



PAO NOVATEK

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

FOR THE THREE MONTHS ENDED 31 MARCH 2018

General Provisions	3
Overview	3
Recent Developments	4
Basis of presentation	5
Selected data	6
Selected macro-economic data	8
Certain Factors Affecting our Results of Operations	9
Current economic conditions	9
Natural gas prices	9
Stable gas condensate and refined products, crude oil and liquefied petroleum gas prices	10
Transportation tariffs	12
Our tax burden and obligatory payments	13
Operational Highlights	16
Results of Operations for the three months ended 31 March 2018 compared to the corresponding period in 2017	20
Total revenues	21
Operating expenses	24
Other operating income (loss)	28
Net gain on disposal of interests in joint ventures	28
Profit from operations and EBITDA	29
Finance income (expense)	29
Share of profit (loss) of joint ventures, net of income tax	30
Income tax expense	30
Profit attributable to shareholders and earnings per share	31
Liquidity and Capital Resources	32
Cash flows	32
Liquidity and working capital	35
Capital expenditures	35
Qualitative and quantitative disclosures and market risks	37
Terms and abbreviations	39

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 2018 together with our unaudited consolidated interim condensed financial statements as of and for the three months ended 31 March 2018. The unaudited consolidated interim condensed financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". These consolidated interim condensed financial statements should be read together with the audited consolidated financial statements for the year ended 31 December 2017 prepared in accordance with International Financial Reporting Standards (IFRS).

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

OVERVIEW

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

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

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

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

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

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

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

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

RECENT DEVELOPMENTS

Implementing our Yamal LNG project

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

In late February 2018, Yamal LNG completed the main performance tests to confirm the design parameters of the plant's first LNG train. Average production rate per hour in winter conditions exceeded the plant's design capacity by 9%, demonstrating a higher efficiency of liquefying natural gas in the arctic climatic environment. In total, in the first quarter of 2018, 17 cargoes of LNG and six cargoes of stable gas condensate were shipped from the port of Sabetta.

Currently, the second and the third LNG trains are in advanced stage of construction. The launches of the second and third LNG trains are planned in 2018 and 2019, respectively.

Obtaining a patent for natural gas liquefaction technology

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

Increasing our resource base and production facilities

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

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

- In April 2018, we obtained the right for geological research works at the Centralno-Nadoyakhskiy license area. The license area is located in the YNAO and borders with the West-Solpatinskiy license area of the Group. As of 31 December 2017, the license area's recoverable resources under the category D of the Russian reserve classification totaled 258 bcm of natural gas and 144 million tons of liquid hydrocarbons.
- In March 2018, the Group won an auction held by the Federal Agency for the Use of Natural Resources of the Russian Federation for the right for geological research works, exploration and production of hydrocarbons at the Payutskiy license area. The license area is located in the Krasnoyarsk Region in close proximity to the Group's license areas on the Gydan peninsula, the West-Solpatinskiy, the North-Tanamskiy, the Nyavuyahskiy and Tanamskiy license areas. As of 31 December 2017, the license area's reserves and recoverable resources under the category C+D of the Russian reserve classification totaled 54 bcm of natural gas. The payment for the license was set at RR 66 million.

- In January 2018, the Group acquired a 100% participation interest in OOO Chernichnoye for RR 616 million. OOO Chernichnoye is a holder of the license for geological research works, exploration and production of hydrocarbons within the Chernichniy license area located in the YNAO in close proximity to the Termokarstovoye field of our joint venture ZAO Terneftegas. As of 31 December 2017, the license area's reserves under the category B of the Russian reserve classification totaled 17.7 bcm of natural gas and 7.8 million tons of liquid hydrocarbons.

The change in the participation interest in AO Arcticgas

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

- In January 2018, Yamal Development and SeverEnergiya were merged with Arcticgas. As a result, the Group and Gazprom Neft obtained direct participation interests in Arcticgas of 53.3% and 46.7%, respectively.
- In March 2018, Gazprom Neft subscribed to an additional share emission of Arcticgas for a total cash consideration of RR 32.1 billion.

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

International oil and gas projects

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

BASIS OF PRESENTATION

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

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

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

PAO NOVATEK
Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018

SELECTED DATA

<i>millions of Russian roubles except as stated</i>	Three months ended 31 March:		Change %
	2018	2017	
Financial results			
Total revenues ⁽¹⁾	179,403	154,628	16.0%
Operating expenses	(131,037)	(109,364)	19.8%
Normalized EBITDA ^{(2),(3)}	76,306	68,180	11.9%
Normalized profit attributable to shareholders of PAO NOVATEK ⁽³⁾	41,476	71,018	(41.6%)
Normalized profit attributable to shareholders of PAO NOVATEK ⁽³⁾ , excluding the effect of foreign exchange gains (losses) ⁽⁴⁾	46,910	44,345	5.8%
Normalized earnings per share ⁽³⁾ (in Russian roubles)	13.75	23.54	(41.6%)
Normalized earnings per share ⁽³⁾ , excluding the effect of foreign exchange gains (losses) ⁽⁴⁾ (in Russian roubles)	15.56	14.70	5.8%
Net debt ⁽⁵⁾	88,859	114,413	(22.3%)
Production volumes ⁽⁶⁾			
Hydrocarbons production (million barrels of oil equivalent)	132.5	130.5	1.5%
Daily production (million barrels of oil equivalent per day)	1.47	1.45	1.5%
Operating results			
Natural gas sales volumes (million cubic meters)	20,263	18,752	8.1%
Crude oil sales volumes (thousand tons)	1,123	1,072	4.8%
Naphtha sales volumes (thousand tons)	943	1,130	(16.5%)
Liquefied petroleum gas sales volumes (thousand tons)	649	677	(4.1%)
Other stable gas condensate refined products (thousand tons)	623	707	(11.9%)
Stable gas condensate sales volumes (thousand tons)	436	524	(16.8%)
Cash flow results			
Net cash provided by operating activities	48,125	48,842	(1.5%)
Cash used for capital expenditures ⁽⁷⁾	9,712	4,738	105.0%
Free cash flow ⁽⁸⁾	38,413	44,104	(12.9%)

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

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

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

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

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

⁽⁶⁾ Oil and gas production is calculated based on 100% of production of our subsidiaries and our proportionate share in the production of our joint ventures including fuel gas. Production of the South-Tambeyskoye field of Yamal LNG is reported at 60% (see "Basis of presentation" above). Figures for the first quarter of 2017 were recalculated accordingly.

⁽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.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

Reconciliation of EBITDA and normalized EBITDA is as follows:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Profit	46,929	73,207	(35.9%)
Depreciation, depletion and amortization	8,097	8,488	(4.6%)
Impairment expenses (reversals), net	(4)	-	n/a
Loss (income) from changes in fair value of derivative financial instruments	(140)	(211)	(33.6%)
Total finance expense (income)	(5,402)	8,602	n/a
Total income tax expense	9,749	7,355	32.5%
Share of loss (profit) of joint ventures, net of income tax	(1,163)	(43,626)	(97.3%)
EBITDA from subsidiaries	58,066	53,815	7.9%
Share in EBITDA of joint ventures	19,885	14,365	38.4%
EBITDA	77,951	68,180	14.3%
Net gain on disposal of interests in joint ventures	(1,645)	-	n/a
Normalized EBITDA	76,306	68,180	11.9%
Normalized EBITDA from subsidiaries	56,421	53,815	4.8%

PAO NOVATEK

**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

SELECTED MACRO-ECONOMIC DATA

<i>Exchange rate, Russian roubles for one foreign currency unit ⁽¹⁾</i>	Three months ended 31 March:		Change %
	2018	2017	
US dollar (USD)			
Average for the period	56.88	58.84	(3.3%)
At the beginning of the period	57.60	60.66	(5.0%)
At the end of the period	57.26	56.38	1.6%
Depreciation (appreciation) of Russian rouble to US dollar	(0.6%)	(7.1%)	n/a
Euro			
Average for the period	69.87	62.65	11.5%
At the beginning of the period	68.87	63.81	7.9%
At the end of the period	70.56	60.60	16.4%
Depreciation (appreciation) of Russian rouble to Euro	2.5%	(5.0%)	n/a

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

• • •

<i>Average for the period</i>	Three months ended 31 March:		Change %
	2018	2017	
Benchmark natural gas prices ⁽²⁾			
NBP, USD per mmbtu	8.1	6.0	35.0%
Benchmark crude oil prices ⁽³⁾			
Brent, USD per barrel	66.8	53.7	24.4%
Urals, USD per barrel	65.2	52.2	24.9%
Urals, Russian roubles per barrel	3,709	3,071	20.8%
Benchmark crude oil prices excluding export duties ⁽⁴⁾			
Urals, USD per barrel	49.2	40.4	21.8%
Urals, Russian roubles per barrel	2,798	2,377	17.7%
Benchmark oil products ⁽⁵⁾ and liquefied petroleum gas ⁽⁶⁾ prices, USD per ton			
Naphtha Japan	582	497	17.1%
Naphtha CIF NWE	574	485	18.4%
Jet fuel	647	513	26.1%
Gasoil	588	481	22.2%
Fuel oil	370	318	16.4%
Liquefied petroleum gas	422	395	6.8%
Export duties, USD per ton ⁽⁷⁾			
Crude oil, stable gas condensate	117.0	86.5	35.3%
Naphtha	64.3	47.6	35.1%
Jet fuel, gasoil	35.1	25.9	35.5%
Fuel oil	117.0	86.5	35.3%
Liquefied petroleum gas	0.0	0.0	n/a

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

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

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

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

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

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

CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Current economic conditions

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

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

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

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

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

Natural gas prices

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

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

During the first half of 2017, wholesale natural gas prices for sales to all customer categories (excluding residential customers) on the domestic market remained unchanged. Effective 1 July 2017, the Regulator increased wholesale prices by 3.9% and they remained unchanged until the end of the first quarter of 2018.

In November 2017, the Ministry of Economic Development of the Russian Federation published the "Forecast of Socio-economic Development of the Russian Federation for 2018 and planned period 2019 and 2020" stating that wholesale natural gas prices for sales to all customer categories (excluding residential customers) will be increased from July 2018, 2019 and 2020 by an average of 3.4%, 3.1% and 3.0%, respectively. The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth rates on the domestic market.

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

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

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

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

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

	Three months ended 31 March:		Change %
	2018	2017	
Average natural gas price, RR per mcm	4,367	3,600	21.3%
Average natural gas price, USD per mcm ⁽¹⁾	76.8	61.2	25.5%

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

In the three months ended 31 March 2018, our aggregate average price for natural gas sold in the Russian Federation and on the international markets increased by 21.3% mainly due to the commencement of LNG sales to international markets from December 2017, as well as an increase in the regulated Russian domestic price by 3.9% effective 1 July 2017.

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

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

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

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

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

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

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

<i>Russian roubles or US dollars per ton ⁽¹⁾</i>	Three months ended 31 March:		Change %
	2018	2017	
Stable gas condensate			
Average net price, RR per ton	20,381	18,657	9.2%
Average net price, USD per ton	358	315	13.7%
Naphtha			
Average net price, RR per ton	31,071	27,181	14.3%
Average net price, USD per ton	547	461	18.7%
Other stable gas condensate refined products			
Average net price, RR per ton	29,897	25,656	16.5%
Average net price, USD per ton	526	433	21.5%
Crude oil			
Average net price, RR per ton	19,982	16,438	21.6%
Average net price, USD per ton	352	279	26.2%
LPG			
Average net price, RR per ton	16,337	14,972	9.1%
Average net price, USD per ton	287	254	13.0%

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

In the three months ended 31 March 2018, our weighted-average realized net prices for our liquid hydrocarbons increased compared to the corresponding period in 2017 due to an increase in the underlying benchmark prices for these products excluding export duties (see "Selected macro-economic data" above). Our weighted-average realized net prices in Russian roubles terms increased to a lesser extent compared to US dollar prices as a result of 3.3% Russian rouble appreciation relative to the US dollar in the three months ended 31 March 2018 compared to the corresponding period in 2017.

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

Transportation tariffs*Natural gas by pipelines*

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

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

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

According to the Forecast of the Ministry of Economic Development of the Russian Federation published in November 2017, the increase in tariffs for natural gas transportation through the trunk pipeline in 2018 to 2020 will not exceed the growth rate for wholesale natural gas prices (see "Natural gas prices" above). The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth on the domestic market.

Stable gas condensate and LPG by rail

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

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

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

In 2017 and in the first quarter of 2018, we applied the discount coefficient of 0.94 to the existing railroad transportation tariffs for stable gas condensate deliveries from the Limbey rail station to the port of Ust-Luga and to end-customers on the domestic and export markets. The discount coefficient is set by the decision of the Management Board of RZD as part of the Strategic Partnership Agreement between the Group and RZD.

Stable gas condensate, refined products and liquefied natural gas by tankers

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

Crude oil

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

Effective 1 January 2018, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 3.9% relative to the 2017 tariffs.

Our tax burden and obligatory payments

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

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

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

UPT – natural gas and gas condensate

In accordance with the Tax Code of the Russian Federation, the UPT rates for natural gas and gas condensate are calculated monthly according to a formula based on which the set base UPT rate is multiplied by the base value of a standard fuel equivalent and a coefficient characterizing the difficulty of extracting natural gas and gas condensate from each particular field. In addition, the formula for gas condensate UPT rate is multiplied by an adjusting coefficient (set at 6.5 in both reporting periods), and the UPT rate for natural gas also takes into account a parameter characterizing natural gas transportation costs (set at zero in both reporting periods and did not affect the UPT rate).

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

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

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018***UPT – crude oil*

In both reporting periods, the UPT rate for crude oil was calculated as a product of a coefficient characterizing the dynamics of world crude oil prices and the base UPT rate adjusted for parameters characterizing crude oil production peculiarities at the particular area. The result was then additionally increased by RR 306 per ton in 2017 and by RR 357 per ton in 2018 (in 2019 and 2020, the increase is set at RR 428 per ton).

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

Export duties and excise taxes

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

The export duty rate for stable gas condensate and crude oil for the next calendar month is calculated based on the average Urals crude oil price for the period from the 15th calendar day in the previous month to the 14th calendar day of the current month. In both reporting periods, the calculation of the export duty rate in US dollars per ton when the average Urals crude oil price is more than USD 182.5 per ton (or USD 25 per barrel) was set as follows: USD 29.2 plus 30% of the difference between the average Urals crude oil price and USD 182.5 per ton.

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

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

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

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

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

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

Most of our LPG sales in Poland are subject to excise and fuel taxes in accordance with the local legislation. The amount of excise and fuel tax payments depends on the volume of excisable goods sold and the respective tax rates (the excise tax rate in both reporting periods amounted to 670 Polish zloty per ton, and the fuel tax rate was increased from 159.71 Polish zloty per ton in 2017 to 162.27 Polish zloty per ton in 2018).

Social contributions

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

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

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

The table below provides for the rates and maximum taxable bases set by the Russian Federation government for social contributions in 2017 and 2018:

	2017		2018	
	Base, RR thousand	Rate, %	Base, RR thousand	Rate, %
Pension Fund of the Russian Federation	less 876 above 876	22.0% 10.0%	less 1,021 above 1,021	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 755 above 755	2.9% 0.0%	less 815 above 815	2.9% 0.0%

OPERATIONAL HIGHLIGHTS

Hydrocarbon production and sales volumes

In the current reporting period, our operational results were significantly impacted by the production launch at the first LNG train at Yamal LNG at the end of 2017, as well as the acquisitions of new production assets at the end of 2017 and during the first quarter of 2018. As a result, our total natural gas production increased by 2.2%, and our total liquids production decreased slightly by 1.0%.

In the three months ended 31 March 2018, our total natural gas sales volumes increased by 1,511 mmcm, or 8.1%, due to sales of LNG purchased from our joint venture Yamal LNG to international markets from December 2017, as well as an increase in volumes sold in the Russian Federation.

In the three months ended 31 March 2018, our liquids sales volumes decreased by 336 thousand tons, or 8.2%, mainly due to changes in inventory balances that vary period-to-period depending on shipping schedules and final destinations of our liquid hydrocarbons shipments.

Natural gas production volumes

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

<i>millions of cubic meters if not stated otherwise</i>	Three months ended 31 March:		Change %
	2018	2017	
Production by subsidiaries from:			
Yurkharovskoye field	7,031	8,107	(13.3%)
East-Tarkosalinskoye field	1,672	1,894	(11.7%)
Khancheyevskoye field	514	606	(15.2%)
Other fields	1,146	652	75.8%
Total natural gas production by subsidiaries ⁽¹⁾	10,363	11,259	(8.0%)
Group's proportionate share in the production of joint ventures:			
Arcticgas	3,555	3,453	3.0%
Yamal LNG ⁽²⁾	1,340	39	n/a
Nortgas	937	1,086	(13.7%)
Terneftegas	313	313	0.0%
Total Group's proportionate share in the natural gas production of joint ventures ⁽¹⁾	6,145	4,891	25.6%
Total natural gas production including proportionate share in the production of joint ventures	16,508	16,150	2.2%
<i>The Group's proportionate share in LNG production of joint ventures (thousands of tons) ⁽²⁾</i>	799	-	n/a
⁽¹⁾ Natural gas production includes natural gas volumes consumed in oil and gas production and development activities (primarily, as fuel gas):			
in subsidiaries	333	338	(1.5%)
in joint ventures (Group's proportionate share)	85	91	(6.6%)

Production for 2017 was recalculated accordingly.

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

The commencement of natural gas production for subsequent liquefaction at Yamal LNG at the end of 2017, as well as the acquisition by the Group of new production fields at the end of 2017 and during the first quarter of 2018 (the Beregovoye, the West-Yaroyakhinskoye and the Syskonsyninskoye) fully compensated the decrease in production at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint venture Nortgas, which resulted mainly from natural declines in the reservoir pressure at the current gas producing horizons. As a result, in the three months ended 31 March 2018, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 358 mmcm, or 2.2%, to 16,508 mmcm from 16,150 mmcm in the corresponding period in 2017.

Natural gas sales volumes

In the three months ended 31 March 2018, our total natural gas sales volumes increased by 1,511 mmcm, or 8.1%, to 20,263 mmcm from 18,752 mmcm in the corresponding period in 2017.

<i>millions of cubic meters</i>	Three months ended 31 March:		Change %
	2018	2017	
Production by subsidiaries	10,363	11,259	(8.0%)
Purchases from the Group's joint ventures	7,587	5,301	43.1%
Other purchases	1,729	1,860	(7.0%)
Total production and purchases	19,679	18,420	6.8%
Own usage ⁽¹⁾	(370)	(372)	(0.5%)
Decrease (increase) in natural gas inventory balance	954	704	35.5%
Total natural gas sales volumes in the Russian Federation	20,263	18,752	8.1%
<i>Sold to end-customers</i>	<i>18,063</i>	<i>17,329</i>	<i>4.2%</i>
<i>Sold ex-field</i>	<i>1,242</i>	<i>1,423</i>	<i>(12.7%)</i>
<i>Subtotal sold in the Russian Federation</i>	<i>19,305</i>	<i>18,752</i>	<i>2.9%</i>
<i>Sold on international markets</i>	<i>958</i>	<i>-</i>	<i>n/a</i>

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

In the three months ended 31 March 2018, natural gas purchases from our joint ventures increased by 2,286 mmcm, or 43.1%, to 7,587 mmcm from 5,301 mmcm in the corresponding period in 2017 primarily due to the commencement of purchases of LNG produced at Yamal LNG for subsequent sale on international markets from December 2017 and an increase in purchases of natural gas from Arcticgas in order to fulfill our Russian domestic contractual sales obligations.

Other natural gas purchases decreased by 131 mmcm, or 7.0%, to 1,729 mmcm from 1,860 mmcm in the corresponding period in 2017, and are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize end-customers portfolios.

As of 31 March 2018, our cumulative natural gas inventory balance, representing our inventory balances mainly in the GTS, the UGSF and our own pipeline infrastructure, aggregated 79 mmcm and decreased by 954 mmcm during the quarter as compared to a decrease by 704 mmcm in the corresponding period in 2017.

PAO NOVATEK

**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

Liquids production volumes

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

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2018	2017	
Production by subsidiaries from:			
Yarudeyskoye field	864	886	(2.5%)
Yurkharovskoye field	328	400	(18.0%)
East-Tarkosalinskoye field	318	326	(2.5%)
Khancheyskoye field	59	74	(20.3%)
Other fields	59	27	118.5%
Total liquids production by subsidiaries	1,628	1,713	(5.0%)
<i>including crude oil</i>	<i>1,160</i>	<i>1,183</i>	<i>(1.9%)</i>
<i>including gas condensate</i>	<i>468</i>	<i>530</i>	<i>(11.7%)</i>
Group's proportionate share in the production of joint ventures:			
Arcticgas	1,041	1,047	(0.6%)
Terneftegas	103	107	(3.7%)
Yamal LNG ⁽¹⁾	83	-	n/a
Nortgas	81	100	(19.0%)
Total Group's proportionate share in the liquids production of joint ventures	1,308	1,254	4.3%
Total liquids production including proportionate share in the production of joint ventures	2,936	2,967	(1.0%)

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

The commencement of gas condensate production at Yamal LNG at the end of 2017, as well as the acquisition by the Group of new production fields almost compensated for the decrease in gas condensate production at mature fields of our subsidiaries (Yurkharovskoye, East-Tarkosalinskoye and Khancheyskoye) and our joint venture Nortgas mainly due to natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons. As a result, in the three months ended 31 March 2018, our total liquids production (including our proportionate share in the production of joint ventures) decreased slightly by 31 thousand tons, or 1.0%, to 2,936 thousand tons from 2,967 thousand tons in the corresponding period in 2017.

PAO NOVATEK

**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

Liquids sales volumes

In the three months ended 31 March 2018, our total liquids sales volumes decreased by 336 thousand tons, or 8.2%, to 3,777 thousand tons from 4,113 thousand tons in the corresponding period in 2017.

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2018	2017	
Production by subsidiaries	1,628	1,713	(5.0%)
Purchases from the Group's joint ventures	2,300	2,343	(1.8%)
Other purchases	44	37	18.9%
Total production and purchases	3,972	4,093	(3.0%)
Losses ⁽¹⁾ and own usage ⁽²⁾	(55)	(70)	(21.4%)
Decreases (increases) in liquids inventory balances	(140)	90	n/a
Total liquids sales volumes	3,777	4,113	(8.2%)
<i>Naphtha export</i>	943	1,130	(16.5%)
<i>Other stable gas condensate refined products export</i> ⁽³⁾	600	674	(11.0%)
<i>Other stable gas condensate refined products domestic</i> ⁽³⁾	23	33	(30.3%)
Subtotal stable gas condensate refined products	1,566	1,837	(14.8%)
<i>Crude oil export</i>	379	257	47.5%
<i>Crude oil domestic</i>	744	815	(8.7%)
Subtotal crude oil	1,123	1,072	4.8%
<i>LPG export</i>	139	133	4.5%
<i>LPG domestic</i>	510	544	(6.3%)
Subtotal LPG	649	677	(4.1%)
<i>Stable gas condensate export</i>	-	134	n/a
<i>Stable gas condensate domestic</i>	436	390	11.8%
Subtotal stable gas condensate	436	524	(16.8%)
Other oil products	3	3	0.0%

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

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

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

In the three months ended 31 March 2018, our purchases of liquid hydrocarbons from joint ventures decreased by 43 thousand tons, or 1.8%, due to a decrease in purchases of gas condensate from Nortgas (see "Liquids production volumes" above).

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

In the 2018 reporting period, our liquids inventory balances increased by 140 thousand tons to 1,102 thousand tons as of 31 March 2018 as compared to a decrease in inventory balances by 90 thousand tons to 813 thousand tons in the corresponding period in 2017. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018****RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2018 COMPARED
TO THE CORRESPONDING PERIOD IN 2017**

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2018 and 2017. Each line item is also shown as a percentage of our total revenues.

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2018	% of total revenues	2017	% of total revenues
Total revenues ⁽¹⁾	179,403	100.0%	154,628	100.0%
<i>including:</i>				
natural gas sales	88,485	49.3%	67,503	43.7%
liquids sales	90,000	50.2%	86,498	55.9%
Operating expenses	(131,037)	(73.0%)	(109,364)	(70.7%)
Other operating income (loss)	102	0.0%	274	0.2%
Profit from operations before disposals of interests in joint ventures	48,468	27.0%	45,538	29.5%
Net gain on disposal of interests in joint ventures	1,645	0.9%	-	<i>n/a</i>
Profit from operations	50,113	27.9%	45,538	29.5%
Finance income (expense)	5,402	3.0%	(8,602)	(5.6%)
Share of profit (loss) of joint ventures, net of income tax	1,163	0.7%	43,626	28.2%
Profit before income tax	56,678	31.6%	80,562	52.1%
Total income tax expense	(9,749)	(5.4%)	(7,355)	(4.8%)
Profit	46,929	26.2%	73,207	47.3%
Less: profit (loss) attributable to non-controlling interest	(3,808)	(2.2%)	(2,189)	(1.4%)
Profit attributable to shareholders of PAO NOVATEK	43,121	24.0%	71,018	45.9%
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	46,910	26.1%	44,345	28.7%

⁽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 2018 and 2017:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %	Change ⁽¹⁾		
	2018	2017		Total	Due to volume ⁽²⁾	Due to price ⁽³⁾
Natural gas sales	88,485	67,503	31.1%	20,982	5,439	15,543
Stable gas condensate refined products sales	47,934	48,854	(1.9%)	(920)	(7,231)	6,311
<i>Naphtha</i>	29,290	30,722	(4.7%)	(1,432)	(5,099)	3,667
<i>Other refined products</i>	18,644	18,132	2.8%	512	(2,132)	2,644
Crude oil sales	22,448	17,621	27.4%	4,827	846	3,981
Liquefied petroleum gas sales	10,604	10,138	4.6%	466	(419)	885
Stable gas condensate sales	8,886	9,785	(9.2%)	(899)	(1,652)	753
Other products sales	128	100	28.0%	28	n/a	n/a
Total oil and gas sales	178,485	154,001	15.9%	24,484	n/a	n/a
Other revenues	918	627	46.4%	291	n/a	n/a
Total revenues	179,403	154,628	16.0%	24,775	n/a	n/a

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

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

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

Natural gas sales

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

The commencement of sales of LNG purchased from our joint venture Yamal LNG to international markets from December 2017, as well as an increase in sales prices and volumes in the Russian domestic market resulted in an increase in our aggregate average price by 21.3% and sales volumes by 8.1% (see "Natural gas prices" and "Natural gas sales volumes" above). As a result, in the three months ended 31 March 2018, our total revenues from natural gas sales increased by RR 20,982 million, or 31.1%, compared to the corresponding period in 2017.

Stable gas condensate refined products sales

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

In the three months ended 31 March 2018, our revenues from sales of stable gas condensate refined products decreased by RR 920 million, or 1.9%, to 47,934 million from 48,854 million in the corresponding period in 2017 due to a decrease in sales volumes (see "Liquids sales volumes" above) which was largely offset by an increase in average realized prices.

In the three months ended 31 March 2018, our revenues from sales of naphtha decreased by RR 1,432 million, or 4.7%, as compared to the corresponding period in 2017. In the three months ended 31 March 2018 and 2017, we exported 943 thousand and 1,130 thousand tons of naphtha, respectively, to the APR, and the European and North America markets. We sold naphtha at different delivery terms: CFR, CIF, DES and FOB (only in the first quarter of 2017). Our average realized net price, excluding export duties, where applicable, increased by RR 3,890 per ton, or 14.3%, to RR 31,071 per ton from RR 27,181 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2018, our total revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 512 million, or 2.8%, as compared to the corresponding period in 2017. In the three months ended 31 March 2018 and 2017, we exported in aggregate 600 thousand and 674 thousand tons of these products mainly to the European markets, or 96.3% and 95.3% of total sales volumes (on the domestic and export markets), respectively. In both reporting periods, the export delivery terms were CIF, DES and FOB. Our average realized net price, excluding export duties, where applicable, increased by RR 4,241 per ton, or 16.5%, to RR 29,897 per ton from RR 25,656 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Crude oil sales

In the three months ended 31 March 2018, our revenues from crude oil sales increased by RR 4,827 million, or 27.4%, compared to the corresponding period in 2017 primarily due to an increase in average realized prices and, to a lesser extent, an increase in sales volumes.

In the three months ended 31 March 2018, we sold 744 thousand tons, or 66.3% of our total crude oil sales volumes, domestically as compared to sales of 815 thousand tons, or 76.0%, in the corresponding period in 2017. The remaining 379 thousand tons of crude oil, or 33.7% of our total crude oil sales volumes, in the current reporting period and 257 thousand tons, or 24.0%, in the corresponding period in 2017 were sold to the European and the APR markets under FOB delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 3,544 per ton, or 21.6%, to RR 19,982 per ton from RR 16,438 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Liquefied petroleum gas sales

In the three months ended 31 March 2018, our revenues from sales of LPG increased by RR 466 million, or 4.6%, compared to the corresponding period in 2017 due to an increase in average realized prices.

In the three months ended 31 March 2018, we sold 510 thousand tons of LPG, or 78.6% of our total LPG sales volumes, on the domestic market compared to sales of 544 thousand tons, or 80.4%, in the corresponding period in 2017. The remaining 139 thousand tons of LPG, or 21.4% of our total LPG sales volumes, in the three months ended 31 March 2018 and 133 thousand tons of LPG, or 19.6%, in the corresponding period in 2017 were sold to the European markets (primarily to the Polish market) under free carrier FCA (at terminal points in Poland) delivery terms and also under DAP (at the border of the customer's country) delivery terms in the first quarter of 2017.

Our average realized LPG net price, excluding export and import duties, excise and fuel taxes expense, where applicable, in the three months ended 31 March 2018 increased by RR 1,365 per ton, or 9.1%, to RR 16,337 per ton from RR 14,972 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Stable gas condensate sales

In the three months ended 31 March 2018, our revenues from sales of stable gas condensate decreased by RR 899 million, or 9.2%, compared to the corresponding period in 2017 due to a decrease in sales volumes in the current reporting period (see "Liquids sales volumes" above) that was partially offset by an increase in average realized net prices.

In the three months ended 31 March 2018, we sold 436 thousand tons of stable gas condensate, or 100.0% of our total stable gas condensate sales volumes, on the domestic market compared to sales of 390 thousand tons, or 74.4%, in the corresponding period in 2017. The remaining 134 thousand tons, or 25.6% of our total stable gas condensate sales volumes, in the first quarter of 2017 we sold to the European markets under DAP and CIF delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 1,724 per ton, or 9.2%, to RR 20,381 per ton from RR 18,657 per ton in the corresponding period in 2017 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

Other products sales

Other products sales represent our revenues from the domestic sales of purchased oil products (diesel fuel and petrol) through our retail stations, sales of other purchased liquid hydrocarbons, and sales of our produced methanol. In the three months ended 31 March 2018, our revenues from other products sales increased by RR 28 million, or 28.0%, to RR 128 million from RR 100 million in the corresponding period in 2017.

Other revenues

Other revenues include revenue from transportation, geological and geophysical research services, repair and maintenance of energy equipment services, and other services. In the three months ended 31 March 2018, other revenues increased by RR 291 million, or 46.4%, to RR 918 million from RR 627 million in the corresponding period in 2017 primarily due to an increase in revenues from tankers transporting third party goods by RR 261 million.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018****Operating expenses**

In the three months ended 31 March 2018, our total operating expenses increased by RR 21,673 million, or 19.8%, to RR 131,037 million compared to RR 109,364 million in the corresponding period in 2017 mainly due to an increase in purchases of natural gas and liquid hydrocarbons as a result of an increase in volumes of natural gas purchased from our joint ventures, in particular, in connection with the commencement of LNG production at Yamal LNG at the end of 2017, as well as an increase in the average purchase prices for hydrocarbons (see "Purchases of natural gas and liquid hydrocarbons" below), which in turn allowed us to earn higher revenues from hydrocarbons sales. Our total operating expenses as a percentage of total revenues increased from 70.7% to 73.0%.

<i>millions of Russian roubles</i>	Three months ended 31 March:			
	2018	% of total revenues	2017	% of total revenues
Purchases of natural gas and liquid hydrocarbons	61,815	34.5%	41,970	27.1%
Transportation expenses	37,794	21.1%	36,782	23.8%
Taxes other than income tax	13,422	7.5%	12,341	8.0%
Depreciation, depletion and amortization	8,097	4.5%	8,488	5.5%
Materials, services and other	5,563	3.1%	4,800	3.1%
General and administrative expenses	4,593	2.6%	3,993	2.6%
Exploration expenses	1,709	1.0%	388	0.3%
Impairment expenses (reversals), net	(4)	n/a	-	n/a
Changes in natural gas, liquid hydrocarbons and work-in-progress	(1,952)	n/a	602	0.4%
Total operating expenses	131,037	73.0%	109,364	70.7%

Purchases of natural gas and liquid hydrocarbons

In the three months ended 31 March 2018, our purchases of natural gas and liquid hydrocarbons increased by RR 19,845 million, or 47.3%, to RR 61,815 million from RR 41,970 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Unstable gas condensate	31,313	26,691	17.3%
Natural gas	29,645	14,615	102.8%
Other hydrocarbons	857	664	29.1%
Total purchases of natural gas and liquid hydrocarbons	61,815	41,970	47.3%

In the three months ended 31 March 2018, our purchases of unstable gas condensate from our joint ventures increased by RR 4,622 million, or 17.3%, as compared to the corresponding period in 2017 due to an increase in purchase prices, which are impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

In the three months ended 31 March 2018, our purchases of natural gas increased by RR 15,030 million, or 102.8%, as compared to the corresponding period in 2017 mainly due to the commencement of purchases of LNG produced at Yamal LNG for subsequent sale on international markets from December 2017 and an increase in volumes of natural gas purchased from Arcticgas in order to fulfill our contractual sales obligations on the domestic market. In addition, our purchases of natural gas increased due to an increase in purchase prices on the domestic market that are influenced by the regulated natural gas prices (see "Prices for natural gas sold in the Russian Federation" above).

Other hydrocarbons purchases represent our purchases of oil products and LPG for subsequent resale depending on the demand for these types of products. In the three months ended 31 March 2018, our purchases of other hydrocarbons increased by RR 193 million, or 29.1%, as compared to the corresponding period in 2017 mainly due to an increase in volumes of LPG purchases for subsequent small volume wholesale and retail sales.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018***Transportation expenses*

In the three months ended 31 March 2018, our total transportation expenses increased by RR 1,012 million, or 2.8%, to RR 37,794 million as compared to RR 36,782 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Natural gas transportation			
by trunk and low-pressure pipelines	26,617	25,371	4.9%
Stable gas condensate and liquefied petroleum gas transportation by rail	7,146	7,975	(10.4%)
Crude oil transportation by trunk pipelines	2,086	1,636	27.5%
Stable gas condensate and refined products, crude oil and liquefied natural gas transportation by tankers	1,924	1,785	7.8%
Other	21	15	40.0%
Total transportation expenses	37,794	36,782	2.8%

In the three months ended 31 March 2018, our expenses for natural gas transportation increased by RR 1,246 million, or 4.9%, to RR 26,617 million from RR 25,371 million in the corresponding period in 2017 due to a 4.2% increase in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses, as well as an increase in the proportion of sales to our end-customers located at more distant regions from our production fields in the current period as compared to the reporting period in the previous year.

In the three months ended 31 March 2018, our total expenses for stable gas condensate and LPG transportation by rail decreased by RR 829 million, or 10.4%, to RR 7,146 million from RR 7,975 million in the corresponding period in 2017 due to a 14.8% decrease in volumes of liquids sold and transported via rail. The weighted average transportation cost per unit increased by 5.2% mainly due to a 5.4% increase in the regulated railroad transportation tariffs effective January 2018 (see "Transportation tariffs" above).

In the three months ended 31 March 2018, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 450 million, or 27.5%, to RR 2,086 million from RR 1,636 million in the corresponding period in 2017. The increase was due to an increase in the proportion of crude oil sales to more distant regions from our production fields, a 4.8% increase in sales volumes compared to the corresponding period of the prior year, as well as a 3.9% increase in the regulated transportation tariffs effective 1 January 2018 (see "Transportation tariffs" above).

In the three months ended 31 March 2018, our total transportation expenses for hydrocarbons delivered by tankers to international markets increased by RR 139 million, or 7.8%, to RR 1,924 million from RR 1,785 million in the corresponding period in 2017 primarily due to the commencement of sales of LNG purchased from our Yamal LNG to international markets from December 2017.

Taxes other than income tax

In the three months ended 31 March 2018, taxes other than income tax increased by RR 1,081 million, or 8.8%, to RR 13,422 million from RR 12,341 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Unified natural resources production tax (UPT)	12,385	11,458	8.1%
Property tax	949	825	15.0%
Other taxes	88	58	51.7%
Total taxes other than income tax	13,422	12,341	8.8%

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

In the three months ended 31 March 2018, our unified natural resources production tax expense increased by RR 927 million, or 8.1%, to RR 12,385 million from RR 11,458 million in the corresponding period in 2017 mainly due to an increase in UPT rates for crude oil as a result of an increase in benchmark crude oil prices, as well as due to changes in the formula for crude oil UPT rate calculation effective 1 January 2018 (see "Our tax burden and obligatory payments" above).

In the three months ended 31 March 2018, our property tax expense increased by RR 124 million, or 15.0%, to RR 949 million from RR 825 million in the corresponding period in 2017 mainly due to acquisitions of new production assets at the end of 2017 and in the first quarter of 2018.

Depreciation, depletion and amortization

In the three months ended 31 March 2018, our depreciation, depletion and amortization ("DDA") expense decreased by RR 391 million, or 4.6%, to RR 8,097 million from RR 8,488 million in the corresponding period in 2017 mainly due to an increase in total proved reserves (excluding acquisitions) in our subsidiaries as at the end of 2017 compared to the previous period. This effect was partially offset as a result of consolidating new production assets at the end of 2017 and in the first quarter of 2018. 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 2018, our materials, services and other expenses increased by RR 763 million, or 15.9%, to RR 5,563 million compared to RR 4,800 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Employee compensation	2,739	2,179	25.7%
Repair and maintenance	517	580	(10.9%)
Complex of services for preparation, transportation and processing of hydrocarbons	494	494	0.0%
Materials and supplies	419	434	(3.5%)
Electricity and fuel	338	299	13.0%
Liquefied petroleum gas volumes reservation expenses	273	216	26.4%
Fire safety and security expenses	225	171	31.6%
Transportation services	191	170	12.4%
Rent expenses	92	68	35.3%
Insurance expense	82	50	64.0%
Other	193	139	38.8%
Total materials, services and other	5,563	4,800	15.9%

Operating employee compensation increased by RR 560 million, or 25.7%, to RR 2,739 million compared to RR 2,179 million in the corresponding period in 2017 due to the acquisition of new production assets at the end of 2017 and in the first quarter of 2018, an indexation of base salaries effective from 1 July 2017 and the related increase in social contributions for medical and social insurance and to the Pension Fund.

In the three months ended 31 March 2018, liquefied petroleum gas volumes reservation costs increased by RR 57 million, or 26.4%, to RR 273 million from RR 216 million in the corresponding period in 2017 as a result of a 15.5% depreciation of the average exchange rate of the Russian rouble relative to the Polish zloty, since this expense is denominated in Polish zloty, as well as due to an increase in LPG volumes sold through our subsidiary in Poland. The reservation of LPG is required in order to maintain the necessary strategic reserve in Poland in accordance with local regulation.

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

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018***General and administrative expenses*

In the three months ended 31 March 2018, our general and administrative expenses increased by RR 600 million, or 15.0%, to RR 4,593 million compared to RR 3,993 million in the corresponding period in 2017. The main components of these expenses were employee compensation and social expenses and compensatory payments, which, on aggregate, comprised 83.8% and 80.9% of total general and administrative expenses in the three months ended 31 March 2018 and 2017, respectively.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Employee compensation	3,073	2,564	19.9%
Social expenses and compensatory payments	775	665	16.5%
Legal, audit and consulting services	259	246	5.3%
Fire safety and security expenses	112	106	5.7%
Business travel expense	89	62	43.5%
Repair and maintenance expenses	46	42	9.5%
Advertising expenses	26	49	(46.9%)
Rent expense	20	24	(16.7%)
Other	193	235	(17.9%)
Total general and administrative expenses	4,593	3,993	15.0%

Employee compensation relating to administrative personnel increased by RR 509 million, or 19.9%, to RR 3,073 million in the three months ended 31 March 2018 from RR 2,564 million in the corresponding period in 2017 due to an indexation of base salaries effective from 1 July 2017 and the related increase in social contributions for medical and social insurance and to the Pension Fund, as well as the acquisition of new assets at the end of 2017 and in the first quarter of 2018.

In the three months ended 31 March 2018, our social expenses and compensatory payments increased by RR 110 million, or 16.5%, to RR 775 million compared to RR 665 million in the corresponding period in 2017. The increase was largely due to increased social expenses related mainly to continued support of charities and social programs in the regions where we operate. In addition, in the three months ended 31 March 2018 and 2017, we made compensatory payments in the amount of RR 375 million and RR 364 million, respectively, which related to the development of the Salmanovskoye (Utrenneye) field in the current reporting period and mainly the Yarudeyskoye field in the corresponding period in 2017. Social expenses and compensatory payments fluctuate period-on-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

Exploration expenses

In the three months ended 31 March 2018, our exploration expenses significantly increased by RR 1,321 million, or 340.5%, to RR 1,709 million from RR 388 million in the corresponding period in 2017 and mainly related to exploration works performed at the Verhnetiuteyskiy and the West-Seyakhinskiy, the Gydanskiy, the Trekhbugorniy, the North-Tanamskiy, the Olimpiyskiy, the Shtormovoy and the North-Russkiy license areas in the current reporting period, and at the Trekhbugorniy license area in the corresponding period in 2017. Exploration expenses include geological and geophysical research services expenditures, expenditures associated with the maintenance of license areas with non-proven reserves and other expenditures relating to exploration activity, as well as expenses of our science and technology center associated with the exploration activities at our fields. The exploration expenses fluctuate period-to-period in accordance with the approved working schedule of exploration works at our production subsidiaries.

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

In the three months ended 31 March 2018, we recorded a reversal of RR 1,952 million to changes in inventory expense mainly due to an increase in stable gas condensate refined products inventory balances as of 31 March compared to 1 January. In the corresponding period in 2017, we recorded a charge of RR 602 million to changes in inventory expense as a result of a decrease in our hydrocarbons inventory balances.

In the three months ended 31 March 2018 and 2017, our cumulative natural gas inventory balance located mainly in the Underground Gas Storage Facilities ("UGSF"), the GTS and own pipeline infrastructure, decreased by 954 mmcm and 704 mmcm, respectively, due to a seasonal withdrawal of natural gas during the period of higher demand to fulfill our contractual sales obligations.

In the three months ended 31 March 2018, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, increased by 140 thousand tons mainly due to an increase in inventory balance of stable gas condensate refined products in storage capacities of our Ust-Luga Complex and in tankers in transit not realized at the reporting date. In the corresponding period in 2017, our cumulative liquid hydrocarbons inventory balances decreased by 90 thousand tons primarily due to a decrease in inventory balance of stable gas condensate refined products in storage capacities of our Ust-Luga Complex. Inventory balances of stable gas condensate and refined products tend to fluctuate period-to-period depending on shipment schedules and final destination of our shipments.

The following table highlights movements in our hydrocarbons inventory balances:

<i>Inventory balances in transit or in storage</i>	2018			2017		
	At 31 March	At 1 January	Increase / (decrease)	At 31 March	At 1 January	Increase / (decrease)
Natural gas (millions of cubic meters)	79	1,033	(954)	130	834	(704)
<i>incl. Gazprom's UGSF</i>	-	870	(870)	-	787	(787)
Liquid hydrocarbons (thousand tons)	1,102	962	140	813	903	(90)
<i>incl. stable gas condensate refined products</i>	631	464	167	284	395	(111)
<i>stable gas condensate</i>	261	290	(29)	258	307	(49)
<i>crude oil</i>	107	103	4	177	105	72

Other operating income (loss)

Other operating income (loss) includes realized income (loss) from hydrocarbons trading on the international markets, income (loss) from the change in the fair value of the aforementioned contracts, as well as other income (loss) relating to penalty charges, disposal of materials, fixed assets and other transactions. In the three months ended 31 March 2018, we recognized other operating income of RR 102 million compared to other operating income of RR 274 million in the corresponding period in 2017.

In the three months ended 31 March 2018, within our trading activities we purchased and sold approximately 1.4 bcm of natural gas, as well as various derivative commodity instruments, and recognized the aggregate realized loss from trading activities of RR 270 million as compared to RR 30 million of loss in the corresponding period in 2017. At the same time, we recognized non-cash income of RR 140 million in the three months ended 31 March 2018 as a result of an increase in the fair value of aforementioned contracts as compared to RR 211 million of non-cash income in the corresponding period in 2017.

Net gain on disposal of interests in joint ventures

In the first quarter of 2018, the Group and PAO Gazprom Neft completed the final stage of the previously commenced restructuring procedures to achieve parity shareholdings in our joint venture AO Arcticgas. As a result, the Group's participation interest in Arcticgas decreased from 53.3% to 50.0% and the Group recognized a gain on the disposal of the 3.3% participation interest in Arcticgas in the amount of RR 1,645 million.

Profit from operations and EBITDA

In the three months ended 31 March 2018, our profit from operations and EBITDA including our proportionate share of joint ventures increased due to the production launch of the first LNG train at Yamal LNG in the end of 2017 and an increase in average realized liquid hydrocarbons and natural gas prices.

Our aggregate EBITDA including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in joint ventures, increased to RR 76,306 million from RR 68,180 million in the corresponding period in 2017. Our cumulative profit from operations including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in joint ventures, amounted to RR 63,108 million as compared to RR 55,444 million in the corresponding period in 2017, including profit from operations of our subsidiaries in the amount of RR 48,468 million and RR 45,538 million, respectively.

Finance income (expense)

In the three months ended 31 March 2018, we recorded net finance income of RR 5,402 million compared to net finance expense of RR 8,602 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Accrued interest expense on loans received	(2,028)	(2,958)	(31.4%)
Less: capitalized interest	1,040	890	16.9%
Provisions for asset retirement obligations:			
effect of the present value discount unwinding	(143)	(165)	(13.3%)
Interest expense on lease liabilities	(88)	(5)	n/a
Interest expense	(1,219)	(2,238)	(45.5%)
Interest income	3,191	4,521	(29.4%)
Change in fair value of non-commodity financial instruments	21	(7,110)	n/a
Foreign exchange gain (loss), net	3,409	(3,775)	n/a
Total finance income (expense)	5,402	(8,602)	n/a

In the three months ended 31 March 2018, our interest expense decreased by RR 1,019 million, or 45.5%, to RR 1,219 million primarily due to repayments of the Group's borrowings.

Interest income decreased by RR 1,330 million, or 29.4%, to RR 3,191 million in the three months ended 31 March 2018 from RR 4,521 million in the corresponding period in 2017. In both reporting periods, interest income primarily related to loans provided to our joint ventures for the development and expansion of their activities. According to IFRS 9 "Financial instruments", the Group accounts for the most of these loans as at fair value through profit or loss with a portion of changes in fair value relating to interest income (calculated based on the amortised cost of the loans using the effective interest method) presented separately from other factors of changes in fair value (such as changes in interest rates and expected maturities).

In the three months ended 31 March 2018, we recognized a non-cash gain of RR 21 million compared to a non-cash loss of RR 7,110 million in the corresponding period in 2017 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IFRS 9 "Financial instruments". The effect of the fair value remeasurement of shareholders' loans may change period-to-period due to the change in market interest rates and other macroeconomic parameters and does not affect real future cash flows of loans repayments.

The Group continues to record non-cash foreign exchange gains and losses each reporting period due to movements between currency exchange rates. In the three months ended 31 March 2018, we recorded a net foreign exchange gain of RR 3,409 million compared to a net loss of RR 3,775 million in the corresponding period in 2017 due to the revaluation of our foreign currency denominated borrowings and loans provided, as well as cash balances in foreign currency.

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

In the three months ended 31 March 2018, the Group's proportionate share of profit of joint ventures decreased by RR 42,463 million, or 97.3%, to RR 1,163 million as compared to RR 43,626 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Share in profit from operations	14,640	9,906	47.8%
Share in finance income (expense)			
Share in interest income (expense), net	(3,940)	(3,091)	27.5%
Share in foreign exchange gain (loss), net	(9,773)	35,219	n/a
Share in change in fair value of non-commodity financial instruments	939	10,755	(91.3%)
Total share in finance income (expense)	(12,774)	42,883	n/a
Share in total income tax benefit (expense)	(703)	(9,163)	(92.3%)
Total share of profit (loss) of joint ventures, net of income tax	1,163	43,626	(97.3%)

Our proportionate share in the profit from operations of our joint ventures significantly increased by RR 4,734 million, or 47.8%, due to the production launch at the first LNG train at our joint venture Yamal LNG in the end of 2017, as well as an increase in revenues from liquids and natural gas sales in our joint venture Arcticgas as a result of higher average realized prices.

In the three months ended 31 March 2018, our proportionate share in the finance expense of our joint ventures amounted to RR 12,774 million compared to the share in the finance income of RR 42,883 million in the corresponding period in 2017. The main factor impacting the change in our share in finance income (expense) was the recognition of a non-cash foreign exchange loss on foreign currency denominated loans at our joint ventures Yamal LNG and Terneftegas in the first quarter of 2018 (our share amounted to RR 9.8 billion) as compared to a recognition of substantial non-cash foreign exchange gain in the corresponding period in 2017 (our share amounted to RR 35.2 billion). In addition, in the current reporting period, our share in the non-cash gain from the remeasurement of the fair value of shareholders' loans in Yamal LNG and Terneftegas decreased by RR 9.8 billion. The remaining changes related to an increase in our share in the interest expense by RR 0.8 billion that was mainly due to the production launch of LNG at Yamal LNG in the end of 2017 and the cessation of the respective interest expense capitalization.

Income tax expense

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

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

Without the effect of net profit (loss) and dividends from joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of profit before income tax) in the three months ended 31 March 2018 and 2017, was 17.9% and 20.0%, respectively.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018****Profit attributable to shareholders and earnings per share**

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK decreased by RR 27,897 million, or 39.3%, to RR 43,121 million in the three months ended 31 March 2018 compared to RR 71,018 million in the corresponding period in 2017. The Group's financial results in both reporting periods were significantly impacted by the recognition of substantial non-cash foreign exchange effects on foreign currency denominated loans of the Group and its joint ventures. Excluding the effect of foreign exchange gains (losses), as well as the one-time effect from the disposal of interests in joint ventures, our profit attributable to shareholders of PAO NOVATEK increased by RR 2,565 million, or 5.8%, and amounted to RR 46,910 million in the three months ended 31 March 2018 compared to RR 44,345 million in the corresponding period in 2017 (see the table below):

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Profit attributable to shareholders of PAO NOVATEK	43,121	71,018	(39.3%)
Net gain on disposal of interests in joint ventures	(1,645)	-	n/a
Normalized profit attributable to shareholders of PAO NOVATEK	41,476	71,018	(41.6%)
Foreign exchange (gains) losses	(3,409)	3,775	n/a
Income tax expense (benefit) relating to foreign exchange (gains) losses	682	(755)	n/a
Share of foreign exchange (gains) losses of joint ventures	9,773	(35,219)	n/a
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	(1,612)	5,526	n/a
Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)	46,910	44,345	5.8%

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK decreased by RR 9.24 per share, or 39.2%, to RR 14.30 per share in the three months ended 31 March 2018 from RR 23.54 per share in the corresponding period in 2017. Excluding the effects of foreign exchange gains (losses) and the disposal of interests in joint ventures, our weighted average basic and diluted earnings per share increased by RR 0.86, or 5.8%, to RR 15.56 per share in the three months ended 31 March 2018 from RR 14.70 per share in the corresponding period in 2017.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2018 and 2017:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Net cash provided by operating activities	48,125	48,842	(1.5%)
Net cash used for investing activities	(40,745)	(2,963)	n/a
Net cash used for financing activities	(17,970)	(26,918)	(33.2%)

Net cash provided by operating activities

Our net cash provided by operating activities decreased marginally by RR 717 million, or 1.5%, to RR 48,125 million compared to RR 48,842 million in the corresponding period in 2017 primarily as a result of the offsetting effects of two factors: an increase in profit from operations, on the one hand, and an increase in income tax payments, on the other hand.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Profit from operations before disposals of interests in joint ventures	48,468	45,538	6.4%
Non-cash adjustments ⁽¹⁾	7,763	8,264	(6.1%)
Changes in working capital and long-term advances given	2,853	1,838	55.2%
Interest received	346	1,010	(65.7%)
Income taxes paid	(11,305)	(7,808)	44.8%
Total net cash provided by operating activities	48,125	48,842	(1.5%)

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

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

The Group pays income tax in the Russian Federation using the advance payments system under which in the current quarter we make advance income tax payments based on the actual profit for the previous quarter, and additionally we pay the difference between actual income tax and advance income tax payments for the previous quarter. An increase in income tax payments in the first quarter of 2018 primarily related to additional income tax paid for the fourth quarter of 2017 based on the actual profit (additional income tax payment in the corresponding period of the prior year was less significant).

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018***Net cash used for investing activities*

In the three months ended 31 March 2018, our net cash used for investing activities increased by RR 37,782 million to RR 40,745 million compared to RR 2,963 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Cash used for capital expenditures	(9,712)	(4,738)	105.0%
Payments for mineral licenses	(227)	(59)	284.7%
Payments for acquisition of subsidiaries net of cash acquired	(30,492)	-	n/a
Loans provided to joint ventures	(186)	-	n/a
Repayments of loans provided to joint ventures	282	2,161	(87.0%)
Other	(410)	(327)	25.4%
Net cash used for investing activities	(40,745)	(2,963)	n/a

Cash used for capital expenditures increased by RR 4,974 million, or 105.0%, as compared to the 2017 reporting period. In both reporting periods, we used cash for the development of our future LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field and the development of the front-end engineering design (FEED) for the new LNG plant. In addition, our capital expenditures in both reporting periods related to ongoing development of the East-Tarkosalinskoye and the Yarudeyskoye field's crude oil deposits, as well as the ongoing development of the North-Russkiy and the East-Tazovski license areas.

In February 2018, we made a payment in the amount of RR 60 million for participation in an auction for the right for geological research works, exploration and production of hydrocarbons at the Payutskiy license area (according to the results of the auction, the license fee payment was set at RR 66 million). In addition, in February 2018, we paid a one-time payment fee for expanding the borders of the Salmanovskiy (Utrenniy) license area in the amount of RR 167 million. In the 2017 reporting period, we paid a part of a one-time payment fee for the exploration and production license for our discovered Kharbeyskoye field in the amount of RR 59 million.

In February 2018, upon the results of an auction, the Group acquired 100% participation interests in companies Maretiom Investments Limited and Velarion Investments Limited, the owners of 100% participation interests in AO Geotransgas and OOO Urengoyanskaya gasovaya kompaniya, respectively, for RR 29,876 million net of cash acquired. In addition, in January 2018, the Group acquired a 100% participation interest in OOO Chernichnoye for RR 616 million (see "Recent Developments" above).

In the three months ended 31 March 2018, we provided loans to our joint venture Cryogas-Vysotsk in the amount of RR 186 million. In the current reporting period, we received RR 282 million due to a partial repayment of the loans provided to Terneftegas, while in the corresponding period in 2017, we received RR 2,161 million due to a partial repayment of the loans provided to Terneftegas and Yamal Development.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018***Net cash used for financing activities*

In the three months ended 31 March 2018, our net cash used for financing activities decreased by RR 8,948 million, or 33.2%, to RR 17,970 million as compared to RR 26,918 million in the corresponding period in 2017.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2018	2017	
Repayments of long-term debt	(12,966)	(24,524)	(47.1%)
Proceeds from (repayments of) short-term debt with original maturity three months or less, net	1,182	13	n/a
Dividends paid to non-controlling interest	(5,553)	-	n/a
Interest paid	(275)	(1,755)	(84.3%)
Payments of lease liabilities	(358)	(34)	n/a
Purchase of treasury shares	-	(618)	n/a
Net cash used for financing activities	(17,970)	(26,918)	(33.2%)

In both reporting periods we did not obtain long-term loans. In the current reporting period, the Group fully repaid a loan obtained under our syndicated credit line facility in the amount of RR 12,966 million (USD 231 million). In the first quarter of 2017, the Group fully repaid its four-year Rouble denominated Eurobonds in the amount of RR 14 billion according to the bonds maturity schedule, partially repaid a loan obtained under our syndicated credit line facility in the amount of RR 6,788 million (USD 115 million), as well as partially repaid a loan obtained by a Group subsidiary from its non-controlling shareholder.

In the reporting periods of 2018 and 2017, we obtained short-term loans to finance trade activities. In the current reporting period, net proceeds of short-term loans amounted to RR 1,182 million, while in the corresponding period in 2017 the total amount of short-term loans repayments substantially corresponded to the amount of proceeds.

In the first quarter of 2018, a Group subsidiary paid dividends in the amount of RR 5,553 million to its non-controlling shareholder.

The remaining change primarily related to a decrease in interest paid on borrowings and loans and shares buy-back.

Liquidity and working capital

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

	31 March 2018	31 December 2017	Change, %
Absolute amounts, RR million			
Net debt ⁽¹⁾	88,859	89,807	(1.1%)
Net working capital position ⁽²⁾	66,848	69,478	(3.8%)
Liquidity and credit ratios			
Current ratio ⁽³⁾	1.87	1.83	2.2%
Total debt to total equity	0.18	0.20	(10.0%)
Long-term debt to long-term debt and total equity	0.15	0.15	0.0%
Net debt to total capitalization ⁽⁴⁾	0.09	0.09	0.0%
Net debt to normalized EBITDA from subsidiaries ⁽⁵⁾	0.44	0.45	(2.2%)

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

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

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

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

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

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

Capital expenditures

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

<i>millions of Russian roubles</i>	Three months ended 31 March:	
	2018	2017
Arctic LNG 2 project	2,597	515
North-Russkiy and East-Tazovski license areas	1,518	331
East-Tarkosalinskoye field	1,340	826
Infrastructure for future LNG projects ⁽¹⁾	980	295
Yurkharovskoye field	755	156
Yarudeyskoye field	627	447
Gydanskiy license area	417	-
Other	2,414	1,191
Capital expenditures	10,648	3,761

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

Total capital expenditures on property, plant and equipment in the three months ended 31 March 2018 significantly increased by RR 6,887 million, or 183.1%, to RR 10,648 million from RR 3,761 million. In both reporting periods, a significant part of our capital expenditures related to the development of our future LNG projects: the Arctic LNG 2 project and the project for the construction of a center to build and fabricate large-scale marine facilities located in the Murmansk region. In this regard, we continued to invest in the development of the Salmanovskoye (Utrenneye) field and the development of the front-end engineering design (FEED) for the new LNG plant. In addition, our capital expenditures in both reporting periods related to ongoing development of the East-Tarkosalinskoye and the Yarudeyskoye field's crude oil deposits, as well as the ongoing development of the North-Russkiy and the East-Tazovski license areas.

PAO NOVATEK**Management's Discussion and Analysis of Financial Condition and Results of Operations
for the three months ended 31 March 2018**

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

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

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change
	2018	2017	%
Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements	13,139	4,056	223.9%
Less: acquisition of mineral licenses	(227)	(295)	n/a
Less: right-of-use assets ⁽¹⁾ additions	(2,264)	-	n/a
Capital expenditures	10,648	3,761	183.1%
Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments	(936)	977	n/a
Cash used for capital expenditures ⁽²⁾	9,712	4,738	105.0%

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

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

In March 2018, the Group won an auction for geological research works, exploration and hydrocarbons production at the Payutskiy license area (see "Recent Developments" above) and paid RR 60 million. The remaining amount of RR six million will be paid after the state registration of the license. In addition, in February 2018, we also paid a one-time fee in the amount of RR 167 million for expanding the borders of the Salmanovskiy (Utrenniy) license area.

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

QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar. As of 31 March 2018, the total amount of our debt denominated in US dollars was RR 133,955 million, or 92.9% 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, 41.8% in the three months ended 31 March 2018, was denominated in foreign currencies.

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

As of 31 March 2018, the Russian rouble appreciated by 0.6% against the US dollar and depreciated by 2.5% against the Euro, compared to 31 December 2017 (see "Selected macro-economic data" above).

Commodity risk

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

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

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

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

Pipeline access

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

Ability to reinvest

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

Forward-looking statements

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

Off balance sheet activities

As of 31 March 2018, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

TERMS AND ABBREVIATIONS

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