



PJSC LUKOIL

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

**for the three and nine-month periods ended
30 September 2017 and 2016**

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 30 September 2017 and the results of its operations for the three and nine month periods ended 30 September 2017 and 2016, as well as significant factors that may affect its future performance. It should be read in conjunction with our International Financial Reporting Standards (“IFRS”) condensed interim consolidated financial statements, including notes.

References to “LUKOIL,” “the Company,” “the Group,” “we” or “us” are references to PJSC LUKOIL and its subsidiaries and equity affiliates. All ruble amounts are in millions of Russian rubles (“RUB”), unless otherwise indicated. Income and expenses of our foreign subsidiaries were translated to rubles at rates which approximate actual rates at the date of the transaction. Tonnes of crude oil and natural gas liquids produced were translated into barrels using conversion rates characterizing the density of crude oil from each of our oilfields and the actual density of liquids produced at our gas processing plants. Hydrocarbon extraction expenses per barrel were calculated using these actual production volumes. Other operational indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent (“BOE”) were made at the rate of 1 barrel per BOE and of cubic feet – at the rate of 6 thousand cubic feet per BOE.

This report includes forward-looking statements – words such as “believes,” “anticipates,” “expects,” “estimates,” “intends,” “plans,” etc. – that reflect management’s current estimates and beliefs, but are not guarantees of future results.

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Business overview

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

LUKOIL is one of the world's largest publicly traded vertically integrated energy companies. Our proved reserves under SEC standards amounted to 16.4 billion BOE at 1 January 2017 and comprised of 12.5 billion barrels of crude oil and 23.5 trillion cubic feet of gas. Most of our reserves are conventional. We undertake exploration for and production of crude oil and natural gas in Russia and internationally. In Russia, our major oil producing regions are Western Siberia, Timan-Pechora, Ural and Volga region. Our international upstream segment includes stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Romania, Iraq, Egypt, Ghana, Norway, Cameroon, Nigeria and Mexico. Our daily hydrocarbon production in the nine months of 2017 amounted to 2.3 million BOE with liquid hydrocarbons representing approximately 80% of our overall production volumes.

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

We own and operate four refineries located in European Russia and three refineries located outside Russia – in Bulgaria, Romania, and Italy. Moreover, we have a 45% interest in the Zeeland refinery in the Netherlands. We also own two petrochemical plants in Russia and petrochemical capacities at our refineries in Bulgaria and Italy. Along with our own production of refined products we refine crude oil at third party refineries depending on market conditions and other factors. Our refinery throughput in the nine months of 2017 amounted to 1.3 million barrels per day, and we produced 0.9 million tonnes of petrochemicals.

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. We own petrol stations in 17 countries. Most of our retail networks are located close to our refineries. Our retail sales in the nine months of 2017 amounted to 10.6 million tonnes of refined products.

We are involved in production, distribution and marketing of electrical energy and heat both in Russia and internationally. In the nine months of 2017, our total output of electrical energy was 12.4 billion kWh.

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

Key financial and operational results

	3 rd quarter of 2017	2016	Change, %	9 months of 2017	2016	Change, %
(millions of rubles, except for figures in percent)						
Sales.....	1,483,484	1,309,488	13.3	4,274,253	3,826,121	11.7
EBITDA ⁽¹⁾ , including	221,146	165,890	33.3	607,835	547,453	11.0
Exploration and production segment.....	155,092	111,791	38.7	396,456	379,604	4.4
Refining, marketing and distribution segment ..	81,381	60,551	34.4	214,376	175,704	22.0
EBITDA ⁽¹⁾ net of West Qurna-2 project	215,347	160,436	34.2	595,250	513,615	15.9
Profit for the period attributable to LUKOIL shareholders	97,341	54,803	77.6	298,295	160,195	86.2
Capital expenditures	118,902	108,728	9.4	373,770	357,392	4.6
Free cash flow ⁽²⁾	90,663	104,673	(13.4)	173,696	200,487	(13.4)
Free cash flow before changes in working capital.....	83,835	58,312	43.8	194,094	166,500	16.6
(thousand BOE per day, except for figures in percent)						
Production of hydrocarbons, including our share in equity affiliates.....	2,259	2,207	2.4	2,254	2,280	(1.1)
Crude oil and natural gas liquids.....	1,795	1,815	(1.1)	1,808	1,886	(4.1)
Gas	464	392	18.4	446	394	13.2
Refinery throughput at the Group refineries	1,383	1,364	1.4	1,341	1,320	1.6

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

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

In the nine months of 2017, profit attributable to LUKOIL shareholders amounted to 298 billion RUB, an increase of 86.2% to the nine months of 2016. Our profit for the third quarter of 2017 increased by 77.6% compared to the third quarter of 2016 and amounted to 97 billion RUB.

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

In the nine months of 2017, our EBITDA amounted to 608 billion RUB, an increase of 11.0% to the nine months of 2016. Our EBITDA was affected by the decrease in volumes of compensation crude oil within the West Qurna-2 project. Net of this project, the Group’s EBITDA increased by 15.9% compared to the nine months of 2016.

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

Our free cash flow decreased by 27 billion RUB, or 13.4%, compared to the nine months of 2016 mostly as a result of an increase in working capital. In the nine months of 2016, our cash flow from operating activities was supported by the decrease in receivables related to the West Qurna-2 project, while in the nine months of 2017 this factor was insignificant. Our free cash flow was also affected by a moderate increase in our capital expenditures.

The Group’s average daily hydrocarbon production in the nine months of 2017 decreased by 1.1% compared to the nine months of 2016, driven primarily by lower volume of compensation crude oil from the West Qurna-2 project, as well as temporary external limitations due to the OPEC agreement. Planned increase in production from V.Filanovsky and Pyakyakhinskoe fields, commissioned in 2016, continued. Net of the West Qurna-2 project, our daily hydrocarbon production increased by 2.3% compared to the nine months of 2016.

In the nine months of 2017, throughput at own refineries increased by 1.6% compared to the nine months of 2016 mainly due to the higher utilization rates at refineries in Nizhny Novgorod and Volgograd. We also achieved better product slate due to modernization of our refining capacities in Russia and feedstock optimization.

Changes in Group structure

In December 2016, the Company entered into a contract with a company of the “Otkrytie Holding” group to sell the Group’s 100% interest in JSC “Arkhangelskgeoldobycha” (“AGD”), a company developing the diamond field named after V.P. Grib located in Arkhangelsk region of Russia. The transaction in the amount of Russian ruble equivalent of \$1.45 billion was completed on 24 May 2017 after all necessary governmental approvals were received. As a result the Group recognized profit before income tax in the amount of 48 billion RUB that is included in “Other income (expenses)” in the consolidated statement of profit or loss and other comprehensive income (profit after income tax – 38 billion RUB).

In February 2017, LUKOIL completed the sale of wholly owned subsidiary – LUKOIL Chemical B.V., which owns “Karpatneftekhim” petrochemical plant located in Ivano-Frankovsk area of Ukraine.

Within the framework of retail business optimization, we sold petrol station networks in Poland, Latvia, Lithuania and Cyprus in 2016.

Main macroeconomic factors affecting our results of operations

International crude oil and refined products prices

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

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

During the nine months of 2017, the price for Brent crude oil fluctuated between \$44 and \$59 per barrel, reached its maximum of \$59.3 in the end of September and then minimum of \$44.3 in the end of June, and averaged 23.8% higher than in the nine months of 2016. Nevertheless, as a result of the ruble appreciation, the prices expressed in rubles increased less significantly.

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

	3 rd quarter of		Change,	9 months of		Change,
	2017	2016	%	2017	2016	%
(in US dollars per barrel, except for figures in percent)						
Brent crude.....	52.08	45.86	13.6	51.84	41.88	23.8
Urals crude (CIF Mediterranean)	51.03	44.35	15.1	50.83	40.54	25.4
Urals crude (CIF Rotterdam)	50.73	43.73	16.0	50.39	39.67	27.0
(in US dollars per metric tonne, except for figures in percent)						
Fuel oil 3.5% (FOB Rotterdam).....	295.75	228.98	29.2	288.20	188.71	52.7
Diesel fuel 10 ppm (FOB Rotterdam)	488.20	407.10	19.9	472.91	377.62	25.2
High-octane gasoline (FOB Rotterdam)	560.06	472.82	18.5	544.40	454.59	19.8
Naphtha (FOB Rotterdam).....	458.59	377.71	21.4	456.26	363.74	25.4
Jet fuel (FOB Rotterdam).....	517.62	434.14	19.2	502.49	402.53	24.8
Vacuum gas oil (FOB Rotterdam)	357.82	310.94	15.1	352.01	282.37	24.7

Source: Platts.

	3 rd quarter of		Change,	9 months of		Change,
	2017	2016	%	2017	2016	%
(in rubles per barrel, except for figures in percent)						
Brent crude.....	3,074	2,964	3.7	3,024	2,863	5.6
Urals crude (CIF Mediterranean)	3,012	2,866	5.1	2,965	2,772	7.0
Urals crude (CIF Rotterdam)	2,994	2,826	5.9	2,940	2,712	8.4
(in rubles per metric tonne, except for figures in percent)						
Fuel oil 3.5% (FOB Rotterdam).....	17,455	14,798	18.0	16,812	12,901	30.3
Diesel fuel 10 ppm (FOB Rotterdam)	28,813	26,309	9.5	27,587	25,817	6.9
High-octane gasoline (FOB Rotterdam)	33,055	30,556	8.2	31,757	31,079	2.2
Naphtha (FOB Rotterdam).....	27,066	24,409	10.9	26,616	24,867	7.0
Jet fuel (FOB Rotterdam).....	30,550	28,056	8.9	29,312	27,520	6.5
Vacuum gas oil (FOB Rotterdam)	21,118	20,094	5.1	20,535	19,305	6.4

Translated into rubles using average exchange rate for the period.

Domestic crude oil and refined products prices

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

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

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

	3 rd quarter of		Change,	9 months of		Change,
	2017	2016	%	2017	2016	%
(in rubles per metric tonne, except for figures in percent)						
Fuel oil.....	11,151	8,446	32.0	9,953	6,598	50.8
Diesel fuel.....	33,014	29,548	11.7	32,111	28,523	12.6
High-octane gasoline (Regular).....	36,631	34,647	5.7	36,021	33,603	7.2
High-octane gasoline (Premium).....	37,987	36,582	3.8	36,763	35,285	4.2

Source: InfoTEK (excluding VAT).

Changes in ruble exchange rate and inflation

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

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
Ruble inflation (CPI), %	(0.6)	0.8	1.7	4.1
Ruble to US dollar exchange rate				
Average for the period	59.0	64.6	58.3	68.4
At the beginning of the period	59.1	64.3	60.7	72.9
At the end of the period.....	58.0	63.2	58.0	63.2
Ruble to euro exchange rate				
Average for the period	69.3	72.2	64.9	76.3
At the beginning of the period	67.5	71.2	63.8	79.7
At the end of the period.....	68.4	70.9	68.4	70.9

Source: CBR, Federal State Statistics Service.

Taxation

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

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

	3 rd quarter of		Change,	9 months of		Change,
	2017	2016	%	2017	2016	%
(in US dollars per tonne, except for figures in percent)						
Export duties on crude oil	79.75	88.76	(10.2)	83.47	70.37	18.6
Export duties on refined products						
Fuel oil.....	79.75	72.74	9.6	83.47	57.66	44.8
Gasoline	23.89	54.09	(55.8)	25.01	42.87	(41.7)
Straight-run gasoline.....	43.81	62.97	(30.4)	45.87	49.92	(8.1)
Diesel fuel	23.89	35.47	(32.6)	25.01	28.12	(11.1)
Light and middle distillates.....	23.89	35.47	(32.6)	25.01	28.12	(11.1)
Mineral extraction tax ⁽¹⁾						
Crude oil	132.36	94.36	40.3	130.28	79.59	63.7
(in US dollars per thousand cubic meters, except for figures in percent)						
Natural gas (Nakhodkinskoe field).....	4.37	3.22	35.7	4.31	3.04	41.6
Natural gas (Pyakyakhinskoye field) ⁽²⁾	8.35	—	—	8.10	—	—

⁽¹⁾ Translated from rubles using average exchange rate for the period.

⁽²⁾ Gas production started in January 2017.

	3 rd quarter of 2017	2016	Change, %	9 months of 2017	2016	Change, %
(in rubles per tonne, except for figures in percent)						
Export duties on crude oil ⁽¹⁾	4,707	5,736	(17.9)	4,869	4,811	1.2
Export duties on refined products ⁽¹⁾						
Fuel oil	4,707	4,701	0.1	4,869	3,942	23.5
Gasoline	1,410	3,496	(59.7)	1,459	2,931	(50.2)
Straight-run gasoline	2,586	4,069	(36.4)	2,676	3,413	(21.6)
Diesel fuel	1,410	2,292	(38.5)	1,459	1,923	(24.1)
Light and middle distillates	1,410	2,292	(38.5)	1,459	1,923	(24.1)
Mineral extraction tax						
Crude oil	7,812	6,098	28.1	7,600	5,441	39.7
(in rubles per thousand cubic meters, except for figures in percent)						
Natural gas (Nakhodkinskoe field).....	258	208	23.9	251	208	20.8
Natural gas (Pyakyakhinskoye field) ⁽²⁾	493	—	—	472	—	—

⁽¹⁾ Translated to rubles using average exchange rate for the period.

⁽²⁾ Gas production started in January 2017.

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

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

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

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

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

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

	2016	2017	2018	2019	2020	2021
(in rubles per tonne)						
Base Rate	857	919	919	919	919	919
Fixed Component.....	—	306	357	428	428	0

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

- A special reducing coefficient is applied to the standard tax rate depending on location, depletion, type of reserves, size and complexity of a particular field. This type of incentive with different coefficients is applied to our highly depleted fields (more than 80% depletion), our Yu. Korchagin field located in the Caspian offshore, the Permian layers of our Usinskoye field in Timan-Pechora producing high-viscous crude oil, our Pyakyakhinskoye field located in the Yamal-Nenets Autonomous region of Western Siberia, a number of fields in the Nenets Autonomous region, as well as to our new small-sized fields (recoverable reserves less than 5 million tonnes) and fields and deposits with low permeability like V.N. Vinogradov field and Tyumen deposits;
- A fixed tax rate of 15% of the international Urals price is applied to our V. Filanovsky field, located in the Caspian offshore;
- A zero tax rate is applied to our Yaregskoye field producing extra-viscous crude oil, as well as to 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. 9 illustrates the impact of crude oil extraction tax incentives on taxation of crude oil production from different fields and deposits at \$50 per barrel Urals price.

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

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

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

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

The table below illustrates the impact of the “export duty lag effect” on the Urals price net of taxes.

	3 rd quarter of		Change,	9 months of		Change,
	2017	2016	%	2017	2016	%
(in US dollars per barrel, except for figures in percent)						
Urals price (Argus)	51.16	43.73	17.0	50.51	39.69	27.3
Enacted export duty on crude oil	10.92	12.16	(10.2)	11.43	9.64	18.6
Net Urals price ⁽¹⁾	22.10	18.64	18.5	21.23	19.15	10.9
Lag effect	0.92	(0.30)	–	0.21	0.51	(58.3)
Net Urals price ⁽¹⁾ assuming no lag	21.18	18.94	11.9	21.02	18.64	12.8
(in rubles per barrel, except for figures in percent) ⁽²⁾						
Urals price (Argus)	3,019	2,826	6.8	2,946	2,713	8.6
Enacted export duty on crude oil	645	786	(17.9)	667	659	1.2
Net Urals price ⁽¹⁾	1,305	1,205	8.3	1,238	1,309	(5.4)
Lag effect	54	(19)	–	12	35	(64.5)
Net Urals price ⁽¹⁾ assuming no lag	1,250	1,224	2.1	1,226	1,274	(3.8)

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

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

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

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

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

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

Crude oil and refined products 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.

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

	3 rd quarter of 2017	2016	Change, %	9 months of 2017	2016	Change, %
(in rubles per tonne, except for figures in percent)						
Gasoline						
Below Euro-5.....	13,100	13,100	–	13,100	12,236	7.1
Euro-5	10,130	10,130	–	10,130	9,266	9.3
Diesel fuel						
All ecological classes.....	6,800	5,293	28.5	6,800	4,913	38.4
Motor oils.....	5,400	6,000	(10.0)	5,400	6,000	(10.0)
Straight-run gasoline	13,100	13,100	–	13,100	12,236	7.1

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

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

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

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

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

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

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

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

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

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

	3 rd quarter of 2017 to 3 rd quarter of 2016	9 months of 2017 to 9 months of 2016
Transneft		
Crude oil	3.5%	3.4%
Russian Railways		
Crude oil and refined products	6.0%	6.0%

Segments highlights

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations related to crude oil and gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, Northern and Western Africa, Norway, Romania and Mexico.
- **Refining, Marketing and Distribution** – which includes refining, petrochemical and transport operations, marketing and trading of crude oil, natural gas and refined products, generation, transportation and sales of electricity, heat and related services.
- **Corporate and other** – which includes operations related to our headquarters (which coordinates the operations of Group companies), finance activities, and certain other activities.

Each of our segments is dependent on the 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. 7, 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. We present the financial data for each segment in Note 29 “Segment information” to our condensed interim consolidated financial statements.

Exploration and production

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
EBITDA in Russia.....	133,637	99,904	341,375	322,459
EBITDA outside Russia ⁽¹⁾	21,455	11,887	55,081	57,145
EBITDA.....	155,092	111,791	396,456	379,604
Hydrocarbon extraction expenses	52,156	51,967	154,165	159,638
- in Russia.....	43,978	41,880	131,243	122,698
- outside Russia ⁽²⁾	4,537	3,346	10,238	11,589
- in Iraq	3,641	6,741	12,684	25,351
	(ruble per BOE)			
Hydrocarbon extraction expenses ⁽²⁾	245	237	242	234
- in Russia	245	238	245	232
- outside Russia ⁽²⁾	250	228	204	257
	(US dollar per BOE)			
Hydrocarbon extraction expenses ⁽²⁾	4.15	3.67	4.14	3.43
- in Russia.....	4.14	3.68	4.20	3.41
- outside Russia ⁽²⁾	4.23	3.54	3.50	3.75

⁽¹⁾ Including EBITDA of the West Qurna-2 project in the amounts of 5,799 million RUB and 5,454 million RUB in the third quarter of 2017 and 2016 and in the amounts of 12,585 million RUB and 33,838 million RUB in the nine months of 2017 and 2016, respectively.

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

Our upstream EBITDA increased by 38.7%, compared to the third quarter of 2016, and by 4.4%, compared to the nine months of 2016.

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

Outside Russia, EBITDA of the West Qurna-2 project decreased compared to the nine months of 2016 as we were compensated for the most part of costs incurred at the field development stage and moved to production maintenance stage. Excluding West Qurna-2, our international upstream EBITDA increased due to higher average international hydrocarbon prices and positive production dynamics of our gas projects, as well as business optimization measures.

The following table summarizes or hydrocarbon production by major regions.

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousand BOE per day)			
Crude oil and natural gas liquids⁽¹⁾				
Consolidated subsidiaries				
Western Siberia	795	818	808	842
Timan-Pechora	312	338	312	342
Ural region	321	321	323	322
Volga region.....	201	133	194	131
Other in Russia	33	36	33	36
Total in Russia.....	1,662	1,646	1,670	1,673
Iraq ⁽²⁾	40	72	36	112
Other outside Russia.....	41	45	44	44
Total outside Russia.....	81	117	80	156
Total consolidated subsidiaries	1,743	1,763	1,750	1,829
Our share in equity affiliates				
in Russia	17	21	20	20
outside Russia	35	31	38	37
Total share in equity affiliates.....	52	52	58	57
Total crude oil and natural gas liquids	1,795	1,815	1,808	1,886
Natural and petroleum gas⁽³⁾				
Consolidated subsidiaries				
Western Siberia	222	184	218	184
Timan-Pechora	34	35	35	33
Ural region	15	16	16	16
Volga region.....	22	30	22	26
Other in Russia	1	1	1	1
Total in Russia.....	294	266	292	260
Total outside Russia.....	156	114	140	121
Total consolidated subsidiaries	450	380	432	381
Share in equity affiliates				
in Russia	2	1	2	1
outside Russia	12	11	12	12
Total share in production of equity affiliates.....	14	12	14	13
Total natural and petroleum gas.....	464	392	446	394
Total daily hydrocarbon production	2,259	2,207	2,254	2,280

⁽¹⁾ Natural gas liquids produced at the Group gas processing plants in the amounts of 33 thousand BOE per day and 16 thousand BOE per day in the third quarter of 2017 and 2016 and in the amounts of 35 thousand BOE per day and 30 thousand BOE per day in the nine months of 2017 and 2016, respectively.

⁽²⁾ Compensation oil that represented approximately 9.1% of production from the West Qurna-2 field in the nine months of 2017 and 27.3% in the nine months of 2016.

⁽³⁾ Natural and petroleum gas production excluding flaring, reinjection, and direction to Group's gas processing plants.

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Western Siberia.....	9,702	10,164	29,262	30,793
Timan-Pechora.....	3,983	4,312	11,804	12,956
Ural region.....	3,794	3,839	11,316	11,387
Volga region.....	2,431	1,635	6,983	4,795
Other in Russia.....	427	464	1,270	1,386
Crude oil produced in Russia	20,337	20,414	60,635	61,317
Iraq ⁽¹⁾	539	967	1,426	4,477
Other outside Russia	464	533	1,477	1,533
Crude oil produced outside Russia.....	1,003	1,500	2,903	6,010
Total crude oil produced by consolidated subsidiaries	21,340	21,914	63,538	67,327
Our share in crude oil produced by equity affiliates:				
in Russia	201	246	719	714
outside Russia.....	410	367	1,284	1,260
Total crude oil produced	21,951	22,527	65,541	69,301

⁽¹⁾ Compensation oil that represented approximately 9.1% of production from the West Qurna-2 field in the nine months of 2017 and 27.3% in the nine months of 2016.

The main oil producing region for the Company is Western Siberia where we produced 46.1% of our crude oil in the nine months of 2017 (45.7% in the nine months of 2016).

In October 2016, we started commercial production at two new major fields, the V. Filanovsky field in the Caspian Sea (Volga region) and the Pyakyakhinskoye field in the Bolshekhetskaya depression (Western Siberia). These fields have a major positive impact on our financial results due to high quality reserve base and tax incentives. In the nine months of 2017, the Group produced 3,171 thousand tonnes of crude oil at the V. Filanovsky field and 1,135 thousand tonnes of liquids at the Pyakyakhinskoye field. In the third quarter of 2017, production from these fields increased by 4.5% and 2.4%, respectively, compared to the second quarter of 2017.

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

The decrease in our international production was a result of lower volumes of production from the West Qurna-2 oilfield in Iraq attributable to the Company. We were compensated for most of the costs incurred within the construction stage of the project and therefore were eligible for less volumes of compensation crude oil (for details see p. 16).

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

	3rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of cubic meters)			
Western Siberia.....	3,465	2,879	10,123	8,580
Timan-Pechora.....	533	550	1,628	1,554
Ural region.....	240	243	738	726
Volga region.....	350	476	1,011	1,227
Other in Russia.....	8	8	24	26
Gas produced in Russia	4,596	4,156	13,524	12,113
Gas produced outside Russia	2,445	1,782	6,472	5,646
Total gas produced by consolidated subsidiaries	7,041	5,938	19,996	17,759
Our share in gas produced by equity affiliates:				
in Russia	23	22	71	63
outside Russia.....	193	162	601	561
Total gas produced.....	7,257	6,122	20,668	18,383

Our major gas production region is Western Siberia (Bolshekhetskaya depression), where the major part of gas is produced from the Nakhodkinskoe field, which has been developed since 2005. In January 2017, we started gas production from our second field in Bolshekhetskaya depression, the Pyakyakhinskoye field, which substantially contributed to our overall gas production in Russia that increased by 11.6% compared to the nine months of 2016. Natural gas production from Pyakyakhinskoe field amounted to 1,994 million cubic meters. Our international gas production (including our share in affiliates' production) increased by 14.0%, compared to the nine months of 2016, as a result of commissioning of new gas treatment facilities within Gissar project in Uzbekistan.

West Qurna-2 project

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

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

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

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

There are two steps of revenue recognition:

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

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

	Costs incurred ⁽¹⁾	Remuneration fee (millions of US dollars)	Crude oil received	Crude oil to be received
Cumulative at 31 December 2016.....	7,532	272	7,275	529
Change during the nine months of 2017.....	378	60	412	26
Income tax ⁽²⁾	—	(60)	—	(60)
Cumulative at 30 September 2017	7,910	272	7,687	495

⁽¹⁾ Including prepayments.

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

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

	3 rd quarter of			
	2017		2016	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production.....	35,605	5,190	37,249	5,430
Production related to cost compensation and remuneration ⁽¹⁾	3,700	539	6,633	967
Shipment of compensation crude oil ^{(1) (2)}	3,924	572	17,788	2,593
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation	7,712	131	10,210	158
Remuneration fee	1,810	30	2,067	31
	9,522	161	12,277	189
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i>) ⁽²⁾	10,775	182	45,037	697
Extraction expenses	3,641	62	6,741	105
Depreciation, depletion and amortization.....	4,150	71	3,117	54
EBITDA.....	5,799	99	5,454	84

⁽¹⁾ Translated into barrels using conversion rate characterizing the density of the field.

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

	9 months of			
	2017		2016	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production.....	107,320	15,644	112,311	16,372
Production related to cost compensation and remuneration ⁽¹⁾	9,784	1,426	30,714	4,477
Shipment of compensation crude oil ^{(1) (2)}	8,942	1,303	53,070	7,736
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation	22,274	382	53,070	756
Remuneration fee	3,529	60	6,603	96
	25,803	442	59,673	852
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i>) ⁽²⁾	24,142	412	119,031	1,768
Extraction expenses	12,684	218	25,351	369
Depreciation, depletion and amortization.....	9,826	169	27,462	384
EBITDA.....	12,585	216	33,838	477

⁽¹⁾ Translated into barrels using conversion rate characterizing the density of the field.

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

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

Refining, marketing and distribution

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
EBITDA in Russia	62,565	43,495	156,212	116,131
EBITDA outside Russia	18,816	17,056	58,164	59,573
EBITDA	81,381	60,551	214,376	175,704
Refining expenses at the Group refineries	22,456	21,102	63,458	66,356
- in Russia	10,207	10,799	29,788	32,010
- outside Russia	12,249	10,303	33,670	34,346
	(ruble per tonne)			
Refining expenses at the Group refineries	1,294	1,233	1,271	1,345
- in Russia	927	974	932	1,032
- outside Russia	1,930	1,709	1,872	1,876
	(US dollar per tonne)			
Refining expenses at the Group refineries	21.92	19.08	21.77	19.73
- in Russia	15.71	15.07	15.97	15.18
- outside Russia	32.71	26.45	32.08	27.44

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

Refining and petrochemicals

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Refinery throughput at the Group refineries	17,356	17,119	49,946	49,339
- in Russia	11,010	11,092	31,963	31,029
- outside Russia, including	6,346	6,027	17,983	18,310
- crude oil	5,823	5,362	16,301	14,900
- refined products	523	665	1,682	3,410
Refinery throughput at third party refineries	1,670	80	4,744	245
Total refinery throughput	19,026	17,199	54,690	49,584
Production of the Group refineries in Russia⁽¹⁾	10,471	10,554	30,239	29,372
- diesel fuel	4,070	3,241	11,648	9,630
- gasoline	2,198	2,152	6,077	5,795
- fuel oil	1,089	1,560	3,800	4,232
- jet fuel	803	695	2,021	1,605
- lubricants and components	321	265	872	767
- straight-run gasoline	482	347	1,590	1,353
- vacuum gas oil	72	873	575	2,166
- bitumen	293	285	711	649
- coke	277	269	749	728
- other products	866	867	2,196	2,447
Production of the Group refineries outside Russia	5,984	5,695	16,933	17,204
- diesel fuel	2,676	2,450	7,425	7,345
- gasoline	1,347	1,180	3,806	3,648
- fuel oil	560	726	2,178	2,512
- jet fuel	327	266	822	686
- straight-run gasoline	205	190	602	554
- coke	51	58	135	166
- other products	818	825	1,965	2,293
Refined products produced by the Group	16,455	16,249	47,172	46,576
Refined products produced at third party refineries	1,627	76	4,658	235
Total refined products produced	18,082	16,325	51,830	46,811
Products produced at petrochemical plants and facilities	303	319	942	965
- in Russia	204	233	656	691
- outside Russia	99	86	286	274

⁽¹⁾ Net of cross-supplies of refined products among the Group refineries in the amounts of 444 thousand tonnes and 308 thousand tonnes in the third quarter of 2017 and 2016 and 1,321 thousand tonnes and 994 thousand tonnes in the nine months of 2017 and 2016, respectively.

Compared to the nine months of 2016, the total volume of refined products produced by the Group increased by 1.3%.

Production at our refineries in Russia increased by 3.0% largely as a result of the planned maintenance at our refineries in Nizhny Novgorod and Volgograd in the nine months of 2016.

In Russia, we continued improving our refined product slate by launching new conversion facilities and cross-supplies of dark products produced at Perm and Ukhta refineries to catalytic cracking units at our refineries in Nizhny Novgorod and Volgograd. As a result, share of gasoline and diesel fuel in our total production volumes increased by 6.1 p.p. compared the nine months of 2016 and share of fuel oil and vacuum gasoil decreased by 7.3 p.p. Also, purchased additives were partially substituted with additives of own production that resulted in the optimization of operating expenses.

Internationally, the production decreased by 1.6% due to scheduled maintenance works at our refineries in Italy and Romania. At the same time, as a result of the change in price environment, the volume of crude oil processing increased by 9.4% while the volume of refined product processing decreased more than twofold.

In the periods considered, we processed our crude oil at third party refineries in Belarus and Kazakhstan. Moreover, in the end of 2016, a Group company entered into a tolling agreement with a Canadian refinery. In the nine months of 2017, attributable refined products output amounted to 4.5 million tonnes. The agreement is valid through 2019.

Marketing and trading

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

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

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

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Crude oil purchases				
in Russia	236	224	747	638
for trading internationally	8,044	6,544	25,096	18,663
for refining internationally	5,799	4,102	16,654	11,395
Shipment of the West Qurna-2 compensation crude oil.....	572	2,593	1,303	7,736
Total crude oil purchased.....	14,651	13,463	43,800	38,432

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Retail sales.....	3,820	3,833	10,626	10,474
Wholesale sales.....	28,820	26,407	86,384	81,009
Total refined products sales	32,640	30,240	97,010	91,483
Refined products purchased in Russia	386	458	1,335	1,287
Refined products purchased internationally	13,715	13,883	44,609	46,515
Total refined products purchased	14,101	14,341	45,944	47,802

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

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Exports of crude oil to Customs Union	695	582	2,124	2,536
Exports of crude oil beyond Customs Union	8,359	6,414	25,585	22,291
Total crude oil exports.....	9,054	6,996	27,709	24,827
Exports of crude oil through Transneft and other third party infrastructure.....	6,699	4,970	20,733	18,710
including volumes exported through ESPO pipeline	300	309	840	909
Exports of crude oil through the Group's transportation infrastructure.....	2,355	2,026	6,976	6,117
Total crude oil exports.....	9,054	6,996	27,709	24,827
	(millions of rubles)			
Exports of crude oil to Customs Union	11,699	8,436	34,310	36,409
Exports of crude oil beyond Customs Union	176,781	123,215	524,777	402,050
Total crude oil exports.....	188,480	131,651	559,087	438,459

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Refined products exports				
- diesel fuel	2,386	1,929	7,531	6,322
- gasoline	57	68	146	307
- fuel oil	342	1,019	2,011	2,629
- jet fuel	18	60	76	180
- lubricants and components	152	139	476	463
- gas refinery products	275	104	871	438
- other products	557	1,228	1,996	3,913
Total refined products exports	3,787	4,547	13,107	14,252
	(millions of rubles)			
Total refined products exports	98,199	94,736	316,897	284,059

In the nine months of 2017, the volume of our crude oil exports from Russia increased by 11.6%, and we exported 45.7% of our domestic crude oil production (40.5% in the nine months of 2016) and 311 thousand tonnes of crude oil purchased from our affiliates and third parties (326 thousand tonnes in the nine months of 2016). The increase in export volumes was a result of lower domestic sales. The volume of our refined products exports decreased by 8.0% compared to the nine months of 2016 following the increase in domestic sales due to higher profitability of the domestic market.

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

The Company also exports its light crude oil through the Caspian Pipeline Consortium and Eastern Siberia – Pacific Ocean pipelines that allows us to preserve the premium quality of crude oil and thus enables us to achieve higher netbacks compared to traditional exports.

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

In the nine months of 2017, we sold 8 million tonnes of motor fuels via our domestic retail network, that represented an increase of 3.8% against the nine months of 2016. Outside Russia, retail sales decreased to 3 million tonnes, or by 3.9%, mostly as a result of divestment of our retail networks in Poland, the Baltic states and Cyprus.

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

Power generation. We established a vertically integrated chain from generation to transportation and sale of power and heat for third party customers (commercial generation) and own consumption. We own commercial generation facilities in the Southern regions of European Russia. We also own renewable energy capacity in Russia and abroad. In the nine months of 2017, our total output of commercial electrical energy was 12.4 billion kWh (12.9 billion kWh in the nine months of 2016), and our total output of commercial heat energy was approximately 7.2 million Gcal (8.5 million Gcal in the nine months of 2016).

Financial results

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Revenues				
Sales (including excise and export tariffs)	1,483,484	1,309,488	4,274,253	3,826,121
Costs and other deductions				
Operating expenses	(120,608)	(112,133)	(338,674)	(339,086)
Cost of purchased crude oil, gas and products	(782,950)	(654,871)	(2,226,683)	(1,869,901)
Transportation expenses.....	(62,980)	(71,169)	(204,210)	(235,533)
Selling, general and administrative expenses.....	(42,872)	(52,658)	(118,403)	(145,783)
Depreciation, depletion and amortization	(83,920)	(74,790)	(248,856)	(230,746)
Taxes other than income taxes	(135,266)	(122,245)	(434,588)	(324,522)
Excise and export tariffs	(116,820)	(129,440)	(341,595)	(358,209)
Exploration expenses	(842)	(1,082)	(2,265)	(5,634)
Profit from operating activities.....	137,226	91,100	358,979	316,707
Finance income	3,261	3,778	9,662	11,120
Finance costs.....	(5,925)	(11,949)	(22,162)	(33,418)
Equity share in income of affiliates.....	3,985	198	11,670	5,976
Foreign exchange loss.....	(9,441)	(10,207)	(25,149)	(84,530)
Other (expenses) income.....	(737)	2,872	44,604	(4,676)
Profit before income taxes	128,369	75,792	377,604	211,179
Current income taxes	(30,157)	(19,389)	(75,096)	(47,048)
Deferred income taxes	(427)	(1,300)	(3,245)	(3,364)
Total income tax expense.....	(30,584)	(20,689)	(78,341)	(50,412)
Profit for the period.....	97,785	55,103	299,263	160,767
Profit for the period attributable to non-controlling interests.....	(444)	(300)	(968)	(572)
Profit for the period attributable to PJSC LUKOIL shareholders	97,341	54,803	298,295	160,195
Basic and diluted earnings per share of common stock attributable to PJSC LUKOIL shareholders (in Russian rubles).....	137.17	76.87	419.37	224.70

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

Sales revenues

Sales breakdown	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Crude oil				
Export and sales on international markets other than Customs Union	348,206	306,259	1,071,351	864,501
Export and sales to Customs Union	11,473	8,411	33,582	36,179
Domestic sales	9,930	31,177	27,942	75,921
	369,609	345,847	1,132,875	976,601
Cost compensation and remuneration at the West Qurna-2 project	9,522	12,277	25,803	59,673
	379,131	358,124	1,158,678	1,036,274
Refined products ⁽¹⁾				
Export and sales on international markets				
Wholesale	725,931	611,782	2,093,493	1,846,724
Retail	76,253	77,372	205,353	232,835
Domestic sales				
Wholesale	104,882	78,240	257,284	185,652
Retail	114,026	107,460	309,329	280,081
	1,021,092	874,854	2,865,459	2,545,292
Petrochemicals				
Export and sales on international markets	10,345	7,915	35,807	26,877
Domestic sales	9,445	10,521	28,552	28,615
	19,790	18,436	64,359	55,492
Gas				
Sales on international markets	14,468	6,929	36,649	26,444
Domestic sales	7,788	6,343	22,719	20,416
	22,256	13,272	59,368	46,860
Sales of energy and related services				
Sales on international markets	3,558	3,859	9,149	10,384
Domestic sales	12,725	12,268	44,913	42,946
	16,283	16,127	54,062	53,330
Other				
Export and sales on international markets	12,381	16,059	38,096	53,361
Domestic sales	12,551	12,616	34,231	35,512
	24,932	28,675	72,327	88,873
Total sales	1,483,484	1,309,488	4,274,253	3,826,121

Sales volumes	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(thousands of tonnes)			
Crude oil				
Export and sales on international markets other than Customs Union	15,626	15,150	49,216	45,469
Export and sales to Customs Union	680	577	2,083	2,509
Domestic sales	607	2,357	1,802	5,824
	16,913	18,084	53,101	53,802
Crude oil volumes related to cost compensation and remuneration at the West Qurna-2 project	539	967	1,426	4,477
	17,452	19,051	54,527	58,279
Refined products ⁽¹⁾				
Export and sales on international markets				
Wholesale	24,605	22,951	75,722	72,035
Retail	1,104	1,102	3,103	3,229
Domestic sales				
Wholesale	4,215	3,456	10,662	8,974
Retail	2,716	2,731	7,523	7,245
	32,640	30,240	97,010	91,483
Petrochemicals				
Export and sales on international markets	213	158	697	576
Domestic sales	206	212	583	536
	419	370	1,280	1,112
Total sales volumes	50,511	49,661	152,817	150,874

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

Realized average sales prices

		3 rd quarter of		9 months of	
		2017	2016	2017	2016
Average realized price on international markets					
Crude oil (beyond Customs Union) ⁽¹⁾	(RUB/barrel)	3,040	2,758	2,970	2,594
Crude oil (Customs Union)	(RUB/barrel)	2,302	1,989	2,199	1,967
Refined products					
Wholesale	(RUB/tonne)	29,503	26,656	27,647	25,636
Retail.....	(RUB/tonne)	69,070	70,211	66,179	72,107
Petrochemicals.....	(RUB/tonne)	48,568	50,095	51,373	46,661
Crude oil (beyond Customs Union) ⁽¹⁾	(\$/barrel)	51.51	42.68	50.91	37.94
Crude oil (Customs Union)	(\$/barrel)	39.00	30.77	37.70	28.77
Refined products					
Wholesale	(\$/tonne)	500	412	474	375
Retail.....	(\$/tonne)	1,170	1,086	1,134	1,055
Petrochemicals.....	(\$/tonne)	823	775	881	683
Average realized price within Russia					
Crude oil	(RUB/barrel)	2,232	1,805	2,115	1,778
Refined products					
Wholesale	(RUB/tonne)	24,883	22,639	24,131	20,688
Retail.....	(RUB/tonne)	41,983	39,348	41,118	38,659
Petrochemicals.....	(RUB/tonne)	45,850	49,627	48,974	53,386

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

During the third quarter of 2017, our revenues increased by 174 billion RUB, or by 13.3%, compared to the third quarter of 2016. Our revenues from crude oil sales increased by 21 billion RUB, or by 5.9%, and our revenues from sales of refined products increased by 146 billion RUB, or by 16.7%.

During the nine months of 2017, our revenues increased by 448 billion RUB, or by 11.7%, compared to the nine months of 2016. Our revenues from crude oil sales increased by 122 billion RUB, or by 11.8%, and our revenues from sales of refined products increased by 320 billion RUB, or by 12.6%.

The main reason for that was the increase in international hydrocarbon prices as well as the increase in crude oil trading volumes. That was partially compensated for by the effect of the ruble appreciation on our revenues denominated in other currencies.

Sales of crude oil

Compared to the third quarter and the nine months of 2016, our international crude oil sales revenue increased by 13.7%, or by 42 billion RUB, and by 23.9%, or by 207 billion RUB, respectively. Our international sales volumes (beyond the Customs Union) increased by 476 thousand tonnes, or by 3.1%, in the third quarter of 2017, and by 3,747 thousand tonnes, or by 8.2%, in the nine months of 2017, due to higher volumes of crude oil trading. Our average international ruble realized prices increased by 10.2% and by 14.5% compared to the third quarter and the nine months of 2016, respectively.

Our realized domestic crude oil sales price increased by 23.7% and by 19.0% compared to the third quarter and the nine months of 2016, respectively. Our domestic sales volumes decreased by 1,750 thousand tonnes, or by 74.2%, and by 4,022 thousand tonnes, or by 69.1%, respectively, in favor of export deliveries and refining and also as a result of lower production. As a consequence, in the third quarter and the nine months of 2017, our domestic sales revenue decreased by 68.1%, or by 21 billion RUB, and by 63.2%, or by 48 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.

In the nine months of 2017, the volumes of crude oil related to cost compensation and remuneration fee significantly decreased to the nine months of 2016. Therefore the amount of cost compensation and remuneration fee decreased by 3 billion RUB, or by 22.4%, compared to the third quarter of 2016 and by 34 billion RUB, or by 56.8%, compared to the nine months of 2016. For details see p. 16.

Sales of refined products

Compared to the third quarter of 2016, our revenue from the wholesale of refined products outside Russia increased by 114 billion RUB, or by 18.7%, and compared to the nine months of 2016, it increased by 247 billion RUB, or by 13.4%, that was both price and volume driven. During the third quarter and the nine months of 2017, our sales volumes increased by 7.2% and by 5.1%, respectively. Our dollar realized prices increased by 21.2% and by 26.4%, and our ruble realized prices increased by 10.7% and by 7.8%, respectively.

During the third quarter and the nine months of 2017, our dollar realized retail prices outside Russia increased by 7.7% and by 7.6%, respectively, while our ruble realized prices decreased by 1.6% and by 8.2%, respectively, due to the ruble appreciation. Our sales volumes were flat to the third quarter of 2016 and decreased by 3.9% to the nine months of 2016 as a consequence of sale of our retail networks in Eastern Europe. As a result, our international retail revenue decreased by 1 billion RUB, or by 1.4%, and by 27 billion RUB, or by 11.8%, compared to the third quarter and the nine months of 2016, respectively.

During the third quarter and the nine months of 2017, our revenue from the wholesale of refined products on the domestic market increased by 27 billion RUB, or by 34.1%, and by 72 billion RUB, or by 38.6%, respectively. Our realized prices increased by 9.9% and by 16.6% and our sales volumes increased by 22.0% and by 18.8%, respectively.

In the third quarter and the nine months of 2017, our revenue from refined products retail sales in Russia increased by 7 billion RUB, or by 6.1%, and by 29 billion RUB, or by 10.4%, respectively. Our average domestic retail prices increased by 6.7% and by 6.4% and our average domestic retail volumes decreased by 0.5% and increased by 3.8%, respectively.

Sales of petrochemical products

In the third quarter and the nine months of 2017, our revenue from sales of petrochemical products increased by 1 billion RUB, or by 7.3%, and by 9 billion RUB, or by 16.0%, respectively, largely as a result of the increased sales volumes.

Sales of gas

Compared to the third quarter and the nine months of 2016, sales of gas increased by 9 billion RUB, or by 67.7%, and by 13 billion RUB, or by 26.7%, respectively, mainly as a result of the increase in gas production and higher realized prices.

Sales of energy and related services

Compared to the respective periods of 2016, our revenue from sales of energy and related services didn't change significantly.

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 2017, revenue from other sales decreased by 4 billion RUB, or by 13.1%, and by 17 billion RUB, or by 18.6%, respectively. In the second quarter of 2017, we divested our diamond business and therefore had no respective revenue in the third quarter of 2017 (in the third quarter of 2016 it amounted to 4 billion RUB). Our nine months results included 6 billion RUB of revenue from sales of diamonds (15 billion RUB in the nine months of 2016). Our revenue from transportation services decreased by 1 billion RUB, or by 29.2%, in the third quarter of 2017 and by 6 billion RUB, or by 37.1%, in the nine months of 2017. This was partially offset by the increase in non-petrol revenue of our retail network.

Operating expenses

Operating expenses include the following:

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Hydrocarbon extraction expenses ⁽¹⁾	48,515	45,226	141,481	134,287
Extraction expenses at the West Qurna-2 field	3,641	6,741	12,684	25,351
Own refining expenses.....	22,456	21,102	63,458	66,356
Refining expenses at third parties refineries	7,223	185	10,235	606
Expenses for crude oil transportation to refineries.....	12,896	11,229	36,281	34,457
Power generation and distribution expenses	9,204	10,186	28,903	29,075
Petrochemical expenses	2,987	3,097	8,901	9,699
Other operating expenses	13,686	14,367	36,731	39,255
Total operating expenses	120,608	112,133	338,674	339,086

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

The method of allocation of operating expenses above differs from the approach used in preparing data for Note 29 “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 2016, our operating expenses increased by 8 billion RUB, or by 7.6%, as a result of the increase in refining expenses at third parties refineries. During the nine months of 2017, the effect of the ruble appreciation to US dollar and Euro on the ruble value of foreign subsidiaries’ expenses and the decrease in expenses at the West Qurna-2 oilfield were partially offset by the increase in refining expenses at third parties refineries, and our operation expenses didn’t change significantly.

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.

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Hydrocarbon extraction expenses ⁽¹⁾	48,515	45,226	141,481	134,287
- in Russia.....	43,978	41,880	131,243	122,698
- outside Russia ⁽¹⁾	4,537	3,346	10,238	11,589
	(ruble per BOE)			
Hydrocarbon extraction expenses ⁽¹⁾	245	237	242	234
- in Russia	245	238	245	232
- outside Russia ⁽¹⁾	250	228	204	257

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

In the third quarter and the nine months of 2017, our extraction expenses increased by 3 billion RUB, or by 7.3%, and by 7 billion RUB, or by 5.4%, respectively.

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

The increase in extraction expenses outside Russia in the third quarter of 2017 was a result of launching new production facilities as part of the Gissar project in Uzbekistan. Compared to the nine months of 2016, the decrease in expenses outside Russia was due to planned overhauls at our project in Kazakhstan in the second quarter of 2016 as well as the ruble appreciation.

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. 16.

The decrease in expenses in the nine months of 2017 was a result of completion of commissioning stage of the field development and consecutive decrease in personnel involved and associated transportation, security and other related services provided.

Own refining expense

	3rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Refining expenses at the Group refineries	22,456	21,102	63,458	66,356
- in Russia	10,207	10,799	29,788	32,010
- outside Russia	12,249	10,303	33,670	34,346
	(ruble per tonne)			
Refining expenses at the Group refineries	1,294	1,233	1,271	1,345
- in Russia	927	974	932	1,032
- outside Russia	1,930	1,709	1,872	1,876

During the third quarter and the nine months of 2017, our own refining expenses increased by 1 billion RUB, or by 6.4%, and decreased by 3 billion RUB, or by 4.4%, respectively.

Despite the inflation, refining expenses at our domestic refineries decreased as a result of consumption of additives of own production following our refineries' upgrade and lower overhaul costs.

Outside Russia, the increase in expenses compared to the third quarter of 2016 amounted to 18.9% and was mainly a result of increased cost of methane and higher overhaul expenses at our Italian refinery. Compared to the nine months of 2016, our refining expenses outside Russia decreased by 2.0% following the ruble appreciation.

Refining expenses at third parties refineries

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

In the end of 2016, as part of our trading business development, a Group company entered into a 3-year tolling agreement with a Canadian refinery. Related refining expenses represent variable toll that is mostly the difference between the price of feedstocks supplied, including various related costs, and the selling price of the refined products taken. In the third quarter and the nine months of 2017, this tolling fee amounted to 7 billion RUB and 10 billion RUB, respectively. When the refined products are sold, this toll is naturally offset by the respective refined products sales revenue. The agreed compensation is received by the Group company for execution of this agreement.

Expenses for crude oil transportation to refineries

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

As a result of the increase in volumes of supplies of own crude oil to our refineries outside Russia, our expenses for crude oil transportation to refineries increased by 2 billion RUB, or by 14.8%, compared to the third quarter of 2016 and by 2 billion RUB, or by 5.3%, compared to the nine months of 2016.

Petrochemical expenses

In the third quarter and the nine months of 2017, our petrochemical expenses decreased by 3.6% and by 8.2%, respectively, largely as a result of a decrease in raw materials cost in Russia and the effect of the ruble appreciation.

Other operating expenses

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

In the third quarter and the nine months of 2017, other operating expenses decreased by 0.7 billion RUB, or by 4.7%, and by 3 billion RUB, or by 6.4%, respectively, largely as a result of the decreased cost of transportation services provided to third parties and the decrease in the ruble value of other operating expenses of our foreign subsidiaries.

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.

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Cost of purchased crude oil in Russia	4,071	3,170	12,450	8,833
Cost of purchased crude oil outside Russia	302,990	210,263	882,669	572,654
Compensation crude oil related to West Qurna-2 project	10,775	45,037	24,142	119,031
Cost of purchased crude oil	317,836	258,470	919,261	700,518
Cost of purchased refined products in Russia	12,530	15,231	40,053	35,909
Cost of purchased refined products outside Russia	400,036	360,764	1,217,495	1,144,226
Cost of purchased refined products	412,566	375,995	1,257,548	1,180,135
Other purchases	7,176	5,117	27,035	20,102
Net loss (gain) from hedging of trading operations	23,727	(2,830)	(13,880)	31,514
Change in crude oil and petroleum products inventory	21,645	18,119	36,719	(62,368)
Total cost of purchased crude oil, gas and products	782,950	654,871	2,226,683	1,869,901

In the third quarter and the nine months of 2017, the cost of purchased crude oil, gas and products increased by 128 billion RUB, or by 19.6%, and by 357 billion RUB, or by 19.1%, respectively, following the increase in hydrocarbon prices and volumes of crude oil trading. Crude oil purchases in the third quarter and the nine months of 2017 also included 11 billion RUB and 24 billion RUB related to 572 thousand tonnes and 1,303 thousand tonnes of compensation crude oil received from Iraq's state-owned South Oil Company within the West Qurna-2 project (45 billion RUB and 119 billion RUB related to 2,593 thousand tonnes and 7,736 thousand tonnes of compensation crude oil in the third quarter and the nine months of 2016).

Transportation expenses

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Crude oil transportation expenses	19,891	20,290	66,364	69,907
Refined products transportation expenses	37,941	44,551	123,296	150,157
Other transportation expenses	5,148	6,328	14,550	15,469
Total transportation expenses	62,980	71,169	204,210	235,533

Our transportation expenses decreased by 8 billion RUB, or by 11.5%, in the third quarter of 2017 and by 31 billion RUB, or by 13.3%, in the nine months of 2017.

Our expenses for transportation of crude oil decreased both in Russia and internationally. In Russia, the increase in tariffs was outweighed by the decrease in volumes transported. Moreover, the increase in share of crude oil from new high-margin oilfields in total volume of export also contributed to the decrease in transportation expenses as these fields are closer to markets as compared to traditional fields of Western Siberia. Outside Russia, the increase in tariffs and trading volumes was generally offset by the ruble appreciation.

Compared to the third quarter and the nine months of 2016, our domestic expenses for transportation of refined products decreased following the decrease in export volumes in favor of domestic sales. Outside Russia, the decrease was mainly a result of a decrease in tariffs amplified by the effect of the ruble appreciation.

Selling, general and administrative expenses

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Labor costs included in selling, general and administrative expenses.....	15,854	17,167	45,328	52,022
Other selling, general and administrative expenses	24,130	25,677	70,126	74,690
Increase in liability related to share-based compensation program	3,043	5,965	325	12,309
(Income) expenses on provision for doubtful debts	(155)	3,849	2,624	6,762
Total selling, general and administrative expenses	42,872	52,658	118,403	145,783

Our selling, general and administrative expenses decreased by 10 billion RUB, or by 18.6%, in the third quarter of 2017, and by 27 billion RUB, or by 18.8%, in the nine months of 2017. In Russia, expenses decreased mostly as a result of lower accruals within share-based compensation program due to LUKOIL share price fluctuations. Our expenses outside Russia decreased largely as a result of the effect of the ruble appreciation on the expenses of our foreign subsidiaries along with the restructuring of our international upstream business sector and the divestment of retail networks in Poland, Lithuania, Latvia and Cyprus.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses increased by 9 billion RUB, or by 12.2%, compared to the third quarter of 2016, and by 18 billion RUB, or by 7.8%, compared to the nine months of 2016, resulting from the increase in value of depreciable assets. This was partially offset by the decrease in expenses related to the West Qurna-2 project. Our depreciation, depletion and amortization expenses for the third quarter and the nine months of 2017 included 4 billion RUB and 10 billion RUB, respectively, related to the West Qurna-2 field. In the third quarter and the nine months of 2016, those expenses amounted to 3 billion RUB and 27 billion RUB, respectively.

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, South Caucasus Pipeline Company and Caspian Pipeline Consortium, midstream companies in Azerbaijan and Kazakhstan.

Our share in income of affiliates increased by 4 billion RUB compared to the third quarter of 2016 and by 6 billion RUB compared to the nine months of 2016, largely, as a result of the increase in income of Tengizchevroil.

Taxes other than income taxes

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
In Russia				
Mineral extraction taxes.....	121,084	108,073	392,123	282,884
Social security taxes and contributions	6,421	5,895	19,709	17,730
Property tax.....	4,882	4,820	14,491	14,086
Other taxes	650	961	1,877	2,058
Total in Russia.....	133,037	119,749	428,200	316,758
International				
Social security taxes and contributions	1,416	1,410	3,964	4,569
Property tax.....	209	305	615	869
Other taxes	604	781	1,809	2,326
Total internationally	2,229	2,496	6,388	7,764
Total taxes other than income taxes	135,266	122,245	434,588	324,522

In the third quarter of 2017, our taxes other than income taxes increased by 13 billion RUB, or by 10.7%, and in the nine months of 2017, they increased by 110 billion RUB, or by 33.9%. This was driven by the increase in the mineral extraction tax rate in Russia resulting from the increase in crude oil prices and mineral extraction tax base rate.

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Decrease in extraction taxes from application of reduced and zero rates for crude oil and gas production.....	19,260	15,463	54,828	41,851
	(thousands of tonnes)			
Volume of crude oil production subject to:				
zero rates	326	262	790	730
reduced rates (tax holidays for specific regions and high viscosity oil).....	1,368	1,148	4,135	3,513
reduced rates (depleted fields)	3,511	3,516	10,645	10,713
reduced rates (other)	865	891	2,487	2,592
Total volume of production subject to reduced or zero rates.....	6,070	5,817	18,057	17,548

Excise and export tariffs

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
In Russia				
Excise tax on refined products	33,576	28,316	88,476	68,498
Crude oil export tariffs	29,419	33,916	101,985	96,280
Refined products export tariffs.....	7,008	15,201	30,751	39,887
Total in Russia.....	70,003	77,433	221,212	204,665
International				
Excise tax and sales taxes on refined products.....	46,724	51,877	120,015	153,194
Crude oil export tariffs	9	16	118	37
Refined products export tariffs.....	84	114	250	313
Total internationally	46,817	52,007	120,383	153,544
Total excise and export tariffs.....	116,820	129,440	341,595	358,209

In the third quarter and the nine months of 2017, export tariffs decreased by 13 billion RUB, or by 25.8%, and by 3 billion RUB, or by 2.5%, respectively. The decrease both to the third quarter and the nine months of 2016 was mostly a result of lower export duty rates for refined products. Compared to the third quarter and the nine months of 2016, the volumes of crude oil export beyond the Customs Union increased by 30.3% and 14.8% and the volumes of refined products exports decreased by 16.7% and 8.0%, respectively. The increase in excise tax expenses in Russia was driven by increase in rates and domestic sales volumes, while international excise expenses decreased due to the ruble appreciation and divestment of retail networks in Eastern Europe.

Foreign exchange loss

Foreign exchange gains or losses are mostly related to revaluation of US dollar and euro net monetary position of Russian entities that largely consists of accounts receivables, loans to our foreign subsidiaries and loans received in other currencies, and it's current structure results in exchange gains when the ruble devaluates and losses when it appreciates to that currencies.

The increase in ruble exchange rate resulted in foreign exchange losses of 9 billion RUB and 10 billion RUB in the third quarter of 2017 and 2016, respectively, and foreign exchange losses of 25 billion RUB and 85 billion RUB in the nine months of 2017 and 2016, respectively.

Other (expenses) income

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

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

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 2017, our total income tax expense increased by 10 billion RUB, or by 47.8%, compared to the third quarter of 2016. At the same time, our profit before income tax increased by 53 billion RUB, or by 69.4%.

In the nine months of 2017, our total income tax expense increased by 28 billion RUB, or by 55.4%, compared to the nine months of 2016. At the same time, our profit before income tax increased by 166 billion RUB, or by 78.8%.

In the third quarter of 2017, our effective income tax rate was 23.8%, compared to 27.3% in the third quarter of 2016. In the nine months of 2017, our effective income tax rate was 20.7%, compared to 23.9% in the nine months of 2016.

Non-GAAP items reconciliation

Reconciliation of profit for the period to EBITDA

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

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Profit for the period	97,785	55,103	299,263	160,767
Add back				
Income tax expense.....	30,584	20,689	78,341	50,412
Financial income.....	(3,261)	(3,778)	(9,662)	(11,120)
Financial costs	5,925	11,949	22,162	33,418
Foreign exchange loss.....	9,441	10,207	25,149	84,530
Equity share in income of affiliates	(3,985)	(198)	(11,670)	(5,976)
Other expenses (income).....	737	(2,872)	(44,604)	4,676
Depreciation, depletion and amortization	83,920	74,790	248,856	230,746
EBITDA	221,146	165,890	607,835	547,453
EBITDA by operating segments				
Exploration and production.....	155,092	111,791	396,456	379,604
- in Russia	133,637	99,904	341,375	322,459
- outside Russia ⁽¹⁾	21,455	11,887	55,081	57,145
Refining, marketing and distribution segment	81,381	60,551	214,376	175,704
- in Russia	62,565	43,495	156,212	116,131
- outside Russia.....	18,816	17,056	58,164	59,573
Corporate and other.....	(6,075)	(10,856)	(4,668)	(11,134)
Elimination.....	(9,252)	4,404	1,671	3,279
EBITDA	221,146	165,890	607,835	547,453

⁽¹⁾ Including EBITDA of the West Qurna-2 project in the amounts of 5,799 million RUB and 5,454 million RUB in the third quarter of 2017 and 2016 and in the amounts of 12,585 million RUB and 33,838 million RUB in the nine months of 2017 and 2016, respectively.

Reconciliation of Cash provided by operating activities to Free cash flow

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Net cash provided by operating activities	209,565	213,401	547,466	557,879
Capital expenditures.....	(118,902)	(108,728)	(373,770)	(357,392)
Free cash flow	90,663	104,673	173,696	200,487

Liquidity and capital resources

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Net cash provided by operating activities	209,565	213,401	547,466	557,879
including decrease (increase) in working capital	6,828	46,361	(20,398)	33,987
Net cash used in investing activities	(121,430)	(108,671)	(291,316)	(367,186)
Net cash used in financing activities	(91,393)	(101,354)	(216,185)	(64,087)

Operating activities

Our primary source of cash flow is funds generated from our operations. In the nine months of 2017, cash generated from operations decreased by 10 billion RUB, or by 1.9%, compared to the nine months of 2016. This was mostly due to the increase in working capital in the nine months of 2017 compared to the decrease in working capital in the nine months of 2016. The latter was a result of the decrease in receivables related to the West Qurna-2 project during the nine months of 2016 due to costs reimbursement. Net of working capital changes, our net cash provided by operating activities increased by 8.4% compared to the nine months of 2016.

Investing activities

In the nine months of 2017, the amount of cash used in investing activities decreased by 76 billion RUB, or by 20.7%. This decrease was mostly a result of proceeds from sale of our diamond business in the amount of 81 billion RUB.

In the nine months of 2017, our capital expenditures increased by 16 billion RUB, or by 4.6%.

	3 rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Capital expenditures				
Exploration and production				
Western Siberia	30,771	27,347	99,836	87,029
Timan-Pechora	17,352	17,208	58,031	67,957
Ural region	7,312	6,483	21,468	19,845
Volga region.....	16,335	15,456	43,734	34,991
Other in Russia.....	2,977	1,641	9,253	4,684
Total in Russia	74,747	68,135	232,322	214,506
Iraq	3,142	5,617	10,729	17,316
Other outside Russia	26,149	18,140	90,977	72,167
Total outside Russia	29,291	23,757	101,706	89,483
Total exploration and production	104,038	91,892	334,028	303,989
Refining, marketing and distribution				
Russia.....	10,830	11,163	28,030	39,648
- refining	5,074	6,064	15,198	28,566
- retail	1,950	1,577	4,096	3,238
- other	3,806	3,522	8,736	7,844
International	3,847	5,594	10,760	12,523
- refining	2,540	4,350	7,112	8,263
- retail	1,529	1,024	3,592	3,377
- other	(222)	220	56	883
Total refining, marketing and distribution	14,677	16,757	38,790	52,171
Corporate and other	187	79	952	1,232
Total capital expenditures	118,902	108,728	373,770	357,392

In the nine months of 2017, our capital expenditures in the exploration and production segment increased by 30 billion RUB, or by 9.9%. The increase in capital expenditures in Volga region was a result of continuing development of Yu. Korchagin and V. Filanovsky fields, and the decrease in capital expenditures in Timan-Pechora was due to completion of another stage of Yaregskoe field development. In Western Siberia, we increased production drilling.

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

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

	3rd quarter of		9 months of	
	2017	2016	2017	2016
	(millions of rubles)			
Western Siberia (Yamal).....	2,732	6,102	11,303	19,435
Caspian region (Projects in Russia).....	15,615	13,670	41,277	28,696
Timan-Pechora (Yaregkoye field).....	4,077	5,081	9,901	17,153
Iraq (West Qurna-2 project).....	2,796	5,094	9,754	16,245
Iraq (Block-10).....	346	523	975	1,071
Uzbekistan	19,113	10,766	69,674	36,964
Total	44,679	41,236	142,884	119,564

Financing activities

In the nine months of 2017, net movements of short-term and long-term debt generated an outflow of 41 billion RUB, compared to an inflow of 97 billion RUB in the nine months of 2016.

Other information

Sectorial sanctions against the Russian companies

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

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

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

Operations in Iraq

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