PJSC “LUKOIL”

2Q 2021 Results

Conference Call and Webcast Transcript

August 27, 2021

Speakers:

Alexander Matytsyn, First Vice President

Pavel Zhdanov, Vice President for Finance

Alexander Palivoda, Head of Investor Relations

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 second quarter and the first half of 2021. 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.

You may find more detailed information on the slide.

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

Alexander Matytsyn

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

Slide "Macro environment and operating results"

In the second quarter, we delivered very strong financial results on the back of efficient recovery of production volumes and further improvements in the market environment.

Oil prices continued to climb thanks to reviving demand and concerted efforts by OPEC+ countries. In the second quarter, we ramped up hydrocarbon production by more than 4% year-on-year. Average daily oil production in Russia was up 3% quarter-on-quarter following amendments to the OPEC+ agreement. Considering the July amendments thereto, we plan to keep ramping up production volumes as quickly as possible.

Refining margins continued to improve in the second quarter, though still staying below pre-COVID-19 levels. Quickly responding to the changing market environment, we increased capacity utilization at our refineries by 8% quarter-on-quarter. I would like to note that our Russian refineries greatly improved their margins on the back of better yields while the country's benchmark refining margin was declining.

Slide "Financial results"

Although production volumes and the market environment are still below the pre-crisis levels, our financial results for the second quarter are on par with 2019, with EBITDA hitting an all-time high at 340 billion rubles.

Free cash flow declined quarter-on-quarter, driven by a significant increase in the working capital due to rising oil prices and implementation of international trading strategies. It should be noted that our free cash flow before changes in the working capital amounted to a record high of 212 billion rubles, or nearly USD 3 billion, while the first half of the year saw it reach 400 billion rubles, which is twice above that in the entire 2020, accounting for about 9% free cash flow yield.

Slide "Leadership in efficiency"

Thanks to its highly efficient business model, LUKOIL continues to maintain a strong leadership among Russian oil and gas companies in terms of per unit financial metrics in any market environment.

Specifically, we maintained our leadership in free cash flow per unit, despite a significant increase in the working capital.

Slide "Financial position"

LUKOIL further improved its already very strong financial position in the second quarter. As at the end of June, our financial debt was slightly above 440 billion rubles, while the net debt to EBITDA ratio declined to zero. In July, we paid final dividends for 2020 in the amount of 148 billion rubles, or 213 rubles per share. In October, the Board of Directors will recommend interim dividend distribution for 2021 based on the semi-annual financial statements.

Slide "Sustainable development"

LUKOIL has recently released its Sustainability Report for 2020 prepared in line with the international and industry non-financial reporting standards. In preparing this Report, we strived for fuller and better disclosure on issues of greatest relevance for our stakeholders.

We recognize that sustainable development is of major importance for ensuring the Company's investment appeal and effective implementation of its strategy and keep improving our sustainable development management system, while also enhancing disclosure transparency.

I would like to highlight that our efforts invested over the past year helped LUKOIL make its way through key sustainability ratings. As a result, LUKOIL is now among the industry leaders in many ratings.

In wrapping up, we are optimistic about the prospects for a further recovery in global oil demand and the market environment in Downstream, and we plan to fully unlock the existing potential to ramp up production volumes and further develop our business. In doing so, we will continue to rigorously control costs and pay even more attention to managing climate risks and opportunities.

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

LUKOIL

Pavel Zhdanov (Upstream)

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

Slide "Price and tax environment"

Let me begin with the price environment. In the second quarter, the average Urals oil price went up by 12% quarter-on-quarter. However, the Urals net ruble price remained virtually flat due to the progressive tax scale in Russia and a positive effect of the tax lag. It averaged at 1,840 rubles per barrel in the second quarter, thus maintaining the all-time high.

We also see the relatively favorable market environment to continue into the third quarter.

Slide "Key operating results"

In the 2Q 2021, the Group's hydrocarbon production excluding West Qurna-2 totaled 2.1 million barrels of oil equivalent per day, up 4.2% year-on-year.

We continued to recover our oil output in Russia in accordance with the instructions of the Russia's Ministry of Energy. The recovery is going as quickly as possible by restarting shut-in wells at mature fields. We also continue to develop our priority projects. Their share rose by 2 percentage points in the first half of the current year to reach 27% of the total output.

The quarter-on-quarter production decline in 2Q 2021 is attributable to maintenance works at the gas projects in Uzbekistan.

Slide "Effective production management within OPEC+ limitations"

At present, our spare oil production capacity in Russia stands at 90 thousand barrels per day. By now, we have recovered the output by two thirds as compared to May 2020.

Given an improved market environment and optimistic expectations about the demand recovery, we increased drilling volumes in the second quarter. This will help us keep to a minimum the use of spare capacity to offset the naturally declining production and secure the output growth to above the pre-crisis level.

Slide "Upstream EBITDA"

As for our financial performance in the second quarter, EBITDA in the Russian upstream segment rose by 3% quarter-on-quarter to 193 billion rubles on the back of growing prices and oil production, but the reduction of the positive tax lag had a negative effect on the indicator. The weaker upstream EBITDA outside Russia is due to a decline in gas production in Uzbekistan and lower EBITDA from West Qurna-2, which is associated with a decrease in capital expenditures.

In the first half of the year, EBITDA more than doubled year-on-year to 445 billion rubles. The growth was driven mostly by the Russian upstream segment thanks to oil prices, ruble devaluation and a positive tax lag. It was, however, constrained by the tax incentives being canceled for high-viscosity oil projects and oil production being cut in Russia in line with the OPEC+ agreement. EBITDA in the international segment also grew on the back of higher oil prices, recovery of gas production in Uzbekistan and ruble devaluation.

Slide "North Caspian"

Now let us move on to our high-priority projects.

In the first half of 2021, we maintained production at our Vladimir Filanovsky and Yuri Korchagin fields at the project level, having commissioned three production wells. Their combined oil and gas condensate production reached 3.7 million tonnes, up 2% year-on-year.

As part of the Valery Grayfer field development, shipyards continued to build platforms. As at the end of the first half of the year, the fixed ice-resistant platform was 80% complete, and the living platform was 87% complete. We plan to deliver a topside of the living platform and install it on the offshore jackets by the end of the current year. Production at the Valery Grayfer field is scheduled to start in 2022.

Slide "Development of offshore projects in the Baltic Sea"

In April, we made our final investment decision on the D33 field, which we discovered in the Baltic Sea in 2015. We have been operating in this region since 1995 and gained solid experience in oil production and transportation. With a developed infrastructure in place, we are well positioned to roll out new offshore projects and achieve significant synergies.

The D33 field is planned to be put into operation already in 2024 and produce 1.8 million tonnes per year. For this purpose, we are going to begin drilling operations in late 2022 using a jack-up floating drilling rig.

We will use a mini-platform to produce oil. The bidding for the platform has been completed, with suppliers and contractors selected, and the construction is already underway. The platform will be unmanned: all the processes and functions will be remotely controlled from the shore. Oil will be supplied to consumers through the company’s oil terminal. Proximity to consumers and, consequently, short delivery distances are major advantages of this project. Compared to our fields in West Siberia, transportation costs for this project are lower by more than 75%.

We put much emphasis on the environmental aspects when developing any offshore projects. In particular, we use a zero-discharge technology. It was the Baltic Sea, by the way, where it was employed for the first time. The D33 project will use the most advanced and reliable automatic control systems for primary and auxiliary processes. Associated gas flaring and offshore power generation will be totally excluded.

Slide “Hard-to-recover: high viscous oil”

In the first half of 2021, high-viscosity oil production in Timan-Pechora was up by 5% year-on-year to reach 2.6 million tonnes. I would like to note that, following many years of production growth after large-scale investments in the Yaregskoye and Usinskoye fields, the output has finally stabilized this year. This is a consequence of investment cuts for these fields due to tax incentives being canceled. We expect the Russian Government to make a decision to reinstate incentives for this category of hard-to-recover reserves, so that we have a stimulus to resume their development.

Slide “Hard-to-recover: low permeability”

Our low-permeability projects in West Siberia continued to demonstrate a double-digit growth in oil production. As compared to the first half of 2020, the production increased by 16% due to an extensive drilling program.

We keep working to improve technology and efficiency. I will give you some examples of cost cuts at hard-to-recover fields. We managed to increase the drilling speed for horizontal wells at the Imilorskoye field by 13%, additionally reducing the per unit drilling costs by 15% year-on-year.

At the Sredne-Nazymskoye field, we optimized the well design and used our proprietary completion system in horizontal wells for multi-stage hydraulic fracking which led to cut in per unit cost of horizontal well by 39% and increase of drilling speed by more than 45% year-on-year.

Slide "Development of offshore projects in Mexico"

Now let us proceed to our overseas projects.

In July, LUKOIL entered into an agreement to acquire a 50% operator interest in the Area 4 project offshore Mexico. The transaction value is 435 million US dollars plus expenditures incurred since the start of 2021. The completion of the transaction is subject to conditions precedent and is expected until the end of the year.

The project includes two oil fields with high-quality oil and is developed in three phases, with a peak daily production rate estimated to be more than 115 thousand barrels of oil equivalent. Preparatory work before the start of production is currently being finalized.

Acquiring an interest in a project with considerable explored reserves at an early development stage in a region where we already operate is fully in line with our M&A strategy. It naturally complements our existing portfolio of projects in the Gulf of Mexico.

Our Mexican exploration portfolio is delivering excellent performance. Let me remind you that in early 2020, we drilled the first exploration well at the Block 10 offshore project, and a second one followed in August this year with both wells having been successful. As a result, we discovered two oil fields with total estimated geological reserves of 350–500 million barrels. In August, LUKOIL started exploration drilling at Block 12, where we act as the operator.

Slide "Gas projects in Uzbekistan"

To conclude, I would like to speak briefly on our Uzbekistan gas projects.

Following the production decline in 2020 that was caused by a temporary pandemic-induced decrease in demand from China, we saw our gas output in Uzbekistan recover back to the project capacity at the end of the year. In 1Q 2021, production exceeded its designed capacity, and in the second quarter we had to cut the output due to scheduled maintenance. As a result, we produced 6.6 billion cubic meters of gas in the first half of 2021 (based on a 100% share) and, provided the market environment remains favorable, we expect to reach 14 billion cubic meters of output for the full year. For the second half of the year, this will represent a growth of over 10% versus the first half.

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

Alexander Palivoda (Downstream)

Thank you, Pavel.

Slide "Refining profitability"

In the second quarter, the refining market environment continued on the recovery path. In Europe, the benchmark margin grew more than 1.5 times quarter-on-quarter, driven by an increase in the crack spreads of light products, primarily gasoline, as a result of declining global inventories and seasonal growth in demand. Growing margins also reflected a wider Brent/Urals spread at around 2 US dollars per barrel, which can be attributed to increased oil production in OPEC+ countries and weaker demand for heavy crude oil amid better economics of light products. Despite this growth, benchmark margins in Europe are still far below pre-pandemic levels, as crack spreads for mid-distillates remain at multi-year lows primarily due to weak demand for jet fuel.

The Russian benchmark refining margin went down quarter-on-quarter due to a widened crack spread for fuel oil, which was partially offset by higher export duty differentials. As for our own refining margin in Russia, we saw it almost double quarter-on-quarter on the back of our high-quality product slate and increased light products yield. Starting 1 May 2021, an amended formula for the motor fuels damper went into effect, which was another positive factor for the economics of our Russian refineries.

In the third quarter we are witnessing a significant increase in the benchmark refining margins in Europe and Russia both driven by further improvements in light products crack spreads, increase in export duty differentials and higher export netbacks.

Slide "Key operating results"

In the second quarter, we continued to ramp up capacity utilization at our refineries, flexibly responding to improvements in the market environment. Refining volumes were up by 8% quarter-on-quarter, while utilization reached 90% of the pre-crisis level.

Domestic refineries increased their throughput by 3% quarter-on-quarter, driven by higher volumes of Nizhny Novgorod and Volgograd plants. However, the growth was constrained by repairs at the Perm refinery.

At European refineries, utilization grew more significantly – by 20% quarter-on-quarter, mainly on the back of higher throughput at the ISAB plant in Italy. At the end of the first quarter, it underwent process optimization, enabling it to effectively process light sweet crude oil blends and maximize the yield of gasoline and low-sulfur bunker fuel, thus translating into higher margins in the current market conditions. The growth overseas was constrained by lower utilization at the Zeeland refinery due to its scheduled maintenance.

The increase in utilization was coupled with improvements in product slate. Compared to the first quarter of 2021, light product yield increased, while the yield of fuel oil remained flat, despite higher throughput volumes.

Slide "Priority sales channels"

The second quarter saw exceptionally strong retail sales of motor fuels, with the difference from the pre-pandemic 2019 levels standing at just 3%. Sales volumes recovered completely by the end of the quarter, even exceeding the pre-pandemic levels in July.

Jet fuel sales were very strong, too. For sales in a form of aircraft fueling, the difference from the pre-pandemic levels tightened to 30% in the second quarter and to 20% in July, but widened again in August due to new mobility restrictions.

Slide "Allocation of Russian oil"

The second quarter saw a considerable increase in Russian downstream margin, which is the difference between the netback for oil to be refined and sold in Russia through all sales channels, and export sales.

Despite rising refinery utilization, oil exports also increased quarter-on-quarter due to higher production. A decrease in the exports of oil subject to a lower-rate export duty was attributable to a reduced output due to a seasonal decline in production across Group 1 TAI fields in the Republic of Komi.

Slide "Downstream EBITDA"

As for our financial performance in the downstream segment, total EBITDA rose by 6% quarter-on-quarter to 127 billion rubles, mainly driven by Russian refineries, where EBITDA added 28% on the back of higher refining margins and throughput volumes, as well as strong performance in petrochemicals, lubricants and aircraft refueling segments. The growth was constrained by a weaker positive inventory effect at our refineries and lower retail margins.

Downstream EBITDA outside of Russia declined due to the accounting specifics of hedging operations in international trading and a weaker positive inventory effect at our overseas refineries.

In the first half of the year, downstream EBITDA more than doubled year-on-year to 247 billion rubles. Downstream EBITDA in Russia rose by 60% as a result of higher refining margins, a positive inventory effect at domestic refineries, and strong results of the petrochemical segment.

Downstream EBITDA outside of Russia almost quadrupled year-on-year on the back of a positive inventory effect at refineries, better results in international trading, accounting specifics of hedging operations, as well as better results in the retail segment. The positive factors were partially offset by lower throughput and refining margins.

Slide "Selective projects at Russian refineries"

This year, we are completing several refinery upgrade projects in Russia.

Let me remind you that following the launch of the de-asphalting unit at the Volgograd refinery in January 2021, we increased the output of lubricants with improved features.

In June, the Nizhny Novgorod refinery completed the construction of an isomerization unit with an annual capacity of 800 thousand tonnes, which is intended to process light gasoline fraction into a high-octane blending component of commercial gasoline. This will help bring to the market an additional of some 400 thousand tonnes of high-octane motor gasoline annually.

In July, the same refinery launched a polymer-bitumen binder production unit, which is set to expand our product slate with innovative and modified bituminous materials.

By the end of the year, the Nizhny Novgorod refinery plans to launch a delayed coker. As of today, the construction and installation operations are more than 95% complete, with pipeline testing commenced. I would also like to note that in March 2021, we signed an agreement with the Russia's Ministry of Energy in relation to this project. The agreement provides for an investment increment to the reverse excise tax on petroleum feedstock and greatly improves the project economics.

We have recently made a similar agreement for the construction of a catalytic cracking unit at the Perm refinery. This is a new project that we expect to complete in 2026. We have already defined the key project details and are now preparing to start construction. The facility's annual feedstock capacity will be 1.8 million tonnes. It will process vacuum gas oil into high-octane motor gasoline and propylene. The facility will have a distinctive feature of high adjustable yield of propylene, which will be used as feedstock by our petrochemical plants.

Alexander Palivoda (Finance)

Now let me briefly outline our financial performance in the second quarter.

Slide "Revenue"

Higher hydrocarbon prices were the key factor driving revenue up by 17% quarter-on-quarter. Other factors contributing to the revenue growth included higher oil production and petroleum product output, as well as increased oil trading volumes. On top of that, the revenue growth was backed by higher volumes of oil exports and retail sales of petroleum products.

Negative factors included lower trading volumes of petroleum products, a decrease in gas production from international projects, and a seasonal decline in power and heat sales.

Slide "EBITDA"

EBITDA was up by 8% quarter-on-quarter to a new high of 340 billion rubles, exceeding the record-breaking level of the second quarter of the pre-pandemic 2019 featured with higher production volumes and refining margin.

We have already spoken in detail on EBITDA drivers for each segment. I would also like to note that inventory sales in the second quarter were a strong contributor to the increase in EBITDA, which is reflected in the Elimination line of the EBITDA breakdown.

Furthermore, with the market environment back to normal in the second quarter, the carrying over drivers and one-off factors had a less pronounced effect on EBITDA quarter-on-quarter performance.

Slide "Profit"

In the second quarter of 2021, the Company posted net profit of 190 billion rubles, an increase of more than 20% quarter-on-quarter. The growth was supported primarily by stronger EBITDA. Items below the operating profit line saw no impact from one-off or carrying over factors.

Slide "Cash flow"

Free cash flow in the second quarter stood at 112 billion rubles, going down quarter-on-quarter as the working capital expanded by 100 billion rubles, which was driven by higher oil prices and implementation of international trading strategies.

Free cash flow before changes in the working capital hit a record high of 212 billion rubles, up 13% quarter-on-quarter. The key driver behind this growth was stronger operating cash flow associated with higher production volumes and improved market environment.

Slide "2021 outlook"

At the end of our presentation today, let me talk briefly about our plans for this year.

Given the July decision of the OPEC+ members to increase oil output on a monthly basis, we expect hydrocarbon production to grow by about 4% excluding the West Qurna-2 project.

Depending on the market environment, we will stay flexible in managing our refining fleet utilization in Russia and abroad.

We updated our investment plans and now expect the 2021 capital expenditures, excluding the West Qurna-2 project in Iraq, to be in the range of 470–490 billion rubles.

Slide "LUKOIL – a unique investment proposition in Oil&Gas"

LUKOIL continues to boast a very strong investment story. The Company's efficient management enables us to maximize the benefit from the market recovery while the current dividend policy transforms this benefit into higher shareholder returns. Very soon we expect our production to recover completely, and we continue to develop our business with due account for all the industry trends, including climate change.

We see that LUKOIL's market capitalization is lagging behind our financial performance, so we still believe that our shares are strongly undervalued.

Thank you.