



LUKOIL

PJSC LUKOIL

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

**for the three and nine-month periods ended
30 September 2016 and 2015**

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 30 September 2016 and the results of its operations for the three and nine month periods ended 30 September 2016 and 2015, as well as significant factors that may affect its future performance. It should be read in conjunction with our International Financial Reporting Standards (“IFRS”) condensed interim consolidated financial statements and notes thereto for the respective periods.

References to “LUKOIL,” “the Company,” “the Group,” “we” or “us” are references to PJSC LUKOIL and its subsidiaries and equity affiliates. All ruble amounts are in millions of Russian rubles (“RUB”), unless otherwise indicated. Income and expenses of our foreign subsidiaries were translated to rubles at rates which approximate actual rates at the date of the transaction. Tonnes of crude oil and natural gas liquids produced were translated into barrels using conversion rates characterizing the density of crude oil from each of our oilfields and the actual density of liquids produced at our gas processing plants. Tonnes of crude oil purchased as well as other operational indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per

Main macroeconomic factors affecting our results of operations

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, a devaluation of the ruble against the US dollar generally causes our revenues to increase in ruble terms, and vice versa. Ruble inflation also affects the results of our operations.

The following table provides data on inflation in Russia and change in the ruble-dollar and ruble-euro exchange rates.

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
Ruble inflation (CPI), %	0.8	1.7	4.1	10.4
Ruble exchange rate to US dollar				
Average for the period	64.6	63.0	68.4	59.3
At the beginning of the period	64.3	55.5	72.9	56.3
At the end of the period.....	63.2	66.2	63.2	66.2
Ruble exchange rate to euro				
Average for the period	72.2	70.1	76.3	66.3
At the beginning of the period	71.2	61.5	79.7	68.3
At the end of the period.....	70.9	74.6	70.9	74.6

Taxation

The rates of taxes specific to the oil industry in Russia are linked to international crude oil prices and are changed in line with them. The methods to determine the rates for such taxes are presented below.

Crude oil extraction tax rate is changed monthly and is calculated by multiplying the base rate by a coefficient reflecting average international Urals price and ruble-dollar exchange rate during the month. The base rate for 2016 is set at 857 rubles per metric tonne extracted (766 rubles for 2015).

The tax rate is zero when the average international Urals price is less than, or equal to, \$15.00 per barrel. In 2016, each \$1.00 per barrel increase in the international Urals price above \$15.00 per barrel results in an increase in the tax rate by \$0.45 per barrel (\$0.40 per barrel in 2015).

The mineral extraction tax on crude oil is payable in rubles per tonne of crude oil extracted.

There are different types of tax incentives on the mineral extraction tax on crude oil applied to our fields and deposits:

A special coefficient is applied to the standard tax rate depending on location, depletion, type of reserves, size and complexity of a particular field. This type of incentive with different coefficients is applied to our highly depleted fields (more than 80% depletion), our Yu. Korchagin field located in the Caspian offshore, the Permian layers of our Usinskoye field in Timan-Pechora producing high-viscous crude oil, our Pyakyakhinskoye field located in the Yamal-Nenets region of Western Siberia, a number of fields in the Nenets Autonomous region, as well as to our new small-sized fields (recoverable reserves less than 5 million tonnes) and fields and deposits with low permeability like V.N. Vinogradov field and Tyumen deposits;

A fixed tax rate of 15% of the international Urals price is applied to our V. Filanovsky field, located in the Caspian offshore;

A zero tax rate is applied to our Yaregskoye field producing extra-viscous crude oil, as well as to unconventional deposits (Bazhenov and others).

Some of the mineral extraction tax incentives are limited in time or by cumulative oil production volumes.

The table on the p. 6 illustrates the impact of mineral extraction tax incentives on the tax rate at \$50 Urals price.

Natural gas extraction tax rate. The base rate amounts to 35 rubles per thousand cubic meters and is adjusted depending on average wholesale natural gas price in Russia, share of gas production in total hydrocarbon production, regional location and complexity of particular gas field.

In the nine months of 2016, actual average natural gas extraction tax rate for our major gas field – Nakhodkinsk23(i)0.721099(n)-6.3d lu

Crude oil export duty rate is denominated in US dollars per tonne of crude oil exported and is calculated on a progressive scale according to the bellow table.

International Urals price

Export duty rate

Crude oil and refined products exported to member countries of the Customs Union in the Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia and the Kyrgyz Republic (Customs Union) are not subject to export duties.

The following tables represent average enacted rates for taxes specific to the oil industry in Russia for the respective periods.

3rd quarter of			9 months of		
2016	2015	Change,	2016	2015	Change,
		%			%

Transportation of crude oil, natural gas and refined products in Russia

The main Russian crude oil production regions are remote from the main crude oil and refined products markets. Therefore, access by crude oil production companies to the markets is dependent on the extent of diversification of the transport infrastructure and access to it. As a result, transportation cost is an important macroeconomic factor affecting our profit.

Transportation of crude oil produced in Russia to refineries and export destinations is primarily through the trunk oil pipeline system of the state-owned company, Transneft, or by railway transport.

Transportation of refined products in Russia is by railway transport and the pipeline system of Transnefteproduct. The Russian railway infrastructure is owned and operated by Russian Railways. Both these companies are state-owned. We transport the major part of our refined products by railway transport.

In Russia, gas is mostly sold at the wellhead and then transported through the Unified Gas Supply System (“UGSS”). The UGSS is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia and is owned and operated by Gazprom.

Operational highlights

Hydrocarbon production

The table below summarizes the results of our exploration and production activities.

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
Crude oil and natural gas liquids⁽¹⁾	(thousand BOE per day)			
Consolidated subsidiaries				
Western Siberia	818	901	842	923
Timan-Pechora	338	340	342	335
Ural region	321	317	322	316
Volga region.....	133	136	131	139
Other in Russia.....	36	38	36	37
Total in Russia.....	1,646	1,732	1,673	1,750
Iraq ⁽²⁾	72	235	112	190
Other outside Russia.....	45	36	44	39
Total outside Russia.....	117	271	156	229
Total consolidated subsidiaries	1,763	2,003	1,829	1,979
Our share in equity affiliates				
in Russia				

We undertake exploration for, and production of, cr

	9 months of			
	2016			2015
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production ⁽¹⁾	112,311	16,372	99,134	14,453
Production related to cost compensation and remuneration ⁽¹⁾	30,714	4,477	51,843	7,558
Shipment of compensation crude oil ⁽¹⁾⁽²⁾	53,070	7,736	48,077	7,009
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation ⁽³⁾	53,070	756	137,159	2,327
Remuneration fee				

The following table summarizes key figures for our refining activities.

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Refinery throughput at the Group refineries	17,119	17,349	49,339	47,896
- in Russia	11,092	11,182	31,029	31,379
- outside Russia ⁽¹⁾	6,027	6,167	18,310	16,517
Refinery throughput at third party refineries	80	298	245	715
Total refinery throughput	17,199	17,647	49,584	48,611
Production of the Group refineries in Russia	10,554	10,597	29,372	29,791
- diesel fuel.....	3,241	3,448	9,630	9,583
- gasoline.....	2,152	1,916	5,795	5,135
- fuel oil.....	1,560	1,926	4,232	6,006
- jet fuel.....	695	618	1,605	1,694
- motor oils.....	265	234	767	681
- other products	2,641	2,455	7,343	6,692
Production of the Group refineries outside Russia	5,695	5,910	17,204	15,509
- diesel fuel.....	2,450	2,463	7,345	6,366
- gasoline	1,180	1,343	3,648	3,557
- fuel oil.....	726	879	2,512	2,351
- jet fuel.....	266	242	686	651
- motor oils.....	58	53	158	151
- other products	1,015	930	2,855	2,433
Refined products produced by the Group.....	16,249	16,507	46,576	45,300
Refined products produced at third party refineries	76	277	235	683
Total refined products produced	16,325	16,784	46,811	45,983
Products produced at petrochemical plants and facilities	319	314	965	747
- in Russia	233	221	691	476
- outside Russia	86	93	274	271
	(millions of RUB)			
Refining expenses at the Group refineries.....	21,102	24,786	66,356	67,958
- in Russia	10,799	12,528	32,010	31,453
- outside Russia	10,303	12,258	34,346	36,505
	(ruble per tonne)			
Refining expenses	1,233	1,429	1,345	1,419
- in Russia	974	1,120	1,032	1,002
- outside Russia	1,709	1,988	1,876	2,210
	(US dollar per tonne)			
Refining expenses	19.08	22.69	19.73	23.99
- in Russia	15.07	17.79	15.18	17.00
- outside Russia	26.45	31.56	27.44	37.26
	(millions of RUB)			

Cap3.47856(.)-.33333 0 ap3.28 9 Tf 3 0 0 8.33333 0 0 cdJTJ -313.019 -11.-6.9t11(u)-6.999(d)-6.95711(u)-6.95711(p)-6.9575021(a)6.38223.3

The following tables show the volumes of crude oil

In the nine months of 2016, the Company exported 90

Three and nine months ended 30 September 2016 compared to three and nine months ended 30 September 2015

The table below sets forth data from our consolidated statements of profit or loss and other comprehensive income for the periods indicated.

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Revenues				
Sales (including excise and export tariffs)	1,309,488	1,464,053	3,826,121	4,381,324
Costs and other deductions				
Operating expenses				

Sales revenues

Sales breakdown	3 rd quarter of		9 months of	
	2016	2015	2016	2015
<hr/>				
(millions of rubles)				
<hr/>				
Crude oil				
Export and sales on international markets other than Customs Union	306,259	232,523	864,501	888,478
Export and sales to Customs Union	8,411	9,409	36,179	37,508
Domestic sales	31,177	39,147	75,921	114,379
	345,847	281,079	976,601	1,040,365

During the third quarter and the nine months of 2016, our dollar realized retail prices outside Russia decreased by 9.0% and 13.0%, respectively, while our ruble realized prices decreased by 6.7% in the third quarter of 2016 and increased by 0.3% in the nine months of 2016. Our sales volumes decreased by 11.6% and 8.7% as a consequence of sale of our retail networks in Eastern Europe. As a result, our international retail revenue decreased by 16 billion RUB, or by 17.5%, and by 20 billion RUB, or by 8.3%, compared to the third quarter and the nine months of 2015, respectively.

During the third quarter and the nine months of 2016, our revenue from the wholesale of refined products on the domestic market increased by 19.1%, or by 12 billion RUB, and by 1.5%, or by 3 billion RUB, respectively. Our realized prices decreased by 5.0% and 11.1%, but our sales volumes increased by 25.4% and 14.2% in the third quarter and the nine months of 2016.

During the third quarter and the nine months of 2016, our revenue from refined products retail sales in Russia increased by 6 billion RUB, or by 6.4%, and by 12 billion RUB, or by 4.6%, respectively. Our average domestic retail prices increased by 3.0% and 3.5%, while our retail volumes increased by 3.3% and 1.0%, respectively.

Sales of petrochemical products

In the third quarter of 2016, our revenue from sales of petrochemical products decreased by 2 billion RUB, or by 8.3%, due to both decrease in prices and volumes, compared to the third quarter of 2015. In the nine months of 2016 this revenue increased by 9 billion RUB, or by 19.1%, largely due to the increase in domestic output against the background of low production as a consequence of a fire at our plant in the Stavropol region of Russia at the end of the first quarter of 2014. Production at the plant was resumed in early April 2015.

Sales of gas and gas products

Compared to the third quarter and the nine months of 2015, sales of gas and gas refined products decreased by 6 billion RUB, or by 18.4%, and by 12 billion RUB, or by 11.6%, respectively, mainly as a result of the decrease in sales prices.

Natural gas sales revenue decreased by 3 billion RUB, or by 17.6%, in the third quarter of 2016 and by 6 billion RUB, or by 11.0%, in the nine months of 2016.

Gas products revenue decreased by 3 billion RUB, or by 19.2%, and by 6 billion RUB, or by 12.3%, compared to the third quarter and the nine months of 2015, respectively.

Sales of energy and related services

During the third quarter of 2016, or revenue from sales asr2s 9.96 TTd [(a)-2.05734(1)0.(i)0.721099(v)5 272.17(6)-2189734(0)

Operating expenses

Operating expenses include the following:

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Hydrocarbon extraction expenses ⁽¹⁾	45,226	43,800	134,287	123,842
Extraction expenses at the West Qurna-2 field	6,741	11,273	25,351	35,209
Own refining expenses	21,102	24,786	66,356	67,958
Refining expenses at third parties refineries	185	914	606	1,992
Expenses for crude oil transportation to refineries	11,229	11,357	34,457	31,477
Power generation and distribution expenses	10,186	8,804	29,	

Refining expenses at our refineries outside Russia decreased by 2 billion RUB, or by 15.9%, compared to the third quarter of 2015 and by 2 billion RUB, or by 5.9%, compared to the nine months of 2015, largely due to lower overhaul expenses.

Expenses for crude oil transportation to refineries

Expenses for crude oil transportation to refineries include pipeline, railway, freight and other costs related to delivery of crude oil and refined products to refineries for further processing.

Our expenses for crude oil transportation to refineries didn't change significantly, compared to the third quarter of 2015, and increased by 3 billion RUB, or by 9.5%, compared to the nine months of 2015, largely as a result of the increase in transportation tariffs, international refining volumes and the effect of the ruble devaluation.

Petrochemical expenses

In the third quarter of 2016, operating expenses of our petrochemical plants didn't change significantly and in the nine months of 2016 they increased by 2 billion RUB, or by 23.3%, due to the increase in domestic production volumes after commencement of production at our petrochemical plant in the Stavropol region of Russia in April 2015.

Other operating expenses

Other operating expenses include expenses of the Group's upstream and downstream entities that do not relate to their core activities, namely rendering of transportation and extraction services, costs of other

Transportation expenses

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Crude oil transportation expenses.....	20,290	20,063	69,907	66,145
- in Russia.....	10,044	11,002	36,983	38,070
- outside Russia.....	10,246	9,061	32,924	28,075
Refined products transportation expenses	42,964	46,576	144,156	138,661
- in Russia.....	18,368	18,633	60,609	58,411
- outside Russia.....	24,596	27,943	83,547	80,250
Other transportation expenses.....	7,915	4,732	21,470	13,727
- in Russia.....	4,069	1,551	11,268	6,482
- outside Russia.....	3,846	3,181	10,202	7,245
Total transportation expenses.....	71,169	71,371	235,533	218,533

Our transportation expenses didn't change significantly in the third quarter of 2016 and increased by 17 billion RUB, or by 7.8%, in the nine months of 2016.

Our expenses for transportation of crude oil in Russia decreased by 8.7% to the third quarter of 2015 and by 2.9% to the nine months of 2015 mostly due to the decrease in exports volumes. Outside of Russia, increase in crude oil transportation expenses was driven primarily by the effect of the ruble devaluation.

Our domestic expenses for transportation of refined products were almost flat to the third quarter of 2015, but increased by 3.8% against the nine months of 2015 as a result of the increase in tariffs. Outside of Russia, the decrease compared to the third quarter of 2015 was due to lower volumes of trading and production and the increase compared to the nine months of 2015 was mainly a result of the ruble devaluation.

Other transportation expenses were mostly represented by the expenses for transportation of gas. In Russia, the increase to the respective periods of 2015 was mainly due to higher volumes of transport

Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan. Currently, our largest affiliates are Tengizchevroil, exploration and production company operating in Kazakhstan, Bashneft-Polus, an exploration and production company that develops th

Excise and export tariffs

	3 rd quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
In Russia				
Excise tax on refined products	28,316	14,541	68,498	40,214
Crude oil export tariffs	33,916	48,728	96,280	168,551
Refined products export tariffs.....	15,201	28,661	39,887	92,835
Total in Russia.....	77,433	91,930	204,665	301,600

Liquidity and capital resources

9 months of
2016 2015
(millions of rubles)

