

TRANSNEFT

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE GROUP'S FINANCIAL POSITION
AND RESULTS OF ITS OPERATIONS

FOR THE THREE MONTHS ENDED 31 MARCH 2018





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(in millions of Russian roubles, if not stated otherwise)

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The following analysis provides an overview of the financial position of Transneft and its subsidiaries (hereinafter – the “Group”) as at 31 March 2018 and results of operations for the three months ended 31 March 2018, compared to the three months ended 31 March 2017, as well as, other important factors which could affect the future results of the Group. This analysis should be read in conjunction with the interim consolidated condensed financial statements prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” (hereinafter – “IFRS”) for the three months ended 31 March 2018.

Key financial and operating results

	Three months ended 31 March 2018	Three months ended 31 March 2017	Change, %
Revenue	225,239	219,071	2.8
Profit for the period	46,991	79,507	(40.9)
Earnings before interest, income tax, depreciation and amortisation (EBITDA*)	107,533	110,385	(2.6)
Oil delivered to consignees, mln tons	116.5	117.7	(1.0)
including:			
Russian oil refineries, mln tons	60.9	60.2	1.2
transshipment into the CPC-R system, mln tons	-	0.002	X
exports to neighboring countries, mln tons	4.7	4.1	14.6
exports to other countries, mln tons	50.8	53.4	(4.9)
Oil products delivered to consignees, mln tons	9.9	8.1	22.2
including:			
Russia's domestic market, mln tons	2.0	1.5	33.3
exports to the Customs Union member countries, mln tons	0.1	0.1	-
exports to other countries, mln tons	7.8	6.5	20.0

* Less crude oil sale and purchase operations under contracts with Rosneft and China National United Oil Corporation.

The main non-operating factors which influenced the profit for the period are disclosed in the table below:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Profit for the period	46,991	79,507	(32,516)	(40.9)
Net gain from foreign exchange differences	(3,209)	(13,522)	10,313	(76.3)
Net interest expense	13,211	7,409	5,802	78.3
Net gain/ (loss) from operations with financial instruments	(280)	362	(642)	x
Share of profit from associates and jointly controlled entities	(1,757)	(17,265)	15,508	(89.8)
Adjusted profit for the period	54,956	56,491	(1,535)	(2.7)



1. General information and overview of the Group's activities

Public joint stock company Transneft was incorporated in accordance the Russian Government Resolution No. 810 dated 14 August 1993, hereinafter the "Company".

According to its Charter Transneft was established for the purpose of generating profit.

The main areas of Transneft's and its subsidiaries' operations are as follows:

- providing services of transporting oil and oil products via trunk pipelines in the Russian Federation as well as outside of Russia including interstate and intergovernmental agreements;
- raising of and making investments in development of the oil trunk pipeline and oil products trunk pipeline network including production of goods, works and services for servicing trunk oil pipeline and trunk oil products pipeline system to maintain its working condition, increase efficiency and safety of its operations;
- performing of scientific, technical, production, financial and foreign economic activities including mediating activity in the territory of the Russian Federation and outside of Russia;
- carrying out works relating to use of information constituting state secrets (protection of state secrets), provision of services for keeping state secrets safe;
- operating of oil and oil products trunk pipeline transport, sale of and storage of oil and oil products;
- carrying out activities to organize departmental protection of fuel and energy complex facilities owned by the Company and (or) companies, more than 50 percent of voting shares (stakes in the authorized capital) of which are owned by the Company and (or) companies, whose decisions the Company has the ability to determine, and the products supplied under the state contract.

The Group also provides services of oil storage, oil compounding, crude oil sales.

Transneft is also responsible for oil transportation planning and management on foreign territory, for exercising control of oil storage at and delivery to foreign oil receipt-and-delivery facilities, and for data gathering and summarizing.

The Group as at 31 March 2018 possesses an extensive network of trunk oil pipelines with a total length of approximately 51.7 thousand km and trunk oil products pipelines with a total length of some 16.7 thousand km.

During the three months ended 31 March 2018 the Group transported more than 83% of oil produced in Russia and more than 31% of light oil products produced in Russia, as well as significant volume of hydrocarbons and oil products from CIS countries.

Transneft's key competitive advantages include:

- a monopoly position in the oil pipeline transport market;
- a low ratio of operating costs to total oil transportation volume compared to railway or water transport;
- average level of oil transportation tariffs, compared to those in the CIS and Europe.



1.1. Key investment projects of the Group

Transneft pays considerable attention to comprehensive development of its trunk pipeline network, promotion of scientific and technical progress, and implementation of new equipment and technology. Transneft's capital investment policy is aimed at achieving system-wide targets for production base development, as well as expansion, reconstruction, and technical upgrades of pipeline transport facilities.

Fulfillment by Transneft of investment projects provides development of the system of trunk pipelines that allows to redistribute operationally export flows to both the Western and the Eastern directions depending on the market situation.

The largest investment projects for construction and expansion of pipeline systems under realization are:

- Expansion of the ESPO pipeline system in the GNPS Taishet – NPS Skovorodino section to 80 mln tons annually;
- Expansion of the ESPO pipeline system in the NPS Skovorodino – SMNP Kozmino to 50 mln tons annually;
- Oil pipeline TS ESPO – Komsomolskiy NPZ;
- Development of the trunk pipeline system for increase of deliveries of oil products to Primorsk Sea Port to 25 mln tons (Project “Sever”);
- Reconstruction of the trunk pipeline system for increase of transportation volumes of oil products to the Moscow area;

1.2. Environmental policy

The Group's management is fully aware of potential danger of a possible negative impact of technologically complex production activities on the environment, will develop and operate the oil and oil products trunk pipeline system, take adjacent works so that not to harm environment and ensure the most higher level of ecological safety of its activities. The Group, being the key element of energy industry of the Russian Federation and providing final results of its activities, sets as its superior and permanent priority protection of environment, provision of high level of environmental safety of the Group's production facilities.

The Group's management is fully informed of the conditions of all fixed assets and the pace of their wear and tear, and uses these data to plan reconstruction or building of new facilities.

The amount of funding of the ecological safety program, building and reconstruction of environmental facilities and acquisition of environmental protection equipment enable Transneft to meet the strictest Russian and international environmental standards.

As at today all subsidiaries of Transneft have developed, introduced and certified the environmental management System, the international certificate DQS and IQNet conformity to the standard ISO 14001-2004 have been received.



2. Tariffs and key macroeconomic factors affecting the Group's performance

2.1. Oil and oil products transportation tariffs

Transneft provides tariff-based oil and oil products transportation services to consignors.

Tariff rates are currently calculated in accordance with the Rules of state regulation of tariffs or their maximum limits for services of natural monopolies with respect to transportation of oil and oil products via trunk pipelines, approved by a Decree of the Government of the Russian Federation of 29.12.2007 No. 980, as well as in accordance with the Regulations on setting fees for services of transportation of oil via trunk pipelines, approved by an Order of the Federal Tariff Service of Russia of 17.08.2005 No. 380-e/2, the Methodology of setting tariffs on oil products transportation via trunk pipelines of the Russian Federation approved by Federal Energy Commission of Russia of 16.10.2002 No. 70-e/5, as well as, by the Decree of the Government of the Russian Federation of 14.03.2014 No. 377-r.

During the year ended 31 December 2017 and three months ended 31 March 2018 Transneft was performing its core operations:

- a) of transporting oil, by charging fees for its services in accordance with oil transportation tariff rates approved by orders of the state regulatory body for natural monopolies – the Federal Tariff Service of Russia (FTS of Russia) and Federal Antimonopoly Service (FAS of Russia)¹:
 - Order of the FTS of Russia of 22.12.2009 No. 455-t/1 Concerning the setting of fees for sea port services provided to OOO Specialized Oil Loading Sea Port Kozmino;
 - Order of the FTS of Russia of 31.10.2014 No. 240-e/2 Concerning the setting of fee for the service of OAO AK Transneft for transportation of oil via the Ephimoffka – OOO LUKOIL-Volgogradneftepererabotka route rendered for OAO LUKOIL;
 - Order of the FAS of Russia of 07.09.2015 No. 814/15 Concerning the setting of tariff for the service of AO Transneft-Terminal for filling oil from trunk pipelines of OAO AK Transneft into railway tank cars on the territory of Grushevaya industrial site of the transshipment complex Sheskharis;
 - Order of the FAS of Russia of 15.10.2015 No. 964/15 Concerning the setting of tariff for the service of OAO AK Transneft for delivery of oil to AO NNK-Khabarovskiy NPZ;
 - Order of the FAS of Russia of 22.10.2015 No. 991/15 Concerning the setting of tariff for the service of OAO AK Transneft for delivery of oil by oil trunk pipeline system (with amendments included by the order of the FAS of Russia of 13.09.2016 No. 1289/16 Concerning the amendments to the order of the FAS of Russia of 22.10.2015 No. 991/15 Concerning the setting of tariff for the services of OAO AK Transneft for transportation of oil through trunk pipeline system);
 - Order of the FAS of Russia of 30.12.2015 No. 1359/15 Concerning the setting of tariff for the service of OAO AK Transneft for delivery of oil to OOO Ilskiy NPZ;
 - Order of the FAS of Russia of 26.05.2016 No. 666/16 Concerning the setting of tariff for the services of OAO AK Transneft for delivery of oil via Uhta – Yaroslavl trunk pipeline through Uhta – OOO Lukoil – UNP route provided to PJSC LUKOIL;
 - Order of the FAS of Russia of 26.05.2016 No. 667/16 Concerning the setting of tariff for the services of OAO AK Transneft for delivery of oil via Uhta – Yaroslavl trunk pipeline through Synya – Pechora route provided to OOO SK Rusvietpetro;
 - Order of the FAS of Russia of 01.07.2016 No. 876/16 Concerning the setting of tariff for the services of OAO AK Transneft for delivery of oil via Uhta – Yaroslavl trunk pipeline through Pechora – Chickshino provided to AO NNK – Pechoraneft;
 - Order of the FAS of Russia of 29.08.2016 No. 1216/16 Concerning the setting of tariff for the services of Transneft for delivery of oil via Uhta – Yaroslavl trunk pipeline through Urdoma – Privodino provided to AO NK – Neftisa;
 - Order of the FAS of Russia of 29.08.2016 No. 1217/16 Concerning the setting of tariff for the services of Transneft for delivery of oil via Uhta – Yaroslavl trunk pipeline through Uhta - Sindor provided to OOO Nizhneomrinskaya neft;
 - Order of FAS of Russia of 09.12.2016 No. 1742/16 Concerning the setting of tariff for the services of Transneft for delivery of oil through Chikshino-Zelenoborsk route via Usa – Uhta trunk pipeline provided to OOO ZARUBEZHNEFT – dobitcha Kharyaga;
 - Order of FAS of Russia of 23.12.2016 No. 1825/16 Concerning the setting of tariff for the services of Transneft for delivery of oil via trunk pipeline system;

¹ the FAS of Russia is a successor of the FTS of Russia. Decree of the President of the Russian Federation of 21.07.2015 No.373 Concerning different issues on state administration and control in antimonopoly and tariff regulation.



2.1. Oil and oil products transportation tariffs (continued)

- Order of FAS of Russia of 26.12.2016 No. 1863/16 Concerning the setting of tariff for the services of Transneft for delivery of oil through Tikhoretsk – Tuapse-2 route provided to Rosneft;
- Order of FAS of Russia of 26.12.2016 No. 1842/16 Concerning the setting of tariff for the services of Transneft-Terminal for loading of oil into railway tank cars on the territory of Grushevaya industrial site of the transshipment complex Sheskharis from trunk pipeline system of Transneft;
- Order of FAS of Russia of 27.03.2017 No. 392/17 Concerning the setting of tariff for the services of Transneft for transportation of oil through Sindor-Mikun route of Uhta-Yaroslavl pipeline provided to OOO TSNPSEI;
- Order of FAS of Russia of 28.04.2017 No. 580/17 Concerning the setting of network tariff for the services of Transneft for transportation of oil via Kuyumba-Taishet trunk pipeline system and amending of the order of the FAS of Russia of 23.12.2016 No. 1825/16 Concerning the setting of tariff for the services of Transneft for delivery of oil via trunk pipeline system;
- Order of FAS of Russia of 13.03.2017 No. 294/17 Concerning the setting of tariff for the services of Transneft for delivery of oil from trunk pipeline system to OOO Tomskneftepererabotka;
- Order of FAS of Russia of 11.12.2017 No. 1659/17 Concerning the setting of tariff for the services of Transneft for transportation of oil via trunk pipeline system;
- Order of FAS of Russia of 11.12.2017 No. 1660/17 Concerning the setting of tariff for the services of Transneft for transportation of oil through Tikhoretsk – Tuapse-2 provided to Rosneft.
- b) of transporting oil products, by charging fees for its services in accordance with fee rates approved by Transneft in accordance with orders of the FTS of Russia, the FAS of Russia:
 - Order of the FTS of Russia of 30.04.2013 No. 90-e/2 Concerning the setting of maximum tariff rates for services of OAO AK Transneft for execution of orders and scheduling deliveries of oil products which are in transit to LPDS Sokur and are further exported outside the customs territory of the Russian Federation and the states - members of the Customs Union;
 - Order of the FTS of Russia of 30.05.2014 No. 132-e/2 Concerning the setting of tariff for services rendered by OAO AK Transneft for transportation of oil products through the route “LUKOIL – Nizhegorodnefteorgsynthez” – MP “Primorsk” for OAO NK LUKOIL;
 - Order of the FTS of Russia of 07.10.2014 No.223-e/1 Concerning the setting of tariff for the services of OAO AK Transneft and its affiliated parties for transportation of oil products by trunk pipelines;
 - Order of the FTS of Russia of 24.12.2014 No.307-e/1 Concerning the setting of maximum rates of tariff for the services of OAO AK Transneft and its affiliated entities for loading of oil products from trunk pipeline system and making amendments to the Order of the FTS of Russia No.223-e/1 of 07.10.2014;
 - Order of the FTS of Russia of 10.02.2015 No.19-e/2 Concerning the setting of maximum rate of tariff for the services of OAO AK Transneft and making amendments to appendix 1 of the Order of the FTS of Russian No.223-e/1 of 07.10.2014;
 - Order of the FTS of Russia of 11.06.2015 No. 234-e/4 Concerning the setting of tariff for the services rendered by OAO AK Transneft for transportation of oil products through OOO KINEF – MP “Primorsk” route for OAO Surgutneftegaz;
 - Order of the FAS of Russia of 15.10.2015 No. 965/15 Concerning the setting limit for maximum tariff rates for the services of OAO AK Transneft for filling of oil products from trunk pipeline network;
 - Order of the FAS of Russia of 01.07.2016 No. 875/16 Concerning the setting limit for maximum tariff rates for the services of OAO AK Transneft and its affiliated parties for filling of oil products from trunk pipeline network and making amendments to the order of 07.10.2014 of the FST of Russia No. 223-e/1 Concerning the setting of tariff for the services of OAO AK Transneft and its affiliated parties for transportation of oil products by trunk pipelines;
 - Order of the FAS of Russia of 26.12.2016 No. 1843/16 Concerning the setting limit for maximum tariff rates for the services of Transneft and its affiliated parties for filling of oil products from trunk pipeline network and making amendments to the order of 07.10.2014 of the FST of Russia No. 223-e/1 Concerning the setting of tariff for the services of OAO AK Transneft and its affiliated parties for transportation of oil products by trunk pipelines;
 - Order of the FAS of Russia of 26.12.2016 No. 1844/16 Concerning the setting limit for maximum tariff rates for the services of Transneft for filling of oil products from trunk pipeline network;
 - Order of the FAS of Russia of 14.04.2017 No. 501/17 Concerning the setting of tariff for transportation of oil products through PSP Antipinskiy NPZ-DT (loading from AO Antipinskiy NPZ) – MP Primorsk;



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2.1. Oil and oil products transportation tariffs (continued)

- Order of the FAS of Russia of 01.12.2017 No. 1627/17 Concerning the setting of tariff for services of Transneft for oil products transportation services through PSP Volgograd (loading from OOO LUKOIL-VOLGOGRADNEFTEPERERABOTKA) – MP Novorossiysk (PK Sheskhari) provided to PJSC LUKOIL.

2.2. The rouble's exchange rate against foreign currencies

Services for transportation of oil through trunk oil pipelines located in the territory of the Russian Federation are paid for in Russian roubles.

Oil products transportation services are paid for in the following main currencies:

- in the Russian Federation - Russian roubles;
- in the Republic of Belarus - US dollars;
- in the Republic of Kazakhstan - the rouble equivalent calculated at the exchange rate of the Kazakhstan tenge established by the Bank of Russia on the payment date.

Fluctuations of US Dollar and Kazakhstan tenge do not significantly affect the Group's operating results as the portion of revenue which is paid for in US Dollars or rouble equivalent, calculated at the Kazakhstan tenge exchange rate, established by Bank of Russia at the date of payment, in the total revenue is relatively small.

	Three months ended 31 March 2018	Three months ended 31 March 2017	Change, %
Change in the rouble's exchange rate against the US dollar for the reporting period, %	(0.58)	(7.05)	x
Average exchange rate for the period (roubles per US dollar)	56.88	58.84	(3.3)
Exchange rate at the end of the period (roubles per US dollar)	57.26	56.38	1.6

2.3. Inflation rates

Russia's inflation rates as per Federal state statistics service during the period in question were as follows:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Change, pp
Rouble inflation (CPI), %	0.8	1.0	(0.2)

2.4. Taxation

Most of the Group's companies are incorporated in the Russian Federation and subject to taxation under the Tax Code of the Russian Federation.

The amount of taxes accrued by the Group (except for taxes and contributions accrued in connection with salaries) was as follows:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Change, %
Current income tax	11,014	16,619	(33.7)
Property tax	9,612	7,407	29.8
Other taxes and levies	163	302	(46.0)

Income tax

The federal income tax rate in 2018 is 3% (for the same period of 2017 – 3%), while the regional tax rates range from 12.5% to 17.0% (from 12.5% to 17% for the same period of 2017). The Group's international operations are taxable at rates established by the laws of countries where they took place.

Property tax

The amount of property tax increased by RUB 2,205 or by 29.8%. The increase was a result of putting into use of fixed assets, revaluation of property, plant and equipment which was held at 31 December 2017, increase of a tax rate applied to trunk pipelines as well as constructions which are integral technological part of these facilities. These properties are taxed at the rates set locally by regions of the Russian Federation and cannot be more than 1.6% during 2017, 1.9% during 2018.

Other taxes and levies

Other taxes and levies mainly include land tax, transport tax and other taxes and levies.



3. Analysis of the Group's performance

The table below presents interim consolidated condensed statements of profit or loss and other comprehensive income for the three months ended 31 March 2018 and the relative period of 2017.

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Revenue	225,239	219,071	6,168	2.8
Revenue from oil transportation services	157,503	155,022	2,481	1.6
Revenue from oil products transportation services	19,052	18,704	348	1.9
Revenue from crude oil sales	41,759	38,590	3,169	8.2
Other revenue	6,925	6,755	170	2.5
Operating expenses net of amortisation and depreciation	(117,922)	(108,904)	(9,018)	8.3
Operating profit net of amortisation and depreciation	107,317	110,167	(2,850)	(2.59)
Amortisation and depreciation	(43,596)	(37,379)	(6,217)	16.6
Operating profit	63,721	72,788	(9,067)	(12.5)
Other income	3,591	4,024	(433)	(10.8)
Share of profit from associates and jointly controlled entities	1,757	17,265	(15,508)	(89.8)
Profit before income tax and finance income/ (costs)	69,069	94,077	(25,008)	(26.6)
Net finance (costs)/ income	(9,722)	5,751	(15,473)	x
Profit before income tax	59,347	99,828	(40,481)	(40.6)
Income tax expense	(12,356)	(20,321)	7,965	(39.2)
Profit for the reporting period	46,991	79,507	(32,516)	(40.9)
Other comprehensive loss, net of income tax	(1,190)	(669)	(521)	77.9
Total comprehensive income, net of income tax	45,801	78,838	(33,037)	(41.9)



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3.1. Revenue

Revenue by type of operations	Three months ended 31 March 2018	Share of total revenue, %	Three months ended 31 March 2017	Share of total revenue, %	Absolute change	Change, %
Revenue from crude oil transportation services	157,503	69.9	155,022	70.8	2,481	1.6
exports, except the CIS	89,291	39.6	88,211	40.3	1,080	1.2
exports in the CIS	4,504	2.0	4,241	1.9	263	6.2
domestic sales	63,708	28.3	62,570	28.6	1,138	1.8
Revenue from oil products transportation services	19,052	8.5	18,704	8.5	348	1.9
Revenue from oil compounding services	1,432	0.6	1,620	0.7	(188)	(11.6)
Revenue from sales of crude oil in the domestic market	2,071	0.9	2,946	1.4	(875)	(29.7)
Revenue from sales of oil products	826	0.4	900	0.4	(74)	(8.2)
Other revenue	4,667	2.1	4,235	1.9	432	10.2
Total revenue (without revenue from export sales of crude oil)	185,551	82.4	183,427	83.7	2,124	1.2
Revenue from export sales of crude oil	39,688	17.6	35,644	16.3	4,044	11.3
Total revenue	225,239	100.0	219,071	100.0	6,168	2.8

For the three months ended 31 March 2018, the Group's revenue increased by RUB 6,168, or by 2.8%, attributable mainly to an increase in revenue from crude oil transportation services, increase in revenue from export sales of crude oil and other revenue. Without taking into account revenue from export sales of crude oil, revenue for the three months ended 31 March 2018 increased by RUB 2,124 or 1.2% compared to the same period of the previous year and accounted for 82.4% of total revenue as for the reporting period.

The changes if the Group's revenue were also affected by adoption of the new IFRS 15 *Revenue from Contracts with Customers* starting 1 January 2018. The adoption of the IFRS 15 changes recognition of the revenue from provision of oil and oil products transportation services in accordance with long-term (agreed) tariffs and revenue from provision of services for technological connection to the trunk pipeline system.

Under previously effective IAS 18 *Revenue* revenue from provision of oil and oil products transportation services in accordance with long-term (agreed) tariffs was recognised as revenue from transportation services of crude oil and oil products during the term of these tariffs.

Under previously effective IFRIC 18 *Transfer of Assets from Customers* revenue from provision of services for technological connection to the trunk pipeline system was recognised as other revenue as costs were incurred for construction of assets financed in accordance with such agreements.

Because of the adoption of the requirements of the new IFRS 15 *Revenue from Contracts with Customers* starting from the financial statements as for the three months ended 31 March 2018 revenue from provision of oil and oil products transportation services under long-term (agreed) tariffs and revenue from provision of services for technological connection to the trunk pipeline system are recognised based on the useful life of facilities which have been financed from cash received under respective agreements.



3.1. Revenue (continued)

The table below provides data adjusted for requirements of the new IFRS 15 *Revenue from Contracts with Customers* compared to the previous requirements of IAS 18 *Revenue* and IFRIC 18 *Transfer of Assets from Customers*.

	Three months ended 31 March 2018	Three months ended 31 March 2018 (without IFRS 15 impact)	Absolute change	Change, %
Revenue from oil transportation services	157,503	160,409	(2,906)	(1.8)
Revenue from crude oil sales	41,759	41,759	-	-
Revenue from oil products transportation services	19,052	19,509	(457)	(2.3)
Other revenue	6,925	13,744	(6,819)	(49.6)
Total revenue	225,239	235,421	(10,182)	(4.3)

3.1.1. Oil and oil products transportation services

Increase in revenue from oil transportation services amounted to RUB 2,481 or by 1.6% for the three months ended 31 March 2018 comparable to the same period of 2017 and was attributable to increase in tariffs with simultaneous decrease of revenue due to changes in oil transportation turnover and the impact from adoption of requirements of the new IFRS 15 *Revenue from Contracts with Customers* (ref. to 3.1).

Increase in revenue from oil products transportation services by RUB 348 or by 1.9% for the three months ended 31 March 2018 compared to the same period of 2017 was driven by changes in tariffs, changes in turnover volumes taking into account simultaneous decrease of revenue from the adoption of requirements of the new IFRS 15 *Revenue from Contracts with Customers* (ref. to 3.1).

3.1.2. Revenue from sales of crude oil

Revenue from export sales of crude oil was driven by oil sales to the People's Republic of China under a 20-year contract to supply 6 mln tons of crude oil annually effective 1 January 2011. This contract was signed as collateral for a loan obtained from the China Development Bank. The respective oil volumes are being purchased from Rosneft.

Increase in revenue from export sales of crude oil by RUB 4,044 or 11.3% as for the three months ended 31 March 2018 compared to the three months ended 31 March 2017 was mainly a result of growth in average oil market price per barrel set in USD as well as decrease of average USD/RUB exchange rate during the reporting period as compared to the same period of the previous year which resulted in the growth of average oil price per barrel set in RUB for the three months ended 31 March 2018 as compared to the three months ended 31 March 2017.

Decrease in revenue from domestic sales of crude oil as for the three months ended 31 March 2018 by RUB 875 or by 29.7% compared to the relative period of the previous year was a result of decrease of sale volumes of crude oil.

3.1.3. Revenue from oil compounding services

Decline in revenue from oil compounding services by RUB 188 or by 11.6% as for the three months ended 31 March 2018 compared to the three months ended 31 March 2017 was a result of decrease in oil compounding volumes by 13.4% (9,874.8 thousand tons for the three months ended 31 March 2018; 11,407.5 thousand tons for the three months ended 31 March 2017).

3.1.4. Other revenue

Other revenue includes revenue from oil and oil products storage services, provision of communication services, diagnostic services, construction services, information services related to oil transportation, rent services, resale of goods, organisation of transporting of cargoes, revenue from provision of other services.

Increase in other revenue as for the three months ended 31 March 2018 compared to the relative period of the previous year by RUB 432 or 10.2% was mainly driven by growth of revenue from electricity resale.



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3.2. Operating expenses net of depreciation and amortisation

Operating expenses net of amortisation and depreciation for the three months ended 31 March 2018, and the three months ended 31 March 2017, are detailed in the table below:

Operating expense line items	Three months ended 31 March 2018	Share of total expenses, %	Three months ended 31 March 2017	Share of total expenses, %	Absolute change	Change, %
Salaries, insurance contributions and social expenses	35,722	30.3	32,531	29.9	3,191	9.8
Energy	10,744	9.1	11,029	10.1	(285)	(2.6)
Materials	6,894	5.8	7,210	6.6	(316)	(4.4)
Repair and maintenance of relevant technical condition of pipeline	1,927	1.6	2,279	2.1	(352)	(15.4)
Insurance expenses	1,522	1.3	1,522	1.4	-	-
Taxes (other than income tax)	9,148	7.8	7,260	6.7	1,888	26.0
Pension expense	1,893	1.6	1,834	1.7	59	3.2
Cost of crude oil sold in the domestic market	1,892	1.6	2,585	2.4	(693)	(26.8)
Cost of oil products sold	743	0.6	813	0.7	(70)	(8.6)
Cost of other goods for resale sold	876	0.7	420	0.4	456	2.1 times
Other operating expenses	6,657	5.8	5,559	5.1	1,098	19.8
Operating expenses (net of export crude oil sales)	78,018	66.2	73,042	67.1	4,976	6.8
Cost of export crude oil sales (including export custom duties)	39,904	33.8	35,862	32.9	4,042	11.3
Operating expenses net of depreciation and amortisation	117,922	100.0	108,904	100.0	9,018	8.3

For the three months ended 31 March 2018, compared to the three months ended 31 March 2017, the amount of operating expenses net of depreciation and amortisation increased by RUB 9,018 or by 8.3%.

The increase of the operating expenses net of amortisation and depreciation was driven by the following factors:

- increase of the cost of export crude oil sales (ref. to 3.2.6);
- increase of other taxes (ref. to 3.2.7);
- increase of salaries, insurance contributions and social expenses (ref. to 3.2.1).



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3.2 Operating expenses net of amortisation and depreciation (continued)

After applying inflation rates*, operating expenses net of amortisation and depreciation for the three months ended 31 March 2018, and for the three months ended 31 March 2017, were as follows:

Operating expense line items	Three months ended 31 March 2018	Share of total expenses, %	Inflation rates (2018 to 2017), %*	Three months ended 31 March 2017 (inflated to 2018)	Share of total expenses, %	Absolute change	Change, %
Salaries, insurance contributions and social expenses	35,722	30.3	3.7	33,735	30.0	1,987	5.9
Energy	10,744	9.1	4.7	11,547	10.3	(803)	(7.0)
Materials	6,894	5.8	4.0	7,498	6.7	(604)	(8.1)
Repair and maintenance of relevant technical condition of pipeline	1,927	1.6	4.6	2,384	2.1	(457)	(19.2)
Insurance expenses	1,522	1.3	3.7	1,578	1.4	(56)	(3.5)
Taxes (other than income tax)	9,148	7.8	4.0	7,550	6.7	1,598	21.2
Pension expense	1,893	1.6	3.7	1,902	1.7	(9)	(0.5)
Cost of crude oil sold in the domestic market	1,892	1.6	2.4	2,647	2.4	(755)	(28.5)
Cost of oil products sold	743	0.6	3.2	839	0.7	(96)	(11.4)
Cost of other goods for resale sold	876	0.7	4.0	437	0.4	439	2.0 times
Other operating expenses	6,657	5.8	4.0	5,781	5.0	876	15.2
Operating expenses (net of export crude oil sales)	78,018	66.2	X	75,898	67.4	2,120	2.8
Cost of export crude oil sales (including export custom duties)	39,904	33.8	2.4	36,723	32.6	3,181	8.7
Operating expenses net of amortisation and depreciation	117,922	100.0	X	112,621	100.0	5,301	4.7

*The inflation rates used are based on the prepared by the Ministry of Economic Development forecast of social-economic development of the Russian Federation for 2018 and forecast periods of 2019 and 2020.

Unit costs broken-down by Oil transportation and Oil products transportation activities based on indicators developed under the Russian Accounting Standards

Unit costs were calculated using operating expenses indicator based on aggregated RAS data which considers the previous year data adjusted for conditions of the reporting period. For calculation of inflated unit costs the index of inflation was used which was based on the prepared by the Ministry of Economic Development forecast of social-economic development of the Russian Federation for 2018 and forecast periods of 2019 and 2020.

Unit costs for transportation of oil as per 100 tons-kilometers as for the three months ended 31 March 2018 and for the three months ended 31 March 2017 were as follows:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Oil transportation services				
Turnover, mln tons x km	294,856	296,666	(1,810)	(0.6)
Unit costs per 100 tons x km, RUB (2017 figures inflated to 2018)	17.56	17.82	(0.26)	(1.5)
Unit costs per 100 tons x km net of new facilities expenditure, RUB (2017 figures inflated to 2018)	17.26	17.82	(0.56)	(3.2)



3.2 Operating expenses net of amortisation and depreciation (continued)

Unit costs for oil products transportation per ton as for the three months ended 31 March 2018 and as for the three months ended 31 March 2017 were as follows:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Oil products transportation services				
Volume turnover, mln of tons	9.9	8.1	1.8	22.2
Unit costs per ton, RUB (2017 figures inflated to 2018)	640.63	650.94	(10.31)	(1.6)
Unit costs per ton net of new facilities expenditure, RUB (2017 figures inflated to 2018)	548.90	650.94	(102.04)	(15.7)

3.2.1. Salaries, insurance contributions and social expenses

Salaries comprise wages, accrual of provision for annual bonus, provision for unused vacation and other remuneration in accordance with IAS 19 *Employee Benefits*.

As for the three months ended 31 March 2018 compared to the relative period of three months ended 31 March 2017 salaries, insurance contributions and social expenses increased by RUB 3,191, or by 9.8% due to increase of insurance contributions to the state extra-budgetary funds because of growth of the base limit for their accrual, indexation held in 2017, increase in the average number of employees connected with construction and putting into use of new trunk pipeline facilities.

3.2.2. Pension expense

Transneft has set the protection of the life and health of its employees as well as the creation of safe working conditions for them as its highest priority. One of the key tasks of social policy is to create conditions for effective work and social protection of workers.

An important area of social protection of employees of the industry is a non-state pension system providing various options for pension plans.

Pension expenses changed under following factors which influence expenses:

- inclusion of pension liabilities of JSC "NPF "Transneft" in the consolidated financial statements of the Group;
- recognition of obligations of the Group under defined benefit plan in accordance with IAS 19 "Employee benefits" and related expenses accrued.

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Employers' contributions to JSC "NPF "Transneft" in favor of employees	1,578	1,712	(134)	(7.8)

3.2.3. Energy

Energy expenses for the three months ended 31 March 2018 decreased by RUB 285 or 2.6% compared to the same period of the previous year. The decrease of energy expenses was caused by decline of weighted-average price (tariff) for energy, as well as, decline of consumed electricity and power volumes.

The movement of energy consumption for oil transporting and oil products transporting subsidiaries of the Group is presented in the table below:

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Consumption of energy, mln kW*h	3,621	3,629	(8)	(0.2)

3.2.4. Materials

Expenses on materials for the three months ended 31 March 2018 as compared to the same period of 2017, decreased by RUB 316 or 4.4%.



3.2.5. Repair and maintenance of relevant technical condition of pipeline

The amount of expense for repair and maintenance of relevant technical condition of pipeline decreased as for the reporting period by RUB 352 or by 15.4% as compared to the relative period of the previous year.

3.2.6. Cost of crude oil and oil products sold

The cost of export crude oil sales for the three months ended 31 March 2018 in the amount of RUB 39,904 includes cost of sales in the amount of RUB 30,410 of crude oil purchased from Rosneft under a contract signed in April 2009 and custom duties in the amount of RUB 9,494. This figure is a result of oil supplies to the People's Republic of China (ref. to 3.1.2.).

Decrease in cost of oil sold in the domestic market as for the three months ended 31 March 2018 amounted to RUB 693 or 26.8% as compared to the relative period of 2017 and was caused by decrease in sale volumes of oil by the Group's subsidiaries.

Decrease in cost of oil products sold in the domestic market as for the three months ended 31 March 2018 by RUB 70 or 8.6% compared to the relative period of 2017 was caused by decline of sale volumes of oil products by the Group's subsidiaries.

3.2.7. Taxes (other than income tax)

The amount of the Group's other taxes recognised in operating expenses primarily contains property tax, tax on land and transport tax. The increase of these items by RUB 1,888 or 26.0% was mainly caused by the increase of the property tax expense (ref. to 2.4).

3.2.8. Other operating expenses

Other expenses include communication services, rent expenses, transportation services, business trip expenses, the summarized gains and losses relating to disposal of property, plant and equipment and other assets, fines and penalties received and paid, as well as other income and expenses.

3.3. Share of results from associates and jointly controlled entities

The Group holds a number of financial investments in associated and jointly controlled entities reported on an equity method basis. The main activities of those entities are stevedoring operations, towing services, ship repair and the provision of additional port services, cargo handling, transport of oil products, wholesale of electric and heat power.

The decrease of the amount of profit recognised by the Group in "Share of profit from associates and jointly controlled entities" as for the three months ended 31 March 2018 as compared to the relative period of 2017 amounted to RUB 15,508 or 89.8%, and was mainly caused by the recognition of income from the closed combined mutual fund "Gazprombank-Finansoviy" for the three months ended 31 March 2017.

3.4. Finance income and costs

Interest income and expenses

Interest income is generated from depositing available cash in bank accounts, deposits as well as investing in fixed-income securities.

Interest income	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Interest income from cash and equivalents	1,897	955	942	98.6
Interest income from other financial assets	3,396	4,105	(709)	(17.3)
Other interest income	248	196	52	26.5
Total interest receivable	5,541	5,256	285	5.4
Less interest income on the temporary investment of free cash from borrowings	-	(148)	148	x
Total interest income recognised in the statement of profit or loss and other comprehensive income	5,541	5,108	433	8.5



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3.4. Finance income and costs (continued)

Accrued interest expenses and amounts of capitalized interest expenses for the relevant periods were as follows:

Interest expenses	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Interest expenses on loans and borrowings	14,961	11,089	3,872	34.9
Distribution of investment income to pension liabilities	1,565	1,076	489	45.4
Other interest expenses	2,754	1,035	1,719	2.7 times
Total interest expenses	19,280	13,200	6,080	46.1
Less finance costs to be capitalised	(528)	(683)	155	(22.7)
Total interest expense recognised in the statement of profit or loss and other comprehensive income	18,752	12,517	6,235	49.8

The amount of interest expenses was composed of:

- interest payable on the USD denominated loan obtained from the China Development Bank Corporation;
- interest payable on USD denominated Eurobonds;
- interest payable on corporate bonds issued in Russian roubles;
- interest payable on marketable bonds issued in Russian roubles;
- interest payable on loans received in Russian roubles.

The dynamics of interest expense as for the three months ended 31 March 2018 as compared to the similar period of 2017 was mainly driven by decline of USD/RUB exchange rate during the three months ended 31 March 2018 compared to the three months ended 31 March 2017 (ref. to 2.2), increase of debt denominated in Russian roubles.

Increase of interest expense for the three months ended 31 March 2018 as compared to the relative period of the previous year was mainly caused by recognition of interest expense from adoption of the requirements of the new IFRS 15 *Revenue from Contracts with Customers* regarding liabilities from agreements for the provision of oil and oil products transportation services at long-term (agreed) tariffs and agreements for the technological connection to the trunk pipelines.

During the three months ended 31 March 2018, interest in the amount of RUB 528 was capitalised as part of cost of assets under construction (for the three months ended 31 March 2017 – RUB 535) including:

- interest expenses to be capitalised in the amount of RUB 528 (for the three months ended 31 March 2017 – RUB 683);
- there was no interest income to be excluded from interest expenses to be capitalised (for the three months ended 31 March 2017 – RUB 148).

Foreign currency exchange gains and losses

The amount of foreign currency exchange gains and losses for the three months ended 31 March 2018, compared to the three months ended 31 March 2017, was a result of changes in the exchange rate of the US dollar to the Russian rouble.

Due to a remeasurement of assets and liabilities denominated in foreign currency at the end of every month, foreign currency gains and losses arise, which are presented in the interim consolidated condensed financial statements on a gross basis.



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3.4. Finance income and costs (continued)

Foreign exchange differences by sources are disclosed in the table below.

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Foreign exchange gains on financial assets	4,279	348	3,931	12.3 times
Foreign exchange gains on loans and borrowings	8,183	34,458	(26,275)	(76.3)
Other foreign exchange gains	5,712	1,977	3,735	2.9 times
Total foreign exchange gains recognised in the statement of profit or loss and other comprehensive income	18,174	36,783	(18,609)	(50.6)
Foreign exchange loss on financial assets	(5,719)	(19,676)	13,957	(70.9)
Foreign exchange loss on loans and borrowings	(5,355)	(47)	(5,308)	113.9 times
Other foreign exchange loss	(3,891)	(3,538)	(353)	10.0
Total foreign exchange loss recognised in the statement of profit or loss and other comprehensive income	(14,965)	(23,261)	8,296	(35.7)
Net foreign exchange gain	3,209	13,522	(10,313)	(76.3)

Dynamics of exchange differences presented in the table was driven by lesser strengthening of RUB to USD during the three months ended 31 March 2018 as compared to the strengthening of RUB to USD as for the three months ended 31 March 2017 (ref. to 2.2).

3.5. Reconciliation of profit and earnings before interest, income tax, depreciation and amortisation (EBITDA)

	Three months ended 31 March 2018	Three months ended 31 March 2017	Change, %
Profit for the period	46,991	79,507	(40.9)
Adjustments for:			
income tax expense	12,356	20,321	(39.2)
amortisation and depreciation	43,596	37,379	16.6
result of crude oil sales to China	216	218	(0.9)
net finance costs/ (income)	9,722	(5,751)	x
share of profit from associates and jointly controlled entities	(1,757)	(17,265)	(89.8)
other income	(3,591)	(4,024)	(10.8)
EBITDA*	107,533	110,385	(2.6)

* Less crude oil sale and purchase operations under contracts with Rosneft and the China National United Oil Corporation.

EBITDA is a useful indicator for investors, as it reflects the Group's operating performance, including its ability to finance capital expenditures, company acquisitions, and other investments, as well as its ability to raise and service borrowings and loans. Some investors, analysts, and rating agencies tend to use EBITDA as a basis for estimating and projecting the efficiency and value of oil & gas companies. This indicator should not be considered separately, as an alternative to net income, operating income, or any other of Group's performance indicators reported in its interim consolidated condensed financial statements.



4. Cash flow analysis

	Three months ended 31 March 2018	Three months ended 31 March 2017	Absolute change	Change, %
Cash flows from operating activities	92,505	95,973	(3,468)	(3.6)
Cash flows used for purchase of property, plant and equipment, net	(64,187)	(74,368)	10,181	(13.7)
Free cash flow	28,318	21,605	6,713	31.1
Cash flows (used in) / received from investing activities	(17,485)	5,199	(22,684)	x
Cash flows received from financing activities	72,161	1,343	70,818	53.7 times
Net cash flow	82,994	28,147	54,847	2.9 times
Change in cash and cash equivalents due to deviation of currency exchange rate	1,315	(661)	1,976	x
Net increase in cash and cash equivalents	84,309	27,486	56,823	3.1 times

Positive free cash flow for the three months ended 31 March 2018 amounted to RUB 28,318 which was by RUB 6,713 or 31.1% higher than the figure of the relevant period of the previous year.

4.1. Operating activities

Cash received from operating activities is the Group's main source of cash. The net cash generated from operating activities amounted to RUB 92,505 for the three months ended 31 March 2018, which is RUB 3,468 or 3.6% lower than for the three months ended 31 March 2017.

The main factors which influenced on the increase of cash generated from operating activities for the three months ended 31 March 2018 as compared to the similar period in 2017 were as follows:

- increase in cash paid to suppliers by RUB 2,283;
- decrease in refunds of insurance contributions, VAT and other taxes from the budget by RUB 3,498;
- decrease in income tax paid amounting to RUB 3,819.

4.2. Investing activities

The primary factors resulting in an increase in cash used in investing activities by RUB 12,503 or 18.1% as for the three months ended 31 March 2018 compared to the same period of 2017 were:

- decrease in the net amount of purchase of property, plant and equipment by RUB 10,181 as compared to the relative period of the previous year;
- increase of cash received from other investing activities amounted to RUB 22,684 because of the following operations:
 - increase in net cash inflow as for the three months ended 31 March 2018 from purchase-and-sale transactions of debt securities, equity securities and allocation-closure of deposits in the amount of RUB 87,392 compared to the relative period of the previous year;
 - decrease in net cash outflow as for the three months ended 31 March 2018 paid for acquisition of share of associates and jointly controlled entities by RUB 59,845 which was a result of acquisition of 57.41% share in closed combined mutual investment fund "Gazprombank – Finansoviy" for RUB 60,000 as for the three months ended 31 March 2017;
 - cash inflow in the result of obtaining ownership over 100% of shares of CPC Company and CPC Investments Company for the amount of RUB 5,203 during the three months ended 31 March 2018;
 - increase in net loans granted by RUB 552 as compared to the relative period of the previous year.

4.3. Financing activities

The main factors which influenced on the increase of cash inflow from financing activities for the three months ended 31 March 2018 in the amount of RUB 70,818 as compared to the relative periods of the previous year were:

- increase of cash inflow by RUB 192,627 from issue of non-convertible interest-bearing documentary bonds and attraction of loans for the three months ended 31 March 2018 as compared to the relative period of the previous year;



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4.3. Financing activities (continued)

- increase of cash flows used for repayment of bonds, loans and borrowings as for the three months ended 31 March 2018 as compared to the relative period of 2017 by RUB 121,778 which was a result of the following operations:
 - for the three months ended 31 March 2018 monthly repayments and early repayments of the loan to China Development Bank in the total amount of USD 2,735.5 mln (RUB 155,789 at the rate of Central Bank of the Russian Federation on the dates of operations);
 - during the three months ended 31 March 2017 monthly repayments of loan to China Development Bank were made in the amount of USD 416.7 mln (RUB 24,042 at the rate of Central Bank of the Russian Federation on the date of operation), RUB denominated bonds were repaid (repurchased) in the amount of RUB 10 billion.

4.4. Disclosure of cash flows from operating activities using indirect method

Cash flows received from operating activities using the indirect method are disclosed in the table below in addition to the interim consolidated condensed statement of cash flows prepared using the direct method and disclosed in the interim consolidated condensed financial statements prepared in accordance with IFRS for the three months ended 31 March 2018.

Under the indirect method, the net cash flow from operating activities is determined by adjusting profit before tax for the effects of:

- changes during the reporting period in inventories and operating receivables and payables;
- non-cash items such as amortisation and depreciation, provisions, unrealized foreign currency gains and losses, interest income and expenses, share of profit from associates and jointly controlled entities;
- all other items for which the cash effects are investing or financing cash flows.

	Three months ended 31 March 2018	Three months ended 31 March 2017
OPERATING ACTIVITIES		
Profit before income tax	59,347	99,828
Adjustments for:		
Amortisation and depreciation	43,596	37,379
Loss from disposal of property, plant and equipment	224	31
Finance income	(24,021)	(41,891)
Finance costs	33,743	36,140
Share of profit from associates and jointly controlled entities	(1,757)	(17,265)
Other	(10,818)	(6,496)
Operating profit before changes in working capital and reserves	100,314	107,726
Changes in operating assets and liabilities:		
Changes in inventories	900	2,294
Changes in trade and other receivables relating to operating activity and VAT assets	3,403	2,007
Changes in trade and other payables, and accruals relating to operating activity	(4,356)	4,693
Changes in contract liabilities	9,963	-
Cash flows from operating activities before payment of income tax expense and interest	110,224	116,720
Income tax paid	(7,114)	(10,933)
Income tax refund	81	43
Interest paid	(10,686)	(9,857)
Net cash flows received from operating activities	92,505	95,973



5. Liquidity analysis

	31 March 2018	31 December 2017	Change, %
Current assets	556,741	457,864	21.6
including:			
cash and cash equivalents	160,471	76,162	2.1 times
short-term bank deposits and bonds*	291,739	262,910	11.0
Current liabilities	272,212	280,455	(2.9)
Net working capital	284,529	177,409	60.4
Current ratio	2.0	1.6	x
Quick ratio**	1.8	1.4	x
Debt / EBITDA	1.9	1.7	x
Debt / Equity	0.4	0.4	x

* The main part of short-term bank deposits and bonds consist of deposits and bonds issued by banks and other companies with credit ratings at Ba1 – Ba2 at the Moody's adjusted scale. Thus, short-term bank deposits and bonds consist of highly reliable or reliable financial instruments issued by credit organisations and companies.

** Quick ratio = (Cash and cash equivalents + Current financial assets + Short-term receivables) / Current liabilities.