PJSC LUKOIL

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Speakers:

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Alexander Palivoda, Head of IR

Alexander Palivoda

Slide 2. Forward looking statements

Good afternoon ladies and gentlemen and it's our pleasure to welcome you today on LUKOIL's third quarter and nine months 2018 financial results conference call and web-cast. Thank you for joining us. On today's call we have our Chief Financial Officer, Mr. Alexander Matytsyn; VP for Corporate Development and Investor Relations, Mr. Pavel Zhdanov; VP for Economics and Planning, Mr. Gennady Fedotov; Chief Accountant, Mr. Viacheslav Verkhov; as well as our colleagues from the Accounting Team.

Mr. Matytsyn will start today's call with a general overview of the results followed by a more detailed discussion by Pavel Zhdanov and myself. We will then have a Q&A session.

I have to draw your attention to our cautionary statement. Some of our comments during this call constitute "forward looking statements" that involve risks, uncertainties and other factors, which may cause our actual results to be materially different from what's expressed or implied by such forward looking statements.

Now, I would like to hand over to our Chief Financial Officer, Mr. Alexander Matytsyn.

Alexander Matytsyn

Slide 3. Operating results

Thank you, Alexander, and good afternoon ladies and gentlemen.

Third quarter results were outstanding for LUKOIL. The growth was driven by the supportive price environment and even stronger operational performance.

Our daily hydrocarbon production increased by almost 5% compared to the third quarter of 2017, which translated into a solid 3.7% production growth year-on-year for the nine months of 2018. This is the highest growth rate for LUKOIL over the past decade. It represents a substantial outperformance on our original production plans for the year, as well as on our strategic targets. Key drivers for such strong dynamics were our international gas projects and crude oil production ramp-up following the easing of OPEC+ limitations from July.

Importantly, the growth was achieved without compromising our production mix. The share of high-margin barrels in our portfolio continued to increase and reached 27% in the third quarter of 2018.

As for the downstream, our refining volumes were almost flat year-on-year and we also kept light product yield at steady levels. At the same time we posted strong volume growth in our retail business and premium marketing channels.

Slide 4. Macro environment

A combination of higher oil price and weaker ruble further accelerated our financial performance, which was partially muted by domestic prices lagging the export netbacks.

Slide 5. Financial results

Our EBITDA for the nine months of 2018 was almost 840 billion rubles, which is 38% higher year-on-year. EBITDA for the third quarter of 2018 of more than 320 billion rubles became an all-time high result. The growth was mainly driven by our upstream business, underpinned by the exceptional project execution and strong production dynamics. Financial performance of the downstream was also very robust considering weak benchmark refining margins.

We almost doubled our free cash flow in the first nine months of 2018 to more than 340 billion rubles, or 5.6 billion dollars. Almost half of it was generated in the third quarter. Apart from strong operating cash flow, our investment discipline was an important growth factor, as our capital expenditures were below originally planned levels due to cost savings. Overall focus on cost efficiency across the value chain supported and will further support our cash flows.

Slide 6. Leadership in efficiency

Third quarter results confirmed again our leadership position in terms of EBITDA and free cash flow per barrel of oil equivalent among Russian peers and even certain international majors. The leadership is based on our vertically integrated value chain, efficient production mix in the upstream and exceptional quality of our downstream asset portfolio.

Slide 7. Progressive dividend policy

We continue to deliver on our progressive dividend policy. In October the Board of directors recommended the interim dividend of 95 rubles per share, which is 12% higher year-on-year. We consistently outperform on the minimum policy targets, setting a higher base for future dividend growth. I would like to reiterate that we are able to continue delivering on the progressive dividend policy on the long-term horizon in any environment.

Slide 8. Delivery of the strategic initiatives

Among other important recent developments was the progress on the strategic initiatives announced in the beginning of this year.

Earlier in November, we cancelled 100 million treasury shares and reduced the share capital to 750 million shares. Taking into account complications related to the cancellation procedure and the fact that share cancellation is not commonly practiced in Russia, this action evidences our very strong commitment to the best corporate governance standards.

To the benefit of our shareholders, the cancellation of treasury shares triggered the upward revision of our weight in the MSCI Indexes resulting in an incremental inflow of funds into LUKOIL shares.

In September, we launched the share buyback on the open market and to date we have purchased more than 430 million dollar worth of shares.

Slide 9. Balanced distribution of additional cash flows to shareholders

The recent oil price correction proves the efficiency of our chosen strategy, which enables us to navigate the Company through the periods of price volatility without compromising business growth and distributions to shareholders.

At LUKOIL, we are very focused on investment discipline. The conservative oil price scenario of 50 dollars per barrel that we use to test all of our investment projects is surely the right approach.

We currently finalize our next year budget whereby investment discipline is a top priority. Our key focus is on the Russian upstream and every dollar of investment is properly evaluated before we decide on its allocation.

Since the beginning of the year we generated substantial incremental cash flows and we actively work on preparing the existing and potential reinvestment opportunities. We invest sufficient time to evaluate compliance of projects with our key investment criteria, as well as to prepare documentation and secure necessary approvals.

As we start reinvesting the incremental cash flows, our capital expenditures in 2019 will exceed 2018 level and our production volumes will also be higher than the plans we presented in March.

Given our actual free cash flow generation to date, we have the capacity to further increase shareholder distributions. Therefore we made the decision to accelerate the pace of the buyback. We think, it is a very timely decision considering the current oil price downturn, the strength of our balance sheet and general sustainability of our business. According to our estimates and subject to the oil price dynamics, we might complete the announced 3 billion dollar share buyback program already next year.

With this, I would like to pass the word to Pavel, who will elaborate on the upstream results.

Pavel Zhdanov

Thank you Alexander, and good afternoon ladies and gentlemen.

Slide 11. Price and tax environment

The macro environment in the third quarter and nine months of 2018 was very favorable for our upstream business. The increase in oil prices was accompanied by weakening of the ruble, which resulted in a 9% oil price growth in ruble terms quarter-on-quarter. The average oil price net of taxes hit a record high level of more than 17 hundred rubles per barrel.

Slide 12. Key operating results

Our total daily hydrocarbon production for the nine months of 2018 excluding West Qurna-2 project increased year-on-year by a significant 3.7%, or by 83,000 barrels per day. This is well ahead of our strategic targets and results in acceleration of our cash flows.

Most of the growth was represented by high-margin barrels, the share of which in our total hydrocarbon production increased by 6 percentage points year-on-year, to 27%. In absolute terms high-margin production volumes increased by impressive 34% primarily driven by the Caspian crude oil, heavy crude oil and international gas.

As OPEC+ agreed to raise production limits from the 1st of July, we rapidly increased our daily crude oil output in Russia by more than 30,000 barrels per day. Most of the ramp up occurred in July, much faster than we initially anticipated. As a result, our production in West Siberia increased by 1.3% quarter-on-quarter and we fully utilized the spare capacity we built up when cutting our production in the beginning of 2017. Further production growth is therefore subject to incremental drilling and investments.

Slide 13. Upstream EBITDA

Supportive macro, production growth, increased share of high-margin barrels and stringent costs control underpinned record EBITDA in our upstream business. In the nine months of 2018 it increased by 72% year-on-year to 680 billion rubles, with 40% of it generated in the third quarter.

In absolute terms most of EBITDA growth was driven by our assets in Russia. However, the contribution of our international upstream was also substantial on the back of higher oil and gas prices, as well as growing volumes at our gas projects in Uzbekistan.

I would like to especially highlight the results of our cost control initiatives, as we were able to reduce our per unit lifting costs in ruble terms in Russia and internationally quarter-on-quarter and year-on-year. This is a great result relative to industry trends and we continue to put effort into raising cost efficiency as a way to unlock the incremental potential of our vast resource base in Russia.

Slide 14. Filanovsky field

Let me now move to the detailed project discussion.

At Filanovsky field we launched the fifth well at the second development stage in October. It is a production well with a bilateral horizontal smart design and completion. Its initial daily flow rate is 3.3 thousand tonnes or 25 thousand barrels of oil.

Further development of the field aims at sustaining the production plateau of 6 million tons of crude oil per year.

In 2019 we plan to complete the drilling program at the second development stage and proceed with drilling at the third stage. We recently installed the substructure of the wellhead platform for the third stage in the sea and the top side of the platform is currently 70% complete.

At Korchagin field we proceed with the drilling program. During the third quarter we drilled one well from the field's wellhead platform. We also drilled a sidetrack at the field's first development stage. As a result, production at the field increased by 6% quarter-on-quarter. In October we completed the second well at the wellhead platform. For the first time we used an electro-hydraulic intelligent completion that allows to control the horizontal wellbore in the real time mode, providing for an optimized oil influx and higher operational safety.

Slide 15. West Siberia

Now moving to our onshore fields.

Our mature fields contributed most of the production growth post the easing of OPEC+ production limitations from July. Our West Siberian production increased as we launched the wells that were shut down in 2017 to cut production. Production growth from the low base is obviously a temporary trend. But I would like to reiterate that deceleration of production decline rates and cost efficiency are the key focus areas for us at our mature fields.

Our preliminary plan for 2019 envisages deceleration of production decline in West Siberia to 2%, which is ahead of our strategic targets.

We also achieved very good progress on the cost side. For example, our average per-meter drilling costs for deviational wells in the region were reduced by solid 5% year-on-year, while lifting costs remain stable in nominal terms in rubles for the last 18 months.

The recently introduced changes to the profit based tax regime enable us to include two more West Siberian fields into the list. This will result in higher share of our production covered by this new tax regime. The launch of profit based tax creates an additional upside potential to our strategic targets in respect to the share of high-margin barrels. This is a great new reinvestment opportunity for us and we will accelerate spending into these projects.

Slide 16. Hard-to-recover: heavy crude oil

Our heavy crude oil production in Timan-Pechora for the nine months of this year increased by 29% year-on-year. The growth at Yaregskoye field was even more impressive – the field produced 60% more heavy crude oil year-on-year.

New steam generation facilities were launched both at Yaregskoe and Usinskoye fields, which will facilitate further production growth. The development of the fields progresses in line with our plans.

Slide 17. Hard-to-recover: low permeability

Our crude oil production from reservoirs with low permeability continues to grow.

At Vinogradov field during the first nine months of this year we successfully drilled 13 horizontal production wells, which resulted in production growth by 12% year-on-year.

The new wells that we drill yield higher flows and are cheaper as compared to the wells we drilled a year ago. One of the reasons is the new approach to multistage hydrofracking, like using less proppant per port frac as well as optimized fluids. The development of the field continues in the pilot mode and we plan to move to the commercial development stage next year.

We also continue with production drilling at Imilorskoe field in order to ramp-up production to a plateau level of approximately 50 thousand barrels per day. We launched 50 oil production wells at the field since the beginning of the year. In the third quarter we achieved a significant 14% quarter-on-quarter production growth, while year-on-year the growth was 23% which puts us right on track to deliver field's production plateau level.

Slide 18. Gas projects in Uzbekistan

Now moving to our gas projects in Uzbekistan.

Our gas production from the region increased by impressive 84% year-on-year driven by the early launch of all of the gas treatment and processing facilities at Kandym and Gissar projects as well as accelerated drilling. As of now production is already at its designed daily level equivalent to 13.5 billion cubic meters of marketable gas per year in our share. We are very pleased with the outperformance in Uzbekistan as it represents a substantial contribution to our production profile and financial results.

Few words on other international projects.

In Iraq, the development of West Qurna-2 goes on track and our financial exposure was further reduced to approximately 350 million US dollars. In addition, we were reimbursed for the lower remuneration fee in the second and third quarters of last year due to application of the performance factor. We get ready to start the next phase of the project to double production by 2025. This expansion will be financed from the current production.

At Block 10 we started drilling another appraisal well and plan to further accelerate the project.

We achieved good progress in Mexico by expanding our exploration assets portfolio in the area and diversifying risks by cooperating with ENI. Start of drilling of the first exploration well is scheduled for the end of next year.

With that I would like to pass the floor to Alexander Palivoda.

Alexander Palivoda

Thank you, Pavel! I'll continue with our Downstream operations.

Slide 20. Price environment

Benchmark European refining margins moderately improved quarter-on-quarter driven by the seasonal factors.

In Russia benchmark refining margins recovered more significantly underpinned by higher export duty differentials and lower excise tax, while product prices were relatively flat. Our better than average product slate resulted in a more substantial increase in our actual refining margins compared to benchmark.

Slide 21. Key operating results

In Russia, our daily refinery throughput volumes increased by 1.4% quarter-on-quarter, while light product yield decreased slightly due to maintenance works at hydrocracking unit at Perm refinery and catalytic cracking units at Nizhniy Novgorod refinery. The decrease was partially offset by improved utilization of the secondary processing units at our refinery in Volgograd.

On a year-on-year basis our light product yield continued growing on the back of maximizing utilization of the conversion facilities built as part of the major refinery upgrade program completed in 2016.

We maintained the volume of cross supplies of semi-finished products between our refineries during the nine months of 2018 at the level of corresponding period of last year. To remind you, this is a very efficient mechanism that we rely on to incrementally enhance our consolidated product basket.

At our refineries in Europe throughput volumes increased by 6.4% quarter-on-quarter backed by seasonal demand growth for motor fuels as well as higher utilization of our refinery in Bulgaria post maintenance works in the first half of 2018. The significant increase in light product yield was also driven by completion of maintenance works at secondary processing units at our refineries in Bulgaria and the Netherlands.

Regarding our new projects in the downstream – in September we started piling works for the delayed coker complex at the Nizhniy Novgorod refinery. As we discussed at the previous call all of the long lead items for the complex are already under construction at the contractors' yards. To remind you, this project will be the main contributor to a reduction in fuel oil output and an increase in light product yield in 2021, which will further support our already strong positions for the upcoming IMO regulation.

Our fuel oil yield already stands at as low as 10%, while mid-distillates yield is a solid 46%. Our competitive advantage is further strengthened by significant production volumes of bunker fuel which is already compliant with the IMO requirements.

Slide 22. Premium sales channels

Our priority marketing channels continue to expand driven not only by the seasonal factors but also by our premium-quality product offering.

We delivered 6% growth in retail sales volumes of our motor fuels year-on-year and achieved a much faster growth in profits from non-fuel goods and services, which increased by 21% in Russia and 15% internationally. The latter represents a great progress in our strategy aimed at increasing the coverage of operating expenses of our retail network by profits from non-fuel sales.

We continue growing in the premium sales channels.

Our bunker fuel sales volumes increased by solid 8% year-on-year driven by expansion into new ports and also market growth at the port of Novorossiysk.

In July our new aircraft refueling facility started to operate at the Sheremetyevo airport in Moscow. It was a key factor behind double-digit growth in end-customer sales of jet fuel.

Slide 23. Efficient allocation of Russian oil

Our integrated margin from processing crude oil at the refineries in Russia and distributing the products through our marketing channels improved quarter-on-quarter on the back of slightly lower crude oil export net backs, lower domestic excise taxes and seasonally higher sales volumes through the premium channels.

Slide 24. Downstream EBITDA

As a result, the Russian downstream became the largest contributor to the quarter-on-quarter increase in overall downstream EBITDA, which grew by 15% to 82 billion rubles.

Internationally, our downstream EBITDA amounted to 23 billion rubles, increasing by 21% quarter-on-quarter. The growth was driven by better performance of our trading and retail businesses. At the same time the positive effect of higher European benchmark refining margins was muted by lower positive inventory effect.

Year-on-year EBITDA dynamics in the downstream was mainly driven by the international part of the business due to accounting specifics of hedging as part of our international trading operations which resulted in substantial gains in the first nine months of 2017. Trading margin was also weaker than last year.

Year-on-year EBITDA of our downstream in Russia was almost flat as significantly lower benchmark refining margins were offset by positive inventory effect and our premium quality product slate.

Slide 25. Finance

Now briefly on the dynamics of our financial results.

Slide 26. Revenue

The quarter-on-quarter increase in revenue was driven by both price and volume.

In addition to oil production growth we also released more than half a million tonnes of crude oil from inventory and increased international crude oil trading volumes. However, overall crude oil sales volume increased quarter-on-quarter by only 0.5 million tonnes due to substantial inventory release in the second quarter.

Petroleum product sales volume increased by 2 million tonnes quarter-on-quarter due to higher refinery throughput, as well as inventory release of 0.7 million tonnes compared to inventory accumulation in the second quarter.

Slide 27. OPEX

We continue delivering great results on our mid-term cost optimization targets and executing stringent control over our cost base.

Our lifting costs in Russia in the third quarter decreased by 2% both quarter-on-quarter and year-on-year as a result of cost optimization measures aimed at higher energy efficiency, better management of fields infrastructure and maintenance works, enhancing secondary oil recovery methods and technologies in general. This is an outstanding dynamics considering the industry trends and gradual depletion of our reserve base. Cost and processes optimization is a strategic target for us as it enables to unlock incremental production potential at our fields.

Our lifting costs outside Russia in dollar terms decreased even faster - by impressive 10% quarter-on-quarter and 30% year-on-year, which was driven by the rapidly growing share of gas production.

The increase in our refining expenses in Russia by 17% quarter-on-quarter was mainly driven by a one-off effect of maintenance works at own additives production unit at Nizhny Novgorod refinery. Temporary suspension of own additives production resulted in higher utilization of purchased additives for gasoline production driving the costs up.

In Europe our per unit refining expenses decreased by 7% quarter-on-quarter in Euro terms and by 4% in ruble terms as a result of higher expenses in the second quarter of 2018 due to scheduled maintenance works at Burgas refinery.

Growth in refining expenses at third party refineries was driven by the specifics of our contracts due to higher refining margins in Canada.

Slide 28. EBITDA

Among other substantial factors which impacted the quarter-on-quarter EBITDA dynamics were lower positive export duty lag effect in the upstream and substantial effect from releasing crude oil and products inventory.

On the cost side, a moderate increase in transportation expenses was mainly due to ruble devaluation and an increase in crude oil export volumes.

I would like to spend more time on the SG&A cost line. The substantial quarter-on-quarter increase was driven by the beginning of accounting for the new long-term incentive plan for management and key employees.

The plan is for the period from 2018 to 2022 and is based on 40 million shares. The plan was approved in December 2017 and implemented in July 2018. According to the IFRS rules for share-based plans the fair value of the plan was estimated at 157 billion rubles and is charged to SG&A by equal installments of 7.8 billion rubles per quarter. As far as the plan covers the period from the beginning of 2018 in the third quarter we charged expenses for the first three quarters of 2018 in the amount of 23.5 billion rubles. Next quarter the sum will decline to 7.8 billion rubles. Importantly, as far as the plan is based on real shares these are non-cash expenses.

Slide 29. Profit

One of the main factors affecting quarter-on-quarter profit dynamics was the decrease in foreign exchange gain by 11 billion rubles as a result of lower volatility of the exchange rate.

Our DD&A increased by 8 billion rubles. The increase was mainly due to the launch of new production facilities in Uzbekistan in the second quarter, ruble devaluation, and an increase in crude oil production in Russia in the third quarter.

Another factor behind profit dynamics was net impairment loss in the second quarter of 5 billion rubles, as well as settlement in the third quarter of 2018 of a 4 billion rubles claim won in a legal case related to one of our international assets.

Slide 30. CAPEX

Our capital expenditures in the nine months of 2018 decreased by 10% year-on-year to 338 billion rubles, which was due to completion of construction works at the main production facilities in Uzbekistan. The decline was partially offset by higher capex in the Russian downstream due to the beginning of construction works at the delayed coker facility in Nizhny Novgorod and several other smaller sized facilities.

The quarter-on-quarter increase in our capex was also driven by the Russian downstream.

Slide 31. Cash flows

Our free cash flow generation was very strong in the third quarter on the back of growing operating cash flow and relatively flat capex. Before working capital build up the number is approximately 200 billion rubles. The increase in working capital of 40 bln RUB was driven by higher hydrocarbon prices, ruble devaluation and growth in trading volumes.

Net of working capital build up the free cash flow was 160 billion RUB, 16% up quarter-on-quarter. We directed 104 billion RUB to pay out dividends and buy back shares. We also paid back 22 bln RUB of debt on a net basis and our cash position increased to 372 billion RUB.

Slide 32. Financial position

Our balance sheet remains very strong with net debt to EBITDA of 0.2 as of the end of the third quarter.

In the third quarter, we extended a lease agreement for railroad tank cars in Russia on new terms. As a result, under IFRS we classified it as financial lease and added 23 billion rubles to our total debt position.

I would like to stop here and pass the word back to Pavel.

Pavel Zhdanov

Slide 33. 2018 Outlook

Thank you, Alexander.

Before opening the line for questions, I would like to update our 2018 guidance and provide some color on 2019.

We now expect our total hydrocarbon production to grow by 3.5% this year which is three times faster than our original plan. A substantial part of this growth results from an early launch of facilities at Kandym and Gissar projects in Uzbekistan. This has a certain impact on our production growth plans for next year, however, since we start reinvesting incremental cash flows into Upstream, we will continue growing our production next year by approximately 1%, subject to OPEC+ decisions in December.

Taking into account the higher growth rate this year, the cumulative production growth for the first two years of the new strategy implementation exceeds 4.5%, which is twice faster than our initial guidance.

As we explained at our strategy presentation the incremental production growth is primarily a function of incremental investments.

We had a plan to spend approximately 8 billion dollars or 500 billion rubles of capex this year. We made a lot of effort during the year to achieve structural cost savings and now expect 5 to 10% lower capital expenditures for this year compared to our plan. The effect of these savings will be carried over to next year. This means that despite spending more to accelerate the production growth we don’t expect our 2019 capex, excluding service contracts, to exceed our base level of 8 billion dollars, which at the current exchange rate is slightly more than 500 billion roubles.

We are very optimistic about the future. Our business model is very sustainable and our strategy is designed for pretty much any oil price environment, whereby we can comfortably deliver both business growth and progressive dividend policy.

We continue to be focused on continuous delivery of shareholder value through diligent project execution, investment discipline and a very clear capital distribution policy, which makes LUKOIL a unique investment proposition among the peers.

Thank you for your attention!