (in Russian roubles)	18.01	11.20	60.9%
Net debt ⁽⁴⁾	90,692	115,075	(21.2%)
Production volumes ⁽⁵⁾			
Hydrocarbons production (million barrels of oil equivalent)	131.8	127.5	3.4%
Daily production (million barrels of oil equivalent per day)	1.45	1.40	3.4%
Operating results			
Natural gas sales volumes (million cubic meters)	15,149	14,380	5.3%
Naphtha sales volumes (thousand tons)	1,317	1,060	24.2%
Crude oil sales volumes (thousand tons)	1,148	1,211	(5.2%)
Other stable gas condensate refined products (thousand tons)	711	703	1.1%
Liquefied petroleum gas sales volumes (thousand tons)	658	645	2.0%
Stable gas condensate sales volumes (thousand tons)	436	450	(3.1%)
Cash flow results			
Net cash provided by operating activities	61,885	39,114	58.2%
Cash used for capital expenditures ⁽⁶⁾	22,052	8,123	171.5%
Free cash flow ⁽⁷⁾	39,833	30,991	28.5%

⁽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, cash equivalents and bank deposits with original maturity more than three months.

⁽⁵⁾ Oil and gas production is calculated based on 100% of production of our subsidiaries and our proportionate share in the production of our joint ventures including fuel gas. Production of the South-Tambeyskoye field of Yamal LNG is reported at 60% (see "Basis of presentation" above). Figures for the second quarter of 2017 were recalculated accordingly.

⁽⁶⁾ 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.

⁽⁷⁾ Free cash flow represents the difference between Net cash provided by operating activities and Cash used for capital expenditures.

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Reconciliation of EBITDA is as follows:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Profit	37,274	5,243	n/a
Depreciation, depletion and amortization	8,655	8,572	1.0%
Net impairment reversals (expenses)	89	-	n/a
Loss (income) from changes in fair value of commodity derivative instruments	619	78	n/a
Total finance expense (income)	(7,380)	(13,414)	(45.0%)
Total income tax expense	11,486	9,551	20.3%
Share of loss (profit) of joint ventures, net of income tax	18,215	33,768	(46.1%)
EBITDA from subsidiaries	68,958	43,798	57.4%
Share in EBITDA of joint ventures	32,381	12,274	163.8%
EBITDA	101,339	56,072	80.7%

PAO NOVATEK

**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 30 June 2018**

SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate, Russian roubles for one foreign currency unit ⁽¹⁾</i>	Three months ended 30 June:		Change %
	2018	2017	
US dollar (USD)			
Average for the period	61.80	57.15	8.1%
At the beginning of the period	57.26	56.38	1.6%
At the end of the period	62.76	59.09	6.2%
Depreciation (appreciation) of Russian rouble to US dollar	9.6%	4.8%	n/a
Euro			
Average for the period	73.75	62.79	17.5%
At the beginning of the period	70.56	60.60	16.4%
At the end of the period	72.99	67.50	8.1%
Depreciation (appreciation) of Russian rouble to Euro	3.4%	11.4%	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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<i>Average for the period</i>	Three months ended 30 June:		Change %
	2018	2017	
Benchmark natural gas prices ⁽²⁾			
NBP, USD per mmbtu	7.3	4.8	52.1%
Benchmark crude oil prices ⁽³⁾			
Brent, USD per barrel	74.4	49.6	50.0%
Urals, USD per barrel	72.5	48.7	48.9%
Urals, Russian roubles per barrel	4,481	2,783	61.0%
Benchmark crude oil prices excluding export duties ⁽⁴⁾			
Urals, USD per barrel	56.0	37.2	50.5%
Urals, Russian roubles per barrel	3,461	2,126	62.8%
Benchmark oil products ⁽⁵⁾ and liquefied petroleum gas ⁽⁶⁾ prices, USD per ton			
Naphtha Japan	640	445	43.8%
Naphtha CIF NWE	636	432	47.2%
Jet fuel	709	483	46.8%
Gasoil	647	446	45.1%
Fuel oil	417	300	39.0%
Liquefied petroleum gas	456	336	35.7%
Export duties, USD per ton ⁽⁷⁾			
Crude oil, stable gas condensate	120.6	84.3	43.1%
Naphtha	66.2	46.3	43.0%
Jet fuel, gasoil	36.1	25.3	42.7%
Fuel oil	120.6	84.3	43.1%
Liquefied petroleum gas	0.0	0.0	n/a

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

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

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

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

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

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current economic conditions

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

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

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

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

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

Natural gas prices

We sell our natural gas to customers in the Russian domestic market, mainly through trunk pipelines and local distribution networks, and deliver LNG purchased from our joint venture OAO Yamal LNG to international markets (starting from December 2017). In addition, we perform LNG regasification activities in Poland by purchasing LNG in Poland, regasifying it at our own regasification station and selling natural gas to customers in Poland.

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

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 prices by 3.9% and they remained unchanged until the end of the second quarter of 2018.

In November 2017, the Ministry of Economic Development of the Russian Federation published the “Forecast of Socio-economic Development of the Russian Federation for 2018 and planned period 2019 and 2020” stating that wholesale natural gas prices for sales to all customer categories (excluding residential customers) will be increased from July 2018, 2019 and 2020 by an average of 3.4%, 3.1% and 3.0%, respectively. As of our report date, no information regarding the effective date of the next adjustment of wholesale prices 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 rates on the domestic market.

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

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

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

The Group's natural gas prices on international markets are influenced by many factors, such as the balance between supply and demand fundamentals, weather, the geography of sales, the delivery terms to name a few. The Group sells LNG on international markets under short-term contracts and, since April 2018, under long-term contracts with prices based on the prices for natural gas at major natural gas hubs and on the benchmark crude oil prices. The Group's prices for regasified LNG sold as natural gas on the Polish market are based on the prices regulated by the Energy Regulatory Office of Poland.

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

	Three months ended 30 June:		Change %
	2018	2017	
Average natural gas price, RR per mcm	4,409	3,795	16.2%
Average natural gas price, USD per mcm ⁽¹⁾	71.5	66.4	7.7%

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

In the three months ended 30 June 2018, our aggregate average price for natural gas sold in the Russian Federation and on the international markets increased by 16.2% mainly due to the commencement of LNG sales to international markets from December 2017, as well as an increase in the regulated Russian domestic price by 3.9% effective 1 July 2017.

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

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

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

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

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

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

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

<i>Russian roubles or US dollars per ton</i> ⁽¹⁾	Three months ended 30 June:		Change %
	2018	2017	
Stable gas condensate			
Average net price, RR per ton	23,412	15,876	47.5%
Average net price, USD per ton	379	278	36.3%
Naphtha			
Average net price, RR per ton	37,595	22,910	64.1%
Average net price, USD per ton	609	399	52.6%
Other stable gas condensate refined products			
Average net price, RR per ton	37,178	22,886	62.4%
Average net price, USD per ton	601	401	49.9%
Crude oil			
Average net price, RR per ton	24,767	14,768	67.7%
Average net price, USD per ton	400	258	55.0%
LPG			
Average net price, RR per ton	20,239	12,228	65.5%
Average net price, USD per ton	327	214	52.8%

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

In the three months ended 30 June 2018, our weighted-average realized net prices for our liquid hydrocarbons increased compared to the corresponding period in 2017 due to an increase in the underlying benchmark prices for these products excluding export duties (see "Selected macro-economic data" above). Our weighted-average realized net prices in Russian roubles terms increased to a greater extent compared to US dollar prices as a result of 8.1% Russian rouble depreciation relative to the US dollar in the three months ended 30 June 2018 compared to the corresponding period in 2017.

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

Transportation tariffs*Natural gas by pipelines*

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

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

In 2017 and during the first half of 2018, the average tariff for natural gas transportation through the trunk pipeline did not change. The transportation rate amounted to RR 13.04 per mcm per 100 km (excluding VAT), and the rate for utilization of the trunk pipeline was set in the range from RR 62.57 to RR 2,014.16 per mcm (excluding VAT).

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in November 2017, the increase in tariffs for natural gas transportation through the trunk pipeline in 2018 to 2020 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). There was no indexation of transportation tariffs effective 1 July 2018, 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

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

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

Effective January 2018, railroad freight transportation tariffs for all types of hydrocarbons were increased by 5.4% relative to the 2017 tariffs.

In 2017 and in the first half of 2018, 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, refined products and liquefied natural gas by tankers

We deliver part of our stable gas condensate and substantially all stable gas condensate refined products, as well as liquefied natural gas (excluding volumes purchased and sold to customers in the same location) to international markets by chartered tankers. Besides time chartering expenses we also may incur transshipment, bunkering, port charges and other expenses depending on the delivery terms, which are included in the transportation by tankers expense category. In addition, our tanker transportation expenses are also influenced by the distance to the final port of destination, tanker availability, seasonality of deliveries and other factors.

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 2018, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 3.9% relative to the 2017 tariffs.

Our tax burden and obligatory payments

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

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

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

Information regarding UPT, export duties and excise taxes described below is based on the Tax Code of the Russian Federation and the law "On Customs Tariff" effective as at this report date and does not take into account possible amendments to the taxation effective 2019. Presently, draft laws on completion of the tax maneuver in the oil and gas industry are under consideration, which envisage a phased decrease in crude oil export duty rate from 30% to 0% of crude oil price during the six years starting from 1 January 2019 with a respective increase in UPT rates.

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 (set at 6.5 in both reporting periods), and the UPT rate for natural gas also takes into account a parameter characterizing natural gas transportation costs (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.

Effective January 2018, in accordance with the Tax Code of the Russian Federation, the Group began to apply a tax deduction on gas condensate produced for processing into NGL. The amount of the tax deduction is calculated monthly by multiplying a coefficient of NGL recovery from gas condensate processing, the quantity of gas condensate produced and processed, and the tax deduction rate in Russian roubles per ton of NGL derived. The tax deduction rate is determined as a serial number of the respective month starting from January 2018 multiplied by RR 147 per ton, and, from January 2021, the tax deduction rate will be fixed at RR 5,280 per ton of NGL.

UPT – crude oil

In both reporting periods, 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. The result was then additionally increased by RR 306 per ton in 2017 and by RR 357 per ton in 2018.

In 2017 and 2018, the base crude oil UPT rate is set at RR 919 per ton. In both reporting periods, in accordance with the Tax Code of the Russian Federation, we applied a reduced UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye and Yarudeyskoye fields since these fields are located fully or partially to the north of the 65th degree of the northern latitude fully or partially in the YNAO. Therefore, the adjusted base UPT rate for crude oil produced at these fields for the Group amounted to RR 360 per ton.

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 both reporting periods, 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 30% of the difference between the average Urals crude oil price and USD 182.5 per ton.

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 stable gas condensate refined products as a percentage of the crude oil export duty rate are presented below:

	% from the crude oil export duty rate
Naphtha	55%
Jet fuel	30%
Gasoil	30%
Fuel oil	100%

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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:

<i>Average LPG price, USD per ton (P)</i>	Formula for export duty rate calculation
less 490 (inclusive)	Zero rate
between 490 and 640 (inclusive)	$0.5 \times (P - 490)$
between 640 and 740 (inclusive)	$75 + 0.6 \times (P - 640)$
above 740	$135 + 0.7 \times (P - 740)$

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.

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 tax rate in both reporting periods amounted to 670 Polish zloty per ton, and the fuel tax rate was increased from 159.71 Polish zloty per ton in 2017 to 162.27 Polish zloty per ton in 2018).

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 2017 and 2018:

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

In the current reporting period, our operational results were significantly impacted by the production launch at the first LNG train at Yamal LNG at the end of 2017, as well as the acquisitions of new production assets at the end of 2017 and during the first quarter of 2018. As a result, our total natural gas and liquids production increased by 4.2% and by 0.3%, respectively.

In the three months ended 30 June 2018, our total natural gas sales volumes increased by 769 mmcm, or 5.3%, due to sales of LNG purchased from our joint venture Yamal LNG to international markets from December 2017, as well as an increase in volumes sold in the Russian Federation.

In the three months ended 30 June 2018, our liquids sales volumes increased by 201 thousand tons, or 4.9%, mainly due to the sale of stable gas condensate refined products in transit at the end of the first quarter of 2018.

Natural gas production volumes

The following table presents natural gas production of the Group's subsidiaries by major production fields and our proportionate share in natural gas production of joint ventures by entities:

<i>millions of cubic meters if not stated otherwise</i>	Three months ended 30 June:		Change %
	2018	2017	
Production by subsidiaries from:			
Yurkharovskoye field	6,975	7,746	(10.0%)
East-Tarkosalinskoye field	1,677	1,877	(10.7%)
Khancheykskoye field	501	571	(12.3%)
Other fields	1,409	758	85.9%
Total natural gas production by subsidiaries ⁽¹⁾	10,562	10,952	(3.6%)
Group's proportionate share in the production of joint ventures:			
Arcticgas	3,424	3,438	(0.4%)
Yamal LNG ⁽²⁾	1,219	36	n/a
Nortgas	898	1,021	(12.0%)
Terneftegas	315	315	0.0%
Total Group's proportionate share in the natural gas production of joint ventures ⁽¹⁾	5,856	4,810	21.7%
Total natural gas production including proportionate share in the production of joint ventures	16,418	15,762	4.2%
<i>The Group's proportionate share in LNG production of joint ventures (thousands of tons) ⁽²⁾</i>	773	-	n/a
⁽¹⁾ Natural gas production includes natural gas volumes consumed in oil and gas production and development activities (primarily, as fuel gas):			
in subsidiaries	342	352	(2.8%)
in joint ventures (Group's proportionate share)	81	87	(6.9%)

Production for 2017 was recalculated accordingly.

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

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In the three months ended 30 June 2018, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 656 mmcm, or 4.2%, to 16,418 mmcm from 15,762 mmcm in the corresponding period in 2017. The main factors positively impacting our production growth were the commencement of natural gas production for subsequent liquefaction at Yamal LNG at the end of 2017, as well as the acquisition by the Group of new production fields at the end of 2017 and during the first quarter of 2018 (the Beregovoye, the West-Yaroyakhinskoye and the Syskonsyninskoye). This allowed us to fully compensate the decrease in production at mature fields of our subsidiaries (the Yurkharovskoye, the East-Tarkosalinskoye and the Khancheyskoye) and our joint venture Nortgas, which resulted mainly from natural declines in the reservoir pressure at the current gas producing horizons.

Our proportionate share in the production of Arcticgas marginally decreased by 0.4% as a result of a decrease in the Group's effective participation interest in Arcticgas from 53.3% to 50.0% in March 2018 (see "Recent Developments" above).

Natural gas sales volumes

In the three months ended 30 June 2018, our total natural gas sales volumes increased by 769 mmcm, or 5.3%, to 15,149 mmcm from 14,380 mmcm in the corresponding period in 2017.

<i>millions of cubic meters</i>	Three months ended 30 June:		Change %
	2018	2017	
Production by subsidiaries	10,562	10,952	(3.6%)
Purchases from the Group's joint ventures	4,420	2,356	87.6%
Other purchases	1,708	1,936	(11.8%)
Total production and purchases	16,690	15,244	9.5%
Own usage ⁽¹⁾	(368)	(383)	(3.9%)
Decrease (increase) in natural gas inventory balance	(1,173)	(481)	143.9%
Total natural gas sales volumes	15,149	14,380	5.3%
<i>Sold to end-customers</i>	<i>13,569</i>	<i>13,780</i>	<i>(1.5%)</i>
<i>Sold ex-field</i>	<i>927</i>	<i>600</i>	<i>54.5%</i>
Subtotal sold in the Russian Federation	14,496	14,380	0.8%
<i>Sold on international markets</i>	<i>653</i>	<i>-</i>	<i>n/a</i>

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

In the three months ended 30 June 2018, natural gas purchases from our joint ventures increased by 2,064 mmcm, or 87.6%, to 4,420 mmcm from 2,356 mmcm in the corresponding period in 2017 primarily due to the commencement of purchases of LNG produced at Yamal LNG for subsequent sale on international markets from December 2017 and an increase in purchases of natural gas from Arcticgas in order to fulfill our Russian domestic contractual sales obligations.

Other natural gas purchases decreased by 228 mmcm, or 11.8%, to 1,708 mmcm from 1,936 mmcm in the corresponding period in 2017, 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 2018, our cumulative natural gas inventory balance, representing our inventory balances mainly in the UGSF, the GTS and our own pipeline infrastructure, aggregated 1,252 mmcm and increased by 1,173 mmcm during the quarter as compared to an increase by 481 mmcm in the corresponding period in 2017.

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Liquids production volumes

The following table presents liquids production of the Group's subsidiaries by major production fields and our proportionate share in the liquids production of joint ventures by entities:

<i>thousands of tons</i>	Three months ended 30 June:		Change %
	2018	2017	
Production by subsidiaries from:			
Yarudeyskoye field	874	896	(2.5%)
Yurkharovskoye field	314	380	(17.4%)
East-Tarkosalinskoye field	329	315	4.4%
Khancheyskoye field	57	70	(18.6%)
Other fields	76	26	192.3%
Total liquids production by subsidiaries	1,650	1,687	(2.2%)
<i>including crude oil</i>	<i>1,182</i>	<i>1,181</i>	<i>0.1%</i>
<i>including gas condensate</i>	<i>468</i>	<i>506</i>	<i>(7.5%)</i>
Group's proportionate share in the production of joint ventures:			
Arcticgas	1,000	1,036	(3.5%)
Terneftegas	102	105	(2.9%)
Yamal LNG ⁽¹⁾	100	-	n/a
Nortgas	76	90	(15.6%)
Total Group's proportionate share in the liquids production of joint ventures	1,278	1,231	3.8%
Total liquids production including proportionate share in the production of joint ventures	2,928	2,918	0.3%

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

In the three months ended 30 June 2018, our total liquids production (including our proportionate share in the production of joint ventures) increased by 10 thousand tons, or 0.3%, to 2,928 thousand tons from 2,918 thousand tons in the corresponding period in 2017. The main factors positively impacting our production growth were the commencement of gas condensate production at Yamal LNG at the end of 2017, as well as the acquisition by the Group of new production fields. This allowed us to fully compensate for the decrease in gas condensate production at mature fields of our subsidiaries and our joint venture Nortgas mainly due to natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons.

Our proportionate share in the production of Arcticgas decreased by 3.5% as a result of a decrease in the Group's effective participation interest in Arcticgas from 53.3% to 50.0% in March 2018 (see "Recent Developments" above).

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Liquids sales volumes

In the three months ended 30 June 2018, our total liquids sales volumes increased by 201 thousand tons, or 4.9%, to 4,273 thousand tons from 4,072 thousand tons in the corresponding period in 2017.

<i>thousands of tons</i>	Three months ended 30 June:		Change %
	2018	2017	
Production by subsidiaries	1,650	1,687	(2.2%)
Purchases from the Group's joint ventures	2,322	2,296	1.1%
Other purchases	56	41	36.6%
Total production and purchases	4,028	4,024	0.1%
Losses ⁽¹⁾ and own usage ⁽²⁾	(51)	(66)	(22.7%)
Decreases (increases) in liquids inventory balances	296	114	159.6%
Total liquids sales volumes	4,273	4,072	4.9%
<i>Naphtha export</i>	<i>1,317</i>	<i>1,060</i>	<i>24.2%</i>
<i>Other stable gas condensate refined products export</i> ⁽³⁾	<i>681</i>	<i>667</i>	<i>2.1%</i>
<i>Other stable gas condensate refined products domestic</i> ⁽³⁾	<i>30</i>	<i>36</i>	<i>(16.7%)</i>
<i>Subtotal stable gas condensate refined products</i>	<i>2,028</i>	<i>1,763</i>	<i>15.0%</i>
<i>Crude oil export</i>	<i>385</i>	<i>462</i>	<i>(16.7%)</i>
<i>Crude oil domestic</i>	<i>763</i>	<i>749</i>	<i>1.9%</i>
<i>Subtotal crude oil</i>	<i>1,148</i>	<i>1,211</i>	<i>(5.2%)</i>
<i>LPG export</i>	<i>153</i>	<i>134</i>	<i>14.2%</i>
<i>LPG domestic</i>	<i>505</i>	<i>511</i>	<i>(1.2%)</i>
<i>Subtotal LPG</i>	<i>658</i>	<i>645</i>	<i>2.0%</i>
<i>Stable gas condensate export</i>	<i>1</i>	<i>57</i>	<i>(98.2%)</i>
<i>Stable gas condensate domestic</i>	<i>435</i>	<i>393</i>	<i>10.7%</i>
<i>Subtotal stable gas condensate</i>	<i>436</i>	<i>450</i>	<i>(3.1%)</i>
<i>Other oil products</i>	<i>3</i>	<i>3</i>	<i>0.0%</i>

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

Our sales volumes of naphtha and other stable 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 2018 reporting period, our liquids inventory balances decreased by 296 thousand tons to 806 thousand tons as of 30 June 2018 as compared to a decrease in inventory balances by 114 thousand tons to 699 thousand tons in the corresponding period in 2017. 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).

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TO THE CORRESPONDING PERIOD IN 2017**

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 June 2018 and 2017. Each line item is also shown as a percentage of our total revenues.

<i>millions of Russian roubles</i>	Three months ended 30 June:			
	2018	% of total revenues	2017	% of total revenues
Total revenues ⁽¹⁾	195,822	100.0%	128,830	100.0%
<i>including:</i>				
natural gas sales	66,798	34.1%	54,569	42.4%
liquids' sales	128,020	65.4%	73,461	57.0%
Operating expenses	(135,606)	(69.3%)	(94,033)	(73.0%)
Other operating income (loss)	(621)	(0.3%)	351	0.3%
Profit from operations	59,595	30.4%	35,148	27.3%
Finance income (expense)	7,380	3.8%	13,414	10.4%
Share of profit (loss) of joint ventures, net of income tax	(18,215)	(9.3%)	(33,768)	(26.2%)
Profit before income tax	48,760	24.9%	14,794	11.5%
Total income tax expense	(11,486)	(5.9%)	(9,551)	(7.4%)
Profit	37,274	19.0%	5,243	4.1%
Less: profit (loss) attributable to non-controlling interest	(5,233)	(2.6%)	(2,000)	(1.6%)
Profit attributable to shareholders of PAO NOVATEK	32,041	16.4%	3,243	2.5%
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	54,289	27.7%	33,772	26.2%

⁽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 2018 and 2017:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %	Change ⁽¹⁾		
	2018	2017		Total	Due to volume ⁽²⁾	Due to price ⁽³⁾
Natural gas sales	66,798	54,569	22.4%	12,229	2,917	9,312
Stable gas condensate refined products sales	75,937	40,396	88.0%	35,541	6,040	29,501
<i>Naphtha</i>	49,539	24,294	103.9%	25,245	5,892	19,353
<i>Other refined products</i>	26,398	16,102	63.9%	10,296	147	10,149
Crude oil sales	28,425	17,894	58.9%	10,531	(944)	11,475
Liquefied petroleum gas sales	13,310	7,882	68.9%	5,428	159	5,269
Stable gas condensate sales	10,208	7,134	43.1%	3,074	(210)	3,284
Other products sales	140	155	(9.7%)	(15)	n/a	n/a
Total oil and gas sales	194,818	128,030	52.2%	66,788	n/a	n/a
Other revenues	1,004	800	25.5%	204	n/a	n/a
Total revenues	195,822	128,830	52.0%	66,992	n/a	n/a

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

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

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

Natural gas sales

Revenues from natural gas sales represent our revenues from natural gas sales in the Russian Federation (to end-customers and wholesale traders), revenues from LNG sales to international markets, as well as revenues from sales of regasified LNG to customers in Poland through our wholly owned subsidiary, Blue Gaz Sp. z o.o.

The commencement of sales of LNG purchased from our joint venture Yamal LNG to international markets from December 2017, as well as an increase in sales prices and volumes in the Russian domestic market resulted in an increase in our aggregate average price by 16.2% and sales volumes by 5.3% (see "Natural gas prices" and "Natural gas sales volumes" above). As a result, in the three months ended 30 June 2018, our total revenues from natural gas sales increased by RR 12,229 million, or 22.4%, compared to the corresponding period in 2017.

Stable gas condensate refined products sales

Stable 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 2018, our revenues from sales of stable gas condensate refined products increased by RR 35,541 million, or 88.0%, to 75,937 million from 40,396 million in the corresponding period in 2017 primarily due to an increase in average realized prices and, to a lesser extent, an increase in naphtha sales volumes (see "Liquids sales volumes" above).

In the three months ended 30 June 2018, our revenues from sales of naphtha increased by RR 25,245 million, or 103.9%, as compared to the corresponding period in 2017. In the three months ended 30 June 2018 and 2017, we exported 1,317 thousand and 1,060 thousand tons of naphtha, respectively, mainly to the APR, and the European and North America markets. We sold naphtha at different delivery terms: CFR, CIF, DES, FOB and DAP (only in the second quarter of 2018). Our average realized net price, excluding export duties, where applicable, increased by RR 14,685 per ton, or 64.1%, to RR 37,595 per ton from RR 22,910 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 June 2018, our total revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 10,296 million, or 63.9%, as compared to the corresponding period in 2017. In the three months ended 30 June 2018 and 2017, we exported in aggregate 681 thousand and 667 thousand tons of these products mainly to the European markets, or 95.8% and 94.9% of total sales volumes (on the domestic and export markets), respectively. The export delivery terms were CIF, FOB and DES (only in the second quarter of 2018). Our average realized net price, excluding export duties, where applicable, increased by RR 14,292 per ton, or 62.4%, to RR 37,178 per ton from RR 22,886 per ton in the corresponding period in 2017 (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 2018, our revenues from crude oil sales increased by RR 10,531 million, or 58.9%, compared to the corresponding period in 2017 due to an increase in average realized prices.

In the three months ended 30 June 2018, we sold 763 thousand tons, or 66.5% of our total crude oil sales volumes, domestically as compared to sales of 749 thousand tons, or 61.8%, in the corresponding period in 2017. The remaining 385 thousand tons of crude oil, or 33.5% of our total crude oil sales volumes, in the current reporting period and 462 thousand tons, or 38.2%, in the corresponding period in 2017 were sold to the European and the APR markets under FOB delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 9,999 per ton, or 67.7%, to RR 24,767 per ton from RR 14,768 per ton in the corresponding period in 2017 (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 2018, our revenues from sales of LPG increased by RR 5,428 million, or 68.9%, compared to the corresponding period in 2017 primarily due to an increase in average realized prices and, to a lesser extent, an increase in sales volumes (see "Liquids sales volumes" above).

In the three months ended 30 June 2018, we sold 505 thousand tons of LPG, or 76.7% of our total LPG sales volumes, on the domestic market compared to sales of 511 thousand tons, or 79.2%, in the corresponding period in 2017. The remaining 153 thousand tons of LPG, or 23.3% of our total LPG sales volumes, in the three months ended 30 June 2018 and 134 thousand tons of LPG, or 20.8%, in the corresponding period in 2017 were sold to the European markets (primarily to the Polish market) under free carrier FCA (at terminal points in Poland) delivery terms and also under DAP (at the border of the customer's country) delivery terms in the second quarter of 2017.

Our average realized LPG net price, excluding export and import duties, excise and fuel taxes expense, where applicable, in the three months ended 30 June 2018 increased by RR 8,011 per ton, or 65.5%, to RR 20,239 per ton from RR 12,228 per ton in the corresponding period in 2017 (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 2018, our revenues from sales of stable gas condensate increased by RR 3,074 million, or 43.1%, compared to the corresponding period in 2017 due to an increase in average realized prices.

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In the three months ended 30 June 2018, we sold 435 thousand tons of stable gas condensate, or 99.8% of our total stable gas condensate sales volumes, on the domestic market compared to sales of 393 thousand tons, or 87.3%, in the corresponding period in 2017. The remaining one thousand tons of stable gas condensate, or 0.2% of our total stable gas condensate sales volumes, in the second quarter of 2018, and 57 thousand tons, or 12.7%, in the second quarter of 2017, were sold to the European markets under DAF and DAP delivery terms, respectively.

Our average realized net price, excluding export duties, where applicable, increased by RR 7,536 per ton, or 47.5%, to RR 23,412 per ton from RR 15,876 per ton in the corresponding period in 2017 (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 2018, our revenues from other products sales decreased by RR 15 million, or 9.7%, to RR 140 million from RR 155 million in the corresponding period in 2017.

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 2018, other revenues increased by RR 204 million, or 25.5%, to RR 1,004 million from RR 800 million in the corresponding period in 2017 primarily due to an increase in revenues from tankers transporting third party goods by RR 101 million.

Operating expenses

In the three months ended 30 June 2018, our total operating expenses increased by RR 41,573 million, or 44.2%, to RR 135,606 million compared to RR 94,033 million in the corresponding period in 2017 mainly due to an increase in purchases of natural gas and liquid hydrocarbons as a result of an increase in volumes of natural gas purchased from our joint ventures, in particular, with the commencement of LNG production at Yamal LNG at the end of 2017, as well as an increase in the average purchase prices for hydrocarbons (see "Purchases of natural gas and liquid hydrocarbons" below), which in turn allowed us to earn higher revenues from hydrocarbons sales. Our total operating expenses as a percentage of total revenues decreased from 73.0% to 69.3%.

<i>millions of Russian roubles</i>	Three months ended 30 June:			
	2018	% of total revenues	2017	% of total revenues
Purchases of natural gas and liquid hydrocarbons	63,585	32.5%	30,990	24.1%
Transportation expenses	34,554	17.6%	32,567	25.2%
Taxes other than income tax	14,871	7.6%	11,531	9.0%
Depreciation, depletion and amortization	8,655	4.4%	8,572	6.7%
Materials, services and other	5,826	3.0%	5,084	3.9%
General and administrative expenses	5,079	2.6%	3,911	3.0%
Exploration expenses	2,004	1.0%	504	0.4%
Impairment expenses (reversals), net	89	n/a	-	n/a
Changes in natural gas, liquid hydrocarbons and work-in-progress	943	0.5%	874	0.7%
Total operating expenses	135,606	69.3%	94,033	73.0%

Purchases of natural gas and liquid hydrocarbons

In the three months ended 30 June 2018, our purchases of natural gas and liquid hydrocarbons increased by RR 32,595 million, or 105.2%, to RR 63,585 million from RR 30,990 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Unstable gas condensate	42,209	21,388	97.3%
Natural gas	19,884	8,908	123.2%
Other hydrocarbons	1,492	694	115.0%
Total purchases of natural gas and liquid hydrocarbons	63,585	30,990	105.2%

In the three months ended 30 June 2018, our purchases of unstable gas condensate from our joint ventures increased by RR 20,821 million, or 97.3%, as compared to the corresponding period in 2017 due to an increase in purchase prices, which are impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

In the three months ended 30 June 2018, our purchases of natural gas increased by RR 10,976 million, or 123.2%, as compared to the corresponding period in 2017 mainly due to the commencement of purchases of LNG produced at Yamal LNG for subsequent sale on international markets from December 2017 and an increase in volumes of natural gas purchased from Arcticgas in order to fulfill our contractual sales obligations on the domestic market. In addition, our purchases of natural gas increased due to an increase in purchase prices on the domestic market that are influenced by the regulated natural gas prices (see "Natural gas prices" above).

Other hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products. In the three months ended 30 June 2018, our purchases of other hydrocarbons increased by RR 798 million, or 115.0%, as compared to the corresponding period in 2017 mainly due to an increase in prices and volumes of LPG purchased for subsequent small volume wholesale and retail sales.

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In the three months ended 30 June 2018, our total transportation expenses increased by RR 1,987 million, or 6.1%, to RR 34,554 million as compared to RR 32,567 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Natural gas transportation			
by trunk and low-pressure pipelines	21,688	21,361	1.5%
Stable gas condensate and liquefied petroleum gas transportation by rail	8,755	7,623	14.8%
Crude oil transportation by trunk pipelines	2,194	2,080	5.5%
Stable gas condensate and refined products, crude oil and liquefied natural gas transportation by tankers	1,867	1,488	25.5%
Other	50	15	n/a
Total transportation expenses	34,554	32,567	6.1%

In the three months ended 30 June 2018, our expenses for natural gas transportation increased slightly by RR 327 million, or 1.5%, to RR 21,688 million from RR 21,361 million in the corresponding period in 2017 mainly 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 period as compared to the reporting period in the previous year. This effect was partially offset by a 1.5% decrease in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses.

In the three months ended 30 June 2018, our total expenses for stable gas condensate and LPG transportation by rail increased by RR 1,132 million, or 14.8%, to RR 8,755 million from RR 7,623 million in the corresponding period in 2017. The increase was due to a 10.5% increase in volumes of liquids sold and transported via rail, as well as a 3.9% increase in weighted average transportation cost per unit mainly resulted from a 5.4% increase in the regulated railroad transportation tariffs effective January 2018 (see "Transportation tariffs" above).

In the three months ended 30 June 2018, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 114 million, or 5.5%, to RR 2,194 million from RR 2,080 million in the corresponding period in 2017. The increase was due to an increase in the proportion of crude oil sales to more distant regions from our production fields, as well as a 3.9% increase in the regulated transportation tariffs effective 1 January 2018 (see "Transportation tariffs" above). The impact of these factors was partially offset by a 5.2% decrease in sales volumes compared to the corresponding period of the prior year.

In the three months ended 30 June 2018, our total transportation expenses for hydrocarbons delivered by tankers to international markets increased by RR 379 million, or 25.5%, to RR 1,867 million from RR 1,488 million in the corresponding period in 2017. The increase was due to a 16.5% increase in volumes of stable gas condensate refined products sold and transported via tankers, a 8.1% depreciation of the average exchange rate of the Russian rouble relative to the US dollar (since all our tankers transportation expenses are US dollar denominated).

Taxes other than income tax

In the three months ended 30 June 2018, taxes other than income tax increased by RR 3,340 million, or 29.0%, to RR 14,871 million from RR 11,531 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Unified natural resources production tax (UPT)	13,734	10,626	29.2%
Property tax	978	847	15.5%
Other taxes	159	58	174.1%
Total taxes other than income tax	14,871	11,531	29.0%

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In the three months ended 30 June 2018, our unified natural resources production tax expense increased by RR 3,108 million, or 29.2%, to RR 13,734 million from RR 10,626 million in the corresponding period in 2017 mainly due to an increase in UPT rates for crude oil and natural gas as a result of an increase in benchmark crude oil prices, as well as due to changes in the formula for crude oil UPT rate calculation effective 1 January 2018 (see "Our tax burden and obligatory payments" above).

In the three months ended 30 June 2018, our property tax expense increased by RR 131 million, or 15.5%, to RR 978 million from RR 847 million in the corresponding period in 2017 due to acquisitions of new production assets at the end of 2017 and in the first quarter of 2018, as well as additions to property, plant and equipment at our other production subsidiaries.

Depreciation, depletion and amortization

In the three months ended 30 June 2018, our depreciation, depletion and amortization ("DDA") expense changed marginally (increased by RR 83 million to RR 8,655 million from RR 8,572 million in the corresponding period in 2017) as a result of the offsetting effects of two factors: consolidation of new production assets at the end of 2017 and in the first quarter of 2018, on the one hand, and increase in total proved reserves (excluding acquisitions) in our subsidiaries as at the end of 2017 compared to the previous period, on the other hand. 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 2018, our materials, services and other expenses increased by RR 742 million, or 14.6%, to RR 5,826 million compared to RR 5,084 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Employee compensation	2,364	2,295	3.0%
Repair and maintenance	818	628	30.3%
Materials and supplies	544	416	30.8%
Complex of services for preparation, transportation and processing of hydrocarbons	518	498	4.0%
Electricity and fuel	339	297	14.1%
Liquefied petroleum gas volumes reservation expenses	296	217	36.4%
Fire safety and security expenses	245	182	34.6%
Transportation services	206	193	6.7%
Rent expenses	109	77	41.6%
Insurance expense	77	56	37.5%
Other	310	225	37.8%
Total materials, services and other	5,826	5,084	14.6%

Operating employee compensation increased by RR 69 million, or 3.0%, to RR 2,364 million compared to RR 2,295 million in the corresponding period in 2017 due to the acquisition of new production assets at the end of 2017 and in the first quarter of 2018, an indexation of base salaries effective from 1 July 2017 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Repair and maintenance services expenses increased by RR 190 million, or 30.3%, to RR 818 million compared to RR 628 million in the corresponding period in 2017 due to an increase in current repair works performed on wells and maintenance of fixed assets at our core production subsidiaries. Repair expenses fluctuate period-to-period depending on the assets repair schedule at our production subsidiaries.

Materials and supplies expenses increased by RR 128 million, or 30.8%, to RR 544 million in the three months ended 30 June 2018 compared to RR 416 million in the corresponding period in 2017 primarily due to write-off of materials used for current repair works and technological process maintenance at our production subsidiaries.

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In the three months ended 30 June 2018, liquefied petroleum gas volumes reservation costs increased by RR 79 million, or 36.4%, to RR 296 million from RR 217 million in the corresponding period in 2017 as a result of a 16.4% depreciation of the average exchange rate of the Russian rouble relative to the Polish zloty, since this expense is denominated in Polish zloty, as well as due to an increase in LPG volumes sold through our subsidiary in Poland. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

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

General and administrative expenses

In the three months ended 30 June 2018, our general and administrative expenses increased by RR 1,168 million, or 29.9%, to RR 5,079 million compared to RR 3,911 million in the corresponding period in 2017. The main components of these expenses were employee compensation and social expenses and compensatory payments, which, on aggregate, comprised 81.0% and 78.4% of total general and administrative expenses in the three months ended 30 June 2018 and 2017, respectively.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Employee compensation	3,924	2,403	63.3%
Social expenses and compensatory payments	190	663	(71.3%)
Legal, audit and consulting services	183	118	55.1%
Business travel expense	143	166	(13.9%)
Advertising expenses	140	191	(26.7%)
Fire safety and security expenses	116	98	18.4%
Repair and maintenance expenses	64	50	28.0%
Rent expense	53	19	178.9%
Other	266	203	31.0%
Total general and administrative expenses	5,079	3,911	29.9%

Employee compensation relating to administrative personnel increased by RR 1,521 million, or 63.3%, to RR 3,924 million in the three months ended 30 June 2018 from RR 2,403 million in the corresponding period in 2017 due to an indexation of base salaries effective from 1 July 2017, an increase in accrued provision for bonuses to key management and the related increase in social contributions for medical and social insurance and to the Pension Fund, as well as the acquisition of new assets at the end of 2017 and in the first quarter of 2018.

In the three months ended 30 June 2018, our social expenses and compensatory payments decreased by RR 473 million, or 71.3%, to RR 190 million compared to RR 663 million in the corresponding period in 2017. In the current reporting period, a major part of these expenses represented our social expenses related to continued support of charities and social programs in the regions where we operate. In the corresponding period in 2017, besides social expenses we also made compensatory payments of RR 336 million, which primarily related to the development of the Yarudeyskoye field. 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 2018, our exploration expenses significantly increased by RR 1,500 million, or four-fold, to RR 2,004 million from RR 504 million in the corresponding period in 2017 mainly due to an increase in exploration works performed at the West-Solpatinskiy, the North-Tanamskiy, the Gydanskiy and the North-Russkiy license areas. The increase in exploration works will ensure timely preparation of the reserves at our promising fields for development and further progress of the Group's hydrocarbons production projects in line with our long-term strategy. 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 2018 and 2017, we recorded charges of RR 943 million and RR 874 million, respectively, to changes in inventory expense due to a decrease in most of our liquid hydrocarbons inventory balances in both reporting periods.

In the three months ended 30 June 2018 and 2017, our cumulative natural gas inventory balance located mainly in the Underground Gas Storage Facilities ("UGSF"), the GTS and our own pipeline infrastructure, increased by 1,173 mmcm and 481 mmcm, respectively, due to seasonal injection of natural gas for the subsequent sale in the period of higher seasonal demand in both reporting periods. Natural gas inventory balances tend to fluctuate period-to-period depending on the Group's demand for natural gas withdrawal for the sale in the subsequent periods.

In the three months ended 30 June 2018, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, decreased by 296 thousand tons mainly due to a decrease in inventory balance of stable gas condensate refined products in storage capacities of our Ust-Luga Complex and in tankers in transit not realized at the reporting date. In the corresponding period in 2017, our cumulative liquid hydrocarbons inventory balances decreased by 114 thousand tons primarily due to a decrease in inventory balance of crude oil. 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:

<i>Inventory balances in transit or in storage</i>	2018			2017		
	At 30 June	At 31 March	Increase / (decrease)	At 30 June	At 31 March	Increase / (decrease)
Natural gas (millions of cubic meters)	1,252	79	1,173	611	130	481
<i>incl. Gazprom's UGSF</i>	<i>1,170</i>	<i>-</i>	<i>1,170</i>	<i>550</i>	<i>-</i>	<i>550</i>
Liquid hydrocarbons (thousand tons)	806	1,102	(296)	699	813	(114)
<i>incl. stable gas condensate refined products</i>	<i>334</i>	<i>631</i>	<i>(297)</i>	<i>264</i>	<i>284</i>	<i>(20)</i>
<i>stable gas condensate</i>	<i>259</i>	<i>261</i>	<i>(2)</i>	<i>227</i>	<i>258</i>	<i>(31)</i>
<i>crude oil</i>	<i>107</i>	<i>107</i>	<i>-</i>	<i>108</i>	<i>177</i>	<i>(69)</i>

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 2018, we recognized other operating loss of RR 621 million compared to other operating income of RR 351 million in the corresponding period in 2017.

In the three months ended 30 June 2018, within our trading activities we purchased and sold approximately 1.5 bcm of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized gain from trading activities of RR 63 million as compared to RR 372 million of gain in the corresponding period in 2017. At the same time, we recognized non-cash loss of RR 619 million in the three months ended 30 June 2018 as a result of a decrease in the fair value of aforementioned contracts as compared to RR 78 million of non-cash loss in the corresponding period in 2017. The effect of the change in fair value of the commodity contracts fluctuate from period to period depending on the forecast prices for hydrocarbons on international markets and other macroeconomic parameters and may or may not reflect actual future cash flows from trading activities.

Profit from operations and EBITDA

In the three months ended 30 June 2018, our profit from operations and EBITDA including our proportionate share of joint ventures increased due to the production launch at the first LNG train at Yamal LNG in the end of 2017 and an increase in average realized liquid hydrocarbons and natural gas prices.

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Our aggregate EBITDA including our proportionate share of joint ventures increased to RR 101,339 million from RR 56,072 million in the corresponding period in 2017. Our cumulative profit from operations including our proportionate share of joint ventures amounted to RR 85,106 million as compared to RR 43,040 million in the corresponding period in 2017, including profit from operations of our subsidiaries in the amount of RR 59,595 million and RR 35,148 million, respectively.

Finance income (expense)

In the three months ended 30 June 2018, we recorded net finance income of RR 7,380 million compared to net finance income of RR 13,414 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Accrued interest expense on loans received	(2,172)	(2,582)	(15.9%)
Less: capitalized interest	1,260	896	40.6%
Provisions for asset retirement obligations: effect of the present value discount unwinding	(157)	(183)	(14.2%)
Interest expense on lease liabilities	(141)	(4)	n/a
Interest expense	(1,210)	(1,873)	(35.4%)
Interest income	3,395	4,359	(22.1%)
Change in fair value of non-commodity financial instruments	679	(2,841)	n/a
Foreign exchange gain (loss), net	4,516	13,769	(67.2%)
Total finance income (expense)	7,380	13,414	(45.0%)

In the three months ended 30 June 2018, our interest expense decreased by RR 663 million, or 35.4%, to RR 1,210 million primarily due to repayments of the Group's borrowings.

Interest income decreased by RR 964 million, or 22.1%, to RR 3,395 million in the three months ended 30 June 2018 from RR 4,359 million in the corresponding period in 2017. In both reporting periods, interest income primarily related to loans provided to our joint ventures for the development and expansion of their activities. According to IFRS 9 "Financial instruments", the Group accounts for the most of these loans as at fair value through profit or loss with a portion of changes in fair value relating to interest income (calculated based on the amortised cost of the loans using the effective interest method) presented separately from other factors of changes in fair value (such as changes in interest rates and expected maturities).

In the three months ended 30 June 2018, we recognized a non-cash gain of RR 679 million compared to a non-cash loss of RR 2,841 million in the corresponding period in 2017 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IFRS 9 "Financial instruments". 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 2018, we recorded a net foreign exchange gain of RR 4,516 million compared to a net gain of RR 13,769 million in the corresponding period in 2017 due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

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In the three months ended 30 June 2018, the Group's proportionate share of loss of joint ventures decreased by RR 15,553 million, or 46.1%, to RR 18,215 million as compared to RR 33,768 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Share in profit from operations	25,511	7,892	223.3%
Share in finance income (expense)			
Share in interest income (expense), net	(8,482)	(2,644)	220.8%
Share in foreign exchange gain (loss), net	(30,987)	(49,518)	(37.4%)
Share in change in fair value of non-commodity financial instruments	(7,438)	4,000	n/a
Total share in finance income (expense)	(46,907)	(48,162)	(2.6%)
Share in total income tax benefit (expense)	3,181	6,502	(51.1%)
Total share of profit (loss) of joint ventures, net of income tax	(18,215)	(33,768)	(46.1%)

Our proportionate share in the profit from operations of our joint ventures significantly increased by RR 17,619 million, or 223.3%, due to the production launch at the first LNG train at our joint venture Yamal LNG in the end of 2017, as well as an increase in revenues from liquids and natural gas sales in our joint venture Arcticgas primarily as a result of higher average realized prices.

In the three months ended 30 June 2018, our proportionate share in the finance expense of our joint ventures decreased by RR 1,255 million, or 2.6%, compared to the corresponding period in 2017. In both reporting periods, our proportionate share in the finance expense was significantly impacted by the recognition of a non-cash foreign exchange loss on foreign currency denominated loans primarily at our joint ventures Yamal LNG and Terneftegas (our share amounted to RR 31.0 billion compared to RR 49.5 billion in the corresponding period in 2017). In addition, in the current reporting period, we recognized the non-cash loss from the remeasurement of the fair value of shareholders' loans in Yamal LNG and Terneftegas (our share amounted to RR 7.4 billion) as compared to the recognition of a non-cash gain (our share amounted to RR 4.0 billion) in the second quarter of 2017. The remaining changes related to an increase in our share in the interest expense by RR 5.8 billion that was mainly due to the production launch at the first LNG train at Yamal LNG in the end of 2017 and the cessation of the respective interest expense capitalization.

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 2018 and 2017, was 17.1% and 19.6%, respectively.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 30 June 2018****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 increased by RR 28,798 million, or by approximately ten-fold, to RR 32,041 million in the three months ended 30 June 2018 compared to RR 3,243 million in the corresponding period in 2017.

In each reporting period, as a result of currency exchange rates fluctuations, the Group records non-cash foreign exchange gains and/or losses primarily related to the revaluation of foreign currency denominated borrowings and loans provided in the Group and the joint ventures. Excluding the effect of foreign exchange gains and losses, our profit attributable to shareholders of PAO NOVATEK increased by RR 20,517 million, or 60.8%, and amounted to RR 54,289 million in the three months ended 30 June 2018 compared to RR 33,772 million in the corresponding period in 2017 (see the table below):

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Profit attributable to shareholders of PAO NOVATEK	32,041	3,243	n/a
Foreign exchange (gains) losses	(4,516)	(13,769)	(67.2%)
Income tax expense (benefit) relating to foreign exchange (gains) losses	903	2,754	(67.2%)
Share of foreign exchange (gains) losses of joint ventures	30,987	49,518	(37.4%)
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	(5,126)	(7,974)	(35.7%)
Profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	54,289	33,772	60.8%

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK increased by RR 9.55 per share, or by approximately ten-fold, to RR 10.63 per share in the three months ended 30 June 2018 from RR 1.08 per share in the corresponding period in 2017. Excluding the effects of foreign exchange gains and losses, our weighted average basic and diluted earnings per share increased by RR 6.81, or 60.9%, to RR 18.01 per share in the three months ended 30 June 2018 from RR 11.20 per share in the corresponding period in 2017.

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 2018 and 2017:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Net cash provided by operating activities	61,885	39,114	58.2%
Net cash used for investing activities	(51,851)	(10,596)	389.3%
Net cash used for financing activities	(32,465)	(32,727)	(0.8%)

Net cash provided by operating activities

Our net cash provided by operating activities increased by RR 22,771 million, or 58.2%, to RR 61,885 million compared to RR 39,114 million in the corresponding period in 2017 primarily due to an increase in profit from operations adjusted for non-cash items, net of related income tax.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Profit from operations	59,595	35,148	69.6%
Non-cash adjustments ⁽¹⁾	9,785	8,768	11.6%
Changes in working capital and long-term advances given	(1,604)	182	n/a
Dividends received from joint ventures	4,100	-	n/a
Interest received	307	2,484	(87.6%)
Income taxes paid	(10,298)	(7,468)	37.9%
Total net cash provided by operating activities	61,885	39,114	58.2%

⁽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.

Profit from operations adjusted for non-cash items increased due to the production launch at the first LNG train at Yamal LNG in the end of 2017 and an increase in average realized liquid hydrocarbons and natural gas prices (see "Profit from operations and EBITDA" above).

In April 2018, we received RR 4,100 million of dividends from our joint venture Nortgas.

In both reporting periods, interest received related to interest on deposits and loans provided to our joint ventures, Terneftegas and Yamal Development (only in the second quarter of 2017).

Net cash used for investing activities

In the three months ended 30 June 2018, our net cash used for investing activities increased by RR 41,255 million, or 389.3%, to RR 51,851 million compared to RR 10,596 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change %
	2018	2017	
Cash used for capital expenditures	(22,052)	(8,123)	171.5%
Net decrease (increase) in bank deposits with original maturity more than three months	(29,671)	-	n/a
Payments for mineral licenses	(65)	(2,057)	(96.8%)
Repayments of loans provided to joint ventures	389	309	25.9%
Other	(452)	(725)	(37.7%)
Net cash used for investing activities	(51,851)	(10,596)	389.3%

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Cash used for capital expenditures increased by RR 13,929 million, or 171.5%, as compared to the 2017 reporting period. In both reporting periods, we used cash for the development of our future LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field and the development of the front-end engineering design (FEED) for the LNG plant. In addition, in the current reporting period, we significantly increased our investments related to the ongoing development of the North-Russkiy and East-Tazovski license areas.

The Group's cash management involves periodic cash placement on bank deposits with different maturities. Deposits are reported in "Cash and cash equivalents" if opened for three months or less, or otherwise in "Short-term bank deposits with original maturity more than three months". Transactions with bank deposits with original maturity more than three months are classified as investing activities in the Consolidated Statement of Cash Flows. In the current quarter, the Group placed approximately RR 30 billion (USD 478 million) on short-term deposits with original maturity more than three months.

In May 2018, we paid a part of a one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field in the amount of RR 59 million. In addition, in April 2018, we made a final payment in the amount of RR six million for the acquisition of a license to use the Payutskiy license area (an advance payment in the amount of RR 60 million was made in the first quarter of 2018). In the 2017 reporting period, 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 three months ended 30 June 2018 and 2017, we received RR 389 million and RR 309 million, respectively, due to a partial repayment of the loans provided to Terneftegas and Yamal Development (only in the second quarter of 2017).

Net cash used for financing activities

In the three months ended 30 June 2018, our net cash used for financing activities decreased by RR 262 million, or 0.8%, to RR 32,465 million as compared to RR 32,727 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change
	2018	2017	%
Proceeds from (repayments of) long-term debt, net	-	(8,839)	n/a
Proceeds from (repayments of) short-term debt with original maturity three months or less	(1,332)	(49)	n/a
Dividends paid to shareholders of PAO NOVATEK	(24,109)	(21,111)	14.2%
Dividends paid to non-controlling interest	(3,136)	-	n/a
Interest paid	(1,321)	(2,038)	(35.2%)
Purchase of treasury shares	(2,019)	(655)	208.2%
Payments of lease liabilities	(548)	(35)	n/a
Net cash used for financing activities	(32,465)	(32,727)	(0.8%)

In the second quarter of 2017, the Group partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,530 million (USD 115 million) according to the loan's maturity schedule as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In the reporting periods of 2018 and 2017, we obtained short-term loans to finance trade activities. In the current reporting period, net repayments of short-term loans amounted to RR 1,332 million, while in the corresponding period in 2017 the total amount of short-term loans repayments substantially corresponded to the amount of proceeds.

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 30 June 2018****Liquidity and working capital**

The following table shows the Group's liquidity and credit measures as of 30 June 2018 and 31 December 2017:

	30 June 2018	31 December 2017	Change, %
Absolute amounts, RR million			
Net debt ⁽¹⁾	90,692	89,807	1.0%
Net working capital position ⁽²⁾	81,086	69,478	16.7%
Liquidity and credit ratios			
Current ratio ⁽³⁾	2.06	1.83	12.6%
Total debt to total equity	0.19	0.20	(5.0%)
Long-term debt to long-term debt and total equity	0.16	0.15	6.7%
Net debt to total capitalization ⁽⁴⁾	0.09	0.09	0.0%
Net debt to normalized EBITDA from subsidiaries ⁽⁵⁾	0.40	0.45	(11.1%)

⁽¹⁾ Net debt represents total debt less cash, cash equivalents and bank deposits with original maturity more than three months.

⁽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 each quarter of 2017 and 2018, 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:

<i>millions of Russian roubles</i>	Three months ended 30 June:	
	2018	2017
Arctic LNG 2 project	6,266	3,815
North-Russkiy and East-Tazovski license areas	4,963	827
Infrastructure for future LNG projects ⁽¹⁾	2,951	1,049
East-Tarkosalinskoye field	1,268	1,059
Yarudeyskoye field	1,233	890
Yurkharovskoye field	1,073	165
Gydanskiy license area	820	-
Other	3,403	1,535
Capital expenditures	21,977	9,340

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

Total capital expenditures on property, plant and equipment in the three months ended 30 June 2018 significantly increased by RR 12,637 million, or 135.3%, to RR 21,977 million from RR 9,340 million. In both reporting periods, a significant part of our capital expenditures related to the development of our future LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field and the development of the front-end engineering design (FEED) for the LNG plant. In addition, in the current reporting period, we significantly increased our investments related to the ongoing development of the North-Russkiy and East-Tazovski license areas.

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

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:

<i>millions of Russian roubles</i>	Three months ended 30 June:		Change
	2018	2017	%
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	21,997	13,892	58.3%
Less: acquisition of mineral licenses	(6)	(2,057)	(99.7%)
Less: right-of-use assets ⁽¹⁾ additions	(14)	(2,495)	(99.4%)
Capital expenditures	21,977	9,340	135.3%
Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments	75	(1,217)	n/a
Cash used for capital expenditures ⁽²⁾	22,052	8,123	171.5%

⁽¹⁾ In 2017, related mainly to long-term agreements on time chartering of marine tankers.

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

In the second quarter of 2018, we made a final payment in the amount of RR six million for the right for the usage of the Payutskiy license area won at the auction held in March 2018 (an advance payment of RR 60 million was made in the first quarter of 2018). In the corresponding period in 2017, RR 2,057 million related to the acquisition of the right for geological research works, exploration and hydrocarbons production at the Gydanskiy 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 2018, the total amount of our debt denominated in US dollars was RR 147,012 million, or 94.0% 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, 51.0% in the three months ended 30 June 2018, was denominated in foreign currencies.

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

As of 30 June 2018, the Russian rouble depreciated by 9.0% and 6.0% against the US dollar and the Euro, respectively, compared to 31 December 2017.

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 stable 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.

Within our trading activities, 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 within the Russian Federation territory 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 the domestic market. 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 2018, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

TERMS AND ABBREVIATIONS

APR	Asian-Pacific Region
bbl	barrel
bcm	billion cubic meters
boe	barrels of oil equivalent
CBR	Central Bank of Russian Federation
CFR	"Cost and freight"
CIF	"Cost, insurance and freight"
DAP	"Delivery at point of destination"
DDA	depreciation, depletion and amortization
DES	"Delivery to the port of destination ex-ship"
FCA	"Free carrier"
FEED	Front-End Engineering Design
FOB	"Free on board"
Forecast of the Ministry of Economic Development	The document " <i>Forecast of Socio-economic Development of the Russian Federation for 2017 and planned period 2018 and 2019</i> " 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
NGL	natural gas liquids
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	OAD Russian Railways, Russia's state-owned monopoly railway operator
SEC	Securities and Exchange Commission
Tobolsk Refining Facilities	Refining facilities of OOO SIBUR Tobolsk
UGSF	Underground Gas Storage Facilities
UGSS	Unified Gas Supply System owned and operated by PAO Gazprom
UPT	unified natural resources production tax
USD, US dollar	United States Dollar
Ust-Luga Complex	Gas Condensate Fractionation and Transshipment Complex located at the port of Ust-Luga on the Baltic Sea
VAT	value added tax
Yamal LNG project	A large-scale project on constructing a liquefied natural gas plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula that Group undertakes jointly with TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through its joint venture OAO Yamal LNG
YNAO	Yamal-Nenets Autonomous Region