PJSC LUKOIL

Results 2018 Conference Call and Webcast Transcript

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Speakers:

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Alexander Palivoda

1. Title slide

Good afternoon, ladies and gentlemen. Thank you for joining us today on LUKOIL's 2018 results conference call. Since this call is focused on the annual results, it includes a wider list of participants. On today's call, we have Mr. Alexander Matytsyn, First Vice President, CFO, Mr. Azat Shamsuarov, Senior Vice President for Exploration and Production, Mr. Vadim Vorobyov, First Vice President for Refining and Distribution, Mr. Pavel Zhdanov, Vice President for Corporate Development and Investor Relations, and Mr. Gennady Fedotov, Vice President for Economics and Planning, as well as our colleagues from the Accounting Team.

2. Forward-looking statements

Before we proceed to the presentation, I would like to draw your attention to the fact that 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.

More detailed information is presented on the slide.

3. The presentation's contents

In March 2018, we presented our new long-term strategy with its cornerstone goal of unlocking existing potential. At today's call, we will elaborate in detail on interim results of its execution. After the presentation, we will hold a Q&A session.

Now I would like to hand over to our CFO, Mr. Alexander Matytsyn.

<u>Alexander Matytsyn</u>

4. Title slide "Interim results of strategy implementation"

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

5. Strategic goals and 2018 results

LUKOIL delivered outstanding results in 2018. We successfully achieved and, in some areas, exceeded all our interim objectives, thus progressing with confidence under our established strategy.

Despite the external limitations, our hydrocarbon production was up by 4% – a record growth rate for the last decade. This rate exceeds our initial plan for the year by three times and our minimum strategic goal by four times.

The production growth was accompanied by the improvement of production mix. The share of high-margin barrels reached 26%, which had a significant positive impact on our financial performance. In line with our strategy we prioritize value creation over production volumes growth, showing solid results for both these goals in 2018.

In order to expand our production potential, we make special effort to boost technology development, efficiency improvement, and cost reduction, all of which strongly contributed to the full replacement of our proved liquids reserves in 2018.

In Downstream, throughput volume remained flat year-on-year while fuel oil output continued to decline. In line with our strategy, we focused on enhancing operational efficiency and cost optimization. We have also launched several selective projects aimed at improving the product slate at our refineries.

In the marketing sector, we have increased our sales volumes, with a special emphasis on premium high-margin segments.

6. Growing distributions to shareholders

As part of our progressive dividend policy, we have continued increasing dividends faster than the guaranteed minimum growth rate, thus setting a higher base for future dividend growth. We have been executing our open market buyback program since last September, and we have already allocated over 1.5 billion US dollars to this end and purchased almost 3% of the charter capital.

I also would like to remind you that in November 2018, we canceled 100 million treasury shares as part of our strategic initiatives and reduced the share capital to 750 million shares. This was an important step toward enhancing our corporate governance standards.

We recently launched another initiative and brought to the upcoming Board of Directors' meeting the question on amending our dividend policy. The proposed amendment will enable to reflect the effect of the reduction in the number of outstanding shares due to the buyback, which in turn will lead to a higher dividend per share growth rate. This step reflects LUKOIL's commitment to consistently elevating our standards.

7. 2018 results

The macroeconomics in 2018 were favorable for our business – the average annual oil price grew by more than 30%, while the ruble depreciation continued. Along with our strong operational performance, this contributed to the achievement of record-high financial results.

EBITDA grew by 34% and exceeded 1.1 trillion rubles. This is a record-high for LUKOIL. Upstream was the main growth driver, partly due to the volume increase and production mix improvement. I would like to underline the quality of our key projects delivery. For some of them, we were able to significantly exceed our targets.

Our free cash flow more than doubled, reaching a historical record high in both ruble and dollar terms. It amounted to 555 billion rubles or 8.7 billion US dollars. Capital expenditures was one of the factors behind the free cash flow growth.

In line with our strategy, we have substantially strengthened our capital reinvestment discipline. Our actual capital expenditures in 2018 were 10% lower than initially planned. To a big extend this was a result of structural savings which positively impact not only the 2018 free cash flow, but also on our plans for future periods.

In 2018, we actively developed a key tool for our strategy implementation, namely the flexibility of our planning and capital reinvestment system. We worked on creating a pool of prepared investment projects in order to reinvest additional cash flows resulting from favorable price environment. We meticulously analyze all parameters and risks in every detail to ensure a guaranteed target return. Capital reinvestment discipline is one of our key priorities.

In 2018, the return on capital employed was 15%, which is in line with the strategic target. Our main objective is to keep achieving at least similar returns in the future. Needless to say, a lot depends on factors beyond our control, including prices, but we will make every effort to ensure that the factors we do control support the achievement of our goals.

8. Efficiency leadership

In 2018, we increased our advantage over our Russian peers in financial results per barrel of production, and even outperformed certain majors. These achievements were driven by focus on improving the production mix, advanced Downstream segment and constant cost optimization efforts.

We consider continuous efficiency improvement as one of the key drivers of our strategy aimed at unlocking existing potential. In 2018, we analyzed our expenses in detail and launched optimization programs in both Upstream and Downstream. My colleagues will later provide you with further details. And I would like to note that, given the scale of our business, we expect these programs to generate significant savings compared to our earlier plans, which will certainly support an increase in LUKOIL’s shareholder value.

9. Conservative planning in volatile macro environment

We are looking to the future with confidence and believe that our conservative approach to planning and investment decisions, along with our continuous efficiency improvements, form the foundation for sustainable development of our business and shareholder value creation, and is a key guarantor of dividend growth and return of capital to our shareholders through share buyback.

A high level of uncertainty strongly supported by speculative factors persists in the oil market, driving a high price volatility.

Our price benchmark used for investment decisions is at 50 US dollars per barrel. This figure's position near the lower end of the fundamentally justified oil price range guarantees that we achieve the required level of return on investment. We intend to retain this approach, which proved highly efficient in 2018 when spikes in oil prices were followed by sharp declines.

Another important factor of our success is the stability of the tax regime. In 2018, a number of changes were introduced to the taxes applied to the Russian oil industry. The changes reflect the high stability of the taxation system's development trend and its focus on involving more hydrocarbon resources into production. We are very positive about the introduction of the profit based tax, which further enables us to unlock the incremental potential of our upstream assets in Russia.

10.Sustainable development

The sustainability of our business largely relies on maintaining high HSE standards, which is central to our risk management framework.

Our 2018 results are a good example of the consistent improvements achieved in this area. Injury and accident rates are steadily decreasing along with our overall environmental impact.

In the past few years, we have actively engaged with our contractors to ensure their health and safety standards are raised to the level of LUKOIL's. These efforts have provided excellent results.

We maintain a strong focus on improving the reliability of our pipeline network, handling waste, and reclaiming disturbed land.

We also make efforts in contributing to climate change response and are working to improve energy efficiency and reduce our air emissions while continuously reducing our GHG emissions despite growing production volumes.

Commitment to the UN Global Compact’s principles and sustainable development goals remains an integral part of our strategy and is vital to long-term shareholder value creation.

To conclude, I will reiterate that we have achieved a lot this past year and will continue to develop LUKOIL in full compliance with the strategy.

Now I would like to hand over to Azat Shamsuarov.

Azat Shamsuarov

11. Title slide "Upstream"

Thank you, Alexander! Good afternoon, ladies and gentlemen!

12. Upstream strategy

Good morning! In 2018, we showed strong Upstream performance under our long-term strategy. In some areas, the results have greatly exceeded our plans and expectations.

As with the year prior, we worked under the OPEC+ limitations. Our baseline year-on-year hydrocarbon production growth plan was in the 1% to 2% range. In the middle of the year, we rapidly boosted our daily production by 35 thousand barrels through the efficient management of our mature fields following the changes in OPEC+ arrangements. We also progressed with our Uzbekistan gas projects well ahead of schedule. As a result, our total hydrocarbon production excluding the West Qurna-2 project grew by 3.8% in 2018 – considerably above the minimum growth rates set out in our strategy.

Following our value-over-volume strategy, we continued focusing on accelerated production growth at high-margin projects. We have significantly increased our production of high-viscosity, Caspian, and tight oil. As a result, the share of high-margin barrels grew by 5 percentage points and exceeded one quarter of total production.

As compared to previous years, we have intensified our efforts towards building up additional production potential through developing technologies and cost reduction initiatives.

13.West Siberia

Our West Siberian fields were the key balancing factor to meet external production limitation. But even with the limitations in place, we were still able to enhance production profile in West Siberia, with decline slowing to 3% while production drilling volumes and number of wellworks remained almost flat.

This was driven by performance improvements achieved across the board. These achievements allow us to look to the future with even more optimist and set more ambitious goals to improve the production profile at our mature fields.

In West Siberia we actively adopt tailored solutions for each deposit. This is supported by technological progress in the areas of multi-zone fracturing, drilling multilateral and multi-bore wells.

Technologies development allowed to increase the share of complex wells in West Siberia by 6 percentage points year-on-year to 39%.

14.Horizontal wells with three-string design

Among the key achievements in 2018 was the successful deployment of horizontal three-string wells.

We drilled 43 of these wells in 2018, including three multi-bore wells. On average, the technology speeds up well construction by about 40% while reducing costs by approximately 15%.

We plan to expand the use of three-string wells. Our mid-term plan provides for a 30% share of such wells in the total number of horizontal wells to be drilled in West Siberia. We explore potential extra value from this technology while working on removing technical hurdles that constrain its wider application.

15.Small-diameter wells

Small-diameter wells are another example of LUKOIL’s improved technological performance.

In 2018, we continued actively rolling out this technology in the Volga region and also drilled the first small diameter wells in West Siberia and Timan-Pechora.

A total of 48 small diameter wells were drilled in 2018. The average savings exceeded 30% of standard well costs, while some wells reached savings of as high as 50%. The result is well above our initial expectations. Another advantage of small diameter wells is the reduced well pad costs.

We see a huge potential in this technology, and plan to considerably increase the number of small diameter wells in the next few years.

16.Increasing energy efficiency

We continue working on raising energy efficiency within the approved programs. In 2018, the number of artificial lift wells with permanent magnet motors increased by 60% and as at year-end, 37% of artificial lift wells were equipped with permanent magnet motors. The energy-efficient pump fleet grew by 14% in 2018. These activities translated into cost savings equal to more than 10% of our corresponding electricity costs.

17.Medium-term cost reduction targets

Reducing per-unit costs is key to meeting our strategic goal of accelerating the pace at which reserves and contingent resources are involved into production.

As part of our strategy, we have defined our baseline cost reduction targets and set out to design even more ambitious targeted cost optimization programs. I am pleased to announce that we were able to meet and exceed these plans in 2018 and deliver significant structural budget savings.

Drilling cost per meter was down 5% in comparable structure due to changes in well designs, optimized associated operations as well as optimized contractor management.

In 2018, we performed additional analyses to set even more ambitious drilling cost optimization targets. In the medium term, we now plan to at least keep the drilling costs per meter flat in nominal terms.

Per unit lifting costs also improved and were down by 2% in 2018, breaking a long-term rising trend. I believe this to be a major breakthrough worthy of high praise.

In 2018 we ran integrated analysis on enhancing operating efficiency based on fields in West Siberia. A priority actions plan was designed and a decision was made to roll out the solutions across all LUKOIL's upstream subsidiaries in Russia. We have set a rather ambitious goal of keeping per unit lifting at 2017 levels in the near term, despite the continued natural depletion of our reserves.

We have also met our construction cost targets. Key cost items remained flat from 2017. We see significant potential for further optimization and will continue to focus on related initiatives.

18.Profit based tax (PBT)

We are glad that the government supports our efforts to improve the oil recovery rate and involve more oil resources into production. As you all know, the profit based tax has been in effect since 2019 and is particularly important for our mature fields.

The profit based tax allows to fundamentally transform the production profile by accelerating the recovery of existing proved reserves and providing the ability to tap contingent resources. For example, we plan to double the production profile from our mature licensed areas in West Siberia covered by the profit based tax framework as compared to the profile under the standard tax system. As a result, mature fields will be rejuvenated and transformed into growth projects. These fields currently produce close to 3% of our total oil output in Russia. Including them in the profit based tax framework further boosts the share of high-margin barrels in our total production.

We see it as another attractive opportunity to reinvest capital, with additional investment in mature fields under the profit based tax estimated at approximately 65 billion rubles during the first five years.

19.North Caspian

I would now like to present the key results at our priority projects.

In 2018, second production platform was launched at the V. Filanovsky field in the Caspian Sea, from which four production wells were drilled and launched into production. Three of these are TAML Level-5 bilateral wells.

The application of the integrated model while developing the field enabled effective solution adjustments for well location and engineering. As a result, the field ramped up to design capacity of 6 million tonnes of oil per year in a record time of less than two years. Due to record-high flow rates, plateau production was reached at only 7 production wells.

Phase 3 construction is under way at the field. In 2018, jackets were installed in the sea for the third production platform. At the moment, construction works at the platform's topside are in their final stage. Mounting the topside on the jackets and commencing drilling operations is planned for mid-2019.

The second production platform was commissioned and the drilling program was launched at the Yu. Korchagin field resulting in completion of 2 production wells. We also started the additional drilling program at the first phase of field development with one production well and two sidetracks completed and launched. Those programs allowed for a 23% increase in average daily production at the field in Q4 2018 versus Q1.

20.North Caspian: new projects

In July 2018, we made a final investment decision to develop the Rakushechnoye field.

The project will use the existing infrastructure of the V. Filanovsky field for production treatment, thereby driving considerable capex savings.

So far, the main contractor has been selected, the development of detailed design documentation has commenced, tenders are held for the supply of equipment and materials, and manufacturing of jackets and metal topsides began.

Commercial oil production is planned to start in 2023 with a projected plateau level of 1.2 million tonnes per year. We are working to accelerate the field's launch.

Before we proceed to onshore, I would like to touch upon our projects in the Baltic Sea. We have recently drilled the first horizontal well at the D41 field with a reach of almost seven km. The well has been drilled from the shore. Production at the field is due to commence in the nearest future, while drilling of the second well is already under way. At the D33 field, we have proceeded to the development of the design documentation.

21.Hard-to-recover: heavy crude oil

Now I move to our onshore projects. In 2018, we delivered impressive performance in high-viscosity oil production.

Production at the Yaregskoye field increased by half. We successfully launched commercial use of underground low-angle upward boreholes of up to 800 meters in length at the field, which enabled to significantly reduce the scope and cost of mining operations while speeding up reserves development.

At the Permian reservoir of the Usinskoye field production grew by 13% year-on-year. The introduction of day rate contracts helped to achieve record commercial drilling speed: an increase of over 30%. We also confirmed efficiency of the small-diameter wells which delivered cost savings of over 10%. Full-scale rollout of this technology will yield significant capex savings due to the high number of wells planned for drilling at the field.

22.Hard-to-recover: low permeability

Active development of low-permeability reservoirs was continued.

We commissioned 67 production wells at the Imilorskoye field, delivering a 31% production increase year-on-year. Technology advancement and cost optimization measures allowed to increase the planned plateau production level at the field to 2.5 million tonnes per year as compared to the 2.2 million tonnes per year announced last year.

In 2018, we commissioned 20 production wells at the V. Vinogradov field, where oil production grew by 15%. The field is now at the final pilot development phase to test a development system based on horizontal wells with multi-stage fracs both for oil production and reservoir pressure maintenance, which is a unique technological solution in Russia. Actual results have proven the solution's effectiveness and we plan to move the field into commercial development phase.

The V. Vinogradov field can truly be called an R&D site. We drill there horizontal wells of a unique completion design with the horizontal boreholes exceeding 2 thousand meters and have up to 16 frac ports.

We continued working on transferring our tight oil reserves across the fields to the tax-advantaged category. We transferred approximately 130 million barrels of reserves in 2018, which builds up incremental upside potential in tight oil production.

23.Gas projects in Uzbekistan

We have achieved solid operational results in Uzbekistan through the implementation of the project approach. The 8-billion-cubic-meter Kandym gas processing complex was launched five months ahead of schedule, which is a major achievement for a project of such scale and complexity. The complex was completed in a record time of 24 months. The early launch of the complex resulted in our average daily gas production in Uzbekistan being ramped up to design capacity equivalent to around 14.5 billion cubic meters of gas per year in LUKOIL's share, achieved as early as September 2018. Incremental gas production exceeded 2 billion cubic meters due to the early launch of the complex with the total production volumes grew by 67% year-on-year.

In 2018, we faced an increase in receivables from our Uzbekistan partners for our gas supplies, as some of our supplied gas was directed to the domestic market. I would like to remind that the Production Sharing Agreement terms provide that all gas must be exported. The exports are through UzTransGaz under a commission agreement. During negotiations on debt recovery, the Uzbekistan counterparty indicated that the debt could not be repaid immediately, and that they would need to continue gas withdrawals for the domestic market in the future. In order to stabilize the situation, we have agreed to restructure the debt against a guarantee by the Ministry of Finance of Uzbekistan by extending its maturity by two years with repayment in equal monthly instalments. The payments under the new schedule have already begun. We have also committed to sell up to 5 billion cubic meters of gas annually on a prepaid basis for domestic consumption at a 12.5% discount to the average weighted export netback price. We believe that the agreement reached establishes a robust foothold for continuing our projects and recovering our investment.

24.Building up exploration portfolio in Mexico

In mid-2017, we entered the promising region of the Gulf of Mexico, having obtained the mineral rights to Block 12 offshore Mexico. We expanded our portfolio considerably in 2018 by adding three more blocks. We won Block 28 in a tender together with Italy's Eni. We will obtain stakes in Blocks 10 and 14 following a swap deal with Eni which is subject to Mexican authorities' approval.

The expansion of our portfolio in the Gulf of Mexico is a logical international application of our accumulated expertise in offshore projects.

25.Projects in Iraq

In Iraq, we successfully negotiated adjustments to the West Qurna-2 project parameters to improve the economics of the field's Phase 2 development. The key adjustment was reducing the production plateau from 1.2 million barrels per day to 800 thousand barrels per day. We have already commenced works under Phase 2 and expect to double production at the field by 2025 from the current level of 400 thousand barrels per day. The project development will be financed from current production. Thus the amount of our capital employed will remain at about half a billion US dollars.

We also continued drilling the appraisal wells at the Block 10 in Iraq where we had previously discovered the Eridu field. Given the size of the discovery and considerably higher service fee compared to the West Qurna-2 project, we began working on accelerating the launch of commercial production, including through negotiations with the Iraqi government regarding pilot oil production from exploration wells.

26.Upstream Strategy

To conclude, I would like to say that the 2018 results prove the effectiveness of our new strategy. We will continue working on technology enhancement, process optimization, and cost reduction in order to expand the production potential at our existing resource base.

Thank you for your time. Now I will give the floor to Vadim Vorobyov.

Vadim Vorobyev

27.Title slide “Downstream”

Thank you, Azat. Let me start with key results in the refining segment.

28.Refining. 2018 results

Our refining volumes remained stable year-on-year.

Our Russian refineries underwent major maintenance of the catalytic cracking units at Nizhny Novgorod and the delayed coker at Volgograd. Despite the maintenance works, our light product yield remained unchanged, which we managed to achieve by increasing the utilization of our most complex refineries in Perm and Volgograd.

We continued reducing production of fuel oil and cut its output by 800 thousand tons or by 9% year-on-year.

The prompt completion of our large-scale upgrade program has made our Russian refineries among the most advanced in the country. To give you perspective, the national average light product yield net of LUKOIL’s refineries was less than 60% in 2018 against approximately 70% at our refineries. As a result, our refining margin is considerably above the industry average, which enables us to generate strong free cash flows from our refineries.

Our European refineries also outperform the industry’s average in terms of complexity, thus generating margins above the industry average.

We keep going beyond what we have achieved and implement additional selective projects to increase our light product yield to 76% by 2022 and further ramp up our output of high value-added petroleum products.

29.Delayed coker at Nizhny Novgorod Refinery

Our largest selective project is the construction of the heavy residuals processing complex based on the delayed coker unit with 2.1 million tons capacity at Nizhny Novgorod Refinery. The complex is scheduled for launch in 2021.

So far, we have entered into EPC contracts and started piling works and building foundations for the process units.

The complex will become the key driver in reducing fuel oil production and increasing the light product yield, mainly diesel fuel output. According to our plans, starting from 2022 the fuel oil yield will not exceed 4% across our Russian refineries, including the effect of cross supplies.

30.Selective projects at Russian refineries

We are also building isomerization unit at Nizhny Novgorod Refinery to increase its output of high-quality motor gasolines. In late 2018, we signed an EPC contract. Preparations for launching the active construction phase are currently under way.

Our other selective projects at refineries are driven by the development of our premium businesses. The deasphaltizing unit at Volgograd is an advanced technology that will help increasing the lubes' quality while reducing the production costs simultaneously. Pile driving is currently under way at the site.

The bitumen production upgrade at Nizhny Novgorod Refinery will position us to deliver on our bitumen business development strategy. The upgrade will ensure production of a full range of products, including Superpave bitumen, polymer-modified bitumen and different kinds of mastics.

31.Efficiency improvement program at refineries

Refining efficiency is our main priority. We are continuously seeking to cut costs and streamline processes in order to increase the free cash flow.

All our refineries have annually-updated three-year roadmaps to improve their operational efficiency. The roadmaps outline a range of operational measures with zero investment as well as investment projects with very short payback periods.

In 2018, we achieved considerable benefits estimated at about 20 billion rubles, including about 5 billion rubles in cost savings. The roadmap goals set out for the next three years are equally as ambitious.

32.Readiness of LUKOIL refineries for IMO 2020

New global limits on the sulfur content in marine fuels, known as MARPOL, are coming into effect next year. These are likely to cause deterioration of crack spreads for high-sulfur fuel oil and improvement for middle distillates and may affect some other spreads.

Given our petroleum product slate, our refineries are well-prepared for MARPOL already today and are expected to benefit from the new regulations through improved refining margins.

In 2018, the fuel oil output at LUKOIL's refineries declined to 11% while middle distillates accounted for 47% of the total output. Some of our refineries already have 'fuel oil'-free product slate. We also benefit from our existing production of substantial volume of marine fuels with a sulfur content below 0.5%. On top of that, of our total fuel oil production, 1 million tons is 1% sulfur content. We produce it at our refinery in Volgograd.

As part of MARPOL 2020 preparations, we have designed a set of measures to optimize capacity utilization, product slates, cross-supplies between refineries, and the use of fuel oil at our power generation facilities to maximize MARPOL's positive impact depending on the crack spreads.

The launch of a delayed coker at Nizhny Novgorod Refinery in 2021 will deliver additional positive impact. Depending on the crack spreads, we will be able to cut the total fuel oil production across all our refineries including the cross-supplies to less than 3 million tonnes, which is less than 4% of our total refinery throughput and 5 million tons less than our fuel oil production in 2018. It also must be considered that some of our refineries will continue processing purchased fuel oil, which brings the balancing production volume even lower.

33.Growth projects in petrochemistry at refining sites

We consider development of our petrochemical business supplied with our own feedstock already produced at our refineries as the next stage in developing our refining capacities. Considering high capital intensity of petrochemical projects, we are thoroughly analyzing all the details.

The feasibility study for a polypropylene facility at Nizhny Novgorod Refinery is close to completion. The concept of the project implies upgrading the existing catalytic cracking units to increase propylene yield. In the coming months, we expect to make a decision on the facility's capacity.

We are also working on feasibility study on styrol production complex at the refinery in Nizhny Novgorod. The concept of the complex implies making use of ethylene produced from the fuel gas of catalytic cracking and benzene from the reforming unit as feedstock.

In addition, we started exploring potential construction of a pyrolysis facility of a global-scale at one of our Russian refineries. The concept provides for consolidating light pyrolysis feedstock from our plants.

34.Refining strategy

I will wrap up the refining section with a reminder of our key strategic goals. Given the substantial contribution of oil refining in LUKOIL's consolidated free cash flow, our main focus is on improving the efficiency of our existing capacities and streamlining maintenance costs to maximize free cash flow. Our second point of focus is making selective investments to further improve our product slates. The third goal is development of our petrochemical production on the base of existing feedstock.

35.Refined products logistics optimization

Before moving on to the marketing segment, I would like to discuss logistics. Transportation expenses are one of our major cost items. Transportation tariffs are beyond our control, but we can minimize expenses through optimized supply channel mix. In 2018, we achieved excellent results in this area by considerably increasing supplies via the new petroleum product pipelines launched by Transneft in 2017.

They include the South project that supplies our diesel fuel from Volgograd Refinery to exports through the port of Novorossiysk, as well as a pipeline carrying our gasoline from Nizhny Novgorod Refinery to the Moscow region. In 2018, the two pipelines transported a total of almost five million tonnes of our products, up ten times year-on-year, resulting in substantial savings on transportation expenses.

36. Filling stations

Our key task in retail is to improve efficiency and maximize the free cash flow from our filling stations network. We have a number of priorities in this segment.

First, we focus on streamlining our operating and administrative expenses. In 2018, we reduced our per-unit costs in real terms.

Second, we are optimizing the geographic footprint and formats of our filling stations network. We implement an upgrade program to increase the share of filling stations with non-fuel marketing space, we build and acquire new stations and also close and divest low-margin outlets.

Third, we focus on increasing sales of premium branded fuels and non-fuel products and services. In this area, we achieve steady double-digit growth. For instance, our sales of ECTO branded fuels in Russia rose 14% year-on-year.

37. Optimization of retail management system in Russia

The recent reorganization of our Russian retail network management system has been an important step toward further cost optimization. We have consolidated eight managing entities into four with the direct impact on administrative expenses estimated at at least half a billion roubles per year. We also expect benefits from consolidating our procurement and logistics management, and from unifying our marketing policy. Additionally, we began enhancing our IT platforms to further improve the efficiency of our retail business management.

38. Developing nonfuel sales and services at Russian filling stations

Growing sales of non-fuel products and services is an important part of our efforts to increase the cash flow from the retail network. Non-fuel sales are a rapidly-growing high-margin segment. In 2018, our gross profit from non-fuel sales was up 21% in Russia and up 19% across our international networks in ruble terms, per unit indicator grew by more than 10%.

The gross profit from non-fuel sales covered the expenses of our Russian filling stations by 39% in 2018, up 6 percentage point year-on-year.

We have intensified our efforts in promoting non-fuel sales while adopting modern retail best practices to deliver maximum performance in this business.

39. Aircraft fueling and marine bunkering

Today, LUKOIL is a leader in the Russian aircraft refueling and marine bunkering markets. Our strategy in these segments is aimed at maintaining a high market share while increasing sales to our end consumers and improving efficiency.

A key goal in aircraft refueling is growing the share of into-plane fueling, which enable to substantially increase margins for jet fuel sales. In 2018, our into-plane fuel sales volumes grew by 20%, while the total volume of kerosene sales remained practically flat.

This impressive growth was primarily driven by the launch of the refueling facility at Moscow Sheremetyevo airport. This is the most advanced refueling facility in Russia.

In marine bunkering in Russia, we increased sales volumes by 3% year-on-year while small- wholesale sales volumes increased by 9%.

40. Lubricants and bitumen

The production and sales of LUKOIL-branded lubricants continue to demonstrate a double-digit growth. We increased the sales of our high value-added lubricant range by 12%. We launched online stores, as well as sales through global marketplaces. A special emphasis was placed on developing high-tech integrated B2B services.

We also believe that the development of our polymer modified bitumen business holds significant potential. As highlighted earlier, we develop bitumen production capacities at our refineries and established a center of expertise, as cutting-edge technology is vital to ensuring the success of the business.

41. Marketing strategy

In conclusion, I would like to reiterate our key strategic goal in the distribution segment.

Just as with refining, distribution is a major source of free cash flow for the Group. Therefore, our strategic priority in the segment is improving efficiency.

Thank you. I will now hand over to Pavel Zhdanov.

Pavel Zhdanov

42. Title slide "Finance"

Thank you, Vadim. Good afternoon, ladies and gentlemen. Let me present the financial part of the presentation.

43. Macro environment

The macro environment was more favorable as compared to 2017. Oil price increase by 31% was accompanied by weakening ruble, which had a positive impact on our upstream results. In the downstream there was a slight decrease in benchmark refining margins. In Europe, it was driven by deterioration of crack spreads for fuel oil. In Russia, domestic prices for refined products were lagging export netbacks.

Sharp decrease in oil prices in the fourth quarter had a negative impact on the upstream, but was positive for the Russian downstream due to the stable level of prices for refined products. In the European downstream, refining margins decreased quarter-on-quarter due to deterioration of crack spreads for gasoline.

44.Revenue

The increase in revenue by 35% year-on-year was primarily due to price factor as well as higher oil trading volumes. Refined products sales volumes grew in Russia mainly because of stronger demand for our products. Lower refined products sales volumes outside Russia were due to lower volume of exports from Russia.

In the fourth quarter, our sales were 11% lower quarter-on-quarter on the back of lower oil prices, lower oil trading volumes as well as oil and refined products inventory build-up.

45. OPEX

We achieved good results in optimizing and controlling our operating costs. In 2018, our lifting costs in Russia decreased by 2%, thus reversing the multi-year growing trend. Outside Russia, lifting costs were down 10% in dollar terms driven by growing volumes of gas in overall production structure.

Higher per unit refining expenses in Russia were due to large-scale scheduled maintenance works at the conversion units and growing share of higher-octane gasoline grades in the product slate, which led to higher purchases of additives and gasoline components. In Europe, higher refining expenses were due to uncontrolled factors including weaker ruble and higher gas prices.

46. EBITDA

Our EBITDA grew by 34% year-on-year and hit a record level of 1.1 trillion rubles.

The upstream segment was the main growth driver, its EBITDA grew by half. Besides higher oil prices and weaker ruble, EBITDA dynamics in the upstream was positively affected by bigger share of high-margin barrels in total production, higher overall production and lower per unit lifting costs. Export duty lag effect in Russia and external production limits constrained the EBITDA growth.

In the fourth quarter of 2018, there was an opposite situation in the upstream. EBITDA was down 29% quarter-on-quarter due to lower oil prices and substantial export duty lag effect. Negative effect from the weak macro environment was partly offset by production volumes grow and the share of high-margin barrels reaching 28%.

In the downstream, there was a mixed dynamics in 2018. In Russia, the quality of our product slate allowed us to show an increase in margins at our refineries despite lower benchmark refining margins. In addition, we saw better results in petrochemicals due to better price environment. EBITDA in retail business decreased due to retail prices lagging wholesale benchmarks. EBITDA of the European refineries significantly decreased due to lower refining margins and inventory effects. Besides that, our trading business showed weaker results.

In the fourth quarter, our Russian refineries recorded higher EBITDA on the back of better refining margins. The growth was constrained by inventory effect due to oil price decline. EBITDA of retail business was negative in the fourth quarter, while our power generation business showed significant seasonal growth. Refining margins at our European refineries contracted following the benchmark margins and the decrease in EBITDA was even more substantial due to inventory effect.

At the corporate center level, EBITDA was mainly affected by accost ccruals under the new long-term incentive program.

47.Profit

Our profit dynamics as compared to 2017 was mainly impacted by the following three factors: foreign exchange effect, gain on sale of diamonds business in 2017 and depreciation growth. Effective income tax rate remained practically unchanged at 20%.

As for foreign exchange effect, we had positive net monetary position in foreign currency, therefore, ruble appreciation in 2017 led to foreign exchange loss, while ruble depreciation in 2018 led to foreign exchange gain. I'd like to draw your attention to the fact that due to changes in intragroup financing structure as of the end of 2018 our net monetary position in foreign currency became negative. This will lead to positive foreign exchange effect in case of ruble appreciation and vice versa.

Increase in depreciation in 2018 was driven by the launch of new production facilities, mainly in the Caspian Sea and Uzbekistan. A two-fold decline in depreciation in the fourth quarter was due to an increase in the volume of proved developed reserves, mainly at capital-intensive projects, and booking in the fourth quarter the corresponding recalculation of depreciation for the full year in the amount of 48 billion rubles.

48.CAPEX

Capital expenditures decreased by 12% in 2018. The main decline driver was completion of main construction works in Uzbekistan, and our costs declined even faster than planned due to cost savings. Decrease in capital expenditures in Russia at unchanged volume of construction and drilling works was due to structural savings driven by optimization measures, as well as due to transferring of some of the payments to 2019.

An increase in capital expenditures in the downstream segment was due to the start of works at selective projects at our Russian refineries, mainly at the delayed coker at Nizhny Novgorod refinery.

The share of upstream segment in 2018 capital expenditures was 81%, while the share of Russia was the same, which generally corresponds to our strategic target.

49. Sources and uses of cash

In 2018 our operating cash flow for the first time exceeded one trillion rubles, while free cash flow more than doubled, partly owing to lower capital expenditures.

Dividend payments were growing several times faster than the minimal growth rate set in our progressive dividend policy.

In September, 2018, we started buying back shares in the open market in accordance with new capital distribution policy that was announced a year ago. We spent 60 billion rubles on the buyback as of the end of 2018, and more than 100 billion rubles or 1.5 billion dollars as of the beginning of March.

50. Financial position

Our balance sheet remains very strong. At the end of January Moody's rating agency increased our credit rating to Baa2 following the increase in the sovereign rating.

Starting form the first quarter of 2019 we will begin to apply IFRS 16 standard, which implies that operating lease contracts and some service contracts will be put on the balance sheet, which will increase our assets and total debt. According to preliminary estimates, the effect on our balance sheet will be in the range from 140 to 200 billion rubles.

51. 2019 outlook

Several words on our plans for 2019.

We expect our hydrocarbon production to grow by up to 1% depending on OPEC+ decisions.

Refinery throughput growth may be up to 5% depending on the spreads. We plan to keep light product yield at 2018 level.

Capital expenditures excluding West Qurna-2 project are expected to be up to 500 billion rubles or 8 billion dollars depending on OPEC+ decisions. Capex structure will remain practically unchanged compared to 2018. About 80% of expenditures will be spent in the upstream segment. Russian projects account for approximately 85% of the total budget.

52.LUKOIL – a unique investment proposition in Oil&Gas

In conclusion I'd like to emphasize that LUKOIL is a unique investment story combining the best features of both Russian and international oil and gas companies. We have assets of outstanding quality, a massive resource base, a strong balance sheet and a flexible strategy. We are focused on sustainable delivery of shareholder value.

I would like to conclude the presentation here and open the line for questions and answers.

Thank you for attention!