PJSC LUKOIL

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL 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 ("IFRS") consolidated financial statements, including notes and supplementary information on oil and gas exploration and production activities.

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. Hydrocarbon extraction expenses per barrel were calculated using these actual production volumes. 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 – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 40 for a discussion of some factors that could cause actual results to differ materially.

Table of Contents

Business overview

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

LUKOIL is one of the world's largest publicly traded vertically integrated energy companies. Our proved 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 stakes in PSA's and other projects in Kazakhstan, Azerbaijan, 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 – in Bulgaria, Romania, and Italy. Moreover, we have a 45% interest in the Zeeland refinery in the Netherlands. We also own two petrochemical plants in Russia and have petrochemical capacities at our refineries in Bulgaria and Italy. Along with our own production of refined products we refine crude oil at third party refineries depending on market conditions and other factors. Our refinery throughput in 2017 amounted to 1.4 million barrels per day, and we produced 1.2 million tonnes of petrochemicals.

We market our own and third-party crude oil and refined products through our wholesale and retail channels in Russia, Europe, South-East Asia, Central and North America and other regions. We own petrol stations in 17 countries. Most of our retail networks are located close to our refineries. Our retail sales in 2017 amounted to 14.2 million tonnes of refined products.

We are involved in production, distribution and marketing of electrical energy and heat both in Russia and internationally. In 2017, our total output of electrical energy was 17.6 billion kWh.

Our operations and finance activities are coordinated from our headquarters in Moscow. We divide our operations into three main business segments: "Exploration and production," "Refining, marketing and distribution," and "Corporate and other".

Key financial and operational results

	Q4 2017	Q3 2017	Change %	12 months 2017	12 months 2016	Change, %
	(millions of rubles, except for figures in percent)					
Sales	1,662,452	1,483,484	12.1	5,936,705	5,227,045	13.6
EBITDA[1], including	223,735	221,146	1.2	831,570	730,731	13.8
Exploration and production segment	172,961	155,092	11.5	569,417	521,190	9.3
Refining, marketing and distribution segment	49,009	81,381	(39.8)	263,385	233,297	12.9
EBITDA[1] net of West Qurna-2 project	219,132	215,347	1.8	814,382	691,263	17.8
Profit for the period attributable to LUKOIL shareholders	120,510	97,341	23.8	418,805	206,794	102.5
Capital expenditures	137,726	118,902	15.8	511,496	497,130	2.9
Free cash flow[2]	73,298	90,663	(19.2)	246,994	255,117	(3.2)
Free cash flow before changes in working capital	77,883	83,835	(7.1)	271,977	204,886	32.7
	(thousand BOE per day, except for figures in percent)					
Production of hydrocarbons, including our share in equity affiliates	2,315	2,259	2.5	2,269	2,276	(0.3)
Crude oil and natural gas liquids	1,791	1,795	(0.2)	1,804	1,875	(3.8)
Gas	524	464	12.9	465	401	16.0
Refinery throughput at the Group refineries	1,378	1,383	(0.4)	1,350	1,323	2.0

(1) Profit from operating activities before depreciation, depletion and amortization.

(2) Cash flow from operating activities less capital expenditures.

In 2017, profit attributable to LUKOIL shareholders amounted to 419 billion RUB, an increase of 102.5% to 2016. Our profit for the fourth quarter of 2017 increased by 23.8% compared to the previous quarter and amounted to 121 billion RUB.

Our profit was supported by increased hydrocarbon prices and lower ruble volatility. Moreover, in the second quarter of 2017, we recognized a gain on sale of JSC "Arkhangelskgeoldobycha" in the after-tax amount of 38 billion RUB.

In 2017, our EBITDA amounted to 832 billion RUB, an increase of 13.8% to 2016. Our EBITDA was affected by the decrease in volumes of compensation crude oil within the West Qurna-2 project. Net of this project, the Group's EBITDA increased by 17.8% compared to 2016.

Our results were positively impacted by an increase in share of high-margin projects in crude oil production structure, growth in gas production volumes in Russia and Uzbekistan, better product slate at our refineries, a decrease in transportation, selling, general and administrative expenses and an increase in international hydrocarbon prices. The latter however was generally offset by strengthening of the ruble. Among other negative factors were external limitations of our liquids production in Russia due to the OPEC agreement and higher excise tax and mineral extraction tax rates in Russia.

Our free cash flow decreased by 8.1 billion RUB, or by 3.2%, compared to 2016 mostly as a result of an increase in working capital. In 2016, our cash flow from operating activities was positively impacted by the decrease in receivables related to the West Qurna-2 project, while in 2017 this factor was insignificant. Our free cash flow was also negatively affected by a moderate increase in our capital expenditures.

The Group's average daily hydrocarbon production in 2017 decreased by 0.3% compared to 2016, driven primarily by lower volumes of compensation crude oil from the West Qurna-2 project, as well as temporary external limitations due to the OPEC agreement. Planned increase in production from V.Filanovsky and Pyakyakhinskoe fields, commissioned in 2016, continued. Net of the West Qurna-2 project, our daily hydrocarbon production increased by 2.5% compared to 2016.

In 2017, throughput at own refineries increased by 2.0% compared to 2016 mainly due to the higher utilization rates at refineries in Nizhny Novgorod and Volgograd. We also achieved better refined product slates due to the modernization of our refining capacities in Russia and feedstock optimization.

Changes in Group structure

In December 2016, the Company entered into a contract with a company of the “Otkrytie Holding” group to sell the Group’s 100% interest in JSC “Arkhangelskgeoldobycha” (“AGD”), a company developing the 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 billion RUB that is included in “Other income (expenses)” in the consolidated statement of 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 located in the Ivano-Frankovsk area of Ukraine.

As part of optimizing our retail business, we sold petrol station networks in Poland, Latvia, Lithuania and Cyprus in 2016.

Main macroeconomic factors affecting our results of operations

International crude oil and refined products prices

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues.

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, %
	(in rubles per barrel, except for figures in percent)					
Brent crude	3,588	3,074	16.7	3,167	2,931	8.1
Urals crude (CIF Mediterranean)	3,550	3,012	17.9	3,114	2,850	9.3
Urals crude (CIF Rotterdam)	3,526	2,994	17.8	3,088	2,794	10.5
	(in rubles per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	19,653	17,455	12.6	17,534	13,919	26.0
Diesel fuel 10 ppm (FOB Rotterdam)	32,449	28,813	12.6	28,822	26,612	8.3
High-octane gasoline (FOB Rotterdam)	34,793	33,055	5.3	32,541	31,309	3.9
Naphtha (FOB Rotterdam)	32,281	27,066	19.3	28,053	25,638	9.4
Jet fuel (FOB Rotterdam)	34,779	30,550	13.8	30,703	28,302	8.5
Vacuum gas oil (FOB Rotterdam)	24,481	21,118	15.9	21,541	19,661	9.6

Translated into rubles using average exchange rate for the period.

Domestic crude oil and refined products prices

Most of the crude oil in Russia is produced and then refined or exported by vertically integrated oil companies. As a result, there is no liquid spot market for crude oil in Russia and no publicly available spot price benchmark. Domestic prices may deviate significantly from export netbacks and they also vary between different regions of Russia driven by supply demand balance on regional markets.

Domestic prices for refined products correlate to some extent with export netbacks, but are also materially affected by supply demand balance on regional markets.

The table below represents average domestic wholesale prices for refined products for the respective periods.

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
	(in rubles per metric tonne, except for figures in percent)					
Fuel oil	12,168	11,151	9.1	10,507	7,525	39.6
Diesel fuel	36,819	33,014	11.5	33,288	28,899	15.2
High-octane gasoline (Regular)	36,702	36,631	0.2	36,191	33,784	7.1
High-octane gasoline (Premium)	37,754	37,987	(0.6)	37,011	35,491	4.3

Source: InfoTEK (excluding VAT).

Changes in ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or euro or is correlated to some extent with US dollar crude oil prices, while most of our costs are settled in Russian rubles. Therefore, a devaluation of the ruble against the US dollar and euro 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 the ruble-euro exchange rates.

	Q4 2017	Q3 2017	12 months of 2017	2016
Ruble inflation (CPI), %	0.8	(0.6)	2.5	5.4
Ruble to US dollar exchange rate				
Average for the period	58.4	59.0	58.4	67.0
At the beginning of the period	58.0	59.1	60.7	72.9
At the end of the period	57.6	58.0	57.6	60.7
Ruble to euro exchange rate				
Average for the period	68.8	69.3	65.9	74.2
At the beginning of the period	68.4	67.5	63.8	79.7
At the end of the period	68.9	68.4	68.9	63.8

Source: CBR, Federal State Statistics Service.

Taxation

Between 2015 and 2017, the Russian Government implemented the tax manoeuvre in the oil industry which involved reduction of export duty rate and increase in the crude oil extraction tax and excise tax rates. Changes within this tax manoeuvre that became effective from January and April 2016 had a negative impact on our upstream, refining and marketing margins. Changes that became effective from January 2017 had a positive impact on our upstream margins and a negative impact on our refining and marketing margins, while overall impact of tax changes on our financial results wasn't significant.

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

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
	(in US dollars per tonne, except for figures in percent)					
Export duties on crude oil	96.34	79.75	20.8	86.71	75.72	14.5
Export duties on refined products						
Fuel oil	96.34	79.75	20.8	86.71	62.05	39.7
Gasoline	28.87	23.89	20.8	25.98	46.14	(43.7)
Straight-run gasoline	52.93	43.81	20.8	47.65	53.71	(11.3)
Diesel fuel and refined products	28.87	23.89	20.8	25.98	30.25	(14.1)
Mineral extraction tax(1)						
Crude oil	166.40	132.36	25.7	139.39	86.18	61.7
	(in US dollars per thousand cubic meters, except for figures in percent)					
Natural gas (Nakhodkinskoe field)	4.42	4.37	1.2	4.34	3.10	39.7
Natural gas (Pyakyakhinskoye field)(2)	8.78	8.35	5.1	8.28	–	–

(1) Translated from rubles using average exchange rate for the period.
(2) Gas production started in January 2017.

	Q4 2017	Q3 2017	Change, %	12 months 2017	2016	Change, %
	(in rubles per tonne, except for figures in percent)					
Export duties on crude oil[1]	5,627	4,707	19.6	5,060	5,076	(0.3)
Export duties on refined products[1]						
Fuel oil	5,627	4,707	19.6	5,060	4,160	21.6
Gasoline	1,686	1,410	19.6	1,516	3,093	(51.0)
Straight-run gasoline	3,092	2,586	19.6	2,781	3,601	(22.8)
Diesel fuel and refined products	1,686	1,410	19.6	1,516	2,028	(25.2)
Mineral extraction tax						
Crude oil	9,719	7,812	24.4	8,134	5,777	40.8
	(in rubles per thousand cubic meters, except for figures in percent)					
Natural gas (Nakhodkinskoe field)	258	258	0.1	253	208	21.6
Natural gas (Pyakyakhinskoye field)[2]	513	493	4.1	483	–	–

[1] Translated to rubles using average exchange rate for the period.
[2] Gas production started in January 2017.

The table below illustrates the impact of tax incentives on taxation of crude oil production from different fields and deposits in our portfolio at $50 per barrel Urals price.

	Mineral extraction tax	Export duty	Total	As % of oil price
	(in US dollars per barrel, except for figures in percent)			
Under 2017 tax formulae				
Standard	**17.5**	**11.5**	**29.0**	**58.1**
Yaregskoye field	0.0	1.8	1.8	3.6
Yu. Korchagin field	7.3	0.0	7.3	14.5
V. Filanovsky field	7.5	0.0	7.5	15.0
Usinskoye (Permian layers)	7.3	11.5	18.8	37.5
Pyakyakhinskoye field	7.3	11.5	18.8	37.5
V. Vinogradov field	9.3	11.5	20.8	41.6
Fields with depletion above 80%	10.4–17.5	11.5	21.9–29.0	43.7–58.1
New fields with reserves below 5 million tonnes	11.1–17.5	11.5	22.6–29.0	45.2–58.1
Tyumen deposits	15.5	11.5	27.0	54.0

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. Crude oil extraction tax is payable in rubles for metric tonnes extracted and is calculated according to the formula below:

$$Rate = Base\ Rate \times (Price - 15) \times \frac{Exchange\ Rate}{261} - Incentive + Fixed\ Factor,$$

where *Price* is a Urals blend price in US dollars per barrel and *Exchange Rate* is an average ruble exchange rate to US dollar during the period. The *Base Rates* and *Fixed Factors* (where applicable) are presented below:

	2016	2017	2018	2019	2020	2021 and further
	(ruble)					
Base Rate	857	919	919	919	919	919
Fixed Component	–	306	357	428	428	0

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

- A special reducing 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 Autonomous 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 particular unconventional deposits.

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

The table on the p. 9 illustrates the impact of crude oil extraction tax incentives on taxation of crude oil production from our different fields and deposits at $50 per barrel Urals price.

Natural gas extraction tax rate is calculated using a special formula depending on average wholesale natural gas price in Russia, the share of gas production in particular taxpayer's total hydrocarbon production, regional location and complexity of particular gas field. Associated petroleum gas and reinjected natural gas are subject to zero extraction tax rate.

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 table below.

International Urals price	Export duty rate
Less than, or equal to, $109.5 per tonne ($15 per barrel)	$0 per tonne
Above $109.5 but less than, or equal to, $146.0 per tonne ($20 per barrel)	35% of the difference between the actual price and $109.5 per tonne (or $0.35 per barrel per each $1 increase in the Urals price over $15 per barrel)
Above $146.0 but less than, or equal to, $182.5 per tonne ($25 per barrel)	$12.78 per tonne plus 45% of the difference between the actual price and $146 per tonne (or $1.75 plus $0.45 per barrel per each $1 increase in the Urals price over $20 per barrel)
Above $182.5 per tonne ($25 per barrel)	**2015–2016:** $29.2 per tonne plus 42% of the difference between the actual price and $182.5 per tonne (or $4 plus $0.42 per barrel per each $1 increase in the Urals price over $25 per barrel) **Starting from 1 January 2017:** $29.2 per tonne plus 30% of the difference between the actual price and $182.5 per tonne (or $4 plus $0.3 per barrel per each $1 increase in the Urals price over $25 per barrel)

The export duty rate changes every month with the rate for the next month being based on average Urals price for the period from the 15th day of the previous month to the 14th day of the current month. This calculation methodology results in the so-called "export duty lag effect," when export duty rate lags the oil price changes, which may result in sizeable impact on our financial results in the periods of high oil price volatility.

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.

Excise rates on motor fuels in Russia are tied to the ecological class of fuel. Excise tax rates for the respective periods of 2017 and 2016 are listed below.

	Q4 2017	Q3 2017	Change, %	12 months 2017	12 months 2016	Change, %
	(in rubles per tonne, except for figures in percent)					
Gasoline						
Below Euro-5	13,100	13,100	–	13,100	12,454	5.2
Euro-5	10,130	10,130	–	10,130	9,484	6.8
Diesel fuel						
All ecological classes	6,800	6,800	–	6,800	5,009	35.8
Motor oils	5,400	5,400	–	5,400	6,000	(10.0)
Straight-run gasoline	13,100	13,100	–	13,100	12,454	5.2

Excise tax rates in Russia were increased twice in 2016, on 1 January and 1 April, and once in 2017, on 1 January.

Excise tax rates starting from 2018 are listed below.

	1 December to 30 June, 2018	1 July to 31 December, 2018	2019	2020 and further
	(in rubles per tonne)			
Gasoline				
Below Euro-5	13,100	13,100	13,100	13,100
Euro-5	11,213	11,892	12,314	12,752
Diesel fuel				
All ecological classes	7,665	8,258	8,541	8,835
Motor oils	5,400	5,400	5,400	5,616
Straight-run gasoline	13,100	13,100	13,100	13,100

Income tax. Until 2017, the federal income tax rate was 2.0% and the regional income tax rate varied between 13.5% and 18.0%. In 2017–2020, the federal income tax rate is 3.0% and the regional income tax rate may vary between 12.5% and 17.0%.

The Company and its Russian subsidiaries file income tax returns in Russia. A number of Group companies in Russia are paying income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG.

The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

Transportation tariffs on crude oil, natural gas and refined products in Russia

Many of our production assets are located relatively far from our customers. As a result, transportation tariffs are an important factor affecting our profitability.

Crude oil produced at our fields in Russia is transported to refineries and exported primarily through the trunk oil pipeline system of the state-owned company, Transneft. In some cases, crude oil is also transportated via railway infrastructure of the state-owned company, Russian Railways.

Refined products produced at our Russian refineries are transported primarily by railway (Russian Railways) and the pipeline system of Transnefteproduct, a subsidiary of Transneft.

Gas that is not sold at the wellhead is transported through the Unified Gas Supply System owned and operated by Gazprom.

Transneft, Russian Railways and Gazprom are state-controlled natural transportation infrastructure monopolies and their tariffs are regulated by the Federal Antimonopoly Service of Russia and set in rubles.

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

	4th 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%	6.0%

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 "Domestic crude oil and refined products prices" section on p. 7, benchmark crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. We present the financial data for each segment in Note 32 "Segment information" to our consolidated financial statements.

Reserves base

The table below summarizes the net proved reserves of consolidated subsidiaries and our share in equity affiliates under the standards of the US Securities and Exchange Commission (until the economic limit of commercial production is reached) that have been derived from our reserve reports audited by Miller and Lents Ltd, our independent reservoir engineers, at 31 December 2017 and 2016.

		Changes in 2017			
(millions of BOE)	**31 December 2017**	**Production[1]**	**Extensions, discoveries and changes in structure**	**Revision of previous estimates**	**31 December 2016**
Western Siberia	8,384	(371)	208	(16)	8,563
Timan-Pechora	2,311	(131)	56	49	2,337
Ural region	2,196	(125)	83	23	2,215
Volga region	1,088	(84)	121	(22)	1,073
Other in Russia	179	(12)	9	–	182
Outside Russia	1,860	(105)	34	(97)	2,028
Proved oil and gas reserves	**16,018**	**(828)**	**511**	**(63)**	**16,398**
Probable oil and gas reserves	**6,409**				**6,684**
Possible oil and gas reserves	**3,087**				**2,981**

[1] Gas production shown before own consumption.

The Company's proved hydrocarbon reserves at 31 December 2017 amounted to 16,018 million BOE and comprised of 12,077 million barrels of crude oil and 23,649 billion cubic feet of gas.

The increase in proved reserves related to geological exploration and production drilling totaled 501 million BOE and was mostly related to the traditional regions of the Group's operations in Russia.

Western Siberia, the Company's main producing region, accounted for the largest reserves addition in the amount of 198 million barrels of oil equivalent. Further development of Russian offshore fields in the Caspian Sea ensured another significant addition of 100 million barrels of oil equivalent with 95 million barrels coming from the V. Filanovsky field where we started production in 2016.

Exploration and production

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

	Q4 2017	Q3 2017	12 months of 2017	12 months of 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 quarters of 2017 and in the amounts of 17,188 million RUB and 39,468 million RUB in 2017 and 2016, respectively.
(2) Excluding expenses at the West Qurna-2 field.

Our upstream EBITDA increased by 11.5%, compared to the third quarter of 2017, and by 9.3%, compared to 2016.

Despite lower crude oil production volumes as a result of temporary external limitations driven by the OPEC agreement, our EBITDA in Russia increased due to the increase in hydrocarbon prices and the export duty lag effect. The increase in share of high-margin volumes in our overall production mix also substantially contributed to the increase.

Outside Russia, EBITDA of the West Qurna-2 project decreased compared to 2016 as we were previously compensated for the most of costs we incurred during the field development stage and the project has since moved to production maintenance stage. Excluding West Qurna-2, our international upstream EBITDA increased by 69.5% due to higher average international hydrocarbon prices and positive production trends in our gas projects, as well as business optimization measures.

The following table summarizes our hydrocarbon production by major regions.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 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	14	17	19	21
outside Russia	37	35	37	37
Total share in equity affiliates	51	52	56	58
Total crude oil and natural gas liquids	**1,791**	**1,795**	**1,804**	**1,875**
Natural and petroleum gas[3]				
Consolidated subsidiaries				
Western Siberia	215	222	217	185
Timan-Pechora	34	34	35	34
Ural region	15	15	16	16
Volga region	26	22	23	28
Other in Russia	1	1	1	1
Total in Russia	291	294	292	264
Total outside Russia	218	156	159	123
Total consolidated subsidiaries	**509**	**450**	**451**	**387**
Share in equity affiliates				
in Russia	2	2	2	2
outside Russia	13	12	12	12
Total share in production of equity affiliates	15	14	14	14
Total natural and petroleum gas	**524**	**464**	**465**	**401**
Total daily hydrocarbon production	**2,315**	**2,259**	**2,269**	**2,276**

(1) Natural gas liquids produced at the Group gas processing plants in the amounts of 37 thousand BOE per day and 33 thousand BOE per day in the fourth and third quarters of 2017 and in the amounts of 36 thousand BOE per day and 27 thousand BOE per day in 2017 and 2016, respectively.

(2) Compensation oil that represented approximately 8.8% and 23.3% of production from the West Qurna-2 field in 2017 and 2016, respectively.

(3) Natural and petroleum gas production excluding flaring, reinjection, and usage at the Group's gas processing plants.

Crude oil production by major regions is presented in the table below.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Western Siberia	9,517	9,702	38,779	41,037
Timan-Pechora	4,033	3,983	15,837	17,150
Ural region	3,823	3,794	15,139	15,248
Volga region	2,571	2,431	9,554	6,939
Other in Russia	416	427	1,686	1,832
Crude oil produced in Russia	20 360	20,337	80,995	82,206
Iraq[1]	396	539	1,822	5,064
Other outside Russia	526	464	2,003	2,037
Crude oil produced outside Russia	922	1,003	3,825	7,101
Total crude oil produced by consolidated subsidiaries	**21,282**	**21,340**	**84,820**	**89,307**
Our share in crude oil produced by equity affiliates:				
in Russia	165	201	884	971
outside Russia	426	410	1,710	1,714
Total crude oil produced	**21,873**	**21,951**	**87,414**	**91,992**

[1] Compensation oil that represented approximately 8.8% and 23.3% of production from the West Qurna-2 field in 2017 and 2016, respectively.

The main oil producing region for the Company is Western Siberia where we produced 45.7% of our crude oil in 2017 (46.0% in 2016).

In October 2016, we started commercial production at two new major fields, the V. Filanovsky field in the Caspian Sea (Volga region) and the Pyakyakhinskoye field in the Bolshekhetskaya depression (Western Siberia). These fields have a major positive impact on our financial results due to high quality reserve base and tax incentives. In 2017, the Group produced 4,584 thousand tonnes of crude oil at the V. Filanovsky field and 1,531 thousand tonnes of liquids at the Pyakyakhinskoye field. In the fourth quarter of 2017, production from the V. Filanovsky field increased by 21% and production from the Pyakyakhinskoye field didn't change significantly, compared to the previos quarter.

The decrease in our production volumes in 2017 in Russia was mainly driven by a temporary external limitation due to an agreement of OPEC and some of the non-OPEC countries, including Russia, to cut production from October 2016 levels in order to stabilize the global crude oil market. We limited production in our traditional regions (Western Siberia, Timan-Pechora, Ural) by closing least-productive wells, wells with high water cut and high lifting costs. We also decreased a number of workover operations. Moreover, crude oil production in Timan-Pechora was affected by adverse weather conditions and temporary decrease in production from one of the fields as a result of a fire. At the same time, we continued ramping up production at the V. Filanovsky, Pyakyakhinskoye and other high-margin fields.

The decrease in our international production was a result of lower volumes of production from the West Qurna-2 oilfield in Iraq attributable to the Company. We were compensated for most of the costs incurred within the construction stage of the project and therefore were eligible for less volumes of compensation crude oil (for details see p. 18).

Gas production (excluding flaring, reinjected gas and gas used in production of natural gas liquids) by major regions is presented in the table below.

	Q4 2017	Q3 2017	12 months of 2017	2016
	(millions of cubic meters)			
Western Siberia	3,356	3,465	13,479	11,522
Timan-Pechora	538	533	2,166	2,127
Ural region	240	240	978	976
Volga region	414	350	1,425	1,748
Other in Russia	8	8	32	34
Gas produced in Russia	**4,556**	**4,596**	**18,080**	**16,407**
Gas produced outside Russia	3,413	2,445	9,885	7,654
Total gas produced by consolidated subsidiaries	**7,969**	**7,041**	**27,965**	**24,061**
Our share in gas produced by equity affiliates:				
in Russia	25	23	96	89
outside Russia	199	193	800	772
Total gas produced	**8,193**	**7,257**	**28,861**	**24,922**

Our major gas production region is Western Siberia (Bolshekhetskaya depression), where the major part of gas is produced from the Nakhodkinskoe field, which has been developed since 2005. In January 2017, we started gas production from our second field in Bolshekhetskaya depression, the Pyakyakhinskoye field, which substantially contributed to our overall gas production in Russia that increased by 10.2% compared to 2016. Natural gas production from Pyakyakhinskoe field amounted to 2,790 million cubic meters. Our international gas production (including our share in affiliates' production) increased by 26.8%, compared to 2016, as a result of commissioning of new gas treatment facilities within Gissar and Kandym projects in Uzbekistan.

West Qurna-2 project

The West Qurna-2 field in Iraq is one of the largest crude oil fields discovered in the world, with estimated recoverable oil reserves of 12.9 billion barrels (1.8 billion tonnes). Service agreement for the West Qurna-2 field development and production was signed on 31 January 2010. Currently, the parties of the project are Iraq's state-owned South Oil Company and a consortium of contractors, consisting of a Group company (75% interest) and Iraq's state-owned North Oil Company (25% interest).

The Group launched the "Mishrif Early Oil" stage on the field and reached the production of 120 thousand barrels per day in March 2014. According to the service agreement, starting from the second quarter of 2014, we receive cost compensation. The total term of the contract is 25 years.

Accounting for the cost compensation within the West Qurna-2 project in our consolidated statement of financial position and consolidated statement of profit or loss and other comprehensive income is as follows.

Capital expenditures are recognized in *Property, plant and equipment*. Extraction expenses are recognized in *Operating expenses* in respect of all the volume of crude oil production at the field regardless of the volume of compensation crude oil the Group is eligible for. As the compensation revenue is recognized, capitalized costs are amortized.

There are two steps of revenue recognition:

- The Iraqi party, on a quarterly basis, approves invoice for cost recovery and remuneration fee for which the Group is eligible in the reporting period. Amount of the invoice depends on crude oil production volumes during the period and amount of costs claimed for reimbursement. Approved invoice amount and remuneration fee for the reporting quarter are recognized in crude oil sales revenue.
- Based on the approved invoices, the Iraqi party arranges schedule of crude oil shipments against its liability for cost compensation and remuneration. As this crude oil is actually shipped, its cost is recognized at current market price in Cost of purchased crude oil, gas and products. Further, revenue from sales of this crude oil, or products from its refining, is recognized in *Sales*. Unsold crude oil and refined products are recognized in *Inventories*.

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	Crude oil received	Crude oil to be received
		(millions of US dollars)		
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)
Cost compensation	10,048	172	7,712	131
Remuneration fee	1,778	31	1,810	30
	11,826	203	9,522	161
Cost of compensation crude oil, received as liability settlement (included in *Cost of purchased crude oil, gas and products*)[2]	9,049	155	10,775	182
Extraction expenses	3,494	60	3,641	62
Depreciation, depletion and amortization	6,628	113	4,150	71
EBITDA	4,603	78	5,799	99

[1] Translated into barrels using conversion rate characterizing the density of oil at the field.
[2] This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

	12 months of 2017		12 months of 2016	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production	142,224	20,793	149,341	21,770
Production related to cost compensation and remuneration[1]	12,466	1,822	34,742	5,064
Shipment of compensation crude oil[1] [2]	11,854	1,733	61,005	8,893
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation	32,322	554	62,998	914
Remuneration fee	5,307	91	8,612	128
	37,629	645	71,610	1,042
Cost of compensation crude oil, received as liability settlement (included in *Cost of purchased crude oil, gas and products*)[2]	33,191	567	140,392	2,106
Extraction expenses	16,178	278	31,231	462
Depreciation, depletion and amortization	16,454	282	31,438	447
EBITDA	17,188	294	39,468	566

[1] Translated into barrels using conversion rate characterizing the density of oil at the field.
[2] This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

The decrease in volumes of crude oil production related to cost compensation and remuneration was due to compensation of the most part of costs incurred at the field development stage and approximately threefold decrease in remuneration fee in February-June 2017 due to a so-called performance factor that represents a ratio of actual production volumes to target production volumes according to the provisions of the service contract. The performance factor was not applied in the second half of 2017.

Refining, marketing and distribution

The following table summarizes key figures on our Refining, marketing and distribution segment:

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
EBITDA in Russia	39,267	62,565	195,479	162,447
EBITDA outside Russia	9,742	18,816	67,906	70,850
EBITDA	**49,009**	**81,381**	**263,385**	**233,297**
Refining expenses at the Group refineries	23,050	22,456	86,508	90,673
- in Russia	11,182	10,207	40,970	43,742
- outside Russia	11,868	12,249	45,538	46,931
	(ruble per tonne)			
Refining expenses at the Group refineries	1,333	1,294	1,287	1,373
- in Russia	1,003	927	950	1,048
- outside Russia	1,930	1,930	1,887	1,931
	(US dollar per tonne)			
Refining expenses at the Group refineries	22.82	21.92	22.04	20.57
- in Russia	17.18	15.71	16.28	15.74
- outside Russia	33.04	32.71	32.33	28.88

In Russia, our downstream EBITDA increased substantially compared to 2016 due to better product slate at our refineries, higher domestic prices, increased throughput volumes and decrease in refining expenses, as well as the expansion of our priority sales channels. Outside Russia, our EBITDA was affected by lower trading margins and the ruble appreciation that was offset by increased refining volumes and crude oil inventory effect at the refineries driven by increasing oil price trend.

Quarter on quarter, our EBITDA was affected by seasonal decrease in retail profitability in Russia, as well as by lower refining margins both in Russia and abroad, that was partially offset by the positive inventory effect of our refineries.

Refining and petrochemicals

The following table summarizes key figures for our refining and petrochemical volumes.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Refinery throughput at the Group refineries	17,294	17,356	67,240	66,061
- in Russia	11,144	11,010	43,107	41,752
- outside Russia, including	6,150	6,346	24,133	24,309
- crude oil	5,669	5,823	21,970	20,356
- refined products	481	523	2,163	3,953
Refinery throughput at third party refineries	1,803	1,670	6,547	744
Total refinery throughput	**19,097**	**19,026**	**73,787**	**66,805**
Production of the Group refineries in Russia[(1)]	**10,507**	**10,471**	**40,746**	**39,623**
- diesel fuel	4,109	4,070	15,757	12,889
- gasoline	2,066	2,198	8,143	7,773
- fuel oil	1,512	1,089	5,312	5,995
- jet fuel	723	803	2,744	2,188
- lubricants and components	291	321	1,163	1,015
- straight-run gasoline	602	482	2,192	1,900
- vacuum gas oil	11	72	586	2,806
- bitumen	177	293	888	801
- coke	233	277	982	905
- other products	783	866	2,979	3,351
Production of the Group refineries outside Russia	**5,812**	**5,984**	**22,745**	**22,720**
- diesel fuel	2,446	2,676	9,871	9,779
- gasoline	1,334	1,347	5,140	4,984
- fuel oil	795	560	2,973	3,215
- jet fuel	227	327	1,049	922
- straight-run gasoline	184	205	786	726
- coke	55	51	190	221
- other products	771	818	2,736	2,873
Refined products produced by the Group	**16,319**	**16,455**	**63,491**	**62,343**
Refined products produced at third party refineries	1,759	1,627	6,417	726
Total refined products produced	**18,078**	**18,082**	**69,908**	**63,069**
Products produced at petrochemical plants and facilities	**229**	**303**	**1,171**	**1,270**
- in Russia	142	204	798	895
- outside Russia	87	99	373	375

(1) Net of cross-supplies of refined products among the Group refineries in the amounts of 381 thousand tonnes and 444 thousand tonnes in the fourh and third quarters of 2017 and in the amounts of 1,702 thousand tonnes and 1,316 thousand tonnes in 2017 and 2016, respectively.

Compared to 2016, the total volume of refined products produced by the Group increased by 1.8%.

Production at our refineries in Russia increased by 2.8% largely as a result of the planned maintenance at our refineries in Nizhny Novgorod and Volgograd in 2016. In Russia, we continued improving our refined product slate by launching new conversion facilities and cross-supplies of own dark products to catalytic cracking units at our refineries in Nizhny Novgorod and Volgograd and to coking unit in Perm. As a result, the share of gasoline and diesel fuel in our total production volumes increased by 6.5 p.p. compared to 2016 and share of fuel oil and vacuum gasoil decreased by 7.7 p.p. Also, purchased additives were partially substituted with additives of own production that resulted in the optimization of operating expenses.

Internationally, production didn’t change significantly. At the same time, as a result of the change in price environment, the volume of crude oil processing increased by 7.9% while the volume of refined product processing decreased almost twofold.

In the periods considered, we processed our crude oil at third party refineries in Belarus and Kazakhstan. Moreover, at the end of 2016, a Group company entered into a tolling agreement with a Canadian refinery. In 2017, attributable refined products output amounted to 6.2 million tonnes. The agreement is valid through 2019.

Marketing and trading

In addition to our production, we purchase crude oil in Russia and on international markets. In Russia, we primarily purchase crude oil from affiliated producing companies and other producers. Then we either refine or export purchased crude oil. Crude oil purchased on international markets is normally used for trading activities, for supplying our international refineries or for processing at third party refineries.

In Russia, we purchase refined products on occasion, primarily to manage supply chain bottlenecks. Refined products purchases outside Russia are either traded or supplied to our international refineries.

We undertake trading operations on international markets through our 100% subsidiary LITASCO. We use traditional physical volumes hedging techniques to hedge our trading operations to secure trading margin.

The following table shows the volumes of crude oil purchases by the Group during the periods considered.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Crude oil purchases				
in Russia	215	236	962	849
for trading internationally	11,041	8,044	36,137	28,385
for refining internationally	5,873	5,799	22,527	15,213
Shipment of the West Qurna-2 compensation crude oil	430	572	1,733	8,893
Total crude oil purchased	**17,559**	**14,651**	**61,359**	**53,340**

The table below summarizes figures for our refined products marketing and trading activities.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Retail sales	3,612	3,820	14,238	14,193
Wholesale sales	27,899	28,820	114,283	107,429
Total refined products sales	**31,511**	**32,640**	**128,521**	**121,622**
Refined products purchased in Russia	310	386	1,645	1,667
Refined products purchased internationally	13,758	13,715	58,367	61,640
Total refined products purchased	**14,068**	**14,101**	**60,012**	**63,307**

In 2016, in order to optimize our downstream operations, a Group company sold distribution companies operating in Poland, Lithuania, Latvia and Cyprus.

Exports of crude oil and refined products from Russia. The volumes of crude oil and refined products exported from Russia by our subsidiaries and export revenues (both to the Group companies and third parties) are summarized as follows:

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Exports of crude oil to Customs Union	683	695	2,807	3,007
Exports of crude oil beyond Customs Union	8,194	8,359	33,779	30,899
Total crude oil exports	**8,877**	**9,054**	**36,586**	**33,906**
Exports of crude oil through Transneft and other third party infrastructure	6,596	6,699	27,329	25,865
including volumes exported through ESPO pipeline	300	300	1,140	1,215
Exports of crude oil through the Group's transportation infrastructure	2,281	2,355	9,257	8,041
Total crude oil exports	**8,877**	**9,054**	**36,586**	**33,906**
	(millions of rubles)			
Exports of crude oil to Customs Union	13,707	11,699	48,017	44,117
Exports of crude oil beyond Customs Union	205,272	176,781	730,049	581,138
Total crude oil exports	**218,979**	**188,480**	**778,066**	**625,255**

	Q4	Q3	12 months of	
	2017	**2017**	**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	**4,417**	**3,787**	**17,524**	**18,741**
	(millions of rubles)			
Total refined products exports	**131,060**	**98,199**	**447,957**	**384,819**

In 2017, the volume of our crude oil exports from Russia increased by 7.9%, and we exported 45.2% of our domestic crude oil production (41.2% in 2016) and 366 thousand tonnes of crude oil purchased from our affiliates and third parties (458 thousand tonnes in 2016). The increase in export volumes was a result of lower domestic sales. The volume of our refined products exports decreased by 6.5% compared to 2016 following the increase in domestic sales due to higher profitability of the domestic market.

Substantially, we use the Transneft infrastructure to export our crude oil. Nevertheless, a sizeable amount of crude oil is exported through our own infrastructure. All the volume of crude oil exported that bypassed Transneft was routed beyond the Customs Union.

Besides our own infrastructure, we also export the light crude oil through the Caspian Pipeline Consortium and Eastern Siberia – Pacific Ocean pipelines that allows us to preserve the premium quality of crude oil and thus enables us to achieve higher netbacks compared to traditional exports.

Priority sales channels. We develop our priority sales channels aiming at increasing our margin on sale of refined products produced by the Group.

In 2017, we sold 10 million tonnes of motor fuels via our domestic retail network, that represented an increase of 1.8% against 2016. Outside Russia, retail sales decreased to 4 million tonnes, or by 3.2%, mostly as a result of divestment of our retail networks in Poland, the Baltic states and Cyprus.

We also supply jet fuel to airports and bunker fuel to sea and river ports in and outside Russia.

Power generation. We established a vertically integrated chain from generation to transportation and sale of power and heat for third party customers (commercial generation) and own consumption. We own commercial generation facilities in the Southern regions of European Russia. We also own renewable energy capacity in Russia and abroad. In 2017, our total output of commercial electrical energy was 17.6 billion kWh (18.3 billion kWh in 2016), and our total output of commercial heat energy was approximately 10.7 million Gcal (12.4 million Gcal in 2016).

Financial results

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

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Revenues				
Sales (including excise and export tariffs)	1,662,452	1,483,484	5,936,705	5,227,045
Costs and other deductions				
Operating expenses	(118,091)	(120,608)	(456,765)	(456,433)
Cost of purchased crude oil, gas and products	(903,181)	(782,950)	(3,129,864)	(2,609,764)
Transportation expenses	(68,582)	(62,980)	(272,792)	(299,017)
Selling, general and administrative expenses	(46,928)	(42,872)	(165,331)	(196,156)
Depreciation, depletion and amortization	(76,198)	(83,920)	(325,054)	(311,588)
Taxes other than income taxes	(171,922)	(135,266)	(606,510)	(443,338)
Excise and export tariffs	(119,930)	(116,820)	(461,525)	(483,313)
Exploration expenses	(10,083)	(842)	(12,348)	(8,293)
Profit from operating activities	**147,537**	**137,226**	**506,516**	**419,143**
Finance income	5,489	3,261	15,151	14,756
Finance costs	(5,169)	(5,925)	(27,331)	(47,030)
Equity share in income of affiliates	5,194	3,985	16,864	7,967
Foreign exchange gain (loss)	5,201	(9,441)	(19,948)	(111,976)
Other (expenses) income	(11,672)	(737)	32,932	(10,345)
Profit before income taxes	**146,580**	**128,369**	**524,184**	**272,515**
Current income taxes	(24,880)	(30,157)	(99,976)	(58,170)
Deferred income taxes	(541)	(427)	(3,786)	(6,703)
Total income tax expense	**(25,421)**	**(30,584)**	**(103,762)**	**(64,873)**
Profit for the period	**121,159**	**97,785**	**420,422**	**207,642**
Profit for the period attributable to non-controlling interests	(649)	(444)	(1,617)	(848)
Profit for the period attributable to PJSC LUKOIL shareholders	**120,510**	**97,341**	**418,805**	**206,794**
Basic and diluted earnings per share of common stock attributable to PJSC LUKOIL shareholders (in Russian rubles)	169.82	137.17	589.14	290.06

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

Sales revenues

Sales breakdown	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Crude oil				
Export and sales on international markets other than Customs Union	485,460	348,206	1,556,811	1,238,836
Export and sales to Customs Union	13,216	11,473	46,798	42,888
Domestic sales	9,583	9,930	37,525	94,985
	508,259	**369,609**	**1,641,134**	**1,376,709**
Cost compensation and remuneration at the West Qurna-2 project	11,826	9,522	37,629	71,610
	520,085	**379,131**	**1,678,763**	**1,448,319**
Refined products(1)				
Export and sales on international markets				
Wholesale	769,886	725,931	2,863,379	2,512,261
Retail	75,494	76,253	280,847	305,797
Domestic sales				
Wholesale	102,898	104,882	360,182	251,109
Retail	106,491	114,026	415,820	383,217
	1,054,769	**1,021,092**	**3,920,228**	**3,452,384**
Petrochemicals				
Export and sales on international markets	12,380	10,345	48,187	34,711
Domestic sales	5,899	9,445	34,451	38,092
	18,279	**19,790**	**82,638**	**72,803**
Gas				
Sales on international markets	17,962	14,468	54,611	33,663
Domestic sales	8,390	7,788	31,109	27,030
	26,352	**22,256**	**85,720**	**60,693**
Sales of energy and related services				
Sales on international markets	3,735	3,558	12,884	14,178
Domestic sales	16,115	12,725	61,028	61,920
	19,850	**16,283**	**73,912**	**76,098**
Other				
Export and sales on international markets	11,621	12,381	49,717	69,881
Domestic sales	11,496	12,551	45,727	46,867
	23,117	**24,932**	**95,444**	**116,748**
Total sales	**1,662,452**	**1,483,484**	**5,936,705**	**5,227,045**

Sales volumes	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(thousands of tonnes)			
Crude oil				
Export and sales on international markets other than Customs Union	18,719	15,626	67,935	62,318
Export and sales to Customs Union	658	680	2,741	2,942
Domestic sales	492	607	2,294	7,124
	19,869	**16,913**	**72,970**	**72,384**
Crude oil volumes related to cost compensation and remuneration at the West Qurna-2 project	396	539	1,822	5,064
	20,265	**17,452**	**74,792**	**77,448**
Refined products(1)				
Export and sales on international markets				
Wholesale	23,822	24,605	99,544	95,571
Retail	1,052	1,104	4,155	4,293
Domestic sales				
Wholesale	4,077	4,215	14,739	11,858
Retail	2,560	2,716	10,083	9,900
	31,511	**32,640**	**128,521**	**121,622**
Petrochemicals				
Export and sales on international markets	252	213	949	747
Domestic sales	116	206	699	730
	368	**419**	**1,648**	**1,477**
Total sales volumes	**52,144**	**50,511**	**204,961**	**200,547**

(1) Including revenue from, and volumes of, gas refined products sales.

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/barrel)	2,657	2,232	2,232	1,819
Refined products					
Wholesale	(RUB/tonne)	25,239	24,883	24,437	21,176
Retail	(RUB/tonne)	41,598	41,983	41,240	38,709
Petrochemicals	(RUB/tonne)	50,853	45,850	49,286	52,181

(1) Excluding cost compensation and remuneration at the West Qurna-2 project.

During the fourth quarter of 2017, our revenues increased by 179 billion RUB, or by 12.1%, compared to the third quarter of 2017. Our revenues from crude oil sales increased by 141 billion RUB, or by 37.2%, and our revenues from sales of refined products increased by 34 billion RUB, or by 3.3%. The main reasons for that were the increase in international hydrocarbon prices and the increase in crude oil trading volumes.

In 2017, our revenues increased by 710 billion RUB, or by 13.6%, compared to 2016. Our revenues from crude oil sales increased by 230 billion RUB, or by 15.9%, and our revenues from sales of refined products increased by 468 billion RUB, or by 13.6%, largely, as a result of the increase in hydrocarbon prices which was partially offset by the effect of the ruble appreciation on our revenues denominated in other currencies.

Sales of crude oil

Compared to the third quarter of 2017, our international crude oil sales revenue increased by 39.4%, or by 137 billion RUB. Our international sales volumes (beyond the Customs Union) increased by 3,093 thousand tonnes, or by 19.8%, due to higher volumes of crude oil trading. Our average international ruble realized prices increased by 16.4%. In the fourth quarter of 2017, our realized domestic crude oil sales price increased by 19.0%, and our domestic sales volumes decreased by 115 thousand tonnes, or by 18.9%. As a consequence, our domestic sales revenue decreased by 3.5%, or by 0.3 billion RUB.

Compared to 2016, our international crude oil sales revenue increased by 25.7%, or by 318 billion RUB. In 2017, our international sales volumes (beyond the Customs Union) increased by 5,617 thousand tonnes, or by 9.0%, due to higher volumes of exports from Russia and trading. Our average international ruble realized prices increased by 15.3%. Our realized domestic crude oil sales price increased by 22.7%, compared to 2016, and our domestic sales volumes decreased by 4,830 thousand tonnes, or by 67.8%, in favor of export deliveries and refining and also as a result of lower production. As a consequence, in 2017, our domestic sales revenue decreased by 60.5%, or by 57 billion RUB.

Cost compensation and remuneration at the West Qurna-2 project

Included in Group's revenue is the cost compensation and remuneration fee related to the West Qurna-2 project in Iraq.

During the fourth quarter of 2017, the amount of cost compensation and remuneration fee increased by 2 billion RUB, or by 24.2%, compared to the third quarter of 2017.

At the same time, in 2017, the volumes of crude oil related to cost compensation and remuneration fee significantly decreased compared to 2016. Therefore the amount of cost compensation and remuneration fee decreased by 34 billion RUB, or by 47.5%. For details see p. 18.

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 fourth quarter of 2017 as a result of an increase in gas production and by 25 billion RUB, or by 41.2%, in 2017 also as a result of an increase in production and higher realized prices.

The increase in revenue from sales of gas mostly related to our operations outside of Russia and was a result of commissioning of new gas treatment facilities within Gissar and Kandym projects in Uzbekistan.

Sales of energy and related services

Compared to the third quarter of 2017, our revenue from sales of energy and related services increased by 4 billion RUB, or by 21.9%, due to a seasolnal factor.

In 2017, our revenue from sales of energy and related services decreased by 2 billion RUB, or by 2.9%.

Other sales

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.

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	Q3	12 months of	
	2017	**2017**	**2017**	**2016**
		(millions of rubles)		
Hydrocarbon extraction expenses[1]	51,300	48,515	192,781	180,223
Extraction expenses at the West Qurna-2 field	3,494	3,641	16,178	31,231
Own refining expenses	23,050	22,456	86,508	90,673
Refining expenses at third-party refineries	5,168	7,223	15,403	1,959
Expenses for crude oil transportation to refineries	12,473	12,896	48,754	46,349
Power generation and distribution expenses	10,143	9,204	39,046	39,406
Petrochemical expenses	3,180	2,987	12,081	12,758
Other operating expenses	9,283	13,686	46,014	53,834
Total operating expenses	**118,091**	**120,608**	**456,765**	**456,433**

(1) Excluding extraction expenses at the West Qurna-2 field.

The method of allocation of operating expenses above differs from the approach used in preparing data for Note 32 “Segment information” to our consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

Compared to the third quarter of 2017, our operating expenses decreased by 3 billion RUB, or by 2.1%. Seasonal increase in hydrocarbon extraction expenses, own refining expenses and power generation expenses was offset by the decrease in refining expenses at third-party refineries and other operating expenses.

In 2017, our operating expenses remained at the same level as in 2016. The effect of the ruble appreciation to US dollar and Euro on the ruble value of foreign subsidiaries’ expenses and the decrease in expenses at the West Qurna-2 oilfield were offset by the increase in hydrocarbon extraction expenses and refining expenses at third parties refineries.

Hydrocarbon extraction expenses

Our extraction expenses include expenditures related to repairs of extraction equipment, labor costs, expenses on artificial stimulation of reservoirs, fuel and electricity costs, cost of extraction of natural gas liquids, property insurance of extraction equipment and other similar costs.

	Q4	Q3	12 months of	
	2017	**2017**	**2017**	**2016**
		(millions of rubles)		
Hydrocarbon extraction expenses[1]	51,300	48,515	192,781	180,223
- in Russia	46,311	43,978	177,554	165,641
- outside Russia[1]	4,989	4,537	15,227	14,582
		(ruble per BOE)		
Hydrocarbon extraction expenses[1]	251	245	244	233
- in Russia	257	245	248	233
- outside Russia[1]	205	250	204	237

(1) Excluding expenses at the West Qurna-2 field.

Our extraction expenses increased by 3 billion RUB, or by 5.7%, in the fourth quarter of 2017 and by 13 billion RUB, or by 7.0%, in 2017.

In Russia, average hydrocarbon extraction expenses increased driven by higher energy costs, costs of materials and services, as well as shift to more costly project benefiting from tax exemptions.

The increase in extraction expenses outside Russia was mainly a result of launching new production facilities as part of the Gissar and Kandym project in Uzbekistan. At the same time, per BOE expenses significantly decreased due to sizeable contribution of gas to overall hydrocarbon production increase outside Russia.

Crude oil extraction expenses at the West Qurna-2 field

Crude oil extraction expenses at the West Qurna-2 field represent expenses related to 100% production from the field, while we are only eligible for a share of production that compensates our historically incurred costs and expenses. For details see p. 18.

The decrease in expenses in 2017 was a result of completion of commissioning stage of the field development and consecutive decrease in personnel involved and associated transportation, security and other related services provided. Quarter on quarter, expenses were relatively flat.

Own refining expense

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Refining expenses at the Group refineries	23,050	22,456	86,508	90,673
- in Russia	11,182	10,207	40,970	43,742
- outside Russia	11,868	12,249	45,538	46,931
	(ruble per tonne)			
Refining expenses at the Group refineries	1,333	1,294	1,287	1,373
- in Russia	1,003	927	950	1,048
- outside Russia	1,930	1,930	1,887	1,931

Our own refining expenses increased by 1 billion RUB, or by 2.6%, during the fourth quarter of 2017 and decreased by 4 billion RUB, or by 4.6%, in 2017.

Despite the inflation, refining expenses at our domestic refineries decreased year on year as a result of consumption of additives of own production following our refineries' upgrade and lower overhaul costs. Quarter on quarter, the growth was owing to seasonal increase in energy consumption and higher consumption of additives.

Outside Russia, our refining expenses decreased following the ruble appreciation.

Refining expenses at third-party refineries

Along with our own production of refined products we refine crude oil at third-party refineries.

At the end of 2016, as part of our trading business development, a Group company entered into a 3-year tolling agreement with a Canadian refinery. Related refining expenses represent variable toll that is mostly the difference between the price of feedstocks supplied, including various related costs, and the selling price of the refined products taken. In 2017, this tolling fee amounted to 15 billion RUB. When the refined products are sold, this toll is naturally offset by the respective refined products sales revenue. The agreed compensation is received by the Group company for execution of this agreement.

Expenses for crude oil transportation to refineries

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

During the fourth quarter of 2017, our expenses for crude oil transportation to refineries didn't change significantly, compared to the previous quarter.

In 2017, as a result of the increase in volumes of own crude oil supplies to our refineries outside Russia, our expenses for crude oil transportation to refineries increased by 2 billion RUB, or by 5.2%, compared to 2016.

Petrochemical expenses

In the fourth quarter of 2017, our petrochemical expenses increased by 6.5% due to planned repairs at our petrochemical plant in Stavropol region of Russia.

In 2017, our petrochemical expenses went down by 5.3%, largely as a result of the effect of the ruble appreciation.

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 services provided and goods sold by our production and marketing companies, and of non-core businesses of the Group.

In the fourth quarter of 2017, other operating expenses decreased by 4.4 billion RUB, or by 32.2%, largely as a result of a seasonal decrease in cost of non-petrol goods sold, and services provided, by our retail network.

Compared to 2016, other operating expenses decreased by 8 billion RUB, or by 14.5%, largely as a result of the decreased cost of transportation services provided to third parties and the decrease in the ruble value of other operating expenses of our foreign subsidiaries. This decrease also reflects the effect from sale of our diamond business in the middle of 2017.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products includes the cost of crude oil and refined products purchased for trading or refining, gas and fuel oil to supply our power generation entities and the result of hedging of crude oil and refined products sales.

	Q4	Q3	12 months of	
	2017	2017	2017	2016
		(millions of rubles)		
Cost of purchased crude oil in Russia	4,446	4,071	16,896	12,046
Cost of purchased crude oil outside Russia	432,095	302,990	1,314,764	869,090
Compensation crude oil related to West Qurna-2 project	9,049	10,775	33,191	140,392
Cost of purchased crude oil	**445,590**	**317,836**	**1,364,851**	**1,021,528**
Cost of purchased refined products in Russia	10,339	12,530	50,392	45,435
Cost of purchased refined products outside Russia	442,466	400,036	1,659,961	1,569,366
Cost of purchased refined products	**452,805**	**412,566**	**1,710,353**	**1,614,801**
Other purchases	14,600	7,176	41,635	29,107
Net loss from hedging of trading operations	29,789	23,727	15,909	60,487
Change in crude oil and petroleum products inventory	(39,603)	21,645	(2,884)	(116,159)
Total cost of purchased crude oil, gas and products	**903,181**	**782,950**	**3,129,864**	**2,609,764**

In the fourth quarter of 2017, the cost of purchased crude oil, gas and products increased by 120 billion RUB, or by 15.4%, largely as a result of the increase in volumes of crude oil trading and hydrocarbon prices.

In 2017, the cost of purchased crude oil, gas and products increased by 520 billion RUB, or by 19.9%, following the increase in hydrocarbon prices and volumes of crude oil trading. Crude oil purchases in 2017 also included 33 billion RUB related to 1,733 thousand tonnes of compensation crude oil received from Iraq's state-owned South Oil Company within the West Qurna-2 project (140 billion RUB related to 8,893 thousand tonnes of compensation crude oil in 2016).

Transportation expenses

	Q4	Q3	12 months of	
	2017	2017	2017	2016
		(millions of rubles)		
Crude oil transportation expenses	25,271	19,891	91,635	91,628
Refined products transportation expenses	39,874	37,941	163,170	189,405
Other transportation expenses	3,437	5,148	17,987	17,984
Total transportation expenses	**68,582**	**62,980**	**272,792**	**299,017**

Our transportation expenses increased by 6 billion RUB, or by 8.9%, in the fourth quarter of 2017 and decreased by 26 billion RUB, or by 8.8%, in 2017.

In the fourth quarter of 2017, our expenses for transportation of crude oil increased by 5 billion RUB as a result of the increase in sales volumes and changes in delivery terms abroad, while expenses in Russia didn't change significantly. Our expenses for transportation of refined products increased by 2 billion RUB as the decrease in expenses abroad was outweighed by the expenses growth in Russia.

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, general and administrative expenses include payroll costs (excluding extraction entities', refineries' and power generation entities' production staff costs), 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	98,937	101,887
Increase in liability related to share-based compensation program	810	3,043	1,135	20,370
Expenses (income) on provision for doubtful debts	3,515	(155)	6,139	6,401
Total selling, general and administrative expenses	**46,928**	**42,872**	**165,331**	**196,156**

Our selling, general and administrative expenses increased by 4 billion RUB, or by 9.5%, in the fourth quarter of 2017, compared to the previous quarter. In 2017, our selling, general and administrative expenses decreased by 31 billion RUB, or by 15.7%.

In Russia, expenses decreased mostly as a result of lower accruals within share-based compensation program due to LUKOIL share price fluctuations. Our expenses outside Russia decreased largely as a result of the effect of the ruble appreciation on the expenses of our foreign subsidiaries along with the restructuring of our international upstream business sector and the divestment of retail networks in Poland, Lithuania, Latvia and Cyprus.

Depreciation, depletion and amortization

Compared to the third quarter of 2017, our depreciation, depletion and amortization expenses decreased by 8 billion RUB, or by 9.2%, largely due to a decrease of depreciation rate at Group's certain fields as a result of positive revision of respective hydrocarbon reserves.

Year-on-year, depreciation, depletion and amortization expenses increased by 13 billion RUB, or by 4.3%, compared to 2016, resulting from the increase in value of depreciable assets. This was partially offset by the decrease in expenses related to the West Qurna-2 project. Our depreciation, depletion and amortization expenses for 2017 included 16 billion RUB related to the West Qurna-2 field, compared to 31 billion RUB in 2016.

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, an exploration and production company, operating in Kazakhstan, Bashneft-Polus, an exploration and production company that develops the Trebs and Titov oilfelds in Timan-Pechora, Russia, South Caucasus Pipeline Company and Caspian Pipeline Consortium, midstream companies in Azerbaijan and Kazakhstan.

Our share in income of affiliates increased by 1 billion RUB compared to the third quarter of 2017 and increased by 9 billion RUB compared to 2016, largely, as a result of the increase in income of Tengizchevroil.

Taxes other than income taxes

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
In Russia				
Mineral extraction taxes	152,463	121,084	544,586	388,835
Social security taxes and contributions	9,469	6,421	29,178	22,863
Property tax	5,817	4,882	20,308	18,437
Other taxes	1,121	650	2,998	2,402
Total in Russia	**168,870**	**133,037**	**597,070**	**432,537**
International				
Social security taxes and contributions	2,246	1,416	6,210	6,016
Property tax	295	209	910	1,122
Other taxes	511	604	2,320	3,663
Total internationally	**3,052**	**2,229**	**9,440**	**10,801**
Total taxes other than income taxes	**171,922**	**135,266**	**606,510**	**443,338**

Our taxes other than income taxes increased by 37 billion RUB, or by 27.1%, quarter on quarter and by 163 billion RUB, or by 36.8%, year-on-year. This was driven by the increase in the mineral extraction tax rate in Russia resulting from the increase in crude oil prices. The year-on-year increase was amplified by an increase in mineral extraction tax base rate.

The following table summarizes data on application of reduced and zero mineral extraction tax rates for crude oil and natural gas produced in Russia (excluding V. Filanovsky field).

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Decrease in extraction taxes from application of reduced and zero rates for crude oil and gas production	20,886	19,260	75,714	59,527
	(thousands of tonnes)			
Volume of crude oil production subject to:				
zero rates	357	326	1,147	977
reduced rates (tax holidays for specific regions and high viscosity oil)	1,304	1,368	5,439	4,854
reduced rates (depleted fields)	3,687	3,511	14,332	14,202
reduced rates (other)	624	865	3,111	3,480
Total volume of production subject to reduced or zero rates	**5,972**	**6,070**	**24,029**	**23,513**

Excise and export tariffs

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
In Russia				
Excise tax on refined products	30,676	33,576	119,152	95,692
Crude oil export tariffs	35,394	29,419	137,379	136,126
Refined products export tariffs	10,616	7,008	41,367	54,444
Total in Russia	**76,686**	**70,003**	**297,898**	**286,262**
International				
Excise tax and sales taxes on refined products	43,147	46,724	163,162	196,484
Crude oil export tariffs	16	9	134	81
Refined products export tariffs	81	84	331	486
Total internationally	**43,244**	**46,817**	**163,627**	**197,051**
Total excise and export tariffs	**119,930**	**116,820**	**461,525**	**483,313**

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%. The decrease was mostly a result of lower export duty rates for refined products. Compared to 2016, the volumes of crude oil export beyond the Customs Union increased by 9.3% and the volumes of refined products exports decreased by 6.5%. The increase in excise tax expenses in Russia was driven by increase in rates and domestic sales volumes, while international excise expenses decreased due to the ruble appreciation and divestment of retail networks in Eastern Europe.

Foreign exchange gain (loss)

Foreign exchange gains or losses are mostly related to revaluation of US dollar and euro net monetary position of Russian entities that largely consists of accounts receivables, loans to our foreign subsidiaries and loans received in other currencies, and it's current structure results in exchange gains when the ruble devaluates and losses when it appreciates to that currencies. Nevertheless, in the fourth quarter of 2017, the Company's US dollar net monetary position significantly decreased as a result of the change in the structure of intra-group financing.

During the fourth quarter of 2017, foreign exchange gain amounted to 5 billion RUB compared to foreign exchange loss of 9 billion RUB in the previous quarter.

In 2017, foreign exchange loss amounted to 20 billion RUB compared to 112 billion RUB loss in 2016.

Other (expenses) income

Other (expenses) income include the financial effects of disposals of assets, impairment losses, extraordinary gains and losses, revisions of estimates and other non-operating gains and losses.

As a result of the test, during 2017, the Group recognized an impairment loss for its exploration and production assets in Russia in the amount of 20.9 billion RUB and for its refining, marketing and distribution assets in Russia in the amount of 2.2 billion RUB.

In 2017, the Group recognized an impairment reversal in the amount of 22.2 billion RUB, which was a result of improvement of economic parameters of some of our production projects in Western Siberia and European Russia.

In 2017, we recognized a profit before income tax from sale of our diamond business in the amount of 48 billion RUB (38 billion RUB after income tax). Moreover, in 2017, we received $74 million (approximately 4.3 billion RUB) as a repayment of previously impaired receivable related to our international upstream project.

As a result of the test, during 2016, the Group recognised an impairment loss for its exploration and production assets in Russia in the amount of 5.7 billion RUB, for its international exploration and production assets in the amount of 1.9 billion RUB and for its refining, marketing and distribution assets in the amount of 1.2 billion RUB.

Income taxes

The maximum statutory income tax rate in Russia is 20%. Nevertheless, the actual effective income tax rate may be higher due to non-deductible expenses or lower due to certain non-taxable gains.

In the fourth quarter of 2017, our total income tax expense didn't change significantly as compared to the third quarter of 2017. At the same time, our profit before income tax increased by 18 billion RUB, or by 14.2%. In the fourth quarter of 2017, our effective income tax rate was 17.3%, compared to 23.8% in the third quarter of 2017.

In 2017, our total income tax expense increased by 39 billion RUB, or by 59.9%, compared to 2016. At the same time, our profit before income tax increased by 252 billion RUB, or by 92.4%. In 2017, our effective income tax rate was 19.8%, compared to 23.8% in 2016.

The effective income tax rate decrease compared to the third quarter of 2017 and to the year 2016 was generally due to recalculation of the Group's deferred tax liabitities in Russia as a result of reassessment of the amounts of incentives subject to regional income tax rates.

Non-GAAP items reconciliation

Reconciliation of profit for the period to EBITDA

EBITDA is not defined under IFRS. We define EBITDA as profit from operating activities before depreciation, depletion and amortization. We believe that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to raise and service debt. EBITDA should not be considered in isolation as an alternative to profit or any other measure of performance under IFRS.

	Q4	Q3	12 months of	
	2017	**2017**	**2017**	**2016**
		(millions of rubles)		
Profit for the period	**121,159**	**97,785**	**420,422**	**207,642**
Add back				
Income tax expense	25,421	30,584	103,762	64,873
Financial income	(5,489)	(3,261)	(15,151)	(14,756)
Financial costs	5,169	5,925	27,331	47,030
Foreign exchange (gain) loss	(5,201)	9,441	19,948	111,976
Equity share in income of affiliates	(5,194)	(3,985)	(16,864)	(7,967)
Other expenses (income)	11,672	737	(32,932)	10,345
Depreciation, depletion and amortization	76,198	83,920	325,054	311,588
EBITDA	**223,735**	**221,146**	**831,570**	**730,731**
EBITDA by operating segments				
Exploration and production	172,961	155,092	569,417	521,190
- in Russia	149,816	133,637	491,191	445,716
- outside Russia[1]	23,145	21,455	78,226	75,474
Refining, marketing and distribution segment	49,009	81,381	263,385	233,297
- in Russia	39,267	62,565	195,479	162,447
- outside Russia	9,742	18,816	67,906	70,850
Corporate and other	5,696	(6,075)	1,028	(18,271)
Elimination	(3,931)	(9,252)	(2,260)	(5,485)
EBITDA	**223,735**	**221,146**	**831,570**	**730,731**

[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 quarter and third quarter of 2017 and in the amounts of 17,188 million RUB and 39,468 million RUB in 2017 and 2016, respectively.

Reconciliation of Cash provided by operating activities to Free cash flow

	Q4	Q3	12 months of	
	2017	**2017**	**2017**	**2016**
		(millions of rubles)		
Net cash provided by operating activities	211,024	209,565	758,490	752,247
Capital expenditures	(137,726)	(118,902)	(511,496)	(497,130)
Free cash flow	**73,298**	**90,663**	**246,994**	**255,117**

Non-recurring losses and gains

As a result of impairment tests in 2017 and 2016, the Group recognized losses on assets impairment. At the same time, due to an improvement in economic parameters of some of our projects, in 2017, the Group reversed significant impairment losses recognized in prior periods. Moreover, in 2017, we recognized a profit before income tax from sale of our diamond business in the amount of 48 billion RUB (38 billion RUB after income tax).

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
	(millions of rubles)	
Impairment losses included in *Other expense*		
Impairment losses in Exploration and Production segment	(20,886)	(7,632)
Impairment losses in Refining, Marketing and Distribution segment	(2,241)	(1,172)
Other impairments	(8,259)	(667)
Total impairment losses in *Other expense*	(31,386)	(9,471)
Impairment reversal included in *Other income*		
in Exploration and Production segment	22,202	–
in Refining, Marketing and Distribution segment	–	891
Other reversals	6,246	–
Total reversals of impairment of assets in *Other income*	28,448	891
Profit from sale of our diamond business in *Other income*	47,575	–
Total non-recurring gains (losses)	**44,637**	**(8,580)**
Income tax effect	(9,262)	1,150
Total after tax non-recurring gains (losses)	**35,375**	**(7,430)**

Liquidity and capital resources

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Net cash provided by operating activities	211,024	209,565	758,490	752,247
including (increase) decrease in working capital	(4,585)	6,828	(24,983)	50,231
Net cash used in investing activities	(141,970)	(121,430)	(433,286)	(500,343)
Net cash used in financing activities	(31,210)	(91,393)	(247,395)	(193,134)

Operating activities

Our primary source of cash flow is funds generated from our operations. In 2017, cash generated from operations increased by 6 billion RUB, or by 0.8%, compared to 2016. Our cash flow from operating activities was significantly affected by the increase in working capital. Net of working capital changes, our net cash provided by operating activities increased by 11.6% compared to 2016. The negative trend in the working capital was a result of the decrease in receivables related to the West Qurna-2 project in 2016 due to costs reimbursement.

Investing activities

In 2017, the amount of cash used in investing activities decreased by 67 billion RUB, or by 13.4%. This decrease was mostly a result of proceeds from sale of our diamond business in the amount of 81 billion RUB.

At the same time, in 2017, our capital expenditures increased by 14 billion RUB, or by 2.9%, compared to 2016.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Capital expenditures				
Exploration and production				
Western Siberia	32,334	30,771	132,170	115,152
Timan-Pechora	19,048	17,352	77,079	83,870
Ural region	9,981	7,312	31,449	26,668
Volga region	17,098	16,335	60,832	50,060
Other in Russia	4,691	2,977	13,944	8,015
Total in Russia	83,152	74,747	315,474	283,765
Iraq	5,249	3,142	15,978	31,845
Other outside Russia	21,205	26,149	112,182	111,841
Total outside Russia	26,454	29,291	128,160	143,686
Total exploration and production	**109,606**	**104,038**	**443,634**	**427,451**
Refining, marketing and distribution				
Russia	22,263	10,830	50,293	51,588
- refining	10,022	5,074	25,220	32,624
- retail	6,581	1,950	10,677	6,888
- other	5,660	3,806	14,396	12,076
International	5,374	3,847	16,134	16,547
- refining	2,728	2,540	9,840	9,814
- retail	1,898	1,529	5,490	5,383
- other	748	(222)	804	1,350
Total refining, marketing and distribution	**27,637**	**14,677**	**66,427**	**68,135**
Corporate and other	**483**	**187**	**1,435**	**1,544**
Total capital expenditures	**137,726**	**118,902**	**511,496**	**497,130**

In 2017, our capital expenditures in the exploration and production segment increased by 16 billion RUB, or by 3.8%. In Western Siberia, we increased production drilling. The increase in capital expenditures in Volga region was a result of continuing development of Yu. Korchagin and V. Filanovsky fields, and the decrease in capital expenditures in Timan-Pechora was due to completion of another stage of Yaregskoe field development. Outside Russia, higher investments in Uzbekistan projects were partially offset by lower capital expenditures in other upstream projects.

The decrease in capital expenditures in the domestic refining, marketing and distribution segment was due to completion of upgrades at our refineries.

The table below presents our exploration and production capital expenditures in new promising oil regions.

	Q4 2017	Q3 2017	12 months of 2017	12 months of 2016
	(millions of rubles)			
Western Siberia (Yamal)	4,420	2,732	15,723	24,453
Caspian region (Projects in Russia)	14,655	15,615	55,932	41,422
Timan-Pechora (Yaregkoye field)	4,863	4,077	14,764	24,180
Iraq (West Qurna-2 project)	4,430	2,796	14,184	27,490
Iraq (Block-10)	819	346	1,794	4,355
Uzbekistan	14,351	19,113	84,025	65,780
Total	**43,538**	**44,679**	**186,422**	**187,620**

Financing activities

In 2017, net movements of short-term and long-term debt generated an outflow of 58 billion RUB, compared to an outflow of 12 billion RUB in 2016.

Credit rating

Standard & Poor's Ratings Services set the Company's long-term corporate credit rating and all debt ratings to BBB.

Moody's set the Company's long-term corporate family rating and long-term issuer rating to Baa3.

Fitch Ratings set the Company's long-term issuer default rating to BBB+.

Debt maturity

The following table displays the breakdown of our total debt obligation by maturity dates.

	Total	2018	2019	2020	2021	2022	After
	(millions of rubles)						
Short term debt	18,669	18,669	–	–	–	–	–
Long-term bank loans and borrowings	244,000	22,909	41,243	23,303	46,020	70,283	40,242
3,416% Non-convertible US dollar bonds, maturing 2018	86,384	86,384	–	–	–	–	–
7,250% Non-convertible US dollar bonds, maturing 2019	34,466	–	34,466	–	–	–	–
6,125% Non-convertible US dollar bonds, maturing 2020	57,506	–	–	57,506	–	–	–
6,656% Non-convertible US dollar bonds, maturing 2022	28,748	–	–	–	–	28,748	–
4,563% Non-convertible US dollar bonds, maturing 2023	86,274	–	–	–	–	–	86,274
4,750% Non-convertible US dollar bonds, maturing 2026	57,467	–	–	–	–	–	57,467
Capital lease obligation	2,846	751	741	810	519	25	–
Total	**616,360**	**128,713**	**76,450**	**81,619**	**46,539**	**99,056**	**183,983**

Litigation and claims

The Group is involved in various claims and legal proceedings arising in the normal course of business. While these claims may seek substantial damages against the Group and are subject to uncertainty inherent in any litigation, management does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group's operating results or financial condition. See Note 29 "Commitments and contingencies" to our consolidated financial statements for detailed information on claims and legal proceedings involving the Group.

Critical accounting policies

The preparation of financial statements in conformity with IFRS requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. See Note 3 "Summary of significant accounting policies" to our consolidated financial statements for descriptions of the Company's major accounting policies. Certain of these accounting policies involve judgments and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts would have been reported under different conditions, or if different assumptions had been used.

Other information

Sectorial sanctions against the Russian companies

In July-September 2014, the United States ("US"), the European Union ("EU") and several other countries imposed a set of sanctions on Russia, including sectoral sanctions which affect several Russian oil and gas companies. The US has placed the Company onto the Sectoral Sanctions Identifications List subject to Directive 4. Directive 4 prohibits US companies and individuals from providing, exporting, or re-exporting directly or indirectly, goods, services (except for financial services), or technology in support of exploration or production for deepwater, Arctic offshore or shale projects that have the potential to produce oil in the Russian Federation, or in maritime area claimed by the Russian Federation and extending from its territory.

In August-October 2017, the US expanded abovementioned sanctions to include international oil projects initiated on or after 29 January 2018 that have the potential to produce oil in any location, and in which companies placed on the Sectoral Sanctions Identifications List (subject to Directive 4) have an ownership interest of 33% or more, or ownership of a majority of the voting interests.

The management believes that current sanctions do not have a material adverse effect on the Group's oil projects. The Company continues to monitor and evaluate potential risks for its operations in connection with sanctions.

Operations in Iraq

The Group is exposed to various risks due to its operations in Iraq. The management monitors these risks and believes that there is no adverse effect on the Group's financial position that can be reasonably estimated at present.

Forward-looking statements

Certain statements in this document are not historical facts and are “forward-looking.” We may from time 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) per share, dividends, capital structure or other financial items or ratios. Words such as “believes,” “anticipates,” “expects,” “estimates,” “intends” and “plans” and similar expressions are intended 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 carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made, and, subject to any continuing obligations under the Listing Rules of the U.K. Listing Authority, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.