# PAO NOVATEK

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

# FOR THE THREE MONTHS ENDED 30 SEPTEMBER 2019

**CONTENTS** **Page**

## GENERAL PROVISIONS

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 30 September 2019 together with our unaudited consolidated interim condensed financial statements as of and for the three and nine months ended 30 September 2019. 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 2018 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 Russia's second largest natural gas producer and one of the world leaders in terms of proved natural gas reserves 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, our joint venture OAO Yamal LNG commenced producing LNG at the first train of its liquefaction plant, and in the third and fourth quarters of 2018, the second and third LNG trains were launched. The launch of the three LNG trains with nameplate capacity of 16.5 million tons per annum allowed Yamal LNG to become one of the largest suppliers of LNG to international markets. In 2019, our joint venture OOO Cryogas-Vysotsk commissioned its medium-scale LNG plant.

We deliver unstable gas condensate produced by our subsidiaries and our joint ventures Arcticgas, Nortgas and Terneftegas 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 volumes produced at the Purovsky Plant is dispatched via pipeline for further processing at the refining facilities of OOO SIBUR Tobolsk (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 Arctic LNG 2 project

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

The Arctic LNG 2 plant will be built on gravity-based platforms and will consist of three processing trains with an annual capacity of 6.6 million tons of LNG per year each, or an aggregated capacity of 19.8 million tons of LNG per year. The licenses for natural gas liquefaction technology were purchased from Linde AG.

At present, the FEED work on the LNG plant construction is completed, and the EPC agreements on the design and construction of gravity-based platforms, topsides and onshore facilities for the three liquefaction trains of the plant are signed. In September 2019, the final investment decision (FID) was made. The launch of the first train is expected to be in 2023, the second and the third trains – in 2024 and 2026, respectively.

Gravity-based platforms and other major units for the plant will be produced at our own LNG construction center in the Murmansk region (the "Murmansk yard"), which will also be used for the Group's subsequent LNG projects. In the third quarter of 2019, the construction of a gravity-based platform for the first train of the LNG plant of the Arctic LNG 2 project was commenced.

The use of gravity-based platforms technology for the plant construction, as well as localizing production will contribute to lower LNG liquefaction costs compared to other LNG projects.

The Salmanovskoye (Utrenneye) field's development is ongoing. Construction of two power plants was completed with exploratory wells drilled to supply their operation.

In the nine months ended 30 September 2019, the Group signed heads of agreements with several international companies to supply liquefied natural gas from the Arctic LNG 2 project as well as other Group's projects. The signing of these agreements is a vital step in the successful and timely implementation of the Arctic LNG 2 project.

In March 2019, the Group sold a 10% participation interest in OOO Arctic LNG 2 to a subsidiary of TOTAL S.A. After transaction closing, the key project's financial and operational decisions are approved unanimously by all participants, implying joint control over the company. As a result, the Group recognized Arctic LNG 2 as a joint venture and started to account for its participation interest in the company using the equity method.

In July 2019, the Group sold a 30% participation interest in OOO Arctic LNG 2 to three new participants (10% to each participant): to China National Petroleum Corporation ("CNPC") and CNOOC Limited (through their respective subsidiaries), and to Japan Arctic LNG B.V., a joint venture of Mitsui & Co., Ltd and Japan Oil, Gas and Metals National Corporation ("JOGMEC"). As a result, the Group's participation interest in OOO Arctic LNG 2 further decreased to 60%.

### Start of LNG production at the medium-scale LNG plant at the port of Vysotsk

In March 2019, our joint venture OOO Cryogas-Vysotsk commenced initial LNG production at the first train of its medium-scale LNG plant located at the port of Vysotsk on the Baltic Sea, and in April reached nameplate capacity of 660 thousand tons per annum.

### Reorganization of AO Arcticgas

At the end of 2018, the Group and PAO Gazprom Neft agreed to hold a series of transactions on reorganizing its joint venture AO Arcticgas, aimed at obtaining by the Group the full ownership over the licenses for exploration and production for the North-Chaselskiy and Yevo-Yakhinskiy license areas from Arcticgas and transfer of the license for the Malo-Yamalskiy license area to Gazprom Neft.

The reorganization transactions were completed in October 2019; therefore, as the transactions are treated as interrelated, the financial result from the reorganization will be recognized in the fourth quarter of 2019.

**Increasing our resource base and production facilities**

In the nine months ended 30 September 2019, the Group obtained rights to use six license areas located in close proximity to Group's other assets in YNAO:

- In May 2019, the Group obtained the rights for geological research works at five license areas in the Krasnoyarsk Territory: Khalmeryakhskiy, Dorofeevskiy, West-Dorofeevskiy, South-Khalmeryakhskiy and South-Dorofeevskiy. The license areas are located on the Gydan peninsula in the close proximity to our South-Leskinskiy license area.

- In August 2019, the Group won an auction for the right for geological research works, exploration and production of hydrocarbons at a new license area, which includes the Soletsko-Khanaveyskoye field. The license area has estimated hydrocarbon resources of 2,183 billion cubic meters of natural gas and 212 million tons of liquids under the Russian reserve classification, including natural gas reserves under category C1+C2 in the amount of 155 billion cubic meters. The payment for the license was set at RR 2,586 million. The license area is located on the Gydan peninsula bordering the Group's Trekhbugorniy and Gydanskiy license areas. The acquisition of the license area allows us to expand the resource base for one more new LNG project similar in scale to Arctic LNG 2, with liquefaction trains to be located at the Utrenniy terminal.

In October 2019, our joint venture AO Arcticgas commenced commercial production at the East-Urengoyskoye+North-Esetinskoye field within the Samburgskiy license area, with estimated annual production capacity of more than one billion cubic meters of natural gas and 0.2 million tons of gas condensate. The new production facility will contribute to the natural gas production growth at our production assets connected to the Unified Gas Supply System.

## BASIS OF PRESENTATION

Oil and gas production in the current report 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. Production of the South-Tambeyskoye field developed by the Group's joint venture OAO 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.

Our oil and gas revenues and average realized net prices are presented net of VAT and export duties, where applicable. Our LPG revenues and average realized net prices also exclude excise and fuel taxes incurred on sales in Poland. Starting from January 2019, the Group accrues excise tax on raw oil and claims the double excise tax deduction. The net result, or so-called "reverse excise", is reported as a deduction to our "Purchases of natural gas and liquid hydrocarbons" in our consolidated statement of income (see "Our tax burden and obligatory payments" below).

## SELECTED DATA

| *millions of Russian roubles except as stated* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| **Financial results** | | | |
| Total revenues (1) | 189,162 | 219,366 | (13.8%) |
| Operating expenses | (140,604) | (156,903) | (10.4%) |
| Normalized EBITDA (2),(3) | 104,519 | 118,091 | (11.5%) |
| Normalized profit attributable to shareholders of PAO NOVATEK (3) | 58,237 | 45,900 | 26.9% |
| Normalized profit attributable to shareholders of PAO NOVATEK (3), excluding the effect of foreign exchange gains (losses) (4) | 48,539 | 65,522 | (25.9%) |
| Normalized earnings per share (3) (in Russian roubles) | 19.34 | 15.23 | 27.0% |
| Normalized earnings per share (3), excluding the effect of foreign exchange gains (losses) (4) (in Russian roubles) | 16.12 | 21.75 | (25.9%) |
| Net debt (5) | 11,979 | 77,638 | (84.6%) |
| **Production volumes (6)** | | | |
| Hydrocarbons production (million barrels of oil equivalent) | 145.2 | 138.0 | 5.2% |
| Daily production (million barrels of oil equivalent per day) | 1.58 | 1.50 | 5.2% |
| **Operating results** | | | |
| Natural gas sales volumes (million cubic meters) | 16,700 | 15,589 | 7.1% |
| Crude oil sales volumes (thousand tons) | 1,265 | 1,134 | 11.6% |
| Naphtha sales volumes (thousand tons) | 987 | 970 | 1.8% |
| Liquefied petroleum gas sales volumes (thousand tons) | 684 | 679 | 0.7% |
| Other stable gas condensate refined products (thousand tons) | 564 | 582 | (3.1%) |
| Stable gas condensate sales volumes (thousand tons) | 489 | 566 | (13.6%) |
| **Cash flow results** | | | |
| Net cash provided by operating activities | 54,276 | 50,371 | 7.8% |
| Cash used for capital expenditures (7) | 36,519 | 24,783 | 47.4% |
| Free cash flow (8) | 17,757 | 25,588 | (30.6%) |

(1) Net of VAT and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland.
(2) EBITDA represents profit (loss) adjusted for the add-back of depreciation, depletion and amortization, net impairment expenses (reversals), finance income (expense), income tax expense, as well as income (loss) from changes in fair value of derivative financial instruments. EBITDA includes EBITDA from subsidiaries and our proportionate share in the EBITDA of our joint ventures.
(3) Excluding the effect from the disposal of interests in subsidiaries and joint ventures.
(4) Excluding the effect of foreign exchange gains (losses) of subsidiaries and our proportionate share in foreign exchange gains (losses) of our joint ventures (see "Profit attributable to shareholders and earnings per share" below).
(5) Net Debt represents our total debt net of cash, cash equivalents and bank deposits with original maturity more than three months.
(6) 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).
(7) Cash used for capital expenditures represents purchases of property, plant and equipment, materials for construction and capitalized interest paid per Consolidated Statement of Cash Flows net of payments for mineral licenses and acquisition of subsidiaries.
(8) Free cash flow represents the difference between Net cash provided by operating activities and Cash used for capital expenditures.

Reconciliation of EBITDA and normalized EBITDA is as follows:

| | Three months ended 30 September: | | Change |
|---|---|---|---|
| *millions of Russian roubles* | 2019 | 2018 | % |
| **Profit** | **374,176** | **51,397** | **n/a** |
| Depreciation, depletion and amortization | 8,183 | 8,511 | (3.9%) |
| Impairment expenses (reversals), net | (7) | 30 | n/a |
| Loss (income) from changes in fair value of commodity derivative instruments | (492) | 225 | n/a |
| Total finance expense (income) | (5,740) | (14,560) | (60.6%) |
| Total income tax expense | 65,399 | 13,199 | 395.5% |
| Share of loss (profit) of joint ventures, net of income tax | (18,714) | 11,942 | n/a |
| **EBITDA from subsidiaries** | **422,805** | **70,744** | **497.7%** |
| **Share in EBITDA of joint ventures** | **48,104** | **47,347** | **1.6%** |
| **EBITDA** | **470,909** | **118,091** | **298.8%** |
| Net gain on disposal of interests in subsidiaries and joint ventures | (366,390) | - | n/a |
| **Normalized EBITDA** | **104,519** | **118,091** | **(11.5%)** |
| **Normalized EBITDA from subsidiaries** | **56,415** | **70,744** | **(20.3%)** |

## SELECTED MACRO-ECONOMIC DATA

| *Exchange rate, Russian roubles for one foreign currency unit* (1) | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| **US dollar (USD)** | | | |
| Average for the period | 64.57 | 65.53 | (1.5%) |
| At the beginning of the period | 63.08 | 62.76 | 0.5% |
| At the end of the period | 64.42 | 65.59 | (1.8%) |
| Depreciation (appreciation) of Russian rouble to US dollar | 2.1% | 4.5% | n/a |
| **Euro** | | | |
| Average for the period | 71.83 | 76.18 | (5.7%) |
| At the beginning of the period | 71.82 | 72.99 | (1.6%) |
| At the end of the period | 70.32 | 76.23 | (7.8%) |
| Depreciation (appreciation) of Russian rouble to Euro | (2.1%) | 4.4% | 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).

● ● ●

| *Average for the period* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| **Benchmark natural gas prices, USD per mmbtu (2)** | | | |
| NBP (National Balancing Point) | 3.4 | 8.4 | (59.5%) |
| TTF (Title Transfer Facility) | 3.3 | 8.4 | (60.7%) |
| **Benchmark crude oil prices (3)** | | | |
| Brent, USD per barrel | 62.0 | 75.2 | (17.6%) |
| Urals, USD per barrel | 61.3 | 74.2 | (17.4%) |
| Urals, Russian roubles per barrel | 3,958 | 4,862 | (18.6%) |
| **Benchmark crude oil prices excluding export duties (4)** | | | |
| Urals, USD per barrel | 48.3 | 55.7 | (13.3%) |
| Urals, Russian roubles per barrel | 3,119 | 3,650 | (14.5%) |
| **Benchmark oil products (5) and liquefied petroleum gas (6) prices, USD per ton** | | | |
| Naphtha Japan | 495 | 666 | (25.7%) |
| Naphtha CIF NWE | 477 | 652 | (26.8%) |
| Jet fuel | 629 | 710 | (11.4%) |
| Gasoil | 578 | 661 | (12.6%) |
| Fuel oil | 387 | 436 | (11.2%) |
| Liquefied petroleum gas | 339 | 541 | (37.3%) |
| **Export duties, USD per ton (7)** | | | |
| Crude oil, stable gas condensate | 95.0 | 134.8 | (29.5%) |
| Naphtha | 52.2 | 74.1 | (29.6%) |
| Jet fuel, gasoil | 28.5 | 40.4 | (29.5%) |
| Fuel oil | 95.0 | 134.8 | (29.5%) |
| Liquefied petroleum gas | 0.0 | 8.9 | n/a |

(2) Based on spot natural gas prices at natural gas hubs in the United Kingdom (NBP) and the Netherlands (TTF).

(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 regional distribution networks, and deliver LNG purchased primarily from our joint ventures, OAO Yamal LNG and OOO Cryogas-Vysotsk, to international markets. In addition, we sell on the European market regasified liquefied natural gas arising during the transshipment of LNG (boil-off gas), as well as during the regasification of purchased LNG at our own regasification stations in Poland.

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

In 2018, wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market were increased by the Regulator by 3.4% effective 21 August 2018, and remained unchanged through the end of the second quarter of 2019. Effective 1 July 2019, the Regulator increased wholesale prices by 1.4%.

In September 2019, the Ministry of Economic Development of the Russian Federation published the "Forecast of Socio-economic Development of the Russian Federation for the period until 2024" stating that wholesale natural gas prices for sales to all customer categories (excluding residential customers) will be increased from July 2020 to 2024 by an average of 3.0% on an annual basis. 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 on the domestic market 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, and the delivery terms to name a few. The Group sells LNG on international markets under short- and long-term contracts with prices based on the prices for natural gas at major natural gas hubs and on benchmark crude oil prices. We sell boil-off gas in Europe at prices linked to natural gas prices at major European natural gas hubs. The Group's prices for regasified LNG sold as natural gas on the Polish market are based on the prices regulated by the Energy Regulatory Office of Poland.

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

| | Three months ended 30 September: | | Change |
|---|---|---|---|
| | 2019 | 2018 | % |
| Average natural gas price, RR per mcm | 5,257 | 5,869 | (10.4%) |
| Average natural gas price, USD per mcm [(1)] | 81.3 | 89.3 | (9.0%) |

[(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 September 2019, our aggregate average price for natural gas in Russian roubles terms decreased by 10.4% mainly due to a decrease in LNG prices on international markets, which was partially offset by an increase in the share of LNG sales volumes in our total natural gas sales volumes, as well as an increase in the regulated Russian domestic price by 3.4% effective 21 August 2018 and by 1.4% effective 1 July 2019.

**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 lag 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 declining crude oil prices, the export duty rate is calculated based on higher prices compared to the actual prices, resulting 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 and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland:

| *Russian roubles or US dollars per ton* (1) | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| **Naphtha** | | | |
| Average net price, RR per ton | 29,669 | 40,747 | (27.2%) |
| Average net price, USD per ton | 459 | 621 | (26.1%) |
| **Other stable gas condensate refined products** | | | |
| Average net price, RR per ton | 34,709 | 38,938 | (10.9%) |
| Average net price, USD per ton | 540 | 597 | (9.5%) |
| **Crude oil** | | | |
| Average net price, RR per ton | 22,625 | 25,996 | (13.0%) |
| Average net price, USD per ton | 351 | 396 | (11.4%) |
| **LPG** | | | |
| Average net price, RR per ton | 14,566 | 26,564 | (45.2%) |
| Average net price, USD per ton | 226 | 405 | (44.2%) |
| **Stable gas condensate** | | | |
| Average net price, RR per ton | 23,740 | 29,334 | (19.1%) |
| Average net price, USD per ton | 368 | 450 | (18.2%) |

(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 September 2019, our weighted-average realized net prices for our liquid hydrocarbons decreased compared to the corresponding period in prior year due to a decrease in the underlying benchmark prices for these products excluding export duties (see “Selected macro-economic data” above).

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 2018 and during the nine months of 2019, 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 September 2019, the increase in tariffs for natural gas transportation through the trunk pipeline beginning in 2020 through 2024 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). The Russian Federation Government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth on the domestic market.

*Stable gas condensate and LPG by rail*

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 product, and the 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 2019, railroad freight transportation tariffs for all types of hydrocarbons were increased by 3.56% relative to the 2018 tariffs.

In 2018 and during the nine months of 2019, 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 international 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. In addition to 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. The distance to the final port of destination, tanker availability, seasonality of deliveries and other factors also influence our tanker transportation expenses.

*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 2019, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 3.87% relative to the 2018 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, excise, 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 and other 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.

Detailed information regarding UPT, export duties, excise and social contributions to non-budget funds described below is based on the current versions of the Tax Code of the Russian Federation and the law "On Customs Tariff" including the amendments that were introduced to these laws in the second half of 2018 and became effective 1 January 2019. In particular, the amendments changed the UPT and the export duties rates formulas, introduced new types of excisable goods and specific procedures for excise tax deductions applicable for processors of raw oil.

The changes in legislation mentioned above were introduced as part of the completion stage of the tax maneuver in the oil and gas industry in the Russian Federation and envisage a gradual decrease in export duties for crude oil and oil products with a respective increase in unified production taxes for crude oil and gas condensate during the periods 2019 to 2024. The UPT rates will be increased by the same amount of a decrease in export duty rate for crude oil, which will result in economic losses to raw oil processors as the export duty rates for oil products are calculated with a discount to crude oil export duty rate. Starting from January 2019, the excise tax for raw oil and the double deductions for this tax were introduced to compensate for these losses.

Starting from January 2019 and during the next six years, the above mentioned legislation changes, with other factors being equal, will influence line items in our consolidated financial statements by increasing our liquids net prices and revenues due to a gradual decrease in export duties, increasing our UPT expenses, as well as our hydrocarbons purchases due to an increase in UPT expenses in our joint ventures. The increase in our UPT expenses and cost of hydrocarbons purchases will be offset by excise tax deductions for raw oil.

*Export duties*

Procedure for calculation and payment of export duties is set in the Law of the Russian Federation "On Customs Tariff". According to this law, we are subject to export duties on our exports of liquid hydrocarbons (stable gas condensate and refined products, LPG and crude oil).

Crude oil export duty rate formulas are set by the Russian Federation Government and are based on the average Urals crude oil price (Mediterranean and Rotterdam) for the so called "monitoring period" (the period from the 15th calendar day in the previous month to the 14th calendar day of the current month).

In 2018, the calculation of the export duty rate in US dollars when the average Urals crude oil price was 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.

Starting from January 2019, as part of the completion stage of the tax maneuver in the oil and gas industry, the above export duty rate is multiplied by a coefficient, which will be gradually decreased on an annual basis from 0.833 in 2019 to zero in 2024. Thus, the export duty rate for crude oil will be decreased to zero by 2024.

We pay export duties for our stable gas condensate export sales volumes at the export duty rate for crude oil.

The export duty rates for oil products are calculated based on the export duty rate for crude oil adjusted by a coefficient (discount) 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% |

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 current monitoring period and is calculated using the formula presented in the table below:

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

We record export duties as a deduction to our revenues in the consolidated statement of income.

*UPT – natural gas*

We pay UPT for natural gas on a monthly basis. The UPT rate for natural gas is set in Russian roubles per one mcm of extracted natural gas.

The UPT rate for natural gas is calculated as a product of the base UPT rate (RR 35 per mcm), the base value of a standard fuel equivalent and a coefficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field. The result is then increased by a parameter characterizing natural gas transportation costs (was set at zero in both reporting periods).

The base value of a standard fuel equivalent is calculated by a taxpayer based on natural gas prices, Urals crude oil prices and crude oil export duty rate.

*UPT – crude oil*

We pay UPT for crude oil on a monthly basis. The UPT rate for crude oil is set in Russian roubles per ton of extracted crude oil.

The UPT rate is calculated as a product of a coefficient characterizing the dynamics of world crude oil prices and the base UPT rate (RR 919 per ton) adjusted for parameters characterizing crude oil production peculiarities (the reserves' depletion, complexity of extraction, the region, crude oil properties). The result is then increased by a fixed amount of RR 357 per ton in 2018, and by RR 428 per ton since 2019.

Starting from January 2019, and during the next six years, the UPT rate for crude oil will be gradually increased on an annual basis by the amount of a decrease in the crude oil export duty rate, and will be finally increased by the full amount of export duty rate by 2024.

In both reporting periods, 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.

Starting from January 2019, where the average export alternative prices for petrol and diesel fuel exceed the regulated wholesale prices for these products on the Russian domestic market, the UPT rate for crude oil is also increased by the so called "petrol and diesel fuel premiums" (set at RR 125 and RR 110 per ton, respectively, from 1 January to 30 September 2019, and at RR 200 and RR 185 per ton, respectively, from 1 October to 31 December 2019). The petrol and diesel fuel premiums are payable by all crude oil producers regardless of whether the extracted crude oil volumes will be further sold or refined.

*UPT – gas condensate*

We pay UPT for gas condensate on a monthly basis. The UPT rate for gas condensate is set in Russian roubles per ton of extracted gas condensate.

The UPT rate for gas condensate is calculated as a product of the base UPT rate (RR 42 per ton), the base value of a standard fuel equivalent, a coefficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field and an adjusting coefficient of 6.5. The base value of a standard fuel equivalent is calculated by a taxpayer based on natural gas prices, Urals crude oil prices and crude oil export duty rate.

The Group reduces its overall UPT expense accrued for gas condensate production volumes by applying a UPT tax deduction on gas condensate volumes 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 was set at RR 147 per ton for January 2018 and since then is increasing monthly by the same amount until the end of 2020. Starting from January 2021, the tax deduction rate will be fixed at RR 5,280 per ton of produced NGL.

During the six years starting from January 2019, the UPT rate for gas condensate will be increased on an annual basis by 75% of a decrease in the crude oil export duty rate. The share of 75% is deemed to represent volumes of produced gas condensate excluding the share of NGL received from gas condensate processing.

*Excise and fuel taxes*

Starting from January 2019, a new excisable type of product was introduced – "raw oil", which represents a mixture of hydrocarbons composed of one or more components of crude oil, stable gas condensate, vacuum gasoil, tar, and fuel oil. The tax base for raw oil excise tax is the volume of raw oil sent by the owner for processing.

The amount of excise tax accrued on raw oil volumes may be claimed for deduction at a double rate. This deduction is introduced to compensate economic losses of oil and gas refining companies arising as a result of the tax maneuver and the transfer of tax burden from export duties to the UPT in the amount of full export duty rate for crude oil while export duties for oil products are paid at a discount to crude oil export duty rate.

The excise tax rate for raw oil is calculated based on the average Urals crude oil prices, the mix of processed products, region of processing, and the adjusting coefficient, which will be gradually increased on an annual basis from 0.167 in 2019 to 1.0 in 2024 as part of the completion stage of the tax maneuver in the oil and gas industry.

Starting from January 2019, we accrue excise tax on volumes of stable gas condensate sent for processing to our Ust-Luga Complex on a monthly basis and simultaneously claim the double excise tax deduction. The net result, or so called "reverse excise", is reported as a deduction to our "Purchases of natural gas and liquid hydrocarbons" in our consolidated statement of income as most of our unstable gas condensate volumes used to produce stable gas condensate we purchase from our joint ventures.

In both reporting periods, most of our LPG sales in Poland were 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 162.27 Polish zloty per ton in 2018 to 164.61 Polish zloty per ton in 2019). We disclose LPG revenues net of excise and fuel taxes expense accrued on LPG volumes sold in Poland in our consolidated statement of income.

*Social contributions*

The Group makes contributions to the Pension Fund, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund on behalf of employees in Russia. The base for social contributions accrual is the amount of salaries and similar employee compensation stipulated by the employment contracts.

The rates for social contributions depend on the fund and the employee's annual income:

| | **2019** | | **2018** | |
|---|---|---|---|---|
| | **Base, RR thousand** | **Rate, %** | **Base, RR thousand** | **Rate, %** |
| Pension Fund of the Russian Federation | less 1,150<br>above 1,150 | 22.0%<br>10.0% | less 1,021<br>above 1,021 | 22.0%<br>10.0% |
| Federal Compulsory Medical Insurance Fund | No limit | 5.1% | No limit | 5.1% |
| Social Insurance Fund of the Russian Federation | less 865<br>above 865 | 2.9%<br>0.0% | less 815<br>above 815 | 2.9%<br>0.0% |

## OPERATIONAL HIGHLIGHTS

### Hydrocarbon production and sales volumes

Our total natural gas and liquids production including the proportionate share in the production of our joint ventures increased by 5.3% and by 4.5%, respectively. The main factors positively impacting our production growth were the commencement of LNG production at the second and third LNG trains at Yamal LNG in July and November 2018, respectively, and the launch of crude oil production at the Yaro-Yakhinskoye field of our joint venture AO Arcticgas in December 2018.

In the three months ended 30 September 2019, our total natural gas sales volumes increased by 1,111 mmcm, or 7.1%, due to increased sales of LNG on international markets purchased primarily from our joint ventures OAO Yamal LNG and OOO Cryogas-Vysotsk.

In the three months ended 30 September 2019, our liquids sales volumes increased by 66 thousand tons, or 1.7%, mainly due to crude oil purchases from our joint venture Arcticgas.

*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:

| *millions of cubic meters if not stated otherwise* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| **Production by subsidiaries from:** | | | |
| Yurkharovskoye field | 6,308 | 6,867 | (8.1%) |
| East-Tarkosalinskoye field | 1,456 | 1,665 | (12.6%) |
| Beregovoye field | 484 | 358 | 35.2% |
| Yarudeyskoye field | 445 | 445 | 0.0% |
| Khancheyskoye field | 374 | 475 | (21.3%) |
| East-Urengoyskoye + North-Esetinskoye field (West-Yaroyakhinskiy license area) | 137 | 177 | (22.6%) |
| Other fields | 475 | 537 | (11.5%) |
| **Total natural gas production by subsidiaries (1)** | **9,679** | **10,524** | **(8.0%)** |
| **Group's proportionate share in the production of joint ventures:** | | | |
| Yamal LNG (2) | 4,114 | 2,331 | 76.5% |
| Arcticgas | 3,319 | 3,258 | 1.9% |
| Nortgas | 891 | 972 | (8.3%) |
| Terneftegas | 299 | 301 | (0.7%) |
| Arctic LNG 2 | 11 | - | n/a |
| **Total Group's proportionate share in the natural gas production of joint ventures (1)** | **8,634** | **6,862** | **25.8%** |
| **Total natural gas production including proportionate share in the production of joint ventures** | **18,313** | **17,386** | **5.3%** |
| *The Group's proportionate share in LNG production of joint ventures (thousands of tons) (2)* | *2,770* | *1,462* | *89.5%* |

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

| | | | |
|---|---|---|---|
| in subsidiaries | 408 | 354 | 15.3% |
| in joint ventures (Group's proportionate share) | 99 | 80 | 23.8% |

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

In the three months ended 30 September 2019, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 927 mmcm, or 5.3%, to 18,313 mmcm from 17,386 mmcm in the corresponding period in 2018. The main factor positively impacting our production growth was the increase of natural gas production at Yamal LNG resulting from the start of LNG production at the second and third LNG trains in July and November 2018, respectively. In addition, our production increased at the Beregovoye field due to the commissioning of new wells. These allowed us to fully compensate for the decrease in production at mature fields of our subsidiaries (the Yurkharovskoye, the East-Tarkosalinskoye and the Khancheyskoye fields) and at our joint venture Nortgas, which resulted mainly from natural declines in the reservoir pressure at the current gas producing horizons.

*Natural gas sales volumes*

In the three months ended 30 September 2019, our total natural gas sales volumes increased by 1,111 mmcm, or 7.1%, to 16,700 mmcm from 15,589 mmcm in the corresponding period in 2018.

| | **Three months ended 30 September:** | | **Change** |
|---|---|---|---|
| *millions of cubic meters* | **2019** | **2018** | **%** |
| Production by subsidiaries | 9,679 | 10,524 | (8.0%) |
| Purchases from the Group's joint ventures | 5,668 | 4,133 | 37.1% |
| Other purchases | 2,137 | 2,439 | (12.4%) |
| **Total production and purchases** | **17,484** | **17,096** | **2.3%** |
| Own usage [1] | (439) | (396) | 10.9% |
| Decrease (increase) in natural gas inventory balance | (345) | (1,111) | (68.9%) |
| **Total natural gas sales volumes** | **16,700** | **15,589** | **7.1%** |
| *Sold to end-customers* | *13,160* | *12,917* | *1.9%* |
| *Sold ex-field* | *500* | *849* | *(41.1%)* |
| ***Subtotal sold in the Russian Federation*** | ***13,660*** | ***13,766*** | ***(0.8%)*** |
| ***Sold on international markets*** | ***3,040*** | ***1,823*** | ***66.8%*** |

[1] Own usage represents volumes of natural gas consumed in oil and gas producing and development activities (primarily, as fuel gas), as well as used to maintain the refining process at the Purovsky Plant and methanol production.

In the three months ended 30 September 2019, natural gas purchases from our joint ventures increased by 1,535 mmcm, or 37.1%, to 5,668 mmcm from 4,133 mmcm in the corresponding period in 2018 primarily due to an increase in purchases of LNG produced by Yamal LNG for subsequent sale on international markets.

Other natural gas purchases are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize our end-customers portfolios. In the three months ended 30 September 2019 and 2018, we purchased from third parties 2,035 mmcm and 2,021 mmcm of natural gas, respectively, on the Russian domestic market, and 102 mmcm and 418 mmcm, respectively, on international markets.

As of 30 September 2019, our cumulative natural gas inventory balance, mainly representing our inventory balances of natural gas in the UGSF, aggregated 1,772 mmcm and increased by 345 mmcm during the quarter as compared to an increase by 1,111 mmcm in the corresponding period in 2018. Natural gas inventory balances tend to fluctuate period-to-period depending on the Group's demand for natural gas withdrawal from the UGSF for the sale in the subsequent periods.

*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:

| *thousands of tons* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| **Production by subsidiaries from:** | | | |
| Yarudeyskoye field | 828 | 850 | (2.6%) |
| East-Tarkosalinskoye field | 370 | 344 | 7.6% |
| Yurkharovskoye field | 288 | 305 | (5.6%) |
| Khancheyskoye field | 44 | 56 | (21.4%) |
| Other fields | 102 | 76 | 34.2% |
| **Total liquids production by subsidiaries** | **1,632** | **1,631** | **0.1%** |
| *including crude oil* | *1,187* | *1,174* | *1.1%* |
| *including gas condensate* | *445* | *457* | *(2.6%)* |
| **Group's proportionate share in the production of joint ventures:** | | | |
| Arcticgas | 1,038 | 952 | 9.0% |
| Yamal LNG (1) | 207 | 155 | 33.5% |
| Terneftegas | 94 | 97 | (3.1%) |
| Nortgas | 70 | 76 | (7.9%) |
| **Total Group's proportionate share in the liquids production of joint ventures** | **1,409** | **1,280** | **10.1%** |
| **Total liquids production including proportionate share in the production of joint ventures** | **3,041** | **2,911** | **4.5%** |

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

In the three months ended 30 September 2019, our total liquids production (including our proportionate share in the production of joint ventures) increased by 130 thousand tons, or 4.5%, to 3,041 thousand tons from 2,911 thousand tons in the corresponding period in 2018. The increase was due to gas condensate production growth at Yamal LNG resulting from the production commencement at the second and third LNG trains in July and November 2018, respectively, the launch of crude oil deposits at the Yaro-Yakhinskoye field of Arcticgas in December 2018, as well as an increase in crude oil production at the East-Tarkosalinskoye field due to the commissioning of new wells. This allowed us to fully compensate for a decrease in gas condensate production at mature fields of our subsidiaries and joint ventures 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.

*Liquids sales volumes*

In the three months ended 30 September 2019, our total liquids sales volumes increased by 66 thousand tons, or 1.7%, to 4,000 thousand tons from 3,934 thousand tons in the corresponding period in 2018.

| *thousands of tons* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| Production by subsidiaries | 1,632 | 1,631 | 0.1% |
| Purchases from the Group's joint ventures | 2,434 | 2,333 | 4.3% |
| Other purchases | 70 | 65 | 7.7% |
| **Total production and purchases** | **4,136** | **4,029** | **2.7%** |
| Losses [1] and own usage [2] | (51) | (51) | 0.0% |
| Decreases (increases) in liquids inventory balances | (85) | (44) | 93.2% |
| **Total liquids sales volumes** | **4,000** | **3,934** | **1.7%** |
| *Naphtha export* | *987* | *970* | *1.8%* |
| *Other stable gas condensate refined products export* [3] | *521* | *546* | *(4.6%)* |
| *Other stable gas condensate refined products domestic* [3] | *43* | *36* | *19.4%* |
| ***Subtotal stable gas condensate refined products*** | ***1,551*** | ***1,552*** | ***(0.1%)*** |
| *Crude oil export* | *536* | *385* | *39.2%* |
| *Crude oil domestic* | *729* | *749* | *(2.7%)* |
| ***Subtotal crude oil*** | ***1,265*** | ***1,134*** | ***11.6%*** |
| *LPG export* | *151* | *152* | *(0.7%)* |
| *LPG domestic* | *533* | *527* | *1.1%* |
| ***Subtotal LPG*** | ***684*** | ***679*** | ***0.7%*** |
| *Stable gas condensate export* | *119* | *158* | *(24.7%)* |
| *Stable gas condensate domestic* | *370* | *408* | *(9.3%)* |
| ***Subtotal stable gas condensate*** | ***489*** | ***566*** | ***(13.6%)*** |
| ***Other oil products*** | ***11*** | ***3*** | ***266.7%*** |

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

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

(3) Other 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, as well as volumes purchased by the Group for subsequent sale on international markets, including purchases from our joint venture Yamal LNG.

Our crude oil sales volumes increased by 11.6% primarily due to crude oil purchases from our joint venture Arcticgas resulting from the commencement of crude oil commercial production at the Yaro-Yakhinskoye field in December 2018.

In the 2019 reporting period, our liquids inventory balances increased by 85 thousand tons to 938 thousand tons as of 30 September 2019 as compared to an increase in inventory balances by 44 thousand tons to 850 thousand tons in the corresponding period in 2018. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 30 SEPTEMBER 2019 COMPARED TO THE CORRESPONDING PERIOD IN 2018

The following table and discussion is a summary of our consolidated results of operations for the three months ended 30 September 2019 and 2018. Each line item is also shown as a percentage of our total revenues.

| | Three months ended 30 September: | | | |
|---|---|---|---|---|
| *millions of Russian roubles* | **2019** | **% of total revenues** | **2018** | **% of total revenues** |
| **Total revenues [1]** | **189,162** | ***100.0%*** | **219,366** | ***100.0%*** |
| *including:* | | | | |
| natural gas sales | 87,791 | *46.4%* | 91,488 | *41.7%* |
| liquids sales | 99,467 | *52.6%* | 126,446 | *57.6%* |
| Operating expenses | (140,604) | *(74.3%)* | (156,903) | *(71.5%)* |
| Other operating income (loss) | 173 | *0.1%* | (485) | *(0.2%)* |
| **Normalized profit from operations [2]** | **48,731** | ***25.8%*** | **61,978** | ***28.3%*** |
| Gain on disposal of interests in subsidiaries and joint ventures, net | 366,390 | *193.7%* | - | *n/a* |
| **Profit from operations** | **415,121** | ***219.5%*** | **61,978** | ***28.3%*** |
| Finance income (expense) | 5,740 | *3.0%* | 14,560 | *6.5%* |
| Share of profit (loss) of joint ventures, net of income tax | 18,714 | *9.9%* | (11,942) | *(5.4%)* |
| **Profit before income tax** | **439,575** | ***232.4%*** | **64,596** | ***29.4%*** |
| Total income tax expense | (65,399) | *(34.6%)* | (13,199) | *(6.0%)* |
| **Profit** | **374,176** | ***197.8%*** | **51,397** | ***23.4%*** |
| Less: profit (loss) attributable to non-controlling interest | (4,217) | *(2.2%)* | (5,497) | *(2.5%)* |
| **Profit attributable to shareholders of PAO NOVATEK** | **369,959** | ***195.6%*** | **45,900** | ***20.9%*** |
| **Normalized profit attributable to shareholders of PAO NOVATEK [2], excluding the effect of foreign exchange gains (losses)** | **48,539** | ***25.7%*** | **65,522** | ***29.9%*** |

(1) Net of VAT and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland.

(2) Excluding the effect from the disposal of interests in subsidiaries and joint ventures.

## Total revenues

The following table sets forth our sales (excluding VAT and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland) for the three months ended 30 September 2019 and 2018:

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 | Change % | Change [(1)] Total | Due to volume [(2)] | Due to price [(3)] |
|---|---|---|---|---|---|---|
| Natural gas sales | 87,791 | 91,488 | (4.0%) | (3,697) | 6,520 | (10,217) |
| Stable gas condensate refined products sales | 48,857 | 62,185 | (21.4%) | (13,328) | (14) | (13,314) |
| *Naphtha* | *29,275* | *39,513* | *(25.9%)* | *(10,238)* | *691* | *(10,929)* |
| *Other refined products* | *19,582* | *22,672* | *(13.6%)* | *(3,090)* | *(705)* | *(2,385)* |
| Crude oil sales | 28,625 | 29,479 | (2.9%) | (854) | 3,411 | (4,265) |
| Stable gas condensate sales | 11,603 | 16,601 | (30.1%) | (4,998) | (2,262) | (2,736) |
| Liquefied petroleum gas sales | 9,963 | 18,036 | (44.8%) | (8,073) | 134 | (8,207) |
| Other products sales | 419 | 145 | 189.0% | 274 | n/a | n/a |
| **Total oil and gas sales** | **187,258** | **217,934** | **(14.1%)** | **(30,676)** | **n/a** | **n/a** |
| Other revenues | 1,904 | 1,432 | 33.0% | 472 | n/a | n/a |
| **Total revenues** | **189,162** | **219,366** | **(13.8%)** | **(30,204)** | **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 Europe.

In the three months ended 30 September 2019, our total revenues from natural gas sales decreased by RR 3,697 million, or 4.0%, compared to the corresponding period in 2018 due to a significant decline in LNG prices on international markets. The impact of this factor was largely offset by an increase in LNG sales volumes purchased primarily from our joint ventures, OAO Yamal LNG and OOO Cryogas-Vysotsk, as well as an increase in sales prices in the Russian domestic market (see "Natural gas prices" and "Natural gas sales volumes" above).

*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 September 2019, our revenues from sales of stable gas condensate refined products decreased by RR 13,328 million, or 21.4%, to RR 48,857 million from RR 62,185 million in the corresponding period in 2018 due to a decrease in average realized prices.

In the three months ended 30 September 2019, our revenues from sales of naphtha decreased by RR 10,238 million, or 25.9%, as compared to the corresponding period in 2018. In the three months ended 30 September 2019 and 2018, we exported 987 thousand and 970 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, DAP, DES (only in the third quarter of 2018) and FOB (only in the third quarter of 2019). Our average realized net price, excluding export duties, where applicable, decreased by RR 11,078 per ton, or 27.2%, to RR 29,669 per ton from RR 40,747 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 30 September 2019, our total revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets decreased by RR 3,090 million, or 13.6%, as compared to the corresponding period in 2018. In the three months ended 30 September 2019 and 2018, we exported in aggregate 521 thousand and 546 thousand tons of these products mainly to the European markets, or 92.4% and 93.8% of total sales volumes (on both the domestic and export markets), respectively. The export delivery terms were FOB, CIF and DES in the third quarter of 2019, and CIF, DAP, FOB and CFR in the third quarter of 2018. Our average realized net price, excluding export duties, where applicable, decreased by RR 4,229 per ton, or 10.9%, to RR 34,709 per ton from RR 38,938 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

*Crude oil sales*

In the three months ended 30 September 2019, our revenues from crude oil sales decreased by RR 854 million, or 2.9%, compared to the corresponding period in 2018 due to a decrease in average realized prices that was almost offset by an increase in sales volumes (see "Liquids sales volumes" above).

In the three months ended 30 September 2019, we sold 729 thousand tons, or 57.6% of our total crude oil sales volumes, domestically as compared to sales of 749 thousand tons, or 66.0%, in the corresponding period in 2018. The remaining 536 thousand tons of crude oil, or 42.4% of our total crude oil sales volumes, in the current reporting period and 385 thousand tons, or 34.0%, in the corresponding period in 2018 were sold under FOB delivery terms with destination points in the APR and the European markets.

Our average realized net price, excluding export duties, where applicable, decreased by RR 3,371 per ton, or 13.0%, to RR 22,625 per ton from RR 25,996 per ton in the corresponding period in 2018 (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 September 2019, our revenues from sales of stable gas condensate decreased by RR 4,998 million, or 30.1%, compared to the corresponding period in 2018 due to decreases in average realized prices and sales volumes (see "Liquids sales volumes" above).

In the three months ended 30 September 2019, we sold 370 thousand tons of stable gas condensate, or 75.7% of our total stable gas condensate sales volumes, on the domestic market compared to sales of 408 thousand tons, or 72.1%, in the corresponding period in 2018. The remaining 119 thousand tons of stable gas condensate, or 24.3% of our total stable gas condensate sales volumes, in the current reporting period were sold to the APR and European markets under DES and CFR delivery terms compared to sales of 158 thousand tons, or 27.9%, to the APR, the Middle East and European markets under CFR and DAF delivery terms in the corresponding period in 2018.

Our average realized net price, excluding export duties, where applicable, decreased by RR 5,594 per ton, or 19.1%, to RR 23,740 per ton from RR 29,334 per ton in the corresponding period in 2018 (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 September 2019, our revenues from sales of LPG decreased by RR 8,073 million, or 44.8%, compared to the corresponding period in 2018 due to a decrease in average realized prices.

In the three months ended 30 September 2019, we sold 533 thousand tons of LPG, or 77.9% of our total LPG sales volumes, on the domestic market compared to sales of 527 thousand tons, or 77.6%, in the corresponding period in 2018. The remaining 151 thousand tons of LPG, or 22.1% of our total LPG sales volumes, in the current reporting period and 152 thousand tons, or 22.4%, in the corresponding period in 2018 were sold to the Polish market under free carrier FCA delivery terms.

Our average realized LPG net price, excluding export and import duties, excise and fuel taxes expense, where applicable, in the three months ended 30 September 2019 decreased by RR 11,998 per ton, or 45.2%, to RR 14,566 per ton from RR 26,564 per ton in the corresponding period in 2018 (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 sales of purchased oil products (diesel fuel and petrol) through our retail stations, as well as sales of other liquid hydrocarbons, including methanol of own production. In the three months ended 30 September 2019, our revenues from other products sales increased by RR 274 million, or 189.0%, to RR 419 million from RR 145 million in the corresponding period in 2018.

*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 September 2019, other revenues increased by RR 472 million, or 33.0%, to RR 1,904 million from RR 1,432 million in the corresponding period in 2018. The increase was primarily due to an increase in revenues from power generation, repair and maintenance of energy equipment services by RR 246 million.

### Operating expenses

In the three months ended 30 September 2019, our total operating expenses decreased by RR 16,299 million, or 10.4%, to RR 140,604 million compared to RR 156,903 million in the corresponding period in 2018 mainly due to a decrease in average purchase prices for hydrocarbons resulted from a decline in hydrocarbons prices on international markets in 2019 (see "Purchases of natural gas and liquid hydrocarbons" below).

| | Three months ended 30 September: | | | |
|---|---|---|---|---|
| *millions of Russian roubles* | **2019** | **% of total revenues** | **2018** | **% of total revenues** |
| Purchases of natural gas and liquid hydrocarbons | 72,181 | *38.2%* | 94,158 | *42.9%* |
| Transportation expenses | 34,376 | *18.2%* | 33,672 | *15.3%* |
| Taxes other than income tax | 15,098 | *8.0%* | 15,440 | *7.0%* |
| Depreciation, depletion and amortization | 8,183 | *4.3%* | 8,511 | *3.9%* |
| General and administrative expenses | 6,622 | *3.5%* | 5,940 | *2.7%* |
| Materials, services and other | 6,331 | *3.3%* | 5,474 | *2.5%* |
| Exploration expenses | 384 | *0.2%* | 838 | *0.4%* |
| Impairment expenses (reversals), net | (7) | *n/a* | 30 | *n/a* |
| Changes in natural gas, liquid hydrocarbons and work-in-progress | (2,564) | *n/a* | (7,160) | *n/a* |
| **Total operating expenses** | **140,604** | ***74.3%*** | **156,903** | ***71.5%*** |

*Purchases of natural gas and liquid hydrocarbons*

In the three months ended 30 September 2019, our purchases of natural gas and liquid hydrocarbons decreased by RR 21,977 million, or 23.3%, to RR 72,181 million from RR 94,158 million in the corresponding period in 2018.

| | Three months ended 30 September: | | Change |
|---|---|---|---|
| *millions of Russian roubles* | **2019** | **2018** | **%** |
| Natural gas | 34,054 | 42,408 | (19.7%) |
| Unstable gas condensate | 30,367 | 44,755 | (32.1%) |
| Other hydrocarbons | 8,611 | 6,995 | 23.1% |
| Reverse excise | (851) | - | n/a |
| **Total purchases of natural gas and liquid hydrocarbons** | **72,181** | **94,158** | **(23.3%)** |

In the three months ended 30 September 2019, our purchases of natural gas decreased by RR 8,354 million, or 19.7%, as compared to the corresponding period in 2018 due to a decrease in LNG purchase prices which are based on prices for natural gas at major natural gas hubs and on benchmark crude oil prices (see "Selected macro-economic data" above). The impact of this factor was partially offset by an increase in LNG purchases from our joint ventures, OAO Yamal LNG and OOO Cryogas-Vysotsk, for subsequent sale on international markets, as well as an increase in purchase prices on the domestic market that are influenced by the regulated natural gas prices (see "Natural gas prices" above).

In the three months ended 30 September 2019, our purchases of unstable gas condensate from our joint ventures decreased by RR 14,388 million, or 32.1%, as compared to the corresponding period in 2018 mainly due to a decrease in purchase prices, which are primarily impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

Other hydrocarbons purchases represent our purchases of crude oil, LPG, stable gas condensate, oil products and methanol for subsequent resale depending on the demand for these types of products. In the three months ended 30 September 2019, our purchases of other hydrocarbons increased by RR 1,616 million, or 23.1%, as compared to the corresponding period in 2018 mainly due to purchases of crude oil produced at the Yaro-Yakhinskoye field of Arcticgas for subsequent sale.

Starting from January 2019, we accrue excise tax on volumes of stable gas condensate sent for processing to our Ust-Luga Complex on a monthly basis and simultaneously claim the double excise tax deduction (see "Our tax burden and obligatory payments" above). The net result from these operations is reported as a deduction to our purchases of natural gas and liquid hydrocarbons expenses in the line "Reverse excise" above as most of our unstable gas condensate volumes used to produce stable gas condensate we purchase from our joint ventures.

*Transportation expenses*

In the three months ended 30 September 2019, our total transportation expenses increased by RR 704 million, or 2.1%, to RR 34,376 million as compared to RR 33,672 million in the corresponding period in 2018.

| *millions of Russian roubles* | **Three months ended 30 September:** | | **Change** |
|---|---|---|---|
| | **2019** | **2018** | **%** |
| Natural gas transportation by trunk and low-pressure pipelines | 21,590 | 20,955 | 3.0% |
| Stable gas condensate and liquefied petroleum gas transportation by rail | 7,711 | 7,503 | 2.8% |
| Crude oil transportation by trunk pipelines | 2,641 | 2,170 | 21.7% |
| Stable gas condensate and refined products, crude oil and liquefied natural gas transportation by tankers | 1,984 | 2,605 | (23.8%) |
| Other | 450 | 439 | 2.5% |
| **Total transportation expenses** | **34,376** | **33,672** | **2.1%** |

In the three months ended 30 September 2019, our expenses for natural gas transportation by trunk and low-pressure pipelines increased by RR 635 million, or 3.0%, to RR 21,590 million from RR 20,955 million in the corresponding period in 2018 due to a 1.9% increase in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current reporting period as compared to the reporting period in the previous year.

In the three months ended 30 September 2019, our total expenses for stable gas condensate and LPG transportation by rail increased by RR 208 million, or 2.8%, to RR 7,711 million from RR 7,503 million in the corresponding period in 2018 primarily due to a 4.7% increase in weighted average transportation cost per unit resulted from a 3.56% increase in the regulated railroad transportation tariffs effective 1 January 2019 (see "Transportation tariffs" above), which was partially offset by a 1.9% decrease in volumes of liquids sold and transported via rail.

In the three months ended 30 September 2019, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 471 million, or 21.7%, to RR 2,641 million from RR 2,170 million in the corresponding period in 2018 mainly due to a 11.6% increase in sales volumes, an increase in the regulated transportation tariffs for crude oil by 3.87% effective 1 January 2019 (see "Transportation tariffs" above) and an increase in the proportion of export deliveries in total crude oil sales volumes.

In the three months ended 30 September 2019, our total transportation expenses for our hydrocarbons delivered by tankers to international markets decreased by RR 621 million, or 23.8%, to RR 1,984 million from RR 2,605 million in the corresponding period in 2018 primarily due to a decrease in stable gas condensate and refined products volumes delivered, as well as changes in the LNG delivery terms and points of destination.

Other transportation expenses mainly include our short-term vessels time charter expenses related to our revenues from hydrocarbons transportation by tankers rendered to our joint ventures and third parties (see "Other revenues" above), as well as expenses for hydrocarbons transportation by trucks.

*Taxes other than income tax*

In the three months ended 30 September 2019, taxes other than income tax decreased by RR 342 million, or 2.2%, to RR 15,098 million from RR 15,440 million in the corresponding period in 2018 primarily due to a decrease in unified natural resources production tax expense.

| *millions of Russian roubles* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| Unified natural resources production tax (UPT) | 14,215 | 14,471 | (1.8%) |
| Property tax | 840 | 909 | (7.6%) |
| Other taxes | 43 | 60 | (28.3%) |
| **Total taxes other than income tax** | **15,098** | **15,440** | **(2.2%)** |

In the three months ended 30 September 2019, our unified natural resources production tax expense decreased by RR 256 million, or 1.8%, to RR 14,215 million from RR 14,471 million in the corresponding period in 2018 as a result of the offsetting effects of two factors: a decrease in natural gas production at mature fields of our subsidiaries (see "Natural gas production volumes" above), on the one hand, and an increase in UPT rates for crude oil and gas condensate resulting from changes in the UPT rates formulas effective 1 January 2019 caused by the completion of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above), on the other hand.

*Depreciation, depletion and amortization*

In the three months ended 30 September 2019, our depreciation, depletion and amortization ("DDA") expense decreased by RR 328 million, or 3.9%, to RR 8,183 million from RR 8,511 million in the corresponding period in 2018 mainly due to an increase in total proved reserves in our subsidiaries as at the end of 2018 compared to the previous period. We accrue depreciation and depletion using the "units-of-production" method for our oil and gas assets and using a straight-line method for other facilities.

*General and administrative expenses*

In the three months ended 30 September 2019, our general and administrative expenses increased by RR 682 million, or 11.5%, to RR 6,622 million compared to RR 5,940 million in the corresponding period in 2018.

| *millions of Russian roubles* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| Employee compensation | 4,545 | 3,722 | 22.1% |
| Social expenses and compensatory payments | 1,175 | 1,245 | (5.6%) |
| Legal, audit and consulting services | 251 | 252 | (0.4%) |
| Business travel expense | 175 | 192 | (8.9%) |
| Fire safety and security expenses | 125 | 119 | 5.0% |
| Advertising expenses | 87 | 115 | (24.3%) |
| Rent expense | 60 | 75 | (20.0%) |
| Repair and maintenance expenses | 51 | 57 | (10.5%) |
| Other | 153 | 163 | (6.1%) |
| **Total general and administrative expenses** | **6,622** | **5,940** | **11.5%** |

Employee compensation relating to administrative personnel increased by RR 823 million, or 22.1%, to RR 4,545 million in the three months ended 30 September 2019 from RR 3,722 million in the corresponding period in 2018 due to an increase in average number of employees resulting from the expansion of the Group's operations, an indexation of base salaries effective 1 July 2019 and the related increase in social contributions for medical and social insurance and to the Pension Fund of the Russian Federation.

In the three months ended 30 September 2019, our social expenses and compensatory payments amounted to RR 1,175 million compared to RR 1,245 million in the corresponding period in 2018. In both reporting periods, the significant portion of expenses represented our social expenses related to continued support of charities and social programs in the regions where we operate. In the corresponding period of prior year, besides social expenses, we made compensatory payments of RR 231 million, which mainly related to the development of the Yarudeyskoye field. Social expenses and compensatory payments fluctuate period-to-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

*Materials, services and other*

In the three months ended 30 September 2019, our materials, services and other expenses increased by RR 857 million, or 15.7%, to RR 6,331 million compared to RR 5,474 million in the corresponding period in 2018.

| | Three months ended 30 September: | | Change |
|---|---|---|---|
| *millions of Russian roubles* | **2019** | **2018** | **%** |
| Employee compensation | 2,779 | 2,300 | 20.8% |
| Repair and maintenance | 821 | 772 | 6.3% |
| Complex of services for preparation, transportation and processing of hydrocarbons | 541 | 486 | 11.3% |
| Materials and supplies | 527 | 487 | 8.2% |
| Electricity and fuel | 345 | 295 | 16.9% |
| Liquefied petroleum gas volumes reservation expenses | 295 | 289 | 2.1% |
| Fire safety and security expenses | 264 | 256 | 3.1% |
| Transportation services | 218 | 223 | (2.2%) |
| Rent expenses | 168 | 95 | 76.8% |
| Insurance expense | 106 | 91 | 16.5% |
| Other | 267 | 180 | 48.3% |
| **Total materials, services and other** | **6,331** | **5,474** | **15.7%** |

Employee compensation relating to operating personnel increased by RR 479 million, or 20.8%, to RR 2,779 million compared to RR 2,300 million in the corresponding period in 2018 due to an indexation of base salaries effective from 1 July 2019, an increase in average number of employees, particularly, in our service subsidiary NOVATEK-Energo due to the expansion of its operations and servicing new assets and the related increase in social contributions for medical and social insurance and to the Pension Fund of the Russian Federation.

Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our NGL produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses increased by RR 55 million, or 11.3%, to RR 541 million compared to RR 486 million in the corresponding period in 2018 primarily due to an increase in the contract rate for services at the Tobolsk Refining Facilities from January 2019.

Rent expenses increased by RR 73 million, or 76.8%, to RR 168 million as compared to RR 95 million in the corresponding period in 2018 primarily due to the rent of energy equipment by our service subsidiary NOVATEK-Energo used for rendering energy services to our joint ventures.

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

*Exploration expenses*

In the three months ended 30 September 2019, our exploration expenses amounted to RR 384 million and related to expenditures for geological and geophysical research services at our fields, as well as expenses of our science and technology center. In the corresponding period in 2018, our exploration expenses amounted to RR 838 million, the major part of which related to exploration works performed at the North-Obskiy license area. Exploration expenses fluctuate period-to-period in accordance with the approved exploration work schedule at our production subsidiaries.

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

In the three months ended 30 September 2019 and 2018, we recorded reversals of RR 2,564 million and RR 7,160 million, respectively, to changes in inventory expense due to an increase in natural gas and most of our liquid hydrocarbons inventory balances in both reporting periods.

In 2019 and 2018 reporting periods, our cumulative natural gas inventory balance representing mainly our inventory balances of natural gas in the Underground Gas Storage Facilities ("UGSF") increased by 345 mmcm and 1,111 mmcm, respectively. The increases in both reporting periods were due to seasonal injection of natural gas for the subsequent sale on the territory of the Russian Federation in the period of higher seasonal demand, as well as due to LNG balances in tankers in transit not realized at the end of the third quarter of 2018. Natural gas inventory balances tend to fluctuate period-to-period depending on the Group's demand for natural gas withdrawal from the UGSF for the sale in the subsequent periods in the Russian Federation, as well as depending on shipment schedules and final destination of our LNG shipments via tankers.

In the three months ended 30 September 2019 and 2018, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, increased by 86 thousand tons and 44 thousand tons, respectively, mainly due to an increase in inventory balances of stable gas condensate and its refined products in tankers in transit not realized at the reporting date. Inventory balances of stable gas condensate and refined products tend to fluctuate period-to-period depending on shipment schedules and final destination of our shipments.

The following table highlights movements in our hydrocarbons inventory balances:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| *Inventory balances in transit or in storage* | **At 30 September** | **At 30 June** | **Increase / (decrease)** | **At 30 September** | **At 30 June** | **Increase / (decrease)** |
| **Natural gas (millions of cubic meters)** | **1,772** | **1,427** | **345** | **2,363** | **1,252** | **1,111** |
| *incl. Gazprom's UGSF* | *1,584* | *1,278* | *306* | *2,119* | *1,170* | *949* |
| *tankers in transit (LNG)* | - | - | - | *209* | - | *209* |
| **Liquid hydrocarbons (thousand tons)** | **938** | **852** | **86** | **850** | **806** | **44** |
| *incl. stable gas condensate* | | | | | | |
| *refined products* | *387* | *322* | *65* | *346* | *334* | *12* |
| *stable gas condensate* | *351* | *307* | *44* | *298* | *259* | *39* |
| *crude oil* | *97* | *114* | *(17)* | *103* | *107* | *(4)* |

## 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 September 2019, we recognized other operating income of RR 173 million compared to other operating loss of RR 485 million in the corresponding period in 2018.

In the three months ended 30 September 2019, we purchased and sold approximately 2.9 bcm of natural gas, as well as various derivative commodity instruments within our trading activities, and recognized the aggregate realized loss from trading activities of RR 56 million as compared to a loss of RR 466 million in the corresponding period in 2018. At the same time, we recognized non-cash income of RR 328 million in the three months ended 30 September 2019 as a result of an increase in the fair value of the aforementioned contracts as compared to a non-cash loss of RR 225 million in the corresponding period in 2018. 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.

## Net gain on disposal of interests in subsidiaries and joint ventures

In the three months ended 30 September 2019, we recognized a gain on the disposal of a 30% participation interest in OOO Arctic LNG 2 to three new participants (10% sold to each participant) in the amount of RR 366,390 million before income tax. As a result, our participation interest in Arctic LNG 2 decreased to 60% (see "Recent developments" above).

**Profit from operations and EBITDA**

In the three months ended 30 September 2019, our profit from operations and EBITDA including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in subsidiaries and joint ventures, decreased to RR 79,146 million and RR 104,519 million, respectively, compared to RR 100,913 million and RR 118,091 million in the corresponding period in 2018.

Profit from operations and EBITDA of our subsidiaries, excluding the effect from the disposal of participation interests, also decreased to RR 48,731 million and RR 56,415 million, respectively, compared to RR 61,978 million and RR 70,744 million in the corresponding period in 2018.

The decrease in the above performance measures was caused by a decline in hydrocarbons prices on international markets in the current reporting period compared to the prior year corresponding period. This effect was largely offset by an increase in our natural gas sales volumes due to the commencement of LNG production at the second and third LNG trains at Yamal LNG in July and November 2018, respectively.

**Finance income (expense)**

In the three months ended 30 September 2019, we recorded net finance income of RR 5,740 million compared to net finance income of RR 14,560 million in the corresponding period in 2018.

| *millions of Russian roubles* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| Accrued interest expense on loans received | (2,275) | (2,164) | 5.1% |
| Less: capitalized interest | 1,478 | 1,330 | 11.1% |
| Provisions for asset retirement obligations: | | | |
| effect of the present value discount unwinding | (190) | (153) | 24.2% |
| Interest expense on lease liabilities | (142) | (126) | 12.7% |
| **Interest expense** | **(1,129)** | **(1,113)** | **1.4%** |
| Interest income | 5,933 | 3,666 | 61.8% |
| Change in fair value of non-commodity financial instruments | (1,451) | 2,384 | n/a |
| Foreign exchange gain (loss), net | 2,387 | 9,623 | (75.2%) |
| **Total finance income (expense)** | **5,740** | **14,560** | **(60.6%)** |

In the three months ended 30 September 2019, our interest expense increased marginally by RR 16 million or 1.4%.

Interest income increased by RR 2,267 million, or 61.8%, to RR 5,933 million in the three months ended 30 September 2019 from RR 3,666 million in the corresponding period in 2018 primarily due to new loans provided to our joint venture OOO Arctic LNG 2 and an increase in cash balances on bank deposits.

In the three months ended 30 September 2019, we recognized a non-cash loss of RR 1,451 million compared to a non-cash gain of RR 2,384 million in the corresponding period in 2018 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 September 2019, we recorded a net foreign exchange gain of RR 2,387 million compared to a net foreign exchange gain of RR 9,623 million in the corresponding period in 2018.

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

In the three months ended 30 September 2019, the Group's proportionate share of profit of joint ventures amounted to RR 18,714 million as compared to the share of loss in the amount of RR 11,942 million in the corresponding period in 2018.

| | Three months ended 30 September: | | Change |
|---|---|---|---|
| *millions of Russian roubles* | 2019 | 2018 | % |
| **Share in profit from operations** | **30,415** | **38,935** | **(21.9%)** |
| **Share in finance income (expense)** | | | |
| Share in interest income (expense), net | (17,896) | (11,760) | 52.2% |
| Share in foreign exchange gain (loss), net | 9,279 | (32,733) | n/a |
| Share in change in fair value of non-commodity financial instruments | 677 | (6,367) | n/a |
| **Total share in finance income (expense)** | **(7,940)** | **(50,860)** | **(84.4%)** |
| Share in total income tax benefit (expense) | (3,761) | (17) | n/a |
| **Total share of profit (loss) of joint ventures, net of income tax** | **18,714** | **(11,942)** | **n/a** |

Our proportionate share in the profit from operations of our joint ventures decreased by RR 8,520 million, or 21.9%, due to a decline in hydrocarbons prices on international markets in the current reporting period compared to the prior year corresponding period. This effect was largely offset by the commencement of LNG production at the second and third LNG trains at Yamal LNG in July and November 2018, respectively.

In the three months ended 30 September 2019, our proportionate share in the finance expense of our joint ventures amounted to RR 7,940 million representing a decrease of RR 42,920 million, or 84.4%, compared to the corresponding period in 2018.

The main factor impacting the change in our share in finance expense was the recognition of a non-cash foreign exchange gain in the current reporting period (our share amounted to RR 9.3 billion) as compared to a significant non-cash foreign exchange loss (our share of RR 32.7 billion) in the third quarter of 2018, which in both reporting periods primarily related to the revaluation of foreign currency denominated loans in our joint venture Yamal LNG. We assess that the impact of foreign currency risk relating to the debt portfolio of Yamal LNG is to a large extent mitigated by the fact that all of its products are delivered to international markets and its revenues are denominated in foreign currencies.

In addition, our share in interest expense increased by RR 6.1 billion, or 52.2%, mainly due to the commencement of LNG production at the second and third LNG trains at Yamal LNG in July and November 2018 and ceasing capitalizing the respective interest expense.

The remaining change in our share in finance expense related to the recognition of a non-cash gain from the remeasurement of the fair value of shareholders' loans mainly in Yamal LNG (our share amounted to RR 0.7 billion) in the current reporting period as compared to the recognition of a non-cash loss (our share amounted to RR 6.4 billion) in the corresponding period in 2018.

**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 the joint ventures in which it holds at least a 50% interest is subject to a zero withholding tax rate according to the Russian tax legislation, and also does not result in a tax charge.

Without the effect of net profit (loss) from joint ventures and excluding net gain on disposal of interests in subsidiaries and 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 September 2019 and 2018, was 20.1% and 17.8%, respectively.

**Profit attributable to shareholders and earnings per share**

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK significantly increased by RR 324,059 million, or 8.1 times, to RR 369,959 million in the three months ended 30 September 2019 compared to RR 45,900 million in the corresponding period in 2018.

The Group's financial results were significantly impacted by a gain from the disposal of a 30% participation interest in OOO Arctic LNG 2 in July 2019 (see "Recent developments" above), as well as the recognition of non-cash foreign exchange effects on foreign currency denominated loans of the Group and its joint ventures. Excluding the effects from the disposal of interests in subsidiaries and joint ventures and foreign exchange gains (losses), our profit attributable to shareholders of PAO NOVATEK decreased by RR 16,983 million, or 25.9%, and amounted to RR 48,539 million in the three months ended 30 September 2019 compared to RR 65,522 million in the corresponding period in 2018 (see the table below):

| *millions of Russian roubles* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| Profit attributable to shareholders of PAO NOVATEK | 369,959 | 45,900 | n/a |
| Gain on disposal of interests in subsidiaries and joint ventures, net | (366,390) | - | n/a |
| Income tax expense related to the disposal of interests in subsidiaries and joint ventures | 54,668 | - | n/a |
| **Normalized profit attributable to shareholders of PAO NOVATEK** | **58,237** | **45,900** | **26.9%** |
| Foreign exchange (gains) losses | (2,387) | (9,623) | (75.2%) |
| Income tax expense (benefit) relating to foreign exchange (gains) losses | 477 | 1,925 | (75.2%) |
| Share of foreign exchange (gains) losses of joint ventures | (9,279) | 32,733 | n/a |
| Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures | 1,491 | (5,413) | n/a |
| **Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)** | **48,539** | **65,522** | **(25.9%)** |

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK increased by RR 107.63 per share, or 8.1 times, to RR 122.86 per share in the three months ended 30 September 2019 from RR 15.23 per share in the corresponding period in 2018. Excluding the effects of the disposal of interests in subsidiaries and joint ventures and foreign exchange gains (losses), our weighted average basic and diluted earnings per share decreased by RR 5.63, or 25.9%, to RR 16.12 per share in the three months ended 30 September 2019 from RR 21.75 per share in the corresponding period in 2018.

## 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 September 2019 and 2018:

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| Net cash provided by **operating** activities | 54,276 | 50,371 | 7.8% |
| Net cash used for **investing** activities | (64,105) | (25,328) | 153.1% |
| Net cash used for **financing** activities | (4,159) | (7,041) | (40.9%) |

*Net cash provided by operating activities*

Our net cash provided by operating activities increased by RR 3,905 million, or 7.8%, to RR 54,276 million compared to RR 50,371 million in the corresponding period in 2018 primarily due to an increase in interest received from our joint ventures on loans provided.

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| Profit from operations before disposal of interests in joint ventures | 48,731 | 61,978 | (21.4%) |
| Non-cash adjustments [(1)] | 8,030 | 8,995 | (10.7%) |
| Changes in working capital and long-term advances given | (10,583) | (11,358) | (6.8%) |
| Dividends received from joint ventures | 4,050 | 3,625 | 11.7% |
| Interest received | 15,161 | 179 | n/a |
| Income taxes paid excluding payments relating to disposal of interests in joint ventures | (11,113) | (13,048) | (14.8%) |
| **Total net cash provided by operating activities** | **54,276** | **50,371** | **7.8%** |

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

Profit from operations before disposal of interests in joint ventures adjusted for non-cash items decreased due to a decline in hydrocarbons prices in the current reporting period compared to the corresponding period of prior year. This effect was largely offset by an increase in natural gas volumes sold due to the commencement of LNG production at the second and third LNG trains at Yamal LNG in July and November 2018, respectively (see "Profit from operations and EBITDA" above).

In the third quarter of 2019, we received RR 3,500 million and RR 550 million of dividends from our joint ventures Arcticgas and Nortgas, respectively. In the third quarter of 2018, we received RR 3,625 million of dividends from our joint venture Nortgas.

In the three months ended 30 September 2019, we received approximately RR 15 billion of interest on loans provided to our joint ventures Yamal LNG and Terneftegas.

*Net cash used for investing activities*

In the three months ended 30 September 2019, our net cash used for investing activities increased by RR 38,777 million, or 153.1%, to RR 64,105 million compared to RR 25,328 million in the corresponding period in 2018.

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| Cash used for capital expenditures | (36,519) | (24,783) | 47.4% |
| Proceeds from disposals of interests in joint ventures | 113,088 | - | n/a |
| Income tax payments relating to disposal of interests in joint ventures | (47,840) | - | n/a |
| Payments for mineral licenses | (2,351) | - | n/a |
| Loans provided to joint ventures | (11,776) | (2,567) | 358.7% |
| Repayments of loans provided to joint ventures | 203 | 433 | (53.1%) |
| Capital contributions to joint ventures | (231) | - | n/a |
| Net decrease (increase) in bank deposits with original maturity more than three months | (78,236) | 72 | n/a |
| Proceeds from disposals of property, plant and equipment and materials for construction | - | 2,117 | n/a |
| Other | (443) | (600) | (26.2%) |
| **Net cash used for investing activities** | **(64,105)** | **(25,328)** | **153.1%** |

Cash used for capital expenditures increased by RR 11,736 million, 1.5 times, as compared to the corresponding period in 2018 primarily due to investments in our LNG projects and the ongoing development of our North-Russkoye field. In addition, our capital expenditures in both reporting periods related to the ongoing development of crude oil deposits at the East-Tarkosalinskoye and the Yarudeyskoye fields (see "Capital expenditures" below).

In the third quarter of 2019, the Group sold a 30% participation interest in OOO Arctic LNG 2 to three new participants and received from them first cash payments in the aggregate amount of RR 113,088 million (the equivalent of USD 1.8 billion) for the participation interest disposed (see "Recent developments" above). In the current reporting period, we paid RR 47,840 million of income tax accrued for these sale transactions.

In the three months ended 30 September 2019, we paid RR 2,351 million for participation in an auction for the right for geological research works, exploration and production of hydrocarbons at a license area, which includes the Soletsko-Khanaveyskoye field. According to the results of the auction, the license fee payment was set at RR 2,586 million.

In the current reporting period, we provided loans to our joint venture Arctic LNG 2 in the aggregate amount of RR 11,625 million. In the third quarter of 2018, we provided loans to our joint venture Yamal LNG in the aggregate amount of RR 2,567 million for financing the construction of the fourth LNG train. In the three months ended 30 September 2019 and 2018, we received RR 203 million and RR 433 million, respectively, due to partial repayments of the loans provided to Terneftegas.

In the third quarter of 2019, we made capital contributions to our joint venture Rostock LNG GmbH in the amount of RR 231 million.

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 third quarter of 2019, the net increase in bank deposits with original maturity more than three months amounted to approximately RR 78 billion.

In the third quarter of 2018, we received RR 2,117 million from disposals of property, plant and equipment and materials for construction, which primarily related to the assignment of rights to our joint venture Yamal LNG under concluded contracts for design and equipment production for the fourth LNG train, as well as materials purchased for this purpose.

*Net cash used for financing activities*

In the three months ended 30 September 2019, our net cash used for financing activities decreased by RR 2,882 million, or 40.9%, to RR 4,159 million as compared to RR 7,041 million in the corresponding period in 2018 due primarily to changes in dividends paid to non-controlling interest.

| *millions of Russian roubles* | **Three months ended 30 September: 2019** | **2018** | **Change %** |
|---|---|---|---|
| Repayments of long-term debt | - | (1,141) | n/a |
| Repayments of short-term debt with original maturity more than three months | (1,000) | - | n/a |
| Dividends paid to non-controlling interest | (2,744) | (5,254) | (47.8%) |
| Interest on debt paid | - | (77) | n/a |
| Payments of lease liabilities | (415) | (569) | (27.1%) |
| **Net cash used for financing activities** | **(4,159)** | **(7,041)** | **(40.9%)** |

In the third quarter of 2019, we repaid a short-term loan in the amount of RR one billion obtained in the first quarter of 2019 from a Russian bank under a revolving credit line facility.

In the third quarter of 2018, the Group fully repaid a long-term loan obtained by a Group subsidiary from its non-controlling shareholder.

## Liquidity and working capital

The following table shows the Group's liquidity and credit measures as of 30 September 2019 and 31 December 2018:

| | **30 September 2019** | **31 December 2018** | **Change, %** |
|---|---|---|---|
| **Absolute amounts, RR million** | | | |
| Net debt [(1)] | 11,979 | 102,903 | (88.4%) |
| Net working capital position [(2)] | 354,887 | 186,297 | 90.5% |
| **Liquidity and credit ratios** | | | |
| Current ratio [(3)] | 3.41 | 2.74 | n/a |
| Total debt to total equity | 0.10 | 0.19 | n/a |
| Long-term debt to long-term debt and total equity | 0.08 | 0.16 | n/a |
| Net debt to total capitalization [(4)] | 0.01 | 0.09 | n/a |
| Net debt to normalized EBITDA from subsidiaries [(5)] | 0.05 | 0.40 | n/a |

(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 subsidiaries and joint ventures for the last twelve months.

In each quarter of 2018 and 2019, the Group demonstrated sustainable operating and financial results and achieved positive free cash flows. 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 assets. The following table shows capital expenditures at our main fields, processing facilities and other assets:

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 |
|---|---|---|
| Infrastructure for future LNG projects (1) | 11,376 | 4,816 |
| Arctic LNG 2 project (2) | - | 4,624 |
| North-Russkoye and East-Tazovskoye fields | 8,921 | 3,267 |
| Yarudeyskoye field | 2,093 | 997 |
| Geofizicheskoye field | 2,038 | 142 |
| East-Tarkosalinskoye field | 1,260 | 1,505 |
| Beregovoye field | 1,089 | 196 |
| Yurkharovskoye field | 1,062 | 507 |
| West-Yurkharovskoye field | 959 | 654 |
| South-Khadyryakhinskiy license area | 725 | 59 |
| Verhnetiuteyskiy and West-Seyakhinskiy license area | 654 | 200 |
| Gydanskiy license area | 610 | 687 |
| Ust-Luga Complex | 515 | 1,134 |
| North-Obskiy license area | 17 | 1,658 |
| Office buildings | 980 | 787 |
| Other | 3,615 | 3,059 |
| **Capital expenditures** | **35,914** | **24,292** |

(1) Includes, among others, the project for the LNG construction center located in the Murmansk region.

(2) Capital expenditures are reported before the sale of a 10% participation interest in OOO Arctic LNG 2 to TOTAL S.A. group in March 2019 (see "Recent developments" above).

Total capital expenditures on property, plant and equipment in the three months ended 30 September 2019 significantly increased by RR 11,622 million, or 47.8%, to RR 35,914 million from RR 24,292 million.

In both reporting periods, we made significant investments to the LNG construction center located in the Murmansk region, which will be used to construct and fabricate the gravity-based platforms and topside modules for the Arctic LNG 2 plant, as well as for the Group's future LNG projects. Our capital expenditures for the third quarter of 2018 also included expenditures of OOO Arctic LNG 2, which became our joint venture in March 2019 after the disposal of a 10% participation interest to TOTAL S.A. (see "Recent developments" above).

A significant portion of our capital expenditures related to the ongoing development of the North-Russkoye field, consisting mainly of the construction of field facilities. We also continued the development activities at the East-Tarkosalinskoye and the Yarudeyskoye field's crude oil deposits. In addition, in the current reporting period, we increased our capital investments to develop the Beregovoye field and the South- Khadyryakhinskiy license area, as well as to conduct exploratory drilling at the Geofizicheskoye field and the Verhnetiuteyskiy and West-Seyakhinskiy license area.

In both reporting periods, we also continued to invest in the project for construction of a hydrocracker unit at our Ust-Luga Complex, which will allow us to increase the depth of processing of stable gas condensate and output of light oil products.

The "Office buildings" line in the table above represents our capital expenditures related to construction of our new office buildings in Moscow and Novy Urengoy.

The "Other" line 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 expenditures:

| *millions of Russian roubles* | Three months ended 30 September: 2019 | 2018 | Change % |
|---|---|---|---|
| **Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements** | **38,265** | **24,292** | **57.5%** |
| Less: acquisition of mineral licenses | (2,351) | - | n/a |
| **Capital expenditures** | **35,914** | **24,292** | **47.8%** |
| Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments | 605 | 491 | 23.2% |
| **Cash used for capital expenditures (1)** | **36,519** | **24,783** | **47.4%** |

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

In August 2019, we won an auction for the right for geological research works, exploration and production of hydrocarbons at a license area, which includes the Soletsko-Khanaveyskoye field and paid RR 2,351 million (see "Recent developments" above). The remaining RR 235 million will be paid after the state registration of the license.

## QUANTITATIVE AND QUALITATIVE 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 and the Euro. As of 30 September 2019, the total amount of our debt denominated in foreign currency was RR 159,033 million, or 99.4% of our total borrowings at that date. Changes in the value of the Russian rouble relative to foreign currencies will impact the value in Russian rouble terms of our foreign currency-denominated costs, debt, receivables at our foreign subsidiaries and loans provided to our joint ventures. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, 52.2% in the three months ended 30 September 2019, 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 assess that the impact of foreign currency risk relating to the debt portfolio of Yamal LNG is to a large extent mitigated by the fact that all of its products are delivered to international markets and its revenues are denominated in foreign currencies.

As of 30 September 2019, the Russian rouble appreciated by 7.3% and 11.5% against the US dollar and the Euro, respectively, compared to 31 December 2018.

### Commodity risk

Our export prices for natural gas, stable gas condensate and refined products, LPG and crude oil are primarily linked to international natural gas, crude oil and oil products prices and/or a combination thereof. 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 September 2019, 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 |
| **btu** | British thermal unit |
| **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 |
| **FID** | Final Investment Decision |
| **FOB** | "Free on board" |
| **Forecast of the Ministry of Economic Development** | The document *"Forecast of Socio-economic Development of the Russian Federation for the period till 2024"* 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 |
| **Murmansk yard** | LNG construction center located in the Murmansk region |
| **NBP** | National Balancing Point |
| **NGL** | natural gas liquids |
| **OFAC** | U.S. Treasury Department's Office of Foreign Assets Control |
| **PRMS** | Petroleum Resources Management System |
| **Purovsky Plant** | Purovsky Gas Condensate Plant |
| **Regulator** | A federal executive agency of the Russian Federation that carries out governmental regulation of prices and tariffs for products and services of natural monopolies in energy, utilities and transportation. Effective July 2015, Federal Anti-Monopoly Service fulfills the Regulator's role. |
| **RR** | Russian rouble(s) |
| **RZD** | OAO Russian Railways, Russia's state-owned monopoly railway operator |
| **SEC** | Securities and Exchange Commission |
| **Tobolsk Refining Facilities** | Refining facilities of OOO SIBUR Tobolsk |
| **TTF** | Title Transfer Facility |
| **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 17.4 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 |