Explanatory Note to Item 2 of the Agenda of the Annual General Meeting of Shareholders of PJSC ALROSA

Accounting (financial) statements of PJSC ALROSA (hereinafter – the Company) are formed in accordance with the existing legislation of the Russian Federation.

The accounting records of the Company are maintained according to the Federal Law On Accounting and the associated Accounting Regulations adopted by the decrees of the Ministry of Finance of Russia.

Accounting Policy of the Company for the purpose of accounting (hereinafter – the Accounting Policy) is based on the following basic assumptions:

ringfenced assets – assets and obligations of the Company are detached from property and obligations of the owners of the Company and assets and obligations of other organizations;

continuity of business – the Company is planning to continue its activity in the future and does not have intension to and need for liquidation or significant business reduction and, consequently, obligations will be satisfied in due course;

consistency in applying the accounting policy – established Accounting Policy is applied consistently from one reporting year to another;

time certainty of facts of economic activity – facts of economic activity of the Company are referred to such reporting period (and, consequently, are reflected in the accounting records) where they occurred regardless of the actual time of receipt or payment of funds associated with these facts.

The Accounting Policy of the Company ensures compliance with the requirements of completeness, prudence, priority of substance over form, consistency and rationality.

Methods of accounting, established in the Company when forming the Accounting Policy, are applied by all the branches, representative offices and structural subdivisions of the Company, regardless of their location.

Comprehensive integrated SAP ERP-based system is used for online accounting, record of availability and movement of all assets and liabilities, recognition of commercial operations of branches, representative offices and divisions of the Company in the accounts and generating accounting (financial) statements of the Company.

The auditor's report signed by the auditors of AO PricewaterhouseCoopers Audit on February 12, 2018, based on the results of the audit of the Company's financial status, confirms that the Company's accounting statements fairly, in all material respects, reflect the Company's financial condition as of December 31, 2017, its financial performance and cash flow for 2017 according to the accounting principles established in the Russian Federation.

The analysis of forms of the Company's accounting (financial) statements for 2017

ANALYSIS OF THE BALANCE SHEET

As of December 31, 2017, the balance sheet currency totals RUB 577,464 million and decreased by RUB 104,165 million (by 15.3%) as compared to the previous year.

The balance sheet **Assets**: non-current assets decreased by RUB 94,636 million to RUB 440,772 million, current assets decreased by RUB 9,529 million to RUB 136,692 million.

Main changes in the assets are as follows:

- ✓ fixed assets and interest-bearing investments – decrease by RUB 7,881 million (by 3%) to RUB 245,223 million, including:

  commissioning of new fixed assets – increase of value by RUB 28,038 million, disposal of property, plant and equipment – decrease by RUB 27,513 million (RUB 9,650 million and RUB 17,863 million, respectively),

  decrease in value of incomplete construction by RUB 8,395 million to RUB 26,058 million, commissioning of facilities of completed construction - RUB 27,999 million.

- ✓ Inventory stock – decrease by RUB 4,884 million (by 7%), out of which the decrease of rough diamonds, polished diamonds, diamond grinding powder stock – by RUB 4,491 million, and decrease in volume terms (carats) – by 1,545 thousand carats (by 21.2%).
- ✓ Accounts receivable – increase by RUB 17,531 million (by 83%), including the amount of the accrued insurance compensation of RUB 10,490 million under the insurance agreement of June 29, 2017 N 17 RT 0195 from AO SOGAZ and a letter from AO SOGAZ of December 29, 2017 N SG-124476/1 on recognition of the accident at the Mir underground mine as an insurance case, the overdue debt in total debt amounted to RUB 328 million (0.85%).
- ✓ Finance investments – decrease by RUB 87,658 million (by 29%), out of which the adjustment down to the market value of shares listed on the market – RUB 27,646 million, creation of provision for devaluation of financial investments in Maretiom Investments Limited in the amount of RUB 28,952 million.
- ✓ Cash – decrease by RUB 20,717 million (by 80%), including decrease by RUB 20,614 million in deposit accounts, with an increase of cash balance in foreign currency accounts – RUB 332 million.

The balance sheet **Liabilities**:

The Company's **liabilities** decreased by RUB 55,567 million (by 22.7%) to RUB 188,842 million, including:

- ✓ Borrowings decreased by RUB 48,420 million to RUB 94,829 million, out of which loan repayment – USD 1,320 million (RUB 76,895 million) (the balance of outstanding liabilities as of December 31, 2017, amounted to USD 1,613 million).

- ✓ Deferred tax liabilities decreased by RUB 5,066 million to RUB 46,229 million.

The Company's **equity** decreased by RUB 48,598 million (by 11%) to RUB 388,622 million, including:

- ✓ Undistributed profit decreased by RUB 46,477 million for the following reasons:

Net profit for 2017	+ RUB 16,854 million
Payments made according to the resolution of the General Meeting of Shareholder of June 30, 2016	RUB (65.769) million
Previously declared and unclaimed dividends restored	+ RUB 13 million
Increase in the value of retired fixed assets is transferred from the capital surplus and change in the accounting method	+ RUB 2,469 million

The **main source** of the Company's fixed assets in 2017 is equity, absolute value of which (net assets) has decreased since the beginning of the year by RUB 48,598 million (by 11%) to RUB 388,622 million.

ANALYSIS OF PROFIT AND LOSS STATEMENT

Proceeds from sale of products, works, services for 2017 decreased, as compared to 2016, by RUB 49,528 million (by 20%) and amounted to RUB 200,039 million. Proceeds decrease is associated with strengthening of the ruble against foreign currency, as well as change in the range of diamonds sold (increased volume of sales of small-size raw materials).

Proceeds from sale of core products: natural rough diamonds, polished diamonds and diamond grinding powders amounted to RUB 176,799 million, share in total sales – 88%, decreased by RUB 46,744 million (by 20.9%) as compared to 2016.

Export – 78% of the total proceeds.

The **cost** of sold products, works, services, commercial and administrative expenses, as compared to 2016, decreased by RUB 5,382 million (by 4.6%) and amounted to RUB 110,536 million.

Other income and expenses for 2017 – loss in the amount of RUB 59,661 million, decrease in profit, as compared to the previous year, by 111,630 million (in 2016 profit was RUB 51,969 million)

The main performance drivers of the negative result:

- ✓ Adjustment of the Company's finance investments down to the market value: decrease in the value of PJSC ALROSA-Nuyrba shares in 2017 – RUB 27,646 million (in 2016 – increase in the value of shares in the amount of RUB 57,742 million);

- ✓ Creation of provision for devaluation of financial investments in Maretiom Investments Limited in the amount of RUB 28,982 million.

The Company's **net profit** for 2017 amounted to RUB 16,854 million, decrease by RUB 131,669 million (8.8 times lower) as compared to the previous reporting period.

ANALYSIS OF STATEMENT ON CHANGE IN EQUITY

The Company's equity for 2017 decreased by RUB 48,598 million to RUB 388,622 million.

The **reserve fund** is RUB 737 million (0.2% of the total equity) and is generated from net profit according to the Articles of Association and is intended for covering losses, redemption of bonds and repurchase of shares of the Company where no other funds are available, and may not be utilized for any other purpose.

The Company's **authorized capital** is formed according to the Articles of Association and amounted to RUB 3,628 million (0.8% of the total amount of equity).

The Company's authorized capital is divided into 7,364,965,630 ordinary registered shares with par value of 50 kopecks.

The authorized capital is fully paid-up, in 2017 the Company did not announce any additional issue of shares, placement of bonds or any other issue of securities.

The Company's **capital surplus** – RUB 109,574 million (28.2% of the total amount of equity).

Decrease in the amount of the revaluation of non-current assets by RUB 2,122 million occurred due to transfer of appraisal (markdown) on retired fixed assets from the capital surplus to retained profit.

The capital surplus (without revaluation) is RUB 50,041 million and consists mostly of share premium from additional issue of the Company's shares in 2008.

Undistributed profit – RUB 274,629 million (70.7% of the total amount of equity). Undistributed profit for the reporting 2017 year – RUB 16,854 million.

ANALYSIS OF STATEMENT OF CASH FLOW

Cash flow operating activities in 2017:

Cash received – RUB 200,171 million, including RUB 197,231 million from sale of products, goods, works, services;

Cash paid – RUB 138,657 million, including RUB 39,814 millions – payment to suppliers (contractors) for materials, works, services, RUB 37,646 million – employee

compensation, RUB 26,313 million – tax payment, RUB 17,243 million – profit tax payment.

Cash flow from investing activities in 2017:

Cash received – RUB 59,982 million, including RUB 28,580 million – return of funds from deposits, RUB 10,665 million – repayment of loans granted, sale of debt securities, RUB 19,868 million – dividend, interest under debt financial investments and similar interest participation in other companies.

Cash paid – RUB 33,139 million, including RUB 19,071 million – acquisition, creation, modernization, reconstruction and preparation for use of non-current assets, RUB 9,620 million – acquisition of debt securities, providing loans to others.

Cash flow from financial activities in 2017:

Cash received – loans in the amount of RUB 51,797 million,

Cash paid – RUB 158,562 million including payment of dividends and other profit distribution to shareholders – RUB 65,688 million, due to repayment of loans – RUB 92,874 million.

Result of cash flow for the reporting period – RUB (18,409) million.

The balance of cash and cash equivalent as of the beginning and the end of the reporting period – RUB 25,822 million and RUB 5,105 million, respectively.

Free cash flow – as a result of cash flow from operating activities less payments for acquisition, creation, modernization, reconstruction and preparation for use of non-current assets in 2017 is RUB 42,443 million.

ACCURAL AND PAYMENT OF TAXES, DUTIES, CHARGES AND DIVIDENDS

In 2017, the amount of assessed and paid taxes, duties, charges (hereinafter – taxes) and insurance premium is RUB 50,408 million and RUB 50,261 million, respectively.

As compared to 2016, the amount of paid taxes and insurance premium decreased by RUB 4,184 million (8%).

Paid in 2017:

- ✓ The budget of the Republic of Sakha (Yakutia) received RUB 30,156 million, that is RUB 3,406 million less than in 2016.
- ✓ The federal budget received RUB 3,523 million, including VAT – RUB 742 million.
- ✓ Non-budget funds, local and other budgets received RUB 16,582 million, that is RUB 356 million lower compared to the previous year.

The breakdown of taxes, duties and charges paid in 2017:

Name	2017	2016	Increase (decrease) compared to 2016

	RUB mln	%	RUB mln	%	RUB mln	%
Mineral extraction tax (rough diamonds)	11,779	23,4	12,038	22.1	(259)	1.3
Profit tax	17,561	34.9	22,077	40.5	(4,516)	(5.6)
Property tax	3,646	7.3	3,320	6.1	326	1.2
Personal income tax	5,555	11.1	5,239	9.6	316	1.4
Insurance premium	10,584	21.1	10,321	19.0	263	2.1
VAT	742	1.5	813	1.5	(71)	0.0
Other taxes, charges	394	0.8	637	1.2	(243)	(0.4)
Total	**50,261**	**100**	**54,445**	**100.0**	**(4,184)**	**(0)**

Paid dividends:

Name of a budget	2017 (based on the results of 2016)		2016 (based on the results of 2015)		Increase in 2016 comparing to 2015	
	RUB mln	%	RUB mln	%	RUB mln	%
Russian Federation represented by the Federal Agency for State Property Management	21,721	33.0	5,084	33.0	16,637	0.0
Ministry of Property and Land Relations of the Republic of Sakha (Yakutia)	16,442	25.0	3,848	25.0	12,594	0.0
Administrations of the municipalities of the Republic of Sakha (Yakutia)	5,262	8.0	1,231	8.0	4,031	0.0
Others	22,249	34.0	5,207	34.0	17,042	0.0
Total	**65,674**	**100**	**15,370**	**100.0**	**50,304**	**0.0**
Per 1 share	**8.93**		**2.09**		**6.84**	

On March 1, 2018, the Audit Committee under the Supervisory Board preliminary considered this issue and recommended the Supervisory Board to submit the issue “Approval of the annual accounting (financial) statements for 2017” for the consideration of the Annual General Meeting of Shareholders of PJSC ALROSA and suggested the Annual General Meeting of Shareholders of PJSC ALROSA to approve it.

On April 28, 2018, the Supervisory Board of the Company adopted a resolution to submit for consideration of the Annual General Meeting of Shareholders the issue

“Approval of the annual accounting (financial) statements for 2017” and suggested the Annual General Meeting of Shareholders of PJSC ALROSA to approve it.