



**LUKOIL**

**PJSC LUKOIL**

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

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

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

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

## Key financial and operational results

	3 <sup>rd</sup> quarter of		Change,	9 months of		Change,
	2016	2015	%	2016	2015	%
	(millions of rubles)					
Sales.....	1,309,488	1,464,053	(10.6)	3,826,121	4,381,324	(12.7)
EBITDA (operating) <sup>(1)</sup> , including.....	165,890	213,031	(22.1)	547,453	630,418	(13.2)
Exploration and production segment .....	111,792	138,321	(19.2)	379,604	458,013	(17.1)
Refining, marketing and distribution segment ....	60,550	71,444	(15.2)	175,704	188,864	(7.0)
EBITDA (operating) <sup>(1)</sup> net of West Qurna-2 project.	160,436	168,505	(4.8)	513,615	523,058	(1.8)
Profit for the period attributable to LUKOIL shareholders .....	54,803	188,393	(70.9)	160,195	356,172	(55.0)
Capital expenditures, including non-cash transactions .....	120,615	142,662	(15.5)	362,062	447,506	(19.1)
Free cash flow <sup>(2)</sup> .....	104,525	91,317	14.5	197,931	171,196	15.6
	(thousand BOE per day)					
Production of hydrocarbons, including our share in equity affiliates.....	2,118	2,371	(10.7)	2,212	2,372	(6.7)
Crude oil and natural gas liquids .....	1,815	2,066	(12.1)	1,886	2,051	(8.0)
Gas available for sale .....	303	305	(0.7)	326	321	1.6
Refinery throughput .....	1,364	1,382	(1.3)	1,320	1,286	2.6

<sup>(1)</sup> Profit from operating activities before depreciation, depletion and amortization.

<sup>(2)</sup> Cash flow from operating activities less capital expenditures and acquisition of licenses.

Our financial results for the nine months of 2016 were affected by lower average hydrocarbon prices, increase in the crude oil extraction tax base rate, decline in domestic refining margins, as well as an increase in transportation tariffs.

In the nine months of 2016, our EBITDA (operating) amounted to 547 billion RUB, a decrease of 13.2% to the nine months of 2015. As far as we compensated most of the costs incurred within the West Qurna-2 project, we were eligible for significantly lower volumes of compensation crude oil, compared to the respective period of 2015, that significantly affected our EBITDA (operating). Net of the West Qurna-2 project, the Group’s EBITDA (operating) decreased by 1.8% compared to the nine months of 2015. Our EBITDA (operating) was supported by the ruble devaluation to US dollar and Euro, higher international refinery throughput volumes and substantial improvement in the refined product slate.

In the nine months of 2016, our profit attributable to LUKOIL shareholders amounted to 160 billion RUB, a decrease of 55.0% to the nine months of 2015. Our profit was affected by foreign exchange loss in the nine months of 2016 compared to foreign exchange gain in the nine months of 2015 resulted from ruble volatility.

In the nine months of 2016, we continued generating strong free cash flow that amounted to 198 billion RUB, compared to 171 billion RUB in the nine months of 2015.

### **Business overview**

LUKOIL is one of the world's largest publicly traded vertically integrated energy companies in terms of hydrocarbon reserves that amounted under SEC standards to 16.6 billion BOE at 1 January 2016 and comprised of 12.6 billion barrels of crude oil and 23.8 trillion cubic feet of gas. Most of our reserves are conventional. Our daily hydrocarbon production in the nine months of 2016 amounted to 2.2 million BOE with liquid hydrocarbons representing approximately 85% of our overall production volumes.

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

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, production of diamonds and certain other activities.

Each of our segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. 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. 4, benchmarking 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. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments’ underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 28 “Segment information” to our condensed interim consolidated financial statements.

### **Changes in Group structure**

In line with the Company’s strategy of optimizing its downstream operations in Europe, we sold petrol station networks in Poland, Latvia and Lithuania in the first quarter of 2016 and petrol stations networks in Ukraine and Estonia in 2015.

In August 2015, a Group company closed the transaction to sell its 50% interest in Caspian Investment Resources Ltd, an exploration and production company operating in Kazakhstan, to a Sinopec group company for \$1,067 million (70.1 billion RUB). Related structural decrease in the Group’s crude oil production amounted to approximately 20 thousand barrels per day.

### **Sectorial sanctions against the Russian companies**

In July-September 2014, the United States (“US”), the European Union (“EU”) and other countries imposed a set of economic sanctions on Russia, including certain sectoral sanctions which affect Russian oil and gas companies. Such sectoral sanctions prohibit US and the EU 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 on the territory of the Russian Federation.

The Company is not subject to any financial restrictions and is not currently involved in deepwater, Arctic offshore or shale projects in Russia. That is why we assess the impact of the sanctions on the Company’s activities as immaterial.

## Main macroeconomic factors affecting our results of operations

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

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues. During the nine months of 2016, the price for Brent crude oil fluctuated between \$26 and \$50 per barrel, reached its maximum of \$50.7 in the beginning of June and minimum of \$26.0 in the end of January, and averaged 24.3% less than in the nine months of 2015. Nevertheless, as a result of ruble devaluation, the prices expressed in rubles decreased less significantly.

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

	3 <sup>rd</sup> quarter of		Change,	9 months of		Change,
	2016	2015	%	2016	2015	%
(in US dollars per barrel, except for figures in percent)						
Brent crude.....	45.86	50.47	(9.1)	41.88	55.31	(24.3)
Urals crude (CIF Mediterranean) <sup>(1)</sup> .....	44.35	49.92	(11.2)	40.54	55.01	(26.3)
Urals crude (CIF Rotterdam) <sup>(1)</sup> .....	43.73	49.19	(11.1)	39.67	54.20	(26.8)
(in US dollars per metric tonne, except for figures in percent)						
Fuel oil 3.5% (FOB Rotterdam).....	228.98	243.76	(6.1)	188.71	280.34	(32.7)
Diesel fuel 10 ppm (FOB Rotterdam) .....	407.10	482.89	(15.7)	377.62	529.98	(28.7)
High-octane gasoline (FOB Rotterdam).....	472.82	599.03	(21.1)	454.59	605.51	(24.9)

Source: Platts.

	3 <sup>rd</sup> quarter of		Change,	9 months of		Change,
	2016	2015	%	2016	2015	%
(in rubles per barrel, except for figures in percent)						
Brent crude.....	2,964	3,179	(6.8)	2,863	3,278	(12.7)
Urals crude (CIF Mediterranean) <sup>(1)</sup> .....	2,866	3,144	(8.8)	2,772	3,261	(15.0)
Urals crude (CIF Rotterdam) <sup>(1)</sup> .....	2,826	3,098	(8.8)	2,712	3,213	(15.6)
(in rubles per metric tonne, except for figures in percent)						
Fuel oil 3.5% (FOB Rotterdam).....	14,798	15,351	(3.6)	12,901	16,618	(22.4)
Diesel fuel 10 ppm (FOB Rotterdam) .....	26,309	30,412	(13.5)	25,817	31,416	(17.8)
High-octane gasoline (FOB Rotterdam).....	30,556	37,726	(19.0)	31,079	35,893	(13.4)

Translated into rubles using average exchange rate for the period.

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

### Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of competition and economic conditions in those regions.

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand and competition.

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

	3 <sup>rd</sup> quarter of		Change,	9 months of		Change,
	2016	2015	%	2016	2015	%
(in rubles per metric tonne, except for figures in percent)						
Fuel oil.....	8,446	7,352	14.9	6,598	7,050	(6.4)
Diesel fuel.....	29,548	29,949	(1.3)	28,523	29,062	(1.9)
High-octane gasoline (Regular) .....	34,647	35,636	(2.8)	33,603	31,984	5.1
High-octane gasoline (Premium) .....	36,582	36,808	(0.6)	35,285	33,197	6.3

Source: InfoTEK (excluding VAT).

## Changes in the US dollar-ruble exchange rate and inflation

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

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

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

## Taxation

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

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

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

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

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

- A special coefficient is applied to the standard tax rate depending on location, depletion, type of reserves, size and complexity of a particular field. This type of incentive with different coefficients is applied to our highly depleted fields (more than 80% depletion), our Yu. Korchagin field located in the Caspian offshore, the Permian layers of our Usinskoye field in Timan-Pechora producing high-viscous crude oil, our Pyakyakhinskoye field located in the Yamal-Nenets region of Western Siberia, a number of fields in the Nenets Autonomous region, as well as to our new small-sized fields (recoverable reserves less than 5 million tonnes) and fields and deposits with low permeability like V.N. Vinogradov field and Tyumen deposits;
- A fixed tax rate of 15% of the international Urals price is applied to our V. Filanovsky field, located in the Caspian offshore;
- A zero tax rate is applied to our Yaregskoye field producing extra-viscous crude oil, as well as to unconventional deposits (Bazhenov and others).

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

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

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

In the nine months of 2016, actual average natural gas extraction tax rate for our major gas field – Nakhodkinskoe in Western Siberia amounted to 208 rubles per thousand cubic meters (160 rubles in the nine months of 2015). The rate for this field is subject to a special regional reducing coefficient.

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

<b>International Urals price</b>	<b>Export duty rate</b>
Less than, or equal to, \$109.50 per tonne (\$15.00 per barrel)	\$0.00 per tonne
Above \$109.50 but less than, or equal to, \$146.00 per tonne (\$20.00 per barrel)	35% of the difference between the actual price and \$109.50 per tonne (or \$0.35 per barrel per each \$1.00 increase in the Urals price over \$15.00)
Above \$146.00 but less than, or equal to, \$182.50 per metric tonne (\$25.00 per barrel)	\$12.78 per tonne plus 45% of the difference between the actual price and \$146.00 per tonne (or \$0.45 per barrel per each \$1.00 increase in the Urals price over \$20.00)
Above \$182.50 per metric tonne (\$25.00 per barrel)	\$29.20 per tonne plus 42% of the difference between the actual price and \$182.50 per tonne (or \$0.42 per barrel per each \$1.00 increase in the Urals price over \$25.00)

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.

Crude oil produced at some of our fields is subject to special export duty rates calculated according to special 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. Filanovskogo field also located in the Caspian offshore.

The table below illustrates the impact of tax incentives for different fields and deposits in our portfolio at \$50 per barrel Urals price under 2016 tax formulas.

	<b>Mineral extraction tax</b>	<b>Export duty</b>	<b>Total</b>	<b>As % of oil price</b>
	(in US dollars per barrel, except for figures in percent)			
<b>Standard</b> .....	<b>15.7</b>	<b>14.5</b>	<b>30.2</b>	<b>60.5</b>
Yaregskoye field .....	0.0	1.8	1.8	3.6
Yu. Korchagin field.....	5.5	0.0	5.5	10.9
V. Filanovskogo field.....	7.5	0.0	7.5	15.0
Usinskoye (Permian layers) .....	5.5	14.5	20.0	39.9
Pyakakhinskoye field .....	5.5	14.5	20.0	39.9
V. Vinogradova field.....	7.5	14.5	22.0	44.1
Highly depleted fields .....	8.6-15.7	14.5	23.1-30.2	46.1-60.5
Small sized fields .....	9.3-15.7	14.5	23.8-30.2	47.6-60.5
Tyumen deposits .....	13.7	14.5	28.2	56.4

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

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

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

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

	3 <sup>rd</sup> quarter of			9 months of		
	2016	2015	Change, %	2016	2015	Change, %
(in US dollars per tonne except for figures in percent)						
Export duties on crude oil .....	88.76	128.68	(31.0)	70.37	129.75	(45.8)
Export duties on refined products						
Light and middle distillates .....	35.47	61.70	(42.5)	28.12	62.22	(54.8)
Fuel oil .....	72.74	97.73	(25.6)	57.66	98.57	(41.5)
Gasoline .....	54.09	100.33	(46.1)	42.87	101.17	(57.6)
Straight-run gasoline .....	62.97	109.34	(42.4)	49.92	110.25	(54.7)
Diesel fuel .....	35.47	61.70	(42.5)	28.12	62.22	(54.8)

	3 <sup>rd</sup> quarter of			9 months of		
	2016	2015	Change, %	2016	2015	Change, %
(in rubles per tonne except for figures in percent)						
Export duties on crude oil <sup>(1)</sup> .....	5,736	8,104	(29.2)	4,811	7,692	(37.5)
Export duties on refined products <sup>(1)</sup>						
Light and middle distillates .....	2,292	3,886	(41.0)	1,923	3,688	(47.9)
Fuel oil .....	4,701	6,155	(23.6)	3,942	5,843	(32.5)
Gasoline .....	3,496	6,319	(44.7)	2,931	5,997	(51.1)
Straight-run gasoline .....	4,069	6,886	(40.9)	3,413	6,535	(47.8)
Diesel fuel .....	2,292	3,886	(41.0)	1,923	3,688	(47.9)
Mineral extraction tax						
Crude oil .....	6,098	6,263	(2.6)	5,441	6,721	(19.0)

<sup>(1)</sup> Translated to rubles using average exchange rate for the period.

**Excise 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, excises are paid either by producers or retailers depending on the local legislation.

Excise rates on refined products in Russia are tied to the ecological class of fuel. Excise tax rates for the respective periods of 2016 and 2015 are listed below.

	3 <sup>rd</sup> quarter of			9 months of		
	2016	2015	Change, %	2016	2015	Change, %
(in rubles per tonne except for figures in percent)						
Gasoline						
Euro-4 and below .....	13,100	7,300	79.5	12,236	7,300	67.6
Euro-5 .....	10,130	5,530	83.2	9,266	5,530	67.6
Diesel fuel						
All ecological classes .....	5,293	3,450	53.4	4,913	3,450	42.4
Motor oils .....	6,000	6,500	(7.7)	6,000	6,500	(7.7)
Straight-run gasoline .....	13,100	11,300	15.9	12,236	11,300	8.3

During the nine months of 2016, excise rates in Russia were increased twice, on 1 January and 1 April.

**Income tax.** The federal income tax rate is 2.0% and the regional income tax rate varies between 13.5% and 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

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.

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

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

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

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

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



## Operational highlights

### Hydrocarbon production

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

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
<b>Crude oil and natural gas liquids<sup>(1)</sup></b>	(thousand BOE per day)			
Consolidated subsidiaries				
Western Siberia .....	818	901	842	923
Timan-Pechora .....	338	340	342	335
Ural region .....	321	317	322	316
Volga region .....	133	136	131	139
Other in Russia .....	36	38	36	37
Total in Russia .....	1,646	1,732	1,673	1,750
Iraq <sup>(2)</sup> .....	72	235	112	190
Other outside Russia .....	45	36	44	39
Total outside Russia .....	117	271	156	229
<b>Total consolidated subsidiaries .....</b>	<b>1,763</b>	<b>2,003</b>	<b>1,829</b>	<b>1,979</b>
Our share in equity affiliates				
in Russia .....	21	16	20	15
outside Russia .....	31	47	37	57
<b>Total share in equity affiliates .....</b>	<b>52</b>	<b>63</b>	<b>57</b>	<b>72</b>
<b>Total crude oil and natural gas liquids .....</b>	<b>1,815</b>	<b>2,066</b>	<b>1,886</b>	<b>2,051</b>
<b>Natural and petroleum gas available for sale</b>				
Consolidated subsidiaries				
Western Siberia .....	132	169	152	174
Timan-Pechora .....	16	13	16	12
Ural region .....	13	15	13	20
Volga region .....	29	6	24	6
Total in Russia .....	190	203	205	212
Total outside Russia .....	105	93	112	98
<b>Total consolidated subsidiaries .....</b>	<b>295</b>	<b>296</b>	<b>317</b>	<b>310</b>
Share in equity affiliates				
in Russia .....	1	1	1	1
outside Russia .....	7	8	8	10
<b>Total share in production of equity affiliates .....</b>	<b>8</b>	<b>9</b>	<b>9</b>	<b>11</b>
<b>Total natural and petroleum gas available for sale .....</b>	<b>303</b>	<b>305</b>	<b>326</b>	<b>321</b>
<b>Total daily hydrocarbon production .....</b>	<b>2,118</b>	<b>2,371</b>	<b>2,212</b>	<b>2,372</b>
	(millions of rubles)			
<b>Hydrocarbon extraction expenses .....</b>	51,967	55,073	159,638	159,051
- in Russia .....	41,880	39,597	122,698	113,612
- outside Russia <sup>(3)</sup> .....	3,346	4,203	11,589	10,230
- in Iraq .....	6,741	11,273	25,351	35,209
<b>Mineral extraction tax in Russia .....</b>	108,073	120,539	282,884	365,908
	(ruble per BOE)			
<b>Hydrocarbon extraction expenses<sup>(3)</sup> .....</b>	248	231	242	217
- in Russia .....	248	223	239	212
- outside Russia <sup>(3)</sup> .....	247	359	277	277
	(US dollar per BOE)			
<b>Hydrocarbon extraction expenses<sup>(3)</sup> .....</b>	3.84	3.67	3.55	3.67
- in Russia .....	3.84	3.54	3.51	3.61
- outside Russia <sup>(3)</sup> .....	3.82	5.71	4.05	4.65

<sup>(1)</sup> Natural gas liquids produced at the Group gas processing plants.

<sup>(2)</sup> Compensation oil that represented approximately 27% of production from the West Qurna-2 field in the nine months of 2016 and 52% in the nine months of 2015.

<sup>(3)</sup> Excluding expenses at the West Qurna-2 field.

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia, our major oil producing subsidiaries are LUKOIL-Western Siberia, LUKOIL-Komi and LUKOIL-PERM. Our international upstream segment includes stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Romania, Iraq, Egypt, Ghana, Cote d'Ivoire, Norway, Cameroon, Nigeria and Mexico.

**Crude oil and natural gas liquids production.** During the nine months of 2016, we produced (including the Company's share in equity affiliates) 69.3 million tonnes, or 508.4 million barrels, of crude oil, compared to 75.3 million tonnes, or 550.5 million barrels, of crude oil in the nine months of 2015.

In the nine months of 2016, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 8.3 million BOE, compared to 9.6 million BOE in the nine months of 2015.

The following table presents our crude oil production in the nine months of 2016 and 2015 by major regions.

(thousands of tonnes)	<u>Change to 2015</u>				
	<b>9 months of 2016</b>	<b>Total, %</b>	<b>Change in structure</b>	<b>Organic change</b>	<b>9 months of 2015</b>
Western Siberia.....	30,793	(7.9)	–	(2,635)	33,428
Timan-Pechora.....	12,956	2.4	–	307	12,649
Ural region.....	11,387	1.5	–	172	11,215
Volga region.....	4,795	(5.2)	–	(262)	5,057
Other in Russia.....	1,386	(2.7)	–	(39)	1,425
Crude oil produced in Russia.....	61,317	(3.9)	–	(2,457)	63,774
Iraq <sup>(1)</sup> .....	4,477	(40.8)	–	(3,081)	7,558
Other outside Russia.....	1,533	10.8	–	149	1,384
Crude oil produced outside Russia.....	6,010	(32.8)	–	(2,932)	8,942
<b>Total crude oil produced by consolidated subsidiaries.....</b>	<b>67,327</b>	<b>(7.4)</b>	–	<b>(5,389)</b>	<b>72,716</b>
<b>Our share in crude oil produced by equity affiliates:</b>					
in Russia.....	714	33.2	–	178	536
outside Russia.....	1,260	(37.7)	(663)	(100)	2,023
<b>Total crude oil produced.....</b>	<b>69,301</b>	<b>(7.9)</b>	<b>(663)</b>	<b>(5,311)</b>	<b>75,275</b>

<sup>(1)</sup> Compensation oil that represented approximately 27% of production from the West Qurna-2 field in the nine months of 2016 and 52% in the nine months of 2015.

The main oil producing region for the Company is Western Siberia where we produced 45.7% of our crude oil in the nine months of 2016 (46.0% in the nine months of 2015).

Crude oil production in Western Siberia continued to decline due to natural depletion of reserves, increase in water cut and the Company's decision to reallocate capital to higher return projects in other regions of Russia, in particular those benefiting from tax incentives. We expect production decline rates in Western Siberia to decrease substantially as a result of our recent decision to intensify production drilling in this region. Production growth in Timano-Pechora was primarily driven by ramp-up of production at the Yaregskoye and Usinskoye fields, as well as the fields in Denisovskaya depression. Production growth in Ural region was primarily driven by successful drilling on existing brownfields and launch of new small sized 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 compensated most of the costs incurred within the project and therefore were eligible for less volumes of compensation crude oil compared to the third quarter and the nine months of 2015 (for details see p. 11).

The increase in our share in crude oil produced by equity affiliates in Russia was due to an increase in production at the Trebs and Titov oilfields by Bashneft-Polus, where the Group holds a 25.1% interest.

The decrease in our share in crude oil produced by equity affiliates outside Russia mainly resulted from the disposal of our 50% share in Caspian Investment Resources Ltd in the middle of 2015.

In October 2016, we started commercial production at two new major fields, the V. Filanovskogo field in the Caspian Sea (Volga region) and the Pyakyakhinskoye field in the Bolshekhetskaya depression (Western Siberia). Launch of these fields will enable us to significantly increase our daily hydrocarbon production with a major positive impact on our financial results due to high quality reserve base and tax incentives.

**Natural and petroleum gas production.** In the nine months of 2016, we produced 18,383 million cubic meters (108.2 million BOE) of gas (including our share in equity affiliates), that is 4.2% more than in the nine months of 2015. Our available for sale gas production amounted to 15,184 million cubic meters (89.4 million BOE), compared to 14,883 million cubic meters (87.6 million BOE) in the nine months of 2015.

The following table presents our available for sale gas production in the nine months of 2016 and 2015 by major regions.

(millions of cubic meters)	9 months of 2016	Change to 2015		9 months of 2015	
		Total, %	Change in structure		Organic change
Western Siberia.....	7,082	(12.3)	–	(990)	8,072
Timan-Pechora.....	728	26.4	–	152	576
Ural region .....	597	(33.9)	–	(306)	903
Volga region .....	1,128	298.6	–	845	283
Other in Russia.....	16	(5.9)	–	(1)	17
Gas produced in Russia.....	9,551	(3.0)	–	(300)	9,851
Gas produced outside Russia .....	5,209	14.4	–	655	4,554
<b>Total available for sale gas produced by consolidated subsidiaries .....</b>	<b>14,760</b>	<b>2.5</b>	–	<b>355</b>	<b>14,405</b>
<b>Our share in gas produced by equity affiliates:</b>					
in Russia .....	44	25.7	–	9	35
outside Russia.....	380	(14.2)	(77)	14	443
<b>Total available for sale gas produced .....</b>	<b>15,184</b>	<b>2.0</b>	<b>(77)</b>	<b>378</b>	<b>14,883</b>

Our major gas production field is the Nakhodkinskoe field, which is in natural decline. Our production at the field was 5,097 million cubic meters of natural gas in the nine months of 2016 (5,598 million cubic meters in the nine months of 2015). This decrease was partially offset by commencement of gas production at the Yu. Korchagin field. Decrease in production in Ural region was largely a result of increase in own gas consumption following the launch of new power generation unit at the Perm refinery.

Our international gas production (including our share in affiliates' production) increased by 11.8%, compared to the nine months of 2015, which resulted from the increase in production in Uzbekistan and Azerbaijan. Growth of gas production in Uzbekistan was due to launching new wells and a compressor booster station at the Gissar field. We are currently involved in construction of gas treatment facilities and gas treatment complex in the region, which completion together with further field development will enable us to significantly increase gas production in that region.

**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 West Qurna-2 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 project's target production level is 1.2 million barrels per day and the total term of the contract is 25 years.

Accounting for the cost compensation within the West Qurna-2 project in 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 current crude oil market prices. Approved invoice amount and the 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 (including excise and export tariffs)*. Unsold crude oil and refined products are recognized in *Inventories*.

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

	Costs incurred <sup>(1)</sup>	Crude oil received	Unrecovered costs	Remuneration fee
		(millions of US dollars)		
Cumulative at 31 December 2015 .....	6,801	5,169	1,632	198
Change during the nine months of 2016 .....	578	1,767	(1,189)	96
Income tax .....	–	–	–	(54)
<b>Cumulative at 30 September 2016 ....</b>	<b>7,379</b>	<b>6,936</b>	<b>443</b>	<b>240</b>

<sup>(1)</sup> Including prepayments.

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

	3 <sup>rd</sup> quarter of			
	2016			2015
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production <sup>(1)</sup> .....	37,249	5,430	41,448	6,043
Production related to cost compensation and remuneration <sup>(1)</sup> .....	6,633	967	21,583	3,146
Shipment of compensation crude oil <sup>(1)(2)</sup> .....	17,788	2,593	15,369	2,240
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation <sup>(3)</sup> .....	10,210	158	53,658	852
Remuneration fee .....	2,067	31	2,267	36
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i> ) <sup>(2)</sup> .....	45,037	697	36,779	584
Extraction expenses .....	6,741	105	11,273	179
Depreciation, depletion and amortization .....	3,117	54	42,447	674
<b>EBITDA (operating) .....</b>	<b>5,454</b>	<b>84</b>	<b>44,526</b>	<b>707</b>

<sup>(1)</sup> Translated into barrels using conversion rate characterizing the density of the field.

<sup>(2)</sup> This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

<sup>(3)</sup> Excluding deferred income in the amount of \$69 million in the third quarter of 2016.

	9 months of			
	2016	2015	2015	2015
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production <sup>(1)</sup> .....	112,311	16,372	99,134	14,453
Production related to cost compensation and remuneration <sup>(1)</sup> .....	30,714	4,477	51,843	7,558
Shipment of compensation crude oil <sup>(1)(2)</sup> .....	53,070	7,736	48,077	7,009
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation <sup>(3)</sup> .....	53,070	756	137,159	2,327
Remuneration fee .....	6,603	96	5,713	96
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i> ) <sup>(2)</sup> .....	119,031	1,768	131,844	2,267
Extraction expenses .....	25,351	369	35,209	597
Depreciation, depletion and amortization.....	27,462	384	99,507	1,691
<b>EBITDA (operating) .....</b>	<b>33,838</b>	<b>477</b>	<b>107,360</b>	<b>1,821</b>

<sup>(1)</sup> Translated into barrels using conversion rate characterizing the density of the field.

<sup>(2)</sup> This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

<sup>(3)</sup> Excluding deferred income in the amount of \$69 million in the third quarter of 2016.

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

### Refining, marketing and trading

**Refining.** 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 own two petrochemical plants in Russia, one in Ukraine and petrochemical capacity at our refineries in Bulgaria and Italy. Currently, production at our petrochemical plant in Ukraine is suspended due to adverse economic and political environment in this country.

Compared to the nine months of 2015, the total volume of refined products produced by the Group increased by 2.8%.

In Russia, our production volumes decreased by 1.4% due to throughput optimization as a result of general weakening of refining margins in Russia driven by excise tax increases in January and April 2016. Due to completed upgrade program and throughput optimization, our Russian refineries posted strong results in the nine months of 2016 despite unfavorable macroeconomic environment. Launch of new secondary processing units in 2015 and 2016 enabled us to substantially enhance our refined product slate by reducing production of fuel oil and vacuum gasoil in favor of light products. In order to optimize dark products yield, in the nine months of 2016, we also decreased throughput volumes and redirected vacuum gas oil produced at our Perm and Ukhta refineries from export deliveries to supply catalytic cracking unit at our refinery in Nizhny Novgorod. Maintenance works at our refineries in Nizhny Novgorod and Ukhta also affected our refining volumes in the nine months of 2016.

Internationally, the production increase amounted to 10.9% against the background of low output in the first quarter of 2015 due to overhauls at our Italian refinery as well as strong refining margins.

Along with our own production of refined products we refine crude oil at third party refineries depending on market conditions and other factors. In the periods considered, we processed our crude oil at third party refineries in Belarus and Kazakhstan.

The following table summarizes key figures for our refining activities.

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Refinery throughput at the Group refineries .....	17,119	17,349	49,339	47,896
- in Russia .....	11,092	11,182	31,029	31,379
- outside Russia <sup>(1)</sup> .....	6,027	6,167	18,310	16,517
Refinery throughput at third party refineries .....	80	298	245	715
<b>Total refinery throughput .....</b>	<b>17,199</b>	<b>17,647</b>	<b>49,584</b>	<b>48,611</b>
<b>Production of the Group refineries in Russia .....</b>	<b>10,554</b>	<b>10,597</b>	<b>29,372</b>	<b>29,791</b>
- diesel fuel .....	3,241	3,448	9,630	9,583
- gasoline .....	2,152	1,916	5,795	5,135
- fuel oil .....	1,560	1,926	4,232	6,006
- jet fuel .....	695	618	1,605	1,694
- motor oils .....	265	234	767	681
- other products .....	2,641	2,455	7,343	6,692
<b>Production of the Group refineries outside Russia .....</b>	<b>5,695</b>	<b>5,910</b>	<b>17,204</b>	<b>15,509</b>
- diesel fuel .....	2,450	2,463	7,345	6,366
- gasoline .....	1,180	1,343	3,648	3,557
- fuel oil .....	726	879	2,512	2,351
- jet fuel .....	266	242	686	651
- motor oils .....	58	53	158	151
- other products .....	1,015	930	2,855	2,433
<b>Refined products produced by the Group .....</b>	<b>16,249</b>	<b>16,507</b>	<b>46,576</b>	<b>45,300</b>
Refined products produced at third party refineries .....	76	277	235	683
<b>Total refined products produced .....</b>	<b>16,325</b>	<b>16,784</b>	<b>46,811</b>	<b>45,983</b>
<b>Products produced at petrochemical plants and facilities .....</b>	<b>319</b>	<b>314</b>	<b>965</b>	<b>747</b>
- in Russia .....	233	221	691	476
- outside Russia .....	86	93	274	271
	(millions of RUB)			
Refining expenses at the Group refineries .....	21,102	24,786	66,356	67,958
- in Russia .....	10,799	12,528	32,010	31,453
- outside Russia .....	10,303	12,258	34,346	36,505
	(ruble per tonne)			
Refining expenses .....	1,233	1,429	1,345	1,419
- in Russia .....	974	1,120	1,032	1,002
- outside Russia .....	1,709	1,988	1,876	2,210
	(US dollar per tonne)			
Refining expenses .....	19.08	22.69	19.73	23.99
- in Russia .....	15.07	17.79	15.18	17.00
- outside Russia .....	26.45	31.56	27.44	37.26
	(millions of RUB)			
Capital expenditures .....	8,765	14,463	31,304	57,246
- in Russia .....	5,203	11,540	23,650	41,671
- outside Russia .....	3,562	2,923	7,654	15,575

<sup>(1)</sup> Including refined product processed.

**Marketing and trading.** We are marketing 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.

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 margin on our trading operations. As a result of price volatility, during the nine month of 2016, loss on hedging amounted to 32 billion RUB that was offset by corresponding increase in prices for physical deliveries.

The following tables show the volumes of crude oil purchases by the Group during the periods considered.

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Purchases in Russia.....	224	483	638	1,418
Purchases for trading internationally.....	6,544	3,323	18,663	14,190
Purchases for refining internationally.....	4,102	3,768	11,395	8,945
Shipment of the West Qurna-2 compensation crude oil.....	2,593	2,240	7,736	7,009
<b>Total crude oil purchased.....</b>	<b>13,463</b>	<b>9,814</b>	<b>38,432</b>	<b>31,562</b>

Compared to the third quarter and the nine months of 2015, our purchases of crude oil for refining at international refineries increased by 8.9% and 27.4%, respectively, and our purchases for trading increased by 96.9% and 31.5%, respectively. Moreover, in the third quarter and the nine months of 2016, the Group received 2.6 million tonnes and 7.7 million tonnes, respectively, of compensation crude from Iraq's state-owned South Oil Company as cost compensation within the West Qurna-2 project (in the respective periods of 2015, the Group received 2.2 million tonnes and 7.0 million tonnes of compensation crude oil).

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

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Retail sales.....	3,761	3,810	10,268	10,486
Wholesale sales.....	25,936	28,904	79,326	82,713
<b>Total refined products sales.....</b>	<b>29,697</b>	<b>32,714</b>	<b>89,594</b>	<b>93,199</b>
Refined products purchased in Russia.....	427	358	1,218	1,135
Refined products purchased internationally.....	13,633	17,616	45,722	51,387
<b>Total refined products purchased.....</b>	<b>14,060</b>	<b>17,974</b>	<b>46,940</b>	<b>52,522</b>

In the nine months of 2016, in line with the strategy to optimize our downstream operations, a Group company sold 100% of its interest in LUKOIL Poland, LUKOIL Baltija and LUKOIL Baltija R, distribution companies operating over 270 petrol stations in Poland, Lithuania and Latvia. In July 2015, we sold 100% of interest in LUKOIL Eesti, and in April 2015 – 100% of interest in LUKOIL Ukraine.

**Exports of crude oil and refined products from Russia.** The volumes of crude oil and refined products exported from Russia by our subsidiaries are summarized as follows:

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Exports of crude oil to Customs Union.....	582	957	2,536	2,892
Exports of crude oil beyond Customs Union.....	6,414	6,589	22,291	22,950
<b>Total crude oil exports.....</b>	<b>6,996</b>	<b>7,546</b>	<b>24,827</b>	<b>25,842</b>
<b>Exports of refined products.....</b>	<b>4,444</b>	<b>5,215</b>	<b>13,814</b>	<b>15,618</b>

In the nine months of 2016, the volume of our crude oil exports from Russia decreased by 3.9%, and we exported 40.5% of our domestic crude oil production (the same as in the nine months of 2015) and 326 thousand tonnes of crude oil purchased from our affiliates and third parties (1,200 thousand tonnes in the nine months of 2015). The decrease in crude oil exports was a result of lower domestic production. The volume of our refined products exports decreased by 11.6% compared to the nine months of 2015 due to higher domestic sales volumes driven by favorable netbacks and decreased refining volumes.

Substantially, we use the Transneft infrastructure to export our crude oil. Nevertheless, during the third quarter and nine months of 2016, we exported 2,026 thousand tonnes and 6,117 thousand tonnes, respectively, through our own infrastructure (1,937 thousand tonnes and 5,626 thousand tonnes during the third quarter and nine months of 2015). All the volume of crude oil exported that bypassed Transneft was routed beyond the Customs Union.

In the nine months of 2016, the Company exported 909 thousand tonnes of light crude oil through the Eastern Siberia – Pacific Ocean pipeline compared to 1,165 thousand tonnes in the nine months of 2015. This allowed us to preserve the premium quality of crude oil and thus enabled us to achieve higher netbacks compared to exports to traditional Western markets.

During the third quarter of 2016, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to 131 billion RUB and 99 billion RUB, respectively (150 billion RUB for crude oil and 111 billion RUB for refined products in the third quarter of 2015). During the nine months of 2016, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to 438 billion RUB and 285 billion RUB, respectively (545 billion RUB for crude oil and 350 billion RUB for refined products in the nine months of 2015).

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

We own petrol stations in more than 18 countries. Most of our stations are located close to our refineries. During the nine months of 2016, we sold 7.2 million tonnes of motor fuels via our domestic retail network, or approximately 47% of our domestic motor fuel production, that represents an increase of 1.0% against the same period of 2015. Compared to the nine months of 2015, our domestic sales volumes of premium ECTO branded motor fuels increased by 33%.

During the nine months of 2016, retail sales outside Russia decreased to 3.1 million tonnes, or by 8.7%, mostly as a result of divestment of our retail networks in Poland and the Baltic states. At the same time, ECTO branded sales volumes outside Russia increased by 11%.

We supply jet fuel to airports in and outside Russia. During the nine months of 2016, jet fuel sales volumes amounted to 2.1 million tonnes, which is in line with the nine months of 2015.

We supply bunker fuel to sea and river ports in Russia. During the nine months of 2016, these sales increased by 29% to 2.3 million tonnes as a result of expansion of our market share on the Black and Baltic seas and launch of new premium products.

We produce motor oils at our refineries in Russia and undertake motor oil blending and packaging in Russia and abroad. We focus at premium branded motor and industrial oils that sales volumes increased by 30%.

**Power generation.** In power generation sector, 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. Our total output of commercial electrical energy was 12.9 billion kW-h in the nine month of 2016, an increase of 2.3% compared to the nine months of 2015, and our total output of commercial heat energy was approximately 8.5 million Gcal, or 3.0% less than in the nine months of 2015.



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

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

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
<b>Revenues</b>				
Sales (including excise and export tariffs) .....	1,309,488	1,464,053	3,826,121	4,381,324
<b>Costs and other deductions</b>				
Operating expenses .....	(112,133)	(116,833)	(339,086)	(328,342)
Cost of purchased crude oil, gas and products .....	(654,871)	(733,220)	(1,869,901)	(2,210,925)
Transportation expenses .....	(71,169)	(71,371)	(235,533)	(218,533)
Selling, general and administrative expenses .....	(52,658)	(40,838)	(145,783)	(122,051)
Depreciation, depletion and amortization .....	(74,790)	(100,061)	(230,746)	(265,582)
Taxes other than income taxes .....	(122,245)	(134,256)	(324,522)	(405,310)
Excise and export tariffs .....	(129,440)	(145,685)	(358,209)	(442,143)
Exploration expenses .....	(1,082)	(8,819)	(5,634)	(23,602)
<b>Profit from operating activities.....</b>	<b>91,100</b>	<b>112,970</b>	<b>316,707</b>	<b>364,836</b>
Finance income .....	3,778	4,210	11,120	12,777
Finance costs.....	(11,949)	(11,667)	(33,418)	(34,153)
Equity share in income of affiliates .....	198	2,131	5,976	8,606
Foreign exchange (loss) gain .....	(10,207)	83,762	(84,530)	60,283
Other income (expenses) .....	2,872	36,542	(4,676)	27,986
<b>Profit before income taxes.....</b>	<b>75,792</b>	<b>227,948</b>	<b>211,179</b>	<b>440,335</b>
Current income taxes .....	(19,389)	(33,843)	(47,048)	(76,177)
Deferred income taxes .....	(1,300)	(5,508)	(3,364)	(6,866)
<b>Total income tax expense .....</b>	<b>(20,689)</b>	<b>(39,351)</b>	<b>(50,412)</b>	<b>(83,043)</b>
<b>Profit for the period.....</b>	<b>55,103</b>	<b>188,597</b>	<b>160,767</b>	<b>357,292</b>
Profit for the period attributable to non-controlling interests.....	(300)	(204)	(572)	(1,120)
<b>Profit for the period attributable to PJSC LUKOIL shareholders .....</b>	<b>54,803</b>	<b>188,393</b>	<b>160,195</b>	<b>356,172</b>
Earning per share of common stock attributable to PJSC LUKOIL shareholders (in Russian rubles):				
Basic .....	76.87	264.25	224.70	499.59
Diluted .....	76.87	264.25	224.70	492.85

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

## Sales revenues

Sales breakdown	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Crude oil				
Export and sales on international markets other than Customs Union .....	306,259	232,523	864,501	888,478
Export and sales to Customs Union .....	8,411	9,409	36,179	37,508
Domestic sales .....	31,177	39,147	75,921	114,379
	<b>345,847</b>	<b>281,079</b>	<b>976,601</b>	<b>1,040,365</b>
Cost compensation and remuneration at the West Qurna-2 project .....	12,277	55,925	59,673	142,872
	<b>358,124</b>	<b>337,004</b>	<b>1,036,274</b>	<b>1,183,237</b>
Refined products				
Export and sales on international markets				
Wholesale .....	602,555	774,774	1,818,216	2,240,579
Retail .....	74,704	90,515	224,678	245,140
Domestic sales				
Wholesale .....	76,760	64,453	181,126	178,472
Retail .....	107,041	100,622	278,961	266,799
	<b>861,060</b>	<b>1,030,364</b>	<b>2,502,981</b>	<b>2,930,990</b>
Petrochemicals				
Export and sales on international markets .....	7,915	10,782	26,877	27,871
Domestic sales .....	10,521	9,330	28,615	18,724
	<b>18,436</b>	<b>20,112</b>	<b>55,492</b>	<b>46,595</b>
Gas and gas products				
Export and sales on international markets .....	18,824	23,691	63,109	72,550
Domestic sales .....	8,242	9,483	26,062	28,314
	<b>27,066</b>	<b>33,174</b>	<b>89,171</b>	<b>100,864</b>
Sales of energy and related services				
Sales on international markets .....	3,859	4,294	10,384	8,503
Domestic sales .....	12,268	11,521	42,946	40,941
	<b>16,127</b>	<b>15,815</b>	<b>53,330</b>	<b>49,444</b>
Other				
Sales on international markets .....	16,059	16,092	53,361	40,074
Domestic sales .....	12,616	11,492	35,512	30,120
	<b>28,675</b>	<b>27,584</b>	<b>88,873</b>	<b>70,194</b>
<b>Total sales .....</b>	<b>1,309,488</b>	<b>1,464,053</b>	<b>3,826,121</b>	<b>4,381,324</b>

Sales volumes	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(thousands of tonnes)			
Crude oil				
Export and sales on international markets other than Customs Union .....	15,150	10,559	45,469	39,303
Export and sales to Customs Union .....	577	648	2,509	2,424
Domestic sales .....	2,357	3,087	5,824	8,245
	<b>18,084</b>	<b>14,294</b>	<b>53,802</b>	<b>49,972</b>
Crude oil volumes related to cost compensation and remuneration at the West Qurna-2 project .....	967	3,146	4,477	7,558
	<b>19,051</b>	<b>17,440</b>	<b>58,279</b>	<b>57,530</b>
Refined products				
Export and sales on international markets				
Wholesale .....	22,589	26,234	70,810	75,253
Retail .....	1,046	1,183	3,067	3,358
Domestic sales				
Wholesale .....	3,347	2,670	8,516	7,460
Retail .....	2,715	2,627	7,201	7,128
	<b>29,697</b>	<b>32,714</b>	<b>89,594</b>	<b>93,199</b>
<b>Total sales volume of crude oil and refined products .....</b>	<b>48,748</b>	<b>50,154</b>	<b>147,873</b>	<b>150,729</b>

Realized average sales prices	3 <sup>rd</sup> quarter of		9 months of		
	2016	2015	2016	2015	
Average realized price international					
Crude oil (beyond Customs Union) .....	(RUB/barrel)	2,758	3,004	2,594	3,084
Crude oil (Customs Union) .....	(RUB/barrel)	1,989	1,984	1,967	2,111
Refined products					
Wholesale .....	(RUB/tonne)	26,675	29,534	25,677	29,774
Retail.....	(RUB/tonne)	71,419	76,513	73,257	73,002
Crude oil (beyond Customs Union) .....	(\$/barrel)	42.68	47.70	37.94	52.03
Crude oil (Customs Union) .....	(\$/barrel)	30.77	31.50	28.77	35.62
Refined products					
Wholesale .....	(\$/tonne)	412.76	468.96	375.58	502.28
Retail.....	(\$/tonne)	1,105.13	1,214.91	1,071.53	1,231.52
Average realized price within Russia					
Crude oil .....	(RUB/barrel)	1,805	1,730	1,778	1,893
Refined products					
Wholesale .....	(RUB/tonne)	22,934	24,143	21,269	23,925
Retail.....	(RUB/tonne)	39,426	38,293	38,739	37,428

During the third quarter of 2016, our revenues decreased by 155 billion RUB, or by 10.6%, compared to the third quarter of 2015. Our revenues from crude oil sales increased by 21 billion RUB, or by 6.3%, and our revenues from sales of refined products decreased by 169 billion RUB, or by 16.4%.

During the nine months of 2016, our revenues decreased by 555 billion RUB, or by 12.7%, compared to the nine months of 2015. Our revenues from crude oil sales decreased by 147 billion RUB, or by 12.4%, and our revenues from sales of refined products decreased by 428 billion RUB, or by 14.6%.

The main reason for the decrease in revenue was the decrease in international hydrocarbon prices as well as the decrease in refined products trading volumes. That was partially compensated for by the effect of ruble devaluation on our revenues denominated in other currencies.

#### *Sales of crude oil*

Our international crude oil sales revenue increased by 31.7%, or by 74 billion RUB, and decreased by 2.7%, or by 24 billion RUB, compared to the third quarter and the nine months of 2015, respectively. Our international sales volumes (beyond the Customs Union) increased by 4,591 thousand tonnes, or by 43.5%, in the third quarter of 2016, and by 6,166 thousand tonnes, or by 15.7%, in the nine months of 2016, mainly due to higher volumes of crude oil trading. Our average international ruble realized prices decreased by 8.2% and 15.9% compared to the third quarter and the nine months of 2015, respectively.

Our realized domestic crude oil sales price increased by 4.3% compared to the third quarter of 2015 and decreased by 6.1% compared to the nine months of 2015, while our domestic sales volumes decreased by 730 thousand tonnes, or by 23.6%, and by 2,421 thousand tonnes, or by 29.4%, respectively, following the decrease in production in Russia. As a consequence, in the third quarter and the nine months of 2016, our domestic sales revenue decreased by 20.4%, or by 8 billion RUB, and by 33.6%, or by 38 billion RUB, respectively.

#### *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 that decreased by 44 billion RUB and by 83 billion RUB compared to the third quarter and the nine months of 2015, respectively. The volumes of crude oil, related to cost compensation and remuneration fee, also significantly decreased to the respective periods of 2015. For details see p. 11.

#### *Sales of refined products*

Compared to the third quarter and the nine months of 2015, our revenue from the wholesale of refined products outside Russia decreased by 172 billion RUB, or by 22.2%, and by 422 billion RUB, or by 18.9%, respectively, that was both price and volume driven. During the third quarter of 2016, our dollar and ruble realized prices decreased by 12.0% and 9.7%, respectively, and during the nine months of 2016 they decreased by 25.2% and 13.8%, respectively. Compared to the third quarter and the nine months of 2015, our sales volumes decreased by 13.9% and 5.9%, respectively, largely as a result of the decrease in volumes of trading.

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

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

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

#### *Sales of petrochemical products*

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

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

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

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

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

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

During the third quarter of 2016, our revenue from sales of energy and related services didn't change significantly against the same quarter of 2015. In the nine months of 2016, this revenue increased by 4 billion RUB, or by 7.9%. In Russia, the increase was largely due to putting in operation a combined cycle gas turbine with a capacity of 135 MW at the Group's power plant in the Stavropol region of Russia in March 2015. Our international revenue increased as a result of the increase in volumes of electricity sales in Sicily, Italy.

#### *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 third quarter and the nine months of 2016, revenue from other sales increased by 1 billion RUB, or by 4.0%, and by 19 billion RUB, or by 26.6%, respectively. The non-petrol revenue of our retail network remained nearly flat to the third quarter of 2015, but increased by 2 billion RUB, or by 9.5%, compared to the nine months of 2015. Our revenue from transportation services was also flat to the third quarter of 2015, but increased by 5 billion RUB, or by 47.1%, compared to the nine months of 2015. In the third quarter and the nine months of 2016, our other sales also included revenue from sales of diamonds in the amount of 4 billion RUB and 15 billion RUB, respectively (3 billion RUB and 7 billion RUB in the third quarter and the nine months of 2015).

## Operating expenses

Operating expenses include the following:

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Hydrocarbon extraction expenses <sup>(1)</sup> .....	45,226	43,800	134,287	123,842
Extraction expenses at the West Qurna-2 field .....	6,741	11,273	25,351	35,209
Own refining expenses .....	21,102	24,786	66,356	67,958
Refining expenses at third parties refineries .....	185	914	606	1,992
Expenses for crude oil transportation to refineries .....	11,229	11,357	34,457	31,477
Power generation and distribution expenses .....	10,186	8,804	29,075	27,437
Petrochemical expenses .....	3,097	3,075	9,699	7,868
Other operating expenses .....	14,367	12,824	39,255	32,559
<b>Total operating expenses .....</b>	<b>112,133</b>	<b>116,833</b>	<b>339,086</b>	<b>328,342</b>

<sup>(1)</sup> Excluding extraction expenses at the West Qurna-2 field.

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 28 “Segment information” to our condensed interim 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 2015, our operating expenses decreased by 5 billion RUB, or by 4.0%, largely as a result of the decrease in extraction expenses at the West Qurna-2 field.

Compared to the nine months of 2015, our operating expenses increased by 11 billion RUB, or by 3.3%, in the nine months of 2016, largely as a result of inflation in Russia and the effect of the ruble devaluation on the ruble value of foreign subsidiaries’ expenses.

### *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.

In the third quarter and the nine months of 2016, our extraction expenses increased by 1 billion RUB, or by 3.3%, and by 10 billion RUB, or by 8.4%, respectively.

Our average hydrocarbon extraction expenses increased from 231 RUB per BOE in the third quarter of 2015 to 248 RUB per BOE in the third quarter of 2016, or by 7.4%, and from 217 RUB per BOE in the nine months of 2015 to 242 RUB per BOE in the nine months of 2016, or by 11.5%. In Russia, average hydrocarbon extraction expenses increased by 11.2% to 248 RUB per BOE in the third quarter of 2016 and by 12.7% to 239 RUB per BOE in the nine months of 2016. Our domestic expenses increased driven by higher costs of materials and services and shift towards more cost-intensive projects benefiting from tax exemptions.

### *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. 11.

The decrease in expenses both to the third quarter and the nine months of 2015 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.

### *Own refining expense*

Our own refining expenses decreased by 4 billion RUB, or by 14.9%, during the third quarter of 2016, and by 2 billion RUB, or by 2.4%, in the nine months of 2016.

Refining expenses at our domestic refineries decreased by 13.8%, or by 2 billion RUB, in the third quarter of 2016 that was largely a result of consumption of additives of own production due to upgrades at our refineries, and increased by 1.8%, or by 1 billion RUB, in the nine months of 2016.

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

#### *Expenses for crude oil transportation to refineries*

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

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

#### *Petrochemical expenses*

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

#### *Other operating expenses*

Other operating expenses include expenses of the Group's upstream and downstream entities that do not relate to their core activities, namely rendering of transportation and extraction services, costs of other services provided and goods sold by our production and marketing companies, and of non-core businesses of the Group.

In the third quarter and the nine months of 2016, other operating expenses increased by 2 billion RUB, or by 12.0%, and by 7 billion RUB, or by 20.6%, respectively, largely as a result of the increased cost of transportation services provided to third parties, non-petrol sales of our retail network and the increase in the ruble value of other operating expenses of our foreign subsidiaries.

### **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.

In the third quarter and the nine months of 2016, the cost of purchased crude oil, gas and products decreased by 78 billion RUB, or by 10.7%, and by 341 billion RUB, or by 15.4%, respectively, following the decrease in hydrocarbon prices and refined products trading volumes. Crude oil purchases in the third quarter and the nine months of 2016 also included 45 billion RUB and 119 billion RUB related to 2,593 thousand tonnes and 7,736 thousand tonnes of compensation crude oil received from Iraq's state-owned South Oil Company within the West Qurna-2 project, respectively (37 billion RUB and 132 billion RUB related to 2,240 thousand tonnes and 7,009 thousand tonnes of compensation crude oil in the third quarter and the nine months of 2015).

In the third quarter of 2016, we recognized a 3 billion RUB net gain from hedging, compared to a 56 billion RUB net gain in the third quarter of 2015. In the nine months of 2016, we recognized a 32 billion RUB net loss from hedging, compared to a 30 billion RUB net gain in the nine months of 2015.

## Transportation expenses

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

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

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

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

Other transportation expenses were mostly represented by the expenses for transportation of gas. In Russia, the increase to the respective periods of 2015 was mainly due to higher volumes of transportation of gas from the Yu. Korchagin field in the Caspian Sea. Internationally, the increase that resulted from higher transportation volumes as a result of the increase in gas production was amplified by the ruble devaluation.

## Selling, general and administrative expenses

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

Our selling, general and administrative expenses increased by 12 billion RUB, or by 28.9%, in the third quarter of 2016, and by 24 billion RUB, or by 19.4%, in the nine months of 2016. In Russia, expenses increased by 10 billion RUB, or by 46.7%, in the third quarter of 2016 and by 16 billion RUB, or by 26.4%, in the nine months of 2016 as a result of inflation and higher accruals within share-based management compensation program. Internationally, our expenses outside Russia increased by 2 billion RUB, or by 10.4%, to the third quarter of 2015 largely as a result of the increase in provision for doubtful debts and by 7 billion RUB, or by 12.1%, compared to the nine months of 2015, largely as a result of the effect of the ruble devaluation on the expenses of our foreign subsidiaries.

## Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses decreased by 25 billion RUB, or by 25.3%, compared to the third quarter of 2015, and by 35 billion RUB, or by 13.1%, compared to the nine months of 2015. The effect of the increase in the depreciation rate of upstream assets following the decrease in hydrocarbon proved reserves was offset by the decrease of expenses related to the West Qurna-2 project. Our depreciation, depletion and amortization expenses for the third quarter of 2016 and 2015 included 3 billion RUB and 42 billion RUB, respectively, related to the West Qurna-2 field. In the nine months of 2016 and 2015, those expenses amounted to 27 billion RUB and 100 billion RUB, respectively. Other international subsidiaries' depreciation, depletion and amortization expenses increased as a result of the effect of the ruble devaluation.

## Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan. Currently, our largest affiliates are Tengizchevroil, exploration and production company operating in Kazakhstan, Bashneft-Polus, an exploration and production company that develops the Trebs and Titov oilfields in Timan-Pechora, Russia, Shakh-Deniz Midstream and Caspian Pipeline Consortium, midstream companies in Azerbaijan and Kazakhstan. One of our major affiliates was Caspian Investments Resources Ltd, which was sold in August 2015.

Our share in income of affiliates decreased by 2 billion RUB, or by 90.7%, compared to the third quarter of 2015 and by 3 billion RUB, or by 30.6%, compared to the nine months of 2015, largely as a result of decrease in profits of our affiliates in Kazakhstan.

## Taxes other than income taxes

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
<b>In Russia</b>				
Mineral extraction taxes .....	108,073	120,539	282,884	365,908
Social security taxes and contributions .....	5,895	5,453	17,730	16,303
Property tax .....	4,820	4,743	14,086	13,475
Other taxes .....	961	727	2,058	1,829
<b>Total in Russia.....</b>	<b>119,749</b>	<b>131,462</b>	<b>316,758</b>	<b>397,515</b>
<b>International</b>				
Social security taxes and contributions .....	1,410	1,477	4,569	4,271
Property tax .....	305	651	869	1,400
Other taxes .....	781	666	2,326	2,124
<b>Total internationally .....</b>	<b>2,496</b>	<b>2,794</b>	<b>7,764</b>	<b>7,795</b>
<b>Total .....</b>	<b>122,245</b>	<b>134,256</b>	<b>324,522</b>	<b>405,310</b>

Our taxes other than income taxes decreased by 12 billion RUB, or by 8.9%, compared to the third quarter of 2015 and by 81 billion RUB, or by 19.9%, compared to the nine months of 2015. This was largely driven by the decrease in the mineral extraction tax rate in Russia.

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

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Decrease in extraction taxes from application of reduced and zero rates .....	14,760	19,116	39,710	54,805
	(thousands of tonnes)			
Volume of production subject to:				
zero rates .....	261	209	730	590
reduced rates (tax holidays for specific regions and high viscosity oil).....	1,148	1,555	3,513	4,692
reduced rates (depleted fields).....	3,534	3,730	10,731	11,256
reduced rates (other).....	894	677	2,601	1,788
<b>Total volume of production subject to reduced or zero rates.....</b>	<b>5,837</b>	<b>6,171</b>	<b>17,575</b>	<b>18,326</b>



## Excise and export tariffs

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
(millions of rubles)				
<b>In Russia</b>				
Excise tax on refined products .....	28,316	14,541	68,498	40,214
Crude oil export tariffs .....	33,916	48,728	96,280	168,551
Refined products export tariffs.....	15,201	28,661	39,887	92,835
<b>Total in Russia.....</b>	<b>77,433</b>	<b>91,930</b>	<b>204,665</b>	<b>301,600</b>
<b>International</b>				
Excise tax and sales taxes on refined products.....	51,877	52,984	153,194	138,741
Crude oil export tariffs .....	16	9	37	37
Refined products export tariffs.....	114	762	313	1,765
<b>Total internationally .....</b>	<b>52,007</b>	<b>53,755</b>	<b>153,544</b>	<b>140,543</b>
<b>Total .....</b>	<b>129,440</b>	<b>145,685</b>	<b>358,209</b>	<b>442,143</b>

In the third quarter and the nine months of 2016, export tariffs decreased by 29 billion RUB, or by 37.0%, and by 127 billion RUB, or by 48.1%, respectively, due to the sharp decrease in export duty rates for crude oil and refined products in Russia amplified by the decrease in export volumes. Compared to the third quarter and the nine months of 2015, the volumes of crude oil export beyond the Customs Union decreased by 2.7% and 2.9% and the volumes of the refined products exports decreased by 14.8% and 11.6%, respectively. The increase in excise tax expenses in Russia was driven by increase in rates, while international excise expenses increased due to the ruble devaluation.

### Foreign exchange loss

Foreign exchange loss mostly related to revaluation of US dollar and euro net monetary position of Russian subsidiaries that mostly consists of accounts receivables and loans to our foreign subsidiaries.

During the third quarter of 2016, US dollar exchange rate declined insignificantly that resulted in a foreign exchange loss of 10 billion RUB. Sharp increase in US dollar exchange rate during the third quarter of 2015 resulted in an 84 billion foreign exchange gain in the period.

During the nine months of 2016, US dollar exchange rate decreased from 72.88 rubles per dollar to 63.16 rubles per dollar that resulted in an 85 billion RUB foreign exchange loss. During the nine months of 2015, US dollar exchange rate increased from 56.26 rubles per dollar to 66.24 rubles per dollar at that resulted in a 60 billion RUB foreign exchange gain.

### Other income (expenses)

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

In the third quarter of 2015, other expenses included foreign exchange gain reclassified from other comprehensive income after the sale of Caspian Investment Resources Ltd. in the amount of 37 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 third quarter of 2016, our total income tax expense decreased by 19 billion RUB, or by 47.4%, compared to the third quarter of 2015. At the same time, our profit before income tax decreased by 152 billion RUB, or by 66.8%.

In the nine months of 2016, our total income tax expense decreased by 33 billion RUB, or by 39.3%, compared to the nine months of 2015. At the same time, our profit before income tax decreased by 229 billion RUB, or by 52.0%.

In the third quarter of 2016, our effective income tax rate was 27.3%, compared to 17.3% in the third quarter of 2015, that was a result of an accrual of additional income taxes on prior period income related to our international operations. In the nine months of 2016, our effective income tax rate was 23.9%, compared to 18.9% in the nine months of 2015.

## Liquidity and capital resources

	9 months of	
	2016	2015
	(millions of rubles)	
Net cash provided by operating activities.....	557,879	617,667
Net cash used in investing activities.....	(367,186)	(365,201)
Net cash used in financing activities.....	(64,087)	(155,899)

### Operating activities

Our primary source of cash flow is funds generated from our operations. In the nine months of 2016, cash generated from operations decreased by 60 billion RUB, or by 9.7%, compared to the nine months of 2015, mainly as a result of the decrease in profit.

### Investing activities

In the nine months of 2016, the amount of cash used in investing activities increased by 2 billion RUB, or by 0.5%. In the third quarter of 2015 we received 79 billion RUB from the sale of our share in Caspian Investment Resources Ltd. and some other equity affiliates. At the same time, we significantly decreased our capital expenditures in 2016.

In the nine months of 2016, our capital expenditures decreased by 89 billion RUB, or by 19.9%.

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
<b>Capital expenditures</b>				
Exploration and production				
Western Siberia.....	26,038	22,364	86,214	84,139
Timan-Pechora.....	15,295	23,012	60,830	61,954
Ural region.....	6,695	7,737	18,684	22,529
Volga region.....	19,237	13,750	39,936	36,903
Other in Russia.....	1,723	2,007	4,605	7,470
<b>Total in Russia.....</b>	<b>68,988</b>	<b>68,870</b>	<b>210,269</b>	<b>212,995</b>
Iraq.....	3,910	13,996	15,606	35,418
Other outside Russia.....	31,889	37,030	87,056	114,090
<b>Total outside Russia.....</b>	<b>35,799</b>	<b>51,026</b>	<b>102,662</b>	<b>149,508</b>
<b>Total exploration and production.....</b>	<b>104,787</b>	<b>119,896</b>	<b>312,931</b>	<b>362,503</b>
Refining, marketing and distribution				
Russia.....	10,619	16,887	35,258	60,420
International.....	4,542	4,120	12,077	20,084
<b>Total refining, marketing and distribution.....</b>	<b>15,161</b>	<b>21,007</b>	<b>47,335</b>	<b>80,504</b>
Corporate and other				
Russia.....	534	1,218	1,226	2,715
International.....	133	541	570	1,784
<b>Total corporate and other.....</b>	<b>667</b>	<b>1,759</b>	<b>1,796</b>	<b>4,499</b>
<b>Total capital expenditures, including non-cash transactions.....</b>	<b>120,615</b>	<b>142,662</b>	<b>362,062</b>	<b>447,506</b>
Non-cash transactions.....	(11,887)	454	(4,670)	(1,537)
<b>Total capital expenditures.....</b>	<b>108,728</b>	<b>143,116</b>	<b>357,392</b>	<b>445,969</b>

In the nine months of 2016, our capital expenditures in the exploration and production segment decreased by 50 billion RUB, or by 13.7%. The decrease was largely in our international segment and related to completion of current stage of the West Qurna-2 project and of exploratory drilling in Cameroon and Romania.

The decrease in capital expenditures in the domestic refining, marketing and distribution segment in Russia was due to completion of upgrades at our Russian refineries. The decrease in the international segment was a result of completion of the construction of a heavy residue processing complex at our Bulgarian refinery.

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

	3 <sup>rd</sup> quarter of		9 months of	
	2016	2015	2016	2015
	(millions of rubles)			
Western Siberia (Pyakyakhinskoye field) .....	6,102	5,078	19,435	22,162
Caspian region (Projects in Russia).....	17,451	11,525	33,931	29,518
Timan-Pechora (Yaregkoye field) .....	5,081	6,374	17,153	12,247
Iraq.....	3,910	13,996	15,606	35,418
Uzbekistan .....	23,640	15,128	49,916	42,688
Romania .....	168	5,553	828	17,274
Cameroon.....	855	60	1,114	8,094
<b>Total .....</b>	<b>57,207</b>	<b>57,714</b>	<b>137,983</b>	<b>167,401</b>

### Financing activities

In the nine months of 2016, net movements of short-term and long-term debt generated an inflow of 97 billion RUB, compared to an outflow of 19 billion RUB in the nine months of 2015.

In November 2016, a Group company issued non-convertible bonds totaling \$1 billion (63.2 billion RUB). The bonds were placed with a maturity of 10 years and a coupon yield of 4.750% per annum. The proceeds will be used for general corporate purposes, primarily on refinancing of existing debt.

In November 2016, within the development of Gissar project in Uzbekistan, a Group company received a loan totaling \$500 million (31.6 billion RUB) from a consortium of commercial banks with a maturity of 5 years bearing an interest rate of three months LIBOR plus 3.0% per annum.