



**LUKOIL**

**PJSC LUKOIL**

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

**For the three-month period ended 31 March 2016 and 2015**

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 31 March 2016 and the results of its operations for the first quarter of 2016, compared to the first quarter of 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.

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 cubic meter. Translations of barrels of crude oil into barrels of oil equivalent (“BOE”) were made at the rate of 1 barrel per BOE and of cubic feet – at the rate of 6 thousand cubic feet per BOE.

*This report includes forward-looking statements – w*



## **Operational highlights**

### **Hydrocarbon production**

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





The Group launched the “Mishrif Early Oil” stage on the West Qurna-2 field and reached the planned production of 120 thousand barrels per day in March 2014. According to the service agreement, costs are compensated after this level of production is achieved and maintained during any 90 days within a 120-day period. In June 2014, we met this term and from the second quarter of 2014 started to receive cost compensation. The project’s target production level is 1.2 million barrels per day and the total term of the contract is 25 years.

Accounting for the cost compensation within the West Qurna-2 project in the Group consolidated statement of profit or loss and other comprehensive income is as follows. The crude oil sales revenue is recognized after the Iraqi party has approved the actual invoice for the spending quarter. The invoice total amount depends on crude oil production volumes and the market prices for crude oil during the period. It also includes our remuneration fee. Subsequently, crude oil purchases based on actual crude oil shipments by the Iraqi party against its debt for cost compensation are recognized in *Cost of purchased crude oil, gas and products*. This crude oil is either sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

The West Qurna-2 project’s summary is presented below:







## Main macroeconomic factors affecting our results of operations

### Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues. During the first quarter of 2016, the price for Brent crude oil fluctuated between \$26 and \$40 per barrel, reached its maximum of \$40.25 in the middle of March and minimum of \$25.98 in the beginning of January, and averaged 37.1% less than in the first quarter of 2015. Nevertheless, as a result of ruble devaluation, the prices expressed in rubles decreased less significantly.

Substantially all the crude oil the Group exports is Urals blend. The following tables show the average crude oil and refined product prices in the first quarter of 2016 and 2015.

	3 months of		
	2016	2015	Change, %
	(in US dollars per barrel, except for figures in percent)		
Brent crude.....	33.94	53.94	(37.1)
Urals crude (CIF Mediterranean) <sup>(1)</sup> .....	32.72	53.26	(38.6)
Urals crude (CIF Rotterdam) <sup>(1)</sup> .....	31.66	52.59	(39.8)
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam).....	135.28	276.29	(51.0)
Diesel fuel 10 ppm (FOB Rotterdam) .....	312.55	530.15	(41.0)
High-octane gasoline (FOB Rotterdam).....	386.04	548.78	(29.7)

Source: Platts.

	3 months of		
	2016	2015	Change, %
	(in rubles per barrel, except for figures in percent)		
Brent crude.....	2,532.81	3,354.42	(24.5)
Urals crude (CIF Mediterranean) <sup>(1)</sup> .....	2,441.75	3,312.15	(26.3)
Urals crude (CIF Rotterdam) <sup>(1)</sup> .....	2,362.49	3,270.71	(27.8)
	(in rubles per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam).....	10,095.82	17,183.06	(41.2)
Diesel fuel 10 ppm (FOB Rotterdam) .....	23,325.10	32,971.24	(29.3)
High-octane gasoline (FOB Rotterdam).....	28,809.34	34,129.70	(15.6)

Translated into rubles using average exchange rate for the period.

<sup>(1)</sup> The Company sells various crude oil blends on foreign markets on various delivery terms. Thus, our average realized sale price of oil on international markets differs from the average prices of Urals blend on Mediterranean and Northern Europe markets.

### Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally

The table below represents average domestic wholesale prices of refined products in the first quarter of 2016 and 2015.

	<b>3 months of</b>		<b>Change, %</b>
	<b>2016</b>	<b>2015</b>	
	(in rubles per metric tonne, except for figures in percent)		
Fuel oil.....	4,555.08	6,384.18	(28.7)
Diesel fuel.....	27,186.44	28,336.86	(4.1)
High-octane gasoline (Regular) .....	31,637.01	28,354.52	11.6
High-octane gasoline (Premium) .....	33,497.18	29,766.95	12.5

Source: InfoTEK (excluding VAT).

### **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 gives data on inflation in Russia and the change in the ruble-dollar and ruble-euro exchange rates.

	<b>3 months of</b>	
	<b>2016</b>	<b>2015</b>
Ruble inflation (CPI), % .....	2.1	7.4
Average exchange rate for the period (ruble to US d		

**Crude oil export duty rate** is calculated on a progressive scale. The rate is zero when the average Urals blend international market price is less than or equal to \$15.00 per barrel (\$109.50 per metric tonne). If the Urals blend price is between \$15.00 and \$20.00 per barrel (\$146.00 per metric tonne), each \$1.00 per barrel increase in the Urals blend price over \$15.00 results in an increase in the crude oil export duty rate by \$0.35 per barrel exported. If the Urals blend price is between \$20.00 and \$25.00 per barrel (\$182.50 per metric tonne), each \$1.00 per barrel increase in the Urals blend price over \$20.00 results in an increase in the crude oil export duty rate by \$0.45 per barrel exported. Each \$1.00 per barrel increase in the Urals blend price over \$25.00 per barrel results in an increase in the crude oil export duty rate by no more than \$0.42 per barrel exported.

The crude oil export duty rate is revised monthly on the basis of the preceding one-month period of crude oil price monitoring.

A special export duty regime is in place for certain greenfields. The list of the oilfields where the reduced rate is applied includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea and extra-heavy crude oil fields in Timan-Pechora.

**Export duty rates on refined products** are calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

	<b>From 1 January 2016 to 31 December 2016</b>	<b>From 1 January 2015 to 31 December 2015</b>
Multiplier for:		
Light and middle distillates.....	0.40	0.48
Diesel fuel.....	0.40	0.48
Gasolines.....	0.61	0.78
Straight-run gasoline.....	0.71	0.85
Fuel oil.....	0.82	0.76

Crude oil and refined products exports from Russia are subject to two steps of customs declaration and duty payments: temporary and complete. A temporary declaration is submitted based on preliminary exports volumes and the duty is paid in rubles translated from US dollars at the date of the temporary declaration. A complete declaration is submitted after receiving the actual data on the exported volumes, but no later than six months after the date of the temporary declaration. The final amount of the export duty is adjusted depending on the actual volumes, the US dollar exchange rate at the date of the complete declaration (except for pipeline deliveries when the exchange rate at the temporary declaration date is used) and the export duty rate. If temporary and complete declarations are submitted in different reporting periods, the final amount of the export duty is adjusted in the period of submission of the complete declaration. The high volatility of the ruble-dollar exchange rates may lead to significant adjustments. For the purposes of the IFRS consolidated financial statements, temporary declarations at the reporting period end are translated to rubles from US dollars using the period-end exchange rate.

**Crude oil and refined products exported to the member countries of the Custom Union – Belarus and Kazakhstan**, are not subject to export duties.

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

		<b>3 months of</b>		
		<b>2016</b>	<b>2015</b>	<b>Change, %</b>
Export tariffs on crude oil.....	\$/tonne	55.00	130.19	(57.8)
Export tariffs on refined products				
Light and middle distillates.....	\$/tonne	21.99	62.40	(64.8)
Fuel oil.....	\$/tonne	45.05	98.92	(54.5)
Gasoline.....	\$/tonne	33.51	101.50	(67.0)
Straight-run gasoline.....	\$/tonne	39.01	110.61	(64.7)
Diesel fuel.....	\$/tonne	21.99	62.40	(64.8)

		<b>3 months of</b>		
		<b>2016</b>	<b>2015</b>	<b>Change, %</b>
Export tariffs on crude oil <sup>(1)</sup> .....	RUB/tonne	4,104.36	8,096.87	(49.3)
Export tariffs on refined products <sup>(1)</sup>				
Light and middle distillates .....	RUB/tonne	1,641.24	3,880.86	(57.7)
Fuel oil .....	RUB/tonne	3,362.19	6,152.26	(45.4)

## Three months ended 31 March 2016, compared to three months ended 31 March 2015

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

	3 months of	
	2016	2015
	(millions of rubles)	
<b>Revenues</b>		
Sales (including excise and export tariffs) .....	1,177,674	1,440,305
<b>Costs and other deductions</b>		
Operating expenses .....	(113,244)	(105,681)
Cost of purchased crude oil, gas and products .....	(537,733)	(700,065)
Transportation expenses .....	(86,699)	(78,785)
Selling, general and administrative expenses .....	(47,823)	(41,185)
Depreciation, depletion and amortization .....	(84,348)	(78,463)
Taxes other than income taxes .....	(83,553)	(129,835)
Excise and export tariffs .....	(114,949)	(172,849)
Exploration expenses .....	(1,681)	(1,197)
<b>Profit from operating activities.....</b>	<b>107,644</b>	<b>132,245</b>
Finance income .....	3,831	4,531
Finance costs.....	(10,371)	(11,460)
Equity share in income of affiliates .....	2,353	4,093
Foreign exchange (loss) gain .....	(45,378)	5,675
Other expenses.....	(3,343)	(5,772)
<b>Profit before income taxes.....</b>	<b>54,736</b>	<b>129,312</b>
Current income taxes .....	(10,476)	(22,940)
Deferred income taxes .....	(1,290)	(1,933)
<b>Total income tax expense .....</b>	<b>(11,766)</b>	<b>(24,873)</b>
<b>Profit for the period.....</b>	<b>42,970</b>	<b>104,439</b>
Profit for the period attributable to non-controlling interests.....	(145)	(408)
<b>Profit for the period attributable to PJSC LUKOIL shareholders .....</b>	<b>42,825</b>	<b>104,031</b>
Earning per share of common stock attributable to PJSC LUKOIL shareholders (in rubles):		
Basic .....	60.07	145.92
Diluted .....	60.07	143.02

The analysis of the main financial indicators of the financial statements is provided below.

## Sales revenues

### Sales breakdown

	3 months of	
	2016	2015
	(millions of rubles)	
Crude oil		
Exports and sales on international markets other than Customs Union .....	280,146	365,914
Exports and sales to Customs Union .....	12,402	14,323
Domestic sales .....	21,340	37,373
	<b>313,888</b>	<b>417,610</b>
Refined products		
Exports and sales on international markets		
Wholesale.....	546,573	722,754
Retail.....	78,314	80,032
Domestic sales		
Wholesale.....	48,797	52,974
Retail.....	81,379	78,005
	<b>755,063</b>	<b>933,765</b>
Petrochemicals		
Exports and sales on international markets .....	10,158	8,214
Domestic sales .....	9,179	3,098
	<b>19,337</b>	<b>11,312</b>
Gas and gas products		
Exports and sales on international markets .....	24,408	27,672
Domestic sales .....	9,238	9,298
	<b>33,646</b>	<b>36,970</b>
Sales of energy and related services		
Sales on international markets .....	3,728	2,490
Domestic sales .....	19,036	17,897
	<b>22,764</b>	<b>20,387</b>
Other		
Exports and sales on international markets .....	22,757	11,430
Domestic sales .....	10,219	8,831
	<b>32,976</b>	<b>20,261</b>
<b>Total sales .....</b>	<b>1,177,674</b>	<b>1,440,305</b>

### Sales volumes

	3 months of	
	2016	2015
	(thousands of barrels)	
Crude oil		
Exports and sales on international markets other than Customs Union .....	129,162	117,067
Exports and sales to Customs Union .....	7,132	6,773
Domestic sales .....	13,795	18,977
	<b>150,089</b>	<b>142,817</b>

**Realized average sales prices**

		<b>3 months of</b>	
		<b>2016</b>	<b>2015</b>
<b>Average realized price international</b>			
Oil (excluding Customs Union) .....	(RUB/barrel)	2,168.95	3,125.59
Oil (Customs Union) .....	(RUB/barrel)	1,738.90	2,115.35
<b>Refined products</b>			
Wholesale .....	(RUB/tonne)	23,680.69	30,045.88
Retail.....	(RUB/tonne)	75,665.70	75,787.88
Oil (excluding Customs Union) .....	(\$/barrel)	29.06	50.26
Oil (Customs Union) .....	(\$/barrel)	23.30	34.01
<b>Refined products</b>			
Wholesale .....	(\$/tonne)	317.32	483.11
Retail.....	(\$/tonne)	1,013.91	1,218.61
<b>Average realized price within Russia</b>			
Oil.....	(RUB/barrel)	1,546.93	1,969.57
<b>Refined products</b>			
Wholesale .....	(RUB/tonne)	19,068.78	23,986 p 33.47856(-)-3.



#### *Sales of petrochemical products*

In the first quarter of 2016, our revenue from sales of petrochemical products increased by 8 billion RUB, or by 70.9%, largely due to the three-fold increase in domestic sales volumes 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. In early April 2015, production at the plant was resumed.

#### *Sales of gas and gas products*

Sales of gas and gas refined products decreased by 3 billion RUB, or by 9.0%, compared to the first quarter of 2015, mainly as a result of the decrease in sales prices.

Natural gas sales revenue decreased by 2 billion RUB, or by 10.5%. Gas products revenue decreased by 1 billion RUB, or by 7.1%.

#### *Sales of energy and related services*

In the first quarter of 2016, our revenue from sales of electricity, heat and related services increased by 2 billion RUB, or by 11.7%. In Russia, the increase was largely due to putting in operation a combined cycle gas turbine with a capacity of 135 MW at the Group's power plant in the Stavropol region of Russia in March 2015. Our international revenue increased as a result of the significant increase in volumes of electricity sales in Sicily, Italy.

#### *Sales of other products*

Other sales include non-petroleum sales through our retail network, transportation services, rental revenue, crude oil extraction services, and other revenue of our production and marketing companies from sales of goods and services not related to our primary activities.

In the first quarter of 2016, revenue from other sales increased by 13 billion RUB, or by 62.8%, compared to the first quarter of 2015. The non-petrol revenue of our retail network increased by 1 billion RUB, or by 18.6%. Revenue from transportation services abroad increased by 3 billion RUB, or by 84.0%. In the first quarter of 2016 and 2015, our other sales also included revenue from sales of diamonds in the amount of 8 billion RUB and 2 billion RUB, respectively.

### **Operating expenses**

Operating expenses include the following:

	<b>3 months of</b>	
	<b>2016</b>	<b>2015</b>
	<b>(millions of rubles)</b>	
Hydrocarbon extraction expenses .....	54,077	51,834
Own refining expenses .....	22,450	22,168
Refining expenses at third parties .....	2,057	2,160

In the first quarter of 2016, our extraction expenses increased by 2 billion RUB, or by 4.3%. In the first quarter of 2016 and 2015, our extraction expenses i

In the first quarter of 2016, we recognized a 1 billion RUB net gain from hedging, compared to a 9 billion RUB net loss in the first quarter of 2015.

### **Transportation expenses**

In the first quarter of 2016, our transportation expenses increased by 8 billion RUB, or by 10.0%, compared to the first quarter of 2015.

Our transportation expenses in Russia didn't change significantly as the decrease in export volumes was offset by the increase in tariffs. Our actual transportation tariffs related to crude oil and refined products deliveries to various exports destinations, weighted by volumes transported, changed to the first quarter of 2015 as follows: crude oil pipeline tariffs increased by 8.8%, railway tariffs for refined products transportation increased by 4.7%. Internationally, our transportation expenses increased as a result of the ruble devaluation.

### **Selling, general and administrative expenses**

Selling, general and administrative expenses include payroll costs (excluding extraction entities', refineries' and power generation entities' production staff costs), insurance costs (except for property

**Taxes other than income taxes**

	<b>3 months of</b>	
	<b>2016</b>	<b>2015</b>
	<b>(millions of rubles)</b>	
<b>In Russia</b>		
Mineral extraction taxes.....	69,738	116,649

**Reconciliation of net income to EBITDA (earnings before interest, income taxes, depreciation and amortization)**

	3 months of	
	2016	2015
	(millions of rubles)	
<b>Profit for the period</b> .....	<b>42,825</b>	<b>104,031</b>
Add back:		
Income tax expense .....	11,766	24,873
Depreciation and amortization .....	84,348	78,463
Finance cost .....	10,371	11,460
Finance income .....	(3,831)	(4,531)
<b>EBITDA</b> .....	<b>145,479</b>	<b>214,296</b>
Including impact of West Qurna-2 project .....	21,555	27,240

EB.. e



The table below shows our exploration and production capital expenditures in new production regions.

**3 months of**  
**2016**            **2015**  
(millions of rubles)

Western Siberia<sup>(1)</sup>