



PJSC LUKOIL

CONDITION AND RESULTS OF OPERATIONS

**for the three months ended 31 December and 30 September 2017 and
for the years 2017 and 2016**

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 31 December 2017 and the results of its operations for the three months ended 31 December and 30 September 2017 and for the years 2017 and 2016, as well as significant factors that may affect its future performance. It should be read in conjunction with our International Financial Reporting Standards

exploration and production activities.

Referen

LUKOIL

and its subsidiaries and equity affiliates. All ruble amounts are in millions of Russian

unless otherwise indicated. Income and expenses of our foreign subsidiaries were

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Business overview

The primary activities of LUKOIL and its subsidiaries are hydrocarbon exploration, production, refining, marketing and distribution.

LUKOIL i

reserves under SEC standards amounted to 16.0 billion BOE at 1 January 2018 and comprised of 12.1 billion barrels of crude oil and 23.6 trillion cubic feet of gas. Most of our reserves are conventional. We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia, our major oil producing regions are Western Siberia, Timan-Pechora, Ural and Volga region. Our international upstream segment includes

Uzbekistan, Romania, Iraq, Egypt, Ghana, Norway, Cameroon, Nigeria and Mexico. Our daily hydrocarbon production in 2017 amounted to 2.3 million BOE, with liquid hydrocarbons representing approximately 80% of our overall production volumes.

LUKOIL has geographically diversified downstream assets portfolio primarily in Russia and Europe. Our downstream operations include crude oil refining, petrochemical and transport operations, marketing and trading of crude oil, natural gas and refined products, power generation, transportation and sales of electricity, heat and related services.

We own and operate four refineries located in European Russia and three refineries located outside Russia

Changes in Group structure

diamond field named after V.P. Grib located in Arkhangelsk region of Russia. The transaction in the amount of Russian ruble equivalent of \$1.45 billion was completed on 24 May 2017 after all necessary governmental approvals were received. As a result the Group recognized profit before income tax in the amount of 48

profit or loss and other comprehensive income (profit after income tax 38 billion RUB).

In February 2017, the Group completed the sale of wholly owned subsidiary LUKOIL Chemical B.V., which owns Karpatneftekhim petrochemical plant (m) 1956356309ETBT/F3 9.96tpetro

Main macroeconomic factors affecting our results of operations

International crude oil and refined products prices

The price at which we sell

The dynamics of our realized prices on international markets generally matches the dynamics of commonly used spot benchmarks such as Brent crude oil price, however our average prices are usually different from such benchmarks due to different delivery terms, quality mix, as well as specifics of regional markets in case of petroleum product sales.

In 2017, the price for Brent crude oil fluctuated between \$44 and \$67 per barrel, reached its minimum of \$44.3 in late June and then maximum of \$66.5 in late December, and averaged 24.1% higher compared to 2016. Nevertheless, as a result of the ruble appreciation, the prices expressed in rubles increased less significantly.

The following tables show the average crude oil and refined product prices.

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
(in US dollars per barrel, except for figures in percent)						
Brent crude.....	61.44	52.08	18.0	54.28	43.73	24.1
Urals crude (CIF Mediterranean)	60.79	51.03	19.1	53.37	42.52	25.5
Urals crude (CIF Rotterdam)	60.37	50.73	19.0	52.92	41.68	27.0
(in US dollars per metric tonne, except for figures in percent)						
Fuel oil 3.5% (FOB Rotterdam).....	336.48	295.75	13.8	300.49	207.64	44.7
Diesel fuel 10 ppm (FOB Rotterdam)	555.55	488.20	13.8	493.92	396.99	24.4
High-octane gasoline (FOB Rotterdam)	595.70	560.06	6.4	557.66	467.05	19.4
Naphtha (FOB Rotterdam).....	552.67	458.59	20.5	480.75	382.46	25.7
Jet fuel (FOB Rotterdam).....	595.46	517.62	15.0	526.17	422.20	24.6
Vacuum gas oil (FOB Rotterdam)	419.13	357.82	17.1	369.15	293.29	25.9

Source: Platts.

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
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The table below illustrates the impact of the export duty lag effect on the Urals price net of taxes.

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
(in US dollars per barrel, except for figures in percent)						
Urals price (Argus)	60.74	51.16	18.7	53.09	41.69	27.3
Enacted export duty on crude oil	13.20	10.92	20.8	11.88	10.37	14.5
Net Urals price ⁽¹⁾	24.75	22.10	12.0	22.11	19.51	13.3
Lag effect	1.52	0.92	65.8	0.54	0.63	(13.8)
Net Urals price ⁽¹⁾ assuming no lag	23.23	21.18	9.7	21.57	18.88	14.2
(in rubles per barrel, except for figures in percent) ⁽²⁾						
Urals price (Argus)	3,548	3,019	17.5	3,098	2,795	10.8
Enacted export duty on crude oil	771	645	19.5	693	695	(0.3)
Net Urals price ⁽¹⁾	1,446	1,305	10.8	1,291	1,308	(1.4)
Lag effect	89	54	64.1	32	42	(23.8)
Net Urals price ⁽¹⁾ assuming no lag	1,357	1,250	8.5	1,259	1,266	(0.6)

⁽¹⁾ Urals price net of export duty and crude oil extraction tax.

⁽²⁾ Translated to rubles using average exchange rate for the period.

Crude oil produced at some of our fields is subject to special export duty rates calculated according to specified formulas, which are lower than standard rates. A reduced rate is applied to crude oil produced at our Yaregskoye field producing extra-viscous crude oil and our Yu. Korchagin field in the Caspian offshore. A zero rate applies to crude oil of our V. Filanovsky field also located in the Caspian offshore.

The table on p. 9 illustrates the impact of crude oil export duty incentives on taxation of export of crude oil produced from our different fields and deposits at \$50 per barrel Urals price.

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.

	2017 and further	2016
Multiplier for:		
Light and middle distillates	0.30	0.40
Diesel fuel	0.30	0.40
Gasolines	0.30	0.61
Straight-run gasoline	0.55	0.71
Fuel oil	1.00	0.82

Crude oil and refined products exported 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 ruble-US dollar exchange rate at the date of the complete declaration (except for pipeline deliveries for which 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, data from temporary declarations at the reporting period end is translated to rubles from US dollars using the period-end exchange 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.

Excise taxes on refined products. The responsibility to pay excises on refined products in Russia is imposed on refined product producers (except for straight-run gasoline). Only domestic sales volumes are subject to excises.

In other countries where the Group operates, excise taxes are paid either by producers or retailers depending on the local legislation.

The following table sets forth the changes in the average tariffs charged by the state-controlled transportation service providers in Russia.

	4rd quarter of 2017 to 3rd quarter of 2017	12 months of 2017 to 12 months of 2016
Transneft		
Crude oil	0.0%	3.4%
Russian Railways		
Crude oil and refined products	0.0%	

Segments highlights

Our operations are divided into three main business segments:

Exploration and Production which includes our exploration, development and production operations related to crude oil and gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, Northern and Western Africa, Norway, Romania and Mexico.

Refining, Marketing and Distribution which includes refining, petrochemical and transport operations, marketing and trading of crude oil, natural gas and refined products, generation, transportation and sales of electricity, heat and related services.

Corporate and other which includes operations related to our headquarters (which coordinates the operations of Group companies), finance activities, and certain other activities.

Each of our segments is dependent on the others, with a portion of the revenues of one segment being a part of the costs of the others. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the

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Exploration and production

The following table summarizes key figures on our Exploration and production segment:

	Q4 2017	Q3 2017	12 months of 2017 2016	
			(millions of rubles)	
EBITDA in Russia.....	149,816	133,637	491,191	445,716
EBITDA outside Russia ⁽¹⁾	23,145	21,455	78,226	75,474
EBITDA.....	172,961	155,092	569,417	521,190
Hydrocarbon extraction expenses.....	54,794	52,156	208,959	211,454
- in Russia.....	46,311	43,978	177,554	165,641
- outside Russia ⁽²⁾	4,989	4,537	15,227	14,582
- in Iraq.....	3,494	3,641	16,178	31,231
			(ruble per BOE)	
Hydrocarbon extraction expenses ⁽²⁾	251	245	244	233
- in Russia	257	245	248	233
- outside Russia ⁽²⁾	205	250	204	237
			(US dollar per BOE)	
Hydrocarbon extraction expenses ⁽²⁾	4.30	4.15	4.18	3.50
- in Russia.....	4.41	4.14	4.25	3.50
- outside Russia ⁽²⁾	3.51	4.23	3.50	3.52

⁽¹⁾ Including EBITDA of the West Qurna-2 project in the amounts of 4,603 million RUB and 5,799 million RUB in the fourth and third

The following table summarizes our hydrocarbon production by major regions.

	Q4 2017	Q3 2017	12 months of 2017	2016
	(thousand BOE per day)			
Crude oil and natural gas liquids⁽¹⁾				
Consolidated subsidiaries				
Western Siberia	780	795	801	838
Timan-Pechora	313	312	312	339
Ural region	327	321	324	322
Volga region.....	213	201	199	142
Other in Russia	32	33	33	36
Total in Russia.....	1,665	1,662	1,669	1,677
Iraq ⁽²⁾	29	40	34	95
Other outside Russia.....	46	41	45	45
Total outside Russia.....	75	81	79	140
Total consolidated subsidiaries	1,740	1,743	1,748	1,817
Our share in equity affiliates				
in Russia				

The following table summarizes data on capital and operating costs incurred, compensation crude oil received, costs yet unrecovered and remuneration fee.

	Costs incurred ⁽¹⁾	Remuneration fee (millions of US dollars)	Crude oil received	Crude oil to be received
Cumulative at 31 December 2016	7,532	272	7,275	529
Change in 2017	540	91	567	64
Income tax ⁽²⁾		(60)		(60)
Cumulative at 31 December 2017	8,072	303	7,842	533

⁽¹⁾ Including prepayments.

⁽²⁾ Income tax (including related to prior periods) on remuneration fee offset against crude oil to be received.

The West Qurna-2 project summary is presented below:

	Q4 2017		Q3 2017	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production.....	34,904	5,149	35,605	5,190
Production related to cost compensation and remuneration ⁽¹⁾	2,682	396	3,700	539
Shipment of compensation crude oil ^{(1) (2)}	2,912	430	3,924	572
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)

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	Q4 2017	Q3 2017	12 months of 2017 2016	
			(thousands of tonnes)	
Refined products exports				
- diesel fuel	2,529	2,386	10,060	8,030
- gasoline	185	57	331	408
- fuel oil	751	342	2,762	3,697
- jet fuel	8	18	84	202
- lubricants and components	147	152	623	605
- gas refinery products	433	275	1,304	602
- other products	364	557	2,360	5,197
Total refined products exports				

Sales revenues

Sales breakdown

Q4

Q3

Realized average sales prices

		Q4	Q3	12 months of	
		2017	2017	2017	2016
Average realized price on international markets					
Crude oil (beyond Customs Union) ⁽¹⁾	(RUB/barrel)	3,538	3,040	3,126	2,712
Crude oil (Customs Union)	(RUB/barrel)	2,740	2,302	2,329	1,989
Refined products					
Wholesale	(RUB/tonne)	32,318	29,503	28,765	26,287
Retail.....	(RUB/tonne)	71,762	69,070	67,593	71,232
Petrochemicals.....	(RUB/tonne)	49,127	48,568	50,777	46,467
Crude oil (beyond Customs Union) ⁽¹⁾	(\$/barrel)	60.58	51.51	53.58	40.46
Crude oil (Customs Union)	(\$/barrel)	46.91	39.00	39.92	29.67
Refined products					
Wholesale	(\$/tonne)	553	500	493	392
Retail.....	(\$/tonne)	1,229	1,170	1,158	1,063
Petrochemicals.....	(\$/tonne)	841	823	870	693
Average realized price within Russia					
Crude oil	(RUB/b				

Sales of refined products

During the fourth quarter of 2017, our revenue from the wholesale of refined products outside Russia increased by 44 billion RUB, or by 6.1%. Compared to the previous quarter, our sales volumes decreased by 3.2% and our realized ruble prices increased by 9.5%.

Compared to the third quarter of 2017, our international retail revenue decreased by 1 billion RUB, or by 1.0%. Our international retail realized ruble prices increased by 3.9% and our sales volumes decreased by 52 thousand tonnes, or by 4.7%.

Compared to the third quarter of 2017, our revenue from the wholesale of refined products on the domestic market decreased by 2 billion RUB, or by 1.9%. Our realized prices increased by 1.4% and our sales volumes decreased by 3.3%.

In the fourth quarter of 2017, our revenue from refined products retail sales in Russia decreased by 8 billion RUB, or by 6.6%. Our average domestic retail prices and volumes decreased by 0.9% and by 5.7%, respectively.

In 2017, our revenue from the wholesale of refined products outside Russia increased by 351 billion RUB, or by 14.0%, that was both price and volume driven. Compared to 2016, our sales volumes increased by 4.2%. Our dollar and our ruble realized prices increased by 25.7% and by 9.4%, respectively.

In 2017, our dollar realized retail prices outside Russia increased by 9.0%, while our ruble realized prices decreased by 5.1%, due to the ruble appreciation. Our sales volumes decreased by 3.2% to 2016 as a consequence of sale of our retail networks in Eastern Europe. As a result, our international retail revenue decreased by 25 billion RUB, or by 8.2%, compared to 2016.

In 2017, our revenue from the wholesale of refined products on the domestic market increased by 109 billion RUB, or by 43.4%. Our realized prices and volumes increased by 15.4% and by 24.3%, respectively.

Our revenue from refined products retail sales in Russia increased by 33 billion RUB, or by 8.5%, compared to 2016. Our average domestic retail prices and volumes increased by 6.5% and by 1.8%, respectively.

Sales of petrochemical products

In the fourth quarter of 2017, our revenue from sales of petrochemical products decreased by 2 billion RUB, or by 7.6%, largely, as a result of a decrease in sales volumes following planned repairs at our petrochemical plant in Stavropol region of Russia. That was partially offset by the increase in petrochemical products trading volumes outside Russia.

In 2017, our revenue from sales of petrochemical products increased by 10 billion RUB, or by 13.5%, largely as a result of the increased trading volumes.

Sales of gas

Sales of gas increased by 4 billion RUB, or by 18.4%, in the

During the fourth quarter of 2017, revenue from other sales decreased by 2 billion RUB, or by 7.3%. Our revenue from transportation services increased by 1 billion RUB, or by 19.2%, and non-petrol revenue of our retail network decreased by 3 billion RUB, or by 24.7%, due to seasonal factors and ruble appreciation.

In 2017, revenue from other sales decreased by 21 billion RUB, or by 18.2%. In the second quarter of 2017, we divested our diamond business and therefore had no respective revenue in the second half of 2017. Our results for 2017 included 6 billion RUB of revenue from sales of diamonds (20 billion RUB in 2016). Our revenue from transportation services decreased by 7 billion RUB, or by 33.8%, in 2017. This was partially offset by an increase in non-petrol revenue of our retail network.

Operating expenses

Operating expenses include the following:

Q4 2017	Q3 2017	12 months of 2017
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Other operating expenses

relate to their core activities,

In 2017, our transportation expenses decreased mainly as a result of a decline in refined products transportation tariffs outside Russia which was amplified by the effect of the ruble appreciation. This was partially offset by an increase in domestic expenses for transportation of refined products following the growth both in sales volumes and tariffs. At the same time, our expenses for transportation of crude oil remained at the level of the previous year. The decrease in expenses in Russia was outweighed by the expenses increase abroad. Despite the increase in tariffs in Russia, expenses declined as a result of the decrease in volumes transported. Moreover, the increase in share of crude oil from new high-margin oilfields in total volume of export also contributed to the decrease in transportation expenses as these fields are closer to markets as compared to traditional fields of Western Siberia. Outside Russia, the effect of the ruble appreciation was outweighed by the increase in sales volumes and changes in delivery terms that mostly related to the fourth quarter of 2017.

Selling, general and administrative expenses

Selling, , insurance costs (except for property insurance related to extraction, refinery and power generation equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses. Our selling, general and administrative expenses are roughly equally split between domestic and international operations.

	Q4 2017	Q3 2017	12 months of 2017 2016	
	(millions of rubles)			
Labor costs included in selling, general and administrative expenses.....	13,792	15,854	59,120	67,498
Other selling, general and administrative expenses	28,811	24,130		

In the fourth quarter of 2017, export tariffs increased by 10 billion RUB, or by 26.3%. The increase was a result of higher export duty rates and increased volumes of refined products export. Compared to the third quarter of 2017, the volumes of crude oil export beyond the Customs Union decreased by 2.0% and the volumes of refined products exports increased by 16.6%. The decrease in excise tax expenses both in Russia and abroad was driven by a seasonal decrease in sales volumes.

In 2017, export tariffs decreased by 12 billion RUB, or by 6.2

Non-GAAP items reconciliation

Reconciliation of profit for the period to EBITDA

Table below sets forth summary of data on these gains and losses in the context of consolidated statement of profit and loss and their impact on the Group s profit for the periods considered.

2017 2016

Other information

Forward-looking statements

to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to products or services
- statements of future economic performance
- statements of assumptions underlying such statements.

Forward looking statements that may be made by us from time to time (but that are not included in this document) may also include projections or expectations of revenues, income (or loss), earnings (or loss)

ended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

These factors include:

- inflation, interest rate and exchange rate fluctuations
- the price of oil
- the effects of, and changes in, Russian government policy
- the effects of competition in the geographic and business areas in which we conduct operations
- the effects of changes in laws, regulations, taxation or accounting standards or practices
- our ability to increase market share for our products and control expenses
- acquisitions or divestitures
- technological changes
- our success at managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, you should