



**PAO NOVATEK**

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

**FOR THE THREE MONTHS ENDED 31 MARCH 2019**

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**GENERAL PROVISIONS**

You should read the following discussion and analysis of our financial condition and results of operations for the three months ended 31 March 2019 together with our unaudited consolidated interim condensed financial statements as of and for the three months ended 31 March 2019. The unaudited consolidated interim condensed financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". These consolidated interim condensed financial statements should be read together with the audited consolidated financial statements for the year ended 31 December 2018 prepared in accordance with International Financial Reporting Standards (IFRS).

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

**OVERVIEW**

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

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

The natural gas assets of our subsidiaries and joint ventures include projects where we sell natural gas through the Unified Gas Supply System in the Russian domestic market and liquefied natural gas ("LNG") delivered to international markets.

In the fourth quarter of 2017, our joint venture OAO Yamal LNG commenced producing LNG at the first train of its liquefaction plant, and in the third and fourth quarters of 2018, the second and third LNG trains were launched. The launch of the three LNG trains with nameplate capacity of 16.5 million tons per annum allowed Yamal LNG to become one of the largest suppliers of LNG to international markets.

We deliver unstable gas condensate produced by our subsidiaries and our joint ventures Arcticgas, Nortgas and Terneftegas to our Purovsky Gas Condensate Plant (the "Purovsky Plant") for processing into stable gas condensate and natural gas liquids ("NGL"). The Purovsky Plant allows us to process more than 12 million tons of unstable gas condensate per annum.

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

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

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

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

## **RECENT DEVELOPMENTS**

### **Disposal of a 10% participation interest in the Arctic LNG 2 project**

In March 2019, the Group sold a 10% participation interest in OOO Arctic LNG 2 to TOTAL E&P Salmanov, a wholly owned subsidiary of TOTAL S.A. Arctic LNG 2 undertakes a project to construct a new LNG plant on the Gydan peninsula based on the hydrocarbon resources of the Salmanovskoye (Utrenneye) field.

After transaction closing, the Group's participation interest in Arctic LNG 2 project decreased to 90%, however, the key project's financial and operational decisions are approved unanimously by all participants, which implies a joint control over the company. As a result, the Group recognized Arctic LNG 2 as a joint venture and started to account for its interest in the company using the equity method.

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

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

### **Reorganization of AO Arcticgas**

In February 2019, the Group made a contribution of 100% participation interest in OOO NOVATEK-Yarsaleneftegas, the holder of the license for exploration and production of hydrocarbons within the Malo-Yamalskiy license area, to the capital of our joint venture AO Arcticgas. This transaction was conducted within the framework of the agreement with PAO Gazprom Neft on reorganization of Arcticgas, which envisage the receipt of several assets in full ownership by the Arcticgas' shareholders.

It is expected that the reorganization will be completed in 2019. The financial result from the reorganization will be recognized at its final stage as the transactions are considered to be interrelated.

### **Signing agreements for LNG supply from the Arctic LNG 2 project**

At the end of March and in the beginning of April 2019, the Group signed heads of agreements with several international companies for the supply of liquefied natural gas from the Arctic LNG 2 project as well as other Group's projects. The signing of these agreements is a vital step in the successful and timely implementation of the Arctic LNG 2 project.

## **BASIS OF PRESENTATION**

Oil and gas production in the current report is calculated based on 100% of our subsidiaries production and our proportionate share in the production of our joint ventures including volumes of natural gas consumed in oil and gas producing and development activities. Production of the South-Tambeyskoye field developed by the Group's joint venture Yamal LNG is reported at 60% including an additional 9.9% interest not owned by the Group, since the Group assumes certain economic and operational risks related to this interest.

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

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**SELECTED DATA**

<i>millions of Russian roubles except as stated</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>Financial results</b>			
Total revenues <sup>(1)</sup>	234,106	179,403	30.5%
Operating expenses	(175,140)	(131,037)	33.7%
Normalized EBITDA <sup>(2),(3)</sup>	117,942	76,306	54.6%
Normalized profit attributable to shareholders of PAO NOVATEK <sup>(3)</sup>	110,590	41,476	166.6%
Normalized profit attributable to shareholders of PAO NOVATEK <sup>(3)</sup> , excluding the effect of foreign exchange gains (losses) <sup>(4)</sup>	65,730	46,910	40.1%
Normalized earnings per share <sup>(3)</sup> (in Russian roubles)	36.71	13.75	166.9%
Normalized earnings per share <sup>(3)</sup> , excluding the effect of foreign exchange gains (losses) <sup>(4)</sup> (in Russian roubles)	21.82	15.56	40.3%
Net debt <sup>(5)</sup>	65,040	88,859	(26.8%)
<b>Production volumes <sup>(6)</sup></b>			
Hydrocarbons production (million barrels of oil equivalent)	147.1	132.5	11.0%
Daily production (million barrels of oil equivalent per day)	1.63	1.47	11.0%
<b>Operating results</b>			
Natural gas sales volumes (million cubic meters)	22,195	20,263	9.5%
Naphtha sales volumes (thousand tons)	1,159	943	22.9%
Crude oil sales volumes (thousand tons)	1,127	1,123	0.4%
Liquefied petroleum gas sales volumes (thousand tons)	677	649	4.3%
Other stable gas condensate refined products (thousand tons)	638	623	2.4%
Stable gas condensate sales volumes (thousand tons)	372	436	(14.7%)
<b>Cash flow results</b>			
Net cash provided by operating activities	61,603	48,125	28.0%
Cash used for capital expenditures <sup>(7)</sup>	42,476	9,712	337.4%
Free cash flow <sup>(8)</sup>	19,127	38,413	(50.2%)

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

<sup>(2)</sup> 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.

<sup>(3)</sup> Excluding the effect from the disposal of interests in subsidiaries and joint ventures.

<sup>(4)</sup> 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).

<sup>(5)</sup> Net Debt represents our total debt net of cash, cash equivalents and bank deposits with original maturity more than three months.

<sup>(6)</sup> 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).

<sup>(7)</sup> 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.

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

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Reconciliation of EBITDA and normalized EBITDA is as follows:

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>Profit</b>	<b>386,258</b>	<b>46,929</b>	<b>n/a</b>
Depreciation, depletion and amortization	7,487	8,097	(7.5%)
Impairment expenses (reversals), net	1	(4)	n/a
Loss (income) from changes in fair value of derivative financial instruments and contingent consideration	184	(140)	n/a
Total finance expense (income)	6,021	(5,402)	n/a
Total income tax expense	45,324	9,749	364.9%
Share of loss (profit) of joint ventures, net of income tax	(70,973)	(1,163)	n/a
<b>EBITDA from subsidiaries</b>	<b>374,302</b>	<b>58,066</b>	<b>544.6%</b>
<b>Share in EBITDA of joint ventures</b>	<b>52,218</b>	<b>19,885</b>	<b>162.6%</b>
<b>EBITDA</b>	<b>426,520</b>	<b>77,951</b>	<b>447.2%</b>
Net gain on disposal of interests in subsidiaries and joint ventures	(308,578)	(1,645)	n/a
<b>Normalized EBITDA</b>	<b>117,942</b>	<b>76,306</b>	<b>54.6%</b>
<b>Normalized EBITDA from subsidiaries</b>	<b>65,724</b>	<b>56,421</b>	<b>16.5%</b>

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**SELECTED MACRO-ECONOMIC DATA**

<i>Exchange rate, Russian roubles for one foreign currency unit <sup>(1)</sup></i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>US dollar (USD)</b>			
Average for the period	66.13	56.88	16.3%
At the beginning of the period	69.47	57.60	20.6%
At the end of the period	64.73	57.26	13.0%
Depreciation (appreciation) of Russian rouble to US dollar	(6.8%)	(0.6%)	n/a
<b>Euro</b>			
Average for the period	75.17	69.87	7.6%
At the beginning of the period	79.46	68.87	15.4%
At the end of the period	72.72	70.56	3.1%
Depreciation (appreciation) of Russian rouble to Euro	(8.5%)	2.5%	n/a

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

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<i>Average for the period</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>Benchmark natural gas prices <sup>(2)</sup></b>			
NBP, USD per mmbtu	6.3	8.1	(22.2%)
<b>Benchmark crude oil prices <sup>(3)</sup></b>			
Brent, USD per barrel	63.1	66.8	(5.5%)
Urals, USD per barrel	63.2	65.2	(3.1%)
Urals, Russian roubles per barrel	4,179	3,709	12.7%
<b>Benchmark crude oil prices excluding export duties <sup>(4)</sup></b>			
Urals, USD per barrel	51.3	49.2	4.3%
Urals, Russian roubles per barrel	3,392	2,798	21.2%
<b>Benchmark oil products <sup>(5)</sup> and liquefied petroleum gas <sup>(6)</sup> prices, USD per ton</b>			
Naphtha Japan	519	582	(10.8%)
Naphtha CIF NWE	497	574	(13.4%)
Jet fuel	625	647	(3.4%)
Gasoil	586	588	(0.3%)
Fuel oil	396	370	7.0%
Liquefied petroleum gas	363	422	(14.0%)
<b>Export duties, USD per ton <sup>(7)</sup></b>			
Crude oil, stable gas condensate	87.0	117.0	(25.6%)
Naphtha	47.8	64.3	(25.7%)
Jet fuel, gasoil	26.1	35.1	(25.6%)
Fuel oil	87.0	117.0	(25.6%)
Liquefied petroleum gas	0.0	0.0	n/a

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

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

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

<sup>(5)</sup> 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.

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

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

## **CERTAIN FACTORS AFFECTING OUR RESULTS OF OPERATIONS**

### **Current economic conditions**

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

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

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

Political events in Ukraine in the beginning of 2014 have prompted a negative reaction by the world community, including economic sanctions levied by the United States of America, Canada and the European Union against certain Russian individuals and legal entities. In July 2014, NOVATEK was included on the OFAC's Sectoral Sanctions Identification List (the "List"), which imposed sanctions that prohibit individuals or legal entities registered or working on the territory of the United States from providing new credit facilities to the Group for longer than 60 days (prior to 28 November 2017, the aforementioned restrictions related to new credit facilities with maturity of more than 90 days).

Despite the inclusion on the List, the Group may conduct any other activities, including financial transactions, with U.S. investors and partners. NOVATEK was included on the List even though the Group does not conduct any business activities in Ukraine, nor does it have any impact on the political and economic processes taking place in this country. Management has assessed the impact of the sanctions described above on the Group's activities taking into consideration the current state of the world economy, the condition of domestic and international capital markets, the Group's business, and long-term projects with foreign partners. We have concluded that the inclusion on the List does not significantly impede the Group's operations and business activities in any jurisdiction, nor does it affect the Group's assets and debt, and does not have a material effect on the Group's financial position.

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

### **Natural gas prices**

We sell our natural gas to customers in the Russian domestic market, mainly through trunk pipelines and regional distribution networks, and deliver LNG purchased primarily from our joint venture OAO Yamal LNG to international markets. In addition, we sell on the European market regasified liquefied natural gas arising during the transshipment of LNG (boil-off gas), as well as during the regasification of purchased LNG at our own regasification stations in Poland.

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

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



In October 2018, the Ministry of Economic Development of the Russian Federation published the “Forecast of Socio-economic Development of the Russian Federation for the period until 2024” stating that wholesale natural gas prices for sales to all customer categories (excluding residential customers) will be increased from July 2019 by an average of 1.4% and from July 2020 to 2024 by 3.0% on an annual basis. The Russian Federation government continues to discuss various concepts relating to the natural gas industry development, including natural gas prices and transportation tariffs growth rates on the domestic market.

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

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

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

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

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

	Three months ended 31 March:		Change %
	2019	2018	
Average natural gas price, RR per mcm	5,631	4,367	28.9%
Average natural gas price, USD per mcm <sup>(1)</sup>	85.0	76.8	10.7%

<sup>(1)</sup> 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 2019, our aggregate average price for natural gas sold in the Russian Federation and on the international markets increased by 28.9% mainly due to an increase in LNG sales volumes, as well as an increase in the regulated Russian domestic price by 3.4% effective 21 August 2018.

### 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.

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

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

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

The following table shows our average realized net stable gas condensate and refined products, crude oil and LPG sales prices. Average realized net prices are shown net of VAT and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland:

<i>Russian roubles or US dollars per ton</i> <sup>(1)</sup>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>Stable gas condensate</b>			
Average net price, RR per ton	21,903	20,381	7.5%
Average net price, USD per ton	331	358	(7.5%)
<b>Naphtha</b>			
Average net price, RR per ton	32,163	31,071	3.5%
Average net price, USD per ton	484	547	(11.5%)
<b>Other stable gas condensate refined products</b>			
Average net price, RR per ton	35,746	29,897	19.6%
Average net price, USD per ton	539	526	2.5%
<b>Crude oil</b>			
Average net price, RR per ton	23,990	19,982	20.1%
Average net price, USD per ton	362	352	2.8%
<b>LPG</b>			
Average net price, RR per ton	15,926	16,337	(2.5%)
Average net price, USD per ton	241	287	(16.0%)

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

In the current reporting period, international benchmark prices for almost all liquid hydrocarbons we sell declined compared to the corresponding period in 2018. At the same time, as a result of a significant decrease in export duty rates due to the completion of the tax maneuver in the oil and gas industry and a reduction in benchmark crude oil prices, our average realized net prices for crude oil and stable gas condensate refined products sales (excluding naphtha) in US dollars increased. Our average realized net prices in Russian roubles terms increased for almost all our liquids sales due to a 16.3% Russian rouble depreciation relative to the US dollar in the three months ended 31 March 2019 compared to the corresponding period in 2018.

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

**Transportation tariffs***Natural gas by pipelines*

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

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

In 2018 and during the first quarter of 2019, the average tariff for natural gas transportation through the trunk pipeline did not change. The transportation rate amounted to RR 13.04 per mcm per 100 km (excluding VAT), and the rate for utilization of the trunk pipeline was set in the range from RR 62.57 to RR 2,014.16 per mcm (excluding VAT).

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

*Stable gas condensate and LPG by rail*

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

The railroad transportation tariffs are set by the Regulator and vary depending on the type of 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 2019, railroad freight transportation tariffs for all types of hydrocarbons were increased by 3.56% relative to the 2018 tariffs.

In 2018 and during the first quarter of 2019, we applied the discount coefficient of 0.94 to the existing railroad transportation tariffs for stable gas condensate deliveries from the Limbey rail station to the port of Ust-Luga and to end-customers on the domestic and international markets. The discount coefficient is set by the decision of the Management Board of RZD as part of the Strategic Partnership Agreement between the Group and RZD.

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

We deliver part of our stable gas condensate and substantially all stable gas condensate refined products, as well as liquefied natural gas (excluding volumes purchased and sold to customers in the same location) to international markets by chartered tankers. In addition to time chartering expenses, we also may incur transshipment, bunkering, port charges and other expenses depending on the delivery terms, which are included in the transportation by tankers expense category. 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 2019, crude oil transportation tariffs through the pipeline network within the Russian Federation territory were increased by an average of 3.87% relative to the 2018 tariffs.

**Our tax burden and obligatory payments**

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

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

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

Information regarding UPT, export duties and excise taxes described below is based on the current versions of the Tax Code of the Russian Federation and the law "On Customs Tariff" including the amendments that were introduced to these laws in the second half of 2018. In particular, the amendments changed the UPT and the export duties rates formulas, introduced new types of excisable goods and specific procedures for excise tax deductions applicable for processors of raw oil.

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

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

*Export duties*

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

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

In 2018, the calculation of the export duty rate in US dollars when the average Urals crude oil price was more than USD 182.5 per ton (or USD 25 per barrel) was set as follows: USD 29.2 plus 30% of the difference between the average Urals crude oil price and USD 182.5 per ton.

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

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

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

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

The export duty rate for LPG for the next calendar month is calculated based on the average LPG price at the Polish border (DAF, Brest) for the current monitoring period and is calculated using the formula presented in the table below:

<i>Average LPG price, USD per ton (P)</i>	<b>Formula for export duty rate calculation</b>
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	$135 + 0.7 \times (P - 740)$

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

*UPT – natural gas*

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

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

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

*UPT – crude oil*

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

The UPT rate is calculated as a product of a coefficient characterizing the dynamics of world crude oil prices and the base UPT rate (RR 919 per ton) adjusted for parameters characterizing crude oil production peculiarities (the reserves' depletion, complexity of extraction, the region, crude oil properties). The result is then increased by a fixed amount of RR 357 per ton in 2018, RR 428 per ton in 2019 to 2021 and RR zero from 2022.

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

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

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

#### *UPT – gas condensate*

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

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

The Group applies a UPT tax deduction on gas condensate volumes produced for processing into NGL. The amount of the tax deduction is calculated monthly by multiplying a coefficient of NGL recovery from gas condensate processing, the quantity of gas condensate produced and processed, and the tax deduction rate in Russian roubles per ton of NGL derived. The tax deduction rate was set at RR 147 per ton for January 2018 and since then is increasing monthly by the same amount until the end of 2020. Starting from January 2021, the tax deduction rate will be fixed at RR 5,280 per ton of produced NGL.

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

#### *Excise and fuel taxes*

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

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

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

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

In both reporting periods, most of our LPG sales in Poland were subject to excise and fuel taxes in accordance with the local legislation. The amount of excise and fuel tax payments depends on the volume of excisable goods sold and the respective tax rates (the excise tax rate in both reporting periods amounted to 670 Polish zloty per ton, and the fuel tax rate was increased from 162.27 Polish zloty per ton in 2018 to 164.61 Polish zloty per ton in 2019). We disclose LPG revenues net of excise and fuel taxes expense accrued on LPG volumes sold in Poland in our consolidated statement of income.

#### *Social contributions*

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

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

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

## OPERATIONAL HIGHLIGHTS

## Hydrocarbon production and sales volumes

Our total natural gas and liquids production including the proportionate share in the production of our joint ventures increased by 13.0% and by 1.7%, respectively. The main factor positively impacting our production growth was the commencement of LNG production at the second and third LNG trains at Yamal LNG in the second half of 2018.

In the three months ended 31 March 2019, our total natural gas sales volumes increased by 1,932 mmcm, or 9.5%, due to increased sales of LNG purchased primarily from our joint venture Yamal LNG.

In the three months ended 31 March 2019, our liquids sales volumes increased by 199 thousand tons, or 5.3%, 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 %
	2019	2018	
<b>Production by subsidiaries from:</b>			
Yurkharovskoye field	6,616	7,031	(5.9%)
East-Tarkosalinskoye field	1,516	1,672	(9.3%)
Yarudeyskoye field	455	286	59.1%
Beregovoye field	442	146	202.7%
Khancheyskoye field	416	514	(19.1%)
East-Urengoyskoye + North-Esetinskoye field (West-Yaroyakhinskiy license area)	168	175	(4.0%)
Other fields	486	539	(9.8%)
<b>Total natural gas production by subsidiaries <sup>(1)</sup></b>	<b>10,099</b>	<b>10,363</b>	<b>(2.5%)</b>
<b>Group's proportionate share in the production of joint ventures:</b>			
Yamal LNG <sup>(2)</sup>	3,943	1,340	194.3%
Arcticgas	3,426	3,555	(3.6%)
Nortgas	879	937	(6.2%)
Terneftegas	313	313	0.0%
<b>Total Group's proportionate share in the natural gas production of joint ventures <sup>(1)</sup></b>	<b>8,561</b>	<b>6,145</b>	<b>39.3%</b>
<b>Total natural gas production including proportionate share in the production of joint ventures</b>	<b>18,660</b>	<b>16,508</b>	<b>13.0%</b>
<i>The Group's proportionate share in LNG production of joint ventures (thousands of tons) <sup>(2)</sup></i>	2,586	799	223.7%

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

in subsidiaries	407	333	22.2%
in joint ventures (Group's proportionate share)	87	85	2.4%

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



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In the three months ended 31 March 2019, our total natural gas production (including our proportionate share in the production of joint ventures) increased by 2,152 mmcm, or 13.0%, to 18,660 mmcm from 16,508 mmcm in the corresponding period in 2018. The main factors positively impacting our production growth were the increase of natural gas production at Yamal LNG resulting from the start of LNG production at the second and third LNG trains of the LNG liquefaction plant in the second half of 2018, as well as the acquisition of the Beregovoye field by the Group in the first quarter of 2018. These factors allowed us to fully compensate for the decrease in production at mature fields of our subsidiaries (the Yurkharovskoye, the East-Tarkosalinskoye and the Khancheyevskoye fields) and at our joint venture Nortgas, which resulted mainly from natural declines in the reservoir pressure at the current gas producing horizons.

Our proportionate share in the production of Arcticgas decreased by 3.6% as a result of a decrease in the Group's effective participation interest in Arcticgas from 53.3% to 50.0% in March 2018. Excluding the effect from the decrease in participation interest, our proportionate share in the production of Arcticgas would have increased by 2.0%.

*Natural gas sales volumes*

In the three months ended 31 March 2019, our total natural gas sales volumes increased by 1,932 mmcm, or 9.5%, to 22,195 mmcm from 20,263 mmcm in the corresponding period in 2018.

<i>millions of cubic meters</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Production by subsidiaries	10,099	10,363	(2.5%)
Purchases from the Group's joint ventures	8,921	7,587	17.6%
Other purchases	2,219	1,729	28.3%
<b>Total production and purchases</b>	<b>21,239</b>	<b>19,679</b>	<b>7.9%</b>
Own usage <sup>(1)</sup>	(440)	(370)	18.9%
Decrease (increase) in natural gas inventory balance	1,396	954	46.3%
<b>Total natural gas sales volumes</b>	<b>22,195</b>	<b>20,263</b>	<b>9.5%</b>
<i>Sold to end-customers</i>	<i>17,674</i>	<i>18,063</i>	<i>(2.2%)</i>
<i>Sold ex-field</i>	<i>1,100</i>	<i>1,242</i>	<i>(11.4%)</i>
<b>Subtotal sold in the Russian Federation</b>	<b>18,774</b>	<b>19,305</b>	<b>(2.8%)</b>
<b>Sold on international markets</b>	<b>3,421</b>	<b>958</b>	<b>257.1%</b>

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

In the three months ended 31 March 2019, natural gas purchases from our joint ventures increased by 1,334 mmcm, or 17.6%, to 8,921 mmcm from 7,587 mmcm in the corresponding period in 2018 primarily due to an increase in purchases of LNG produced by Yamal LNG for subsequent sale on international markets.

Other natural gas purchases are included in our natural gas volumes for sale, which allows us to coordinate sales across geographic regions as well as to optimize our end-customers portfolios. In the three months ended 31 March 2019, we purchased from third parties 1,811 mmcm of natural gas on the Russian domestic market, and 408 mmcm of natural gas on international markets. In the corresponding period in 2018, we purchased almost all natural gas volumes from third parties on the Russian domestic market.

As of 31 March 2019, our cumulative natural gas inventory balance, mainly representing our inventory balances of natural gas in the UGSF, aggregated 813 mmcm and decreased by 1,396 mmcm during the quarter as compared to a decrease by 954 mmcm in the corresponding period in 2018. Natural gas inventory balances tend to fluctuate period-to-period depending on the Group's demand for natural gas withdrawal from the UGSF for the sale in the subsequent periods.

*Liquids production volumes*

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

<i>thousands of tons</i>	Three months ended 31 March:		Change %
	2019	2018	
<b>Production by subsidiaries from:</b>			
Yarudeyskoye field	822	864	(4.9%)
East-Tarkosalinskoye field	348	318	9.4%
Yurkharovskoye field	308	328	(6.1%)
Khancheyskoye field	45	59	(23.7%)
Other fields	77	59	30.5%
<b>Total liquids production by subsidiaries</b>			
	<b>1,600</b>	<b>1,628</b>	<b>(1.7%)</b>
<i>including crude oil</i>	<i>1,154</i>	<i>1,160</i>	<i>(0.5%)</i>
<i>including gas condensate</i>	<i>446</i>	<i>468</i>	<i>(4.7%)</i>
<b>Group's proportionate share in the production of joint ventures:</b>			
Arcticgas	1,009	1,041	(3.1%)
Yamal LNG <sup>(1)</sup>	206	83	148.2%
Terneftegas	99	103	(3.9%)
Nortgas	73	81	(9.9%)
<b>Total Group's proportionate share in the liquids production of joint ventures</b>			
	<b>1,387</b>	<b>1,308</b>	<b>6.0%</b>
<b>Total liquids production including proportionate share in the production of joint ventures</b>			
	<b>2,987</b>	<b>2,936</b>	<b>1.7%</b>

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

In the three months ended 31 March 2019, our total liquids production (including our proportionate share in the production of joint ventures) increased by 51 thousand tons, or 1.7%, to 2,987 thousand tons from 2,936 thousand tons in the corresponding period in 2018. The increase was mainly due to a gas condensate production growth at Yamal LNG resulting from the launch of the second and third LNG trains of the LNG liquefaction plant in the second half of 2018, which allowed us to fully compensate for a decrease in gas condensate production at mature fields of our subsidiaries and joint ventures mainly due to natural declines in the concentration of gas condensate as a result of decreasing reservoir pressure at the current gas condensate producing horizons.

Our proportionate share in the production of Arcticgas decreased by 3.1% as a result of a decrease in the Group's effective participation interest in Arcticgas from 53.3% to 50.0% in March 2018. Excluding the effect from the decrease in participation interest, our proportionate share in the production of Arcticgas would have increased by 2.6% mainly due to the commencement of crude oil commercial production at the Yaro-Yakhinskoye field in December 2018.

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*Liquids sales volumes*

In the three months ended 31 March 2019, our total liquids sales volumes increased by 199 thousand tons, or 5.3%, to 3,976 thousand tons from 3,777 thousand tons in the corresponding period in 2018.

<i>thousands of tons</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Production by subsidiaries	1,600	1,628	(1.7%)
Purchases from the Group's joint ventures	2,313	2,300	0.6%
Other purchases	56	44	27.3%
<b>Total production and purchases</b>	<b>3,969</b>	<b>3,972</b>	<b>(0.1%)</b>
Losses <sup>(1)</sup> and own usage <sup>(2)</sup>	(55)	(55)	0.0%
Decreases (increases) in liquids inventory balances	62	(140)	n/a
<b>Total liquids sales volumes</b>	<b>3,976</b>	<b>3,777</b>	<b>5.3%</b>
<i>Naphtha export</i>	<i>1,159</i>	<i>943</i>	<i>22.9%</i>
<i>Other stable gas condensate refined products export</i> <sup>(3)</sup>	<i>625</i>	<i>600</i>	<i>4.2%</i>
<i>Other stable gas condensate refined products domestic</i> <sup>(3)</sup>	<i>13</i>	<i>23</i>	<i>(43.5%)</i>
<b><i>Subtotal stable gas condensate refined products</i></b>	<b><i>1,797</i></b>	<b><i>1,566</i></b>	<b><i>14.8%</i></b>
<i>Crude oil export</i>	<i>389</i>	<i>379</i>	<i>2.6%</i>
<i>Crude oil domestic</i>	<i>738</i>	<i>744</i>	<i>(0.8%)</i>
<b><i>Subtotal crude oil</i></b>	<b><i>1,127</i></b>	<b><i>1,123</i></b>	<b><i>0.4%</i></b>
<i>LPG export</i>	<i>147</i>	<i>139</i>	<i>5.8%</i>
<i>LPG domestic</i>	<i>530</i>	<i>510</i>	<i>3.9%</i>
<b><i>Subtotal LPG</i></b>	<b><i>677</i></b>	<b><i>649</i></b>	<b><i>4.3%</i></b>
<i>Stable gas condensate export</i>	<i>18</i>	<i>-</i>	<i>n/a</i>
<i>Stable gas condensate domestic</i>	<i>354</i>	<i>436</i>	<i>(18.8%)</i>
<b><i>Subtotal stable gas condensate</i></b>	<b><i>372</i></b>	<b><i>436</i></b>	<b><i>(14.7%)</i></b>
<b><i>Other oil products</i></b>	<b><i>3</i></b>	<b><i>3</i></b>	<b><i>0.0%</i></b>

<sup>(1)</sup> 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.

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

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

Our sales volumes of naphtha and other stable gas condensate refined products fluctuate from period-to-period depending on changes in inventory balances, with volumes of the products received from processing at the Ust-Luga Complex staying relatively flat. Our sales volumes of stable gas condensate represent the volumes remaining after we deliver most of our stable gas condensate for further processing to our Ust-Luga Complex, as well as volumes purchased by the Group for subsequent sale on international markets, including purchases from our joint venture Yamal LNG.

In the 2019 reporting period, our liquids inventory balances decreased by 62 thousand tons to 1,007 thousand tons as of 31 March 2019 as compared to an increase in inventory balances by 140 thousand tons to 1,102 thousand tons in the corresponding period in 2018. Our liquids inventory balances may vary period-to-period depending on shipping schedules and final destinations (see "Changes in natural gas, liquid hydrocarbons and work-in-progress" below).

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**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED 31 MARCH 2019 COMPARED  
TO THE CORRESPONDING PERIOD IN 2018**

The following table and discussion is a summary of our consolidated results of operations for the three months ended 31 March 2019 and 2018. Each line item is also shown as a percentage of our total revenues.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>			
	<b>2019</b>	<b>% of total revenues</b>	<b>2018</b>	<b>% of total revenues</b>
<b>Total revenues <sup>(1)</sup></b>	<b>234,106</b>	<b>100.0%</b>	<b>179,403</b>	<b>100.0%</b>
<i>including:</i>				
natural gas sales	124,982	53.4%	88,485	49.3%
liquids sales	106,202	45.4%	90,000	50.2%
Operating expenses	(175,140)	(74.8%)	(131,037)	(73.0%)
Other operating income (loss)	(914)	(0.4%)	102	0.0%
<b>Normalized profit from operations <sup>(2)</sup></b>	<b>58,052</b>	<b>24.8%</b>	<b>48,468</b>	<b>27.0%</b>
Gain on disposal of interests in subsidiaries and joint ventures, net	308,578	131.8%	1,645	0.9%
<b>Profit from operations</b>	<b>366,630</b>	<b>156.6%</b>	<b>50,113</b>	<b>27.9%</b>
Finance income (expense)	(6,021)	(2.6%)	5,402	3.0%
Share of profit (loss) of joint ventures, net of income tax	70,973	30.4%	1,163	0.7%
<b>Profit before income tax</b>	<b>431,582</b>	<b>184.4%</b>	<b>56,678</b>	<b>31.6%</b>
Total income tax expense	(45,324)	(19.4%)	(9,749)	(5.4%)
<b>Profit</b>	<b>386,258</b>	<b>165.0%</b>	<b>46,929</b>	<b>26.2%</b>
Less: profit (loss) attributable to non-controlling interest	(4,462)	(1.9%)	(3,808)	(2.2%)
<b>Profit attributable to shareholders of PAO NOVATEK</b>	<b>381,796</b>	<b>163.1%</b>	<b>43,121</b>	<b>24.0%</b>
<b>Normalized profit attributable to shareholders of PAO NOVATEK <sup>(2)</sup>, excluding the effect of foreign exchange gains (losses)</b>	<b>65,730</b>	<b>28.1%</b>	<b>46,910</b>	<b>26.1%</b>

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

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

**Total revenues**

The following table sets forth our sales (excluding VAT and export duties, as well as excise and fuel taxes incurred on LPG sales in Poland) for the three months ended 31 March 2019 and 2018:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %	Change <sup>(1)</sup>		
	2019	2018		Total	Due to volume <sup>(2)</sup>	Due to price <sup>(3)</sup>
Natural gas sales	124,982	88,485	41.2%	36,497	8,435	28,062
Stable gas condensate refined products sales	60,076	47,934	25.3%	12,142	7,147	4,995
<i>Naphtha</i>	37,284	29,290	27.3%	7,994	6,728	1,266
<i>Other refined products</i>	22,792	18,644	22.2%	4,148	418	3,730
Crude oil sales	27,051	22,448	20.5%	4,603	84	4,519
Liquefied petroleum gas sales	10,776	10,604	1.6%	172	450	(278)
Stable gas condensate sales	8,146	8,886	(8.3%)	(740)	(1,306)	566
Other products sales	153	128	19.5%	25	n/a	n/a
<b>Total oil and gas sales</b>	<b>231,184</b>	<b>178,485</b>	<b>29.5%</b>	<b>52,699</b>	<b>n/a</b>	<b>n/a</b>
Other revenues	2,922	918	218.3%	2,004	n/a	n/a
<b>Total revenues</b>	<b>234,106</b>	<b>179,403</b>	<b>30.5%</b>	<b>54,703</b>	<b>n/a</b>	<b>n/a</b>

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

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

*Natural gas sales*

Revenues from natural gas sales represent our revenues from natural gas sales in the Russian Federation (to end-customers and wholesale traders), revenues from LNG sales to international markets, as well as revenues from sales of regasified LNG to customers in Europe.

The increase in LNG sales volumes purchased primarily from our joint venture Yamal LNG, as well as an increase in sales prices in the Russian domestic market resulted in an increase in our aggregate average price by 28.9% and sales volumes by 9.5% (see "Natural gas prices" and "Natural gas sales volumes" above). As a result, in the three months ended 31 March 2019, our total revenues from natural gas sales increased by RR 36,497 million, or 41.2%, compared to the corresponding period in 2018.

*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 2019, our revenues from sales of stable gas condensate refined products increased by RR 12,142 million, or 25.3%, to RR 60,076 million from RR 47,934 million in the corresponding period in 2018 due to increases in sales volumes and average realized prices.

In the three months ended 31 March 2019, our revenues from sales of naphtha increased by RR 7,994 million, or 27.3%, as compared to the corresponding period in 2018. In the three months ended 31 March 2019 and 2018, we exported 1,159 thousand and 943 thousand tons of naphtha, respectively, to the APR, and the European and North America markets. We sold naphtha at different delivery terms: CIF, CFR and DES in both reporting periods, and also DAP and FOB in the first quarter of 2019. Our average realized net price, excluding export duties, where applicable, increased by RR 1,092 per ton, or 3.5%, to RR 32,163 per ton from RR 31,071 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

In the three months ended 31 March 2019, our total revenues from sales of jet fuel, gasoil and fuel oil on the domestic and export markets increased by RR 4,148 million, or 22.2%, as compared to the corresponding period in 2018. In the three months ended 31 March 2019 and 2018, we exported in aggregate 625 thousand and 600 thousand tons of these products mainly to the European markets, or 98.0% and 96.3% of total sales volumes (on both the domestic and export markets), respectively. The export delivery terms in both reporting periods were FOB, CIF and DES, and also DAP and CFR in the first quarter of 2019. Our average realized net price, excluding export duties, where applicable, increased by RR 5,849 per ton, or 19.6%, to RR 35,746 per ton from RR 29,897 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

#### *Crude oil sales*

In the three months ended 31 March 2019, our revenues from crude oil sales increased by RR 4,603 million, or 20.5%, compared to the corresponding period in 2018 primarily due to an increase in average realized prices.

In the three months ended 31 March 2019, we sold 738 thousand tons, or 65.5% of our total crude oil sales volumes, domestically as compared to sales of 744 thousand tons, or 66.3%, in the corresponding period in 2018. The remaining 389 thousand tons of crude oil, or 34.5% of our total crude oil sales volumes, in the current reporting period and 379 thousand tons, or 33.7%, in the corresponding period in 2018 were sold to the APR and the European markets under FOB delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 4,008 per ton, or 20.1%, to RR 23,990 per ton from RR 19,982 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

#### *Liquefied petroleum gas sales*

In the three months ended 31 March 2019, our revenues from sales of LPG increased by RR 172 million, or 1.6%, compared to the corresponding period in 2018 due to an increase in sales volumes.

In the three months ended 31 March 2019, we sold 530 thousand tons of LPG, or 78.3% of our total LPG sales volumes, on the domestic market compared to sales of 510 thousand tons, or 78.6%, in the corresponding period in 2018. The remaining 147 thousand tons of LPG, or 21.7% of our total LPG sales volumes, in the current reporting period and 139 thousand tons, or 21.4%, in the corresponding period in 2018 were sold to the Polish market under free carrier FCA delivery terms.

Our average realized LPG net price, excluding export and import duties, excise and fuel taxes expense, where applicable, in the three months ended 31 March 2019 decreased by RR 411 per ton, or 2.5%, to RR 15,926 per ton from RR 16,337 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

#### *Stable gas condensate sales*

In the three months ended 31 March 2019, our revenues from sales of stable gas condensate decreased by RR 740 million, or 8.3%, compared to the corresponding period in 2018 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 Russian roubles terms.

In the three months ended 31 March 2019, we sold 354 thousand tons of stable gas condensate, or 95.2% of our total stable gas condensate sales volumes, on the domestic market compared to sales of 436 thousand tons, or 100.0%, in the corresponding period in 2018. The remaining 18 thousand tons of stable gas condensate, or 4.8% of our total stable gas condensate sales volumes, in the first quarter of 2019 were sold to the European markets under DAP delivery terms.

Our average realized net price, excluding export duties, where applicable, increased by RR 1,522 per ton, or 7.5%, to RR 21,903 per ton from RR 20,381 per ton in the corresponding period in 2018 (see "Stable gas condensate and refined products, liquefied petroleum gas and crude oil prices" above).

#### *Other products sales*

Other products sales represent our revenues from 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 2019, our revenues from other products sales increased by RR 25 million, or 19.5%, to RR 153 million from RR 128 million in the corresponding period in 2018.

#### *Other revenues*

Other revenues include revenue from transportation, geological and geophysical research services, repair and maintenance of energy equipment services, and other services. In the three months ended 31 March 2019, other revenues increased by RR 2,004 million, or 218.3%, to RR 2,922 million from RR 918 million in the corresponding period in 2018 primarily due to an increase in revenues from tanker transportation rendered to our joint ventures and third parties by RR 1,816 million.

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In the three months ended 31 March 2019, our total operating expenses increased by RR 44,103 million, or 33.7%, to RR 175,140 million compared to RR 131,037 million in the corresponding period in 2018 mainly due to an increase in volumes of LNG purchased from our joint venture Yamal LNG with the launch of LNG production at the second and third LNG trains in the second half of 2018, 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.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>			
	<b>2019</b>	<b>% of total revenues</b>	<b>2018</b>	<b>% of total revenues</b>
Purchases of natural gas and liquid hydrocarbons	94,760	40.5%	61,815	34.5%
Transportation expenses	40,103	17.1%	37,794	21.0%
Taxes other than income tax	15,542	6.6%	13,422	7.5%
Depreciation, depletion and amortization	7,487	3.2%	8,097	4.5%
Materials, services and other	6,030	2.6%	5,563	3.1%
General and administrative expenses	5,033	2.1%	4,593	2.6%
Exploration expenses	3,377	1.4%	1,709	1.0%
Impairment expenses (reversals), net	1	n/a	(4)	n/a
Changes in natural gas, liquid hydrocarbons and work-in-progress	2,807	1.2%	(1,952)	n/a
<b>Total operating expenses</b>	<b>175,140</b>	<b>74.8%</b>	<b>131,037</b>	<b>73.0%</b>

*Purchases of natural gas and liquid hydrocarbons*

In the three months ended 31 March 2019, our purchases of natural gas and liquid hydrocarbons increased by RR 32,945 million, or 53.3%, to RR 94,760 million from RR 61,815 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Natural gas	58,163	29,645	96.2%
Unstable gas condensate	35,044	31,313	11.9%
Other hydrocarbons	2,632	857	207.1%
Reverse excise	(1,079)	-	n/a
<b>Total purchases of natural gas and liquid hydrocarbons</b>	<b>94,760</b>	<b>61,815</b>	<b>53.3%</b>

In the three months ended 31 March 2019, our purchases of natural gas significantly increased by RR 28,518 million, or 96.2%, as compared to the corresponding period in 2018 due to an increase in LNG purchases mainly from Yamal LNG for subsequent sale on international markets, as well as an increase in purchase prices on the domestic market that are influenced by the regulated natural gas prices (see "Natural gas prices" above).

In the three months ended 31 March 2019, our purchases of unstable gas condensate from our joint ventures increased by RR 3,731 million, or 11.9%, as compared to the corresponding period in 2018 due to an increase in purchase prices, which are impacted by international crude oil prices excluding export duties (see "Selected macro-economic data" above).

Other hydrocarbons purchases represent our purchases of oil products, LPG, stable gas condensate and crude oil for subsequent resale depending on the demand for these types of products. In the three months ended 31 March 2019, our purchases of other hydrocarbons increased by RR 1,775 million, or 207.1%, as compared to the corresponding period in 2018 mainly due to purchases of crude oil from Arcticgas and stable gas condensate from Yamal LNG for subsequent sale.



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

*Transportation expenses*

In the three months ended 31 March 2019, our total transportation expenses increased by RR 2,309 million, or 6.1%, to RR 40,103 million as compared to RR 37,794 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Natural gas transportation			
by trunk and low-pressure pipelines	26,042	26,617	(2.2%)
Stable gas condensate and liquefied petroleum gas transportation by rail	8,262	7,146	15.6%
Stable gas condensate and refined products, crude oil and liquefied natural gas transportation by tankers	3,571	1,924	85.6%
Crude oil transportation by trunk pipelines	2,166	2,086	3.8%
Other	62	21	195.2%
<b>Total transportation expenses</b>	<b>40,103</b>	<b>37,794</b>	<b>6.1%</b>

In the three months ended 31 March 2019, our expenses for natural gas transportation by trunk and low-pressure pipelines decreased by RR 575 million, or 2.2%, to RR 26,042 million from RR 26,617 million in the corresponding period in 2018 mainly due to a 2.2% decrease in our natural gas sales volumes to our end-customers, for which we incurred transportation expenses.

In the three months ended 31 March 2019, our total expenses for stable gas condensate and LPG transportation by rail increased by RR 1,116 million, or 15.6%, to RR 8,262 million from RR 7,146 million in the corresponding period in 2018. The increase was due to an 8.0% increase in volumes of liquids sold and transported via rail and a 7.1% increase in weighted average transportation cost per unit. The increase of weighted average transportation cost per unit was the result of a 3.56% increase in the regulated railroad transportation tariffs effective 1 January 2019 (see "Transportation tariffs" above) and the depreciation of the Russian rouble average exchange rate relative to the US dollar and Polish zloty since part of our transportation expenses by rail is denominated in the referenced foreign currencies.

In the three months ended 31 March 2019, our total transportation expenses for hydrocarbons delivered by tankers to international markets increased by RR 1,647 million, or 85.6%, to RR 3,571 million from RR 1,924 million in the corresponding period in 2018. The increase was due to an increase in sales volumes of stable gas condensate refined products delivered by tankers (see "Liquids sales volumes" above), freight rates, as well as a 16.3% depreciation of the Russian rouble average exchange rate relative to the US dollar since all our tankers transportation expenses are US dollar denominated. In addition, our tankers transportation expenses include short-term vessels time charter expenses related to our revenues from LNG and liquids transportation by tankers rendered to our joint ventures and third parties, which tend to fluctuate period-to-period depending on the volume of such services (see "Other revenues" above).

In the three months ended 31 March 2019, our expenses for crude oil transportation to customers by trunk pipeline increased by RR 80 million, or 3.8%, to RR 2,166 million from RR 2,086 million in the corresponding period in 2018 due to a 3.87% increase in the regulated transportation tariffs effective 1 January 2019 (see "Transportation tariffs" above).

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In the three months ended 31 March 2019, taxes other than income tax increased by RR 2,120 million, or 15.8%, to RR 15,542 million from RR 13,422 million in the corresponding period in 2018 primarily due to an increase in unified natural resources production tax expense.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Unified natural resources production tax (UPT)	14,583	12,385	17.7%
Property tax	867	949	(8.6%)
Other taxes	92	88	4.5%
<b>Total taxes other than income tax</b>	<b>15,542</b>	<b>13,422</b>	<b>15.8%</b>

In the three months ended 31 March 2019, our unified natural resources production tax expense increased by RR 2,198 million, or 17.7%, to RR 14,583 million from RR 12,385 million in the corresponding period in 2018 mainly due to an increase in UPT rates for crude oil and gas condensate. The increase was mainly the result of changes in the UPT rates formulas effective 1 January 2019 caused by the completion of the tax maneuver in the oil and gas industry (see "Our tax burden and obligatory payments" above).

*Depreciation, depletion and amortization*

In the three months ended 31 March 2019, our depreciation, depletion and amortization ("DDA") expense decreased by RR 610 million, or 7.5%, to RR 7,487 million from RR 8,097 million in the corresponding period in 2018 mainly due to an increase in total proved reserves in our subsidiaries as at the end of 2018 compared to the previous period. We accrue depreciation and depletion using the "units-of-production" method for our oil and gas assets and using a straight-line method for other facilities.

*Materials, services and other*

In the three months ended 31 March 2019, our materials, services and other expenses increased by RR 467 million, or 8.4%, to RR 6,030 million compared to RR 5,563 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Employee compensation	3,012	2,739	10.0%
Complex of services for preparation, transportation and processing of hydrocarbons	566	494	14.6%
Repair and maintenance	485	517	(6.2%)
Electricity and fuel	377	338	11.5%
Materials and supplies	375	419	(10.5%)
Liquefied petroleum gas volumes reservation expenses	291	273	6.6%
Fire safety and security expenses	254	225	12.9%
Transportation services	244	191	27.7%
Rent expenses	112	92	21.7%
Insurance expense	85	82	3.7%
Other	229	193	18.7%
<b>Total materials, services and other</b>	<b>6,030</b>	<b>5,563</b>	<b>8.4%</b>

Employee compensation relating to operating personnel increased by RR 273 million, or 10.0%, to RR 3,012 million compared to RR 2,739 million in the corresponding period in 2018 due to the acquisition of a new production asset in the first quarter of 2018 (the Beregovoye field), an increase in average number of employees in our service subsidiary NOVATEK-Energo due to the expansion its operations and servicing new assets, an indexation of base salaries effective from 1 July 2018 and the related increase in social contributions for medical and social insurance and to the Pension Fund of the Russian Federation.

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Complex of services for preparation, transportation and processing of hydrocarbons expenses mainly relate to transportation of our NGL produced at the Purovsky Plant for further processing at the Tobolsk Refining Facilities. These expenses increased by RR 72 million, or 14.6%, to RR 566 million compared to RR 494 million in the corresponding period in 2018 primarily due to an increase in the contract rate for services performed at the Tobolsk Refining Facilities from January 2019.

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

*General and administrative expenses*

In the three months ended 31 March 2019, our general and administrative expenses increased by RR 440 million, or 9.6%, to RR 5,033 million compared to RR 4,593 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Employee compensation	3,941	3,073	28.2%
Legal, audit and consulting services	275	259	6.2%
Social expenses and compensatory payments	250	775	(67.7%)
Business travel expense	130	89	46.1%
Fire safety and security expenses	126	112	12.5%
Repair and maintenance expenses	51	46	10.9%
Rent expense	45	20	125.0%
Advertising expenses	14	26	(46.2%)
Other	201	193	4.1%
<b>Total general and administrative expenses</b>	<b>5,033</b>	<b>4,593</b>	<b>9.6%</b>

Employee compensation relating to administrative personnel increased by RR 868 million, or 28.2%, to RR 3,941 million in the three months ended 31 March 2019 from RR 3,073 million in the corresponding period in 2018 due to an increase in accrued provision for bonuses to key management, an indexation of base salaries effective from 1 July 2018 and the related increase in social contributions for medical and social insurance and to the Pension Fund of the Russian Federation.

In the three months ended 31 March 2019, our social expenses and compensatory payments amounted to RR 250 million compared to RR 775 million in the corresponding period in 2018. In the current reporting period, the significant portion of expenses related to continued support of charities and social programs in the regions where we operate. In the corresponding period of prior year, besides social expenses, we made compensatory payments of RR 375 million, which mainly related to the development of the Salmanovskoye (Utrenneye) field. Social expenses and compensatory payments fluctuate period-on-period depending on the implementation schedules of specific programs we support.

Other items of our general and administrative expenses changed marginally.

*Exploration expenses*

In the three months ended 31 March 2019, our exploration expenses significantly increased by RR 1,668 million, or 97.6%, to RR 3,377 million from RR 1,709 million in the corresponding period in 2018 mainly due to an increase in the volume of activities related to exploration works. In the current reporting period, a major portion of our exploration works were performed at the Gydanskiy, the Nyakhartinskiy, the Nyavuyakhskiy, the West-Solpatinskiy, the Verhnetiuteyskiy and the West-Seyakhinskiy license areas. In the corresponding period in 2018, our exploration expenses primarily related to the Verhnetiuteyskiy and the West-Seyakhinskiy, the Gydanskiy, the Trekhbugorniy, the North-Tanamskiy and the Shtormovoy license areas.

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The increase in exploration works will ensure timely preparation of reserves at our promising fields for development and further progress of the Group's hydrocarbons production projects in line with our long-term strategy. Exploration expenses include geological and geophysical research services expenditures, expenditures associated with the maintenance of license areas with non-proven reserves and other expenditures relating to exploration activity, as well as expenses of our science and technology center associated with the exploration activities at our fields. Exploration expenses fluctuate period-to-period in accordance with the approved exploration work schedule at our production subsidiaries.

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

In the three months ended 31 March 2019, we recorded a charge of RR 2,807 million to changes in inventory expense due to a decrease in our hydrocarbons inventory balances as of 31 March compared to 1 January. In the corresponding period in 2018, we recorded a reversal of RR 1,952 million to changes in inventory expense as a result of an increase in stable gas condensate refined products inventory balances.

In the three months ended 31 March 2019 and 2018, our cumulative natural gas inventory balance representing mainly our inventory balances of natural gas in the Underground Gas Storage Facilities ("UGSF") decreased by 1,396 mmcm and 954 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 2019, our cumulative liquid hydrocarbons inventory balances, recognized as inventory in transit or in storage, decreased by 62 thousand tons mainly due to a decrease in inventory balance of stable gas condensate refined products in storage at our Ust-Luga Complex. In the corresponding period in 2018, our cumulative liquid hydrocarbons inventory balances increased by 140 thousand tons mainly due to an increase in inventory balance of stable gas condensate refined products in storage at our Ust-Luga Complex and in tankers in transit not realized at the reporting date. Inventory balances of stable gas condensate and refined products tend to fluctuate period-to-period depending on shipment schedules and final destination of our shipments.

The following table highlights movements in our hydrocarbons inventory balances:

<i>Inventory balances in transit or in storage</i>	2019			2018		
	At 31 March	At 1 January	Increase / (decrease)	At 31 March	At 1 January	Increase / (decrease)
<b>Natural gas (millions of cubic meters)</b>	<b>813</b>	<b>2,209</b>	<b>(1,396)</b>	<b>79</b>	<b>1,033</b>	<b>(954)</b>
<i>incl. Gazprom's UGSF</i>	765	2,106	(1,341)	-	870	(870)
<b>Liquid hydrocarbons (thousand tons)</b>	<b>1,007</b>	<b>1,069</b>	<b>(62)</b>	<b>1,102</b>	<b>962</b>	<b>140</b>
<i>incl. stable gas condensate refined products</i>	504	578	(74)	631	464	167
<i>stable gas condensate</i>	268	276	(8)	261	290	(29)
<i>crude oil</i>	127	109	18	107	103	4

**Other operating income (loss)**

Other operating income (loss) includes realized income (loss) from hydrocarbons trading on the international markets, income (loss) from the change in the fair value of the aforementioned contracts, as well as other income (loss) relating to penalty charges, disposal of materials, fixed assets and other transactions. In the three months ended 31 March 2019, we recognized other operating loss of RR 914 million compared to other operating income of RR 102 million in the corresponding period in 2018.

In the three months ended 31 March 2019, we purchased and sold approximately 2.5 bcm of natural gas, as well as various derivative commodity instruments within our trading activities, and recognized the aggregate realized loss from trading activities of RR 750 million as compared to RR 270 million of loss in the corresponding period in 2018. At the same time, we recognized non-cash income of RR 307 million in the three months ended 31 March 2019 as a result of an increase in the fair value of the aforementioned contracts as compared to RR 140 million of non-cash income in the corresponding period in 2018. The effect of the change in fair value of the commodity contracts fluctuate from period to period depending on the forecast prices for hydrocarbons on international markets and other macroeconomic parameters and may or may not reflect actual future cash flows from trading activities.

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In addition, in the current reporting period, we recognized a loss in the amount of RR 491 million due to the change in fair value of contingent cash consideration resulted from the disposal of a 10% participation interest in OOO Arctic LNG 2 primarily due to the strengthening of the Russian rouble after the transaction closing. The fair value of the contingent consideration is determined based on a cash flow model using a discount rate, internal projections of the crude oil benchmark price dynamics and the Arctic LNG 2 project realization schedule (see Note 4 "Acquisitions and disposals" to the unaudited consolidated interim condensed financial statements as of and for the three months ended 31 March 2019).

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

In the three months ended 31 March 2019, we recognized a gain on the disposal of a 10% participation interest in OOO Arctic LNG 2 to a subsidiary of TOTAL S.A. in the amount of RR 308,578 million before income tax. As a result, our participation interest in Arctic LNG 2 decreased to 90% (see "Recent developments" above).

In the corresponding period in 2018, the Group recognized a gain on the disposal of a 3.3% participation interest in AO Arcticgas to PAO Gazprom Neft in the amount of RR 1,645 million.

**Profit from operations and EBITDA**

In the three months ended 31 March 2019, our profit from operations and EBITDA including our proportionate share of joint ventures, but excluding the effect from the disposal of interests in subsidiaries and joint ventures, increased to RR 94,847 million and RR 117,942 million, respectively, compared to RR 63,108 million and RR 76,306 million in the corresponding period in 2018.

Profit from operations and EBITDA of our subsidiaries, excluding the effect from the disposal of participation interests, also increased to RR 58,052 million and RR 65,724 million, respectively, compared to RR 48,468 million and RR 56,421 million in the corresponding period in 2018.

The main factors increasing the above performance measures were the commencement of LNG production at the second and third LNG trains at Yamal LNG in the second half of 2018, as well as increases in our sales volumes and net realized prices in Russian roubles terms for the majority of our liquids.

**Finance income (expense)**

In the three months ended 31 March 2019, we recorded net finance loss of RR 6,021 million compared to net finance income of RR 5,402 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Accrued interest expense on loans received	(2,300)	(2,028)	13.4%
Less: capitalized interest	1,498	1,040	44.0%
Provisions for asset retirement obligations: effect of the present value discount unwinding	(176)	(143)	23.1%
Interest expense on lease liabilities	(113)	(88)	28.4%
<b>Interest expense</b>	<b>(1,091)</b>	<b>(1,219)</b>	<b>(10.5%)</b>
Interest income	4,330	3,191	35.7%
Change in fair value of non-commodity financial instruments	10,115	21	n/a
Foreign exchange gain (loss), net	(19,375)	3,409	n/a
<b>Total finance income (expense)</b>	<b>(6,021)</b>	<b>5,402</b>	<b>n/a</b>

In the three months ended 31 March 2019, our interest expense decreased by RR 128 million, or 10.5%, to RR 1,091 million primarily due to an increase in the amount of capitalised interest costs on borrowings as a result of the increased volume of capital expenditures and assets under construction.

Interest income increased by RR 1,139 million, or 35.7%, to RR 4,330 million in the three months ended 31 March 2019 from RR 3,191 million in the corresponding period in 2018. 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 2019, we recognized a non-cash gain of RR 10,115 million compared to a non-cash gain of RR 21 million in the corresponding period in 2018 due to the remeasurement of the shareholders' loans issued by the Group to our joint ventures in accordance with IFRS 9 "Financial instruments". The effect of the fair value remeasurement of shareholders' loans may change period-to-period due to the change in market interest rates and other macroeconomic parameters and does not affect real future cash flows of loans repayments.

The Group continues to record non-cash foreign exchange gains and losses each reporting period due to movements between currency exchange rates. In the three months ended 31 March 2019, we recorded a net foreign exchange loss of RR 19,375 million compared to a net foreign exchange gain of RR 3,409 million in the corresponding period in 2018 due to the revaluation of our foreign currency denominated borrowings and loans received and 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 2019, the Group's proportionate share of income of joint ventures increased to RR 70,973 million as compared to RR 1,163 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2019	2018	
<b>Share in profit from operations</b>	<b>36,795</b>	<b>14,640</b>	<b>151.3%</b>
<b>Share in finance income (expense)</b>			
Share in interest income (expense), net	(15,310)	(3,940)	288.6%
Share in foreign exchange gain (loss), net	72,402	(9,773)	n/a
Share in change in fair value of non-commodity financial instruments	(8,841)	939	n/a
<b>Total share in finance income (expense)</b>	<b>48,251</b>	<b>(12,774)</b>	<b>n/a</b>
Share in total income tax benefit (expense)	(14,073)	(703)	n/a
<b>Total share of profit (loss) of joint ventures, net of income tax</b>	<b>70,973</b>	<b>1,163</b>	<b>n/a</b>

Our proportionate share in the profit from operations of our joint ventures significantly increased by RR 22,155 million, or 151.3%, mainly due to the commencement of LNG production at the second and third LNG trains at Yamal LNG in the second half of 2018, as well as an increase in hydrocarbons revenues in our joint ventures as a result of higher average realized prices.

In the three months ended 31 March 2019, our proportionate share in the finance income of our joint ventures amounted to RR 48,251 million compared to our proportionate share in the finance expense of RR 12,774 million in the corresponding period in 2018.

The main factor impacting the change in our share in finance income (expense) was the recognition of a significant non-cash foreign exchange gain in the current reporting period (our share amounted to RR 72.4 billion compared to non-cash foreign exchange loss (our share of RR 9.8 billion) in the corresponding period of the prior year, which in both reporting periods primarily related to the revaluation of foreign currency denominated loans in our joint venture Yamal LNG. We assess that the impact of foreign currency risk relating to the debt portfolio of Yamal LNG is to a large extent mitigated by the fact that all of its products are delivered to international markets and its revenues are denominated in foreign currencies.

In addition, our share in interest expense increased by RR 11.4 billion mainly due to the launch of the first three LNG trains at Yamal LNG and ceasing capitalizing the respective interest expense.

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The remaining change in our share in finance income (expense) related to the recognition of a non-cash loss from the remeasurement of the fair value of shareholders' loans mainly in Yamal LNG (our share amounted to RR 8.8 billion) in the current reporting period as compared to the recognition of a non-cash gain (our share amounted to RR 0.9 billion) in the corresponding period in 2018.

#### Income tax expense

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

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

Without the effect of net profit (loss) and dividends from joint ventures and excluding net gain on disposal of interests in subsidiaries and joint ventures, the effective income tax rate (total income tax expense calculated as a percentage of profit before income tax) in the three months ended 31 March 2019 and 2018, was 15.0% and 18.5%, respectively.

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

As a result of the factors discussed in the respective sections above, profit attributable to shareholders of PAO NOVATEK significantly increased by RR 338,675 million, or 8.9 times, to RR 381,796 million in the three months ended 31 March 2019 compared to RR 43,121 million in the corresponding period in 2018.

The Group's financial results were significantly impacted by a gain from the disposal of a 10% participation interest in our Arctic LNG 2 project to a subsidiary of TOTAL S.A. in March 2019, as well as the recognition of non-cash foreign exchange effects on foreign currency denominated loans of the Group and its joint ventures. Excluding the effects from the disposal of interests in subsidiaries and joint ventures and foreign exchange gains (losses), our profit attributable to shareholders of PAO NOVATEK increased by RR 18,820 million, or 40.1%, and amounted to RR 65,730 million in the three months ended 31 March 2019 compared to RR 46,910 million in the corresponding period in 2018 (see the table below):

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Profit attributable to shareholders of PAO NOVATEK	381,796	43,121	n/a
Gain on disposal of interests in subsidiaries and joint ventures, net	(308,578)	(1,645)	n/a
Income tax expense related to the disposal of interests in subsidiaries and joint ventures	37,372	-	n/a
<b>Normalized profit attributable to shareholders of PAO NOVATEK</b>	<b>110,590</b>	<b>41,476</b>	<b>166.6%</b>
Foreign exchange (gains) losses	19,375	(3,409)	n/a
Income tax expense (benefit) relating to foreign exchange (gains) losses	(3,875)	682	n/a
Share of foreign exchange (gains) losses of joint ventures	(72,402)	9,773	n/a
Share of income tax expense (benefit) relating to foreign exchange (gains) losses of joint ventures	12,042	(1,612)	n/a
<b>Normalized profit attributable to shareholders of PAO NOVATEK, excluding the effect of foreign exchange gains (losses)</b>	<b>65,730</b>	<b>46,910</b>	<b>40.1%</b>

Our weighted average basic and diluted earnings per share, calculated from the profit attributable to shareholders of PAO NOVATEK increased by RR 112.44 per share, or 8.9 times, to RR 126.74 per share in the three months ended 31 March 2019 from RR 14.30 per share in the corresponding period in 2018. Excluding the effects of the disposal of interests in subsidiaries and joint ventures and foreign exchange gains (losses), our weighted average basic and diluted earnings per share increased by RR 6.26, or 40.3%, to RR 21.82 per share in the three months ended 31 March 2019 from RR 15.56 per share in the corresponding period in 2018.

## LIQUIDITY AND CAPITAL RESOURCES

## Cash flows

The following table shows our net cash flows from operating, investing and financing activities for the three months ended 31 March 2019 and 2018:

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2019	2018	
Net cash provided by <b>operating</b> activities	61,603	48,125	28.0%
Net cash used for <b>investing</b> activities	(10,100)	(40,745)	(75.2%)
Net cash used for <b>financing</b> activities	(4,989)	(17,970)	(72.2%)

*Net cash provided by operating activities*

Our net cash provided by operating activities increased by RR 13,478 million, or 28.0%, to RR 61,603 million compared to RR 48,125 million in the corresponding period in 2018 primarily due to an increase in profit from operations before disposals of interests in subsidiaries and joint ventures adjusted for non-cash items, net of related income tax, as well as changes in working capital, which vary period-to-period depending on various factors.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2019	2018	
Profit from operations before disposals of interests in subsidiaries and joint ventures	58,052	48,468	19.8%
Non-cash adjustments <sup>(1)</sup>	7,989	7,763	2.9%
Changes in working capital and long-term advances given	7,522	2,853	163.7%
Interest received	635	346	83.5%
Income taxes paid	(12,595)	(11,305)	11.4%
<b>Total net cash provided by operating activities</b>	<b>61,603</b>	<b>48,125</b>	<b>28.0%</b>

<sup>(1)</sup> 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 subsidiaries and joint ventures adjusted for non-cash items increased due to the production launch at the second and third LNG trains at Yamal LNG in the second half of 2018, as well as an increase in volumes and average realized prices for the majority of our liquid hydrocarbons (see "Profit from operations and EBITDA" above).

*Net cash used for investing activities*

In the three months ended 31 March 2019, our net cash used for investing activities decreased by RR 30,645 million, or 75.2%, to RR 10,100 million compared to RR 40,745 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	Three months ended 31 March:		Change %
	2019	2018	
Cash used for capital expenditures	(42,476)	(9,712)	337.4%
Payments for mineral licenses	(2,006)	(227)	n/a
Proceeds from disposals of subsidiaries net of cash disposed	23,453	-	n/a
Payments for acquisition of subsidiaries net of cash acquired	-	(30,492)	n/a
Loans provided to joint ventures	(1,129)	(186)	n/a
Repayments of loans provided to joint ventures	268	282	(5.0%)
Net decrease (increase) in bank deposits with original maturity more than three months	12,252	-	n/a
Other	(462)	(410)	12.7%
<b>Net cash used for investing activities</b>	<b>(10,100)</b>	<b>(40,745)</b>	<b>(75.2%)</b>



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Cash used for capital expenditures increased by RR 32,764 million, or 4.4 times, as compared to the corresponding period in 2018 primarily due to investments in our LNG projects and the ongoing development of our North-Russkoye field. In addition, our capital expenditures in both reporting periods related to the ongoing development of crude oil deposits at the East-Tarkosalinskoye and the Yarudeyskoye fields (see "Capital expenditures" below).

In January 2019, we made a final payment in the amount of RR 2,006 million for the acquisition of the license for the South-Leskinskiy license area (an advance payment in the amount of RR 35 million was made in the fourth quarter of 2018). In the first quarter of 2018, we made a one-time payment fee to expand the borders of our Salmanovskiy (Utrenniy) license area in the amount of RR 167 million and paid RR 60 million for participation in the auction for the right to use the Payutskiy license area.

In the first quarter of 2019, the Group sold a 10% participation interest in OOO Arctic LNG 2 and received the first cash transfer in the amount of RR 39,443 million (the equivalent of USD 600 million) as a payment for the disposed participation interest (see "Recent developments" above). Excluding the cash balance in OOO Arctic LNG 2 as at the transaction closing date, the net cash inflow from the transaction amounted to RR 23,453 million.

In the first quarter of 2018, the Group acquired 100% participation interests in AO Geotransgas, OOO Urengoyetskaya gasovaya kompaniya and OOO Chernichnoye for RR 30,492 million net of cash acquired.

In the first quarter of 2019, we provided loans to our joint venture Yamal LNG in the aggregate amount of RR 1,129 million for financing the construction of the fourth LNG train. In the corresponding period in 2018, we provided loans to our joint venture Cryogas-Vysotsk in the amount of RR 186 million. At the same time, in the three months ended 31 March 2019 and 2018, we received RR 268 million and RR 282 million, respectively, due to partial repayments of the loans provided to Terneftegas.

The Group's cash management involves periodic cash placement on bank deposits with different maturities. Deposits are reported in "Cash and cash equivalents" if opened for three months or less, or otherwise in "Short-term bank deposits with original maturity more than three months". Transactions with bank deposits with original maturity more than three months are classified as investing activities in the Consolidated Statement of Cash Flows. In the first quarter of 2019, the net decrease in bank deposits with original maturity more than three months amounted to approximately RR 12 billion.

*Net cash used for financing activities*

In the three months ended 31 March 2019, our net cash used for financing activities decreased by RR 12,981 million, or 72.2%, to RR 4,989 million as compared to RR 17,970 million in the corresponding period in 2018.

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
Proceeds from (repayments of) long-term debt, net	-	(12,966)	n/a
Proceeds from short-term debt			
with original maturity more than three months	1,000	-	n/a
Proceeds from (repayments of) short-term debt			
with original maturity three months or less, net	-	1,182	n/a
Dividends paid to non-controlling interest	(3,871)	(5,553)	(30.3%)
Interest on debt paid	-	(275)	n/a
Payments of lease liabilities	(589)	(358)	64.5%
Purchases of treasury shares	(1,529)	-	n/a
<b>Net cash used for financing activities</b>	<b>(4,989)</b>	<b>(17,970)</b>	<b>(72.2%)</b>

In the reporting period of 2018, the Group fully repaid a loan obtained under our syndicated credit line facility in the amount of RR 12,966 million (USD 231 million).

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In the first quarter of 2019, we obtained a short-term loan in the amount of RR one billion under a revolving credit line facility. In the reporting period of 2018, we obtained short-term loans to finance trade activities and cash inflows from these loans exceeded cash payments by RR 1,182 million.

In the three months ended 31 March 2019 and 2018, a Group subsidiary paid dividends in the amount of RR 3,871 million and RR 5,553 million, respectively, to its non-controlling shareholder.

The remaining change related primarily to the repayment of interest 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 2019 and 31 December 2018:

	31 March 2019	31 December 2018	Change, %
<b>Absolute amounts, RR million</b>			
Net debt <sup>(1)</sup>	65,040	102,903	(36.8%)
Net working capital position <sup>(2)</sup>	260,523	186,297	39.8%
<b>Liquidity and credit ratios</b>			
Current ratio <sup>(3)</sup>	3.17	2.74	n/a
Total debt to total equity	0.13	0.19	n/a
Long-term debt to long-term debt and total equity	0.11	0.16	n/a
Net debt to total capitalization <sup>(4)</sup>	0.04	0.09	n/a
Net debt to normalized EBITDA from subsidiaries <sup>(5)</sup>	0.24	0.40	n/a

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

<sup>(2)</sup> Net working capital position represents current assets less current liabilities.

<sup>(3)</sup> Current ratio is calculated as current assets divided by current liabilities.

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

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

In each quarter of 2018 and 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 assets. The following table shows capital expenditures at our main fields, processing facilities and other assets:

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>	
	<b>2019</b>	<b>2018</b>
Arctic LNG 2 project <sup>(1)</sup>	19,147	2,597
North-Russkoye and East-Tazovskoye fields	6,908	1,518
Infrastructure for future LNG projects <sup>(2)</sup>	5,632	980
East-Tarkosalinskoye field	1,515	1,340
Yarudeyskoye field	1,295	627
Beregovoye field	1,288	146
Ust-Luga Complex	1,269	69
Dorogovskoye field	665	77
West-Yurkharovskoye field	580	219
Yurkharovskoye field	406	755
Office buildings	1,693	329
Other	2,503	1,991
<b>Capital expenditures</b>	<b>42,901</b>	<b>10,648</b>

<sup>(1)</sup> Capital expenditures are reported before the disposal of a 10% participation interest in OOO Arctic LNG 2 in March 2019 (see "Recent developments" above).

<sup>(2)</sup> 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 2019 significantly increased by RR 32,253 million, or 302.9%, to RR 42,901 million from RR 10,648 million. In both reporting periods, a significant portion of our capital expenditures related to the development of our 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 the current reporting period, we significantly increased our investments in the development of the North-Russkoye field, construction of the field facilities is underway. In both reporting periods, we also continued ongoing development of the Yarudeyskoye and the East-Tarkosalinskoye field's crude oil deposits. In addition, in the current reporting period, we invested in the project for construction of a hydrocracker unit at our Ust-Luga Complex, which, when completed and commissioned, will allow us to increase the depth of processing of stable gas condensate and output of light oil products.

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

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

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

<i>millions of Russian roubles</i>	<b>Three months ended 31 March:</b>		<b>Change %</b>
	<b>2019</b>	<b>2018</b>	
<b>Total additions to property, plant and equipment per Note "Property, plant and equipment" in the Group's IFRS Consolidated Financial Statements</b>	<b>44,907</b>	<b>13,139</b>	<b>241.8%</b>
Less: acquisition of mineral licenses	(2,006)	(227)	n/a
Less: right-of-use assets <sup>(1)</sup> additions	-	(2,264)	n/a
<b>Capital expenditures</b>	<b>42,901</b>	<b>10,648</b>	<b>302.9%</b>
Add (less): change in accounts payable, capitalized foreign exchange losses and other non-cash adjustments	(425)	(936)	(54.6%)
<b>Cash used for capital expenditures <sup>(2)</sup></b>	<b>42,476</b>	<b>9,712</b>	<b>337.4%</b>

<sup>(1)</sup> Related mainly to long-term agreements on time chartering of marine tankers.

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

In the current reporting period, we made a final payment of RR 2,006 million for the auction won in December 2018 for the subsoil use of the South-Leskinskiy license area (we prepaid RR 35 million in December 2018).

In March 2018, the Group won the auction for geological research works, exploration and hydrocarbons production at the Payutskiy license area and paid RR 60 million (the remaining RR 6 million was paid after the state registration of the license in the second quarter 2018). In addition, in February 2018, we paid a one-time fee in the amount of RR 167 million to expand the borders of the Salmanovskiy (Utrenniy) license area.

**QUALITATIVE AND QUANTITATIVE DISCLOSURES AND MARKET RISKS**

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

**Foreign currency risk**

Our principal exchange rate risk involves changes in the value of the Russian rouble relative to the US dollar and the Euro. As of 31 March 2019, the total amount of our debt denominated in foreign currency was RR 159,571 million, or 98.8% of our total borrowings at that date. Changes in the value of the Russian rouble relative to foreign currencies will impact the value in Russian rouble terms of our foreign currency-denominated costs, debt, receivables at our foreign subsidiaries and loans provided to our joint ventures. We believe that the risks associated with our foreign currency exposure are partially mitigated by the fact that a portion of our total revenues, 54.6% in the three months ended 31 March 2019, was denominated in foreign currencies.

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

As of 31 March 2019, the Russian rouble appreciated by 6.8% and 8.5% against the US dollar and the Euro, respectively, compared to 31 March 2018.

**Commodity risk**

Our export prices for natural gas, stable gas condensate and refined products, LPG and crude oil are primarily linked to international natural gas, crude oil and oil products prices and/or a combination thereof. External factors such as geopolitical developments, natural disasters and the actions of the Organization of Petroleum Exporting Countries affect crude oil prices and thus our export prices.

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

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

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

**Pipeline access**

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

**Ability to reinvest**

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

**Forward-looking statements**

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

**Off balance sheet activities**

As of 31 March 2019, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements.

## TERMS AND ABBREVIATIONS

<b>APR</b>	Asian-Pacific Region
<b>bbl</b>	barrel
<b>bcm</b>	billion cubic meters
<b>boe</b>	barrels of oil equivalent
<b>btu</b>	British thermal unit
<b>CBR</b>	Central Bank of Russian Federation
<b>CFR</b>	"Cost and freight"
<b>CIF</b>	"Cost, insurance and freight"
<b>DAP</b>	"Delivery at point of destination"
<b>DDA</b>	depreciation, depletion and amortization
<b>DES</b>	"Delivery to the port of destination ex-ship"
<b>FCA</b>	"Free carrier"
<b>FEED</b>	Front-End Engineering Design
<b>FOB</b>	"Free on board"
<b>Forecast of the Ministry of Economic Development</b>	The document " <i>Forecast of Socio-economic Development of the Russian Federation for the period till 2024</i> " prepared by the Ministry of Economic Development of the Russian Federation or the similar document prepared for another period
<b>GTS</b>	Gas Transmission System part of the UGSS
<b>IFRS</b>	International Financial Reporting Standards
<b>List</b>	the OFAC's Sectoral Sanctions Identification List
<b>LNG</b>	liquefied natural gas
<b>LPG</b>	liquefied petroleum gas
<b>mcm</b>	thousand cubic meters
<b>MET</b>	mineral extraction tax
<b>NGL</b>	natural gas liquids
<b>OFAC</b>	U.S. Treasury Department's Office of Foreign Assets Control
<b>PRMS</b>	Petroleum Resources Management System
<b>Purovsky Plant Regulator</b>	Purovsky Gas Condensate Plant 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.
<b>RR</b>	Russian rouble(s)
<b>RZD</b>	OAD Russian Railways, Russia's state-owned monopoly railway operator
<b>SEC</b>	Securities and Exchange Commission
<b>Tobolsk Refining Facilities</b>	Refining facilities of OOO SIBUR Tobolsk
<b>UGSF</b>	Underground Gas Storage Facilities
<b>UGSS</b>	Unified Gas Supply System owned and operated by PAO Gazprom
<b>UPT</b>	unified natural resources production tax
<b>USD, US dollar</b>	United States Dollar
<b>Ust-Luga Complex</b>	Gas Condensate Fractionation and Transshipment Complex located at the port of Ust-Luga on the Baltic Sea
<b>VAT</b>	value added tax
<b>Yamal LNG project</b>	A large-scale project on constructing a liquefied natural gas plant with an annual capacity of 17.4 million tons based on the feedstock resources of the South-Tambeyskoye field located at the northeast of the Yamal Peninsula that Group undertakes jointly with TOTAL S.A., China National Petroleum Corporation and China's Silk Road Fund Co. Ltd., through its joint venture OAO Yamal LNG
<b>YNAO</b>	Yamal-Nenets Autonomous Region