



PAO NOVATEK

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

**FOR THE THREE MONTHS ENDED
31 MARCH 2017 AND 2016**

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GENERAL PROVISIONS

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 31 March 2017 and 2016 together with our unaudited consolidated interim condensed financial statements as of and for the three months ended 31 March 2017. The unaudited consolidated interim condensed financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34 “Interim Financial Reporting”. These consolidated interim condensed financial statements should be read together with the audited consolidated financial statements for the year ended 31 December 2016 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

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

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

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

Several wholly owned subsidiaries of the Group (OOO Arctic LNG 1, OOO Arctic LNG 2, and OOO Arctic LNG 3) and the Group’s joint venture OAO Yamal LNG are the holders of liquefied natural gas (“LNG”) export licenses. The aforementioned subsidiaries hold licenses for exploration and production on the Salmanovskoye (Utrenneye) and Geofizicheskoye fields, and the North-Obskiy and Trekhbugorniy license areas located on the Gydan peninsula and the Gulf of Ob. Yamal LNG holds the exploration and production license for the South-Tambeyskoye field located in the north-eastern part of the Yamal peninsula in the Yamal-Nenets Autonomous Region (“YNAO”).

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

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

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

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

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

The Group, jointly with our international partners TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through our joint venture OAO Yamal LNG, undertakes a large-scale project on constructing a liquefied natural gas plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field (the "Yamal LNG project"). Currently, the Yamal LNG project is in the final stage of preparation for the launch of the first train of the LNG plant and the start of liquefied natural gas shipments planned in 2017. Presently, the project's external financing requirements are covered, most of the infrastructure required for the launch is completed, including the seaport and the international airport, the required production wells have been drilled, and all of the modules for the first LNG train have been delivered and installed. More than 95% of LNG volumes produced within the project have been contracted under long-term agreements and we have signed long-term agreements for time chartering of LNG ice class carriers to ensure future LNG deliveries. In March 2017, the first LNG carrier successfully passed ice trial tests and is now ready for LNG transportation.

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SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Three months ended 31 March:		Change %
	2017	2016	
Financial results			
Total revenues ⁽¹⁾	154,628	139,351	11.0%
Operating expenses	(109,364)	(97,159)	12.6%
Normalized EBITDA ^{(2),(3)}	68,180	62,136	9.7%
Normalized profit attributable to shareholders of PAO NOVATEK ⁽³⁾	71,018	58,240	21.9%
Normalized profit attributable to shareholders of PAO NOVATEK ⁽³⁾ , excluding the effect of foreign exchange gains (losses) ⁽⁴⁾	44,345	36,899	20.2%
Normalized earnings per share ⁽³⁾ (in Russian roubles)	23.54	19.29	22.0%
Normalized earnings per share ⁽³⁾ , excluding the effect of foreign exchange gains (losses) ⁽⁴⁾ (in Russian roubles)	14.70	12.22	20.2%
Net debt ⁽⁵⁾	114,413	203,019	(43.6%)
Production volumes ⁽⁶⁾			
Hydrocarbons production (million barrels of oil equivalent)	127.7	139.5	(8.5%)
Daily production (million barrels of oil equivalent per day)	1.42	1.53	(7.5%)
Operating results			
Natural gas sales volumes (million cubic meters)	18,752	17,775	5.5%
Naphtha sales volumes (thousand tons)	1,130	1,151	(1.8%)
Crude oil sales volumes (thousand tons)	1,072	1,188	(9.8%)
Other gas condensate refined products (thousand tons) ⁽⁷⁾	707	730	(3.2%)
Liquefied petroleum gas sales volumes (thousand tons)	677	703	(3.7%)
Stable gas condensate sales volumes (thousand tons)	524	868	(39.6%)
Cash flow results			
Net cash provided by operating activities	48,842	54,424	(10.3%)
Cash used for capital expenditures ⁽⁸⁾	4,738	8,976	(47.2%)
Free cash flow ⁽⁹⁾	44,104	45,448	(3.0%)

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

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

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

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

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

⁽⁶⁾ Hydrocarbons production and daily production are calculated based on 100% of net production of our subsidiaries and our proportionate share in the production of our joint ventures.

⁽⁷⁾ Other gas condensate refined products include jet fuel, gasoil and fuel oil.

⁽⁸⁾ Cash used for capital expenditures represents purchases of property, plant and equipment, materials for construction and capitalized interest paid per Consolidated Statement of Cash Flows net of payments for mineral licenses and acquisition of subsidiaries.

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

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Reconciliation of EBITDA and normalized EBITDA is as follows:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Profit	73,207	117,577	(37.7%)
Depreciation, depletion and amortization	8,488	7,833	8.4%
Net impairment reversals (expenses)	-	153	n/a
Loss (income) from changes in fair value of commodity derivative instruments	(211)	(326)	(35.3%)
Total finance expense (income)	8,602	(916)	n/a
Total income tax expense	7,355	22,955	(68.0%)
Share of loss (profit) of joint ventures, net of income tax	(43,626)	(23,381)	86.6%
EBITDA from subsidiaries	53,815	123,895	(56.6%)
Share in EBITDA of joint ventures	14,365	11,313	27.0%
EBITDA	68,180	135,208	(49.6%)
Net gain on disposal of interests in joint ventures	-	(73,072)	n/a
Normalized EBITDA	68,180	62,136	9.7%
Normalized EBITDA from subsidiaries	53,815	50,823	5.9%

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SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate, Russian roubles for one foreign currency unit ⁽¹⁾</i>	Three months ended 31 March:		Change %
	2017	2016	
US dollar (USD)			
Average for the period	58.84	74.63	(21.2%)
At the beginning of the period	60.66	72.88	(16.8%)
At the end of the period	56.38	67.61	(16.6%)
Depreciation (appreciation) of Russian rouble to US dollar	(7.1%)	(7.2%)	n/a
Euro			
Average for the period	62.65	82.34	(23.9%)
At the beginning of the period	63.81	79.70	(19.9%)
At the end of the period	60.60	76.54	(20.8%)
Depreciation (appreciation) of Russian rouble to Euro	(5.0%)	(4.0%)	n/a

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

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<i>Average for the period</i>	Three months ended 31 March:		Change %
	2017	2016	
Benchmark crude oil prices ⁽²⁾			
Brent, USD per barrel	53.7	33.9	58.4%
Urals, USD per barrel	52.2	32.2	62.1%
Urals, Russian roubles per barrel	3,071	2,403	27.8%
Benchmark crude oil prices excluding export duties ⁽³⁾			
Urals, USD per barrel	40.4	24.7	63.6%
Urals, Russian roubles per barrel	2,377	1,843	29.0%
World market prices for oil products ⁽⁴⁾ and liquefied petroleum gas ⁽⁵⁾, USD per ton			
Naphtha Japan	497	345	44.1%
Naphtha CIF NWE	485	320	51.6%
Jet fuel	513	342	50.0%
Gasoil	481	310	55.2%
Fuel oil	318	147	116.3%
Liquefied petroleum gas	395	232	70.3%
Export duties, USD per ton ⁽⁶⁾			
Crude oil, stable gas condensate	86.5	54.9	57.6%
Naphtha	47.6	39.0	22.1%
Jet fuel, gasoil	25.9	22.0	17.7%
Fuel oil	86.5	45.0	92.2%
Liquefied petroleum gas	0.0	0.0	n/a

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

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

⁽⁴⁾ Based on Naphtha C+F (cost plus freight) Japan, Naphtha CIF NWE, Jet CIF NWE, Gasoil 0.1% CIF NWE, Fuel Oil 1.0% CIF NWE prices provided by Platts.

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

⁽⁶⁾ Export duties are determined by the Russian Federation government in US dollars and are paid in Russian roubles (see "Our tax burden and obligatory payments" below).

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current economic conditions

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

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

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

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

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

Prices for natural gas sold in the Russian Federation

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

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

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

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

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

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

In the three months ended 31 March 2017, our average natural gas price on end-customers sales increased by 3.9% due to an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current reporting period as compared to the respective period in 2016. The change in the sales geography also increased our average transportation expense per mcm by 10.1%. As a result, the average natural gas price on end-customers sales excluding transportation expenses was relatively flat (increased by 0.2%).

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

<i>Russian roubles per mcm</i>	Three months ended 31 March:		Change %
	2017	2016	
Average natural gas price to end-customers ⁽¹⁾	3,727	3,586	3.9%
Average natural gas transportation expense for sales to end-customers	(1,466)	(1,331)	10.1%
Average natural gas price on end-customer sales excluding transportation expense	2,262	2,257	0.2%
Average natural gas price ex-field (wholesale traders)	2,051	2,051	0.0%
Total average natural gas price excluding transportation expense	2,246	2,237	0.4%

⁽¹⁾ Includes cost of transportation.

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

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

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

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

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

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

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

<i>Russian roubles or US dollars per ton</i>	Three months ended 31 March:		Change %
	2017	2016	
Stable gas condensate			
Export contract price, USD per ton	448	295	51.9%
Net export price, USD per ton	366	238	53.8%
Net export price, RR per ton	22,023	17,649	24.8%
Domestic price, RR per ton	17,498	11,889	47.2%
Naphtha			
Export contract price, USD per ton	508	368	38.0%
Net export price, USD per ton	461	331	39.3%
Net export price, RR per ton	27,181	24,517	10.9%
Other gas condensate refined products			
Export contract price, USD per ton	483	309	56.3%
Net export price, USD per ton	437	279	56.6%
Net export price, RR per ton	25,888	20,704	25.0%
Domestic price, RR per ton	20,848	15,271	36.5%
Crude oil			
Export contract price, USD per ton	393	228	72.4%
Net export price, USD per ton	308	177	74.0%
Net export price, RR per ton	18,156	12,950	40.2%
Domestic price, RR per ton	15,897	11,183	42.2%
LPG			
Export contract price, USD per ton ⁽⁴⁾	595	432	37.7%
Net export price, USD per ton ⁽⁴⁾	469	303	54.8%
Net export price, RR per ton	27,610	22,635	22.0%
Domestic price, RR per ton	11,880	6,519	82.2%

⁽⁴⁾ For operations in Polish zloty price in US dollars was translated from Russian roubles using the average exchange rate for the period.

In the three months ended 31 March 2017, compared to the corresponding period in 2016 our average realized export contract prices for our liquid hydrocarbons increased due to increases in the underlying respective product prices on the international markets used in the price calculation (see "Selected macro-economic data" above). The dynamics of our weighted-average export contract price for each product category also reflects the influence of uneven distribution of sales volumes within periods and changes in the geography of shipments which may significantly impact our average prices in periods of high benchmark crude oil prices volatility on international markets.

Our average realized net export prices in Russian roubles terms for our liquid hydrocarbons also increased for all product categories, although the effect of the increased contract prices was partially offset by a 21.2% appreciation of the Russian rouble relative to the US dollar in the three months ended 31 March 2017 compared to the corresponding period in 2016 (see "Selected macro-economic data" above).

In the three months ended 31 March 2017, our average realized domestic prices for our liquid hydrocarbons increased compared to the corresponding period in 2016 as a result of the respective changes in the underlying benchmark prices for these products excluding export duties in Russian roubles terms, and specifics of pricing mechanism for each particular product on the domestic market (such as time lag of international benchmark crude oil prices and export duty rates used in price calculation, price setting on an individual transaction basis for some deliveries and others).

Transportation tariffs

Natural gas

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

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

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

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in November 2016, the increase in tariffs for natural gas transportation through the trunk pipeline in 2017 to 2019 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth on the domestic market.

Stable gas condensate and LPG by rail

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

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

Effective 3 January 2016, railroad freight transportation tariffs for all types of hydrocarbons were increased by 9% relative to the 2015 tariffs and did not change until the end of 2016. In January 2017, the Regulator increased the aforementioned tariffs by 6.1% relative to the 2016 tariffs.

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

Stable gas condensate and refined products by tankers

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

Crude oil

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

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

Our tax burden and obligatory payments

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

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

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

The tax maneuver in the oil and gas industry

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

UPT – natural gas and gas condensate

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

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

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

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

UPT – crude oil

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

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

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

Export duties and excise taxes

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

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

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

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

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

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

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

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

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

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

Social contributions

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

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

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

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

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

OPERATIONAL HIGHLIGHTS**Hydrocarbon production and sales volumes**

In the three months ended 31 March 2017, our total natural gas sales volumes in Russia increased by 977 mmcm, or 5.5%, due to increased demand for natural gas from end-customers resulted, among other factors, from weather conditions. Natural gas volumes produced at mature fields of our subsidiaries and joint ventures decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons, which was partially offset by the improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field.

In the three months ended 31 March 2017, our liquids sales volumes decreased by 529 thousand tons, or 11.4%, due to a decrease in gas condensate production at mature fields of our subsidiaries and joint ventures, as well as due to changes in inventory balances that vary period-to-period depending on shipping schedules and final destinations of our liquid hydrocarbons shipments.

Natural gas production volumes

In the three months ended 31 March 2017, our total natural gas production (including our proportionate share in the production of joint ventures) decreased by 1,515 mmcm, or 8.8%, to 15,721 mmcm from 17,236 mmcm in the corresponding period in 2016. Our average daily production decreased by 14.7 mmcm, or 7.8%, to 174.7 mmcm per day.

<i>millions of cubic meters</i>	Three months ended 31 March:		Change %
	2017	2016	
Production by subsidiaries from:			
Yurkharovskoye field	7,907	9,035	(12.5%)
East-Tarkosalinskoye field	1,821	2,105	(13.5%)
Khancheyevskoye field	591	643	(8.1%)
Other fields	602	393	53.2%
Total natural gas production by subsidiaries	10,921	12,176	(10.3%)
Group's proportionate share in the production of joint ventures:			
SeverEnergiya (Arcticgas)	3,418	3,480	(1.8%)
Nortgas	1,075	1,310	(17.9%)
Terneftegas	307	270	13.7%
Total Group's proportionate share in the natural gas production of joint ventures	4,800	5,060	(5.1%)
Total natural gas production including proportionate share in the production of joint ventures	15,721	17,236	(8.8%)
<i>Average daily natural gas production including proportionate share in the production of joint ventures</i>	<i>174.7</i>	<i>189.4</i>	<i>(7.8%)</i>

In the three months ended 31 March 2017, our natural gas volumes produced at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyevskoye) and our joint ventures, Nortgas and SeverEnergiya, decreased mainly due to natural declines in the reservoir pressure at the current gas producing horizons. The decrease was partially offset by improved efficiency of associated petroleum gas utilization at our Yarudeyskoye field.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2017 and 2016***Natural gas sales volumes in the Russian Federation*

In the three months ended 31 March 2017, our total natural gas sales volumes in Russia increased by 977 mmcm, or 5.5%, to 18,752 mmcm from 17,775 mmcm in the corresponding period in 2016.

<i>millions of cubic meters</i>	Three months ended 31 March:		Change %
	2017	2016	
Production by subsidiaries	10,921	12,176	(10.3%)
Purchases from the Group's joint ventures	5,301	2,749	92.8%
Other purchases	1,860	2,011	(7.5%)
Total production and purchases	18,082	16,936	6.8%
Own usage ⁽¹⁾	(34)	(59)	(42.4%)
Decrease (increase) in GTS, UGSF and own pipeline infrastructure	704	898	(21.6%)
Total natural gas sales volumes in the Russian Federation	18,752	17,775	5.5%
<i>Sold to end-customers</i>	<i>17,329</i>	<i>16,094</i>	<i>7.7%</i>
<i>Sold ex-field</i>	<i>1,423</i>	<i>1,681</i>	<i>(15.3%)</i>

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

In the three months ended 31 March 2017, natural gas purchases from our joint ventures increased by 2,552 mmcm, or 92.8%, to 5,301 mmcm from 2,749 mmcm in the corresponding period in 2016 primarily due to an increase in purchases from SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) and Nortgas in order to fulfill our contractual sales obligations.

Other natural gas purchases decreased by 151 mmcm, or 7.5%, to 1,860 mmcm from 2,011 mmcm in the corresponding period in 2016, and are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize end-customers portfolios.

As of 31 March 2017, our natural gas inventory balance in the GTS, the UGSF and our own pipeline infrastructure aggregated 130 mmcm and decreased by 704 mmcm during the quarter as compared to a decrease by 898 mmcm in the corresponding period in 2016. The decrease in inventory balances in both reporting quarters was due to the seasonal withdrawal of natural gas from the UGSF in the period of higher seasonal demand.

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Liquids production volumes

In the three months ended 31 March 2017, our total liquids production (including our proportionate share in the production of joint ventures) decreased by 241 thousand tons, or 7.5%, to 2,967 thousand tons from 3,208 thousand tons in the corresponding period in 2016. Our average daily production decreased by 2.3 thousand tons, or 6.5%, to 33.0 thousand tons per day.

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2017	2016	
Production by subsidiaries from:			
Yarudeyskoye field	886	884	0.2%
Yurkharovskoye field	400	495	(19.2%)
East-Tarkosalinskoye field	326	356	(8.4%)
Khancheyskoye field	74	89	(16.9%)
Other fields	27	31	(12.9%)
Total liquids production by subsidiaries	1,713	1,855	(7.7%)
<i>including crude oil</i>	<i>1,183</i>	<i>1,200</i>	<i>(1.4%)</i>
<i>including gas condensate</i>	<i>530</i>	<i>655</i>	<i>(19.1%)</i>
Group's proportionate share in the production of joint ventures:			
SeverEnergiya (Arcticgas)	1,047	1,107	(5.4%)
Terneftegas	107	102	4.9%
Nortgas	100	144	(30.6%)
Total Group's proportionate share in the liquids production of joint ventures	1,254	1,353	(7.3%)
Total liquids production including proportionate share in the production of joint ventures	2,967	3,208	(7.5%)
<i>Average daily liquids production including proportionate share in the production of joint ventures</i>	<i>33.0</i>	<i>35.3</i>	<i>(6.5%)</i>

In the three months ended 31 March 2017, the volumes of liquids produced by subsidiaries and joint ventures decreased as a result of a decrease in gas condensate production mainly at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint ventures, Nortgas and SeverEnergiya, due to the natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons. Crude oil production changed insignificantly.

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Liquids sales volumes

In the three months ended 31 March 2017, our total liquids sales volumes decreased by 529 thousand tons, or 11.4%, to 4,113 thousand tons from 4,642 thousand tons in the corresponding period in 2016.

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2017	2016	
Production by subsidiaries	1,713	1,855	(7.7%)
Purchases from the Group's joint ventures	2,343	2,531	(7.4%)
Other purchases	37	31	19.4%
Total production and purchases	4,093	4,417	(7.3%)
Losses ⁽¹⁾ and own usage ⁽²⁾	(70)	(73)	(4.1%)
Decreases (increases) in liquids inventory balances	90	298	(69.8%)
Total liquids sales volumes	4,113	4,642	(11.4%)
<i>Naphtha export</i>	<i>1,130</i>	<i>1,151</i>	<i>(1.8%)</i>
<i>Other gas condensate refined products export</i>	<i>674</i>	<i>692</i>	<i>(2.6%)</i>
<i>Other gas condensate refined products domestic</i>	<i>33</i>	<i>38</i>	<i>(13.2%)</i>
<i>Subtotal gas condensate refined products</i>	<i>1,837</i>	<i>1,881</i>	<i>(2.3%)</i>
<i>Crude oil export</i>	<i>257</i>	<i>382</i>	<i>(32.7%)</i>
<i>Crude oil domestic</i>	<i>815</i>	<i>806</i>	<i>1.1%</i>
<i>Subtotal crude oil</i>	<i>1,072</i>	<i>1,188</i>	<i>(9.8%)</i>
<i>LPG export</i>	<i>133</i>	<i>138</i>	<i>(3.6%)</i>
<i>LPG domestic</i>	<i>544</i>	<i>565</i>	<i>(3.7%)</i>
<i>Subtotal LPG</i>	<i>677</i>	<i>703</i>	<i>(3.7%)</i>
<i>Stable gas condensate export</i>	<i>134</i>	<i>479</i>	<i>(72.0%)</i>
<i>Stable gas condensate domestic</i>	<i>390</i>	<i>389</i>	<i>0.3%</i>
<i>Subtotal stable gas condensate</i>	<i>524</i>	<i>868</i>	<i>(39.6%)</i>
<i>Other oil products domestic</i>	<i>3</i>	<i>2</i>	<i>50.0%</i>
<i>Subtotal other oil products</i>	<i>3</i>	<i>2</i>	<i>50.0%</i>

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

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

In the three months ended 31 March 2017, our purchases of liquid hydrocarbons from joint ventures decreased by 188 thousand tons, or 7.4%, due to a decrease in purchases of gas condensate from SeverEnergiya and Nortgas (see "Liquids production volumes" above).

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

In the 2017 reporting period, our liquids inventory balances decreased by 90 thousand tons to 814 thousand tons as of 31 March 2017 as compared to a decrease in inventory balances by 298 thousand tons to 612 thousand tons in the corresponding period in 2016. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

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**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2017 COMPARED
TO THE CORRESPONDING PERIOD IN 2016**

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

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2017	% of total revenues	2016	% of total revenues
Total revenues ⁽¹⁾	154,628	100.0%	139,351	100.0%
<i>including:</i>				
natural gas sales	67,503	43.7%	61,163	43.9%
liquids' sales	86,498	55.9%	77,048	55.3%
Operating expenses	(109,364)	(70.7%)	(97,159)	(69.7%)
Other operating income (loss)	274	0.2%	971	0.7%
Profit from operations before disposals of interests in joint ventures	45,538	29.5%	43,163	31.0%
Net gain on disposal of interests in joint ventures	-	<i>n/a</i>	73,072	52.4%
Profit from operations	45,538	29.5%	116,235	83.4%
Finance income (expense)	(8,602)	(5.6%)	916	0.7%
Share of profit (loss) of joint ventures, net of income tax	43,626	28.2%	23,381	16.8%
Profit before income tax	80,562	52.1%	140,532	100.9%
Total income tax expense	(7,355)	(4.8%)	(22,955)	(16.5%)
Profit	73,207	47.3%	117,577	84.4%
Less: profit (loss) attributable to non-controlling interest	(2,189)	(1.4%)	(1,660)	(1.2%)
Profit attributable to shareholders of PAO NOVATEK	71,018	45.9%	115,917	83.2%
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	44,345	28.7%	36,899	26.5%

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

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Total revenues

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %	Change ⁽¹⁾		
	2017	2016		Total	Due to volume ⁽²⁾	Due to price ⁽³⁾
Natural gas sales	67,503	61,163	10.4%	6,340	3,907	2,433
<i>In the Russian Federation – end-customers sales</i>	64,577	57,715	11.9%	6,862	4,429	2,433
<i>In the Russian Federation – ex-field sales</i>	2,919	3,448	(15.3%)	(529)	(529)	-
<i>Outside the Russian Federation</i>	7	-	n/a	7	7	-
Gas condensate refined products sales	48,854	43,125	13.3%	5,729	(698)	6,427
<i>Export – naphtha</i>	30,722	28,210	8.9%	2,512	(500)	3,012
<i>Export – other refined products</i>	17,454	14,338	21.7%	3,115	(117)	3,232
<i>Domestic – other refined products</i>	678	577	17.5%	101	(81)	182
Crude oil sales	17,621	13,959	26.2%	3,662	(1,518)	5,180
<i>Export</i>	4,661	4,951	(5.9%)	(290)	(1,626)	1,336
<i>Domestic</i>	12,960	9,008	43.9%	3,952	108	3,844
Liquefied petroleum gas sales	10,138	6,807	48.9%	3,331	(248)	3,579
<i>Export</i>	3,675	3,120	17.8%	555	(107)	662
<i>Domestic</i>	6,463	3,687	75.3%	2,776	(141)	2,917
Stable gas condensate sales	9,785	13,077	(25.2%)	(3,292)	(6,066)	2,774
<i>Export</i>	2,959	8,460	(65.0%)	(5,501)	(6,087)	586
<i>Domestic</i>	6,826	4,617	47.8%	2,209	21	2,188
Other products sales	100	80	25.0%	20	n/a	n/a
<i>Domestic</i>	100	80	25.0%	20	n/a	n/a
Total oil and gas sales	154,001	138,211	11.4%	15,790	n/a	n/a
Other revenues	627	1,140	(45.0%)	(513)	n/a	n/a
Total revenues	154,628	139,351	11.0%	15,277	n/a	n/a

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

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

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

Natural gas sales

Revenues from natural gas sales represent our revenues from natural gas sales in the Russian Federation (to end-customers and wholesale traders), as well as revenues from sales of regasified LNG to customers in Poland through our wholly owned subsidiary, Blue Gas Sp. z.o.o. In the three months ended 31 March 2017, our total revenues from natural gas sales increased by RR 6,340 million, or 10.4%, compared to the corresponding period in 2016.

Our revenues from natural gas sales in the Russian Federation increased by RR 6,333 million, or 10.4%, compared to the corresponding period in 2016 mainly due to an increase in volumes sold and, to a lesser extent, an increase in our average sales prices. The increase in our total sales volumes by 5.5% was due to a higher demand for natural gas from our end-customers, resulted, among other factors, from weather conditions. Our average sales prices increased by 4.6% due to an increase in the proportion of sales to our end-customers located at more distant regions from our production fields, as well as a decrease from 9.5% to 7.6% in the proportion of natural gas sold to wholesale traders with lower average sales prices compared to end-customer sales (see "Natural gas prices" above).

In the current reporting period, we sold 0.25 mmcm of natural gas in Poland received from regasification of LNG purchased in Poland, and recognized RR seven million of respective revenues.

Gas condensate refined products sales

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

In the three months ended 31 March 2017, our revenues from sales of gas condensate refined products increased by RR 5,729 million, or 13.3%, as compared to the corresponding period in 2016 due to an increase in average realized net export prices with a marginal decrease in sales volume.

In the three months ended 31 March 2017, our revenues from sales of naphtha increased by RR 2,512 million, or 8.9%, as compared to the corresponding period in 2016 due to an increase in average realized net export prices while sales volumes insignificantly decreased by 21 thousand tons, or 1.8%. In the three months ended 31 March 2017 and 2016, we exported 1,130 thousand and 1,151 thousand tons of naphtha, respectively. Nearly all our naphtha volumes were sold to the APR, and the European and North America markets. Our average realized net export price, excluding export duties, increased by RR 2,664 per ton, or 10.9%, to RR 27,181 per ton (CFR, CIF, DES and FOB) from RR 24,517 per ton (CFR and CIF) in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2017, our revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 3,217 million, or 21.6%, as compared to the corresponding period in 2016 primarily due to an increase in average realized net export prices. In the three months ended 31 March 2017 and 2016, we exported in aggregate 674 thousand and 692 thousand tons of these products to the European markets, or 95.3% and 94.8% of total sales volumes (on the domestic and export markets), respectively. Our average realized net export price, excluding export duties, increased by RR 5,184 per ton, or 25.0%, to RR 25,888 per ton (CIF, DES and FOB) from RR 20,704 per ton (CIF, DES, FOB and DAP) in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Crude oil sales

In the three months ended 31 March 2017, our revenues from crude oil sales increased by RR 3,662 million, or 26.2%, compared to the corresponding period in 2016 due to an increase in average realized prices which was partially offset by a decrease in total sales volumes.

In the three months ended 31 March 2017, we sold 815 thousand tons, or 76.0% of our total crude oil sales volumes, domestically as compared to sales of 806 thousand tons, or 67.8%, in the corresponding period in 2016. Our average realized crude oil domestic price increased by RR 4,714 per ton, or 42.2%, to RR 15,897 per ton from RR 11,183 per ton in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

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The remaining 257 thousand tons of crude oil, or 24.0% of our total sales volumes, in the current reporting period and 382 thousand tons, or 32.2%, in the corresponding period in 2016 were sold to the European and the APR markets. The decrease in our export sales volumes of 125 thousand tons, or 32.7%, was due to weather conditions in the port of loading, as a result of which a part of our sales volumes planned for the first quarter of 2017 was still in transit as of 31 March and was sold at the beginning of April. Our average net export price, excluding export duties, increased by RR 5,206 per ton, or 40.2%, to RR 18,156 per ton from RR 12,950 per ton in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Liquefied petroleum gas sales

In the three months ended 31 March 2017, our revenues from sales of LPG increased by RR 3,331 million, or 48.9%, compared to the corresponding period in 2016 primarily due to an increase in average realized prices.

In the three months ended 31 March 2017, we sold 133 thousand tons of LPG, or 19.6% of our total LPG sales volumes, to export markets as compared to sales of 138 thousand tons, or 19.6%, in the corresponding period in 2016. Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, increased by RR 4,975 per ton, or 22.0%, (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In both reporting periods, our LPG export delivery terms were DAP at the border of the customer's country or free carrier (FCA) at terminal points in Poland. We sold most of our LPG export sales volumes to Poland in both reporting periods.

In the three months ended 31 March 2017, we sold 544 thousand tons of LPG, or 80.4% of our total LPG sales volumes, on the domestic market compared to sales of 565 thousand tons, or 80.4%, in the corresponding period in 2016. Our average realized LPG domestic price in the three months ended 31 March 2017 was RR 11,880 per ton representing an increase of RR 5,361 per ton, or 82.2%, compared to the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Stable gas condensate sales

In the three months ended 31 March 2017, our revenues from sales of stable gas condensate decreased by RR 3,292 million, or 25.2%, compared to the corresponding period in 2016 due to a decrease in export sales volumes that was largely offset by an increase in average realized price.

In the three months ended 31 March 2017, we sold 134 thousand tons of stable gas condensate, or 25.6% of our total sales volumes, to the European markets, compared to 479 thousand tons, or 55.2%, in the corresponding period in 2016 to the APR and the European markets. Our average realized stable gas condensate net export price, excluding export duties, increased by RR 4,374 per ton, or 24.8%, to RR 22,023 per ton (DAP and CIF) from RR 17,649 per ton (CFR, DAP, CIF and DES) (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2017, we sold 390 thousand tons of stable gas condensate, or 74.4% of our total sales volumes, on the domestic market compared to 389 thousand tons, or 44.8%, in the corresponding period in 2016. Our average realized price increased by RR 5,609 per ton, or 47.2%, to RR 17,498 per ton from RR 11,889 per ton in the corresponding period in 2016 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Other products sales

Other products sales represent our revenues from the domestic sales of purchased oil products (diesel fuel and petrol) through our retail stations, sales of other purchased liquid hydrocarbons, and sales of our produced methanol. In the three months ended 31 March 2017, our revenues from other products sales increased by RR 20 million, or 25.0%, to RR 100 million from RR 80 million in the corresponding period in 2016.

Other revenues

Other revenues include revenue from transportation, geological and geophysical research services, repair and maintenance of energy equipment services, and other services. In the three months ended 31 March 2017, other revenues decreased by RR 513 million, or 45.0%, to RR 627 million from RR 1,140 million in the corresponding period in 2016 primarily due to a decrease in revenues from tankers transporting third party goods by RR 743 million. At the same time, in the three months ended 31 March 2017, other revenue from power generation services, as well as repair and maintenance of energy equipment services provided by our subsidiary NOVATEK-Energo increased by RR 207 million.

Operating expenses

In the three months ended 31 March 2017, our total operating expenses increased by RR 12,205 million, or 12.6%, to RR 109,364 million compared to RR 97,159 million in the corresponding period in 2016 mainly due to an increase in the average purchase prices for liquid hydrocarbons and increased volume of purchases of natural gas from our joint ventures as a result of higher demand for natural gas from end-customers (see "Purchases of natural gas and liquid hydrocarbons" below), which in turn allowed us to earn higher revenues from hydrocarbons sales, and, to a lesser extent, due to an increase in taxes other than income tax as a result of increased UPT rates for crude oil and gas condensate (see "Taxes other than income tax" below). Our total operating expenses as a percentage of total revenues changed insignificantly (increased to 70.7% from 69.7%).

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2017	% of total revenues	2016 ⁽¹⁾	% of total revenues
Purchases of natural gas and liquid hydrocarbons	41,970	27.1%	29,717	21.3%
Transportation expenses	36,782	23.8%	36,573	26.2%
Taxes other than income tax	12,341	8.0%	10,597	7.6%
Depreciation, depletion and amortization	8,488	5.5%	7,833	5.6%
Materials, services and other	4,800	3.1%	4,466	3.2%
General and administrative expenses	3,993	2.6%	4,012	2.9%
Exploration expenses	388	0.3%	210	0.2%
Impairment expenses (reversals), net	-	n/a	153	n/a
Changes in natural gas, liquid hydrocarbons and work-in-progress	602	0.4%	3,598	2.6%
Total operating expenses	109,364	70.7%	97,159	69.7%

⁽¹⁾ Certain reclassifications have been made to the comparative figures to conform to the current period presentation with no effect on profit for the period or shareholder's equity. Namely, insurance expenses relating to production assets and major part of expenses of the Group's science and technology center for the three months ended 31 March 2016 in the total amount of RR 217 million were reclassified from General and administrative expenses to Materials, services and other expenses and Exploration expenses in the amount of RR 109 million and RR 108 million, respectively.

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2017, our purchases of natural gas and liquid hydrocarbons increased by RR 12,253 million, or 41.2%, to RR 41,970 million from RR 29,717 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Unstable gas condensate	26,691	19,147	39.4%
Natural gas (excluding LNG)	14,610	10,126	44.3%
Other hydrocarbons	669	444	50.7%
Total purchases of natural gas and liquid hydrocarbons	41,970	29,717	41.2%

In the three months ended 31 March 2017, our purchases of unstable gas condensate from our joint ventures increased by RR 7,544 million, or 39.4%, as compared to the corresponding period in 2016 due to an increase in purchase prices, which are impacted by international crude prices excluding export duties.

In the three months ended 31 March 2017, our purchases of natural gas increased by RR 4,484 million, or 44.3%, as compared to the corresponding period in 2016 as a result of an increase in volumes purchased from SeverEnergiya (its wholly owned subsidiary, OAO Arcticgas) and Nortgas in order to fulfill our contractual sales obligations.

Other hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products, as well as purchases of LNG in Poland for its further regasification and sale as natural gas to local customers. In the three months ended 31 March 2017, our purchases of other hydrocarbons increased by RR 225 million, or 50.7%, as compared to the corresponding period in 2016.

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In the three months ended 31 March 2017, our total transportation expenses increased insignificantly by RR 209 million, or 0.6%, to RR 36,782 million as compared to RR 36,573 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Natural gas transportation			
by trunk and low-pressure pipelines	25,371	21,394	18.6%
Stable gas condensate and liquefied petroleum gas transportation by rail	7,975	9,104	(12.4%)
Gas condensate refined products, stable gas condensate and crude oil transportation by tankers	1,785	4,330	(58.8%)
Crude oil transportation by trunk pipelines	1,636	1,703	(3.9%)
Other	15	42	(64.3%)
Total transportation expenses	36,782	36,573	0.6%

In the three months ended 31 March 2017, our expenses for natural gas transportation increased by RR 3,977 million, or 18.6%, to RR 25,371 million from RR 21,394 million in the corresponding period in 2016 due to a 7.7% increase in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current period as compared to the corresponding period of the prior year.

In the three months ended 31 March 2017, our total expenses for stable gas condensate and LPG transportation by rail decreased by RR 1,129 million, or 12.4%, to RR 7,975 million from RR 9,104 million in the corresponding period in 2016. The decrease was due to a 13.3% decrease in volumes of liquids sold and transported via rail. The weighted average transportation cost per unit increased by 1.0% as a result of an increase in the regulated railroad transportation tariffs effective January 2017 (see "Transportation tariffs" above), that was partially offset by a 21.2% appreciation of the average exchange rate of the Russian rouble relative to the US dollar since part of our expenses for LPG transportation by rail are US dollar denominated.

In the three months ended 31 March 2017, our total transportation expenses for liquids delivered by tankers to international markets decreased by RR 2,545 million, or 58.8%, to RR 1,785 million from RR 4,330 million in the corresponding period in 2016 primarily due to a 21.2% appreciation of the average exchange rate of the Russian rouble relative to the US dollar in the three months ended 31 March 2017 compared to the corresponding period in 2016 since all our tankers transportation expenses are US dollar denominated. In addition, our expenses decreased due to a 15.2% decrease in volumes of liquids sold and transported via tankers, as well as changes in the geography of shipments.

In the three months ended 31 March 2017, our expenses for crude oil transportation to customers by trunk pipeline decreased by RR 67 million, or 3.9%, to RR 1,636 million from RR 1,703 million in the corresponding period in 2016 due to a 9.8% decrease in crude oil sales volumes as compared to the corresponding period of the prior year. The impact of this factor was partially mitigated by a 3.6% increase in the regulated transportation tariff effective 1 January 2017 (see "Transportation tariffs" above) and an increase in the proportion of crude oil sales to more distant regions from our production fields on the domestic market.

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In the three months ended 31 March 2017, taxes other than income tax increased by RR 1,744 million, or 16.5%, to RR 12,341 million from RR 10,597 million in the corresponding period in 2016 primarily due to an increase in the unified natural resources production tax expense.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Unified natural resources production tax (UPT)	11,458	9,876	16.0%
Property tax	825	665	24.1%
Other taxes	58	56	3.6%
Total taxes other than income tax	12,341	10,597	16.5%

In the three months ended 31 March 2017, our unified natural resources production tax expense increased by RR 1,582 million, or 16.0%, to RR 11,458 million from RR 9,876 million in the corresponding period in 2016 due to an increase in UPT rates for crude oil and gas condensate effective 1 January 2017 as part of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above).

In the three months ended 31 March 2017, our property tax expense increased by RR 160 million, or 24.1%, to RR 825 million from RR 665 million in the corresponding period in 2016 due to the termination of a property tax relief at one of our processing subsidiaries effective from January 2017, as well as a result of additions to property, plant and equipment at our production subsidiaries.

Depreciation, depletion and amortization

In the three months ended 31 March 2017, our depreciation, depletion and amortization ("DDA") expense increased by RR 655 million, or 8.4%, to RR 8,488 million from RR 7,833 million in the corresponding period in 2016 mainly due to additions of property, plant and equipment at the Yarudeyskoye field (launched in December 2015) and at other fields of our production subsidiaries during the 12 months preceding the reporting period. We accrue depreciation and depletion using the "units-of-production" method for our oil and gas assets and using a straight-line method for other facilities.

Materials, services and other

In the three months ended 31 March 2017, our materials, services and other expenses increased by RR 334 million, or 7.5%, to RR 4,800 million compared to RR 4,466 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Employee compensation	2,179	1,787	21.9%
Repair and maintenance	580	483	20.1%
Complex of services for preparation, transportation and processing of hydrocarbons	494	653	(24.3%)
Materials and supplies	434	364	19.2%
Electricity and fuel	299	276	8.3%
Liquefied petroleum gas volumes reservation expenses	216	296	(27.0%)
Fire safety and assets security expenses	171	148	15.5%
Transportation services	170	152	11.8%
Rent expenses	68	60	13.3%
Insurance expense	50	78	(35.9%)
Other	139	169	(17.8%)
Total materials, services and other	4,800	4,466	7.5%

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Operating employee compensation increased by RR 392 million, or 21.9%, to RR 2,179 million compared to RR 1,787 million in the corresponding period in 2016. The increase was due to an increase in the average number of employees (primarily due to the development of our activities at the Yarudeyskoye field, which was launched in December 2015), an indexation of base salaries effective from 1 July 2016 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Repair and maintenance services expenses increased by RR 97 million, or 20.1%, to RR 580 million in the three months ended 31 March 2017 compared to RR 483 million in the corresponding period in 2016 primarily due to an increase in maintenance services expenses as a result of the development of our activities at the Yarudeyskoye field (launched in December 2015), as well as current repair and maintenance works for property, plant and equipment performed at our production and service subsidiaries.

Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our LPG produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses decreased by RR 159 million, or 24.3%, to RR 494 million in the three months ended 31 March 2017 compared to RR 653 million in the corresponding period in 2016 primarily due to a decrease in the contract rate for services at the Tobolsk Refining Facilities from January 2017.

Materials and supplies expenses increased by RR 70 million, or 19.2%, to RR 434 million in the three months ended 31 March 2017 compared to RR 364 million in the corresponding period in 2016 primarily due to purchases of raw materials by our service subsidiary NOVATEK-Energo to increase supply of power generation services to our joint ventures.

In the three months ended 31 March 2017, liquefied petroleum gas volumes reservation costs decreased by RR 80 million, or 27.0%, to RR 216 million from RR 296 million in the corresponding period in 2016 as a result of the average Russian rouble appreciation relative to the Polish zloty, since this expense is denominated in Polish zloty, as well as a decrease in LPG volumes sold through our subsidiary in Poland. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

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

General and administrative expenses

In the three months ended 31 March 2017, our general and administrative expenses decreased by RR 19 million, or 0.5%, to RR 3,993 million compared to RR 4,012 million in the corresponding period in 2016. The main components of these expenses were employee compensation and social expenses and compensatory payments, which, on aggregate, comprised 80.9% and 82.7% of total general and administrative expenses in the three months ended 31 March 2017 and 2016, respectively.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Employee compensation	2,564	3,039	(15.6%)
Social expenses and compensatory payments	665	280	137.5%
Legal, audit and consulting services	246	208	18.3%
Fire safety and security expenses	106	96	10.4%
Business travel expense	62	101	(38.6%)
Advertising expenses	49	21	133.3%
Repair and maintenance expenses	42	41	2.4%
Rent expense	24	48	(50.0%)
Other	235	178	32.0%
Total general and administrative expenses	3,993	4,012	(0.5%)

Employee compensation relating to administrative personnel decreased by RR 475 million, or 15.6%, to RR 2,564 million in the three months ended 31 March 2017 from RR 3,039 million in the corresponding period in 2016 mainly due to a decrease in bonuses accrued to key management.

In the three months ended 31 March 2017, our social expenses and compensatory payments increased by RR 385 million, or 137.5%, to RR 665 million compared to RR 280 million in the corresponding period in 2016 mainly due to increase in compensatory payments. These payments mainly related to the development of the Yarudeyskoye field and amounted to RR 364 million in the current reporting quarter. In the first quarter of 2016, compensatory payments were insignificant due to the allocation of payments to subsequent quarters in 2016. In addition, social expenses increased due to continued support of charities and social programs in the regions where we operate. Social expenses and compensatory payments fluctuate period-on-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

Exploration expenses

In the three months ended 31 March 2017, our exploration expenses increased by RR 178 million, or 84.8%, to RR 388 million from RR 210 million in the corresponding period in 2016 and mainly related to exploration works performed at the Trekhbugorniy license area in the current reporting period and at the Dorogovskoye field in the corresponding period in 2016. Exploration expenses include geological and geophysical research services expenditures, expenditures associated with the maintenance of license areas with non-proven reserves and other expenditures relating to exploration activity, as well as expenses of our science and technology center associated with the exploration activities at our fields. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

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

In the three months ended 31 March 2017, we recorded a charge of RR 602 million to changes in inventory expense compared to charge of RR 3,598 million in the corresponding period in 2016.

In the three months ended 31 March 2017, our cumulative natural gas inventory balance in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure decreased by 704 mmcm compared to a decrease in inventory balances by 898 mmcm in the corresponding period in 2016. The decrease in inventory balances in both reporting quarters was due to a seasonal withdrawal of natural gas during the period of higher demand to fulfil our contractual sales obligations.

In the three months ended 31 March 2017, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, decreased by 90 thousand tons compared to decrease by 298 thousand tons in the corresponding period in 2016 mainly due to a decrease in inventory balance of stable gas condensate refined products in storage capacities of our Ust-Luga Complex. Inventory balances of stable gas condensate and refined products tend to fluctuate period-to-period depending on shipment schedules and final destination of our shipments.

The following table highlights movements in our hydrocarbons inventory balances:

<i>Inventory balances in transit or in storage</i>	2017			2016		
	At 31 March	At 1 January	Increase / (decrease)	At 31 March	At 1 January	Increase / (decrease)
Natural gas (millions of cubic meters)	130	834	(704)	429	1,327	(898)
<i>including Gazprom's UGSF</i>	-	787	(787)	363	1,245	(882)
Liquid hydrocarbons (thousand tons)	813	903	(90)	612	910	(298)
<i>including naphtha</i>	205	267	(62)	120	184	(64)
<i>stable gas condensate</i>	258	307	(49)	247	369	(122)
<i>crude oil</i>	177	105	72	121	157	(36)

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 31 March 2017, we recognized other operating income of RR 274 million compared to other operating income of RR 971 million in the corresponding period in 2016.

In the three months ended 31 March 2017, within our trading activities we purchased and sold approximately 0.9 bcm of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized loss from trading activities of RR 30 million as compared to RR 704 million of income in the corresponding period in 2016. At the same time, we recognized a non-cash income of RR 211 million in the three months ended 31 March 2017, as a result of an increase in the fair value of aforementioned contracts as compared to RR 326 million non-cash income in the corresponding period in 2016.

Net gain on disposal of interests in joint ventures

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

Profit from operations and EBITDA

Our profit from operations before disposals of interests in joint ventures increased by RR 2,375 million, or 5.5%, to RR 45,538 million in the three months ended 31 March 2017, as compared to RR 43,163 million in the corresponding period in 2016 mainly due to increases in natural gas sales volumes and average realized prices for liquid hydrocarbons. At the same time our share in the profit from operations of our joint ventures increased by RR 4,246 million, or 75.0%, to RR 9,906 million compared to RR 5,660 million in the corresponding period in 2016 (see "Share of profit (loss) of joint ventures, net of income tax" below).

Our EBITDA, normalized for the effect of the disposal of interests in joint ventures, increased by RR 6,044 million, or 9.7%, to RR 68,180 million in the three months ended 31 March 2017 from RR 62,136 million in the corresponding period in 2016 also mainly due to increases in natural gas sales volumes and average realized prices for liquid hydrocarbons.

Finance income (expense)

In the three months ended 31 March 2017, we recorded a net finance expense of RR 8,602 million compared to a net finance income of RR 916 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Accrued interest expense on loans received	(2,958)	(5,253)	(43.7%)
Less: capitalized interest	890	1,721	(48.3%)
Provisions for asset retirement obligations:			
effect of the present value discount unwinding	(165)	(122)	35.2%
Interest expense on lease liabilities	(5)	-	n/a
Interest expense	(2,238)	(3,654)	(38.8%)
Interest income	4,521	5,055	(10.6%)
Change in fair value of non-commodity financial instruments	(7,110)	731	n/a
Foreign exchange gain (loss), net	(3,775)	(1,216)	210.4%
Total finance income (expense)	(8,602)	916	n/a

In the three months ended 31 March 2017, our interest expense decreased by RR 1,416 million, or 38.8%, to RR 2,238 million primarily due to partial repayments of the Group's borrowings, as well as the appreciation of the Russian rouble relative to the US dollar and Euro (most of our long-term borrowings are denominated in foreign currencies).

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Interest income decreased by RR 534 million, or 10.6%, to RR 4,521 million in the three months ended 31 March 2017 from RR 5,055 million in the corresponding period in 2016 primarily due to the appreciation of the average exchange rate of the Russian rouble relative to the US dollar and Euro in the three months ended 31 March 2017 compared to the average exchange rate in the corresponding period in 2016.

In the three months ended 31 March 2017, we recognized a non-cash loss of RR 7,110 million compared to a non-cash gain of RR 731 million in the corresponding period in 2016 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IAS 39 "*Financial instruments: recognition and measurement*". The effect of the fair value remeasurement of shareholders' loans may change period-to-period due to the change in market interest rates and other macroeconomic parameters and does not affect real future cash flows of loans repayments.

The Group continues to record non-cash foreign exchange gains and losses each reporting period due to movements between currency exchange rates. In the three months ended 31 March 2017, we recorded a net foreign exchange loss of RR 3,775 million compared to a net loss of RR 1,216 million in the corresponding period in 2016 due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

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

In the three months ended 31 March 2017, the Group's proportionate share of profit of joint ventures significantly increased by RR 20,245 million, or 86.6%, to RR 43,626 million as compared to RR 23,381 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change
	2017	2016	%
Share in profit from operations	9,906	5,660	75.0%
Share in finance income (expense)			
Share in interest income (expense), net	(3,091)	(4,068)	(24.0%)
Share in foreign exchange gain (loss), net	35,219	26,600	32.4%
Share in change in fair value of non-commodity financial instruments	10,755	(206)	n/a
Total share in finance income (expense)	42,883	22,326	92.1%
Share in total income tax benefit (expense)	(9,163)	(4,605)	99.0%
Total share of profit (loss) of joint ventures, net of income tax	43,626	23,381	86.6%

Our proportionate share in the profit from operations of our joint ventures increased by RR 4,246 million, or 75.0%, primarily due to an increase in revenues from liquids sales as a result of higher average realized prices. The impact of this factor was partially offset by an increase in the unified natural resources production tax expense due to increased UPT rates for crude oil and gas condensate effective 1 January 2017 (see "Our tax burden and obligatory payments" above).

In the three months ended 31 March 2017, our proportionate share in the finance income of our joint ventures significantly increased by RR 20,557 million, or 92.1%, due to a recognition in the current reporting period of a significant non-cash gain from the remeasurement of the fair value of shareholders' loans in our joint ventures Yamal LNG and Terneftegas (our share amounted to RR 10.8 billion), as well as a RR 8.6 billion, or 32.4%, increase of our share in foreign exchange gains on foreign currency denominated loans in our joint ventures. The remaining changes in both reporting periods primarily related to our share in interest expense of our joint ventures.

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Income tax expense

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

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

Without the effect of net profit (loss) and dividends from joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of profit before income tax) in the three months ended 31 March 2017 and 2016, was 20.0% and 19.8%, respectively.

Profit attributable to shareholders and earnings per share

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK decreased by RR 44,899 million, or 38.7%, to RR 71,018 million in the three months ended 31 March 2017 compared to RR 115,917 million in the corresponding period in 2016.

Some of the major factors that had an effect on the Group's financial result were the recognition of significant non-cash foreign exchange gains (losses) on foreign currency denominated loans of the Group and its joint ventures in both reporting periods, and the recognition of a gain on the disposal of interests in joint ventures in the first quarter of 2016. Excluding the one-time effect from the disposal of interests in joint ventures and the effect of foreign exchange gains and losses, our profit attributable to shareholders of PAO NOVATEK increased by RR 7,446 million, or 20.2%, and amounted to RR 44,345 million in the three months ended 31 March 2017 compared to RR 36,899 million in the corresponding period in 2016 (see the table below):

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Profit attributable to shareholders of PAO NOVATEK	71,018	115,917	(38.7%)
Net gain on disposal of interests in joint ventures	-	(73,072)	n/a
Income tax expense relating to the disposal of interests in joint ventures	-	15,395	n/a
Normalized profit attributable to shareholders of PAO NOVATEK	71,018	58,240	21.9%
Foreign exchange (gains) losses	3,775	1,216	210.4%
Income tax expense (benefit) relating to foreign exchange (gains) losses	(755)	(243)	210.7%
Share of foreign exchange (gains) losses of joint ventures	(35,219)	(26,600)	32.4%
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	5,526	4,286	28.9%
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	44,345	36,899	20.2%

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK decreased by RR 14.86 per share, or 38.7%, to RR 23.54 per share in the three months ended 31 March 2017 from RR 38.40 per share in the corresponding period in 2016. Excluding the effects of the disposals of interests in joint ventures and foreign exchange gains and losses, our weighted average basic and diluted earnings per share increased by RR 2.48, or 20.2%, to RR 14.70 per share in the three months ended 31 March 2017 from RR 12.22 per share in the corresponding period in 2016.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Net cash provided by operating activities	48,842	54,424	(10.3%)
Net cash provided by (used for) investing activities	(2,963)	63,500	n/a
Net cash used for financing activities	(26,918)	(58,707)	(54.1%)

Net cash provided by operating activities

Our net cash provided by operating activities decreased by RR 5,582 million, or 10.3%, to RR 48,842 million compared to RR 54,424 million in the corresponding period of 2016. The decrease was primarily due to changes in working capital (mainly as a result of significant amounts of VAT recovered in the first quarter of 2016), that was partially offset by an increase in profit from operations before disposals of interests in joint ventures adjusted for non-cash items.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Profit from operations before disposals of interests in joint ventures	45,538	43,163	5.5%
Non-cash adjustments ⁽¹⁾	8,264	7,685	7.5%
Changes in working capital and long-term advances given	1,838	9,892	(81.4%)
Interest received	1,010	202	400.0%
Income taxes paid	(7,808)	(6,518)	19.8%
Total net cash provided by operating activities	48,842	54,424	(10.3%)

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

Net cash provided by (used for) investing activities

In the three months ended 31 March 2017, our net cash used for investing activities amounted to RR 2,963 million compared to RR 63,500 million provided by investing activities in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Cash used for capital expenditures	(4,738)	(8,976)	(47.2%)
Payments for mineral licenses	(59)	(294)	(79.9%)
Repayments of loans provided to joint ventures	2,161	-	n/a
Loans provided to joint ventures	-	(6,645)	n/a
Proceeds from disposal of stakes in joint ventures net of costs to sell, net	-	82,344	n/a
Payments for acquisition of subsidiaries net of cash acquired	-	(2,929)	n/a
Other	(327)	-	n/a
Net cash provided by (used for) investing activities	(2,963)	63,500	n/a

Cash used for capital expenditures decreased by RR 4,238 million, or 47.2%, as compared to the 2016 reporting period. In the 2017 reporting period, cash was mainly used for the ongoing development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits and the development of the Salmanovskoye (Utrenneye), West-Yurkharovskoye and North-Russkoye fields.

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In the three months ended 31 March 2017, we paid a part of a one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field in the amount of RR 59 million. In the 2016 reporting period, we made an advance payment in the amount of RR 294 million for participation in auction for exploration and production license for the Nyakhartinskiy license area, located in YNAO.

In the three months ended 31 March 2017, we received RR 2,161 million due to a partial repayment of the loans provided to Yamal Development and Terneftegas, while in the 2016 reporting period, we provided loans to our joint venture Yamal LNG in the amount of RR 6,645 million.

In the 2016 reporting period, we received RR 82,344 million (net of costs to sell) for the sale of the 9.9% equity stake in Yamal LNG in March 2016.

In the 2016 reporting period, we made a final payment in the amount of RR 2,929 million (USD 39 million) for the 100% equity stake in AO Office acquired in August 2014.

Net cash used for financing activities

In the three months ended 31 March 2017, our net cash used for financing activities decreased by RR 31,789 million, or 54.1%, to RR 26,918 million as compared to RR 58,707 million in the corresponding period in 2016.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Repayments of long-term debt	(24,524)	(54,959)	(55.4%)
Proceeds from (repayments of) short-term debt with original maturity three months or less, net	13	(436)	n/a
Interest paid	(1,755)	(3,209)	(45.3%)
Payments of lease liabilities	(34)	-	n/a
Purchase of treasury shares	(618)	(103)	n/a
Net cash used for financing activities	(26,918)	(58,707)	(54.1%)

In both reporting periods we did not obtain long-term loans.

In the current reporting period the Group fully repaid four-year Rouble denominated Eurobonds in the amount of RR 14 billion according to the bonds maturity schedule, partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,788 million (USD 115 million), as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In the first quarter of 2016, the Group fully repaid five-year US dollar denominated Eurobonds in the amount of RR 46,756 million (USD 600 million) according to the bonds maturity schedule, as well as partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 8,203 million (USD 115 million).

In both reporting periods we obtained short-term loans to finance trade activities and the total amount of short-term loans repayments substantially corresponded to the amount of proceeds.

The remaining change primarily related to the repayment of interest on borrowings and loans.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2017 and 2016****Liquidity and working capital**

The following table shows our liquidity and credit measures as of 31 March 2017 and 31 December 2016:

	31 March 2017	31 December 2016	Change, %
Absolute amounts, RR million			
Net debt ⁽¹⁾	114,413	168,464	(32.1%)
Net working capital position ⁽²⁾	56,290	23,969	134.8%
Liquidity and credit ratios			
Current ratio ⁽³⁾	1.66	1.22	36.1%
Total debt to total equity	0.25	0.33	(24.2%)
Long-term debt to long-term debt and total equity	0.16	0.20	(20.0%)
Net debt to total capitalization ⁽⁴⁾	0.12	0.19	(36.8%)
Net debt to normalized EBITDA from subsidiaries ⁽⁵⁾	0.60	0.89	(32.6%)

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

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

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

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

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

In the three months ended 31 March 2017, we repaid long-term debt in the aggregate amount of approximately RR 25 billion. As a result, the Group's net debt decreased by 32.1% and net working capital position amounted to RR 56.3 billion as of 31 March 2017.

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

Capital expenditures

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

<i>millions of Russian roubles</i>	Three months ended 31 March:	
	2017	2016
East-Tarkosalinskoye field	826	1,279
Salmanovskoye (Utrenneye) field	515	684
Yarudeyskoye field	447	3,278
West-Yurkharovskoye field	416	119
North-Russkoye field	331	226
Infrastructure for future LNG projects	295	147
Yurkharovskoye field	156	1,284
Other	775	1,050
Capital expenditures	3,761	8,067

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2017 decreased by RR 4,306 million, or 53.4%, to RR 3,761 million from RR 8,067 million in the corresponding period in 2016. In both reporting periods, our main capital expenditures related to the ongoing development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, as well as the development of the Salmanovskoye (Utrenneye) field. In addition, in the 2017 reporting period, we increased our investments in the development of the West-Yurkharovskoye and North-Russkoye fields.

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

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2017	2016	
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	4,056	8,067	(49.7%)
Less: acquisition of mineral licenses	(295)	-	n/a
Capital expenditures	3,761	8,067	(53.4%)
Add (less): change in accounts payable and other non-cash adjustments	977	909	7.5%
Cash used for capital expenditures ⁽¹⁾	4,738	8,976	(47.2%)

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

The acquisition of mineral licenses of RR 295 million related to the stated one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field, of which RR 59 million was paid in the first quarter of 2017.

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 March 2017, the total amount of our long-term debt denominated in US dollars was RR 137,661 million, or 76.7% of our total borrowings at that date. Changes in the value of the Russian rouble relative to foreign currencies will impact our foreign currency-denominated costs and expenses, our debt service obligations for foreign currency-denominated borrowings, as well as receivables at our foreign subsidiaries in Russian rouble terms. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, 38.5% in the three months ended 31 March 2017, was denominated in foreign currencies.

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

As of 31 March 2017, the Russian rouble appreciated by 7.1% and 5.0% against the US dollar and the Euro, respectively, compared to 31 December 2016 (see "Selected macro-economic data" above).

Commodity risk

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

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

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

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

Pipeline access

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

Ability to reinvest

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

Forward-looking statements

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

Off balance sheet activities

As of 31 March 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

TERMS AND ABBREVIATIONS

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