NOVATEK

OAO NOVATEK

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

FOR THE THREE MONTHS ENDED 31 MARCH 2016 AND 2015

TABLE OF CONTENTS

General Provisions 3
Overview 3
Recent Developments 4
Selected data 5
Selected macro-economic data 7
Certain Factors Affecting our Results of Operations 8
    Current economic conditions 8
    Natural gas prices 8
    Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices 10
    Transportation tariffs 13
    Our tax burden and obligatory payments 14
Operational Highlights 17
Results of Operations for the three months ended 31 March 2016
compared to the corresponding period in 2015 21
    Total revenues 22
    Operating expenses 25
    Other operating income (loss) 30
    Net gain on disposal of interests in joint ventures 30
    Profit from operations and EBITDA 30
    Finance income (expense) 31
    Share of profit (loss) of joint ventures, net of income tax 32
    Income tax expense 32
    Profit attributable to shareholders and earnings per share 32
Liquidity and Capital Resources 34
    Cash flows 34
    Working capital 36
    Capital expenditures 36
Qualitative and quantitative disclosures and market risks 38
Terms and abbreviations 40

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

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

OVERVIEW

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

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

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

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

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

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

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

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

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

The Group, jointly with our international partners TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through our joint venture OAO Yamal LNG, undertakes a large-scale project on constructing a liquefied natural gas plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula (the "Yamal LNG project"). The Yamal LNG project also requires the construction of transportation infrastructure, including the seaport and the international airport. Commercial launch of the LNG plant and start of liquefied natural gas shipments is planned in 2017. It is expected that the produced LNG will be sold mainly to the Asian-Pacific Region ("APR") and to the European market. The Yamal LNG project has now concluded the sale of more than 95% of LNG volumes produced under long-term contractual agreements. The remaining portion of LNG will be sold on the spot market.

RECENT DEVELOPMENTS

Increasing our production and utilization of refining capacity

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

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

Increasing our resource base

In April 2016, based on auction results held by the Federal Agency for the Use of Natural Resources of the Russian Federation, the Group won the right for geological research works, exploration and production of hydrocarbons at the Nyakhartinskiy license area located in the Yamal-Nenets Autonomous region ("YNAO") in close proximity to our Yurkharovskoye field. As of 31 December 2015, the field's recoverable reserves according to the Russian reserve classification C3+D totaled 215 billion cubic meters ("bcm") of natural gas and more than 70 million tons of liquid hydrocarbons. The payment for the license was set at RR 1,057 million. The acquisition of a new license is an important step to the expansion of the resource base which is consistent with the Group's long-term development strategy.

Implementing our Yamal LNG project

In December 2015, NOVATEK and China's Silk Road Fund Co. Ltd. signed an agreement on the acquisition of a 9.9% equity stake in Yamal LNG by the fund. In March 2016, the transaction was closed upon the completion of the conditions precedent. As a result of the transaction, the Group's interest in Yamal LNG was reduced from 60% to 50.1%. The Group continues to exercise joint control over Yamal LNG and, accordingly, recognizes the project as a joint venture. The entrance of Silk Road Fund Co. Ltd. to the Yamal LNG project is an important step in the execution of our long-term development strategy for this project.

In April 2016, Yamal LNG signed contracts with two major Russian banks on obtaining a 15-year tenor syndicated term credit line facility in the amount of EUR 3.6 billion. The signing of these credit agreements contributes to the planned financing of the project and its further successful realization.

SELECTED DATA

millions of Russian roubles except as stated	Three months ended 31 March: 2016	2015	Change %
Financial results			
Total revenues [1]	139,351	113,742	22.5%
Operating expenses	(97,159)	(73,896)	31.5%
Normalized EBITDA [2],[3]	62,136	54,832	13.3%
Normalized profit attributable to shareholders of OAO NOVATEK [3]	58,240	31,075	87.4%
Normalized earnings per share [3] (in Russian roubles)	19.29	10.29	87.5%
Net debt [4]	203,019	206,926	(1.9%)
Production volumes [5]			
Hydrocarbons production (million barrels of oil equivalent)	139.5	122.6	13.8%
Daily production (million barrels of oil equivalent per day)	1.53	1.36	13.8%
Operating results			
Natural gas sales volumes (million cubic meters)	17,775	15,977	11.3%
Crude oil sales volumes (thousand tons)	1,188	271	338.4%
Naphtha sales volumes (thousand tons)	1,151	1,127	2.1%
Stable gas condensate sales volumes (thousand tons)	868	276	214.5%
Other gas condensate refined products (thousand tons) [6]	730	710	2.8%
Liquefied petroleum gas sales volumes (thousand tons)	703	448	56.9%
Cash flow results			
Net cash provided by operating activities	54,424	39,717	37.0%
Cash used for capital expenditures [7]	8,976	9,319	(3.7%)
Free cash flow [8]	45,448	30,398	49.5%

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

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

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

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

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

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

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

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

Reconciliation of EBITDA and normalized EBITDA is as follows:

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Profit	**117,577**	**30,745**	**282.4%**
Depreciation, depletion and amortization	7,833	4,515	73.5%
Net impairment reversals (expenses)	153	29	n/a
Loss (income) from changes in fair value of commodity derivative instruments	(326)	513	n/a
Total finance expense (income)	(916)	7,246	n/a
Total income tax expense	22,955	5,930	287.1%
Share of loss (profit) of joint ventures, net of income tax	(23,381)	(4,274)	n/a
EBITDA from subsidiaries	**123,895**	**44,704**	**177.1%**
Share in EBITDA of joint ventures	11,313	10,128	11.7%
EBITDA	**135,208**	**54,832**	**146.6%**
Net gain on disposal of interests in joint ventures	(73,072)	-	n/a
Normalized EBITDA	**62,136**	**54,832**	**13.3%**
Normalized EBITDA from subsidiaries	**50,823**	**44,704**	**13.7%**

SELECTED MACRO-ECONOMIC DATA

Exchange rate, Russian roubles for one foreign currency unit [1]	Three months ended 31 March: 2016	2015	Change %
US dollar (USD)			
Average for the period	74.63	62.19	20.0%
At the beginning of the period	72.88	56.26	29.5%
At the end of the period	67.61	58.46	15.7%
Depreciation (appreciation) of Russian rouble to US dollar	(7.2%)	3.9%	n/a
Euro			
Average for the period	82.34	70.43	16.9%
At the beginning of the period	79.70	68.34	16.6%
At the end of the period	76.54	63.37	20.8%
Depreciation (appreciation) of Russian rouble to Euro	(4.0%)	(7.3%)	n/a

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

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Average for the period	Three months ended 31 March: 2016	2015	Change %
Benchmark crude oil prices [2]			
Brent, USD per barrel	33.9	53.9	(37.1%)
Urals, USD per barrel	32.2	52.9	(39.1%)
Urals, Russian roubles per barrel	2,403	3,290	(27.0%)
Benchmark crude oil prices excluding export duties [3]			
Urals, USD per barrel	24.7	35.1	(29.6%)
Urals, Russian roubles per barrel	1,843	2,183	(15.6%)
World market prices for oil products [4] **and liquefied petroleum gas** [5]**, USD per ton**			
Naphtha Japan	345	493	(30.0%)
Naphtha CIF NWE	320	468	(31.6%)
Jet fuel	342	565	(39.5%)
Gasoil	310	519	(40.3%)
Fuel oil	147	292	(49.7%)
Liquefied petroleum gas	232	316	(26.6%)
Export duties, USD per ton [6]			
Crude oil, stable gas condensate	54.9	129.6	(57.6%)
Liquefied petroleum gas	0.0	16.1	(100.0%)
Naphtha	39.0	110.1	(64.6%)
Jet fuel, gasoil	22.0	62.1	(64.6%)
Fuel oil	45.0	98.5	(54.3%)

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

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

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

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

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current economic conditions

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

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

In 2015, the Central Bank's lending rates were gradually decreasing, whereas the Russian rouble exchange rates relative to world currencies and benchmark commodity prices in international markets remained volatile during the whole year 2015 and later in the first quarter of 2016. Volatility of the world commodity prices continues to exert significant influence on financial and operations results in the global oil and gas industry, and this present macro situation is expected to remain volatile throughout 2016 as present crude oil supplies exceed world demand. Our financial results are obviously impacted by these global developments as our export sales are linked to the specific underlying benchmark commodity prices but we believe our business model representing one of the lowest cost producers in the world insulates us from severe financial and operational stress. We do not expect any asset impairments or write-offs resulting from a lower commodity price environment.

Management continues to closely monitor the economic and political environment in Russia and abroad, including the domestic and international capital markets, to determine if any further corrective and/or preventive measures are required to sustain and grow our business. We are also closely monitoring the present commodity price environment and its impact on our business operations.

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

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

Natural gas prices

The Group's natural gas prices on the domestic market are strongly influenced by the prices set by a federal executive agency of the Russian Federation that carries out governmental regulation of prices and tariffs for products and services of natural monopolies in energy, utilities and transportation (the "Regulator"), as well as present market conditions. During the first half of 2015, the Federal Tariffs Service ("FTS") fulfilled the Regulator's role. In July 2015, a Decree of the President of the Russian Federation became effective abolishing the FTS and transferring its functions to the Federal Anti-Monopoly Service.

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

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

In October 2015, the Ministry of Economic Development of the Russian Federation published the "Forecast of Socio-economic Development of the Russian Federation for 2016 and planned period 2017 and 2018" based on which wholesale natural gas prices for sales to all customer categories (excluding residential customers) in July 2016, 2017 and 2018 will be increased by an average of 2.0%, 3.0% and 3.0%, 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.

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

The specific terms for delivery of natural gas affect our average realized prices. The majority of our natural gas volumes are sold directly to end-customers in the regions of natural gas consumption, so transportation tariff to the end customer's location is included in the contract sales price. The remaining small volumes of natural gas we sell "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, from time to time, based on market situation we sell natural gas at the Saint-Petersburg International Mercantile Exchange. We disclose such sales within our sales to end-customers category.

In the three months ended 31 March 2016, our average natural gas price on end-customers sales increased by 4.0% due to an increase in the average regulated price by 7.5% effective 1 July 2015 partially offset by an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the respective period in 2015. The change in the sales geography also reduced our average transportation expense per mcm by 1.7% despite a 2.0% increase in the natural gas transportation tariff set by the Regulator effective 1 July 2015 (see "Transportation tariffs" below). As a result, the average natural gas price on end-customers sales excluding transportation expenses increased by 7.7%.

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

Russian roubles per mcm	**Three months ended 31 March: 2016**	**2015**	**Change %**
Average natural gas price to end-customers [1]	3,586	3,447	4.0%
Average natural gas transportation expense for sales to end-customers	(1,331)	(1,354)	(1.7%)
Average natural gas price on end-customer sales excluding transportation expense	2,257	2,096	7.7%
Average natural gas price ex-field (wholesale traders)	2,051	1,831	12.0%
Total average natural gas price excluding transportation expense	**2,237**	**2,081**	**7.5%**

[1] Includes cost of transportation.

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

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

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

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

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

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

Stable gas condensate and refined products

As a result of the launch of new fields and full capacity utilization of our Ust-Luga Complex (see “Recent developments” above), we commenced export sales of stable gas condensate effective March 2015. In the three months ended 31 March 2016, our average realized stable gas condensate export contract price, including export duties, significantly decreased by USD 227, or 43.5%, to approximately USD 295 per ton compared to USD 522 in the corresponding period in 2015 as a result of a decrease in the underlying crude oil and oil products prices on the international markets used in the price calculation (see “Selected macro-economic data” above).

At the same time our average realized net export price, excluding export duties, decreased to a lesser extent, by USD 167.7, or 41.3%, to USD 238.4 per ton due to a decrease in average export duties (see “Selected macro-economic data” above). Our average realized net export price for stable gas condensate in Russian roubles terms decreased by 28.8% as a 20.0% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 31 March 2016 compared to the corresponding period in 2015 partially offset the effect of the benchmark prices decrease.

In the three months ended 31 March 2016, our average realized export contract prices for naphtha and other gas condensate refined products produced at the Ust-Luga Complex, including export duties, decreased by USD 148 and USD 185 per ton, or 28.7% and 37.4%, to approximately USD 368 and USD 309 per ton, respectively. The decrease in our average realized export contract prices was as a result of a decrease in the underlying commodity prices of the respective products on the international markets used in the price calculation (see “Selected macro-economic data” above).

At the same time our average realized net export prices, excluding export duties, for naphtha and other gas condensate refined products produced at the Ust-Luga Complex in the three months ended 31 March 2016, decreased to a lesser extent, by USD 61.7 and USD 140.8 per ton, or 15.7% and 33.5%, and amounted to USD 330.5 and USD 279.1 per ton, respectively, due to a significant decrease in average export duties (see "Selected macro-economic data" above). Our average realized net export prices for naphtha and other gas condensate refined products in Russian roubles increased by 0.7% and decreased by 20.6%, respectively, due to a 20.0% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 31 March 2016 compared to the corresponding period in 2015.

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

In the three months ended 31 March 2016 and 2015, we sold small volumes of other gas condensate refined products produced at the Ust-Luga Complex domestically. Prices were set on an individual transaction basis and in the three months ended 31 March 2016, our average realized price amounted to RR 15,271 per ton (excluding VAT), representing a decrease of RR 4,987 per ton, or 24.6%, as compared to the corresponding period in 2015. We expect that we will continue to sell some volumes of other gas condensate refined products domestically.

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

Russian roubles or US dollars per ton	**Three months ended 31 March: 2016**	**2015**	**Change %**
Stable gas condensate			
Net export price, RR per ton	17,649	24,796	(28.8%)
Net export price, USD per ton	238.4	406.1	(41.3%)
Domestic price, RR per ton	11,889	13,114	(9.3%)
Naphtha			
Net export price, RR per ton	24,517	24,354	0.7%
Net export price, USD per ton	330.5	392.2	(15.7%)
Other gas condensate refined products			
Net export price, RR per ton	20,704	26,078	(20.6%)
Net export price, USD per ton	279.1	419.9	(33.5%)
Domestic price, RR per ton	15,271	20,258	(24.6%)

Liquefied petroleum gas

In the three months ended 31 March 2016, our average realized LPG export contract price, including export duties, excise and fuel taxes expense, and excluding trading activities, decreased by USD 35 per ton, or 7.5%, and was approximately USD 432 per ton compared to USD 467 per ton in the corresponding period in 2015. The decrease in our average realized contract price was due to a decrease in the underlying benchmark prices for LPG on international markets used in price calculation (see "Selected macro-economic data" above). The impact of this factor was partially offset by an increase in LPG deliveries through the terminal points in Poland with higher contract prices compared to sales at the border of the customer's country.

Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense, decreased by USD 28.6 per ton, or 8.6%, to USD 303.3 per ton from USD 331.9 per ton. Despite a decrease in the average realized net export price in US dollars, our average realized LPG net export price in Russian roubles terms increased by 9.7% due to a 20.0% increase in average exchange rate of US dollar to Russian rouble in the three months ended 31 March 2016 compared to the corresponding period in 2015.

In both reporting periods our LPG export delivery terms were DAP at the border of the customer's country or free carrier (FCA) at terminal points in Poland. In the three months ended 31 March 2015, we also sold our LPG under carriage paid to (CPT) the Port of Temryuk (southern Russia) delivery terms.

In the three months ended 31 March 2016, our average realized LPG domestic price decreased by RR 3,280 per ton, or 35.8%, to RR 5,890 per ton from RR 9,170 per ton in the corresponding period in 2015. A decrease in our average realized price was due to the reallocation of our LPG sales volumes in favor of ex-works Purovsky Plant and Tobolsk Refining Facilities sales with no additional associated transportation expenses. In addition, decreased underlying benchmark prices for LPG on international markets and increased transportation tariffs also negatively impacted our average realized domestic prices as these figures form the basis for the price setting of some LPG deliveries.

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

	Three months ended 31 March:		Change
Russian roubles or US dollars per ton	**2016**	**2015**	**%**
LPG			
Net export price, RR per ton	22,633	20,639	9.7%
Net export price, USD per ton	303.3	331.9	(8.6%)
Domestic price, RR per ton	5,890	9,170	(35.8%)

Crude oil

Our average realized crude oil export contract price, including export duties, decreased by USD 143 per ton, or 38.5%, and was approximately USD 228 per ton compared to USD 371 per ton in the corresponding period in 2015. The decrease in our average crude oil contract price was a result of a decrease in the Brent benchmark crude oil price on the international markets used as the base for price setting (see “Selected macro-economic data” above).

At the same time our average realized crude oil net export price, excluding export duties, decreased to a lesser extent, by USD 63.5 per ton, or 26.4%, to USD 177.4 per ton from USD 240.9 per ton in the corresponding period in 2015 due to a significant decrease of 57.6% in the average export duty per ton set by the Russian Federation government (see “Selected macro-economic data” above). Our average realized crude oil net export price in Russian roubles decreased by 14.7% as a 20.0% increase in the average exchange rate of the US dollar to the Russian rouble in the three months ended 31 March 2016 compared to the corresponding period in 2015 partially offset the effect of the benchmark prices decrease.

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

In the three months ended 31 March 2016, our average realized crude oil domestic price was RR 11,183 per ton (excluding VAT) representing a decrease of RR 2,796 per ton, or 20.0%, from RR 13,979 per ton (excluding VAT) in the corresponding period in 2015 due to price changes on the domestic market (which were in line with the changes in benchmark crude oil prices excluding export duties), as well as an increase in crude oil deliveries to closer regions.

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

	Three months ended 31 March:		Change
Russian roubles or US dollars per ton	**2016**	**2015**	**%**
Crude oil			
Net export price, RR per ton	12,950	15,188	(14.7%)
Net export price, USD per ton	177.4	240.9	(26.4%)
Domestic price, RR per ton	11,183	13,979	(20.0%)

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 for the use of the Gas Transmission System ("GTS"), as part of the UGSS, by independent producers are set by the Regulator (see "Terms and abbreviations" below).

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

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

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

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in October 2015, the increase in transportation tariffs for natural gas produced by independent producers in 2016, 2017 and 2018 will be in line with the increase in 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 produced at the Purovsky Plant and LPG received from the processing at the Tobolsk Refining Facilities by rail owned by Russia's state-owned monopoly railway operator – OAO Russian Railways ("RZD").

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

Effective 1 January 2015, the Regulator increased railroad freight transportation tariffs for all types of hydrocarbons by 10%, and until the end of 2015 transportation tariffs did not change. Effective 3 January 2016, the Regulator increased railroad freight transportation tariffs for all types of hydrocarbons by an additional 9%, which corresponded to the Ministry of Economic Development Forecast published in October 2015.

In 2015 and in the first quarter of 2016, we applied the discount coefficient of 0.94 to the existing railroad transportation tariffs for stable gas condensate deliveries from the Limbey rail station to the Port of Ust-Luga and to end-customers on the domestic and export (only in 2016) markets. The discount coefficient is set by the decision of the Management Board of RZD as part of the Strategic Partnership Agreement between the Group and RZD.

Stable gas condensate and refined products by tankers

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

Crude oil

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

Effective 1 January 2015, crude oil transportation tariffs within the Russian Federation territory through the pipeline network were increased by an average of 6.75% and did not change until the end of 2015. Effective 1 January 2016, crude oil transportation tariffs were increased by an average of 5.76% relative to the 2015 tariffs.

Our tax burden and obligatory payments

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

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

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

The tax maneuver in the oil and gas industry

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

UPT – natural gas and gas condensate

In accordance with the Tax Code of the Russian Federation, the UPT rates for natural gas and gas condensate are calculated monthly according to a formula based on which the set base UPT rate is multiplied by the base value of a standard fuel equivalent and a coefficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field. The base UPT rate is set at RR 35 per one thousand cubic meters of extracted natural gas and at RR 42 per one ton of extracted gas condensate. The base value of a standard fuel equivalent is calculated monthly and depends primarily on natural gas prices, Urals crude oil prices and crude oil export duty rate. A coefficient characterizing the difficulty of extracting natural gas and gas condensate defined as a minimum value from the coefficients characterizing either the reserves' depletion, the field's geographical location, the deposit's (or reservoir's) depth, assignment of the field to the regional gas supply chain or particular features of certain field deposits development.

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

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

UPT – crude oil

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

In both reporting periods, in accordance with the Tax Code of the Russian Federation, we applied a reduced UPT rate for crude oil produced at our Yurkharovskoye, East-Tarkosalinskoye, Khancheyskoye and Yarudeyskoye fields since these fields are located fully or partially to the north of the 65th degree of the northern latitude fully or partially in the YNAO. In 2016, the UPT rate for crude oil produced at the aforementioned fields was calculated using an effective rate of RR 298 per ton (increased by 26.3% compared to 2015) multiplied by a coefficient characterizing the dynamics of world crude oil prices. From 1 January 2017, the effective rate will be set at RR 360 per ton.

Export duties

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

The export duty rate for stable gas condensate and crude oil for the next calendar month is calculated based on the average Urals crude oil price for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month. In 2015, the calculation of the export duty rate when the average Urals crude oil price is more than USD 182.5 per ton was set as follows: USD 29.2 plus 42% of the difference between the average Urals crude oil price and USD 182.5 per ton. As part of the tax maneuver in the oil and gas industry (see above), effective 1 January 2016 and 2017, the set percentage should have been decreased to 36% and 30%, respectively. However, in order to increase state budget income in 2016 in the anticipation of a lower crude oil price environment, in November 2015, the Russian Federation government made a decision not to adjust the formula for crude oil export duty rate calculation in 2016 and to keep a set percentage at the 2015 level of 42%.

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

% from the crude oil export duty rate	**2015**	**2016**	**2017 and further**
Naphtha	85%	71%	55%
Jet fuel	48%	40%	30%
Gasoil	48%	40%	30%
Fuel oil	76%	82%	100%

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

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

Average LPG price, USD per ton (P)	**Formula for export duty rate calculation**
less 490 (inclusive)	Zero rate
between 490 and 640 (inclusive)	0,5 × (P – 490)
between 640 and 740 (inclusive)	75 + 0,6 × (P – 640)
above 740	135 + 0,7 × (P – 740)

As the average LPG price for the export duty rate calculation was below USD 490 per ton, in both reporting periods (except for January 2015) we applied a zero export duty rate in respect of our LPG export sales.

Social contributions

In both reporting periods the rates for social contributions to the Pension Fund of the Russian Federation, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund of the Russian Federation paid by the employer on behalf of employees did not change and were set at 22.0%, 5.1% and 2.9%, respectively (cumulatively 30.0%).

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

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

The table below provides for the rates and maximum taxable bases set by the Russian Federation government for social contributions in 2015 and 2016:

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

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

Our natural gas sales volumes in the three months ended 31 March 2016, increased by 1,798 mmcm, or 11.3%, as a result of natural gas sales at the Saint-Petersburg International Mercantile Exchange and sales of additional volumes of natural gas to our wholesale traders in the first quarter of 2016, as well as restoring sales to one of our major customers who temporarily did not take full contracted volumes due to technical reasons in the first quarter of 2015. Natural gas production volumes including our proportionate share in the production of joint ventures increased by 6.7% due to the launch of additional production facilities at the end of 2014 and the first half of 2015.

Our liquids sales volumes increased significantly by 1,808 thousand tons, or 63.8%, primarily due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015, as well as an increase in production of gas condensate in our joint ventures.

Natural gas production volumes

As a result of increased production of our joint ventures, in the three months ended 31 March 2016, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 1,085 mmcm, or 6.7%, to 17,236 mmcm from 16,151 mmcm in the corresponding period in 2015.

millions of cubic meters	**Three months ended 31 March: 2016**	**2015**	**Change %**
Production by subsidiaries from:			
Yurkharovskoye field	9,035	8,936	1.1%
East-Tarkosalinskoye field	2,105	2,429	(13.3%)
Khancheyskoye field	643	655	(1.8%)
Other fields	393	441	(10.9%)
Total natural gas production by subsidiaries	**12,176**	**12,461**	**(2.3%)**
Group's proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	3,480	2,328	49.5%
Nortgas	1,310	1,362	(3.8%)
Terneftegas	270	-	n/a
Total Group's proportionate share in the natural gas production of joint ventures	**5,060**	**3,690**	**37.1%**
Total natural gas production including proportionate share in the production of joint ventures	**17,236**	**16,151**	**6.7%**

In the three months ended 31 March 2016, the combined total volumes of natural gas produced by our subsidiaries decreased by 285 mmcm, or 2.3%, to 12,176 mmcm from 12,461 mmcm in the corresponding period in 2015 due to natural decline in the reservoir pressure at the current gas producing horizons at our mature fields (East-Tarkosalinskoye and Khancheyskoye).

In the three months ended 31 March 2016, our proportionate share in the production of our joint ventures increased by 1,370 mmcm, or 37.1%, to 5,060 mmcm from 3,690 mmcm in the corresponding period in 2015 primarily as a result of the production growth in SeverEnergia. The production of SeverEnergia significantly increased due to reaching the nameplate production capacity of the second phase of the Urengoyskoye field in February 2015, as well as the launch of the Yaro-Yakhinskoye field in April 2015, the nameplate production capacity of which was reached in June 2015. In addition, effective May 2015, our joint venture Terneftegas commenced production at the Termokarstovoye field and reached the nameplate production capacity in June 2015.

Natural gas sales volumes

In the three months ended 31 March 2016, our total natural gas sales volumes increased by 1,798 mmcm, or 11.3%, to 17,775 mmcm from 15,977 mmcm in the corresponding period in 2015 as a result of natural gas sales at the Saint-Petersburg International Mercantile Exchange and sales of additional volumes of natural gas to our wholesale traders in the first quarter of 2016, as well as restoring sales to one of our major customers who temporarily did not take full contracted volumes due to technical reasons in the first quarter of 2015.

millions of cubic meters	**Three months ended 31 March:** 2016	2015	**Change** %
Production by subsidiaries	12,176	12,461	(2.3%)
Purchases from the Group's joint ventures	2,749	1,623	69.4%
Other purchases	2,011	1,549	29.8%
Total production and purchases	**16,936**	**15,633**	**8.3%**
Purovsky Plant, own usage and methanol production	(59)	(51)	15.7%
Decrease (increase) in GTS, UGSF and own pipeline infrastructure	898	395	127.3%
Total natural gas sales volumes	**17,775**	**15,977**	**11.3%**
Sold to end-customers	*16,094*	*15,077*	*6.7%*
Sold ex-field	*1,681*	*900*	*86.8%*

In the three months ended 31 March 2016, natural gas purchases from our joint ventures increased by 1,126 mmcm, or 69.4%, to 2,749 mmcm from 1,623 mmcm in the corresponding period in 2015 primarily due to an increase in purchases from SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) and the commencement of purchases from Terneftegas as a result of the launch of the Termokarstovoye field in May 2015.

Other natural gas purchases increased by 462 mmcm, or 29.8%. Other natural gas purchases are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize end-customers portfolios.

In the three months ended 31 March 2016, we used 19 mmcm of natural gas as feedstock for the production of methanol compared to 20 mmcm in the corresponding period in 2015. A significant portion of the methanol we produce is used for our own internal purposes to prevent hydrate formation during the production, preparation and transportation of hydrocarbons.

As of 31 March 2016, our natural gas inventory balance in the GTS, the UGSF and our own pipeline infrastructure aggregated 429 mmcm and decreased by 898 mmcm during the quarter as compared to a decrease by 395 mmcm in the corresponding period in 2015.

Liquids production volumes

In the three months ended 31 March 2016, our total liquids production (including our proportionate share in the production of joint ventures) increased by 1,217 thousand tons, or 61.1%, to 3,208 thousand tons from 1,991 thousand tons in the corresponding period in 2015 primarily due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015, as well as a significant increase in gas condensate production of our joint ventures.

thousands of tons	Three months ended 31 March: 2016	2015	Change %
Production by subsidiaries from:			
Yarudeyskoye field	884	-	n/a
Yurkharovskoye field	495	553	(10.5%)
East-Tarkosalinskoye field	356	355	0.3%
Khancheyskoye field	89	108	(17.6%)
Other fields	31	40	(22.5%)
Total liquids production by subsidiaries	**1,855**	**1,056**	**75.7%**
including crude oil	*1,200*	*330*	*263.6%*
including gas condensate	*655*	*726*	*(9.8%)*
Group’s proportionate share in the production of joint ventures:			
SeverEnergia (Arcticgas)	1,107	776	42.7%
Nortgas	144	159	(9.4%)
Terneftegas	102	-	n/a
Total Group’s proportionate share in the liquids production of joint ventures	**1,353**	**935**	**44.7%**
Total liquids production including proportionate share in the production of joint ventures	**3,208**	**1,991**	**61.1%**

In the three months ended 31 March 2016, the volumes of liquids produced by our subsidiaries increased significantly by 799 thousand tons, or 75.7% due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015 and reaching the nameplate production capacity by the end of the month (see “Recent developments” above). At the same time gas condensate production decreased due to the natural declines in the concentration of gas condensate at our mature fields (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) as a result of decreasing reservoir pressure at the current gas condensate producing horizons.

In the three months ended 31 March 2016, our proportionate share in liquids production of joint ventures increased by 418 thousand tons, or 44.7%, to 1,353 thousand tons from 935 thousand tons in the corresponding period in 2015 mainly as a result of the production growth in SeverEnergia. The production of SeverEnergia increased significantly due to reaching the nameplate production capacity of the second phase of the Urengoyskoye field in February 2015, as well as the launch of the Yaro-Yakhinskoye field in April 2015, the nameplate production capacity of which was reached in June 2015. In addition, our joint venture Terneftegas commenced production at the Termokarstovoye field in May 2015 and reached nameplate production capacity in June 2015.

Liquids sales volumes

In the three months ended 31 March 2016, our total liquids sales volumes increased significantly by 1,808 thousand tons, or 63.8%, to 4,642 thousand tons from 2,834 thousand tons in the corresponding period in 2015 due to an increase in the production of gas condensate in our joint ventures, as well as crude oil production in our subsidiaries.

thousands of tons	**Three months ended 31 March: 2016**	**2015**	**Change %**
Production by subsidiaries	1,855	1,056	75.7%
Purchases from the Group's joint ventures	2,531	1,703	48.6%
Other purchases	31	4	n/a
Total production and purchases	**4,417**	**2,763**	**59.9%**
Losses [(1)] and own usage [(2)]	(73)	(77)	(5.2%)
Decreases (increases) in liquids inventory balances	298	148	101.4%
Total liquids sales volumes	**4,642**	**2,834**	**63.8%**
Naphtha export	*1,151*	*1,127*	*2.1%*
Other gas condensate refined products export	*692*	*688*	*0.6%*
Other gas condensate refined products domestic	*38*	*22*	*72.7%*
Subtotal gas condensate refined products	***1,881***	***1,837***	***2.4%***
Crude oil export	*382*	*96*	*297.9%*
Crude oil domestic	*806*	*175*	*360.6%*
Subtotal crude oil	***1,188***	***271***	***338.4%***
Stable gas condensate export	*479*	*34*	*n/a*
Stable gas condensate domestic	*389*	*242*	*60.7%*
Subtotal stable gas condensate	***868***	***276***	***214.5%***
LPG export	*138*	*145*	*(4.8%)*
LPG domestic	*565*	*303*	*86.5%*
Subtotal LPG	***703***	***448***	***56.9%***
Other oil products domestic	*2*	*2*	*0.0%*
Subtotal other oil products	***2***	***2***	***0.0%***

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

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

In the three months ended 31 March 2016, our purchases of liquid hydrocarbons from joint ventures increased significantly by 828 thousand tons, or 48.6%, due to a significant increase in purchases of gas condensate from SeverEnergia resulting from the launch of additional production facilities in the first half of 2015 (see "Liquids production volumes" above). In addition, effective May 2015, we commenced purchases of gas condensate from our joint venture Terneftegas as a result of the launch of the Termokarstovoye field.

As a result of the launch of new fields and full refining capacity utilization of our Ust-Luga Complex, we commenced stable gas condensate deliveries to export markets from the March 2015.

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

In the 2016 reporting period, our liquids inventory balances decreased by 298 thousand tons to 612 thousand tons as of 31 March 2016 as compared to a decrease in inventory balances by 148 thousand tons to 591 thousand tons in the corresponding period in 2015. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations of stable gas condensate and its refined products shipments (see "Change in natural gas, liquid hydrocarbons and work-in-progress" below).

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2016 COMPARED TO THE CORRESPONDING PERIOD IN 2015

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2016 and 2015. Each line item is also shown as a percentage of our total revenues.

	Three months ended 31 March:			
millions of Russian roubles	**2016**	**% of total revenues**	**2015**	**% of total revenues**
Total revenues [1]	**139,351**	***100.0%***	**113,742**	***100.0%***
including:				
natural gas sales	61,163	*43.9%*	53,621	*47.1%*
liquids' sales	77,048	*55.3%*	59,603	*52.4%*
Operating expenses	(97,159)	*(69.7%)*	(73,896)	*(65.0%)*
Other operating income (loss)	971	*0.7%*	(199)	*(0.1%)*
Profit from operations before disposals of interests in joint ventures	**43,163**	***31.0%***	**39,647**	***34.9%***
Net gain on disposal of interests in joint ventures	73,072	*52.4%*	-	*n/a*
Profit from operations	**116,235**	***83.4%***	**39,647**	***34.9%***
Finance income (expense)	916	*0.7%*	(7,246)	*(6.4%)*
Share of profit (loss) of joint ventures, net of income tax	23,381	*16.8%*	4,274	*3.7%*
Profit before income tax	**140,532**	***100.9%***	**36,675**	***32.2%***
Total income tax expense	(22,955)	*(16.5%)*	(5,930)	*(5.2%)*
Profit	**117,577**	***84.4%***	**30,745**	***27.0%***
Less: profit (loss) attributable to non-controlling interest	(1,660)	*(1.2%)*	330	*0.3%*
Profit attributable to shareholders of OAO NOVATEK	**115,917**	***83.2%***	**31,075**	***27.3%***

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

Total revenues

The following table sets forth our sales (excluding VAT, export duties, excise and fuel taxes expense, where applicable) for the three months ended 31 March 2016 and 2015:

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Natural gas sales	**61,163**	**53,621**	**14.1%**
End-customers	*57,715*	*51,973*	*11.0%*
Ex-field sales	*3,448*	*1,648*	*109.2%*
Gas condensate refined products sales	**43,125**	**45,823**	**(5.9%)**
Export – naphtha	*28,210*	*27,437*	*2.8%*
Export – other refined products	*14,338*	*17,935*	*(20.1%)*
Domestic – other refined products	*577*	*451*	*27.9%*
Crude oil sales	**13,959**	**3,911**	**256.9%**
Export	*4,951*	*1,457*	*239.8%*
Domestic	*9,008*	*2,454*	*267.1%*
Stable gas condensate sales	**13,077**	**4,006**	**226.4%**
Export	*8,460*	*832*	*n/a*
Domestic	*4,617*	*3,174*	*45.5%*
Liquefied petroleum gas sales	**6,807**	**5,774**	**17.9%**
Export	*3,120*	*2,984*	*4.6%*
Domestic	*3,687*	*2,790*	*32.2%*
Other products sales	**80**	**89**	**(10.1%)**
Domestic	*80*	*89*	*(10.1%)*
Total oil and gas sales	**138,211**	**113,224**	**22.1%**
Other revenues	1,140	518	120.1%
Total revenues	**139,351**	**113,742**	**22.5%**

Natural gas sales

In the three months ended 31 March 2016, our revenues from sales of natural gas increased by RR 7,542 million, or 14.1%, compared to the corresponding period in 2015 primarily due to an increase in sales volumes and, to a lesser extent, an increase in average sales prices. The increase in our total sales volumes was as a result of natural gas sales at the Saint-Petersburg International Mercantile Exchange and sales of additional volumes of natural gas to our wholesale traders in the first quarter of 2016, as well as restoring sales to one of our major customers who temporarily did not take full contracted volumes due to technical reasons in the first quarter of 2015. The increase in our natural gas average sales prices was mainly due to an increase in the average regulated prices by 7.5% effective 1 July 2015 that was partially offset by an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the reporting period of the prior year (see "Natural gas prices" above).

Our proportion of natural gas sold to end-customers to total natural gas sales volumes decreased by 3.9% and amounted to 90.5% in the three months ended 31 March 2016 compared to 94.4% in the corresponding period in 2015.

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 2016, our revenues from sales of gas condensate refined products decreased by RR 2,698 million, or 5.9%, as compared to the corresponding period in 2015 due to a decrease in average realized net export prices that was partially offset by a slight increase in sales volumes.

In the three months ended 31 March 2016, our revenues from sales of naphtha increased by RR 773 million, or 2.8%, as compared to the corresponding period in 2015 due to an increase in sales volumes by 2.1% and, to a lesser extent, average realized net export prices in Russian roubles by 0.7%.

In the three months ended 31 March 2016 and 2015, we exported 1,151 thousand and 1,127 thousand tons of naphtha, respectively. Our average realized net export price, excluding export duties, increased by RR 162 per ton, or 0.7%, to RR 24,517 per ton (CFR and CIF) from RR 24,355 per ton (CFR, CIF, DES and DAP) in the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2016, our revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets decreased by RR 3,471 million, or 18.9%, as compared to the corresponding period in 2015 due to a decrease in average realized net export prices in Russian roubles. In the three months ended 31 March 2016 and 2015, we exported in aggregate 692 thousand tons and 688 thousand tons of these products to the European markets, or 94.8% and 96.9% of total sales volumes on the domestic and export markets, respectively. Our average realized net export price, excluding export duties, decreased by RR 5,374 per ton, or 20.6%, to RR 20,704 per ton (CIF, DES, DAP and FOB) from RR 26,078 per ton (CIF and FOB) in the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Crude oil sales

In the three months ended 31 March 2016, revenues from crude oil sales significantly increased by RR 10,048 million, or 3.6 times, compared to the corresponding period in 2015 due to an increase in sales volumes. Our crude oil sales volumes increased by 917 thousand tons, or 338.4%, to 1,188 thousand tons from 271 thousand tons in the corresponding period in 2015 due to the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015 and reaching the nameplate production capacity by the end of the month.

In the three months ended 31 March 2016, we sold 806 thousand tons, or 67.8% of our total crude oil volumes, domestically at an average price of RR 11,183 per ton (excluding VAT) representing a decrease of RR 2,796 per ton, or 20.0%, as compared to the corresponding period in 2015.

The remaining 382 thousand tons, or 32.2% of our total sales volumes, were sold to export markets at an average net export price of RR 12,950 per ton (FOB, excluding export duties) representing a decrease of RR 2,238 per ton, or 14.7%, as compared to the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Stable gas condensate sales

In the three months ended 31 March 2016, our revenues from sales of stable gas condensate significantly increased by RR 9,071 million, or 3.3 times, compared to the corresponding period in 2015 due to a significant increase in volumes sold (see "Hydrocarbon production and sales volumes" above) that was partially offset by a decrease in average realized prices.

In the three months ended 31 March 2016, we sold 479 thousand tons of stable gas condensate, or 55.2% of our total sales volumes, to the European markets and the APR compared to sales of 34 thousand tons, or 12.3%, to the APR in the corresponding period in 2015. Our average realized stable gas condensate net export price, excluding export duties, decreased by RR 7,147 per ton, or 28.8%, to RR 17,649 per ton (DAP, CIF, CFR and DES) from RR 24,796 per ton (CFR) (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2016, we sold 389 thousand tons of stable gas condensate on the domestic market compared to 242 thousand tons in the corresponding period in 2015. Our average realized price for stable gas condensate sales on the domestic market in the three months ended 31 March 2016 amounted to RR 11,889 per ton (excluding VAT), representing a decrease of RR 1,225 per ton, or 9.3%, as compared to the corresponding period in 2015 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Liquefied petroleum gas sales

In the three months ended 31 March 2016, our revenues from sales of LPG increased by RR 1,033 million, or 17.9%, compared to the corresponding period in 2015 due to an increase in total sales volumes. The impact of this factor was partially offset by the reallocation of sales volumes in favor of the domestic market with lower average realized price compared to the net export sales price (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

In the three months ended 31 March 2016, we sold 138 thousand tons of LPG, or 19.6% of our total LPG sales volumes, to export markets as compared to sales of 145 thousand tons, or 32.4%, in the corresponding period in 2015. Our average realized LPG net export price, excluding export duties, excise and fuel taxes expense and including trading activities, increased by RR 1,996 per ton, or 9.7%.

In both reporting periods we sold nearly all export volumes of LPG to the markets of Poland and Finland.

In the three months ended 31 March 2016, we sold 565 thousand tons of LPG on the domestic market compared to sales of 303 thousand tons in the corresponding period in 2015. Our average realized LPG domestic price, including trading activities, in the three months ended 31 March 2016, was RR 6,519 per ton representing a decrease of RR 2,674 per ton, or 29.1%, compared to the corresponding period in 2015 (see “Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices” above).

Other products sales

Other products sales represent our revenues from the domestic sales of methanol, oil products (diesel fuel and petrol) purchased for resale and sold through our retail stations and other liquid hydrocarbons. In the three months ended 31 March 2016, our revenues from other products sales decreased marginally by RR nine million, or 10.1%, to RR 80 million from RR 89 million in the corresponding period in 2015.

Other revenues

Other revenues include revenue from geological and geophysical research services, rent, sublease, repair and maintenance of energy equipment services, as well as other services. In the three months ended 31 March 2016, other revenues increased by RR 622 million, or 120.1%, to RR 1,140 million from RR 518 million in the corresponding period in 2015 primarily due to an increase in revenues from the sublease of tankers by RR 510 million. The related sublease of tankers expenses are included in our transportation expenses in line “Gas condensate refined products and stable gas condensate transportation by tankers”.

In addition, in the three months ended 31 March 2016, other revenues increased by RR 45 million due to an increase in revenues from repair and maintenance of energy equipment services provided by our subsidiary NOVATEK-Energo, as well as by RR 20 million due to an increase in revenues from geological and geophysical research services provided to our joint ventures.

Operating expenses

In the three months ended 31 March 2016, our total operating expenses increased by RR 23,263 million, or 31.5%, to RR 97,159 million compared to RR 73,896 million in the corresponding period in 2015, and our total operating expenses as a percentage of total revenues increased to 69.7% from 65.0% primarily due to increased purchases of natural gas and liquid hydrocarbons from our joint ventures that in turn allowed us to sell increased volumes of hydrocarbons to both domestic and international markets (see "Purchases of natural gas and liquid hydrocarbons" below), as well as an increase in transportation expenses.

millions of Russian roubles	Three months ended 31 March: 2016	% of total revenues	2015	% of total revenues
Transportation expenses	36,573	*26.2%*	30,823	*27.1%*
Purchases of natural gas and liquid hydrocarbons	29,717	*21.3%*	23,423	*20.6%*
Taxes other than income tax	10,597	*7.6%*	9,018	*7.9%*
Depreciation, depletion and amortization	7,833	*5.6%*	4,515	*4.0%*
Materials, services and other	4,357	*3.1%*	3,176	*2.8%*
General and administrative expenses	4,229	*3.0%*	3,113	*2.7%*
Impairment expenses (reversals), net	153	*n/a*	29	*n/a*
Exploration expenses	102	*n/a*	18	*n/a*
Change in natural gas, liquid hydrocarbons and work-in-progress	3,598	*2.6%*	(219)	*n/a*
Total operating expenses	**97,159**	***69.7%***	**73,896**	***65.0%***

Transportation expenses

In the three months ended 31 March 2016, our total transportation expenses increased by RR 5,750 million, or 18.7%, to RR 36,573 million as compared to RR 30,823 million in the corresponding period in 2015.

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Natural gas transportation by trunk and low-pressure pipelines	21,394	20,378	5.0%
Stable gas condensate and liquefied petroleum gas transportation by rail	9,104	6,900	31.9%
Gas condensate refined products, stable gas condensate and crude oil transportation by tankers	4,330	3,128	38.4%
Crude oil transportation by trunk pipelines	1,703	381	347.0%
Other	42	36	16.7%
Total transportation expenses	**36,573**	**30,823**	**18.7%**

In the three months ended 31 March 2016, our expenses for natural gas transportation increased by RR 1,016 million, or 5.0%, to RR 21,394 million from RR 20,378 million in the corresponding period in 2015 due to a 6.7% increase in our natural gas sales volumes to end-customers, for which we incurred transportation expenses, as well as an average 2.0% increase in the natural gas regulated transportation tariff effective 1 July 2015 (see "Transportation tariffs" above). The effect of increased transportation volumes and regulated transportation tariffs on transportation expenses was partially mitigated by an increase in the proportion of sales to our end-customers located closer to our production fields in the current reporting period as compared to the respective period in 2015.

In the three months ended 31 March 2016, our total expenses for stable gas condensate and LPG transportation by rail increased by RR 2,204 million, or 31.9%, to RR 9,104 million from RR 6,900 million in the corresponding period in 2015 mainly due to an increase in volumes of liquids sold and transported via rail by 26.1% and, to a lesser extent, an increase in our weighted average transportation cost per unit.

Our weighted average transportation cost per unit for stable gas condensate and LPG delivered by rail increased by 4.6% due to an increase in the regulated railroad transportation tariffs effective January 2016 (see “Transportation tariffs” above) that was partially offset by a decrease in the share of LPG volumes transported in total volumes (as a result of an increase in LPG volumes sold ex-works Purovsky Plant and Tobolsk Refining Facilities without transportation expenses). The regulated railroad transportation tariffs for LPG are higher than for our other liquid hydrocarbons.

In the three months ended 31 March 2016, our total transportation expenses for liquids delivered by tankers to international markets increased by RR 1,202 million, or 38.4%, to RR 4,330 million from RR 3,128 million in the corresponding period in 2015 due to an increase in volumes of liquids sold and transported via tankers by 16.8%, as well as an increase in the average exchange rate of US dollar to Russian rouble by 20.0% in the three months ended 31 March 2016 compared to the corresponding period in 2015 since all our tankers transportation expenses are US dollar denominated.

In the three months ended 31 March 2016, our expenses for crude oil transportation to customers by trunk pipeline significantly increased by RR 1,322 million, or 4.5 times, to RR 1,703 million from RR 381 million in the corresponding period in 2015 due to a significant 4.4 times increase in volumes transported as a result of the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015 and, to a lesser extent, an increase in the regulated transportation tariff (by 5.76% effective 1 January 2016 (see “Transportation tariffs” above)).

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2016, our purchases of natural gas and liquid hydrocarbons significantly increased by RR 6,294 million, or 26.9%, to RR 29,717 million from RR 23,423 million in the corresponding period in 2015.

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Unstable gas condensate	19,147	17,203	11.3%
Natural gas	10,126	6,134	65.1%
Other liquid hydrocarbons	444	86	n/a
Total purchases of natural gas and liquid hydrocarbons	**29,717**	**23,423**	**26.9%**

In the three months ended 31 March 2016, our purchases of unstable gas condensate from our joint ventures increased by RR 1,944 million, or 11.3%, as compared to the corresponding period in 2015 and were due to an increase in purchases from SeverEnergia (through its wholly owned subsidiary, OAO Arcticgas) as a result of the launch of additional production capacities in the first half of 2015 (see “Liquids production volumes” above), as well as the commencement of purchases from Terneftegas effective May 2015.

In the three months ended 31 March 2016, our purchases of natural gas significantly increased by RR 3,992 million, or 65.1%, as compared to the corresponding period in 2015 as a result of an increase in purchases from SeverEnergia and third parties, as well as the commencement of purchases from Terneftegas.

In the three months ended 31 March 2016, our purchases of other liquid hydrocarbons significantly increased by RR 358 million, or 5.2 times, as compared to the corresponding period in 2015 due to an increase in LPG purchases for the subsequent resale through small wholesale and our retail stations.

Taxes other than income tax

In the three months ended 31 March 2016, taxes other than income tax increased by RR 1,579 million, or 17.5%, to RR 10,597 million from RR 9,018 million in the corresponding period in 2015 primarily due to an increase in the unified natural resources production tax expense.

	Three months ended 31 March:		Change
millions of Russian roubles	**2016**	**2015**	**%**
Unified natural resources production tax (UPT)	9,876	8,354	18.2%
Property tax	665	567	17.3%
Other taxes	56	97	(42.3%)
Total taxes other than income tax	**10,597**	**9,018**	**17.5%**

In the three months ended 31 March 2016, our unified natural resources production tax expense increased by RR 1,522 million, or 18.2%, to RR 9,876 million from RR 8,354 million in the corresponding period in 2015 primarily due to a significant increase in crude oil production as a result of the crude oil commercial production commencement at the Yarudeyskoye field in December 2015. In addition, as a part of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above), the formula used for gas condensate UPT rate calculation was adjusted by a coefficient that increased the rate by 25.0% from the 1 January 2016 in relation to 2015 which also increased our UPT expense.

In the three months ended 31 March 2016, our property tax expense increased by RR 98 million, or 17.3%, to RR 665 million from RR 567 million in the corresponding period in 2015 mainly due to the launch of the Yarudeyskoye field in December 2015, as well as additions to property, plant and equipment at our other production subsidiaries.

Depreciation, depletion and amortization

In the three months ended 31 March 2016, our depreciation, depletion and amortization ("DDA") expense increased by RR 3,318 million, or 73.5%, to RR 7,833 million from RR 4,515 million in the corresponding period in 2015 mainly due to the launch of the Yarudeyskoye field in December 2015, as well as additions of property, plant and equipment at our production subsidiaries during the 12 months preceding the reporting period. We accrue depreciation and depletion using the "units-of-production" method for our oil and gas assets and using a straight-line method for other facilities.

Materials, services and other

In the three months ended 31 March 2016, our materials, services and other expenses increased by RR 1,181 million, or 37.2%, to RR 4,357 million compared to RR 3,176 million in the corresponding period in 2015. The main components of this expense category were expenses relating to complex of services for preparation, transportation and processing of hydrocarbons, repair and maintenance services, as well as employee compensation, which on aggregate comprised 66.6% and 67.3% of total materials, services and other expenses in the three months ended 31 March 2016 and 2015, respectively.

	Three months ended 31 March:		Change
millions of Russian roubles	**2016**	**2015**	**%**
Employee compensation	1,764	1,389	27.0%
Complex of services for preparation, transportation and processing of hydrocarbons	653	430	51.9%
Repair and maintenance	483	318	51.9%
Materials and supplies	364	270	34.8%
Liquefied petroleum gas volumes reservation expenses	296	201	47.3%
Electricity and fuel	276	243	13.6%
Transportation services	152	99	53.5%
Security services	148	110	34.5%
Rent expenses	60	15	300.0%
Other	161	101	59.4%
Total materials, services and other	**4,357**	**3,176**	**37.2%**

Operating employee compensation increased by RR 375 million, or 27.0%, to RR 1,764 million compared to RR 1,389 million in the corresponding period in 2015. The increase was due to an increase in the average number of employees primarily as a result of launch of the Yarudeyskoye field in December 2015, an indexation of base salaries effective from 1 July 2015 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our LPG produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses increased by RR 223 million, or 51.9%, to RR 653 million in the three months ended 31 March 2016 compared to RR 430 million in the corresponding period in 2015 primarily due to an increase in the tariff for complex of services for preparation, transportation and processing of our hydrocarbons at the Tobolsk Refining Facilities effective January 2016, as well as additional expenses for preparation of crude oil for transportation by trunk pipeline resulted from the commencement of crude oil commercial production at the Yarudeyskoye field in December 2015.

Repair and maintenance services expenses increased by RR 165 million, or 51.9%, to RR 483 million in the three months ended 31 March 2016 compared to RR 318 million in the corresponding period in 2015 as a result of current repair works at our production subsidiaries.

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

In the three months ended 31 March 2016, liquefied petroleum gas volumes reservation costs increased by RR 95 million, or 47.3%, to RR 296 million from RR 201 million in the corresponding period in 2015 primarily due to an increase in LPG volumes sold through our subsidiary in Poland, as well as an increase in the average exchange rate of the Polish zloty to the Russian rouble, since this expense is denominated in Polish zloty. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

General and administrative expenses

In the three months ended 31 March 2016, our general and administrative expenses increased by RR 1,116 million, or 35.8%, to RR 4,229 million compared to RR 3,113 million in the corresponding period in 2015. The main components of these expenses were employee compensation, social expenses and compensatory payments, as well as legal, audit and consulting services, which, on aggregate, comprised 86.7% and 82.5% of total general and administrative expenses in the three months ended 31 March 2016 and 2015, respectively.

	Three months ended 31 March:		Change
millions of Russian roubles	**2016**	**2015**	**%**
Employee compensation	3,140	2,117	48.3%
Social expenses and compensatory payments	280	180	55.6%
Legal, audit and consulting services	246	271	(9.2%)
Business travel expense	101	100	1.0%
Fire safety and security expenses	96	78	23.1%
Insurance expense	87	75	16.0%
Rent expense	48	70	(31.4%)
Repair and maintenance expenses	41	40	2.5%
Other	190	182	4.4%
Total general and administrative expenses	**4,229**	**3,113**	**35.8%**

Employee compensation relating to administrative personnel increased by RR 1,023 million, or 48.3%, to RR 3,140 million in the three months ended 31 March 2016 from RR 2,117 million in the corresponding period in 2015. The increase was due to an increase in bonuses accrued to key management based on the first quarter of 2016 results, an indexation of base personnel salaries effective 1 July 2015, and the related increase in social contributions for medical and social insurance and to the Pension Fund.

In the three months ended 31 March 2016, our social expenses and compensatory payments increased by RR 100 million, or 55.6%, to RR 280 million compared to RR 180 million in the corresponding period in 2015 and mainly related to our donations to sport clubs and associations, educational schools, as well as 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.

Impairment expenses (reversals), net

In the three months ended 31 March 2016, we recognized a net impairment expense of RR 153 million which primarily related to trade accounts receivable compared to RR 29 million in the corresponding period in 2015.

Exploration expenses

In the three months ended 31 March 2016, our exploration expenses increased by RR 84 million to RR 102 million from RR 18 million in the corresponding period in 2015 primarily due to exploration works performed at the Dorogovskoye field. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

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

In the three months ended 31 March 2016, we recorded a charge of RR 3,598 million to change in inventory expense due to a significant decrease in our hydrocarbons inventory balances as of 31 March compared to 1 January. In the corresponding period in 2015, a decrease in our hydrocarbons inventory balances was completely offset by an increase in the cost of inventories and, as a result, we recorded a reversal of RR 219 million to change in inventory expense. The cost of our liquid hydrocarbons inventories on a per ton basis increased as a result of a significant increase in the UPT rate for gas condensate, as well as a tax burden on our crude oil production effective from January 2015 (see "Our tax burden and obligatory payments" above).

In the three months ended 31 March 2016, our cumulative natural gas inventory balance in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure decreased by 898 mmcm compared to a 395 mmcm decrease in the inventory balance in the corresponding period in 2015. The decrease in inventory balances in both reporting periods was a result of the seasonal withdrawal of natural gas. In the current reporting period we withdrew significantly more natural gas from the inventory balance as a result of the increase in our natural gas sales volumes (see "Natural gas sales volumes" above).

In the three months ended 31 March 2016, our cumulative liquid hydrocarbons inventory balance, recognized as inventory in transit or in storage, decreased by 298 thousand tons compared to a 148 thousand tons decrease in the inventory balance in the corresponding period in 2015 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:

	2016			**2015**		
Inventory balances in transit or in storage	**At 31 March**	**At 1 January**	**Increase / (decrease)**	**At 31 March**	**At 1 January**	**Increase / (decrease)**
Natural gas (millions of cubic meters)	**429**	**1,327**	**(898)**	**654**	**1,049**	**(395)**
including Gazprom's UGSF	*363*	*1,245*	*(882)*	*511*	*1,016*	*(505)*
Liquid hydrocarbons (thousand tons)	**612**	**910**	**(298)**	**591**	**739**	**(148)**
including naphtha	*120*	*184*	*(64)*	*189*	*305*	*(116)*
stable gas condensate	*247*	*369*	*(122)*	*256*	*219*	*37*
crude oil	*121*	*157*	*(36)*	*25*	*29*	*(4)*

Other operating income (loss)

Other operating income (loss) includes realized income (loss) from natural gas trading on the European market under long-term and short-term purchase and sales contracts, income (loss) from the change in the fair value of aforementioned contracts, as well as other income (loss) related to penalty charges, disposal of materials, fixed assets and other transactions. In the three months ended 31 March 2016, we recognized other operating income of RR 971 million compared to other operating loss of RR 199 million in the corresponding period in 2015.

In the three months ended 31 March 2016, within our trading activities on the European market we purchased and sold 8.0 terawatt-hours (or approximately 760 mmcm) of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized income from trading activities of RR 704 million as compared to RR 170 million of income in the corresponding period in 2015. At the same time, in the three months ended 31 March 2016, we recognized a non-cash income of RR 326 million as a result of an increase in the fair value of the hydrocarbons purchase and sales contracts as compared to RR 513 million of a non-cash loss in the corresponding period in 2015. All trading contracts are classified as derivative instruments in accordance with IAS 39 *"Financial instruments: recognition and measurement"*.

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

As a result of the factors discussed above, our profit from operations significantly increased by RR 76,588 million, or 193.2%, to RR 116,235 million in the three months ended 31 March 2016, as compared to RR 39,647 million in the corresponding period in 2015. Our profit from operations before disposals of interests in joint ventures increased by RR 3,516 million, or 8.9%, to RR 43,163 million in the three months ended 31 March 2016, as compared to RR 39,647 million in the corresponding period in 2015. Our share in the profit from operations of our joint ventures changed marginally and amounted to RR 5,660 million in the three months ended 31 March 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 7,304 million, or 13.3%, to RR 62,136 million in the three months ended 31 March 2016 from RR 54,832 million in the corresponding period in 2015 mainly due to a significant increase in hydrocarbons sales volumes.

Finance income (expense)

In the three months ended 31 March 2016, we recorded a net finance income of RR 916 million compared to net finance expense of RR 7,246 million in the corresponding period in 2015 caused by a significant non-cash foreign exchange loss as a result of the Russian rouble depreciation relative to the US dollar and Euro.

millions of Russian roubles	**Three months ended 31 March: 2016**	**2015**	**Change %**
Accrued interest expense on loans received	(5,253)	(3,254)	61.4%
Less: capitalized interest	1,721	1,106	55.6%
Provisions for asset retirement obligations: effect of the present value discount unwinding	(122)	(53)	130.2%
Interest expense	**(3,654)**	**(2,201)**	**66.0%**
Interest income	5,055	3,186	58.7%
Change in fair value of non-commodity financial instruments	731	2,391	(69.4%)
Foreign exchange gain (loss), net	(1,216)	(10,622)	(88.6%)
Total finance income (expense)	**916**	**(7,246)**	**n/a**

In the three months ended 31 March 2016, our interest expense increased by RR 1,453 million, or 66.0%, to RR 3,654 million due to an increase in the aggregate amount of the Group's borrowing obligations in Russian roubles terms as a result of the depreciation of the average Russian rouble exchange rate relative to the US dollar and Euro (see "Selected macro-economic data" above), as well as an increase in the weighted average interest rate due to changes in our debt portfolio.

Interest income increased by RR 1,869 million, or 58.7%, to RR 5,055 million in the three months ended 31 March 2016 from RR 3,186 million in the corresponding period in 2015 due to an increase in loans provided to our joint ventures for the development and expansion of their activities, as well as a result of the average Russian rouble depreciation relative to the US dollar and Euro in the three months ended 31 March 2016 compared to the average exchange rate in the corresponding period in 2015.

In the three months ended 31 March 2016 and 2015, we recognized non-cash gains of RR 731 million and RR 2,391 million, respectively, 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 2016, we recorded a net foreign exchange loss of RR 1,216 million compared to a net loss of RR 10,622 million in the corresponding period in 2015 primarily due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

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

In the three months ended 31 March 2016, the Group's proportionate share of profit of joint ventures increased significantly by RR 19,107 million to RR 23,381 million compared to RR 4,274 million in the corresponding period in 2015.

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Share in profit from operations	5,660	6,234	(9.2%)
Share in finance income (expense)	22,326	(1,278)	n/a
Share in total income tax expense	(4,605)	(682)	n/a
Total share of profit (loss) of joint ventures, net of income tax	**23,381**	**4,274**	**n/a**

Our proportionate share in the profit from operations of our joint ventures changed marginally as a result of an increase in the unified natural resources production tax expense, as well as depreciation, depletion and amortization expense, that was almost completely offset by higher operating results of SeverEnergia due to reaching the nameplate production capacity of the second phase of the Urengoyskoye field in February 2015, as well as the launch of the Yaro-Yakhinskoye field in April 2015 (the nameplate production capacity was reached in June 2015). In addition, effective May 2015, our joint venture Terneftegas commenced commercial production at the Termokarstovoye field.

In the three months ended 31 March 2016, our proportionate share in the finance income of our joint ventures amounted to RR 22,326 million compared to a share in the finance expense of RR 1,278 million in the corresponding period in 2015. The change in our proportionate share in the finance income (expense) was mainly due to an increase in non-cash foreign exchange profit on foreign currency denominated loans at our joint ventures Yamal LNG and Terneftegas (our share amounted to RR 19.7 billion), as well as due to a lesser non-cash loss recorded by these joint ventures from the remeasurement of the fair value of shareholders' loans (our share of RR 4.6 billion).

Income tax expense

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

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

Without the effect of net profit (loss) and dividends from joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of our reported IFRS profit before income tax) in the three months ended 31 March 2016 and 2015, was 19.8% and 18.3%, respectively.

Profit attributable to shareholders and earnings per share

Our profit attributable to shareholders and earnings per share may vary period-to-period due to one-off events or extraordinary items. In order to normalize earnings and make period-on-period comparisons more meaningful certain adjustments are required to exclude these events.

Our profit for the period increased by RR 86,832 million, or 282.4%, to RR 117,577 million in the three months ended 31 March 2016 from RR 30,745 million in the corresponding period in 2015. The profit attributable to shareholders of OAO NOVATEK increased by RR 84,842 million, or 273.0%, to RR 115,917 million in the three months ended 31 March 2016 as compared to RR 31,075 million in the corresponding period in 2015. The profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interests in joint ventures, increased by RR 27,165 million, or 87.4%, to RR 58,240 million in the three months ended 31 March 2016 as compared to RR 31,075 million in the corresponding period in 2015.

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, increased by RR 28.11 per share, or 273.2%, to RR 38.40 per share in the three months ended 31 March 2016 from RR 10.29 per share in the corresponding period in 2015. Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of OAO NOVATEK, excluding the effect of the disposal of interests in joint ventures, increased by RR 9.00 per share, or 87.5%, to RR 19.29 per share in the three months ended 31 March 2016 from RR 10.29 per share in the corresponding period in 2015.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2016 and 2015:

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Net cash provided by **operating** activities	54,424	39,717	37.0%
Net cash provided by (used in) **investing** activities	63,500	(28,319)	n/a
Net cash provided by (used in) **financing** activities	(58,707)	3,091	n/a

Liquidity and credit ratios	31 March 2016	31 December 2015	Change, %
Current ratio	1.17	0.76	53.9%
Total debt to total equity	0.52	0.84	(38.1%)
Long-term debt to long-term debt and total equity	0.28	0.37	(24.3%)
Net debt to total capitalization (1)	0.24	0.41	(41.5%)
Net debt to normalized EBITDA from subsidiaries (2)	1.22	2.05	(40.5%)

(1) Net debt represents total debt less cash and cash equivalents. Total capitalization represents total debt, total equity and deferred income tax liability.

(2) Net debt to normalized EBITDA from subsidiaries ratio is calculated as Net debt divided by normalized EBITDA from subsidiaries for the last twelve months.

Net cash provided by operating activities

Our net cash provided by operating activities increased by RR 14,707 million, or 37.0%, to RR 54,424 million compared to RR 39,717 million in the corresponding period in 2015 mainly due to the working capital changes (in relation to inventories, receivables and payables) and long-term advances given, as well as higher operating results (increased liquid hydrocarbons and natural gas sales volumes, as well as increased average realized natural gas prices), that was partially offset by an increase in income taxes paid, as well as receiving of RR 1,850 million of dividends from our joint venture Nortgas in the first quarter of 2015. Working capital balances and income tax payments fluctuate from period to period depending on various factors.

millions of Russian roubles	Three months ended 31 March: 2016	2015	Change %
Profit from operations before disposals of interests in joint ventures	43,163	39,647	8.9%
Non-cash adjustments (1)	7,685	5,053	52.1%
Changes in working capital and long-term advances given	9,892	(3,111)	n/a
Dividends received from joint ventures	-	1,850	n/a
Interest received	202	626	(67.7%)
Income taxes paid	(6,518)	(4,348)	49.9%
Total net cash provided by operating activities	**54,424**	**39,717**	**37.0%**

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

Net cash provided by (used for) investing activities

In the three months ended 31 March 2016, our net cash provided by investing activities amounted to RR 63,500 million compared to RR 28,319 million used for investing activities in the corresponding period in 2015.

millions of Russian roubles	**Three months ended 31 March:** **2016**	**2015**	**Change %**
Cash used for capital expenditures	(8,976)	(9,319)	(3.7%)
Loans provided to joint ventures	(6,645)	(19,623)	(66.1%)
Repayments of loans provided to joint ventures	-	623	n/a
Proceeds from disposal of stakes in joint ventures net of costs to sell	82,344	-	n/a
Payments for acquisition of subsidiaries net of cash acquired	(2,929)	-	n/a
Prepayments for participation in auction for mineral license	(294)	-	n/a
Net cash provided by (used for) investing activities	**63,500**	**(28,319)**	**n/a**

Cash used for capital expenditures marginally decreased by RR 343 million, or 3.7%, as compared to the 2015 reporting period. In the 2016 reporting period, the cash was mainly used for the development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, maintenance of production at our Yurkharovskoye field, as well as the development of the Salmanovskoye (Utrenneye) field.

In the three months ended 31 March 2016, we provided loans to our joint venture Yamal LNG in the amount of RR 6,645 million as compared to RR 19,623 million provided to our joint ventures Yamal LNG and Yamal Development in the corresponding period in 2015. In addition, in the 2015 reporting period, we received RR 623 million as a partial repayment of the loan provided to Terneftegas.

In the three months ended 31 March 2016, 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 acquired 100% equity stake in ZAO Office in August 2014.

In addition, in the three months ended 31 March 2016, we made a payment in the amount of RR 294 million for participation in auction for exploration and production license for the Nyakhartinskiy license area, located in the YNAO (see "Recent developments" above).

Net cash provided by (used for) financing activities

In the three months ended 31 March 2016, our net cash used for financing activities amounted to RR 58,707 million as compared to RR 3,091 million provided by financing activities in the corresponding period in 2015.

millions of Russian roubles	**Three months ended 31 March:** **2016**	**2015**	**Change %**
Proceeds from (repayments of) long-term debt, net	(54,959)	-	n/a
Proceeds from (repayments of) short-term debt, net	(436)	5,617	n/a
Other	(3,312)	(2,526)	31.1%
Net cash provided by (used for) financing activities	**(58,707)**	**3,091**	**n/a**

In the three months ended 31 March 2016, we did not obtain long-term loans. In February 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 March 2016.

In both reporting periods we obtained short-term loans, including loans to finance trade activities. In the first quarter of 2015, net proceeds from short-term loans amounted to RR 5,617 million. In 2016 reporting period, total amount of short-term loans repayments substantially corresponded to the amount of proceeds.

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

Working capital

Our net working capital position (current assets plus assets held for sale less current liabilities) as of 31 March 2016 was a positive RR 24,508 million compared to a negative RR 41,203 million as of 31 December 2015. The change in our net working capital was primarily due to a significant increase in cash and cash equivalents by RR 56,344 million as a result of cash proceeds from the disposal of equity stake in our joint venture Yamal LNG. In addition, our net working capital changed as a result of a decrease in the short-term debt and current portion of our long-term debt by RR 32,954 million due to the full repayment of Eurobonds in the amount of USD 600 million in February 2016, that was partially offset by the classification of a portion of our syndicated term credit-facility as part of current liabilities based on the repayment schedule.

In each of the reporting quarters of 2015 as well as in the current reporting period, the Group demonstrated high operating results and had positive free cash flow. We anticipate a further decrease in expenditures relating to our core capital programs as a result of achieving nameplate production levels at our main fields, which will allow us to further increase the Groups' future estimated free cash flows. The Group's management believes that it presently has and will continue to have the ability to generate sufficient cash flows (from operating and financing activities) to repay all its current liabilities and to finance the capital construction programs.

Capital expenditures

Our total capital expenditures in both reporting periods represent our investments in developing our oil and gas properties. The following table shows the expenditures at our main fields and processing facilities:

	Three months ended 31 March:	
millions of Russian roubles	**2016**	**2015**
Yarudeyskoye field	3,278	7,080
Yurkharovskoye field	1,284	1,553
East-Tarkosalinskoye field	1,279	2,393
Salmanovskoye (Utrenneye) field	684	1,180
Khancheyskoye field	485	441
North-Russkoye field	226	436
Ust-Luga Complex	129	56
Purovsky Plant	93	22
Olimpiyskiy license area	41	137
Other	568	775
Capital expenditures	**8,067**	**14,073**

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2016 decreased by RR 6,006 million, or 42.7%, to RR 8,067 million from RR 14,073 million in the corresponding period in 2015. In both reporting periods, our main capital expenditures related to the development of the Yarudeyskoye and East-Tarkosalinskoye field's crude oil deposits, Yurkharovskoye field's production maintenance, as well as the development of the Salmanovskoye (Utrenneye) field.

The "Other" line in the table above represents our capital expenditures related to other fields, 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.

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

	Three months ended 31 March:		Change
millions of Russian roubles	**2016**	**2015**	**%**
Capital expenditures	**8,067**	**14,073**	**(42.7%)**
Less: capitalized foreign exchange differences, increase/decrease in accounts payables and other non-cash adjustments	909	(4,754)	n/a
Cash used in capital expenditures [1]	**8,976**	**9,319**	**(3.7%)**

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 March 2016, the total amount of our long-term debt denominated in US dollars was RR 194,715 million, or 67.5% 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, 40.7% in the three months ended 31 March 2016, was denominated in US dollars.

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

As of 31 March 2016, the Russian rouble appreciated by 7.2% and 4.0% against the US dollar and the Euro, respectively, compared to 31 December 2015.

Commodity risk

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

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

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

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

Pipeline access

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

Ability to reinvest

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

Off balance sheet activities

As of 31 March 2016, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

TERMS AND ABBREVIATIONS

APR	Asian-Pacific Region
bbl	barrel
bcm	billion cubic meters
boe	barrels of oil equivalent
CBR	Central Bank of Russian Federation
CFR	"Cost and freight"
CIF	"Cost, insurance and freight"
DAP	"Delivery at point of destination"
DDA	depreciation, depletion and amortization
DES	"Delivery to the port of destination ex-ship"
FCA	"Free carrier"
FOB	"Free on board"
Forecast of the Ministry of Economic Development	The document *"Forecast of Socio-economic Development of the Russian Federation for 2015 and planned period 2016 and 2017"* prepared by the Ministry of Economic Development of the Russian Federation or the similar document prepared for another period
FTS	Federal Tariffs Service
GTS	Gas Transmission System part of the UGSS
IFRS	International Financial Reporting Standards
List	the OFAC's Sectoral Sanctions Identification List
LNG	liquefied natural gas
LPG	liquefied petroleum gas
mcm	thousand cubic meters
MET	mineral extraction tax
OFAC	Office of Foreign Assets Control
PRMS	Petroleum Resources Management System
Purovsky Plant	Purovsky Gas Condensate Plant
Regulator	A federal executive agency of the Russian Federation that carries out governmental regulation of prices and tariffs for products and services of natural monopolies in energy, utilities and transportation. During the first half of 2015, the Federal Tariffs Service fulfilled the Regulator's role. In July 2015, a Decree of the President of the Russian Federation became effective abolishing the FTS and transferring its functions to the Federal Anti-Monopoly Service
RR	Russian rouble(s)
RZD	OAO Russian Railways, Russia's state-owned monopoly railway operator
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
Tobolsk Refining Facilities	Refining facilities of OOO SIBUR Tobolsk (formerly OOO Tobolsk-Neftekhim)
UGSF	Underground Gas Storage Facilities
UGSS	Unified Gas Supply System owned and operated by PAO Gazprom
UPT	unified natural resources production tax
USD, US dollar	United States Dollar
Ust-Luga Complex	Gas Condensate Fractionation and Transshipment Complex located at the Port of Ust-Luga on the Baltic Sea
VAT	Value added tax
Yamal LNG project	A large-scale project on constructing a liquefied natural gas plant with an annual capacity of 16.5 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula that Group undertakes jointly with TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through its joint venture OAO Yamal LNG
YNAO	Yamal-Nenets Autonomous Region