

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

The accounting (financial) statements of PJSC ALROSA (hereinafter referred to as the Company) are made in accordance with the current laws of the Russian Federation.

The accounting records of the Company are kept pursuant to the Federal Law of the Russian Federation on Accounting and the Accounting Regulations adopted thereunder and approved by orders of the Ministry of Finance of Russia.

The Accounting Policy of the Company for the purpose of business accounting (hereinafter referred to as the Accounting Policy) is based on the following basic assumptions:

Ringfenced assets — the Company's assets and liabilities are separated from the assets and liabilities of the Company's owners, as well as from the assets and liabilities of other entities;

Going concern — the Company is planning to continue its activities in future and does not have an intention to or a need for liquidation or significant business reduction and, consequently, its obligations will be discharged in due course;

Consistency in applying the accounting policy — the Accounting Policy adopted is applied consistently from one reporting year to another;

Time certainty of business operations — the Company's business operations are referred to a reporting period (and, consequently, are recognized in the accounting records) in which they occur regardless of the actual time of receipt or payment of funds associated therewith.

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

The accounting methods used by the Company to make the Accounting Policy are applied by all the branches, representative offices and structural subdivisions of the Company regardless of their location.

A comprehensive integrated ALROSA SAP ERP-based system is used for online accounting of availability and movement of all assets and liabilities, recognizing business operations of branches, representative offices and structural subdivisions of the Company and generating accounting (financial) statements of the Company.

On February 11, 2019, an auditor's report was signed following the results of audit of the Company's financial standing by PricewaterhouseCoopers Audit, JSC which confirms that the Company's accounting (financial) statements give a true and fair view of the Company's financial standing in all material aspects as of December 31, 2018 and outlines its financial performance and cash flow for 2018 according to the accounting principles established in the Russian Federation.

Analysis of the Company's Accounting (Financial) Forms for 2018

ANALYSIS OF THE BALANCE SHEET

As of December 31, 2018, the balance sheet currency totaled RUB 530,217 million and declined by RUB 46,559 million as compared to the previous year (-8%).

Non-current assets within the balance sheet **Assets** declined by RUB 43,282 million and amounted to RUB 396,801 million; current assets declined by RUB 3,276 million and amounted to RUB 133,416 million.

Main changes in the assets are as follows:

✓ Fixed assets and interest-bearing investments — a reduction by RUB 8,268 million (by 3%) whereby their value amounted to RUB 236,955 million including:

commissioning of new items of fixed assets — a growth in the value by RUB 27,909 million, retirement and depreciation — a reduction by RUB 30,504 million (RUB 13,392 million and RUB 17,112 million, correspondingly);

the value of assets under construction declined by RUB 5,251 million and amounted to RUB 20,806 million, and the commissioning of finished capital construction projects declined by RUB 27,907 million;

✓ Financial investments — a reduction by RUB 43,092 million (by 20%) of which there was a downward adjustment of publicly traded securities towards their market value — RUB 52,183; a recovery of allowance for impairment of financial investment in Maretiom Investments Limited for RUB 28,982 million in connection with the sale of shares thereof; an acquisition of 100% participatory interest in Kimberlite Closed Share Investment Fund for RUB 18,400 million; a retirement of financial investment (Maretiom Investments Limited and Velarion Investments Limited) for RUB 56,122 million; and contributions by the Company to the authorized capitals of its subsidiaries for RUB 15,058 million;

✓ Inventories — a reduction by RUB 3,608 million (by 6%), of which there was a reduction in the value of rough diamonds, polished diamonds and diamond grinding powder stock by RUB 3,297 million and a reduction in the stock of rough diamonds in volume terms (carats) by 2,151.5 thousand carats (by 21.1%);

✓ The accounts receivable declined by RUB 10,015 million (by 26%) including by the amount of the accrued insurance indemnity of RUB 10,490 million under the Insurance Agreement dated June 29, 2017 No. 17 PT 0195 with SOGAZ, JSC; the amount of past-due debt as part of the total debt amount was RUB 271 million (0.9 %);

✓ Cash — there was a growth by RUB 19,789 million (by 388%) including a growth in the funds on deposit accounts by RUB 20,457 million.

The balance sheet **Liabilities**:

Liabilities of the Company increased by RUB 6,430 million (3%) and amounted to RUB 197,131 million including:

✓ Borrowed funds increased by RUB 21,823 million and amounted to RUB 116,652 million, which is among other reasons due to the impact of exchange rate differences by RUB 12,768 million and a growth in the intra-group loans by RUB 11,073 million;

✓ Deferred tax liabilities declined by RUB 13,730 million to RUB 32,499 million;
Capital and reserves of the Company declined by RUB 52,990 million (by 14%) whereby their value amounted to RUB 333,085 million including:

- ✓ Undistributed profit declined by RUB 47,727 million for the following reasons:
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|--|----------------------|
| net profit for 2018 | + RUB 29,308 million |
| payments made under decisions of the General Meeting of the Shareholders | (RUB 82,309 million) |
| previously declared and unclaimed dividends restored | + RUB 11 million |
| increase in the value of retired fixed assets transferred from the capital surplus and a change in the accounting method, etc. | + RUB 5,263 million |
- ✓ Revaluation of current assets — (RUB 5,254 million).

Equity and reserves remained the **main source** of the Company's fixed assets in 2018, the absolute value of which (net assets) declined since the beginning of the year by RUB 50,137 million (13%) and amounted to RUB 335,938.

ANALYSIS OF THE PROFIT AND LOSS STATEMENT

Proceeds from the sale of products, works and services in 2018 increased by RUB 19,763 million as compared to 2017 and amounted to RUB 219,802 million (+10%). The increase in the proceeds is due to a stronger ruble and a change in the volume and assortment of diamonds sold.

Proceeds from the sale of main products, i.e. natural rough diamonds, polished diamonds and diamond grinding powders amounted to RUB 196,465 million and a share in the total sales (89%) increased by RUB 19,666 million as compared to 2017 (+11%).

Export accounted for 76% of the total proceeds.

The **cost** of sold products, works, services, commercial and administrative expenses decreased by RUB 1,883 million as compared to 2017 (by 2%) and amounted to RUB 113,050 million.

Other income and expenses for 2018 — loss in the amount of RUB 70,534 million and a reduction by RUB 15,240 million as compared to the previous year (loss for RUB 55,294 million in 2017).

The Company's **net profit** for 2018 amounted to RUB 29,308 million which means a growth by RUB 12,164 million as compared to the previous reporting period (by 71%).

ANALYSIS OF THE STATEMENT OF CHANGES IN EQUITY

In 2017, the Company's equity declined by RUB 52,990 million and amounted to RUB 333,085 million.

The **reserve fund** amounting to RUB 737 million (0.2% of the total equity) was generated from the net profit according to the Articles of Association and is intended for covering of 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 purposes.

The Company's **authorized capital** was formed according to the Articles of Association and amounted to RUB 3,682 million (1% 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 2018, the Company did not announce an additional issue of shares, placement of bonds or any other issue of securities.

The Company's **capital surplus** amounts to RUB 104,312 million (31% of the total amount of equity).

A reduction in the amount of the revaluation of non-current assets by RUB 5,363 million was due to the 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.

The **retained profit** is RUB 224,355 million (67.4% of the total amount of equity).

ANALYSIS OF THE STATEMENT OF CASH FLOW

Cash flow from operating activities in 2018:

receipts amounting to RUB 221,300 million including RUB 218,543 from the sale of products, goods, works and services;

payments amounting to RUB 136,452 million including RUB 39,735 million of payment to suppliers (contractors) for materials, works and services; RUB 35,362 million of employee compensation; RUB 20,401 million of payment of taxes and contributions to extra-budgetary funds; and RUB 22,338 million of income tax payment.

Cash flow from investment activities in 2018:

receipts amounting to RUB 116,630 including: RUB 31,044 million from the sale of shares of other entities (participatory interests); RUB 53,442 million from the repayment of granted loans and sale of debt securities; RUB 14,913 million from the receipt of dividends, interest on debt financial investments and similar receipts from participation in other entities; RUB 3,470 million of a subsidy received for the construction of a road to Verkhne-Munskoe deposit; RUB 10,490 million of an insurance indemnity debt redeemed by SOGAZ, JSC;

payments amounting to RUB 110,725 including: RUB 21,991 million — in connection with the acquisition, creation, upgrading, reconstruction and preparation for the use of non-current assets; RUB 15,034 million — in connection with the acquisition of shares of other entities (participatory interests); RUB 55,224 million — in connection with the acquisition of debt securities and granting of loans to other persons.

Cash flow from financial activities in 2018:

receipts: credits and loans received for the amount of RUB 119,032 million;

payments for the amount of RUB 192,153 million including payment of dividends and other profit distribution to shareholders amounting to RUB 82,238 million and RUB 109,915 due to repayment of credits and loans received.

The **result of cash flow** during the reporting period is RUB 17,632 million.

The balance of cash and cash equivalents as of the beginning and the end of the reporting period is RUB 5,105 million and RUB 24,894 million, respectively.

The **free cash flow** as a result of cash flow from operating activities less payments for acquisition, creation, upgrading, reconstruction and preparation for the use of non-current assets in 2018 is RUB 62,858 million. (RUB 42,443 million in 2017).

ACCRUAL AND PAYMENT OF TAXES, DUTIES, CHARGES AND DIVIDENDS

In 2018, the taxes, duties and charges (hereinafter referred to as the taxes) and insurance premiums accrued and paid amounted to RUB 54,067 million and RUB 51,418 million, respectively.

As compared to 2017, the amount of taxes and insurance premiums paid declined by RUB 1,2 million (2%).

Paid in 2018:

✓ RUB 29,440 million to the budget of the Republic of Sakha (Yakutia) which is more than in 2017 by RUB 232 million;

- ✓ RUB 5,559 million to the federal budget including RUB 1,993 million of VAT;
- ✓ RUB 16,419 million was transferred to extra-budgetary funds, local and other budgets, which is RUB 1,111 million less compared to the previous year.

The breakdown of taxes, duties and charges paid in 2018:

Item	2018		2017		Increase (reduction) compared to 2017	
	RUB, million	%	RUB, million	%	RUB, million	%
Mineral extraction tax (rough diamonds)	7,519	15.0%	11,779	23.4	-4,260	-35.4%
Profit tax	22,501	44.8%	17,561	34.9	4,940	22.4%
Property tax	4,039	8.0%	3,646	7.3	393	11.8%
Personal income tax	5,090	10.1%	5,555	11.1	-465	-8.9%
Insurance contributions	9,802	19.5%	10,584	21.1	-782	-7.6%
VAT	1,993	4.0%	742	1.5	1,251	153.9%
Other taxes and payments	474	0.9%	394	0.8	80	12.6%
Total:	51,418	102.3%	50,261	100	1,157	2.1%

Dividends paid:

Budget	for 2018 (following the results of 2017)		for 2017 (following the results of 2016)		Reduction 2018 to 2017	
	RUB, million	%	RUB, million	%	RUB, million	%
Russian Federation represented by the Federal Agency for State Property Management	12,745	33.0	21,721	33.0	8,976	0.0
Ministry of Property and Land Relations of the Republic of Sakha (Yakutia)	9,648	25.0	16,442	25.0	6,794	0.0
Administrations of the municipalities of the Republic of Sakha (Yakutia)	3,087	8.0	5,262	8.0	2,175	0.0
Other	13,068	34.0	22,249	34.0	9,181	0.0
Total:	38,548	100	65,674	100.0	27,126	0.0
<i>per 1 share</i>	<i>5.24</i>		<i>8.93</i>		<i>3.69</i>	

Budget	Interim for 2018 (following the results of the first half year of 2018)	
	RUB, million	%
Russian Federation represented by the Federal Agency for State Property Management	14,424	33.0
Ministry of Property and Land Relations of the Republic of Sakha (Yakutia)	10,919	25.0
Administrations of the municipalities of the Republic of Sakha (Yakutia)	3,494	8.0
Other	14,828	34.0
Total:	43,665	100
<i>per 1 share</i>	<i>5.93</i>	

On April 16, 2019, the Audit Committee under the Supervisory Board considered this matter preliminarily and recommended the Supervisory Board to put the matter of Approving the Annual Accounting (Financial) Statements for 2018 before the Annual General Meeting of Shareholders

of PJSC ALROSA and suggested that the Annual General Meeting of Shareholders of PJSC ALROSA approve it.

On April 30, 2019, the Supervisory Board of the Company decided to put the matter of Approving the Annual Accounting (Financial) Statements for 2018 before the Annual General Meeting of Shareholders of PJSC ALROSA and suggested that the Annual General Meeting of Shareholders of PJSC ALROSA approve it.