LUKOIL

PJSC "LUKOIL"

3Q 2020 Results

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Speakers:

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Alexander Palivoda

Slide 1

Good afternoon, ladies and gentlemen. Thank you for joining us today for this conference call on LUKOIL's results for the third quarter and first nine months of 2020. On today's call, we have Mr. Alexander Matytsyn, CFO; Mr. Pavel Zhdanov, Vice President for Finance; as well as our colleagues from Accounting Team.

Slide 2

Before we move on to the presentation, I would like to draw your attention to the fact that some of the comments during this call constitute "forward-looking statements" involving risks, uncertainties and other factors that may cause our actual results to be materially different from what is expressed or implied by these forward-looking statements.

More detailed information is presented on the slide.

Now I would like to hand over to Mr. Alexander Matytsyn.

Alexander Matytsyn

Slide 3 "Macro environment and operating results"

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

In the third quarter, the pandemic continued to have a negative impact on the oil and gas industry. Yet, thanks to a partial recovery in demand coupled with the offsetting effect of the OPEC+ agreement, oil prices stabilized at the level reached at the end of the second quarter. As a result, our financial results in Upstream significantly improved despite external limitations on production volumes.

In Downstream, refining margins remained extremely low due to imbalances in the motor fuels market. On top of that, lower price volatility led to a significant reduction in trading margins that had hit record highs in the second quarter. With the scheduled maintenance works completed at our refineries, we increased refinery throughput and took further steps to improve our product slate. Furthermore, sales volumes at our filling stations mostly recovered.

Slide 4 "Financial results"

A better market environment in Upstream and the management team's efficient performance amid diverse market conditions in Downstream helped us achieving outstanding financial results in the third quarter despite the negative impacts of the pandemic.

Our ongoing efforts to boost efficiency, a focus on cost cutting, a well-thought approach to reducing production, and flexibility in throughput optimization were the major drivers behind LUKOIL's financial performance.

Free cash flow in the third quarter more than quadrupled quarter-on-quarter and exceeded the quarterly average of 2017 despite lower oil prices and many-fold higher limitations on production. This was made possible thanks to improved production mix and product slate as well as cost optimization. In the third quarter, cash flow also benefited from working capital release resulting from partial destocking.

EBITDA increased by 40% quarter-on-quarter, supported by Upstream while EBITDA in Downstream remained almost flat.

Slide 5 "Leadership in resilience to external shocks"

I would like to note that in the nine months of 2020 LUKOIL maintained a strong industry leadership in terms of per unit financial metrics, far outstripping its peers on free cash flow per unit.

Our robust results testify to our highest resilience to external shocks, largely driven by our efficient business model, high-quality assets, low costs and natural hedge instruments in Russia.

Slide 6 "Oil market recovery"

Today, we witness mobility restrictions return in a number of countries as the second wave of the pandemic hits. Even though the new restrictions are less extensive than in spring, they still affect oil demand, resulting in slower destocking that is needed to balance the oil market.

Despite analytical agencies downgrade their forecasts for demand recovery dynamics, demand is still expected to return to pre-crisis levels by early 2022. These expectations are largely fostered by the success of vaccine developments and trials.

Oil prices are forecasted to continue on an upward trend, which is, among other things, attributable to a significant negative effect that the pandemic has had on global oil production. This is due to a dramatic drop in investment across the industry, which means faster production decline for existing projects and suspension for new ones.

Even though analysts are optimistic about future oil price trends, we take a traditionally conservative approach to budgeting and investment decision-making based on lower prices compared to the market consensus forecast. This enables us to secure additional resilience during periods of high price volatility.

Slide 7 "Well positioned for market recovery"

Today, LUKOIL is perfectly positioned to get the most benefit from the market recovery, and our third quarter performance demonstrates this clearly.

The ability to quickly recover production along with the ongoing improvements to the production mix help us amplify the positive impact of rising hydrocarbon prices on our financials.

Low refining margins are a temporary trend and the refining profitability is set to improve as mobility restrictions are lifted. The quality of our refining assets is much higher than the industry average. We also expect the launch of new conversion facilities slated for the next year to help our Downstream financials get the most from the market recovery tailwinds.

Although recent changes in Russia's tax legislation will have some negative impact on our future performance, this impact is by far smaller than the upside potential we can unlock as the market environment improves. On top of that, we are working to minimize the effect of negative developments and maximize the impact of new opportunities.

As always, we continue to focus on increasing business efficiency.

Slide 8 "Robust financial position"

LUKOIL maintains very strong financial position. Despite record-high dividends paid in the third quarter of 2020, our financial leverage stands at just 0.2. This is a huge advantage in a volatile environment.

In November, LUKOIL redeemed 1 billion US dollars of Eurobonds. The cash on the Group's balance sheet exceeds its debt maturing in the next three years. On top of that, we increased the amount of committed credit lines to 3.5 billion US dollars amid high volatility.

Slide 9 "CAPEX optimization"

We continued to optimize our investment program. Total actual savings for the nine months of 2020 amounted to around 55 billion rubles, with more than half of that recorded in the third quarter.

You may remember from our previous call that the biggest savings come from our projects abroad and are attributable to the shift of expenditures in exploration and early-stage upstream and downstream projects to later periods. To a lesser extent, optimization affects our ongoing drilling and construction expenditures. Therefore, capex reductions achieved through optimization do not affect the implementation of the Company's key investment projects.

We expect the investments in the current year, excluding the West Qurna-2 project, to be in the range of 460–480 billion rubles. This means that the total savings could amount to 90 billion rubles compared to base-case plan of 550 billion rubles. Due to the ruble devaluation, investment savings in US dollar terms will be much higher – up to 25% of the original target, or about 2 billion US dollars.

Slide 10 "Cost control"

While optimizing our investment program, we also continued our efforts to cut all other expenses across the board. At the end of the third quarter, almost all conditionally controllable expenses decreased in absolute terms quarter-on-quarter. At the same time, per unit costs remain above the 2019 level, which is attributable to a certain share of fixed costs amid a forced reduction in production volumes. We expect per unit costs to normalize as production recovers.

Thank you. Now I would like to hand over to Pavel Zhdanov.

Pavel Zhdanov (Upstream)

Thank you, Alexander. Good afternoon, ladies and gentlemen. I will now present our results in the Upstream segment.

Slide 12 “Price and tax environment”

Let me start with the price environment overview. The average Urals crude oil price went up by almost one and a half times quarter-on-quarter. However, due to the progressive tax scale in Russia, the net oil price added 14% only. Owing to the ruble devaluation, the net price in ruble terms saw a slightly higher increase – by 16%.

The ruble devaluation also kept the net oil price in October and November roughly at the third quarter levels, despite a decrease in the US dollar price.

I would like to note that the current net ruble price is flat year-on-year, although a year ago the Urals price exceeded 60 US dollars per barrel.

Slide 13 “Key operating results”

For the nine months of 2020, LUKOIL Group's average daily hydrocarbon production, excluding the West Qurna-2 project, totaled just slightly below 2.1 million barrels per day, down 12% year-on-year.

We had to cut crude oil production following the new OPEC+ agreement. As discussed during our previous calls, the cuts were implemented based on production economics and predominantly affected mature fields.

We also had to cut gas production due to lower gas supplies from Uzbekistan to China. That is why the chart on this slide shows a decline in production for new projects.

Despite external restrictions, the production of high-margin barrels continued to grow as planned, with their share in total oil output in Russia rising by 4 percentage points year-on-year.

Slide 14 “Production cut due to OPEC+”

I would like to talk more specifically about oil production developments driven by the OPEC+ agreement.

After reducing production since May 1 approximately by 310 thousand barrels per day against average daily production in the first quarter, in July and August we recovered some of the lost output bringing back 80 thousand barrels per day. In doing so, we focused predominantly on production economics, prioritizing and restarting the most profitable wells.

We continue to maintain our spare production capacity in Russia at about 230 thousand barrels per day, so we are able to promptly recover the production back to normal and secure further sustainable growth.

Slide 15 "Upstream EBITDA"

The Upstream financial results improved significantly quarter-on-quarter.

In Russia, the segment's EBITDA more than doubled to 136 billion rubles. Apart from the favorable pricing environment, this growth was supported by improved production mix and lower per unit lifting costs. At the same time, it was held back by production cuts associated with the OPEC+ agreement.

The Group's EBITDA outside Russia increased by 89% to 16 billion rubles. One-off revenue adjustment of 5.5 billion rubles in the second quarter related to the sales of Uzbek gas gave support to the dynamics. Growth headwinds came from lower production volumes in Uzbekistan.

EBITDA for the nine months of 2020 halved year-on-year mainly due to lower hydrocarbon prices, oil production cuts owing to the OPEC+ agreement, lower gas production in Uzbekistan, and the negative tax lag effect in Russia.

Slide 16 "North Caspian"

In the third quarter, we continued to proceed with our priority projects strictly in line with our plans.

The drilling program helped us keep production at the Vladimir Filanovsky and Yuri Korchagin fields in Caspian Sea at the target level. In the nine months of 2020, their combined oil and condensate production reached 5.6 million tonnes, up 2% year-on-year.

In August, we successfully drilled the first production well with the MultiNode intelligent completion system at the Yuri Korchagin field, which enables the best ways to harness the field's geological potential while minimizing geological risks. By year-end, we plan to commission another well at this field.

As part of the Valery Grayfer field development, shipyards continued to build platforms. As at the end of the third quarter, the fixed ice-resistant platform was 59% complete, and the living platform was 77% complete. Offshore jackets for the living platform and for the fixed ice-resistant platform were installed in the Caspian Sea in May and September respectively. Preparations were also made for the laying of subsea pipelines between the Valery Grayfer and Vladimir Filanovsky fields. Let me remind you that the infrastructure of the Vladimir Filanovsky field will be used for processing production from the Valery Grayfer field, which opens up vast synergy opportunities.

Slide 17 "Hard-to-recover: high-viscosity oil"

For the nine months of 2020, production of high-viscosity oil projects in Timan Pechora has increased by 5% year-on-year to almost 4 million tonnes.

In the nine months of 2020, 19 SAGD production wells and 238 underground wells were commissioned at the Yaregskoye field. The Usinskoye field commissioned 34 production wells. We are continuing to expand our infrastructure and production facilities. By the end of the year, the Company plans to commission new steam-generating facilities and proceed with its drilling program.

I would also like to give mention to our success in scaling up the technology to cut costs. Since the beginning of the year, the Usinskoye field has commissioned three small-diameter wells. As these wells are drilled with more lightweight rigs, we can cut drilling costs by more than 10%. As a reminder, this technology is now being successfully rolled out in the Urals and the Volga Region. In the nine months of 2020, the Company launched 108 small-diameter wells, a more than twofold increase year-on-year.

Let me talk in more detail about the latest changes in oil taxation that also affect our high-viscosity oil projects. As a result of tax incentives being abolished, the fiscal burden on oil produced from the Yaregskoye and the Usinskoye fields will increase considerably from 1 January 2021. This will lead to lack of return on investments into further production ramp up from these fields. At present, we are in dialogue with the government about various options of ensuring recovery of investment returns for high-viscosity oil projects. Along with that, we are revising the development plans for these fields.

Slide 18 "Hard-to-recover: low permeability"

Let me say a few words about the progress of operations if the fields with low permeability deposits in West Siberia.

Our three major low permeability fields increased production by 41% year-on-year. Notably, Sredne-Nazymskoye field doubled its production.

With an extensive drilling program underway, 141 production wells were commissioned at these fields in the nine months of 2020 – almost a quarter increase year-on-year.

Given the intensive drilling operations, our continuing efforts to improve efficiency play pivotal role. The results are impressive.

For instance, the improved well design helped increase the horizontal drilling speed at the Sredne-Nazymskoye field by 1.5 times year-on-year, translating into a 22% decrease in cost per meter drilled. The same applies to directional wells at this field, where per unit drilling costs were reduced by more than 15%.

Drilling speed for horizontal wells at the Vladimir Vinogradov field rose by 15% year-on-year. As a result, we managed to cut the per unit drilling costs by 7%. Drilling speed at the Imilorskoye field added 8% year-on-year.

Slide 19 "Gas projects in Uzbekistan"

In conclusion, I want to update you on our projects in Uzbekistan.

As you know, starting from the second quarter we had to cut production across our Uzbek projects as our gas export deliveries declined and then stopped completely. This was mainly attributable to a fall in demand for Uzbek gas from China amid a slump in LNG prices.

As a result, in the third quarter daily production stood at around one-fourth of the designed capacity. Yet, we managed to avoid complete suspension of production as we reached an agreement to supply gas to the Uzbek domestic market.

Since mid-August, LNG spot prices in Asia have been rocketing along with the growing demand for gas. This made China once again take interest in pipeline gas with oil-linked price. Export supplies from our projects resumed, with production being gradually ramped up since September. To date, daily production has been almost completely recovered back to the designed capacity.

Now let me hand over to Alexander Palivoda, who will present our results in Downstream.

Alexander Palivoda (Downstream)

Slide 21 “Refining profitability”

Thank you, Pavel.

In the third quarter, the market environment in Downstream remained weak. The average benchmark margin in Europe decreased by 40% quarter-on-quarter. First, this was due to relatively high cost of feedstock, as Urals crude traded at a premium to Brent because of cuts in oil exports from Russia. Second, the margin was affected by a decrease in crack spreads for diesel fuel resulting from oversupply caused, among other things, by a very low demand for jet fuel.

An improvement in crack spreads for gasoline partly offset the negative effects of the above factors. It is worth mentioning that, despite the increase, crack spreads for gasoline still stay significantly below market averages over the past five years.

In Russia, the refining margin showed a reversed trend, improving considerably from negative values of the second quarter. This is attributable to an increase in global prices for oil and petroleum products, resulting in higher export duty differentials and increased reverse excise tax for feedstock due to, among other things, lower negative damper for motor fuels.

In October the improving crack spreads for gasoline and fuel oil led to rising benchmark refining margin in Europe. However, the drop in gasoline price in November brought the refining margin back to the third quarter level. In Russia the benchmark refining margin slid to close to zero level in November following faster decline in local prices compared to the export netbacks.

Slide 22 “Key operating results”

Following a sharp decline of throughput volumes in the second quarter due to the optimized capacity utilization amid increasingly challenging market conditions and scheduled maintenance at refineries, our domestic and overseas refining volumes partially recovered in the third quarter of 2020. The quarter-on-quarter average daily refining throughput went up 10%.

The key contributors in Russia were Nizhny Novgorod and Ukhta refineries which had seen extensive major repairs in the second quarter of 2020. These repairs take place once every four years.

Across Europe, the biggest throughput growth was registered at our refinery in Bulgaria (also due to the previous quarter's repairs) and in Italy which had seen a sharp decline in utilization rates in the second quarter due to optimization amid weak market conditions.

Importantly, thanks to our own trading operations and developed retail channels, we optimize utilization at refineries aiming to maximize their financial performance, but not because of inability to place volumes. This is our major competitive edge.

The optimized utilization enables us to improve our product slate. In particular, the third quarter saw an increase in the gasoline yield and a decrease in the diesel fuel yield, which helped improve the refineries' financial results amid lower crack spreads for mid-distillates and a partial recovery of those for gasoline. On top of that, the fuel oil yield dropped 2 p.p. year-on-year to 7% across our refineries.

Slide 23 “Premium sales channels”

As for our premium sales channels that can be seen as a kind of an indicator of the trend in demand for petroleum products, the situation is as follows. Overall, the third-quarter retail sales of motor fuels decreased by merely 3% year-on-year in Russia, while declining by 9% across our chain abroad. Yet, the sales volumes recovered year-on-year through to August, but started rapidly weakening again from September amid reintroduced restrictions. In November, the difference from the previous year was as much as around 10%.

Jet fuel sales show a similar trend, but with a much larger year-on-year decline. In particular, aircraft fueling sales recovered to only a half of the 2019 level in the third quarter and the situation began worsening as of October.

We expect the demand to gradually revive as mobility restrictions are lifted, with jet fuel consumption taking longer to get back to normal than that of motor fuels.

Slide 24 “Allocation of Russian oil”

Following the end of scheduled maintenance works and on the back of better domestic refining margins, the third quarter saw us increase oil supplies to our Russian refineries by almost 10% quarter-on-quarter.

Coupled with a forced production cut, these factors caused the exports to further drop, with a quarter-on-quarter and year-on-year decrease amounting to 17% and 23%, respectively. Yet, exports of oil subject to a lower-rate export duty continued to rise driven by increased production from priority projects.

Slide 25 “Downstream EBITDA”

Downstream showed mixed financial performance.

EBITDA in Russia was up 28% to 42 billion rubles mainly due to an increase in the benchmark margin and refining throughput, better product slate and stronger retail sales of motor fuels. The growth was constrained by a weaker positive inventory effect at refineries and lower retail margins.

EBITDA outside Russia went down by 23% to 35 billion rubles largely as a result of lower benchmark refining margin and international trading margins as well as a slight negative inventory effect at overseas refineries compared to a significant positive effect in the second quarter. Downstream EBITDA outside Russia was supported by a higher refining throughput and better product slate, better results in retail segment and a positive accounting effect of hedging in global trading operations.

As a result, total Downstream EBITDA remained almost flat quarter-on-quarter at 78 billion rubles.

Downstream EBITDA for the nine months of 2020 decreased by a third year-on-year mainly driven by the performance of Russian assets. Among the key factors were lower margins and refining throughput, a negative inventory effect at refineries and weaker retail and petrochemical sales. Outside Russia, the metric benefited from the accounting specifics of hedging operations in our international trading and a much stronger trading margin in the second quarter amid high price volatility.

Slide 26 “Selective projects at Russian refineries”

We keep developing selective projects at our Russian refineries.

In the delayed coker construction project in Niznhy Novgorod, main long-lead items have been installed. The work is now underway to install on-site pipelines and complete technological equipment strapping. The project was 79% complete as at the end of the third quarter. Slated for the launch at the end of 2021, the project will dramatically improve the yield at both the refinery and Group-wide by reducing the fuel oil yield.

Construction of the isomerization unit is ongoing at the same refinery. All major units of equipment were delivered and installed, and the auxiliary equipment will soon be delivered in full. The installation of pipelines, power cables and instrumentation is ongoing. The project was 85% complete as at the end of the quarter.

The construction of deasphaltizing unit at our Volgograd refinery is ongoing. The equipment has been installed, and the construction and installation of process and auxiliary pipelines is nearing completion. The hydrostatic testing of pipelines is ongoing, and the installation of power grids and instrumentation is underway. We started testing with inert gas. In October, the project was nearly 90% complete.

Slide 27 “Finance”

Now let me briefly outline our financial performance compared to the second quarter of 2020.

Slide 28 “Revenue”

Revenue increased by 48% quarter-on-quarter. Along with higher hydrocarbon prices and ruble devaluation, there were other positive drivers such as increased petroleum product output, higher crude oil and petroleum trading volumes, and stronger retail sales. Our third-quarter commercial stocks of crude oil and petroleum products shrank by 800 thousand tonnes, which further supported the revenue.

The revenue growth was offset by the oil production cut and weaker exports of crude oil and petroleum products.

Slide 29 "EBITDA"

EBITDA went up 40% to 202 billion rubles driven by robust Upstream results, with Downstream EBITDA flat quarter-on-quarter.

We have already spoken in detail on EBITDA drivers for each segment. I would only like to add that amid lower price volatility, the third-quarter was distinct with only marginal impact of one-off accounting and carry-over factors, such as inventory effect at refineries, inventory write-down to net realizable value and a tax lag effect in Russia. These effects had had a strong impact on our financials in the first and second quarter.

Slide 30 "Profit"

In the third quarter the Company posted net profit of 50 billion rubles against a net loss in the second quarter.

As a reminder, the net loss in the second quarter was due to the recognized impairment loss on assets for 39 billion rubles. By contrast, the third quarter saw the reversal of the impairment loss for 5 billion rubles due to the repayment of debt on projects in Egypt.

A negative impact on the profit came from a significant FX loss driven by ruble devaluation during the third quarter.

Importantly, the sensitivity of the foreign currency translation difference to exchange rate fluctuations increased compared to the second quarter. This is attributed to an increase in the negative monetary position in foreign currencies resulting from the issue of Eurobonds and a decrease in accounts receivable.

Slide 31 "Cash flow"

Free cash flow in the third quarter more than quadrupled quarter-on-quarter to 115 billion rubles. In addition to stronger profitability driven by better market environment in Upstream, free cash flow benefited from working capital release for 26 billion rubles mainly resulting from partial crude oil and petroleum product destocking. Free cash flow was also supported by a decrease in capital expenditures.

Thank you!