

Information about Major Business Risks and Uncertainties of PJSC LUKOIL

The Company's business is predominantly affected by the following risk groups:

- Macroeconomic Risks
- Country Risks
- Industry-Specific Risks
- Financial Risks
- Legal Risks
- Loss of Goodwill Risk (Reputational Risk)
- Strategic risks
- Other risks related to the issuer's business

Realization of any of the below risks may have an adverse impact on the business, performance and value of the issuer's securities. PJSC LUKOIL continuously monitors and takes measures to mitigate risks. However, if such risks materialize, LUKOIL will take measures to mitigate them as soon as possible and minimize loss to the Company. Given the probabilistic nature of risks, as well as the fact that the majority of them are external for the Company, LUKOIL is unable to provide a 100% guarantee that its risk management measures will reduce their negative impact to zero.

Macroeconomic Risks

Risk Description

Macroeconomic changes resulting from the global price volatility for energy carriers, foreign exchange rate fluctuations, inflation processes, changes in fiscal and monetary policies may have an adverse impact on the Company's financial performance.

Risk Management

The Company has been employing a scenario approach to forecast macroeconomic indicators. One of them is defined as a base-case scenario and describes the most likely macroeconomic development trends according to the Company's management. In addition, best-case and worst-case scenarios are being developed. The application of the worst-case scenario makes it possible to identify assets and investment projects that are most vulnerable to negative macroeconomic changes. The data of this analysis serve as the basis for top management decisions.

Country Risks

Risk Description

PJSC LUKOIL has operations in a number of high risk countries (Iraq, Egypt, Uzbekistan, West African countries). Should they be materialized, such risks may significantly complicate the Company's business or even cause the Company to suspend its operations.

The main factors which are capable of affecting LUKOIL's activities in these countries include:

- instability of the political situation;
- escalation of military conflicts;
- macroeconomic instability;
- expropriation of the Company's assets;
- inefficiency of the legislation and judicial system.

Risk Management

The major part of the Group's development and refining assets is located in the Russian Federation; for this reason the impact of this risk is limited. At the same time the Company seeks to diversify its international operations.

When implementing high risk projects, the Company applies more stringent return level requirements. Besides, should the political or social and economic situation deteriorate in a region of the Company's presence, PJSC LUKOIL shall implement a set of crisis response measures, including cost saving, optimization of the investment program, equity drawdown, and partner engagement.

Industry-Specific Risks

Price Risks

Risk Description

The issuer has limited influence on its the output prices that depend a lot on the market situation and measures taken by the regulatory authorities. The oil and petroleum product price drop may adversely affect the Company's financial performance.

Risk Management

The issuer is a vertically integrated oil company which embraces production, refining and distribution assets. This structure serves as a natural hedging mechanism, in which multidirectional risk factors compensate one other.

In addition to this, the Company uses a number of measures to reduce the negative price risk impact:

- as long-term programs are developed, a price scenario is considered, while the investment project portfolio is shaped in view of the tolerance analysis of the project performance figures to the changes in price parameters;
- a commodity supply management system is used which makes it possible to respond to market changes very quickly and conduct arbitrary shipments;
- operations are hedged when the Company conducts its international trade business.

Risks Associated with Well Construction and Hard-to-Recover Hydrocarbon Field Development

Risk Description

A considerable share of the materials and equipment required for well construction is currently purchased by the Company and its contractors from the EU and US manufacturers. Restrictions prohibiting the supply of such equipment and materials may have an adverse impact on the Company's performance.

Risk Management

The Company's projects have stocked spare parts, equipment and supplies for one year. A set of measures has been developed to replace the chemical agents for drill mud preparation and processing purchased from the EU and the US manufacturers with the products manufactured in Russia and other countries.

The Company also seek to promote domestic technologies and consistently reduces the share of imported equipment. As part of the Company's projects, R&D operations are being conducted to test new samples of domestic equipment, while domestic multi-zone hydrofracturing techniques are being introduced on a stage-by-stage basis.

Risks Associated with the Growth of Tariffs and Suppliers' Prices

Risk Description

In its day-to-day business the Company uses the goods and services of third parties, including transportation services. The expenses related to acquisition of goods and services from third parties directly affect the Company's financial performance.

The Company uses the services of such transport monopolies as JSC RZhD, PJSC Transneft, PJSC Gazprom and other similar monopolies in the countries of the Group's presence, while the prices for their services grow on a regular basis.

There is also a risk of price growth for the services and goods of other suppliers, including motor transportation, the services of customs brokers, warehouse storage cost, etc.

Risk Management

In order to minimize the risks associated with tariff growth of monopolies in the countries of its presence, as well as the risk of price growth for the services of other suppliers, the Company:

- diversifies ways of product transportation, also by establishing alternative supply routes;
- participates in the coordinated operations aimed at the prevention of advanced tariff growth of monopolies together with other consumers;
- when suppliers are selected to cooperate on a long-term basis, the Company holds bidding procedures.
- uses a tool to fix the transportation terms on a long-term basis.

To mitigate the risk of price growth on the part of other suppliers of goods and services, the Company improves its bidding procedures and extends its competitive environment (list of suppliers of goods and services).

The Risk of Failure to Discover Geological Reserves or Discovery of the Reserves below the Initially Expected Level

Risk Description

The Company's business is exposed to the risk that while implementing new projects and conducting exploratory drilling, it might not discover any productive (commercially efficient) oil and gas reserves, and/or that the discovered reserves will be considerably below the initially expected level. Therefore, the Company may have to incur additional expenses or even cease operations in a number of license areas.

Risk Management

The Company continuously improves its geologic exploration techniques and employs a staged approach to its operations according to which next stages are planned with due consideration of the results obtained at the previous stage.

Risks Associated with Subsurface Use and Licensing

Risk Description

The applicable Russian legislation on subsurface use and licensing of exploration and production activities, as well as their practical application create a number of risks. The most important are the following ones:

- risk of subsoil license early termination or risk of penalties for failure to comply with the terms of license agreements;
- risk of non-granting the right to subsurface use to a legal entity that discovered a field of federal significance or a field located in the subsurface area of federal significance, including the subsurface users with the share of foreign investors in the authorized capital;
- risk of refusal to accept bidding documents for participation in competitive sales/biddings.

Risk Management

To mitigate the risks associated with subsurface use and licensing, the Company:

- conducts monitoring of the changes in the legislation and in the area of subsurface use and licensing, forwarding proposals to update the applicable regulatory framework;
- regularly updates the list of sites associated with the unallocated subsoil stock, which are of interest to the Company;
- prepares application documents to participate in the bidding procedures and re-register licenses;
- holds annual advanced training workshops for licensing and subsoil use experts, ensures their participation in key workshops in the respective areas of operations;
- monitors current subsoil use state with application of a special information system;
- interacts with the regulatory authorities in order to mitigate the risk of early subsoil license termination.

Financial Risks

Liquidity Risks

Risk Description

High volatility of hydrocarbon and hydrocarbon derivative prices, foreign exchange rates, growth of tariffs and suppliers' prices, and other external factors may create a disproportion in the figures included into plans, budgets and investment programs of LUKOIL Group, thus leading to the shortage of liquidity and financing sources.

Risk Management

LUKOIL Group's liquidity is managed on a centralized basis, with the rolling liquidity forecast serving as a key tool; there is also an efficient global system in place to manage LUKOIL Group's liquidity, which includes an automated system of concentration and re-distribution of funds, as well as corporate dealing. Control of liquidity indicators is exercised on a regular basis, as well as sensitivity assessment of the performance figures included into the plans,

budgets and investment programs to the changes in macroeconomic indicators. The Company also develops proposals related to plan adjustments, possible sequestering of the expenses associated with the transition to the worst-case scenario, rescheduling of due dates and project implementation dates or inclusion of optional projects into the plan in case of improvements in the macroeconomic situation, as well as proposals to ensure well-timed financing of its business activities.

Currently, PJSC LUKOIL has investment ratings from three largest international rating agencies, including: S&P (BBB rating), Fitch (BBB+ rating) and Moody's (Baa2 rating). The last rating was raised in February of 2019.

The Company is monitoring and ensuring compliance of its financial indicators with the rating agencies' requirements on a regular basis.

Foreign Exchange Risks

Risk Description

The Company's proceeds are mainly shaped by US dollar proceeds from the oil and petroleum product sales, while operating and capital expenses are denominated in rubles. In this connection currency exchange fluctuations may adversely affect the Company's financial results.

Risk Management

The Company uses an integrated approach to manage its currency risks, including management of currency structure of cash balances and debt. In order to mitigate the negative consequences of the changes in the currency exchange rates, the Company takes advantage of its geographic diversification and applies hedging instruments of currency proceeds.

Dependence of the ruble exchange rate on oil prices constitutes a natural hedging mechanism.

Risk of Contractor's Default, Failure to Pay on the part of the Contractor

Risk Description

Default events of the Company's contractors may result in failure to collect or delayed collection of proceeds from supplied goods, or, as applied to financial contractors, failure to repay or partial non-repayment of funds placed on their accounts, which may have an adverse impact on the Company's financial performance and call for additional funds to fulfill the Company's obligations.

Risk Management

To mitigate the default risk and that of counterparties' payment default, the Company makes settlements with third parties outside of LUKOIL Group either on a pre-paid basis or based on letters of credit or bank guarantees on the part of the end buyers.

A list of counterparty banks recommended for cooperation is compiled based on regular integrated analysis, also with the use of tools to rank banks and financial institutions.

Legal Risks

Risk Description

Increased tax burden, unexpected changes in the tax and customs duty rates, cancellation of the applicable incentive rates for a number of the Company's fields, legislative changes in the area of power engineering, corporate governance, etc. may affect the Company's financial performance.

Risk Management

The Company is constantly monitoring legislative changes. The Company takes measures to collect information on possible changes at the stage of their preliminary discussion. The Company's representatives participate in such discussions in order to provide a detailed explanation of the Company's standpoint on these issues, risks and uncertainties which may arise as a result of the proposed legislative initiatives.

The Company's representatives also participate in the expert activities focused on the discussion and development of efficient solutions in the area of practical application of the effective legislative innovations.

Risks Associated with Circulation of the Company's Securities

Risk Description

The Company's securities circulate in regulated markets in Russia and abroad. Changes in the requirements to the issuers on the part of the regulatory authorities for securities and stock exchanges, as well as changes in the listing structure may induce the Company to amend its corporate governance procedures and assume extra obligations as to information disclosure and shareholder relations. Should the Company fail to ensure compliance with these requirements and fulfill the required obligations, it may result in transfer of the Company's securities to lower listing segments, including delisting, which may have an adverse impact on the liquidity and cost of the securities.

Risk Management

The Company monitors changes in the listing rules and other requirements of stock exchanges and regulatory authorities to the issuers whose securities are admitted to trading on regulated markets. The Company's representatives participate in the working meetings and other issuer events arranged by stock exchanges and other organizations that provide consulting and educational services to the issuers of the securities circulating in regulated markets. The Company also seeks to introduce the best global practice in corporate governance.

Risks Associated with Disclosure Obligations

Risk Description

In order to maintain its securities listing the Company adheres to certain obligatory information disclosure procedures within the timelines set by the requirements of the regulatory authorities and stock exchanges. The information is disclosed in digital form by transferring it to the organizations authorized to disclose information in stock markets by regulatory authorities (hereinafter, information disclosure services), via websites of the said organizations and e-mails. Should websites of the information disclosure organizations be unreachable (due to hacker attacks, technical failures, etc.), as well as in case of malfunction of the Company's own computer systems, the necessary information cannot be disclosed within the set timelimits, which may be considered as a violation of the Company's obligations and result in imposition of administrative fines on the Company and/or its executive employees by the securities regulatory authorities.

Risk Management

In order to mitigate these risks the Company shall conclude information disclosure agreements with several information disclosure services, seek to submit the information prior to its disclosure thus ensuring extra time to tackle possible technical failures before the deadline arrives. If the need be, the Company's authorized employees can contact the assigned employees of the information disclosure services.

Loss of Goodwill Risk (Reputational Risk)

Risk Description

PJSC LUKOIL faces various factors capable of driving the realization of the reputational risk.

The Company is aware that realization of the said risk may be brought about by both internal and external factors, including failure to meet statutory requirements, those of constituent documents, in-house policies and procedures, non-performance of contractual obligations, quality of finished products, or negative perception of the financial stability and financial position of the Company.

Risk Management

To manage such risks, the Company is working to provide timely and unbiased data of its financial and operating performance, continuously monitor statutory and contractual compliance, and effect timely payments to its counterparties.

The Company maintains control of the quality of its products and provided services: it set up a hotline to ensure timely response to the filling station related feedback.

Much attention has been paid to safety and environment issues. In its operations the Company follows the highest health, safety, and environment standards.

The Company attaches great importance to issues relating to the working environment and social responsibility. The Company implements the programs aimed at support and improvement of the efficient labor and social protection system.

Strategic risks

Risk Description

At the end of 2017 the Company's Board of Directors approved the 2018-2027 Strategic Development Program, including the major risks which may be faced by the Company in the course of Program implementation. The list of these risks also includes the risk of failure to meet the deadline in terms of investment project implementation; the risk of failure to reimburse for the expenses associated with implemented projects; the risk of increased tax burden; accident risks.

Risk Management

Strategic risks are always taken into consideration while drafting the Company strategy. Strategic planning involves assessment of the risks and efficiency of various strategic initiatives, as well as development of a set of strategic decisions that are most preferable in terms of risk to return ratio.

To mitigate its strategic risks, the Company management on a regular basis monitors the macroeconomic environment, development trends existing in the industry and analyzes performance of the Company's subsidiaries and that of its competitors. While developing its strategy and investment Program, the Company relies heavily on the scenario-based and probabilistic modelling tools making it possible to assess various risks.

Other Risks related to Issuer's Business

Risk of Terrorist Attacks, Wrongful Acts by Third Parties

Risk Description

PJSC LUKOIL has operations in a number of countries with high risks of terrorist attacks and other wrongful acts in relation to the Company's assets.

There are also risks related to wrongdoings on the part of LUKOIL's competitors (specifically, risks of unfair competition), risks of financial and other abuses on the part of the employees, as well as those related to theft of financial resources and commodity stocks.

Risk Management

To mitigate these risks the Company:

- participates in the events organized by the National Anti-terrorism Committee of Russia, the RF Federal Security Service, the RF Ministry of Internal Affairs;
- identifies persons among employees who are intentionally inflicting harm on the Company's interests for the benefit of third parties;
- plans and arranges events aimed at information security improvement;
- uses cryptographic tools for information protection.

Health, Safety and Environment (HSE) Risks

Risk Description

The Company's facilities are characterized by risks related to shutdown of engineering processes, discharges of hazardous substances, environmental damage, emergency, accidents, fires, which in its turn may cause shutdown of the Company's production facilities.

Risk Management

To mitigate these risks, the Company has established and successfully runs the HSE Management System certified to comply with the international standards ISO 14001 and OHSAS 18001, based on a number of corporate standards that regulate major procedures as part of the Management System. The Company implements the following measures as part of the HSE Management System:

- implementation of target corporate HSE programs;
- production control over the operation of hazardous production facilities;
- diagnostics (non-destructive inspection) and monitoring of equipment parameters;
- repairs and timely replacement of equipment;
- fulfillment of HSE requirements to contractor entities at all cooperation stages;
- leadership and safety culture promotion;

- ensuring personnel qualification at all levels;
- dedicated working environment assessment, improved labor conditions for employees;
- elaboration of Emergency Response Plans at Hazardous Production Facilities, Oil Spill Response Plans, creation of a pool of rescue teams and reserves for emergency response, training of service personnel at hazardous production facilities and rescue teams in the area of emergency prevention and response;
- other measures to reduce the occupational accident and injury rate in the LUKOIL Group entities.

Climate Change Risk

Risk Description

Toughening standards due to climatic changes and physical consequences related to climatic changes may have an adverse impact on PJSC LUKOIL's business as a major producer of fossil fuels and greenhouse gas emitter thus leading to increased costs and impaired efficiency.

Besides, PJSC LUKOIL operates in different regions where the physical potential of climatic changes is difficult to predict and may produce significant adverse effect (for instance, shortage of water resources in arid regions, flooding of assets located on coastal areas, destruction of assets due to the increased number of extreme weather events).

Risk Management

To mitigate these risks the Company:

- takes account of and plans measures to control greenhouse gas emissions;
- continuously monitors changes in the respective legislation. The Company also takes measures to collect information on such changes at the stage of preliminary discussion, and to ensure participation of the Company's representatives in such discussions in order to provide a detailed explanation of the Company's standpoint on these issues, risks and uncertainties which may arise as a result of the proposed legislative initiatives;
- considers the risk of climatic changes while designing and constructing facilities in the most sensitive territories (the Far North regions, offshore facilities).

Risks of Failure to Implement the Investment Program

Risk Description

While implementing investment projects, the Company has to face the risk of higher costs and untimely commissioning of production assets.

Delays in project implementation, including those caused by the delays in preparing design and estimate documentation, obtainment of approvals, conclusion of contracts, work execution period, as well as changes in field development plans in connection with the collection of additional geological information may result in deterioration of performance indicators in subsequent years, impaired efficiency of investment projects and excessive funds raised.

Risk Management

The Company manages this risk by monitoring project implementation progress on a quarterly basis. While developing its investment program, it makes sure that the initial licenses, permits, and authorizations for the next year are valid and in place.

Competitive Risk

Risk Description

The oil and gas industry exists in a highly competitive environment. The Company competes with other major Russian and international oil and gas companies in the following major areas:

- acquisition of licenses to upstream operations in the course of auctions or biddings;
- acquisition of assets and equipment, participation in new projects;
- engagement of specialized third party service organizations;
- engagement of competent and experienced personnel;

- access to key transportation infrastructure;
- development, search for, acquisition and integration of technologies;
- sales of end products.

Besides, PJSC LUKOIL tackles competition on the part of suppliers of non-conventional energy sources and alternative energy sources, including eco-friendly renewable energy sources.

Risk Management

LUKOIL is one of the largest vertically integrated oil companies both in Russia and abroad. Over a long period the Company has been demonstrating its efficiency, which turns it into one of the industry's leaders and strengthens its competitive positions. The Company has gained a reputation of a reliable partner with strong financial standing. The Company conducts strategic planning to reduce potential risks of increased competition. As part of long-term market situation development the Company selects the most efficient assets and forms of respective participation interests. The Company monitors the market situation on a regular basis and promptly responds to its changes.

Development of personnel professional and managerial competences and introduction of new technologies help the Company to improve its competitive advantages.

Risk Associated with the Lack of Qualified Personnel

Risk Description

The competence and expertise of the employees may prove insufficient for them to adequately fulfill their duties, which, in its turn, may adversely affect the financial performance indicators of the Company.

Risk Management

To mitigate the negative impact of this risk, the Company focuses on integrated development of the talent pool potential. The Company has created and replenishes its talent pool consisting of the most experienced and most promising employees; it pays special attention to the recruitment of young professionals and alumni of the leading universities and colleges.

Risks of Cyberattacks

Risk Description

Information and technological support and hence the automated processes affecting the Company's financial standing and performance, the reliability of its financial and accounting information, as well as its ability to fulfill its obligations, function in an inter-related information environment and are inevitably exposed to the risks of external and internal cyberattacks, which may affect information confidentiality, integrity and availability within IT systems. The Company considers not only its information and its processing tools as assets that have to be protected from exposure to cyberattacks but also the information that was entrusted to it by state authorities, shareholders, business partners and personal data owners.

Risk Management

The Company adheres to the generally accepted global standards and best practices in information security, seeks to use the previously introduced protection means more efficiently, and continuously improves its internal information security services; however, evolving cyber threats require continuous preparedness to be able to respond to the previously unknown cyberattacks. The success of these activities is based on early detection of new cyber threats before they can affect the Company, and counteraction to cyberattacks in real-time mode, which makes it possible to prevent or minimize potential consequences.

Information Technology Support Risks

Risk Description

Besides the risks of cyberattacks which affect confidentiality, integrity and availability of the information within the IT systems used by the Company, information and technological support of its managerial and financial activities is exposed to the risks whose nature is not related to impaired information security. Such risks comprise the risks of failure to implement the projects focused on creation and upgrade of IT systems, their breakdowns and failures, failure to obtain IT services from third party suppliers by the Company (also due to escalation of international sanctions), as well as the risk of market position loss due to delayed application of innovative digital technologies.

Risk Management

As for the risks related to implementation of the projects focused on creation and upgrade of IT systems, the Company applies and intends to improve modern development management practices, adheres to proven engineering solutions with reliable engineering support.

Along with the preventive measures taken to minimize the risks that imply the creation of fail-resistant IT infrastructure, testing of IT systems prior to their commissioning and control of proposed changes, the Company also seeks to plan proactive measures to be taken in case the risk is materialized aimed at reactivation of critical business operations and managerial process before the consequences of their interruption reach the unacceptable limit.

Minimization of risks related to participation of third party IT service providers is ensured both by careful selection of suppliers, control over their activities and support of internal competences related to the provision of IT services that are most critical for the Company.

The Company implements measures to control sanction risks; it also has developed a plan to respond to possible respective events. Digitalization initiatives are included into LUKOIL Group's Information Strategy.

Risk Management Procedures

PJSC LUKOIL Management pays great attention to risk management issues in order to ensure reasonable assurance of the set goals in the conditions characterized by uncertainties and adverse factors. PJSC LUKOIL is constantly identifying, describing, estimating and monitoring the potential events that may affect the Company's business, and is elaborating measures to prevent them or mitigate their negative impact to the greatest extent possible if such events do take place.

The Company seeks to actively promote risk management and is presently focusing its efforts on the improvement of an enterprise-wide risk management system (ERM) based on the best international practices. The Company is constantly improving the applicable regulatory methodological risk management base which establishes uniform requirements for all of the LUKOIL Group entities aimed at organizing the risk management process at all stages, and defines management standards for certain risk types of utmost importance. The Risk Committee, a dedicated body under the President of PJSC LUKOIL, was set up and began its work in 2011.

In order to enhance the efficiency of the corporate-wide governance system through the establishment of a unified information environment, an automated information risk management system has been established and is being constantly improved across the LUKOIL Group entities.

Responsibility statement

I hereby confirm that to the best of my knowledge:

(a) the financial statements, prepared in accordance with the International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole,

(b) the management report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

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President of PJSC LUKOIL

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